



NBN Co Submission to ACCC Consultation Paper on variation of NBN Co SAU

May 2013

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Abbreviations and Acronyms

Throughout this submission, capitalised terms have the same meaning as in the Dictionary set out in Attachment C to the main body of the SAU.

ABBRR	Annual Building Block Revenue Requirement
ACCC	Australian Competition and Consumer Commission
ACT	Australian Competition Tribunal
AD	access determination
ADSL	Asymmetric Digital Subscriber Line
AER	Australian Energy Regulator
ARPU	Average Revenue Per User
AVC	Access Virtual Circuit
BROC	binding rules of conduct
capex	capital expenditure
CCA	<i>Competition and Consumer Act 2010</i>
CDP	Contract Development Process
CFRA	Carry Forward Revenue Adjustment
CIR	Committed Information Rate
CIP	Construction in Progress
CPI	Consumer Price Index
CSA	Connectivity Serving Area
CVC	Connectivity Virtual Circuit
Gbps	Gigabits per second

ICRA	Initial Cost Recovery Account
kbps	kilobits per second
LTIE	long-term interests of end-users
LTRCM	Long Term Revenue Constraint Methodology
Mbps	Megabits per second
NBN	National Broadband Network
NBN Access Bill	<i>Telecommunications Legislation Amendment (National Broadband Network Measures – Access Arrangements) Bill 2011</i>
NBN Co	NBN Co Ltd
NBN Companies Act	<i>National Broadband Network Companies Act 2011</i>
NDRs	Network Design Rules
NNI	Network-Network Interface
NPV	Net Present Value
NTD	Network Termination Device
opex	operating expense
PDF	Product Development Forum
PIR	Peak Information Rate
POI	point of interconnect
RAB	Regulatory Asset Base
RSP	Retail Service Provider
SAO	standard access obligation
SAU	special access undertaking

SFAA	standard form of access agreement
TC	Traffic Class
Telco Act	<i>Telecommunications Act 1997</i>
ULLS	Unconditioned Local Loop Service
UNI	User Network Interface
UNI-D	User Network Interface-Data
UNI-V	User Network Interface-Voice
UNWP	uniform national wholesale pricing
VOIP	Voice over Internet Protocol
WACC	Weighted Average Cost of Capital
WBA	Wholesale Broadband Agreement

1 Overview

Introduction

NBN Co welcomes the publication of the ACCC's Draft Decision¹ on NBN Co's Special Access Undertaking (SAU) on 4 April 2013 and the concurrent release of a Consultation Paper² on proposed variations to the SAU. The feedback provided by the ACCC in these documents establishes a clear path to finalising the SAU in an efficient manner to provide certainty to industry and NBN Co on an important element of the regulatory framework that will apply to NBN Co.

This submission provides NBN Co's detailed response to the ACCC's Draft Decision and Consultation Paper. NBN Co has carefully considered the issues raised by the ACCC, and has developed an integrated package of proposed changes to the SAU that it considers delivers an SAU that is capable of acceptance by the ACCC. NBN Co's proposed changes are strongly aligned with the amendments proposed by the ACCC. Where NBN Co considers that a different approach is required, it provides its rationale for doing so, and has developed refinements that implement workable outcomes that address the legitimate concerns of both the ACCC and NBN Co.

NBN Co welcomes the ACCC's acknowledgement that the SAU contains many features that have merit. These features are preserved and strengthened by NBN Co's proposed variations. In particular, if the variations proposed by NBN Co were accepted, the varied SAU would:

- Reinforce NBN Co's existing commitment to not increase prices by more than CPI-1.5% in any year, by providing the ACCC with new roles in relation to product withdrawal, new prices and the ongoing effectiveness of NBN Co's pricing structures;
- Deliver improvements to the operation of the modular design of the SAU, by allowing greater flexibility in the operation of key elements of the Long Term Revenue Constraint Methodology (LTRCM) in future years to respond to changing circumstances, and confirming the ACCC's ability to make decisions in respect of replacement modules;
- Improve on current commitments in relation to providing information to, and consulting with, NBN Co's customers on the development of new products; and
- Clarify the interaction of the SAU with other parts of the access regime, while at the same time reducing the number of matters directly covered by the SAU, thus providing a more certain role for the operation of ACCC decisions.

Key proposed variations

NBN Co has proposed variations to the SAU in response to the key issues identified in the ACCC's Draft Decision. These proposals build on the suggestions made by the ACCC in the Draft Decision and Consultation Paper, and seek to provide workable outcomes for NBN Co, access seekers and the ACCC that are reasonable and promote the long-term interests of end-users (LTIE). These key proposals are:

- Modifications to the SAU drafting to remove current linkages between the SAU and Standard Forms of Access Agreement (SFAAs), to eliminate any potential uncertainty about the interaction of the SAU with the operation of the telecommunications access regime;

¹ ACCC, Draft Decision on the Special Access Undertaking lodged by NBN Co on 18 December 2012, April 2013.

² ACCC, Consultation Paper — variation of NBN Co Special Access Undertaking, April 2013.

- Refinement of existing SAU provisions in relation to the operation of Replacement Modules to confirm the ACCC's ability to make decisions in relation to the terms that would apply in future regulatory cycles;
- The introduction of the Integrated Price Review Mechanism in Module 2 to provide the ACCC with well specified reserve powers in relation to new product pricing and price rebalancing that provide considerable flexibility to respond to future circumstances. The ACCC (and NBN Co) can initiate a Price Review at any time during Module 2, not just periodically, and may also initiate a Price Review within 2 years of end of the end of Module 1, with the outcomes of that review to take effect once Module 2 commences;
- Providing the ACCC with the ability to disallow product withdrawals;
- Reducing the level of detail in the operation of the Long Term Revenue Constraint Methodology (LTRCM) in Module 2 of the SAU, to provide flexibility in the future operation of this mechanism; and
- Removing the detailed non-price terms and conditions (including service levels) from the SAU, leaving the finalisation of these terms to commercial engagement with Access Seekers.

Context for NBN Co's proposed variations

In developing these variations, NBN Co has been substantially assisted by the views expressed by the ACCC in relation to the ongoing incentives that NBN Co has to operate efficiently and supply products at prices customers will want to pay. In particular, the ACCC acknowledges that NBN Co is likely to face a significant period of 'revenue sufficiency risk', which will provide strong incentives for NBN Co to invest and operate efficiently in its earlier years of operation (including during the rollout period). While the ACCC may have under-estimated the strength of NBN Co's incentives to invest and operate efficiently over the term of the SAU, nonetheless, the ACCC's views on NBN Co's incentives, particularly during the operation of Module 1, have been fundamental in the design of the proposed variations described in this submission.

Importantly, the variations proposed by NBN Co are intended to result in a substantially improved SAU that addresses the issues identified by the ACCC in an integrated manner. The SAU that was lodged in December 2012 was an integrated and co-ordinated package of proposals, and any revised SAU must also be seen in the same light. While NBN Co anticipates that each individual proposed variation will be considered on its own merits, it is the combined operation of the package of variations (with each other, and with the unaltered elements of the SAU), together with NBN Co's pre-existing incentives, that is more significant in the assessment of the SAU.

Effect of NBN Co's proposals

The key proposed variations described above (and the additional variations described in this submission) are intended to improve on the operation of the SAU, as it currently stands, and to deliver a framework for regulation of NBN Co's services which:

- Ensures that end-users pay no more in real terms for services equivalent to what they are receiving today, and that they would only pay more for services that deliver increased capability when they want it;
- Provides incentives for NBN Co to continue to offer innovative services at prices that customers want to pay, while prudently investing in required infrastructure;

- Is consistent with the intended operation of the existing access regime in relation to access to regulatory determinations where NBN Co and access seekers are unable to finalise agreed terms and conditions of access via commercial negotiation;
- Enables vigorous retail competition;
- Provides NBN Co with the opportunity to earn a reasonable return on its investment (but no more);
- Provides incentives for NBN Co and access seekers to commercially negotiate on terms of access, with the ACCC having the ability to make regulatory determinations should agreement not be possible; and
- Provides an appropriate balance between certainty on key principles that will be maintained over 27 years and flexibility to allow terms to evolve to respond to changing circumstances over that time.

Approach taken by NBN Co in responding to the ACCC's Draft Decision

In addition to the key proposed variations described above, NBN Co has responded to all issues raised by the ACCC in the Draft Decision and Consultation Paper. These are described in detail in the body of this submission, and indexed in Appendix A. This submission deals with the ACCC's issues on a 'by exception' basis – if the ACCC has expressed the view that it is satisfied that a term or condition of the SAU is reasonable, NBN Co does not provide additional material in relation to that term or condition in this submission.

Where possible, NBN Co has provided detailed drafting proposals to implement NBN Co's proposed response, to provide clarity to the ACCC and other interested parties as to how NBN Co considers the SAU should be varied to make it capable of acceptance by the ACCC. Taken together, these drafting proposals describe a varied SAU that addresses the concerns articulated by the ACCC, and would result in an SAU that is capable of acceptance by the ACCC. These drafting proposals are included in the body of the submission, or in the case of more extensive and substantial drafting changes, included in Appendix C.

In the majority of cases, NBN Co simply accepts the position put by the ACCC, so that only a minimal response is required. In other cases, NBN Co provides arguments in support of an alternative position, or approach to the relevant ACCC proposal, that NBN Co considers is reasonable and a workable way to address the issue identified by the ACCC. The submission also addresses a number of issues identified by the ACCC in the Draft Decision which are not referenced in the Consultation Paper, but which NBN Co considers are relevant to the ACCC's formulation of a Notice to Vary in relation to the SAU.

The submission is structured using the same categories used in the ACCC's Draft Decision, namely:

- Interaction between the SAU and the telecommunications access regime (section 2);
- Services to which the SAU relates (section 3);
- Product development and withdrawal (section 4);
- Price-related matters (section 5);
- Non-price matters (section 6); and
- Fixed Principles (section 7).

The submission also includes a section on “Assessment of the SAU” (section 8), which provides NBN Co’s response to the ACCC’s preliminary assessment of the SAU against the statutory criteria in section 152CBD of the CCA.

Within each section of this submission, NBN Co has structured its response to each issue raised by the ACCC in the following manner:

- **Summary of ACCC position**, as expressed in the Draft Decision and Consultation Paper;
- **NBN Co response** – summarising how NBN Co is responding to the ACCC’s position;
- **Analysis** – providing NBN Co’s detailed arguments in support of its position; and
- **Proposed SAU changes in Notice to Vary** – NBN Co has provided the details of how it proposes that the SAU variation should be drafted, to provide clarity to both the ACCC and access seekers on precisely what NBN Co is proposing.

This submission also includes a small number of additional suggested variations which NBN Co considers would increase the clarity of the operation of the SAU once finalised. NBN Co has identified these variations as it has further reviewed the SAU in response to feedback received from the ACCC and submissions made by interested parties, as well as the views expressed in the Draft Decision and Consultation Paper.

2 Interaction between the SAU and the telecommunications access regime

2.1 Introduction

Part XIC of the *Competition and Consumer Act 2010* (CCA) provides a number of avenues for regulating eligible services: by declaring such eligible services through an accepted SAU, an ACCC declaration inquiry or via the publishing of a SFAA by NBN Co.³ The regulatory framework in Part XIC was designed to provide for the concurrent operation and interaction of these mechanisms⁴, with a clear 'hierarchy' of the applicable terms and conditions of access when a number of these mechanisms are in operation.⁵

Broadly, the hierarchy operates so that the terms and conditions in an Access Agreement between an Access Seeker and an access provider will prevail over any inconsistent terms and conditions set out in an accepted SAU, or in regulatory determinations (i.e. binding rules of conduct (BROC) or access determinations (AD)). Similarly, terms and conditions set out in an accepted SAU will prevail over any inconsistent terms and conditions in a BROC or AD.

Part XIC also provides for NBN Co to publish standard forms of access agreement (SFAAs) to set out the terms and conditions on which Access Seekers can request supply from NBN Co.⁶ The SFAAs do not form part of the hierarchy of instruments. However, Access Seekers and NBN Co have the option of signing Access Agreements on the basis of a published SFAA⁷, with the resulting Access Agreement sitting at the top of the 'hierarchy'.

NBN Co has always intended to utilise a combination of an SAU and Access Agreements (based on SFAAs) as the means of setting out the terms and conditions of access to be offered by NBN Co.

The 'regulatory recourse' arrangements currently contained in the SAU⁸ were intended as an 'integrated' or explicit approach to facilitate the operation and interaction, over time, of the SAU, SFAAs, and the making and implementation of regulatory decisions of the ACCC, in a manner consistent with the intended operation of Part XIC. The arrangements were also intended to encourage the use of consultation and commercial negotiations to reach terms and conditions of supply, but to ensure that Access Seekers and NBN Co had recourse to regulated outcomes, if necessary.

Section 2 of the Draft Decision and section 2.1 of the Consultation Paper set out the ACCC's views on the interaction between the SAU and Part XIC of the CCA. These sections consider clauses in the SAU that sought to create interactions between the various instruments in Part XIC, including interactions between SAU, SFAAs and ADs and BROCs.

³ Section 152AL of the CCA.

⁴ See section 152AY of the CCA relating to compliance with SAOs.

⁵ Sections 152BCC, 152BDB, 152BDE, 152CBIA, 152CBIB and 152CBIC.

⁶ Division 6A of Part XIC of the CCA.

⁷ Section 152CJA.

⁸ Clause 6 of main body of SAU, Schedule 1B; Supporting Submission pp.146 -147.

In general, the ACCC has noted that in assessing the SAU, the ACCC will consider whether the provisions in the SAU 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. Further, where the ACCC considers that uncertainty does arise from the drafting of the provisions of the SAU, the ACCC states that it cannot be satisfied that the provisions will promote the LTIE.⁹

NBN Co agrees with the principle that the SAU should not create any uncertainty about the operation of Part XIC. NBN Co has had careful regard to this guiding principle in making the following submissions in relation to the views expressed by the ACCC in section 2.1 of the Consultation Paper.

2.2 Conduct about including terms and conditions in SFAAs

In section 2.1.1.1 of the Consultation Paper, the ACCC proposes the removal of clauses in the SAU that the ACCC has termed “SFAA terms and conditions”. This includes clauses where NBN Co commits to including particular terms and conditions as set out in the SAU in any SFAA (e.g. the non-price terms and conditions set out in the Annexures to Schedule 1H) and other commitments NBN Co makes about including terms in an SFAA with specified characteristics (e.g. not including a price for a reference offer in an SFAA that is higher than the Maximum Regulated Price determined under the SAU).¹⁰

The ACCC considers that these clauses create uncertainty in relation to the ability of Access Seekers to obtain supply under these terms because the effect of the drafting could be to require Access Seekers to sign an Access Agreement that is based on an SFAA, which is only one method of supply provided for under Part XIC.

Further, the ACCC also considers the intended effects of these SFAA terms and conditions. The ACCC notes that NBN Co considers that all of the terms and conditions in the SAU are terms and conditions in relation to subsection 152CBA(3A) (i.e. compliance with the SAOs), even though the terms and conditions will be dealt with as a contractual matter between NBN Co and an Access Seeker under their Access Agreement. The ACCC considers that aspects of NBN Co’s position appeared to contradict an interpretation whereby the SAU specifies the terms and conditions in relation to the SAOs.¹¹

In light of this assessment, the Consultation Paper proposes the following amendments:

- removal of the clauses of the SAU that require NBN Co to include particular terms and conditions set out in the SAU in any SFAA and to maintain such terms in any SFAA — instead, the SAU should state that NBN Co will comply with these particular terms and conditions as specified in the SAU (First category); and
- amendment of the clauses of the SAU that require NBN Co to ensure that a term or condition in any SFAA has specified characteristics — instead the SAU should state that the term or condition has the specified characteristics, and is specified in the undertaking (Second category).¹²

⁹ Draft Decision, p.35.

¹⁰ Consultation Paper pp.10-11.

¹¹ Draft Decision, p.213.

¹² Consultation Paper p.11.

NBN Co Response 1

NBN Co proposes to remove all references in the SAU to obligations to include certain terms and conditions in an SFAA. In relation to the First category (principally dealing with non-price terms and conditions), NBN Co proposes to remove the non-price terms from the SAU altogether and hence the issue becomes redundant. In relation to the Second category (principally dealing with how prices are to be included in an SFAA), NBN Co proposes to implement this change by removing the reference to “an SFAA” in the relevant clauses.

Analysis

NBN Co considers that its position in relation to the categorisation of the SFAA terms and conditions remains consistent. As previously noted, NBN Co regards the SFAA terms and conditions as relating to compliance with the SAOs. One way in which compliance with the SAOs is achieved is through terms and conditions specified in an Access Agreement.¹³

Accordingly, NBN Co maintains that an obligation in the SAU to include particular terms and conditions in an SFAA - where those terms and conditions are one basis on which the SAOs are complied with - is entirely consistent with an interpretation that such an obligation relates to compliance with the SAOs.

Nevertheless, NBN Co proposes to address the ACCC’s concerns by either removing obligations in the SAU to certain terms and conditions in the SFAA altogether (i.e. remove the non-price terms and conditions) or by removing the reference to the SFAA from the obligation in the SAU.

More specifically, in relation to the first category of SFAA terms and conditions, NBN Co is proposing to remove the substance of these non-price terms and conditions contained in the Annexures to Schedule 1H, as well as the service levels contained in the Annexure to Schedule 1J. Accordingly there is no need for clauses 1H.5, 1H.6 and 1H.7 and Schedule 1J in the SAU.

Section 6 below, and Appendix B, contain NBN Co’s response to the ACCC’s views on the non-price terms and conditions and service levels.

In relation to the Second category of SFAA terms and conditions, and in particular in relation to pricing commitments, NBN Co’s intent, in creating an explicit link between the SFAA and SAU was to provide a reference point for determining the ‘Price’ (in this case the price in an SFAA) at any given time. However, to avoid any confusion or uncertainty that the drafting may present regarding the operation of Part XIC, NBN Co proposes to remove the references in these clauses to the SFAA. The effect of these changes to the pricing clauses is that the pricing commitments would exist as standalone commitments in the SAU. NBN Co considers that clause 1D.1.6 (status of other published offers) does not form part of the second category of SFAA terms because it does not specify characteristics to be included in the SFAA. NBN Co proposes that the references to SFAA in clause 1D.1.6 are maintained to ensure that any other published charge (and its price(s)) that are not described in the SAU, but are contained in any SFAA as at the SAU commencement date, will be designated a non-reference offer under the SAU. NBN Co submits that this clause is a necessary to ensure consistency between the SAU and SFAA as at the commencement of the SAU.

Some clauses fall outside the categories described above. For example, alignment between SFAAs and the SAU (see discussion in section 2.3.3 below) and the obligation to produce and maintain an SFAA are to be retained.

¹³ Section 152AY(2)(a).

Proposed SAU changes in Notice to Vary 1

Regarding the First category, remove clauses 1H.5, 1H.6 and 1H.7 (and associated Annexures 1, 2 and 3 to Schedule 1H) and Schedule 1J (and associated Annexure 1).

Regarding the Second category, remove references in the SAU to SFAAs. For example, the SFAA reference in clause 1C.1.4 will be removed and hence will read:

“NBN Co will ensure that, from the SAU Commencement Date until 30 June 2017, the Price for a Reference Offer is no higher than the Maximum Regulated Price for that Reference Offer....”

2.3 Regulatory Recourse

2.3.1 ACCC Regulatory Determinations

In section 2.2.2.2 of the Draft Decision, the ACCC has noted a number of concerns with NBN Co's regulatory recourse provisions set out in clause 1B.2 of the SAU. The ACCC is concerned that these provisions could create uncertainties with regard to the normal operation of the hierarchy under Part XIC, particularly in relation to the effect of ADs and BROCs made by the ACCC and Access Seekers' ability to obtain these terms.¹⁴

The ACCC has expressed specific concerns in relation to whether the regulatory recourse provisions could:

- result in NBN Co having the ability to avoid the intended application of ADs and BROCs, by delaying their effect; and
- limit NBN Co's obligation to comply with ADs and BROCs; thereby preventing Access Seekers from seeking to access the terms and conditions in those regulatory determinations without the need to sign an SFAA-based Access Agreement.

Accordingly the Consultation Paper proposes two options:

- removing clauses 1B.1.1, 1B.1.2 and 1B.2.2 of Schedule 1B and amending clauses 6.1 and 6.2 of the SAU to provide that NBN Co will ensure that SFAAs are consistent with ADs and BROCs; or
- amending the SAU to remove linkages between SFAAs and the SAU, and SFAAs and ADs and BROCs.¹⁵

Each of these options seeks to ensure that nothing in the SAU creates uncertainty with regard to the normal operation of Part XIC, specifically the ability of Access Seekers to acquire services under an Access Agreement, SAU or an AD or BROCs.

¹⁴ Draft Decision, pp.44-45.

¹⁵ Consultation Paper, pp.12-14.

NBN Co Response 2

NBN Co proposes to adopt the ACCC's second option and thus allowing for the normal operation of Part XIC without any constraint being imposed by the SAU.

The first option is not acceptable to NBN Co because it creates too much uncertainty. This option requires NBN Co to make a commitment about alignment of the SAU with future ADs/BROCs. Neither NBN Co nor the ACCC has certainty about the subject matter those ADs/BROCs may cover and what may be involved in retaining alignment between the various instruments (i.e. between the SFAA, SAU and ADs/BROCs).

Part XIC should operate as intended if an AD/BROC is issued. Section 152AY(2) of the CCA appears to contemplate the possibility of terms and conditions being derived from several sources and the hierarchy is resolved through the various 'inconsistency provisions' in Part XIC. Accordingly, NBN Co considers that the second option addresses the ACCC's concern without the uncertainty associated with an alignment obligation relating to future instruments.

Analysis

NBN Co understands the ACCC's concern to ensure that nothing in the SAU creates uncertainty with regard to the normal operation of Part XIC, specifically the ability of Access Seekers to acquire services under an Access Agreement, SAU or an AD/BROC. In order to address this concern, NBN Co does not propose to continue with the existing regulatory recourse mechanism.

The ACCC has presented two options for consideration. NBN Co considers that the second option most appropriately addresses the ACCC's concern by "remov[ing] uncertainty about the extent to which NBN Co must comply with Part XIC under its normal operation, and in turn about the ACCC's ability to respond effectively to changing circumstances over the SAU term."¹⁶

The second option allows section 152AY(2) of the CCA to operate in the normal way. Section 152AY(2) contemplates that terms and conditions relating to compliance with the SAOs could be derived from several sources, being:

- the terms and conditions relating to a particular matter in an Access Agreement;
- to the extent the terms and conditions about a particular matter are not set out in an Access Agreement - a term or condition about that particular matter set out in an SAU;
- to the extent the terms and conditions about a particular matter are not set out in an Access Agreement or an SAU – a term or condition about that particular matter set out in a BROC; and
- to the extent the terms and conditions about a particular matter are not set out in an Access Agreement, an SAU or a BROC – a term or condition about that particular matter set out in an AD.

Sections 152BC, 152BDB, 152BDE, 152CBIA, 152CBIB and 152CBIC set out rules about resolving inconsistencies between the various instruments described in section 152AY.

It is clear from the Explanatory Memorandum to the *Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010* under which the revised section 152AY(2) was introduced, that the terms of conditions of supply may be derived from a range of sources:¹⁷

¹⁶ Consultation Paper, p.13.

¹⁷ Explanatory Memorandum to the *Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010*, p.171.

Under the proposed amendments to Part XIC made by the Bill, the terms and conditions on which a carrier/CSP must comply with the standard access obligations may be dealt with in different documents that exist at the same time. The proposed section 152AY establishes a hierarchy between those documents for identifying the terms and conditions on which a carrier/CSP must comply with the standard access obligations.

Under the ACCC's second option, Access Seekers may rely on the available terms and conditions which exist under any of the above listed available instrument at a given time to acquire services from NBN Co, subject to the resolution of inconsistencies in accordance with the operation of the various 'inconsistency provisions' under Part XIC. Allowing Part XIC to operate in its normal way as suggested by the ACCC ensures that Access Seekers can access the benefit of the rights conferred under Part XIC.

Now that the potential scope and content of the SAU is becoming certain, following the Draft Decision and Consultation Paper, it is possible to identify that the ACCC's second option is preferable; because the scope and content of the SAU is known and its potential interaction, over time, with the other instruments provided for in Part XIC can therefore be understood more clearly.

This second option also provides the ACCC with the necessary flexibility to respond to changing circumstances over the SAU term. With this option, the ACCC retains the power to intervene arising from changing circumstances through issuing an AD/BROC which will have effect to the extent to which it is not inconsistent with an Access Agreement or the SAU.

NBN Co is unable to accept the first option proposed by the ACCC; being an obligation to align SFAAs with an AD/BROC that may be issued in the future. Neither NBN Co, the ACCC nor Access Seekers have certainty about what such an AD/BROC may cover in the future and hence an obligation to align SFAAs with an unknown future AD/BROC involves considerable uncertainty.

Given this uncertainty, issues could also arise about how NBN Co should implement an alignment obligation in the event that inconsistencies between various instruments had to be resolved. NBN Co may seek to undertake an alignment on one view of an inconsistency, and the ACCC or Access Seekers may have a different view. NBN Co could then be found to be in breach of the SAU by seeking to resolve an inconsistency in a *bona fide* way but which is ultimately found to be incorrect. Accordingly, NBN Co considers there is a high compliance risk associated with the first option proposed by the ACCC, which NBN Co submits is unacceptably high.

It is not in NBN Co's legitimate business interests to be required to resolve inconsistencies in a way which may result in NBN Co being in breach of the SAU if it does so incorrectly. It is also difficult to see how it could be in Access Seeker's interests to have this burden placed on NBN Co or indeed that it would promote the LTIE. For all of these reasons, NBN Co cannot see how the first option promotes the LTIE or satisfies the reasonableness test.

While inconsistencies may also arise under the second option, the normal operation of Part XIC provides a scheme for the resolution of those inconsistencies without imposing an obligation on any one party to resolve them. In summary, NBN Co does not agree with a provision in the SAU which imposes an obligation on one party (i.e. NBN Co) to resolve an issue which arises under the normal operation of Part XIC anyway and it should be left to Part XIC to resolve.

Proposed SAU changes in Notice to Vary 2

Remove clause 1B.1 (except 1B.1.3(a)), 1B.2.1 and 1B.2.2 (Note 1B.2.3 regarding Facilities Access will be discussed in section 2.3.2).

2.3.2 Facilities Access Decisions

As noted in the Draft Decision, NBN Co and the ACCC currently have contrasting positions on whether acceptance of the SAU will result in the Facilities Access Service becoming a declared service.¹⁸

Consistent with its position that the Facilities Access Service will become a declared service, the ACCC considers that the ability to make a Facilities Access Decision under clause 1B.2.3 of the SAU is an additional power provided by the SAU to the ACCC, beyond its ability to make ADs and BROCs under Part XIC of the CCA. Nevertheless, while acknowledging that nothing in the Facilities Access Decision process impacts on the ACCC exercising its statutory power under Part XIC¹⁹, the ACCC considers that the Facilities Access Decision process does not promote the LTIE.

NBN Co Response 3

In maintaining a consistent position with proposed amendments to 'regulatory recourse' i.e. removal of linkages in the SAU between the SAU, SFAA and ADs/BROCs (section 2.3.1) the Facilities Access Decision process (clause 1B.2.3) should be removed from the SAU.

Analysis

For the reasons outlined below in section 3.3, NBN Co maintains its position that the Facilities Access Service is not currently a declared service by virtue of NBN Co including the Facilities Access Service in the SFAA, nor will it become a declared service by virtue of its inclusion in the SAU. NBN Co does not consider that any of the types of Facilities Access Service described in the SAU fall within the scope of the definition of an 'eligible service' within the meaning of section 152AL(1) of the CCA.

The ACCC has not provided detailed reasons to support its view that the Facilities Access Service should be regarded as an eligible service.

The intended effect of conferring a power on the ACCC to make a Facilities Access Decision, as noted in the Consultation Paper, was to create a process for implementation of ACCC decisions in SFAAs similar to giving effect to ADs and BROCs made with regard to the services NBN Co's regards as declared under the SAU, the NBN Access Service and Ancillary Services.²⁰

The ACCC proposes the removal of clause 1B.2.3 with the effect that the SAU does not contain a conferral on the ACCC to make terms and conditions about the Facilities Access Service. While NBN Co disagrees with the ACCC's position on whether the Facilities Access Service is able to be declared, given that NBN Co is proposing to remove clause 1B.2.2 in relation to ADs and BROCs (section 2.3.1), NBN Co proposes to adopt a consistent approach and remove clause 1B.2.3.

The SAU sets out commitments in relation to 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 Ancillary Services.

¹⁸ Draft Decision, p.70.

¹⁹ Draft Decision, p.47.

²⁰ Consultation Paper, p.13.

NBN Co's proposal to adopt the ACCC's suggestion of removing the Facilities Access Decisions from the SAU will address any uncertainty the ACCC may have with regards to the operation of Part XIC. In the event that the ACCC considers, at some point in the future, that it is necessary to further regulate access to the Facilities Access Service, the issue of whether the Facilities Access Service is able to be declared under Part XIC would be considered at that time. If, having regard to the relevant circumstances at the time, the Facilities Access Service (or elements of the Service) were properly considered to constitute 'eligible services' then the ACCC would need to conduct a declaration inquiry into whether declaration promoted the LTIE. If it could be established that the Facilities Access Service is an 'eligible service', is appropriate for regulation under Part XIC, and declaration was found to promote the LTIE, the ACCC could then set any required additional terms and conditions of access for the Facilities Access Service via the making of ADs and BROCs.

Proposed SAU changes in Notice to Vary 3

Remove clause 1B.2.3 from the SAU.

2.3.3 Alignment of SFAAs and SAU

In section 2.2.6 of the Draft Decision, the ACCC sets out its preliminary views about clauses 6.1 (initial alignment of SAU and SFAA) and 6.2 (ongoing alignment between SAU and SFAA).

In relation to these two clauses, the ACCC states:²¹

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).

The remainder of clause 6 of the SAU, that is clause 6.3, is considered by the ACCC in section 2.2.4.2 of the Draft Decision. The ACCC states:²²

the conduct that NBN Co will engage in under the first part of clause 6.3 of the main body [commitment 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.

In relation to the second part of clause 6.3 the ACCC states:²³

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.

Given this, the ACCC states that it cannot be satisfied that the conduct that NBN Co will engage in under the second aspect of clause 6.3 of the SAU will promote the LTIE.

²¹ Draft Decision p.53.

²² Draft Decision, p.49.

²³ Draft Decision, p.49.

To address the above, the Consultation Paper proposes the:²⁴

removal of the second sentence in clause 6.3 of the main body (that is, the commitment that NBN Co may include terms and conditions about the Facilities Access Service in SFAAs).

NBN Co Response 4

NBN Co proposes that the SFAA and SAU alignment in clauses 6.1 and 6.2 be retained as it will provide certainty for Access Seekers that SAU terms and conditions will always be available in SFAAs.

NBN Co does not understand the ACCC's views in relation to the second part of clause 6.3. However NBN Co proposes to adopt the ACCC's drafting change.

Analysis

NBN Co submits that it remains appropriate (indeed necessary) to keep parts of clause 6 of the SAU which set out NBN Co's commitments to maintain alignment of SFAAs with an accepted SAU.

NBN Co considers that SAU/SFAA alignment will serve as an additional commitment by NBN Co that everything that is available for Access Seekers pursuant to the SAU will, in addition, be available via NBN Co's SFAA in a consistent manner.

NBN Co does not consider that retaining this linkage creates any uncertainty in relation to the operation of Part XIC, as Access Seekers could still seek to access the terms and conditions of the SAU, BROC or AD in addition to those same terms being available in SFAAs.

NBN Co considers that creating an aligned set of terms between the SAU and SFAA will also promote the LTIE.

In section 2.2.6.2 of the Draft Decision, the ACCC acknowledges the utility of an SFAA and SAU alignment clause by stating:²⁵

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).

Further, the commitments in the SAU will be known if the SAU is accepted and, given that the SFAA and SAU are ultimately NBN Co's drafted documents, NBN Co is able to effectively manage inconsistencies between them. For this reason, the same issues do not arise as they did in section 2.3.1 about the alignment of the SFAA with future ADs/BROC where there is significant uncertainty and compliance risk in relation to the content of, and issues that might arise around, these future instruments, which would not promote the LTIE (nor be in NBN Co's legitimate business interests or Access Seekers' interests).

Accordingly, NBN Co submits that there is merit in retaining the SAU and SFAA alignment clause, even with the proposed changes in sections 2.2 and 2.3.1 above, and that the alignment itself will promote the LTIE.

NBN Co does not understand the precise nature of the ACCC's concerns in relation to the second part of clause 6.3; "NBN Co may include in an SFAA the terms and conditions in relation to the supply of the Facilities Access Service".

²⁴ Consultation Paper, p.14.

²⁵ Draft Decision, p.53.

The intention of this part of the clause was to acknowledge the 'link' between the SAU and SFAA for the purpose of facilitating SAU and SFAA alignment, by providing certainty to Access Seekers that the commitments in the SAU in relation to the Facilities Access Service would be available to them via the SFAA.

Noting NBN Co's current views in relation to the Facilities Access Service – i.e. that it is not a service that is able to be declared pursuant to section 152AL(8E)²⁶ – even if the ACCC were to make ADs or BROCC for the Facilities Access Service, NBN Co does not understand the ACCC's concerns with regards to this clause. Specifically, it is not clear how stating in the SAU that NBN Co *may* include terms and conditions relating to the Facilities Access Service in SFAAs creates uncertainty about the effect of ADs and BROCC. The clause does not seek to expressly or implicitly create any linkage between the SFAA and ADs and BROCC, or exclude the operation of ADs and BROCC.

However, NBN Co proposes to remove the second sentence in clause 6.3 of the SAU.

Proposed SAU changes in Notice to Vary 4

Delete the words "NBN Co may include in an SFAA the terms and conditions in relation to the supply of the Facilities Access Service" from clause 6.3.

2.4 Multilateral SFAA Forum

In section 2.1.1.5 of the Consultation Paper, the ACCC proposes the removal of a number of clauses in the SAU that set out the procedural requirements around NBN Co's commitment to establish and operate a Multilateral SFAA Forum. The ACCC notes that the effect of amending the SAU in this way would be that the SAU will only contain commitments to establish a Multilateral SFAA Forum to consult with Access Seekers on future changes to the terms and conditions of SFAAs.²⁷

NBN Co Response 5

NBN Co proposes to adopt the ACCC's proposed amendments to the Multilateral SFAA Forum.

Analysis

As outlined in NBN Co's Supporting Submission that was lodged with the SAU, the Multilateral SFAA Forum is intended to provide an open forum for identifying and prioritising issues associated with the SFAAs and working to develop multilateral resolutions to changes to the SFAAs.²⁸

NBN Co notes that the inclusion of a Multilateral SFAA Forum is a commitment NBN Co offered to facilitate the ongoing development of acceptable terms and conditions of access to be incorporated into NBN Co's SFAA.

NBN Co considers that the approach of having a Multilateral SFAA Forum is consistent with the operation of Part XIC of the CCA and welcomes the ACCC's views that this basic element of clause 1B.3 be retained.

NBN Co agrees with the ACCC's preliminary view that the remaining provisions in relation to the Multilateral SFAA Forum would promote the LTIE for the duration of Module 1 and proposes to retain these provisions in the SAU for the duration of Module 1.

²⁶ NBN Co and the ACCC currently have conflicting views on whether the Facilities Access Service is an 'eligible service' for the purpose of declaration under Part XIC. The ACCC would need to consider this threshold question prior to declaring and the making of Regulatory Determinations for the Facilities Access Service.

²⁷ Consultation Paper, p.15.

²⁸ Supporting Submission, p.149.

NBN Co proposes to adopt the ACCC's proposal of removing clauses 1B.3.1(b) and 1B.3.1(e)-(l) of the SAU.

NBN Co intends to consult with Access Seekers on the terms of reference and procedures for the Multilateral SFAA Forum in due course.

Proposed SAU changes in Notice to Vary 5

Remove clauses 1B.3.1(b) and 1B.3.1(e)-(l) of Schedule 1B.

Remainder of clauses in 1B.3 will operate for the duration of Module 1.

2.5 Replacement module approach

In the Draft Decision, the ACCC's preliminary view is that it is not satisfied that the replacement module submission and assessment process (as set out clauses 4.5 to 4.11 of the SAU) will operate in a manner that will promote the LTIE²⁹. The ACCC cites two reasons for this: the possibility that rejected replacement modules could be deemed to apply; and uncertainty about whether ADs and BROCs about matters that must be addressed in a replacement module application would be inconsistent with the SAU.

As a consequence, although it "has no objection in principle to the SAU specifying SAU variation applications that NBN Co proposes to make"³⁰, the ACCC proposes in the Consultation Paper that the SAU be amended to remove the commitments about the submission and assessment of replacement module applications.³¹

NBN Co Response 6

NBN Co considers that the ACCC's proposed approach in relation to replacement modules creates the real possibility of a significant regulatory 'gap' over the long term and introduces an unnecessary and unacceptable level of uncertainty. To address the concerns identified by the ACCC with the current approach in the SAU, NBN Co proposes that variations be made to the SAU which will confer greater powers on the ACCC as to how the replacement module process will operate and which also removes the deemed application of replacement modules.

Analysis

The ACCC's proposed amendment to the SAU, to remove the replacement module process altogether, is unacceptable to NBN Co because it adopts a 'scorched earth' approach that may lead to a significant regulatory gap during Module 2 with unintended consequences for both NBN Co and Access Seekers. For example, if Module 1 or a subsequent Regulatory Cycle comes to an end and the ACCC has not, prior to that date, accepted a replacement module variation or made a relevant AD or BROC, then:

- the LTRCM would not operate as intended (and the ICRA may become indeterminate) because it relies on *forecasts* of opex, capex, disposals, revenue, taxation and WACC, which need to be established *prior* to the start of each Regulatory Cycle;
- the method for rolling forward the RAB for that Regulatory Cycle would be unknown given the ACCC's proposal to remove the detail of the RAB roll forward in Module 2³²;

²⁹ Draft Decision, p.56.

³⁰ Draft Decision, p.56.

³¹ Consultation Paper, p.16.

³² Consultation Paper, p.33.

- all current Reference Offers would become Non-Reference Offers; and
- there would be substantial erosion of the incentive properties of forecasts, as they would either not exist, or may be established too late to have any value as an incentive. Further, if the ABBRR has not been set during the Building Block Period, NBN Co will not know what revenues it can earn. NBN Co would not know what the allowed revenues were prior to the start of the regulatory cycle thus leading to difficulty in the appropriate calculation of the ABBRR.

To avoid the possibility of such a regulatory gap, and the unintended consequences that may flow from it, NBN Co proposes an amended replacement module process that addresses the ACCC's stated concerns. In so doing, this process addresses the ACCC's stated concerns (see p.167 of the Draft Decision) in regard to how the Replacement Module Term will be determined (this is discussed further in section 5.3.3.2 below).

The key elements of NBN Co's proposed process are as follows:

- Clause 4.5, Description of Replacement Module, would be retained.
- Clause 4.6, Commitment to submit a Replacement Module, will be modified to confer a power on the ACCC to determine:
 - the date by which NBN Co must lodge its Replacement Module Application – this date can be between 9 months and 18 months prior to the expiry of Module 1 or the current Regulatory Cycle, as relevant, and the ACCC must give NBN Co at least 12 months prior notice of this date; and
 - the Replacement Module Term to apply for the next Regulatory Cycle – this term can be either 3, 4 or 5 years in duration, and the ACCC must notify NBN Co of this term at the same time that it notifies NBN Co of the date for lodgement of the Replacement Module Application.
- Clause 4.7, Reference Offer Proposal, would be retained.
- Clause 4.8, LTRCM Proposal, would be modified to reflect the changes to the forecasting principles proposed in section 5.3.3.1 below.
- New Clause 4.9, RAB Roll-Forward Proposal, would be included and its purpose is to specify how, for the purposes of calculating the RAB for each Financial Year of the Regulatory Cycle, the Nominal Value of Capex and Depreciation of the opening real value of the RAB may be determined (and does not lock in the use of a single approach to RAB Roll Forward, such as the use of actual capex). This is discussed further in section 5.3.3.3.
- Clause 4.9, Service Level Proposal, would be deleted, consistent with the removal of Schedule 2F, as discussed in section 6.2 below,
- Clause 4.10, ACCC Replacement Module Determination, existing drafting would be deleted and replaced with new drafting that:
 - if the ACCC has not accepted a Replacement Module Application before the current Cycle Expiry Date, confers a power on the ACCC to determine the elements of a Replacement Module in accordance with the reasonableness criteria, UNWP provisions and in a manner consistent with any fixed principles established under the SAU; and
 - as part of the conferral of power, requires the ACCC to make such a determination:
 - within 20 business days of the Cycle Expiry Date;

- to apply for all years of the next Regulatory Cycle.

This amended process addresses the ACCC's stated concerns with the replacement module process in the current SAU as it removes:

- the need for deeming, by ensuring that the ACCC has the means to make a timely determination where necessary; and
- any uncertainty in relation to the application of ADs and BROc by using a conferral of power to enable the ACCC to make a determination under the SAU in relation to the matters that must be addressed in a Reference Offer Proposal, a LTRCM Proposal and a RAB Roll Forward Proposal.

The criteria the ACCC would have to apply in making a determination under the conferral of power are broadly the same as those that would apply to the ACCC's assessment of a Replacement Module Application as a variation to the SAU. Also, NBN Co is not seeking to prescribe the process by which the ACCC should make the determination, but assumes that the ACCC could consult on the development of any potential determination in parallel with its assessment of NBN Co's Replacement Module Application.

By addressing the potential for a regulatory gap in a manner that addresses the ACCC's stated concerns with the existing process and is otherwise consistent with Part XIC, NBN Co submits that the amended replacement process will promote the LTIE.

Proposed SAU changes in Notice to Vary 6

Refer to Appendix C, section 1: Replacement Module Process.

2.6 Mid-term reviews

In section 2.3.2 of the Draft Decision the ACCC notes that it is not satisfied that the mid-term review mechanism will promote the LTIE.

The ACCC cites a numbers of reasons for this view including that it is not satisfied that the power conferred on the ACCC to review and determine future terms will allow it to make decisions that are reasonable and promote the LTIE, nor that the conduct that NBN Co will subsequently engage in to implement these decisions will promote the LTIE.³³

On this basis, the Consultation Paper proposes to remove Schedule 1K from the SAU, with the effect that the SAU does not contain a specific review mechanism.³⁴

NBN Co Response 7

While NBN Co considers there is merit in maintaining the midpoint reviews of those aspects of the SAU that would still be covered by them, NBN Co proposes to adopt the ACCC's suggested removal of Schedule 1K should be included in the variation of the SAU.

³³ Draft Decision, p.61.

³⁴ Consultation Paper, p.17.

Analysis

NBN Co considers that the mid-term review mechanism provided a proactive and flexible process in the SAU to transparently and rigorously consider the effectiveness of some of the non-price related terms and conditions and processes under the SAU and for the adjustment of those terms and conditions and processes. NBN Co also considers that the ACCC's stated concerns could have been addressed by drafting changes in relation to the review processes, decision making criteria and implementation of outcomes.

Nevertheless, NBN Co proposes to adopt the ACCC's proposed amendment of removing Schedule 1K rather than seeking to revise the drafting of the existing conferral arrangement.

As noted by the ACCC, in the absence of a midpoint review, aspects of Module 1 that are accepted by the ACCC will operate for the period of time specified at the time of SAU acceptance.³⁵

While NBN Co is prepared to remove Schedule 1K, NBN Co submits that reducing the duration of the terms and conditions (that would otherwise be subject to the mid-term reviews) would be inconsistent with the Modular approach. NBN Co notes that there would be a reduced number of provisions subject to the full term of Schedule 1K because many of the aspects of the SAU that were to be subject to the mid-term review are to be removed. For example the non-price terms and conditions in the Annexures to Schedule 1H, and service levels under Schedule 1J (See section 6 below) are to be removed. Similarly, given NBN Co's proposal to remove clause 1B.2 from the SAU, no review is applicable.

In relation to the regulatory reporting requirement in Schedule 1G, NBN Co submits that in the absence of mid-term reviews, this schedule should continue for the duration of Module 1. As noted in NBN Co's Supporting Submission, the regulatory reporting requirements provide the ACCC with transparent oversight of NBN Co's compliance with key cost recovery and pricing commitments in Module 1 of the SAU through NBN Co's obligations to submit detailed annual reporting, as well as through conferring powers on the ACCC to seek additional information it may require.³⁶ NBN Co also notes that these NBN Co reporting obligations are in addition to the ACCC's ability to seek information pursuant to its record keeping rules in section 151BU of the CCA.

In relation to other areas that were to be subject to mid-term reviews, the appropriateness of continuing these provisions for the full duration of Module 1 will be discussed in the relevant sections of this Submission.

Proposed SAU changes in Notice to Vary 7

Remove Schedule 1K from the SAU.

³⁵ Draft Decision, p.61.

³⁶ Supporting Submission, p.156.

2.7 SAU extension mechanism

In section 2.1.3.1 of the Consultation Paper, the ACCC outlines its view that the SAU should not provide for an automatic extension of Module 1 stating:³⁷

the ACCC should not be required to make a regulatory determination to prevent the continuation of the terms and conditions specified by 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.

The ACCC proposes the removal of clause 4.3 of the SAU.

NBN Co Response 8

The inclusion of a mechanism to extend the operation of Module 1 was intended to address the possibility of a regulatory gap at the end of Module 1. NBN Co proposes to adopt the ACCC's proposal to remove clause 4.3, provided that the amendment replacement module process (as described in section 2.5 above) is adopted to address the possibility of a regulatory gap arising .

Analysis

NBN Co has proposed amendments to the Replacement Module Application process. If these amendments are adopted, the need for clause 4.3 becomes redundant. This is because the revised Replacement Module Application process sets up a system by which relevant issues/values are able to be carried forward into the first Regulatory Cycle.

Accordingly, NBN Co considers that it is appropriate to delete clause 4.3, if there is an alternative "saving" mechanism in place as established by NBN Co's Replacement Module Application process.

Proposed SAU changes in Notice to Vary 8

If the proposal in section 2.5 relating to the Replacement Module process is accepted, remove clause 4.3 from the SAU.

2.8 Extension of the SAU term

In section 2.4.2.2 of the Draft Decision the ACCC states that if it approved an extension of the SAU, this extension would result in an extension of Module 0 and 2, including an automatic extension of the fixed principle term and condition, even though the ACCC had not considered the fixed principle against the relevant statutory criteria.³⁸

Section 2.1.3.2 of the Consultation Paper proposes to amend clause 7.3(b) to provide that the criteria for ACCC consideration of an NBN Co extension will be the same as section 152CBD of the CCA.³⁹

NBN Co Response 9

NBN Co will adopt all of section 152CBD of the CCA as criteria for an SAU extension.

Proposed SAU changes in Notice to Vary 9

Amend clause 7.3(b) to provide that the criteria for ACCC consideration of an NBN Co application will be the same as section 152CBD of the CCA.

³⁷ Consultation Paper p.18.

³⁸ Draft Decision, p.64.

³⁹ Consultation Paper, p.18.

3 Services to which the SAU relates

3.1 Declaration of services under Part XIC

In section 3.5.1.1 of the Draft Decision, the ACCC states:⁴⁰

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.

However, the ACCC also states:⁴¹

...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.

NBN Co agrees in principle that there may be periods throughout the SAU term when NBN Co's incentives to develop and supply products are stronger than at other times, but does not accept that there will be periods when it 'does not face revenue sufficiency risk'. Although the level of revenue sufficiency risk may fall, over the term of the SAU, it is unlikely to fall to such an extent that it would undermine NBN Co's incentives to invest, operate and price efficiently. NBN Co's views in relation to the ACCC's analysis of revenue sufficiency are discussed at section 5.1.1.

In considering the possible change in NBN Co's incentives during the term of the SAU, the ACCC notes its ability under section 152AL(8F) of the CCA to declare a service, even if the service is, to any extent covered by the SAU:

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.⁴²

However, the ACCC goes on to state that the drafting of the SAU does not appear to accommodate the ACCC declaring a specific service and that the drafting in the SAU creates uncertainty in relation to the interaction between declaration by the ACCC (section 152AL(8A)) and declaration via an SAU (section 152AL(8E)). The ACCC states:⁴³

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 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]".

⁴⁰ Draft Decision, p.69.

⁴¹ Draft Decision, p.69.

⁴² Draft Decision, p.69.

⁴³ Draft Decision, pp.69-70.

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.

...

The ACCC considers that the provisions in the SAU that narrow what is to be supplied by NBN Co under the SAU creates 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.

To this end, in section 2.2.1 of the Consultation Paper, the ACCC proposes the inclusion of explicit statements in the SAU which acknowledge that:

- 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.⁴⁴

NBN Co deals with the first of these issues in this section of the submission. The means by which NBN Co will fulfil its obligations with respect to services declared by the ACCC in the future is dealt with in section 3.2

NBN Co response 10

NBN Co submits that there is no ambiguity as to how the SAU interacts with a service that may be declared by the ACCC.

The ACCC's power to declare services covered by the SAU is explicitly addressed through section 152AL(8F) of the CCA. NBN Co does not consider that the SAU in any way prevents or limits the ACCC from declaring a service under section 152AL(8A) of the CCA.

Nevertheless, NBN Co has no objection to the SAU acknowledging that the ACCC may declare services, and proposes drafting to do so.

Analysis

The service descriptions for the NBN Access Service and Ancillary Service (as set out in Attachment A of the SAU) are as follows:⁴⁵

The NBN Access Service is a Layer 2 service supplied on the NBN Co Network between and including:

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

(b) the Network-Network Interface associated with the relevant Network Termination Device,

for the purpose of enabling an Access Seeker (or another Service Provider that is a

⁴⁴ Consultation Paper, p.19.

⁴⁵ Attachment A, NBN Co SAU (December 2012).

customer of an Access Seeker) to supply Carriage Services or Content Services.

The Ancillary Services are the services supplied by NBN Co that facilitate the supply of, and are necessary for Access Seekers to acquire, the NBN Access Service, including:

(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 that enables an Access Seeker to prepare for, and perform, certain network and operational

interoperability testing in relation to the NBN Access Service and development and implementation by that Access Seeker of Carriage Services, Content Services and operational platforms that utilise components and functionality of the NBN Access Service, but excludes the Facilities Access Service.

The service descriptions are defined in a functional way, which is consistent with the ACCC's approach to the declaration of eligible services.⁴⁶

The service description for the NBN Access Service declares an end-to-end Layer 2 bitstream service on NBN Co's network, but the SAU also seeks to set out how the NBN Access Service is able, in practice (i.e. technically), to be acquired by Access Seekers through the Product Components and Product Features. Initially, this will include the Product Components and Product Features described in the SAU, but may in the future include other products and services which have been developed utilising the product development processes in Schedule 1I of the SAU. A similar approach is adopted in the SAU for Ancillary Services. This approach provides certainty to Access Seekers regarding the details of supply under the SAU.

Clause 1A.1.3 clarifies that the Product Components which together make up the NBN Access Service, provide the mechanism through which NBN Co will deliver the NBN Access Service and therefore meet its obligations under the SAU and the category B SAOs in relation to the NBN Access Service. A similar approach is adopted for Ancillary Services under clause 1A.4.2 of the SAU.

As noted above, the ACCC states that the provisions in the SAU which narrow what is to be supplied by NBN Co (essentially supply through the Product Components) may be characterised as 'limitations' in which case the ACCC considers that they do not promote the LTIE, or they could be characterised as 'terms and conditions' in which case the ACCC considers that they are not reasonable having regard to the matters in section 152AH.

First, NBN Co does not agree with the ACCC's views that these provisions are 'limitations'.

The difference between a limitation and a term and condition has been explained by the Federal Court as follows:

*limitations (on the one hand) and terms and conditions (on the other) are necessarily in different fields. Terms and conditions can only operate in relation to a "declared service" after any limitations on the service are taken into account. Put another way, limitations bear upon the accurate identification of the service and terms and conditions relate to the provision of the service.*⁴⁷

A limitation would typically cover elements, such as the geographic reach of the service⁴⁸ and the facility or technology used to provide the service⁴⁹ (e.g. Layer 2 service over fibre, fixed wireless and satellite). A term and condition on the other hand goes to how the service is provided.⁵⁰

⁴⁶ Supporting Submission, p.79.

⁴⁷ *Seven Network v Australian Competition and Consumer Commission and Others* [2007] FCA 1929, at 81 per Buchanan J.

⁴⁸ *Ibid*, at 85.

NBN Co submits that the provisions above reflect how the NBN Access Service will be supplied because they set out the method in which the broader service description is able, in practice (i.e. technically), to be acquired by Access Seekers. Accordingly NBN Co submits these provisions are terms and conditions relating to the declared service.

Secondly, proceeding on the premise that the provisions are terms and conditions, NBN Co does not agree that the drafting of the SAU creates uncertainty as to the interaction between the SAU and any specific services that may be declared by the ACCC or the terms and conditions specified in an AD or BROCC in respect of such a service.

NBN Co submits that the ACCC has not provided any reasons why such terms and conditions are not reasonable.

There is nothing in these provisions, either explicit or otherwise, that precludes the ACCC from declaring a service under section 152AL(8A) of the CCA.

Crucially, Part XIC makes it very clear that the ACCC has the ability to unilaterally declare a service under section 152AL(8A) and that the service it declares under that section can include all or part of a service already covered by an SAU that is in operation.

In particular, section 152AL(8F) of the CCA states:

*“The Commission may declare a service under subsection (8A) **even if the service is, to any extent, covered by subsection (8E)**”⁵¹.*

NBN Co acknowledges that the ACCC is able to declare services, even if such services are to any extent covered by an operational SAU containing broad functional service descriptions like the NBN Access Service and Ancillary Services.

Accordingly, NBN Co does not object to the inclusion of a broad acknowledgement that nothing in the SAU is intended to effect the ACCC from declaring a service pursuant to section 152AL(8A) of the CCA.

However, for the reasons expressed below, NBN Co submits that the extension of the obligation to supply under the SAU (i.e. at the time of acceptance) to include future declared services would be potentially inconsistent with the SAOs which would apply to those declared services. Further, NBN Co submits that the ACCC’s proposed drafting around the setting of terms and conditions in relation to such future declared services could also operate inconsistently with the operation of section 152AY(2) of the CCA (or give rise to uncertainty as to its operation).

In section 3.5.1.1 of the Draft Decision, the ACCC provides a specific example of what it considers to be uncertainty between the interaction of the SAU and ACCC declared services:

*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.*⁵²

⁴⁹ Ibid, at 85.

⁵⁰ Ibid, at 85.

⁵¹ Section 152AL(8E) of the CCA provides for declaration of eligible services covered by an accepted SAU.

⁵² Draft Decision, p.70.

NBN Co submits that the drafting in the SAU does not raise any uncertainty in relation to the revenues to be included in the LTRCM. The concept of 'Relevant Assets' in the SAU is defined in a way that is not limited to revenue derived from the declared services described in the SAU. When construed in conjunction with the definition of "Revenue" and Schedules 1E (RAB), 1F (LTRCM) and Schedule 2D (LTRCM), NBN Co submits that even without an 'explicit statement' in the SAU, the definitions and usage of terms, including 'Relevant Assets' and 'Revenue' are broad enough to encompass revenue that NBN Co derives from other services that may be declared by the ACCC, provided that those services utilise the networks or elements included in the definition of Relevant Assets. For this reason NBN Co submits that the SAU establishes a 'whole of business' undertaking for revenue attribution purposes.

Proposed SAU changes in Notice to Vary 10

NBN Co proposes introducing the following acknowledgement as a new clause 1A.1.4:

"Nothing in this clause 1A.1 affects the ACCC's ability to declare an Eligible Service under section 152AL(8A) of the CCA, even if the Eligible Service that is declared by the ACCC is, to any extent, covered by the NBN Access Service".

NBN Co also proposes to introduce a similarly worded acknowledgement as a new clause 1A.4.3 in relation to the Ancillary Services.

3.2 Supply of future services declared by the ACCC

In section 2.2.1 of the Consultation Paper, the ACCC sets out a number of specific proposed variations to address what it describes as 'uncertainty' in relation to the ACCC's ability to set terms and conditions.⁵³

The ACCC's proposals involve:

- extending obligations to supply under the SAU to include an obligation to supply any future declared services that fall within the scope of the NBN Access Service (or Product Components / Product Features that comprise part of the NBN Access Service) and the Ancillary Services.
- the ACCC setting the terms and conditions of supply of such future declared services.

The ACCC has proposed that clause 1A.1 be varied to include the following new clause 1A.1.4:⁵⁴

NBN Co will supply services declared by the ACCC or specified in Access Determinations or Binding Rules of Conduct that fall within the service description of the NBN Access Service, on the terms and conditions specified by the ACCC, to the extent that those terms and conditions are not inconsistent with the SAU.

The ACCC has proposed that clause 1A.4 be varied to include the following new clause 1A.4.3:⁵⁵

NBN Co will supply services declared by the ACCC or specified in Access Determinations or Binding Rules of Conduct that fall within the service description for Ancillary Services, on the terms and conditions specified by the ACCC, to the extent that those terms and conditions are not inconsistent with the SAU.

The ACCC has also proposed a series of changes in Attachment A and Attachment C to the main body of the SAU, including:

⁵³ Consultation Paper, pp.19-20.

⁵⁴ Consultation Paper, p.19.

⁵⁵ Consultation Paper, p.19.

- a variation to clause 3 of Attachment A to the main body of the SAU to extend the definition of Ancillary Services to also include “services declared by the ACCC or specified in Access Determinations or Binding Rules of Conduct”.
- a variation of the dictionary definitions in Attachment C to the main body to extend the definition of:
 - Product Components to include “any new or varied product components introduced by NBN Co pursuant to Schedule 1I (Product Development and Withdrawal) or Schedule 2E (Product Development and Withdrawal), **or declared by the ACCC or specified in Access Determinations or Binding Rules of Conduct**”; and
 - Product Features to include “a feature of a Product Component that is made available by NBN Co **or declared by the ACCC or specified in Access Determinations or Binding Rules of Conduct** and which is selectable by the Customer in connection with that Product Component...”.

NBN Co Response 11

First, NBN Co does not agree that the SAU should include the obligation to supply services declared by the ACCC. Section 152CBA(3A) only requires the service declared by the SAU to be subject to a commitment to comply with the SAOs – which is appropriate because it is the SAU which declares that service.

NBN Co’s obligation to supply future declared services is clearly captured by the SAOs under section 152AXB as they may apply to such services in the future. There is no need for the SAU to deal with the obligation to supply these future declared services. Further, the ACCC’s proposal for the SAU to extend the obligation to supply future declared services is inconsistent with the SAOs in section 152AXB which are drafted differently to, and contain exceptions not reflected in, the ACCC’s proposed drafting. NBN Co submits that it is appropriate for the SAOs to operate in the way provided for under Part XIC.

Second, NBN Co does not agree with the inclusion of the ACCC’s proposed clauses regarding the setting of terms and conditions by the ACCC, as this is already provided for through the normal operation of section 152AY(2). NBN Co submits that the setting of terms and conditions should be left to the normal operation of Part XIC.

However, NBN Co is prepared to amend clauses 1A.1.2, 1A.1.3, 1A.4.1, 1A.4.2 and clauses 2A.1.3 and 2A.1.5 to clarify that NBN Co may also fulfil its SAOs with respect to the NBN Access Service and Ancillary Services by supplying services declared by the ACCC or as specified in ADs /BROC. NBN Co submits that these proposed amendments directly address the ACCC’s concerns relating to uncertainty.

Analysis

Obligation to supply future declared services

The ACCC proposes amendments to clauses 1A.1.4 and 1A.4.3 (and other proposed amendments to Attachments A and C) which together extend the obligation to supply to include all future declared services that fall within the scope of the NBN Access Service (or Product Components / Product Features that comprise part of the NBN Access Service) and the Ancillary Services.

NBN Co is unable to agree with this proposal. The CCA already governs the interaction between services declared via the various mechanisms in Part XIC and the means by which compliance with the SAOs is to occur.

NBN Co submits that the inclusion of these clauses is inconsistent with the operation of section 152CBA(3A), which provides that, in NBN Co's case:

the undertaking must state that, in the event that the person supplies, or becomes capable of supplying, the service (whether to itself or to other persons), the person:

(a) agrees to be bound by the obligations referred to in section 152AXB, to the extent that those obligations would apply to the person in relation to the service if the service were treated as a declared service; and

(b) undertakes to comply with the terms and conditions specified in the undertaking in relation to the obligations referred to in section 152AXB. [Emphasis added]

Section 152CBA(3A) does not require the SAU to contain open ended obligations to supply all services that may be declared by the ACCC in the future.

NBN Co also submits that the inclusion of drafting of the nature proposed by the ACCC is potentially inconsistent with the SAOs under section 152AXB which will apply to future declared services. For example, the SAOs are drafted and operate in a particular way and there are exceptions which may apply.

The SAOs under section 152AXB require an access provider *at the request of a service provider* to supply declared services to the service provider *in order for* the service provider to supply carriage services and content services.

Further, the SAOs contain a number of limitations, including those related to the reasonably anticipated requirements of NBN Co, existing Access Seekers and other pre-existing rights, as well as some exceptions.⁵⁶

NBN Co submits that it is unnecessary and potentially dangerous to reflect statutory drafting in a regulatory instrument when the legislative obligation is not properly or completely reflected in the drafting. Further, the operation of the legislation may change through interpretation and refinement over time. Inconsistencies may then arise between the statutory obligation and the obligation in the SAU.

Accordingly, NBN Co disagrees with the ACCC's view that the provisions in the SAU do not accommodate a scenario where the ACCC declares a service. In its Consultation Paper in November 2012, the ACCC acknowledged that services declared by the SAU would operate in conjunction with services declared by the ACCC, and stated:

Where the services declared by acceptance of the SAU are subject to such limitations, the Category B SAOs only apply to the limited service. The ACCC does not consider these limitations to be problematic in the NBN context, because the combination of sections 152CJA and 152AL of the CCA has the effect of requiring that all of NBN Co's eligible services are declared in order for NBN Co to supply them. As such, services which are not declared by acceptance of the SAU must nonetheless be declared via other means (for example, by NBN Co publishing a SFAA relating to the service or by the ACCC declaring the service).⁵⁷

Any concerns about the ACCC's ability to declare services in the future is dealt with through the inclusion of an acknowledgement as discussed in section 3.1 above.

⁵⁶ For example section 152AXB does not impose an obligation on NBN Co if there are reasonable grounds to believe that the Access Seeker would fail, to a material extent, to comply with the terms and conditions on which the NBN corporation complies, including on grounds of creditworthiness. Sections 152AXB6(a) and (7a).

⁵⁷ ACCC, Consultation Paper on NBN Co 2012 Special Access Undertaking (November 2012), pp.36-37.

NBN Co does not consider that further clarification is required in relation to the obligation to supply future declared services. This obligation is most appropriately addressed through the operation of the SAOs in Part XIC.

However, NBN Co is prepared to amend clauses 1A.1.2, 1A.1.3, 1A.4.1, 1A.4.2 and clauses 2A.1.3 and 2A.1.5 to clarify that NBN Co may also fulfil its SAOs with respect to the NBN Access Service and Ancillary Services by supplying services declared by the ACCC or as specified in ADs /BROC.

NBN Co submits that these proposed amendments directly address the ACCC's concerns with regard to the intended effect of the current drafting in these clauses (as cited above in section 3.1), by clarifying that the clauses do not exclude NBN Co's SAOs in relation to any services declared by the ACCC which would fall within the broad service descriptions of the NBN Access Service and Ancillary Services.

Proposed SAU changes in Notice to Vary 11

Amend clause 1A.1.2 and 1A.1.3 as follows:

“1A.1.2 Offer to supply Product Components and associated Product Features
NBN Co will offer to supply the Product Components and associated Product Features (together with services that fall within the service description of the NBN Access Service that are declared by the ACCC pursuant to Part XIC of the CCA or are specified in Access Determinations or Binding Rules of Conduct) on each NBN Co Network as the means of implementing its obligations under this Special Access Undertaking in connection with the NBN Access Service.

1A.1.3 Implementation of NBN Access Service through Product Components and associated Product Features
The Product Components and associated Product Features (together with services that fall within the service description of the NBN Access Service that are declared by the ACCC pursuant to Part XIC of the CCA or are specified in Access Determinations or Binding Rules of Conduct) provide the means by which:

- (a) NBN Co will fulfil its obligations under the 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”.*

Similar changes would be made to 1A.4.1 and 1A.4.2 regarding Ancillary Services and clauses 2A.1.3 and 2A.1.5.

Setting of terms and conditions of supply of future declared services

The ACCC proposes that in respect of services declared by the ACCC in the future from time to time, NBN Co will be required to supply such future declared services “*on the terms and conditions specified by the ACCC, to the extent that those terms and conditions are not inconsistent with the SAU.*”

NBN Co submits that the proposal that terms and conditions will be set by the ACCC in relation to future declared services is contrary to the operation of section 152AY(2).

The ACCC may declare services in the future, as discussed above, and as will be acknowledged in the varied SAU. If it does so, terms and conditions in relation to that declared service will need to be agreed or determined.

NBN Co submits that it is not appropriate for the SAU to seek to deal now with how terms and conditions are to be agreed between NBN Co and Access Seekers or determined by the ACCC pursuant to its other regulatory powers, as this is already provided for through the normal operation of section 152AY(2), which sets out how a carrier must comply with SAOs (the operation of this section is discussed in detail in section 2.3.1 above). The ACCC's proposal that the ACCC always determine the terms and conditions of supply of future declared services (except to the extent inconsistent with an SAU) is unnecessary in light of, and directly inconsistent with, the operation of section 152AY(2) and would involve a significant and unacceptable degree of uncertainty for NBN Co.

Accordingly, NBN Co submits that Part XIC should be allowed to operate in the normal way, to permit NBN Co to agree or allow the ACCC to determine the terms and conditions of supply of future declared services. There is no need for the SAU to address this issue and NBN Co submits that the ACCC's proposal is contrary to section 152AY(2) of the CCA.

3.3 The Facilities Access Service

In section 3.5.1.2 of the Draft Decision, the ACCC states:

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).⁵⁸

The ACCC further states:

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. The ACCC interprets these provisions to mean that, where an SAU that "relates to" a service is accepted by the ACCC, and NBN Co supplies the service, then the service is a declared 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). 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 1997.⁵⁹

⁵⁸ Draft Decision, p.70.

⁵⁹ Draft Decision, pp.70-71.

NBN Co Response 12

NBN Co does not consider that the acceptance of the SAU by the ACCC would have the effect of making the Facilities Access Service a declared service. The Facilities Access Service is not an “eligible service” (a pre-requisite for declaration), as it is neither a “listed carriage service” nor a “service that facilitate the supply of a listed carriage service”. Rather, it is a service that facilitates “interconnection” for the purposes of 152AXB and is ancillary or incidental to the supply of ‘Eligible Services’. NBN Co notes that the Draft Decision does not include any analysis as to why the ACCC considers that the Facilities Access Service is an “eligible service”.

NBN Co has set out the terms and conditions of supply for Facilities Access Service in connection with the satisfaction of NBN Co’s interconnection obligations under the CCA in relation to the NBN Access Service and Ancillary Service.

Analysis

Given the approach NBN Co has outlined above in section 2.3.2, NBN Co does not consider it is necessary to determine now whether the Facilities Access Service (or components of the Service) is an “eligible service”, however for completeness NBN Co outlines the basis for its current position.

NBN Co does not consider that any of the types of Facilities Access Service described in the SAU fall within the scope of a service that ‘facilitates the supply of a listed carriage service’ within the meaning of the *Telecommunications Act 1997* (Telco Act). NBN Co also does not consider that the cross-connect component of the Facilities Access Service is a ‘listed carriage service’ under the Telco Act.

Consequently, NBN Co submits that the Facilities Access Service is not currently a declared service by virtue of NBN Co including the Facilities Access Service in the SFAA (section 152AL(8D)), nor will it become a declared service by virtue of its inclusion in the SAU (section 152AL(8E)).

Hereafter, listed carriage services and services that facilitate the supply of listed carriage services will be referred to collectively as ‘Eligible Services’.⁶⁰

Eligible Services are different from those which are ancillary or incidental

A distinction can be drawn between the supply of Eligible Services and those services that are ancillary or incidental to the supply of Eligible Services. This distinction is drawn in the *NBN Companies Act 2011* (NBN Companies Act) and the CCA.

For example, the definition of ‘non-communications service’ in section 18 of the NBN Companies Act distinguishes between Eligible Services on the one hand and a “*service that is ancillary or incidental to the supply by an NBN corporation of an eligible service*” on the other. Relevantly, the Explanatory Memorandum states that the reference in the definition of non-communications services to ancillary or incidental services is intended to clarify that an NBN corporation may supply a range of supplementary services to customers that enable the customer to supply services to end-users. Examples of this are facilities access services (such as the leasing of duct or conduit space).⁶¹

It is therefore appropriate to characterise those services that form part of the Facilities Access Service as services that are ancillary or incidental to the supply of eligible services by NBN Co, as this is consistent with the intention of Parliament. Other relevant sections of Part XIC, such as sections 152AXD and 152CBA(3C), also reflect this distinction and indicate that NBN Co was intended to provide services which are preparatory, ancillary or incidental to the supply of ‘eligible services’.

⁶⁰ As noted by the ACCC in the Draft Decision (p.70) the definition of an eligible service under section 152AL for the purpose of services able to be declared by the ACCC) is the same as definition for services able to be declared under an SAU section 152CBA.

⁶¹ Revised Explanatory Memorandum to the NBN Companies Bill 2010, p.73-74.

Access to NBN Co facilities is covered by the Interconnection SAO and Schedule 1 of the Telco Act

Facilities access has historically been distinguished from the declaration of 'eligible services' under Part XIC, with facilities access being provided in relation to declared services by means of the 'interconnection SAO' (under section 152AXB(4) in NBN Co's case) and pursuant to Schedule 1 of the Telco Act.

In particular:

- there is a specific regime to regulate access to facilities which is set out in Parts 3 and 5 of Schedule 1 of the Telco Act. Facilities access has not been declared by the ACCC to date, with Access Seekers instead seeking access to such facilities under the Telco Act and the access provider facilitating interconnection with declared services pursuant to the interconnection SAO. Further, there have been no steps taken to combine the operation of the two regimes, even in circumstances where both the CCA and Telco Act were amended to implement the NBN. As the Telco Act and Part XIC of the CCA were both passed as part of the same legislative package and there is a high degree of interaction between these two regimes,⁶² Parliament is unlikely to have intended that Part XIC would serve as the basis for the regulation of supplementary facilities where a specific regime exists under Schedule 1 of the Telco Act to do so.
- if interconnection was an 'eligible service' and declared under section 152AL of the CCA (as proposed by the ACCC), section 152AXB(4) of the CCA would have no effective scope of operation – as the Facilities Access Service would be a declared service, it would be subject to the statutory obligation to supply under section 152AXB(2) and the operation of the interconnection SAO would be superfluous and would not facilitate a linkage between the declared service under Part XIC and the obligation to provide access to facilities under Schedule 1 of the Telco Act. Such an outcome would not be consistent with the established principle of statutory interpretation which provides that:⁶³

...such a sense is to be made upon the whole as that no clause, sentence, or word shall prove superfluous, void, or insignificant, if by any other construction they may all be made useful and pertinent.

Given the above, NBN Co submits that the terms and conditions of supply for the Facilities Access Service in the SAU (which appear to be acceptable to the ACCC) are set out in connection with the satisfaction of NBN Co's interconnection obligations under section 152AXB(4) of the CCA in relation to the Eligible Services under the SAU - NBN Access Service and Ancillary Services.

3.4 Compliance and consistency with SAOs

Section 3.5.1.3 of the Draft Decision sets out the ACCC's views in relation to whether the terms and conditions of the SAU are consistent with the Category B SAOs. The ACCC has expressed its preliminary view that the drafting of a number of clauses in the SAU may be inconsistent with the SAOs.⁶⁴

The following sections provide NBN Co's views in relation to the specific drafting issues (and proposed amendments) relating to compliance with SAOs identified by the ACCC in the Consultation Paper.

⁶² For example, see clause 17(3) in Schedule 1 of the Telco Act specifically, which references the reasonableness criteria in Part XIC.

⁶³ See Kirby M, J in *Project Blue Sky Inc and Others v Australian Broadcasting Authority* [1998] HCA 0028 citing Griffith CJ in *Commonwealth v Baume* (1905) 2 CLR 405 at 414, in turn quoting *R v Berchet* (1688) 1 Show KB 106; 89 ER 480.

⁶⁴ Draft Decision, p.72.

3.4.1 Offer to supply

In section 2.2.2 of the Consultation Paper, the ACCC states that NBN Co's commitment in the SAU to 'offer to supply' the NBN Access Service, Ancillary Services and the Facilities Access Service is not consistent with the Category B SAOs.

The ACCC has proposed that all references to 'offer to supply' services in the SAU be replaced with a commitment to 'supply' services.

NBN Co Response 13

NBN Co does not object to amending the SAU as proposed by the ACCC, assuming that the ACCC's second option in relation to regulatory recourse is implemented. NBN Co considers that the ACCC's proposed approach is aligned with NBN Co's proposed changes to the regulatory recourse mechanism in this submission (to implement the second of two options proposed by the ACCC) and which permits the normal operation of Part XIC to deal with the interaction between Access Agreements, the SAU, BROCs and ADs.

Analysis

The "offer to supply" language in Schedule 1A of the SAU was intended to reflect the fact that Access Seekers would acquire the NBN Access Service and other services covered by the SAU by entering into an Access Agreement with NBN Co based on the SFAA. When NBN Co's obligation to "offer to supply" was viewed in the context of the SFAA alignment obligations in clause 6 of the SAU, the combined effect of these provisions was that the SFAA would provide the primary mechanism through which NBN Co's commitments in the SAU were to be implemented.

However, given NBN Co's proposal in this submission that Part XIC should operate to determine the interaction between Access Agreements, the SAU, BROCs and ADs, NBN Co consider that the ACCC's proposed change allows for the normal operation of Part XIC, and in particular section 152AY(2), and is an acceptable approach.

Accordingly, NBN Co does not object to varying all references in the SAU of 'offer to supply' to 'supply' services.

Proposed SAU changes in Notice to Vary 12

Amend clauses 1A.1.2, 1A.2.1, 1A.3.1, 1A.4.1 of Schedule 1A and clause 2A.1.2, 2A.1.4 and 2A.1.6 of Schedule 2A to replace "offer to supply" with "supply". By way of example, NBN Co proposes to amend clause 1A.2.1 of the SAU as follows:

NBN Co will ~~offer to~~ supply the following Product Components:

- (a) the UNI;*
- (b) the AVC;*
- (c) the CVC; and*
- (d) the NNI,*

subject to the terms and conditions in clause 1A.3 and Schedule 1I (Product Development and Withdrawal).

NBN Co proposes that similar changes also be made to the other provisions of the SAU that include the phrase "offer to supply".

3.4.2 Reference to Access Agreement and Customers

Under clause 1A.3.1(b)(iii) of the SAU, NBN Co may require Access Seekers to satisfy “any other terms and conditions specified in Access Agreements to be able to acquire the Product Components”.

In section 2.2.2 of the Consultation Paper, the ACCC states:⁶⁵

Clause 1A.3.1 of Schedule 1A specifies conditions that must be met before NBN Co will supply product components. Clause 1A.3.1(iii) states that one of these conditions is that the access seeker has satisfied “any other terms and conditions specified in an Access Agreement to be able to acquire the Product Component”. As noted in the Draft Decision, the ACCC is not satisfied that this 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.

ACCC expresses a similar concern in respect of NBN Co’s use of the term “Customers” (as opposed to “Access Seekers”) stating:⁶⁶

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. In contrast, under Part XIC, access to declared services is not contingent on entry into any Access Agreement.

NBN Co Response 14

NBN Co does not object to the ACCC’s proposal to delete clause 1A.3.1(b)(iii). NBN Co also does not object to replacing the term “Customer” in the SAU with “Access Seeker”. NBN Co is able to accept both proposed variations on the assumption that the ACCC’s second option in relation to regulatory recourse is also implemented.

Analysis

The purpose of clause 1A.3.1(b)(iii) of the SAU is to ensure that an Access Seeker can comply with the various terms and conditions (e.g. legitimate operational and technical requirements) that need to be satisfied before the Access Seeker can commence acquiring services from NBN Co. These requirements are already set out in detail in the SFAA.

NBN Co acknowledges the importance and paramount nature of the SAOs. Accordingly, NBN Co does not object to deleting clause 1A.3.1(b)(iii) in its entirety and relying upon the operation of the limitations and exceptions to its category B SAOs under section 152AXB in relation to such matters.

NBN Co does not object to replacing references to “Customer” in the SAU with “Access Seeker”.

⁶⁵ Consultation Paper, p.21.

⁶⁶ Consultation Paper, p.21.

Proposed SAU changes in Notice to Vary 13

Delete clause 1A.3.1(b)(iii) of Schedule 1A of the SAU.

Replace references in the SAU to 'Customers' with 'Access Seekers' (and any consequential amendments will be made, if required).

In general, replace the term "Customer" with "Access Seeker" throughout the SAU. However, retain the use of the term "Customer" in some limited instances to address the fact that some SAU commitments are intended to apply to Customers only (i.e. Access Seekers that have executed Access Agreements with NBN Co). An example of this includes the prudency dispute provisions in Schedule 1E, which is intended to only provide Customers with the right to submit and join prudency disputes, as it will only be Customers that are ultimately responsible for paying charges that are derived from the costs that NBN Co incurs as a consequence of the implementation of an Endorsed Network Change.

3.4.3 Requirement to acquire each Product Component

In section 3.5.1.3 the Draft Decision ACCC states:

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. The ACCC considers that this clause goes beyond the authorisation provided in the legislation and does not promote the long-term interests of end-users.⁶⁷

In section 2.2.2 of the Consultation Paper, the ACCC proposes:

Clause 1A.3.2 be deleted from the SAU in order to preclude NBN Co from bundling products beyond the authorisation provided by section 151DA of the CCA.⁶⁸

The ACCC has not provided any further analysis or reasoning in relation to this proposal.

NBN Co Response 15

NBN Co submits that the "bundling" of the four Product Components that comprise the NBN Access Service is reasonable within the statutory meaning and can be justified on a range of efficiency, operational and technical grounds.

In any event, NBN Co submits that clause 1A.3.2 is reasonably necessary to ensure NBN Co is permitted to engage in conduct that is expressly permitted by the CCA to support uniform national pricing.

Analysis

Strong efficiency, operational and technical reasons for NBN Co's product construct

The ACCC has not provided any justification in the Draft Decision as to why it considers that clause 1A.3.2 does not promote the LTIE.

NBN Co submits that making supply of Product Components conditional on the acquisition of other Product Components that comprise the NBN Access Service is reasonable within the statutory meaning (and therefore promotes the LTIE) because it can be justified on a range of efficiency, operational and technical grounds.

⁶⁷ Draft Decision, p.73.

⁶⁸ Consultation Paper, p.21.

In particular:

- the Product Components are intended to be configurable (but not technically separable) components of the NBN Access Service. The Product Components are technically dependant on each other as integral components of a single end-to-end service (i.e. the NBN Access Service); and
- the use of such integrated components which need to be acquired together to enable an end-to-end service is supported by international precedents and has been developed in consultation with the industry⁶⁹;
- the component based Product Construct actually increases the efficiency and quality of services that can be provided by Access Seekers in downstream markets by giving Access Seekers the ability to introduce contention into services they provide over the NBN and to use this as the basis for service quality differentiation;
- the requirement to acquire all Product Components reduces the costs of market entry for Access Seekers and establishes a level playing field at the retail level.

The acquisition of all of the components is fundamental to the delivery of the NBN Access Service. For example it is not technically possible:

- for an Access Seeker to not acquire the NNI or the UNI –Access seekers will not be able to interconnect their respective networks with the NBN other than through an NNI. Similarly, the UNI provides the basis for an Access Seeker to handover traffic at an end-user premises and it is not possible for an end-to-end service to be delivered without the UNI;
- for an Access Seeker to deliver bandwidth or classes of services to each end-user without the AVC – this provides the basis for a logical connection between the UNI and the NNI; and
- without the CVC, for Access Seekers to introduce contention into their NBN offerings and to cater their downstream services for different segments of the market. Therefore, the CVC is an essential component, which provides the basis for service differentiation between Access Seekers.⁷⁰

In addition to the technical dependency of the Product Components for supply, NBN Co submits that this approach promotes the LTIE by increasing the efficiency and quality of services that can be provided by Access Seekers in downstream markets by giving Access Seekers the ability to introduce contention into services they provide over the NBN and to use this as the basis for service quality differentiation.

For example, by integrating a configurable CVC component into the end-to-end service, NBN Co is providing the basis for more efficient service delivery and allows for the creation of more dynamically efficient downstream markets. Further, the CVC is designed to allow Access Seekers to scale their capacity requirements as their customer base in a Connectivity Serving Area expands over time. For example, in rural and regional areas where retail broadband competition is currently limited, the CVC allows Access Seekers to enter the market by initially purchasing modest amounts of CVC capacity and to scale up that capacity over time.

⁶⁹ See Supporting Submission, p.71.

⁷⁰ For example some Access Seekers may acquire less CVC capacity as a means of offering more competitively priced offerings, while Other Access Seekers may choose to buy greater amounts of CVC capacity to deliver a higher quality service, or to cater to a more demanding subset of the retail market (e.g. business or enterprise customers).

The Draft Decision does not consider whether NBN Co's product construct constitutes a "bundle"

The Draft Decision does not consider the competitive impact of NBN Co's product construct. NBN Co submits that this is a necessary pre-requisite before the ACCC can definitively determine whether clause 1A.3.2 of the SAU is reasonable (and promotes the LTIE).

Regulatory concerns in relation to traditional bundling or tying are usually twofold:

- the need to prevent a dominant firm from using bundling or tying as a way of leveraging market power from non-competitive to competitive markets, or where the conduct increases barriers to entry;⁷¹ and
- the need to address situations where a dominant firm forces the acquirer of a service to take elements that are not technically necessary to the delivery of services, thereby negatively impacting competition in downstream markets – ULLS is an example of a sensible ex-ante regulatory intervention that prevents a dominant firm from forcing Access Seekers to buy network elements (e.g. backhaul, active layer services) that Access Seekers neither need or want.

Neither of these concerns arise in the context of the NBN Co Access Service. In fact, NBN Co does not accept that the need to acquire each of the Product Components should even be considered a "bundle" in the sense that the concept has traditionally been used in the telecommunications context.

The fact that Access Seekers technically need to acquire each Product Component to be able to offer an end-to-end service on the NBN is not anti-competitive, or problematic from an ex-ante regulatory perspective.

As explained above, in addition to being technically necessary for the supply of the NBN Access Service, NBN Co's product construct approach is efficiency enhancing. It provides the basis for service differentiation by Access Seekers in downstream markets, thereby promoting efficiency. It also ensures that Access Seekers can compete on a level playing field and can more efficiently enter and expand in the marketplace, thereby promoting allocative efficiency. This would not be possible if the NBN Access Service was 'unbundled'.

Even if the clause could be considered to involve bundling in the traditional sense (which NBN Co does not accept), it is clear that it is necessary for the ACCC to look beyond the mere occurrence of bundling or tying and consider the competitive benefits and detriments that result from the conduct. For example, NERA in its report for the ACCC, entitled *Anticompetitive Bundling Strategies*, states that:⁷²

the appropriate point for assessing when firms could be considered to have "cross this line" is when their actions could no longer be considered consistent with behaviour that might be expected in a competitive environment.

And that:⁷³

"Determining whether a tie-in constitutes anti-competitive behaviour therefore requires an assessment of the tradeoffs between any benefits resulting from increased competitive pressures and any detriment resulting from a reduction in rivalry in the market.

⁷¹ ACCC, *Bundling in telecommunications markets: An ACCC information paper*, August 2003, p.11

⁷² n/e/r/a, *Anticompetitive bundling strategies: A Report for the Australian Competition and Consumer Commission*, Prepared by NERA, January 2003, p.1.

⁷³ Ibid, p.2.

Further, the report goes on to state that, several conditions are required for a multi-product firm to use a tying strategy to deter potential entrants from competing in a tied market to be considered anti-competitive:⁷⁴

- the products should be clearly separable, that is, they should be distinct products rather than two components of a single product (for example, a car is generally considered a single product rather than a bundle of individual products, such as engine, wheels, chassis, etc);
- the firm must have market power in the provision of the tying product, such that consumers cannot bypass the multi-product firm;
- a sufficient proportion of consumers in the market for the tied product must also be willing to purchase the tying product; and
- the tying strategy cannot be justified by efficiency or quality improvements that (at least) outweigh any detrimental impact on competition.

It is clear that these threshold requirements for conduct to be viewed as anti-competitive are not satisfied in the case of the NBN Access Service. In particular, as NBN Co demonstrated above:

- the Product Components are not clearly separable, but rather are technically structured as integral components of a single end-to-end service (i.e. the NBN Access Service); and
- four Product Components, which are acquired together to enable an end-to-end service actually increases the efficiency and quality of services that can be provided by Access Seekers in downstream markets by giving Access Seekers the ability to introduce contention into their services and to use this as the basis for service quality differentiation. In addition, the use of the Product Components reduces the costs of market entry for Access Seekers and establishes a level playing field at the retail level. Accordingly, the approach can be justified by efficiency and quality improvements.

Bundling of the Product Components is reasonably necessary to achieve uniform national pricing under section 152CBD(5C)

The ACCC has not provided any explanation of why it considers clause 1A.3.2 goes beyond the terms of the legislative authorisation in relation to bundling. In particular, the ACCC does not discuss why it considers the provision does not fall within the scope of section 152CBD(5C) of the CCA.

Section 151DA(3) of the CCA authorises NBN Co to refuse to supply or refuse to offer the supply of a designated access service (the CVC, UNI, NNI, AVC and a voice telephony facilitation service) to a service provider unless the service provider agrees to acquire one or more other designated access services from NBN Co. Such an authorisation is subject to the refusal being reasonably necessary to achieve uniform national pricing of services supplied by NBN Co.

In addition to the reasons noted above, NBN Co submits that even if clause 1A.3.2 could be considered to involve “bundling”, it is reasonably necessary to achieve uniform national pricing.

In the Supplementary Explanatory Memorandum to the *Telecommunications Legislation Amendment (National Broadband Network Measures – Access Arrangements) Bill 2011*, it was stated:⁷⁵

In its Corporate Plan dated 15 December 2010, NBN Co stated that it will offer its bundled services as a uniform product construct across fibre, wireless and satellite. Technically, all

⁷⁴ Ibid, pp.13-14.

⁷⁵ Supplementary Explanatory Memorandum to the *Telecommunications Legislation Amendment (National Broadband Network Measures – Access Arrangements) Bill 2011*, p.8.

the components work in conjunction with each other to deliver an Ethernet Bitstream Service to an end-user's premises. The bundling of the services promotes uniform national pricing from the end-user's premises to the POI.

As identified in NBN Co's Supporting Submission for the SAU:⁷⁶

NBN Co submits that an access-technology neutral approach is also reasonably necessary to facilitate the objective of the SAU in providing a long term framework necessary for UNWP, by facilitating a degree of cross-subsidisation between the various platforms.

In particular, an SAU that covers fibre, wireless and satellite services facilitates cross-subsidisation across the three technology platforms to allow NBN Co to recover potential losses from its proposed wireless and satellite operations from its fibre operations (which are expected to become profitable over time. Given that it is unlikely that NBN Co will be able to recover the costs of its wireless and satellite operations on a standalone basis, the NBN Access Service service description covers all three technology platforms as a means of addressing its UNWP objectives.

And further:⁷⁷

...NBN Co's overarching pricing strategy involves setting prices for Product Components, Product Features, Ancillary Services and types of Facilities Access Service that vary across the product suite and across time, but do not vary according to the network over which access is provided. This is consistent with the objective of UNWP, and necessarily means that prices are not reflective of the cost of the specific network over which access is actually provided.⁷⁸

...

In developing initial prices, NBN Co has had to form a view about relative willingness to pay for different products, both now and over time. Of note, NBN Co has not used a costing technique such as TSLRIC+ to determine its initial prices. Such techniques suffer from a number of well known theoretical and practical problems that are even more significant in NBN Co's context due to UNWP and the use of different technologies (fibre, wireless and satellite) each of which have very different cost characteristics.

The same Product Components are used for all three technologies. NBN Co has developed prices for its Product Components and Product Features that are not necessarily based on the cost of each of those Product Components or Features, but which are designed to achieve uniform national pricing for end-to-end services supplied over the entire NBN. The cross-subsidy that is required to support higher cost wireless and satellite services is delivered not only through the uniform pricing of AVC speed tiers, but by the revenues generated from the CVC, whose prices are set by reference to the product component approach of NBN Co's services.

⁷⁶ Supporting Submission, p.63.

⁷⁷ Supporting Submission, pp. 108-109.

⁷⁸ Supporting Submission, p.100.

3.4.4 Layer 3 awareness

Clause 1A.2.6 of the SAU provides that the AVC and CVC may incorporate some limited Layer 3 awareness to support certain services including voice service using a UNI-V port, multicast and a number of other optional features on the AVC.

In section 3.5.2.1 of the Draft Decision, the ACCC states:⁷⁹

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.

To address this perceived issue, the ACCC has proposed that the words of clause 1A.2.6 should be amended to specify the Layer 3 awareness that will be used by NBN Co. In the Consultation Paper the ACCC proposes that the words in clause 1A.2.6 be varied to state:⁸⁰

the AVC may incorporate some limited Layer 3 awareness to the extent required to support the following services.

NBN Co Response 16

NBN Co submits that the ACCC concerns in relation to Layer 3 awareness are overstated and placing restrictions on NBN Co's ability to utilise Layer 3 awareness may inadvertently restrict NBN Co's ability to support the delivery of innovative new services by Access Seekers, thereby hindering the promotion of the LTIE.

The NBN Access Service is clearly defined as comprising a Layer 2 wholesale bitstream service. NBN Co's decision to offer Layer 2 services has been set through government policy. NBN Co submits that future concerns about "mission creep" by NBN Co can be better addressed through alternative mechanisms outside of the SAU, for example, through a carrier licence condition, if necessary. Accordingly, NBN Co is proposing not to vary clause 1A.2.6.

Analysis

NBN Co agrees with the ACCC that Layer 3 services are beyond NBN Co's current remit and is aware of the competitive issues that NBN Co's entry into this segment of the wholesale market would entail. However, NBN Co's submits that the ACCC's concerns in relation to Layer 3 awareness are overstated.

NBN Co's proposed service construct is clearly defined as a Layer 2 wholesale bitstream service and the Australian Government has specified in the Statement of Expectations that NBN Co is to be a Layer 2 wholesaler. As with other key policy positions directed by the Shareholders Ministers, including the choice of technology and coverage, the Statement of Expectations require NBN Co to, offer open and equivalent access to wholesale services, at the lowest levels in the network stack necessary to promote efficient and effective retail level competition, via Layer 2 bitstream services.⁸¹ NBN Co's decision to offer a Layer 2 service has been determined by government policy and NBN Co therefore has no current intention to provide Layer 3 services.

⁷⁹ Draft Decision, p.74.

⁸⁰ Consultation Paper, p.22.

⁸¹ Statement of Expectations, p.2.

The fact that NBN Co's network is 'Layer 3 aware' does not necessarily mean that NBN Co is providing Layer 3 wholesale services (in the conventional sense) to Access Seekers, or to itself, or that NBN Co will compete against downstream providers in the provision of Layer 3 wholesale services to RSPs.

The Layer 3 'awareness' in NBN Co's network supports the delivery of certain services, such as IP multicast. It allows for the efficient operation of routing protocols at Layer 3 by Access Seekers, and provides the mechanism for information that exists at Layer 2 to be passed through to a Layer 3 device (e.g. an IPTV set top box connected to the UNI-D on NBN Co's Network Termination Device by an Access Seeker).

Given the fast paced nature of technological developments in the telecoms sector, NBN Co considers that confining NBN Co's ability to utilise Layer 3 awareness to the specific services that are listed in clause 1A.2.6 of the SAU would be unduly and unnecessarily restrictive. Such an approach may inadvertently restrict the ability of NBN Co to support the delivery of innovative services by Access Seekers. In doing so, such a restriction would potentially hinder the promotion of the LTIE by failing to encourage the economically efficient use of, and the economically efficient investment in infrastructure.

If concerns arise in relation to the manner in which NBN Co utilises Layer 3 awareness, then NBN Co submits that there are more appropriate mechanisms outside of the SAU that may be utilised to address NBN Co's actions, including through the imposition of licence conditions, if necessary and other mechanisms available under the NBN Companies Act.

4 Product Development and Withdrawal

4.1 Introduction

The ACCC has identified product development and withdrawal as being issues that have significant implications for NBN Co's price controls and its incentives to invest and operate efficiently. NBN Co maintains that the package of commitments provided in the SAU, coupled with the inherent incentives faced by NBN Co to invest and operate efficiently⁸² are reasonable and would promote the LTIE.

As noted by the ACCC in the Draft Decision, "...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."⁸³ NBN Co welcomes this acknowledgement, and considers that any changes to its proposed approach to product development and withdrawal in Module 1 should be relatively confined and well-justified. For the reasons discussed in section 5.1.1 below, NBN Co considers that it will have ongoing incentives to continue to develop and supply products at prices that Access Seekers will want to acquire. While these incentives may be stronger in earlier years of the SAU, NBN Co submits that these incentives will remain effective well beyond Module 1, and indeed are likely to continue throughout the term of the SAU.

The issues raised by the ACCC and the accompanying proposed variations to the SAU broadly appear to be aimed at strengthening and clarifying commitments that NBN Co had already proposed, and as such, in responding, NBN Co is able to accept the majority of the ACCC's proposals, albeit with some appropriate refinements suggested in some cases.

4.2 Product development and variation

4.2.1 Duration of PDF Processes

In the Consultation Paper (section 2.3.1.1), the ACCC proposes that the PDF Processes should only operate for the first five years of Module 1. The effect of varying the SAU in this way is that:⁸⁴

...the PDF Processes would not be specified in the SAU after the first five years of Module 1. The PDF Processes could therefore be subject to commercial negotiation between NBN Co and its customers after this point. In the event that agreement on the PDF Processes could not be reached, processes for consultation about the development and variation of products could be determined by the ACCC via other regulatory processes under Part XIC. Alternatively, it would be a matter for NBN Co as to whether, around the end of the first five years of the SAU, it wished to seek a variation to the SAU under Part XIC to extend the period that the PDF Processes operate for.

NBN Co Response 17

NBN Co maintains that the PDF Processes contained in Annexure 1 to Schedule I should continue to operate for the duration of Module 1, rather than the 5 years proposed by the ACCC.

⁸² See, for example, sections 6.7 and 6.9 of the Supporting Submission.

⁸³ Draft Decision, section 4.1.2.4.

⁸⁴ Consultation Paper, p.22.

Analysis

As discussed in section 2.6 above, while NBN Co considers there is merit in maintaining the midpoint reviews of those aspects of the SAU that would still be covered by them, including the PDF, NBN Co agrees to adopt the ACCC's suggested removal of Schedule 1K.

However, NBN Co does not agree with the ACCC's position that the duration of the terms and conditions that were to be the subject to mid-term reviews should now be reduced to 5 years. As discussed in section 2.6, NBN Co sees no utility in doing so and NBN Co considers that the operation of the PDF Process for the full term of Module 1 would promote the LTIE.

As the ACCC appears to be of the view that the inclusion of the terms of the PDF in the SAU will promote economically efficient investment in and use of the NBN, it is unclear as to why the ACCC would prefer to only have the certainty as to the PDF operating for the first five years:⁸⁵

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.

In addition, the appropriate term of the PDF Processes should be considered together with the proposed variations to the PDF Processes, as further discussed in this submission, and not independently of them. NBN Co submits that the proposed changes to the PDF Processes as discussed below (including the removal of the IP and confidentiality provisions) means that the PDF Processes can robustly operate for the full term of Module 1 and that it would promote the LTIE for them to do so.

As identified by the ACCC in the Draft Decision, NBN Co will face demand and revenue sufficiency risk during the initial phase of the SAU, which will provide it with incentives to develop products that Customers and end-users want to purchase. The PDF Processes included in the SAU commit NBN Co to engaging with Customers on a non-discriminatory and transparent basis in the development of products, and are aligned with NBN Co's incentives to engage with its Customers to develop appropriate solutions.

As the network build will continue throughout Module 1 and it is likely that NBN Co will face demand and revenue sufficiency risks throughout that period, NBN Co considers that the PDF Processes should be maintained throughout Module 1 to provide certainty for Customers as to how NBN Co will engage with them in relation to product development. The exclusion of the PDF Processes in the SAU after only the first five years of Module 1 is likely to introduce an unnecessary level of uncertainty, for both Access Seekers and NBN Co, into the product development process at that time.

The certainty created by the PDF Processes being included in the SAU for Module 1 is in the interests of both NBN Co and Customers, and will promote co-investment by Access Seekers.

4.2.2 Commitments by NBN Co to share information and consult

In relation to the commitments in the SAU that require NBN Co to consult on product development, the ACCC appears to be reasonably comfortable with the approach adopted by NBN Co (see section 4.2.1 above), but suggests a possible enhancement to the existing commitments:⁸⁶

⁸⁵ Draft Decision, p.82.

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.

NBN Co Response 18

NBN Co accepts the ACCC's recommendation that consumer advocacy groups be able to participate in the product development process, and proposes changes to the SAU that would provide a role for the ACCC in nominating such a group.

Analysis

NBN Co has no objection in principle to the ACCC's proposal⁸⁷ that membership and participation in the PDF is extended to include a consumer advocacy group. NBN Co notes however, that its product development will be in relation to Layer 2 Ethernet bitstream services, which will be at least one layer below those ultimately offered to consumers by RSPs. It has always been assumed by NBN Co that RSPs will be representing the needs of their consumers and potential customers in the PDF, to ensure that products are developed that end-users want to purchase. As NBN Co has an alignment of interest with its Customers in only developing products that end-users would want to purchase, this proposal is aligned in general terms with NBN Co's interests, although it is not clear whether there will be material benefits from it, given the nature of the products that NBN Co actually provides and will be developing over time.

However, NBN Co considers that there should be an approval process around which group is nominated to become a member of the PDF, rather than a default position that would allow any group, or potentially any individual, to seek access to the PDF. To provide a degree of independence to the decision about who could be an approved consumer advocacy group, NBN Co proposes that the ACCC would be conferred a power to approve a consumer advocacy group for membership of the PDF for a period specified by the ACCC which it considers to be appropriate. NBN Co submits that the ACCC is better placed than NBN Co to assess whether the participation of a particular organisation in the PDF would promote the LTIE.

⁸⁶ Draft Decision, p.82.

⁸⁷ Consultation Paper, section 2.3.1.2.

Proposed SAU changes in Notice to Vary 14

A new term “PDF Participant” is to be introduced into the SAU which will be defined as:

“**PDF Participant** means:

- (a) a Customer;
- (b) an Access Seeker who NBN Co permits to participate in the PDF in accordance with clause 11.3.1(b); and
- (c) the Consumer Advocacy Group.”

Consumer Advocacy Group means a consumer protection body nominated by the ACCC to represent the interests of End Users for such period of time as the ACCC may specify.

Throughout clause 11.3 and the PDF Processes, the term “Customer” would be replaced with “PDF Participant” in each case.

Similar amendments would be made to Schedule 2E of the SAU.

4.2.3 Provisions which establish rights and obligations on NBN Co and its customers about how consultation will occur

In assessing the commitments made in Module 1 about how consultation will occur on product development, in the Draft Decision the ACCC considers:⁸⁸

...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

And that

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.

As a result, the ACCC has proposed that clauses 5 and 6 of the PDF Processes should be removed from the SAU.

NBN Co Response 19

NBN Co proposes that the SAU be varied to remove the confidentiality and intellectual property provisions from the PDF Processes. However, this will require the inclusion of additional drafting in the varied SAU to require members of the PDF to enter into appropriate confidentiality arrangements.

Analysis

While NBN Co considers that the inclusion of terms relating to treatment of Confidential Information and Intellectual Property provided certainty to Customers participating in the PDF Forum, certainty for NBN Co in managing its product development activities efficiently, and that those terms were reasonable, NBN Co accepts that there are differing views on the appropriateness of the terms, and is therefore willing to remove these clauses from the SAU.

⁸⁸ Draft Decision, p.83.

However, despite the removal of these clauses from the PDF Processes, the SAU will still need to include a clause that participation in the PDF will be conditional on PDF Participants having entered into appropriate confidentiality and intellectual property arrangements. This is particularly important as participation in the PDF is not limited only to Customers who have signed Access Agreements with NBN Co (where confidentiality and IP provisions will be contained). Access seekers who have not entered into Access Agreements with NBN Co and Consumer Advocacy Groups may not otherwise have signed confidentiality arrangements with NBN Co.

Making provision for appropriate confidentiality and intellectual property arrangements to be entered into is also important to assist NBN Co in undertaking product development activities efficiently and consistently with NBN Co's non-discrimination obligations. This issue was highlighted in NBN Co's Supporting Submission as follows:⁸⁹

In developing the confidentiality and Intellectual Property Rights(IPR) arrangements contained in the PDF processes, NBN Co consulted extensively with Customers in the CDP and has arrived at arrangements that strike an appropriate balance between the interests of Customers to protect their confidential information and IPR rights and the need for NBN Co to consult transparently and in accordance with its non-discrimination obligations to ensure the development of new products (that meet Customer requirements).

...

The confidentiality and IPR terms and conditions incorporated into the PDF processes place a greater emphasis on the requirement for Customers to identify up-front any confidentiality and IPR of the ideas they have submitted. This approach adopts feedback from Customers which indicated a preference to have control over IPR and confidentiality of material they submit. In addition, NBN Co needs to have visibility over Customers' confidentiality and IPR (as well as third party claims) at an early stage in the product development process for the purpose of compiling an accurate business case (e.g. building in licensing costs).

Please see section 6 and Appendix B for NBN Co's response to the ACCC's preliminary views in relation to the confidentiality and IPR arrangements in the PDF context.

Proposed SAU changes in Notice to Vary 15

Clauses 5 and 6 of the PDF Processes to be removed from the SAU. NBN Co will instead include appropriate terms in the SFAA for Customers and in a separate short form agreement or deed for Access Seekers or other participants who are not Customers. NBN Co intends to further refine the confidentiality and intellectual property terms applicable to product development activities in light of the ACCC's feedback in the Draft Decision, and to finalise those terms via commercial engagement.

A new clause 11.3.2(c) to be included in the SAU, with the current clause (c) becoming clause (d). New clause 11.3.2(c) to be:

To participate in the Product Development Forum, each PDF Participant must have entered into confidentiality and intellectual property agreements regarding the treatment of the confidential information and intellectual property of NBN Co, the PDF Participant and other PDF participants in the Product Development Forum.

Similar wording would also be included in Module 2 – e.g. at 2E.4.2.

⁸⁹ Supporting Submission, pp. 92-93.

4.2.4 Provisions which allow for consultation to not be undertaken in particular circumstances

The ACCC has identified a number of SAU provisions that it considers reduce the effectiveness of the commitments made in relation to the development and variation of products. To address the concerns it has identified, the ACCC's general approach has been to propose the removal of these clauses. While understanding the rationale behind the ACCC's proposed approach, NBN Co considers that a more targeted response is appropriate, with refinements being made to the clauses identified by the ACCC which would increase the effectiveness of the commitments made by NBN Co in relation to product development. Each clause is analysed in the following sections, with proposed drafting refinements identified.

4.2.4.1 Exclusion of products covered by the Initial Product Roadmap

In the Draft Decision (section 4.1.2.3) the ACCC states that it considers the current scope of the Initial Product Roadmap exclusion is too broad, and that some product features described on that roadmap will have gone through varying degrees of, or no consultation to date, and concludes that:⁹⁰

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.

NBN Co Response 20

NBN Co proposes removing the references to 'Initial Product Roadmap', and replacing it with a shorter list of products that have already been through significant levels of customer engagement and development. These Initial Products will be included as an Annexure to Schedule 11.

Analysis

Consistent with NBN Co's views on the incentives that it has in Module 1 to develop products that Customers and end-users want (see section 5.1.1 below for detailed discussion on NBN Co's incentives), NBN Co's interests in developing products are strongly aligned with its Customers' interests. However, NBN Co acknowledges that there is merit in an increased level of certainty as to when the PDF will be utilised to reduce information asymmetries, which in turn will promote the ability of Customers to plan for making complementary investments.

NBN Co proposes an alternative approach in relation to which products are excluded from the operation of the PDF. Rather than excluding those products that are 'covered by, or contemplated within, the Initial Product Roadmap' NBN Co submits that it would be appropriate for those products that have already been through a significant level of customer engagement and which are under active development by NBN Co to be excluded from the operation of the PDF. These products have had a significant degree of prior consultation with industry, have been extensively socialised, and are well known to potential Customers of NBN Co.

⁹⁰ Draft Decision, p.85.

NBN Co operates a highly structured product development process to bring to market new products and product features. The product development process is also closely integrated with other key NBN Co end-to-end processes which deliver the underlying network infrastructure, I.T systems and operational capabilities required to realise the new product or product feature. As such, the customer engagement and consultation on product development must be seen as part of a wider set of long-term activities that are required to bring new NBN products to market.

The product development process itself consists of five main phases:

- 1) **Concept Definition:** encompasses opportunity identification and feasibility assessment for a new product or product enhancement. NBN Co conducts high level concept testing and opportunity analysis during this phase.
- 2) **Customer Focussed Design:** encompasses the detailed design of the product, involving considerable interaction with prospective customers, especially in the form of 'Deep Dive' workshops. This is also the phase where NBN Co engages internal delivery groups (i.e. the network, I.T and operational teams) to design the complete product and technical solution. This phase is iterative in nature, with customer feedback shaping and refining the product solution. This is the phase in the product development process that is most closely linked to the Product Development Forum. Collaborative design sessions and participatory workshops are used to refine concepts with customers and test key features. Design principles are used to represent customer requirements through detailed requirements planning
- 3) **Product Build:** this phase commences once NBN Co has formally decided to deliver the product to market, i.e. after the activities that would occur in the Product Development Forum.
- 4) **Product Launch:** this is the phase where the product goes through various stages of testing and is then launched into the market. Pre-launch and limited release trials are used to map the as-is state and identify potential 'in-market' gaps or customer issues.
- 5) **Product Effectiveness:** this phase commences once the product has been launched, and encompasses the 'in-operation' phase of the product, involving ongoing monitoring of the product's performance and providing information to feed into future initiation of product enhancements. Exploratory reviews are used to map the end to end experience and capture the journey of the customer through each phase of the customer lifecycle. Customer feedback is collected at regular intervals through formal and informal channels to allow for iterative improvement

In managing engagement and consultation, the product team employs a customer focused design methodology throughout the five phases of the product development process. This approach employs cutting-edge customer-centred / design thinking techniques to understand the needs, expectations, behaviours and context of our customers. With expertise in framing projects, insight development and solution generation, the Customer Focused Design team work collaboratively as part of the product group to deliver products and systems which are desirable to our customers.

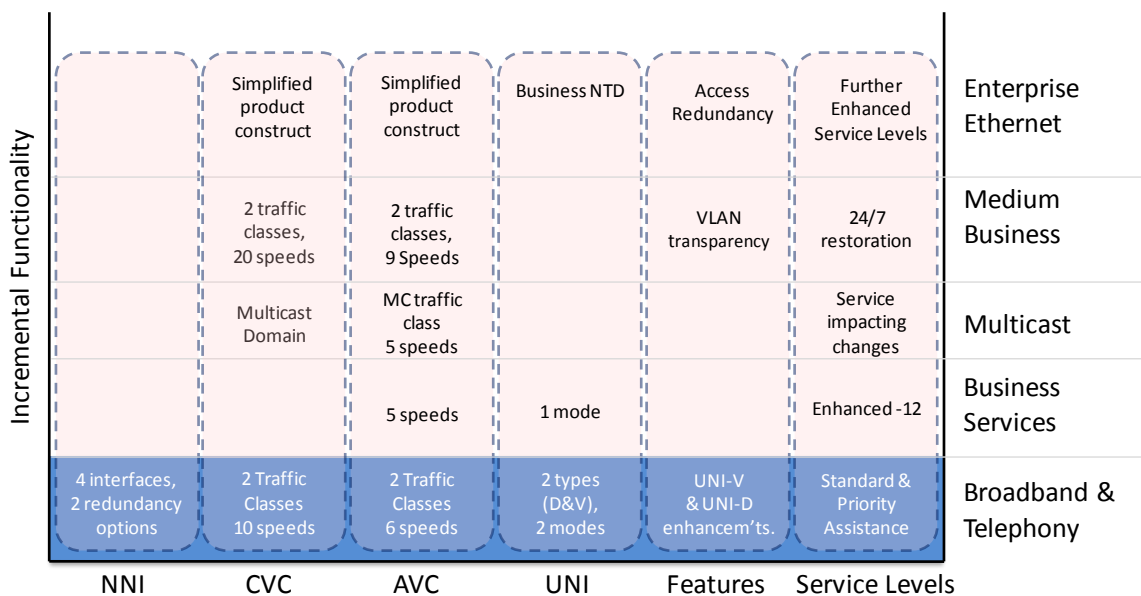
As a general rule, it is relatively easy to make changes to product design during the first two phases of the process outlined above, but can be very difficult, costly and time-consuming to make changes during the third and fourth phases (for example, through IT systems re-work). The product development process employs strong governance and process control arrangements to ensure that NBN Co builds and delivers what was actually designed in the first two phases. There are also significant lead-times involved in bringing a product to market through the various phases of the product development process, and redesigning products that are already being built will add considerable delays in bringing the product to market.

It must also be remembered that NBN Co has built a single foundational Ethernet bitstream product across all three access technologies, with a series of additional features that can be selected to tailor an offering to a particular retail segment (see Figure 1). For example, Retail Service Providers wishing to service the small business market would order the foundational Ethernet bitstream product, and then add some additional Traffic Class one bandwidth for multi-line telephony, as well as an enhanced service restoration option. Retail Service Providers wishing to offer a triple-play (i.e. voice, internet and TV) would order the foundational Ethernet bitstream product, and then add Multicast product components. This “foundation plus features” approach across all three access technologies ensures I.T and network simplicity - removing the need for costly customised I.T and network solutions each time NBN Co launches a new feature into the market. It also seeks to maintain, wherever possible, a uniform product construct across the fibre, wireless and satellite access networks – which also drives network and I.T simplicity.

This approach can make it impractical to seek industry endorsement for a feature that is already launched on one access technology, but not yet on another. For example, NBN Co intends to offer many of the same speed tier, traffic class and enhanced service level options on the fixed wireless and long-term satellite platforms as have already been launched on the fibre network. These options are being offered because Access Seekers have communicated to NBN Co in customer consultation over the past three-and-a-half years that they are features required by the market. NBN Co does not consider there is value in consulting the industry again, on features that they have already indicated are required, but have yet to be launched on all three access technologies.

Figure 1 - The NBN Co Ethernet Bitstream Product Construct

The NBN Co Ethernet Bitstream Product: Foundation plus Additional Functionality



It would be inefficient and costly to require products that are already in the build phase of the product development process to be subject to an additional round of consultations through the PDF. While not every product that is on the Initial Product Roadmap is in the build phase as yet, the majority of them are, and have already been the subject of considerable industry engagement and consultation.

NBN Co therefore proposes that a subset of those products on the Initial Product Roadmap should be excluded from the operation of the PDF (in addition to all products provided over the Interim Satellite network, which are provided over third-party infrastructure). These products and their current phase in the Product Development Process are shown in Table 1 below. For clarity, products which have been described in some form by NBN Co, but which have not yet been developed to the “Build” phase, and therefore would be subject to the operation of the PDF, are described in Table 2 below. By definition, the list of products in Table 2 is not exhaustive, as it only considers products that have already been identified in some form.

Table 1 – Initial Products not subject to the PDF

Product Release	Product Development Process (PDP) Phase	Examples of product features included in Product Release
Broadband & Telephony (Fibre)	- Launched in 2011 - Product Development Process Phase: Product Effectiveness	TC-4 AVC speeds tiers up to & including 1Gbps only. TC-4 CVC speed tiers TC-1 AVC and CVC speed tiers NNI, including chassis diversity & load sharing UNI-D (4 ports) & UNI-V (1 and 2 port) Battery backup (and optional battery backup)
Multicast (Fibre)	- Launched in 2012 - Product Development Process Phase: Product Launch	Multicast AVC Multicast CVC
Business Services (Fibre)	- Launched in 2012 - Product Development Process Phase: Product Effectiveness	TC-1 AVC Enhanced service levels
Medium Business (Fibre)	- Launch: - Phase 1: 2013 - Phase 2: 2014 - Product Development Process Phase: - Phase 1 Product Launch - Phase 2: Product Build	TC-4 AVC up to 1000/400Mbps (Phase 1) TC-2 AVC and CVC (Phase 1) TC-4 CVC up to 2Gbps (Phase 1) Enhanced Service Level options (Phase 1) TC-3 AVC and CVC (Phase 2)
Enhanced Services (Fibre & Wireless)	- Launch: - Phase 1: 2013 - Phase 2: 2014 - Product Development Process Phase: Product Build	Phase 1: SLA Fulfilment and assurance Phase 2: Customer management reporting
Enterprise Ethernet (Fibre)	- Launch target: 2015+ - Product Development Process Phase: Product Build	Up to 1000Mbps symmetric pipe AVC Business grade NTD Access diversity Drop priority based on COS markings Advanced OAM features Enhanced SLA options Note: although this product is scheduled for launch in 2015+, NBN Co has consulted extensively on this product over the last 3 years. During this consultation NBN Co

Product Release	Product Development Process (PDP) Phase	Examples of product features included in Product Release
		received customer guidance in relation to service level options, business NTD specifications, diversity and redundancy options etc.. This consultation resulted in the release of a Business and Enterprise Product Consultation Paper in December 2011. An extensive series of customer 'deep dives' preceded and followed the release of this paper.
Interim Satellite (Satellite)	- Launched in 2011 - Product Development Process Phase: Product Effectiveness	TC-4 AVC UNI-D TC-1 AVC
Long Term Satellite (Satellite)	- Launch target: 2015 - Product Development Process Phase: Product Build	TC-4 AVC UNI-D TC-1 AVC
Fixed Wireless (Wireless)	- Launched in 2012 - Product Development Process Phase: Product Effectiveness Phase	TC-4 AVC UNI-D TC-1 AVC

While the following table will not form part of the SAU, it is included here to indicate those product components and product features that would be subject to the operation of the PDF. NBN Co wishes to emphasise that it intends to use the PDF to consult with customers on product initiatives not listed on existing NBN Co product documents (e.g. TC-4 speed tiers above 1Gbps, any future NBN product variants for non-premises sites, etc.), in addition to any other products developed in future that have not already been identified by NBN Co or its customers.

Table 2 - Products subject to operation of PDF

Product Release	Product Development Process (PDP) Phase	Examples of product features included in Product Release
Enhanced Services (Satellite)	- Launch: 2015+ - Product Development Process Phase: Concept Definition	Customer management reporting OAM tools
Multicast (Satellite)	- Launch target: 2015+ - Product Development Process Phase: Concept Definition	Multicast AVC
Multicast (Wireless)	- Launch target: 2015+ - Product Development Process Phase: Concept Definition	Multicast AVC
Business Services (Wireless & Satellite)	- Launch target: 2015+ - Product Development Process Phase: Concept Definition	TC-1 AVC Enhanced service levels Tagged and priority tagged framing
Medium Business (Satellite & Wireless)	- Launch target: 2015+ - Product Development Process Phase: Concept Definition	TC-2 AVC TC-3 AVC Customer Edge VLAN transparency Additional Enhanced Service Level options

Proposed SAU changes in Notice to Vary 16

Clause 11.1.3(b)(i) be replaced with the following drafting:

The introduction of a Product, Product Component or Product Feature that is an Initial Product;

The definition of Initial Product to be included in the SAU Dictionary:

Initial Product means any Product, Product Component or Product Feature included in Annexure 2 to Schedule 11 of this SAU.

The inclusion of a new Annexure 2 to Schedule 11, which includes the items contained in **Table 1** above.

Similar change to be included in Module 2 of the SAU.

4.2.4.2 Exclusion of minor product variations

In section 2.3.1.4 of the Consultation Paper, the ACCC proposes that the exclusion of minor product variations from the PDF should be removed from the SAU.

NBN Co Response 21

NBN Co proposes that the existing clauses in the SAU in relation to the exclusion of minor products variations from the PDF should be retained.

Analysis

NBN Co notes that the Draft Decision does not contain any analysis of the operation of this clause, and does not examine the actual drafting of the definition of minor product variation in clause 11.4. A minor product variation must:

- update or improve the functionality of an existing product;
- have no material adverse impact on Customers.

The ACCC has not presented arguments from submissions or otherwise as to why it does not promote the LTIE for such minor product variations to be excluded from the PDF, but rather only puts forward the general proposition that:

provisions such as these [i.e. everything in clause 11.1.3(b)] limit the circumstances in which NBN Co will consult and share information with customers ... [and] ... would reduce the extent to which the product development and variation provisions encourage economically investment in and use of the NBN.⁹¹

NBN Co does not consider that the ACCC has established why, in the specific case of minor product variations, that this is in fact the case. Potentially, the reverse may well be true. If NBN Co was obliged to formally consult with Customers (and a Consumer Advocacy Group and potential Customers) on minor enhancements on existing products, which is not a cost-free exercise, this may affect NBN Co's incentives to actually make such minor enhancements.

⁹¹ Draft Decision, p.85.

In addition, the removal of the minor product variations exception from the PDF Processes could mean that the making of positive, Customer-enhancing minor enhancements could be delayed. If consultation is required, these minor variations might end up being aggregated with other variations/enhancements, and the variation delayed until consultation on the larger set of variations has occurred. The delay in the introduction of these minor enhancements would ultimately be to the detriment of Customers and hence not in the interests of Access Seekers, nor in NBN Co's legitimate business interests, nor will it promote the LTIE.

Proposed SAU changes in Notice to Vary 17

The existing clause 11.1.3(b)(iii) should be retained in Module 1 of the SAU, along with the equivalent provision that applies in Module 2 (clause 2E.1.3(b)(iii)).

4.2.4.3 Exclusion of products obliged to be offered as a result of a licence condition

In section 2.3.1.4 of the Consultation Paper, the ACCC has proposed that the clause that excludes the operation of Schedule 11 in respect of the introduction of products imposed by a licence condition should be removed.

NBN Co Response 22

Rather than simply removing the clause in the SAU that excludes products introduced as the result of a licence condition from the operation of the product development process, NBN Co proposes that this clause is modified to ensure that those aspects of the new product not specified by the licence condition would be subject to the product development process.

Analysis

The ACCC does not provide specific arguments from submissions or otherwise in relation to the operation of this clause, and NBN Co submits that this proposal is not warranted. If NBN Co has been required to introduce a new product or feature by a licence condition, the concept of customer engagement on that product or feature appears to be unproductive, as the outcome of that engagement would still necessarily be that the new product or feature would be introduced. As such, NBN Co's position is that the clause should remain, but with a modification to the existing drafting to make it clear that the exclusion only applies to those elements of the new product or feature that are not already specified by the licence condition. If the licence condition only specified some aspects of the required product, leaving other elements open to NBN Co to develop, NBN Co accepts that customer engagement would be appropriate for those other elements.

Proposed SAU changes in Notice to Vary 18

Clause 11.1.3(b)(ii) should not be removed from 11.3(b), but should be varied to make explicit that it only applies to those elements not already covered by the licence condition:

- (ii) the introduction of a Product, Product Component or Product Feature that NBN Co is obliged to offer as a result of a licence condition imposed under section 41(1) of the NBN Companies Act, *to the extent that the characteristics of that Product, Product Component or Product Feature are specified in the licence condition;*

The same modification should be made to clause 2E.1.3(b)(ii).

4.2.4.4 Clarification of application to Ancillary Services

In the Draft Decision the ACCC states that it is “...unclear as to whether the product development provisions apply to ancillary services other than for the Platform Interfacing Service and the Sandpit Service”⁹², and therefore in the Consultation Paper proposes that amendments should be made to make it clear that the provisions apply to all Ancillary Services.

NBN Co Response 23

NBN Co accepts the ACCC’s proposal to extend the application of the product development and variation provisions to other ancillary service, and proposes drafting changes to the SAU to implement this.

Analysis

NBN Co intends for the product development provisions to apply to all ancillary services, and has no issues with clarifying this in the varied SAU.

Proposed SAU changes in Notice to Vary 19

Clause 11.1.2(a) should be modified to include Ancillary Services within the scope of product development as follows:

The following general principles apply to NBN Co’s development of Products, Product Components, Product Features and Ancillary Services (referred to collectively in this Schedule 11 as Products).

NBN Co then proposes to use the term “Products” throughout Schedule 11 when referring to Product Components, Product Features and Ancillary Services.

The definition of Product Idea in the SAU Dictionary should be modified to:

Product Idea means a proposal for the development of a new Product, Product Component, Product Feature or Ancillary Service, or a variation or enhancement to an existing Product, Product Component, Product Feature or Ancillary Service.

Clause 11.4(a) should be modified to include “Ancillary Service” in the list of matters covered by this clause.

The equivalent modifications should be made to Schedule 2E of the SAU.

4.2.4.5 Clarification of application to NBN Co-initiated product development

The Consultation Paper includes a proposal that the variation to the SAU includes “*amendments to make it clear that the product development and variation provisions apply to NBN Co-initiated development and variation*”⁹³.

NBN Co Response 24

NBN Co accepts the ACCC’s proposal to make it clear that product development provisions apply Ancillary Services, and proposes suggested drafting changes to implement this.

⁹² Draft Decision, p.84.

⁹³ Consultation Paper, p.24.

Analysis

NBN Co accepts this proposal, and considers that any uncertainty may be addressed by a relatively minor change to the definition of “Product Idea”, to clarify that this covers both Customer and NBN Co product ideas.

Proposed SAU changes in Notice to Vary 20

The definition of “Product Idea” in the SAU Dictionary should be modified to:

Product Idea means a proposal (*whether initiated by NBN Co or a PDF Participant*) for the development of a new Product, Product Component, Product Feature or Ancillary Service, or a variation or enhancement to an existing Product, Product Component, Product Feature or Ancillary Service.

(note: this change also shows the changes suggested by NBN Co following the discussion in section 4.2.4.4)

Further, clause 11.3.1(c)(i) should be changed to remove the words “from Customers”.

4.2.5 Provisions which set out NBN Co’s ability to make a decision about whether or not to develop or vary a product

In section 4.1.2.4 of the Draft Decision, the ACCC states:⁹⁴

...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), and clauses which state that NBN Co will introduce, develop, prioritise, assess and suspend assessing product ideas at its “absolute discretion”.

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.

Section 2.3.1.5 of the Consultation Paper proposes the inclusion of explicit statements in the SAU which acknowledge that:⁹⁵

- 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.

NBN Co notes that the same variations are discussed in section 2.2.1 of the Consultation Paper.

⁹⁴ Draft Decision p.86.

⁹⁵ Consultation Paper p.24.

NBN Co Response 25

NBN Co proposes to vary the SAU to include an acknowledgement that the ACCC may declare services and amendments to clauses 1A.1.2, 1A.1.3, 1A.4.1, 1A.4.2 and clauses 2A.1.3 and 2A.1.5 to clarify that NBN Co may also fulfil its SAOs with respect to the NBN Access Service and Ancillary Services by supplying services declared by the ACCC or as specified in ADs /BROC. NBN Co submits that these proposed amendments directly address the ACCC's concerns relating to uncertainty.

NBN Co maintains that the SAU should not deal with the obligation to supply such declared services (and the relevant terms and conditions of supply) because this is adequately provided for in Part XIC.

Analysis

As discussed in above in sections 3.1 and 3.2, NBN Co submits that there is no ambiguity as to how the SAU interacts with a service that may be declared by the ACCC.

The ACCC's power to declare services covered by the SAU is explicitly addressed through section 152AL(8F) of the CCA. NBN Co does not consider that the SAU in any way prevents or limits the ACCC from declaring a service under section 152AL(8A) of the CCA.

Nevertheless, NBN Co has no objection to acknowledging that the ACCC may declare services. Nothing in the SAU limits that power.

As discussed above, NBN Co agrees to extend the relevant provisions in the SAU such that the manner in which the SAOs are satisfied in respect of the NBN Access Service could also be through the supply of declared services under Part XIC or services specified in an AD/BROC.

However, the SAU should not deal with the obligation to supply services declared by the ACCC in the future. Section 152CBA(3A) only requires the service declared by the SAU to be subject to a commitment to comply with the SAOs – which is appropriate because it is the SAU which declares the service.

NBN Co's obligation to supply future declared services is clearly captured by the SAOs under section 152AXB as they may apply to such services in the future. There is no need for the SAU to deal with the obligation to supply these future declared services. Further, the ACCC's proposal for the SAU to extend the obligation to supply future declared services is inconsistent with the SAOs in section 152AXB which are drafted differently to, and contain exceptions not reflected in, the ACCC's proposed drafting. NBN Co submits that it is best for the SAOs to operate in the normal way.

Nevertheless NBN Co is prepared to amend clauses 1A.1.2, 1A.1.3, 1A.4.1, 1A.4.2 and clauses 2A.1.3 and 2A.1.5 to clarify that NBN Co may also fulfil its SAOs with respect to the NBN Access Service and Ancillary Services by supplying services declared by the ACCC or as specified in ADs /BROCs.

NBN Co submits that these proposed amendments directly address the ACCC's concerns with regard to the intended effect of the current drafting in these clauses (as cited above in section 3.1), by clarifying that the clauses do not exclude NBN Co's SAOs in relation to any services declared by the ACCC which would fall within the broad service descriptions of the NBN Access Service and Ancillary Services.

Proposed SAU changes in Notice to Vary 21

Adopt drafting proposals in Proposed SAU changes in Notice to Vary numbers 10 and 11

4.3 Product withdrawal

4.3.1 Encouraging efficient use of and investment in the NBN

ACCC's views on product withdrawal

Section 4.2.2.1 of the Draft Decision deals extensively with the ACCC's analysis of the implications of the current product withdrawal provisions in the SAU, in particular as they relate to NBN Co's incentives to set prices efficiently. The core of the ACCC's concern appears to be that they consider that NBN Co may opt to withdraw non-reference offers, and thus require existing end-users to move to higher data rate services (at higher prices) than they were previously acquiring. The ACCC's analysis then suggests that this may lead to a reduction in incentives for NBN Co to price efficiently, and may reduce the level of demand risk that NBN Co is exposed to.

The ACCC expresses the preliminary view 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-term interests of end-users, when their interaction with the CPI-1.5 per cent price control is considered." As a result, the ACCC proposes amendments to the SAU to acknowledge that there will be a role for the ACCC in the process of withdrawing products, with the Consultation Paper crystallising this proposal as⁹⁶:

a commitment that NBN Co provide the same amount of written notice to the ACCC of its intention to withdraw a product, as it provides to its customers;

a conferral of power on the ACCC to disallow the withdrawal of a currently supplied product component, product feature, Ancillary Service or Facilities Access Service by NBN Co

NBN Co Response 26

NBN Co proposes to include variations to the SAU that implement the position expressed by the ACCC, which will be described in detail in this section.

Analysis

NBN Co's incentives to provide products that customers want to acquire

In responding to the ACCC's concerns in relation to product withdrawal, NBN Co refers to the discussion in section 5.1.1, which addresses NBN Co's ongoing revenue sufficiency risk, and the pre-existing and SAU-generated incentives that NBN Co has to invest, operate and price efficiently. NBN Co contends that these incentives are significant in any analysis of NBN Co's potential behaviour in relation to product withdrawal. This is particularly the case for Module 1, as the ACCC acknowledges "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."⁹⁷ NBN Co considers that the incentives created by this revenue sufficiency risk will mean that it would not be in NBN Co's commercial interests to engage in the product withdrawal behaviour described by the ACCC in their Draft Decision. The ACCC also appears to support this view in the Draft Decision, where it states:⁹⁸

⁹⁶ Consultation Paper, section 2.3.2.

⁹⁷ Draft Decision, p.141.

⁹⁸ Draft Decision, p.69.

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.

However, it is also clear that the issue of product withdrawal is a significant one for the ACCC (identified as one of the six key variations to the SAU on p. 15 of the Draft Decision), and underpins their analysis of a number of other issues in the SAU, including pricing of new services⁹⁹, ongoing supply of products currently provided over copper or HFC-based equivalent¹⁰⁰ and the effectiveness of the SAU's price controls.¹⁰¹ NBN Co therefore acknowledges that, despite NBN Co's views on the incentives it faces as result of its revenue sufficiency risk, some modifications to the SAU will be required for the ACCC to be satisfied that the terms of the SAU will promote the LTIE.

NBN Co assumes that a significantly enhanced product withdrawal process, particularly in relation to the ACCC's ability to disallow product withdrawals, should allow the ACCC to reconsider its comments about NBN Co's ability reduce its revenue sufficiency risk by withdrawing products. NBN Co does not agree with the characterisation of the issue by the ACCC. NBN Co strongly believes that given the change in the product withdrawal process described below, NBN Co is subject to significant revenue sufficiency risk particularly during Module 1 and that its incentives remain strongly aligned with those of Access Seekers during this period, as described in section 5.1.1 below.

NBN Co's proposal on product withdrawal disallowance

NBN Co's proposal in response to the position expressed in the Consultation Paper can be summarised as:

- 1) If NBN Co considers that a particular product withdrawal is being made for compelling cost or technical reasons or where there is otherwise no material disadvantage to End Users and Access Seekers, and that NBN Co can demonstrate that the product withdrawal meets specified criteria, NBN Co may nominate the withdrawal as being a "Category A Product Withdrawal" at the time it announces the withdrawal, and provide the ACCC with its reasons for doing so.
- 2) The ACCC will consider NBN Co's reasons for nominating the withdrawal as being a Category A Product Withdrawal, and if it is satisfied that NBN Co has complied with the specified criteria for doing so, would not be able to disallow the product withdrawal. The ACCC would have an initial period of 60 business days (with the ability to extend that period, giving reasons for doing so) to make a decision as to whether it was satisfied with NBN Co's reasons.
- 3) Should the ACCC not accept NBN Co's reasons for the withdrawal being a Category A Product Withdrawal, or NBN Co nominates a product withdrawal as being Category B, then the product withdrawal will be considered a Category B Product Withdrawal.
- 4) For Category B Product Withdrawals, the ACCC would be conferred a power to disallow that product withdrawal, subject to the following:
 - a. The decision to disallow the withdrawal must be made no less than 60 business days before the nominated withdrawal date for the product (noting that NBN Co must nominate at least a 12 month notice period for withdrawal);

⁹⁹ Draft Decision p.102.

¹⁰⁰ Draft Decision, p.109.

¹⁰¹ Draft Decision, p.126.

- b. The ACCC must have regard to the same factors as currently in the SAU, to which NBN Co would have regard to when considering whether to withdraw the product (i.e. clause 11.5.2(b));
- c. The ACCC must be satisfied that the Category B Product Withdrawal promotes the long-term interests of end-users;
- d. The ACCC decision to disallow the withdrawal would have a 'sunset clause' of no more than 2 years, after which NBN Co could seek to withdraw the product, following the same process as for any other product withdrawal.

NBN Co submits that this proposal provides a strong role for the ACCC in the process of NBN Co withdrawing products. It strikes a balance between allowing NBN Co to withdraw products where there are compelling cost or technical reasons for doing so or where there is no material disadvantage to End Users and Access Seekers (with the ACCC having oversight of those reasons), as well as providing the ACCC with a clear role in assessing all other product withdrawals (including those for which the ACCC does not accept NBN Co's cost and technical rationale for withdrawal). This approach should address the ACCC's stated concerns in relation to NBN Co's incentives to withdraw non-reference offers (noting that NBN Co does not accept that NBN Co actually has incentives to do so). The proposed approach also establishes appropriate clarity about how and when the ACCC will make its decision, which provides certainty for both NBN Co and its customers about how the process will be conducted and to plan their activities accordingly.

The SAU will establish a "Product Withdrawal Cost Criterion", "Product Withdrawal Technical Criterion" and "No Material Disadvantage Criterion" which NBN Co must demonstrate it has met in order for a withdrawal to be considered a Category A Product Withdrawal. NBN Co may use any or all criteria as reasons for the withdrawal being Category A, but does not need to use all – that is, it need only meet one of the three criteria. NBN Co notes that the approach used to establish a withdrawal as being a Category A Withdrawal is different to the approach currently in the SAU for product withdrawals, which is expressed in terms of NBN "must have regard to" a set of factors. Instead, to establish a Category A Product Withdrawal, NBN Co must be able to demonstrate that at least one of the three criteria has been met, and the ACCC must be satisfied with those reasons.

NBN Co proposes that the Product Withdrawal Cost Criterion would be "the avoidable costs of continuing to supply the product exceed the expected revenue from the product over the next five years" – this would likely to be the case for products which only marginal numbers of customers were actually still acquiring, and for which there is no commercial rationale for continuing to provide the product.

NBN Co proposes that the Product Withdrawal Technical Criterion would be "the product needs to be withdrawn because NBN Co's networks and/or systems can only cost effectively support a limited number of products, and that not withdrawing the product would result in NBN Co being faced with the choice of either withdrawing other existing products or not introducing new products currently on the Product Roadmap for introduction over the next five years, and where the product that is intended to be withdrawn would have lower demand than the alternative products". This criterion is included to ensure that when NBN Co faces technical limitations that may preclude the introduction of new products, that existing products which are not expected to have as high demand as the potential new products do not inappropriately prevent new product development.

NBN Co proposes that the No Material Disadvantage Criterion would be “NBN Co has already introduced a product (or products collectively) that is functionally equivalent or superior to the existing product and has a price that is the same or lower than the product that is intended to be withdrawn” – this would mean that NBN Co could withdraw products that have effectively been superseded or subsumed into other product constructs, and which would not involve higher prices being paid for the same functionality.

Proposed SAU changes in Notice to Vary 22

NBN Co’s proposed process in relation to Category A Withdrawals and Category B Withdrawals is set out in section 2 of Appendix C.

NBN Co proposes that this mechanism be included in both Module 1 and Module 2.

In relation to the ACCC’s other proposal in the Consultation Paper, that NBN Co be required to provide the ACCC with the same notice as NBN Co’s customers of any proposed product withdrawal, NBN Co has no issue with this, and will propose amendments to the SAU to reflect this proposal.

Proposed SAU changes in Notice to Vary 23

NBN Co proposes to amend the SAU so that NBN Co provides the ACCC with the same notice as it provides to PDF Participants of NBN Co’s intention to withdraw a product:

Clause 11.5.2(a) to be amended to read: “NBN Co may will notify the PDF Participants and the ACCC of its intention to undertake a Product Withdrawal...”

Such a notice triggers the operation of NBN Co’s proposed process in relation to Category A Withdrawals and Category B Withdrawals, which is set out in section 2 of Appendix C.

NBN Co proposes that similar drafting is also reflected in Module 2.

4.3.2 Other clauses related to product withdrawal

4.3.2.1 Notification of product withdrawals to consumer advocacy group

The ACCC notes in the Draft Decision (section 4.2.2.4) that the provisions in the SAU relating to Customer notification of product withdrawal and the factors to be considered when withdrawing a product 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. The ACCC also proposes that the effectiveness of these provisions could be enhanced by an additional commitment by NBN Co to also notify the Consumer Advocacy Group of product withdrawals.

NBN Co Response 27

NBN Co accepts the ACCC’s proposed approach to notification and proposes that the Consumer Advocacy Group (as defined in section 8 of the Appendix C) be notified of any product withdrawal.

Analysis

As NBN Co already proposes to provide a role for approved an Consumer Advocacy Group (as described in section 4.2.2), this recommendation by the ACCC is consistent with that position.

If the references to “Customer” and replaced with “PDF Participant” as described in section 4.2.2 were incorporated into a varied SAU, the effect of this would be that clause 11.5.2(a) would automatically commit NBN Co to notifying approved the Consumer Advocacy Group at the same time as NBN Co’s Customers and other Access Seekers.

4.3.2.2 Product withdrawals required by law

The Draft Decision also notes (section 4.2.3.4) that Optus and Telstra have made submissions in relation to existing clause 11.5.3 (which provides that the product withdrawal provisions do not apply to product withdrawals required by law or a Shareholder Minister, or which NBN Co is prohibited from providing under section 41(3) of the NBN Companies Act), but that the ACCC has not formed a view on these matters at this time.

NBN Co Response 28

NBN Co proposes that variations be made to the SAU to provide additional commitments by NBN Co in relation to notifications to customers of product withdrawals required by law and so provide them with enhanced ability to plan to make changes to their business models.

Analysis

Consistent with the arguments put in section 4.2.4.3, NBN Co considers it is appropriate that those products which NBN Co is no longer able to provide as a matter of law should not be subject to the full operation of the product withdrawal commitments. However, NBN Co recognises that there are some legitimate issues raised by Optus and Telstra, and that it would be reasonable for NBN Co to notify Customers of the product withdrawal in these circumstances, and to consult with Customers on issues related to migration to the extent permitted by law. (Note the words “to the extent permitted by law” are required because there may be circumstances where no notification or consultation is able to be provided (e.g. if NBN Co is required to immediately stop offering a particular product.))

This would be a modified set of commitments based on aspects of clauses 11.5.2(a) and 11.5.2(c), included into existing clause 11.5.3. NBN Co submits that these additional commitments will enhance Access Seekers’ ability to plan to make changes to their business models and investments as a result of these product withdrawals, and ensure that migration issues are identified.

Proposed SAU changes in Notice to Vary 24

[Note: Assuming that the changes proposed by NBN Co in relation to ACCC disallowance of product withdrawal are accepted, the existing clause 11.5.3 would be renumbered as 11.5.6, and it will be referred to as such in this response.]

The existing clause 11.5.6 should become a subclause of 11.5.6, being clause 11.5.5(a).

New clauses 11.5.6(b) and (c) to be added to provide for appropriate customer notification of withdrawal and consultation on migration:

(b) In the event of a withdrawal of a Product, Product Component or Product Feature, Ancillary Service or type of Facilities Access service in accordance with 11.5.6(a), NBN Co will, to the extent permitted by law, provide its Customers and the ACCC with written notice of such withdrawal within 20 business days of NBN Co being notified of its requirement to withdraw, subject to that timeframe being consistent with the timing requirements placed on NBN Co to withdraw;

(c) In the event of a withdrawal of a Product, Product Component or Product Feature, Ancillary Service or type of Facilities Access service in accordance with 11.5.6(a), NBN Co will, to the extent permitted by law, consult with and consider any feedback received from its Customers in relation to the impending withdrawal and related issues, such as migration.

5 Price-related matters

In the Draft Decision, the ACCC has used a three-part approach to analysing the price-related matters in the SAU:

- framework for assessment;
- pricing for individual products; and
- Long Term Revenue Constraint Methodology.

NBN Co's response to the ACCC's analysis follows the order of the ACCC's Draft Decision, and it should be noted that NBN Co has adopted a by-exception approach, only responding to the ACCC's stated concerns.

5.1 Framework for assessment

5.1.1 Incentives faced through the SAU term

In the Draft Decision, the ACCC states that:¹⁰²

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.

NBN Co Response 29

The ACCC's analysis of NBN Co's incentives is incomplete because it does not take into account the revenue sufficiency risk associated with the use of revenue forecasts in the ICRA roll-forward in Module 2 or competition over time from other technologies (such as wireless networks).

Although the level of revenue sufficiency risk may fall over the term of the SAU, it is unlikely to fall to such an extent that it would undermine NBN Co's incentives to invest, operate and price efficiently. This distinguishes NBN Co from a typical regulated utility and likewise distinguishes the regulatory approaches appropriate in NBN Co's context from those appropriate in a typical regulated utility's context.

Analysis

In considering how revenue sufficiency risk may change over the SAU term, the ACCC has focussed solely on the effect of moving from the "loss accumulation phase"¹⁰³, to the "loss recovery phase", to the "revenue cap phase".

Although NBN Co does not take issue with much of the ACCC's analysis of the *change* in NBN Co's incentives that may take place solely as a result of moving progressively from one phase to the next¹⁰⁴, the ACCC's analysis does not take into account two other significant factors affecting the underlying *level* of revenue sufficiency risk in each of those phases. These factors concern:

¹⁰² Draft Decision, p.100.

¹⁰³ In the Draft Decision, the ACCC characterises the loss accumulation phase in terms of "NBN Co not being able to earn sufficient revenues to recover its annualised prudent costs, including a normal commercial return." (p.99) NBN Co notes that the more accurate characterisation, consistent with the ACCC's characterisation of the end of this phase being marked by the ICRA reaching its peak, is that during the loss accumulation phase NBN Co is not able to earn revenues that consistently exceed the sum of the ABBRR and the increase in the ICRA due to the indexation of the opening value at the cost of capital.

¹⁰⁴ NBN Co does note, however, that it is possible that the ICRA may be subject to more than one peak if, for example, there is a disruptive technology change.

- the use of revenue forecasts in the ICRA roll forward in Module 2, which increases revenue sufficiency risk for the period to which the revenue forecasts apply (being 3, 4 or 5 years); and
- competition over time from other technologies (such as wireless networks).

In regard to the ongoing nature of NBN Co's incentives, Ordover and Shampine observe in their expert report that:¹⁰⁵

NBN Co has incentives to price in such a way as to ensure the growth of downstream services, provided of course, that it receives some upside from such pro-growth policies.

The "upside" for NBN Co in this context may variously manifest as an increased probability of extinguishing the ICRA, earning revenue in excess of the revenue cap (by beating the forecast of revenue used in the ICRA roll forward in Module 2), and/or maintaining competitiveness with potential substitutes (such as competing wireless networks, competing multicast platforms and competing fibre and microwave networks focussed on the needs of medium/large business and enterprise end-users¹⁰⁶).

Although the level of revenue sufficiency risk may fall over the term of the SAU, it is unlikely to fall to such an extent that it would undermine NBN Co's incentives to invest, operate and price efficiently. As such, throughout the SAU term, NBN Co would need to remain focussed on Access Seeker and end-user needs and relative willingness to pay amongst other relevant matters, and there would be no room for complacency in what is and will presumably continue to be a very dynamic industry characterised by rapid and potentially disruptive technology change. This distinguishes NBN Co from a typical regulated utility and likewise distinguishes the regulatory approaches appropriate in NBN Co's context from those appropriate in a typical regulated utility's context.

5.1.2 Results of ACCC analysis of cost, demand and prices

In the Draft Decision, the ACCC states that:¹⁰⁷

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.

...

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.

Later in the Draft Decision the ACCC states that its:¹⁰⁸

... 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. [Emphasis added]

¹⁰⁵ Expert Report of Janusz A. Ordover and Allan L. Shampine, September 24 2012, paragraph 36.

¹⁰⁶ Such fibre and microwave networks, being focussed principally on providing services to medium/large business and enterprise end-users, would generally fall outside the definition of a 'designated superfast telecommunications network' under 152AGA of the CCA and would therefore not be subject to the obligations placed on a designated superfast telecommunications network under the CCA.

¹⁰⁷ Draft Decision, pp.101-102.

¹⁰⁸ Draft Decision, p.141.

NBN Co Response 30

The possibility that NBN Co may move from the loss accumulation phase and into the loss recovery phase during Module 2 does not necessarily support the ACCC's conclusion that the approach to regulated pricing needs to be suitably flexible to adapt to a range of possible future scenarios. Indeed, when other relevant factors are taken into account, NBN Co considers that it is likely to face appropriate incentives to invest, operate and price efficiently over the term of the SAU.

Analysis

At a high level, NBN Co concurs with the ACCC's analysis of how the ICRA may change over time based on the information on forecast prices, demand, revenue and costs as provided by NBN Co on 15 February 2013. NBN Co indicated in its 15 February 2013 letter to the ACCC an overall similar pattern of results (although the precise details of such results may differ according to forecast assumptions on relevant inputs, such as future regulated rates of return).

However, the *possibility* that NBN Co may move from the loss accumulation phase and into the loss recovery phase during Module 2 does not necessarily support the ACCC's conclusion that the approach to regulated pricing needs to be suitably flexible to adapt to a range of possible future scenarios. As discussed in section 5.1.1 above, NBN Co considers that: the ACCC's analysis of the revenue sufficiency risk faced by NBN Co over the course of the SAU is incomplete; and, although the level of revenue sufficiency risk may fall over the term of the SAU, it is unlikely to fall to such an extent that it would undermine NBN Co's incentives to invest, operate and price efficiently.

5.1.3 Principles for regulating NBN Co's pricing

In the Draft Decision, the ACCC sets out three principles for regulating NBN Co's pricing:¹⁰⁹

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 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 services in order to ensure that there is no price shock associated with migrating to the NBN.*

....

Secondly, NBN Co must expect to be able to recover its efficient costs of investing in the network, including a normal commercial rate of return given the risk associated with the investment as well as the efficient costs of operating and maintaining the network in a safe and reliable manner.

...

Lastly, NBN Co should face incentives to invest and incur expenditure in an efficient manner.

NBN Co Response 31

NBN Co has no issue at a high level with the ACCC's three principles for regulating NBN Co's pricing, but suggests that the ACCC's first principle (that end-users should not be made worse off by virtue of their migration to the NBN) should be further developed and clarified to address the issues of functional equivalence, price shock and ongoing supply.

¹⁰⁹ Draft Decision, pp.102-103.

Analysis

NBN Co notes that the ACCC's three principles are reasonably well aligned with the pricing objectives described by NBN Co's Supporting Submission,¹¹⁰ which relate to Uniform National Wholesale Pricing (UNWP), long term cost recovery, pricing stability and predictability and efficient take-up and usage.

However, NBN Co suggests that the ACCC's first principle should be refined, not to change the overall principle (that end-users should not be made worse off by virtue of their migration to the NBN), but to address the issues of functional equivalence, price shock and ongoing supply.

NBN Co suggests that a more appropriate outworking of the first principle would be as follows.

1. During the rollout period (Module 1):
 - (a) there should be services supplied over the NBN that are *at least* functionally equivalent to those currently being supplied over Telstra's fixed-line copper network and the Telstra and Optus HFC networks; and
 - (b) the prices for the relevant NBN Co services should be such as to *enable Access Seekers* to ensure that there is no price shock associated with migrating from copper or HFC services to the NBN.
2. After the rollout period (Module 2), NBN Co should continue to supply each of the services in respect of item 1(a), *subject to the price controls*, except if at some point it satisfies an appropriate set of product withdrawal conditions (as discussed in section 4.3.1 above).

These refinements account for the following facts:

- NBN Co is not seeking to replicate legacy network products on the NBN, but will have products that are at least functionally equivalent to such products and are functionally superior in key respects, such as uplink speed and the ability to supply multiple service types over a single access network.
- The potential for retail price shocks in the transition to the NBN will be influenced by a number of factors, including the behaviour of NBN Co and each Access Seeker, and decisions made during that period by the ACCC (for example, in relation to wholesale access prices on Telstra's copper network). In this regard, it is important to note that Access Seekers currently supply voice and broadband services over legacy networks using a number of means (including self-supply using copper and HFC and wholesale access using ULLS, LSS, WLR/LCS, and Wholesale ADSL). NBN Co has designed its products and pricing and makes commitments in the SAU to provide Access Seekers with a firm basis on which to implement a smooth transition of their end-users to the NBN. Ultimately, however, it is a matter for each Access Seeker to determine its retail products and pricing (on both legacy networks and the NBN) in response to NBN Co's products and pricing and its SAU commitments.
- As demand, applications and technology evolve over time, NBN Co will continue to develop its product suite, and in certain circumstances it may be appropriate for NBN Co to withdraw some of the products that end-users migrated to during the rollout period. These circumstances are discussed in section 4.3.1 above in regard to product withdrawal.

¹¹⁰ Supporting Submission, p.99.

5.2 Pricing for individual products

5.2.1 Precedence of price controls and LTRCM

In the Draft Decision, the ACCC raises an issue concerning the precedence of the CPI-1.5% price controls and the Long Term Revenue Constraint Methodology (LTRCM).¹¹¹

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.

However, NBN Co notes that the Consultation Paper does not include any reference to this precedence issue.

NBN Co Response 32

NBN Co agrees that provisions should be included in the SAU to make explicit that NBN Co's obligations that prevailing prices must satisfy the CPI-1.5% price control and the LTRCM are separate, independent obligations and are not alternative (i.e. satisfaction of one, e.g. the LTRCM, does not relieve NBN Co of the other, e.g. the price control).

Analysis

Although NBN Co considers that the SAU drafting is capable of clear interpretation on this issue of precedence, NBN Co proposes changes to the SAU to explicitly address the ACCC's stated concerns.

Proposed SAU changes in Notice to Vary 25

Include in section 3 ('Interpretation') of Attachment C to the main body of the SAU, the following clarifying statement:

"[In this Special Access Undertaking], every provision, including every right, obligation and undertaking, is a separate and independent provision that will apply in accordance with its own terms and will not be read down by reference to any other provision, unless provided otherwise."

¹¹¹ Draft Decision, p.96.

5.2.2 Initial price levels

In the Draft Decision, the ACCC states that:¹¹²

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.

The services listed by the ACCC in Attachment B relate to: the Standard Business Offer; Symmetric Access Capacity Offers TC-1 from 0.15 Mbps to 2 Mbps; and the Restoration charge (for service management on the NBN Co fibre, wireless and satellite networks).

NBN Co Response 33

NBN Co submits that the initial prices are reasonable in respect of: the Standard Business Offer; Symmetric Access Capacity Offers TC-1 from 0.15 Mbps to 2 Mbps; and the Restoration charge.

In this regard, NBN Co would highlight the importance of Access Seekers choosing the most appropriate configuration of NBN Co products in order to achieve a smooth migration from legacy networks to the NBN.

NBN Co's specific responses to the ACCC's concerns in relation to the services listed in Attachment B are set out in the following sections.

5.2.2.1 Business services with a current copper equivalent

In the Draft Decision, the ACCC states that:¹¹³

In its submission, Optus raised concerns that the Standard Business Offer is not sufficient for business grade services.

...

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.

...

In addition to the Standard Business Offer, the SAU specifies pricing for symmetric access capacity AVCs.

...

¹¹² Draft Decision, p.115.

¹¹³ Draft Decision, p.112.

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 [for the Standard Business Offer and Symmetric Access Capacity TC-1 from 0.15 Mbps to 2 Mbps] 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).

Standard Business Offer

NBN Co Response 34

The initial price of the SBO is reasonable, and simply reflects the sum of the initial prices of its components (and the initial prices of which are also reasonable). When the most appropriate configuration of NBN Co product components is used to construct a business grade internet service, the total cost is significantly less than in the examples provided in submissions. The SBO is not intended to be used as the base component for all business services, even those that are based on a 25/10 Mbps AVC (TC-4), and NBN Co notes that the proposal for the ACCC to have a product withdrawal disallowance power means that it is not necessary to rely on the SBO to anchor the prices of NBN Co's business grade products.

Analysis

The SBO consists of a 25/10 Mbps AVC (TC-4), which may be used to construct a range of business services using a variety of Symmetric Access Capacity bandwidths. The SBO also includes a 500kbps Symmetric Access Capacity (TC-1), which may be used in some business services, for example, voice services.

The initial price of the SBO simply reflects the sum of the initial prices of its components, each of which is available separately¹¹⁴. The ACCC has stated in the Draft Decision¹¹⁵, as part of its overall comments on initial prices, that it is satisfied that the initial price of the 25/10 Mbps AVC (TC-4) is reasonable. In the following section, NBN Co discusses the initial pricing of Symmetric Access Capacity (TC-1) from 0.15 Mbps to 2 Mbps and submits that those prices, including in respect of the 500kbps tier included in the SBO, are reasonable. In view of this, NBN Co considers that the initial price of the SBO is reasonable.

In reaching this conclusion, NBN Co highlights that the SBO is not intended (or required) to be the base component of every business service, but rather that Access Seekers will construct business services by using a combination of NBN Co products appropriate to the needs of their business end-users. In this regard, NBN Co notes that the proposal for the ACCC to have a product withdrawal disallowance power (as described in section 4.3.1 above) means that it is not necessary to rely on the SBO to anchor the prices of NBN Co's business grade products and it is artificial to base price comparisons on the SBO just because it is a Reference Offer.

¹¹⁴ The total price of the SBO includes the allowance for the 150kbps Symmetric Access Capacity (TC-1) that is included with the 25/10 Mbps AVC (TC-4).

¹¹⁵ Draft Decision, p.115.

This is best demonstrated by examining the detail provided by Optus in Table 1 of its submission¹¹⁶. Optus constructs an NBN-based product that is intended to be at least functionally equivalent to its business-grade *internet* service with 2Mbps of CIR. However, NBN Co submits that Optus has not combined the appropriate set of NBN product components in constructing its example.

- The appropriate CIR product to use in this context is Symmetric Access Capacity (TC-2), which Optus uses in its second example (also in Optus' Table 1).
- Optus uses the SBO as the base component in constructing its business-grade internet service. However, the SBO includes 500kbps of Symmetric Access Capacity (TC-1), and this is not needed for a business-grade *internet* service, and in practice an Access Seeker would not pay the premium to acquire this capacity.

NBN Co has prepared a comparison between Optus' approach and that recommended by NBN Co for constructing an NBN-based product that is at least functionally equivalent to Optus' business-grade *internet* service with 2Mbps of CIR. This comparison (as set out in the following table), standardises the use of Symmetric Access Capacity (TC-2)¹¹⁷ to provide the CIR functionality.

This comparison shows that if the appropriate product components are used, the cost of constructing an NBN-based product that is functionally equivalent to Optus' business-grade internet service with 2Mbps of CIR is \$33 lower (i.e. 27.5%) than that indicated by Optus in its submission.

Table 3 – NBN input costs for business-grade internet service

Product Components (Optus example)		Product Components (NBN Co example)	
SBO: AVC 25/10Mbps TC-4	\$53	AVC 25/10 TC-4	\$30
AVC 500kbps TC-1 CIR		(including option of 150kbps TC-1)	
AVC 5/5 TC-2 CIR	\$32	AVC 5/5 TC-2 CIR	\$32
TC-2 CVC 2Mbps @ 4:1 contention	\$10	TC-2 CVC 2Mbps @ 4:1 contention	\$10
TC-1 CVC 500kbps @ 1:1 contention	\$10		
Enhanced-12 SLA	\$15	Enhanced-12 SLA	\$15
Total per SIO per month	\$120	Total per SIO per month	\$87

Note – although the Access Seeker would be required, in both the Optus example and the NBN Co example, to have a CVC (TC-4) in the relevant CSA, no cost allowance is included because the service being provided to the end-user is based solely on TC-2 and it is assumed that the Access Seeker will already be acquiring a CVC (TC-4) in the CSA for the purposes of supplying other end-users (and the dimensioning of the CVC (TC-4) would be unaffected by the supply of the TC-2 service in this example).

There are two reasons for this difference.

- The NBN Co recommended approach is based on an AVC 25/10 (TC-4) rather than the SBO, so the Access Seeker does not pay the premium for the 500 kbps of Symmetric Access Capacity (TC-1) that it does not need.

¹¹⁶ Optus Submission to the ACCC Consultation Paper, January 2013, paragraph 7.66.

¹¹⁷ NBN Co's *Integrated Industry Roadmap as at April 2013* (available on NBN Co's website) indicates a delivery timeframe for TC-2 services of Q4 2013 (October to December).

- The NBN Co recommended approach does not include any TC-1 CVC component because the example being considered here is a business-grade internet service, which for the legacy product today would not include any voice circuits.

NBN Co also notes that the configuration of products being supplied for \$87 in the NBN Co recommended approach is for a 5Mbps symmetric CIR service, rather than the 2Mbps business-grade internet service that Optus is using as its point of comparison.¹¹⁸ This provides Access Seekers with the ability to readily upgrade a current retail product offering to a higher CIR bandwidth if required, an option that may not be available on legacy networks.

To reiterate, the above comparison highlights the importance of using the most appropriate product components to construct NBN-based products that are at least functionally equivalent to existing legacy products. In this context, it is not intended (or required) that the SBO should be the base component of every business service.

Symmetric Access Capacity Offers

NBN Co Response 35

The initial prices of Symmetric Access Capacity (TC-1) for 0.15 Mbps to 2 Mbps are reasonable, and will allow for a smooth transition from legacy networks to the NBN. For example, when the most appropriate configuration and dimensioning of product components is used to construct multi-line voice services, the total NBN input costs to Access Seekers is broadly comparable to those faced by Access Seekers on legacy networks.

Analysis

In the Draft Decision¹¹⁹, the ACCC refers to submissions that raise concerns in relation to the initial prices of Symmetric Access Capacity (TC-1). Optus was the only respondent to include substantive information in its submission on this issue, and did so in the context of providing multiple voice line services¹²⁰. Optus concludes in its submission that a business would “*incur significantly greater costs under NBN Co to maintain multiple phone lines, at the same level of service that is available in the market now.*”¹²¹

NBN Co does not agree with Optus’ conclusions in relation to multi-line voice services. NBN Co has performed an analysis of what it considers the NBN input costs would be for providers of multiple voice lines, using standard industry calculations for determining telephony trunk utilisation (Erlang B) in a standard loading environment and allowing for a distribution of trunk lines across NBN Co’s AVC TC-1 speed tiers, and considers these are consistent with the input costs faced by providers on legacy fixed-line networks.

In the interests of transparency, and noting the ACCC’s comment that “*it is not clear on the information before the ACCC whether submissions have identified the lowest cost means of providing comparable products*”¹²², NBN Co has set out below its key input assumptions (Table 4) and the cost elements used in calculating the per line cost of providing services for multi-line voice scenarios ranging from 4 lines up to 50 lines (Table 5). The example scenarios presented below are reflective of commonly offered legacy retail products.

¹¹⁸ If Optus wished to offer a 5 Mbps CIR internet service, it would have to allocate additional TC-2 CVC capacity, which would increase the total cost of the 5 Mbps business-grade internet service to \$102.

¹¹⁹ Draft Decision, p.112.

¹²⁰ Optus Submission to the ACCC Consultation Paper, January 2013, paragraphs 7.71 to 7.75.

¹²¹ Optus Submission to the ACCC Consultation Paper, January 2013, paragraph 7.75.

¹²² Draft Decision, p.112.

Table 4 - NBN Co dimensioning assumptions for multi-line voice service

NBN Co dimensioning assumptions	Rationale
100kbps TC-1 voice circuit for AVC	Cisco recommends 87.2kbps per voice line ¹²³ , including overheads. NBN Co has conservatively increased this to 100kbps to ensure costs are not understated.
0.4 Erlang CVC dimensioning for TC-1 CVC	<p>This is based on NBN Co analysis using Erlang B calculation for the expected distribution of the number of lines per AVC TC-1 speed tier using a 1% blocking assumption. An expected market adoption distribution across the TC-1 speed tiers was used to get a weighted average Erlang value across all TC-1 speeds of 0.36 Erlang. For the purposes of the examples shown below, NBN Co has rounded this up to 0.4 Erlang, to present more conservative (i.e. higher) values for the purpose of comparison.</p> <p>NBN Co notes that Erlang B modelling provides a good representation for an office style environment where the connection is aggregating multiple standard telephone lines, and additional CVC capacity may be required where higher line utilisation will be achieved.</p>

Table 5 - Multi-line voice scenarios on the NBN

Scenario	4 lines	8 lines	10 lines	20 lines	30 lines	50 lines
Total AVC TC-1 required (@100kbps/line)	0.4 Mbps	0.8 Mbps	1 Mbps	2 Mbps	3 Mbps	5 Mbps
NBN TC-1 AVC product component required (and price)	0.5 Mbps \$33.00	1Mbps \$66.00	1Mbps \$66.00	2Mbps \$132.00	5 Mbps \$330.00	5 Mbps \$330.00
NBN TC-4 AVC product component required (and price) ¹²⁴	25/5Mbps \$27	25/10Mbps \$30	25/10Mbps \$30	50/20 Mbps \$34	100/40Mbps \$38	100/40Mbps \$38
Allowance for included 150kbps TC-1 included with TC-4 AVC ¹²⁵	(\$10)	(\$10)	(\$10)	(\$10)	(\$10)	(\$10)
CVC credit amount based on 50kbps CVC ¹²⁶	(\$1)	(\$1)	(\$1)	(\$1)	(\$1)	(\$1)
CVC TC-1 capacity required for voice line provision, at 0.4 Erlang (and priced at \$20/Mbps)	0.16 Mbps \$3.20	0.32 Mbps \$6.40	0.4 Mbps \$8.00	0.8 Mbps \$16.00	1.2 Mbps \$24.00	2 Mbps \$40.00
Enhanced-12 SLA ¹²⁷	\$15	\$15	\$15	\$15	\$15	\$15
Total NBN input costs	\$67.20	\$106.40	\$108.00	\$186.00	\$396.00	\$412.00
Cost per voice line	\$16.80	\$13.30	\$10.80	\$9.30	\$13.20	\$8.24

¹²³ http://www.cisco.com/en/US/tech/tk652/tk698/technologies_tech_note09186a0080094ae2.shtml

¹²⁴ See NBN Co Ethernet Bitstream Service Product Technical Specification, 15 April 2013, Table 28, p.45 for TC-4 AVC required to support TC-1 AVC.

¹²⁵ The TC-4 AVC already includes 150kbs of TC-1 AVC. A rebate of \$10 is applied against TC-1 AVC orders above 150kbs.

¹²⁶ A credit amount based on 50kbps CVC is provided for each asymmetric TC-4 with TC-1 AVC. This is worth \$1 at \$20/Mbps for CVC capacity.

¹²⁷ Assumed to be required for business voice services.

NBN Co considers that these per voice line costs for multi-line voice services are broadly comparable to those faced by operators on legacy networks when similar dimensioning assumptions are employed. The ACCC may wish to seek further information from providers of such services to verify that this is the case.

NBN Co also highlights that there are opportunities for Access Seekers to offer innovative multi-line voice service solutions using TC-2 or TC-3¹²⁸ product components rather than TC-1. This would result in reduced input costs, traded off against the different technical specifications of these traffic classes.

As identified by the ACCC, it is important to ensure that the lowest cost means of providing comparable products over the NBN is identified. As NBN Co's products are sold in discrete steps of data transfer rate, it may be the case that some legacy multi-line voice offerings would benefit from small changes to the number of voice lines that are provided, to effectively manage the capacity available from each product component. For example, NBN Co notes that in the examples shown above, there is almost no difference in the *total* cost of providing either 8 or 10 voice lines (which translates to a lower *per voice line* cost for a 10 line service as compared to an 8 line service), and likewise marginal difference in the *total* cost of providing either 30 or 50 voice lines (which translates to a lower *per voice line* cost for a 50 line service as compared to a 30 line service). Service providers may be able to identify new retail product opportunities as a result.

NBN Co would highlight that this analysis does not factor in the ability that the NBN provides for Access Seekers to readily supply, in addition to existing multi-line voice services, integrated high quality broadband (and other) solutions to their end users over the same access link by dimensioning appropriate AVC and CVC capacity. This is generally not the case on legacy networks today, with multiple copper access links being required to deliver different business-grade services. The converged voice and data solutions able to be provided over the NBN are likely to deliver both cost reductions and an increased ability to offer innovative end user solutions.

In view of the above analysis and in the absence of any evidence to the contrary, NBN Co submits that the initial prices of Symmetric Access Capacity (TC-1) for 0.15 Mbps to 2 Mbps are reasonable, and will allow for a smooth transition from legacy networks to the NBN. This supports NBN Co's response above in relation to the reasonableness of the SBO, which includes 500kbps of Symmetric Access Capacity (TC-1).

5.2.2.2 Other Charges and other services

Restoration charge

In the Draft Decision, the ACCC states that:¹²⁹

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. 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).

...

... 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.

¹²⁸ NBN Co's *Integrated Industry Roadmap as at April 2013* (available on NBN Co's website) indicates a delivery timeframe for TC-2 services of Q4 2013 (October to December) and a delivery timeframe for TC-3 services of H2 2014 (July to December).

¹²⁹ Draft Decision, pp.114-115.

NBN Co Response 36

The Restoration charge is reasonable, and was set by NBN Co by benchmarking against current industry practice for related charging elements.

Analysis

NBN Co notes that the ACCC received no submissions in relation to the Restoration charge and the Draft Decision contains no substantive analysis or discussion in regard to the charge.

In the SAU's Dictionary, "Restoration" is defined as "the restoration of the supply of an Ordered Product after the cessation of an Ordering Freeze, Service Reduction or Suspension in respect of or in connection with that Ordered Product, except where the event or reason giving rise to that Suspension was not contributed to by any act or omission of a Customer." The terms "Ordering Freeze", "Service Reduction" and "Suspension" are also defined in the Dictionary.

The issue at hand is whether the level of the Restoration charge is reasonable given its purpose, rather than whether the Restoration charge should be excluded from Schedule 1D on account of its linkage to the Dispute Management Rules.

The Restoration charge is related to the *activity* that NBN Co would have to undertake in order to restore "the supply of an Ordered Product after the cessation of an Ordering Freeze, Service Reduction or Suspension in respect of or in connection with that Ordered Product, except where the event or reason giving rise to that Suspension was not contributed to by any act or omission of a Customer".

The charge of \$50 per ordered product was set by NBN Co after benchmarking against current industry practice for related charging elements. In this case, the particular benchmark chosen was the Telstra in-place connection charge (which is currently \$53.64 ex GST or \$59.00 including GST), which represents the industry benchmark charge for a connection that is made remotely by a service provider.

NBN Co submits that the Restoration charge is consistent with current industry practice, will not introduce an issue in transition from legacy networks to the NBN, and hence is reasonable.

5.2.3 Changes to prices over time, including determining new prices

In the Draft Decision¹³⁰, the ACCC considers four aspects of how the commitments in the SAU will influence changes to prices over time, including determining new prices. These relate to:

- ensuring current consumers are not worse off over the term of the SAU;
- incentives to set new prices at levels that encourage efficiency and promote competition;
- the ability for relative price levels to change in response to unforeseen circumstances; and
- incentives created by the approach to pricing of individual services for NBN Co to invest in and operate the network efficiently.

NBN Co's responses with regard to each of these aspects are set out below.

¹³⁰ Draft Decision, p.115.

5.2.3.1 Ensuring current consumers are not worse off over the term of the SAU

In the Draft Decision, the ACCC states that it:¹³¹

... 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.

...

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.

NBN Co Response 37

A price review mechanism should not be included in Module 1 of the SAU in relation to either new product pricing or price rebalancing because it is not necessary or useful and is otherwise inconsistent with NBN Co's legitimate business interests.

Analysis

Although NBN Co has separately proposed the inclusion of the Integrated Price Review Mechanism in Module 2 to provide the ACCC with a reserve power in relation to pricing for both new and existing products (see sections 5.2.3.2 and 5.2.3.3 below), NBN Co considers that including such a mechanism in Module 1 is not necessary or useful for the ACCC's stated purpose of addressing potential retail price shock as a result of migration to the NBN during the rollout period, and is otherwise inconsistent with NBN Co's legitimate business interests. The reasons for this are as follows.

- **Not necessary** – NBN Co has appropriate incentives to manage its pricing for both new and existing product over the rollout period to enable Access Seekers to provide a smooth transition for their end-users. As acknowledged by the ACCC in the Draft Decision, NBN Co "is likely to be subject to a high degree of revenue sufficiency risk for most if not all of Module 1"¹³² [Emphasis added] and such risk creates incentives for NBN Co to "price its services in such a way as to encourage end-users to increase their use of the NBN."¹³³

If NBN Co were to be unresponsive to these incentives, it may result in slower than forecast migration to the NBN, slower than forecast overall revenue growth, and higher than forecast losses of potential end-users to wireless-only supply. In addition, NBN Co may face operational difficulties if end-user migration to the fibre network occurs overwhelmingly towards the end of each 18 month disconnection period.

NBN Co also notes, as discussed in section 5.1.3 above, that it is ultimately a matter for each Access Seeker to determine how to transition its end-users to the NBN. In this regard, it is important to note that Access Seekers currently supply voice and broadband services over legacy networks using a number of means (including self supply using copper and HFC and wholesale access using ULLS, LSS, WLR/LCS, and Wholesale ADSL). NBN Co has designed its products and pricing and makes commitments in the SAU to provide Access Seekers with a firm basis on which to implement the smooth transition of their end-users to the NBN.

¹³¹ Draft Decision, p.116.

¹³² Draft Decision, p.141.

¹³³ Draft Decision, p.100.

- **Not useful** – It is difficult to see how a revenue neutral price review and rebalancing mechanism could be applied during the rollout period so as to address potential concerns over price shock without having unintended consequences for some groups of end-users. For example, if a rebalance were to decrease CVC prices then it would almost certainly have to increase AVC prices to achieve a revenue neutral outcome. Although this may be to the advantage of end-users who have above average data usage, it may be to the disadvantage of those with below average data usage. This pattern of advantage and disadvantage would apply to both end-users already on the NBN and those yet to migrate.
- **Inconsistent with NBN Co's legitimate business interests** – Including a price review and rebalancing mechanism in Module 1 is inconsistent with NBN Co's legitimate business interests because it potentially introduces additional pricing uncertainty in a period in which NBN Co already faces considerable revenue sufficiency risk. During the rollout period, NBN Co faces a high degree of uncertainty associated with the overall level and composition of demand for NBN Co's services. This uncertainty would make the application of any revenue neutral criteria subject to a potentially very wide error margin (much larger than in regard to Module 2, once the rollout is complete and it is known what NBN products migrating end-users chose to take-up).

5.2.3.2 Incentives to set new prices at levels that encourage efficiency and promote competition

In the Draft Decision, the ACCC states that:¹³⁴

... 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.

...

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 new prices. The variation would allow for the ACCC to determine new prices 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.*

¹³⁴ Draft Decision, p.121.

NBN Co Response 38

NBN Co notes that the ACCC's analysis of NBN Co's incentives is incomplete and does not necessarily support the ACCC's stated concerns in relation to NBN Co's incentives to set prices for new products in a manner that encourages efficient use of the network.

Nonetheless, NBN Co proposes that the Integrated Price Review Mechanism be included in Module 2 to provide the ACCC with well specified reserve powers in relation to new product pricing and price rebalancing that provide considerable flexibility to respond to future circumstances. The ACCC can initiate a Price Review at any time during Module 2, not just periodically, within a framework that gives due recognition to NBN Co's legitimate business interests (relating in particular to certainty over long term cost recovery arrangements). The ACCC may also initiate a Price Review within 2 years of the end of Module 1, with the outcomes of that review to take effect once Module 2 commences.

The mechanism is not proposed to be included in Module 1 because it is not necessary or useful, and is otherwise inconsistent with NBN Co's legitimate business interests.

Across both Modules 1 and 2, NBN Co proposes that the ACCC be given a disallowance power in relation to NBN Co introducing a New Price for a currently Zero-Priced Reference Offer or Zero-Priced Other Charge associated with the supply of a Reference Offer. This would replace the current regulatory recourse approach in the SAU in relation to such New Prices.

Given the nature and substance of these response in Module 1 and Module 2, NBN Co considers that the SAU should continue to specify that it is for NBN Co to determine prices for new and existing products subject to: the Maximum Regulated Prices under the price controls; any changes to Maximum Regulated Prices in Module 2 due to the use of the proposed Integrated Price Review Mechanism; the proposed ACCC disallowance power in relation to Zero-Priced Offers as discussed above; and the LTRCM.

Analysis

New product pricing

As discussed in section 5.1.2, the possibility that NBN Co may move from the loss accumulation phase and into the loss recovery phase during Module 2 does not necessarily support the ACCC's conclusion that the approach to regulated pricing needs to be suitably flexible to adapt to a range of possible future scenarios. Indeed, when other relevant factors are taken into account, NBN Co considers that it is likely to face appropriate incentives to invest, operate and price efficiently over the term of the SAU.

NBN Co also notes that it is in NBN Co's legitimate business interests to be able to price its new and existing services within a framework that provides certainty over long term cost recovery arrangements.

Nonetheless, NBN Co proposes that the Integrated Price Review Mechanism be included, in Module 2 (only), to address the ACCC's concerns in regard to both new product pricing and the potential need for price rebalancing across NBN Co's suite of products. The reasons for taking this approach are as follows.

- **Module 2 only** – For the same reasons discussed in section 5.2.3.1 above, if the ACCC were to have a role in determining prices for new products or in price rebalancing, this should be limited to Module 2 only. Based on the ACCC’s own analysis¹³⁵, “NBN Co is likely to be subject to a high degree of revenue sufficiency risk for most if not all of Module 1.” [Emphasis added] As such, NBN Co has appropriate incentives in regard to new product pricing and if some form of rebalancing were appropriate in Module 1 then NBN Co could separately seek the ACCC’s approval to vary the SAU as required, and would face appropriate incentives to do so.

This is consistent with the advice of Ordovery and Shampine¹³⁶, in regard to NBN Co’s incentives to price in such a way as to ensure the growth of downstream services, as discussed in section, 5.1.1 above.

- **Integrated Price Review Mechanism** – The periodic price review and rebalancing approach proposed by the ACCC in the Draft Decision would allow some prices to rise and other to fall subject to a revenue neutral constraint. This strikes a balance between promoting efficient use of the NBN and protecting NBN Co’s legitimate business interests. However, the same balance is noticeably absent from the ACCC’s proposed new product pricing power; NBN Co would be exposed to the risk of its current and future revenue streams (which are, in any event, subject to the LTRCM) being undermined by a new price for a new product determined by the ACCC. The risk this poses to NBN Co could be very difficult to manage, with a new price for a new product, if set by the ACCC, having potential widespread effects on existing products and other new products.

NBN Co has developed the Integrated Price Review Mechanism, as described more fully below, to provide the ACCC with well specified reserve powers in relation to new product pricing and price rebalancing that provide considerable flexibility to respond to future circumstances during Module 2. The ACCC can initiate a Price Review at any time, not just periodically, within a framework that gives due recognition to NBN Co’s legitimate business interests (relating in particular to certainty over long term cost recovery arrangements).

The scope, criteria, process and timing aspects of the Integrated Price Review Mechanism are described below. NBN Co considers that these aspects should work together in such a way that the mechanism can address both new product pricing and more strategic price rebalancing issues as and when they arise and provide timely outcomes that are well informed, responsive to prevailing circumstances and meet criteria that are relevant and appropriate in this context.

- **Scope:**
 - A Price Review Arrangement may specify the Maximum Regulated Prices (or formulas for ascertaining those Maximum Regulated Prices) for Reviewable Offers to apply for a period of between one and five Financial. Explicit provision is made for specification of glide paths for Maximum Regulated Prices,
 - The Reviewable Offers that can be included in a Price Review Arrangement include:
 - Reference Offers (excluding any Zero-Priced Reference Offers);
 - Non-Reference Offers (excluding Zero-Priced Non-Reference Offers);
 - Other Charges (excluding any Zero-Priced Other Charges and any Other Charges provided on a “hourly labour rate” or “hourly labour rate plus cost of materials basis”); and

¹³⁵ Draft Decision, p.141.

¹³⁶ Expert Report of Janusz A. Ordovery and Allan L. Shampine, September 24 2012, paragraph 36.

- a New Offer (excluding a Zero-Priced New Offer) or a New Other Charge (excluding a Zero-Priced Other Charge) not in effect as at the effective date of the Price Review Arrangement but in respect of which NBN Co has issued a pricing rationale statement under clause 1D.6(b) or 2C.5(b).
- Criteria – any Price Review Arrangement must satisfy the following.
 - The ACCC must be satisfied that all of the Maximum Regulated Prices of the Reviewable Offers (taken in aggregate) are reasonable having regard to the criteria in section 152AH of the CCA.
 - The ACCC must also be satisfied that the Maximum Regulated Prices meet a number of short/medium term and long term net revenue neutrality requirements. These address both the expected value of net revenue and the risk or variability associated with the net revenue. Net revenue in this context is defined as forecast revenue less forecast ABBRR, and allows for any potential impact of the price rebalancing on NBN Co's costs (for example, due to a need to install more transit capacity or a change in tax expense due to a changed revenue profile) to be accounted for in a manner consistent with the LTRCM. Net revenue neutrality constraints are applied in three time periods, all of which commence when the Price Review Arrangement comes into effect and end as follows: Period 1 – the end of the current Regulatory Cycle; Period 2 – at the end of the Financial Year in which occurs the fourth anniversary of the date that the Arrangement took effect; and Period 3 – the end of the SAU term (30 June 2040). Period 1 is designed to ensure that the incentive properties associated with basing the ICRA roll forward on forecast real revenue and forecast real ABBRR in the current Regulatory Cycle are unaffected. Period 2 is designed to ensure that NBN Co has appropriate stability in its short to medium term cash flows (which is important to being able to cost effectively raise debt finance). Period 3 is designed to ensure that the value of the NBN Co to its shareholders is not damaged.
 - The Maximum Regulated Prices must also be consistent with uniform national pricing and involve no increase to the Maximum Regulated Price for any Basic Access Offer.
- Process
 - The ACCC (or NBN Co) may initiate a Price Review by issuing a written notice if it has a reason to believe that the Maximum Regulated Prices of the Reviewable Offers as at the date of the written notice (taken in aggregate) are not reasonable having regard to the criteria in section 152AH of the CCA. The written notice must include:
 - the reasons for the ACCC's view that the Maximum Regulated Prices of the Reviewable Offers that apply as at the date of the written notice (taken in aggregate) are not reasonable, having regard to the criteria in section 152AH of the CCA; and
 - the proposed term of the Price Review Arrangement (which must not be more than a period of 5 Financial Years).
 - NBN Co will then have 4 months (or a different period by agreement with the ACCC) to provide the ACCC with a Price Review Proposal.

- The ACCC will then decide to accept or reject the proposal or to cease the Review without establishing a Price Review Arrangement. In the course of making its decision, the ACCC may request that NBN Co submit a Revised Price Review Proposal.
- If the ACCC rejects NBN Co's Price Review Proposal or Revised Price Review Proposal then the ACCC may determine its own Price Review Arrangement. In so doing, the ACCC must have regard to forecasts submitted by NBN Co in determining its own Price Review Arrangement, and must consult with the public on any proposed arrangements.
- Timing
 - An initial or further Price Review Arrangement may only commence after the expiry of Module 1 and must commence within 12 months of the date that the ACCC accepts NBN Co's Price Review Proposal or Revised Price Review Proposal or issues an ACCC Determined Price Review Arrangement, with the Maximum Regulated Prices for the Reviewable Offers taking effect from the start of the first Financial Year in respect of which it applies.
 - The ACCC may initiate a Price Review up to 2 years prior to the end of Module 1 and thereafter may initiate a Price Review at any time providing that there is not already such a Review underway.
 - Any prior Price Review Arrangement ceases to apply from the date when a Price Review Arrangement commences.

The Integrated Price Review Mechanism as proposed by NBN Co has a number of practical benefits. First, in the event (however unlikely) that NBN Co's revenue sufficiency risk falls to such an extent during Module 2 that it no longer creates appropriate pricing incentives, the prospect of ACCC intervention via the Integrated Price Review Mechanism may counteract this effect and encourage NBN Co to act in a manner that obviates the need for any such intervention. Second, in considering whether to use the Integrated Price Review Mechanism, the timing flexibility built into it means that the ACCC could monitor how demand for new (and pre-existing) products is developing over time and then decide with the benefit of actual data, whether there was any need to intervene in the circumstances. This is preferable to being required, because of time restrictions, to place reliance on forecasts of demand for an entirely new product or for a product whose demand is evolving rapidly but in a manner that is difficult to forecast. Third, the mechanism would allow the ACCC to commence a Price Review up to 2 years before the end of Module 1, but only to take effect during Module 2 (although NBN Co considers it unlikely that a review would be needed at that time). Fourth, the mechanism makes explicit provision for glide paths of up to five Financial Years, which provide an appropriate means of managing any transition issues in the event of a significant price rebalancing.

Overall, NBN Co submits that the Integrated Price Review Mechanism strikes an appropriate balance between promoting the efficient use of the network and protecting NBN Co's legitimate business interests. It would provide a reserve power for the ACCC that is appropriately defined for the current context; in this regard it is notable that the ACCC has recognised that "in many circumstances NBN Co will have incentives to set new prices efficiently of its own accord"¹³⁷, and that the ACCC's own 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 2." [Emphasis added]¹³⁸

New Prices for currently Zero-Priced Reference Offers and Zero-Priced Other Charges associated with the supply of a Reference Offer

The SAU currently includes in both Modules 1 and 2 a regulatory recourse arrangement that applies in the event that NBN Co proposes to introduce a New Price for a currently Zero-Priced Reference Offer or a Zero-Priced Other Charge associated with the supply of a Reference Offer. This regulatory recourse arrangement was included in recognition of the significance of Zero-Priced items such as the Platform Interfacing Offer and Initial Standard Installation.

In the Draft Decision,¹³⁹ the ACCC states that: "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."

In view of this, NBN Co has reconsidered this aspect of the SAU, and now proposes to confer a disallowance power on the ACCC in Modules 1 and 2, to extend the current notice period from 3 months to 6 months and to require the ACCC to make any disallowance decision at least 20 business days before the end of the notice period. This approach will simplify the nature of the decision to be made by the ACCC (disallowance of NBN Co's New Price rather than determination of that New Price if it was not satisfied with NBN Co's New Price) and provide more time for the ACCC to make any decision (effectively increasing the time available from 3 months to 5 months).

NBN Co also proposes that the ACCC could disallow the introduction of a New Price for a Zero-Priced Reference Offer or Zero Price Other Charge associated with the supply of a Reference Offer for a period of up to 2 year from the end of the notice period. This is intended to provide an appropriate degree of certainty to Access Seekers in regard to the pricing of these important Offers and Charges and is similar to the approach taken in regard to the disallowance power on product withdrawal (see section 4.3.1).

In developing these proposed changes to the SAU, NBN Co did consider whether the Integrated Price Review Mechanism could substitute for the disallowance power in Module 2 (it could not do so in Module 1 as NBN Co does not propose including the Mechanism in that Module). NBN Co concluded that the disallowance power should also be included in Module 2 because it provides for simpler and more direct ACCC oversight using a process and criteria that do not need to deal with relatively complicated issues such as net-revenue neutrality. If a New Price is introduced in Module 2 and is not disallowed by the ACCC then it would fall within the scope of the Integrated Price Review Mechanism from that point on.

¹³⁷ Draft Decision, p.121.

¹³⁸ Draft Decision, p.141.

¹³⁹ Draft Decision, p.120.

NBN Co to determine prices for new and existing products

Given the nature and substance of NBN Co's responses above in relation to new product pricing and New Prices for currently Zero-Priced Reference Offers and Zero-Priced Other Charges associated with the supply of a Reference Offer, it follows logically that the SAU should continue to specify that it is for NBN Co to determine prices for new and existing products subject to:

- the Maximum Regulated Prices under the price controls;
- any changes to Maximum Regulated Prices in Module 2 due to the use of the Integrated Price Review Mechanism;
- the proposed ACCC disallowance power in relation to Zero-Priced Offers as discussed above; and
- the LTRCM,

Essentially, these elements need to be considered as part of one overall package that is designed to appropriately address the ACCC's concerns.

Proposed SAU changes in Notice to Vary 26

Include the Integrated Price Review Mechanism as a new Schedule in Module 2 – refer to proposed drafting in Appendix C, section 3.

In both Modules 1 and 2, change the regulatory recourse arrangements in relation to New Prices for currently Zero-Priced Reference Offers and Zero-Priced Other Charges associated with the supply of a Reference Offer to an ACCC disallowance power, and increase the notice period to 6 months – refer to the proposed drafting in Appendix C – section 4.

5.2.3.3 Ability for relative price levels to change in response to unforeseen circumstances

In the Draft Decision, the ACCC states that it:¹⁴⁰

... 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 an investment in the network throughout the SAU term. This is because there may be times when NBN Co does not face incentives to lower prices of its own accord and because it if 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.

¹⁴⁰ Draft Decision, p.123.

NBN Co Response 39

NBN Co has proposed that the Integrated Price Review Mechanism be included in Module 2 to address the ACCC's concerns in regard to new product pricing and the potential need for price rebalancing. This will address the ACCC's concerns in relation to the ACCC being able to change relative price levels in response to unforeseen circumstances.

The mechanism is not proposed to be included in Module 1 because it is not necessary or useful, and is otherwise inconsistent with NBN Co's legitimate business interests.

Analysis

NBN Co's reasoning in regard to why it has proposed the Integrated Price Review Mechanism to apply in Module 2, but not in Module 1, is set out in section 5.2.3.2 above, and applies equally in regard to addressing the ACCC's stated concerns in regard to being able to change relative prices in response to unforeseen circumstances.

5.2.3.4 Incentives created by the approach to pricing of individual services for NBN Co to invest in and operate the network efficiently

In the Draft Decision, the ACCC states that it:¹⁴¹

... considers that there is considerable potential for the proposed price controls to create incentives for NBN Co to operate and invest efficiently.

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.

NBN Co Response 40

NBN Co has addressed the ACCC's concern in regard to the effectiveness of the price controls by proposing amendments to the SAU's product withdrawal provisions.

Although the level of revenue sufficiency risk may fall over the term of the SAU, it is unlikely to fall to such an extent that it would undermine NBN Co's incentives to invest, operate and price efficiently.

Analysis

As discussed in section 4.3.1, NBN Co has proposed variations to the SAU to address the issues raised by the ACCC in section 4 of the Draft Decision in relation to product withdrawal. These amendments should address any concerns regarding NBN Co's exposure to revenue sufficiency risk in various phases of the SAU.

In view of this, and for the reasons discussed in section 5.1.1 above, NBN Co considers that, although the level of revenue sufficiency risk may fall over the term of the SAU, it is unlikely to fall to such an extent that it would undermine NBN Co's incentives to invest, operate and price efficiently.

¹⁴¹ Draft Decision, pp.125-126.

5.2.4 Tax change events

In the Draft Decision, the ACCC states that it:¹⁴²

... is not satisfied that [NBN Co's discretion under the tax change event clauses] will lead to changes in relative prices that will encourage efficient use of 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.

...

In light of these issues, the Consultation Paper on the Notice to Vary proposes that the SAU be varied so that changes (both increase and decrease) in response to a tax change event could be considered as part of the proposed periodic revenue neutral price rebalancing.

NBN Co notes that the Consultation Paper makes no mention of amendments to the SAU in relation to tax change events.

NBN Co Response 41

NBN Co proposes to amend the tax change clauses so that references to "incremental tax effect" are changed to "net incremental tax effect". This will require NBN Co to net off the effect of any tax decreases against the effect of any tax increases in relation to a tax event.

Analysis

At the outset, NBN Co notes that the Integrated Price Review Mechanism proposed by NBN Co for inclusion in Module 2 would implicitly allow the ACCC to consider whether relative prices were efficient after any changes in Maximum Regulated Prices due to a tax change event. During Module 1, when NBN Co will face appropriate incentives to price efficiently (for the reasons discussed in section 5.2.3.1), for the same reasons NBN Co would face appropriate incentives to pass through the effect of any tax change event into prices in an efficient manner.

Nevertheless, in relation to the issue of increases and decreases in taxes, NBN Co proposes to amend the tax change clauses so that references to "incremental tax effect" are changed to "net incremental tax effect". This will require NBN Co to net off the effect of any tax decreases against the effect of any tax increases in relation to a tax event. This is similar to the approach taken in regard to significant tax change events such as the introduction of the GST, which was associated with the removal of a range of retail and wholesale sales taxes.

Proposed SAU changes in Notice to Vary 27

Change references from "incremental tax effect" to "net incremental tax effect" in clauses 4.7(d) of the main body (formerly clause 4.8(d)), 1C.5.1(b)(ii), 1D.5.1(b)(ii) and 2C.3(a).

¹⁴² Draft Decision, p.127.

5.3 Long Term Revenue Constraint Methodology

5.3.1 Cash flow timing assumptions

In the Draft Decision, the ACCC states that:¹⁴³

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

...

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.

In the Consultation Paper¹⁴⁴, the ACCC goes on to state that

In the event that NBN Co cannot satisfy the ACCC that the assumptions relating to the timing of cash flows reflect its actual circumstances, the ACCC proposes that the long-term revenue constraint methodology be amended to achieve internal consistency with respect to the timing of cash flows.

NBN Co Response 42

In regard to Module 1, no change should be made to the cash flow timing assumptions because the LTRCM, as a whole, is reasonable.

In regard to Module 2, the existing NPV=0 criterion in clause 2D.2.1(b) already addresses the issue of cash flow timing and provides some flexibility in regard to how it can be addressed in each Regulatory Cycle.

Analysis

NBN Co notes that in raising the issue of cash flow timing, the ACCC has not distinguished between the specification of the LTRCM in Module 1 as compared to Module 2. This is unfortunate because the NPV=0 criterion in clause 2D.2.1(b) (of Module 2) deals with this issue specifically by referring to “relevant future cash flow inputs (e.g. Operating Expenditure, Capital Expenditure, Tax and Revenue, with adjustments as required to account for the timing of how such amounts are recognised)” [Emphasis added].

NBN Co submits that Module 2 already addresses the issue of cash flow timing and provides some flexibility in regard to how it can be addressed in each Regulatory Cycle. NBN Co also notes that the half WACC adjustment to capital expenditure is expected, in any event, to be a reasonably robust and realistic assumption, with the value of assets placed in service expected to be relatively evenly distributed throughout the year.

In relation to Module 1, the issue as raised by the ACCC is that the LTRCM contains an apparent internal inconsistency in that it assumes that opex and revenue occur at the end of the year and capex on average in the middle of the year, with a half-WACC adjustment applied to the capex.

¹⁴³ Draft Decision, p.133.

¹⁴⁴ Consultation Paper, p.28.

However, NBN Co submits that the cash flow timing assumptions used in the LTRCM in Module 1 of the SAU are consistent with the Fixed Line Services Model (FLSM) used by the ACCC to set Telstra's fixed line service prices and the Post Tax Revenue Model (PTRM) used by the AER to set revenue and price caps for energy network businesses. As such, the LTRCM reflects current regulatory practice in a number of relevant infrastructure sectors.

NBN Co notes that the ACCC has used the FLSM most recently in its Draft Report on Wholesale ADSL prices (March 2013)¹⁴⁵. The AER is currently using the PTRM to determine building block revenues, and the AER says that the PTRM can "handle input data for up to a 10-year regulatory control period"¹⁴⁶ (which is the same period as Module 1).

In regard to whether the cash flow timing assumptions in the LTRCM reflect NBN Co's actual circumstances, NBN Co highlights that it has developed the LTRCM in Module 1 as a package. The ACCC should be assessing the reasonableness of the LTRCM, and the SAU more generally, as a combined set of commitments, rather than considering each commitment or element individually.

If adjustments were to be made to account for cash flow timing differences, then NBN Co would need to reconsider the adequacy of other aspects of the Module 1 LTRCM, such as the 350bps margin used in calculating the WACC, which Officer and Bishop already consider "would fall at the lower end of a reasonable confidence interval around" their own estimate of a "circa 420 basis points" margin.¹⁴⁷

NBN Co notes that the cash flow timing assumptions in the LTRCM, the FLSM and the PTRM also have the advantages of simplicity and transparency.

Taken together, NBN Co considers that no change should be made in Module 1 in respect of the cash flow timings in the LTRCM. This is because the LTRCM is reasonable as a whole.

5.3.2 LTRCM – Module 1

The ACCC has identified a number of specific issues with the operation of the Long Term Revenue Constraint Methodology (LTRCM) in Module 1. These are dealt with individually below.

5.3.2.1 Adoption of ex-post compliance approach in Module 1

In the Draft Decision, the ACCC states that it:¹⁴⁸

... 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.

In the Consultation Paper (pp.29-30), the ACCC goes on to state that:¹⁴⁹

The ACCC is currently considering how precisely such a role for the ACCC in calculating the values of the long-term revenue constraint could be incorporated into the SAU.

¹⁴⁵ ACCC, *Public inquiry to make a final access determination for the Wholesale ADSL service*, Draft Report March 2013.

¹⁴⁶ AER, *Post-tax revenue model handbook*, December 2010, p.4.

¹⁴⁷ Professor Bob Officer and Dr Steven Bishop, Report on WACC component of NBN Co's Special Access Undertaking, September 2012, p.5.

¹⁴⁸ Draft Decision, p.136.

¹⁴⁹ Consultation Paper, pp.29-30.

For example, one option is to retain the current approach in Module 1 whereby the methodologies for calculating each building block component are set out and NBN Co is required to submit information under Schedule 1G. However, the ACCC would be responsible for determining the final values of the RAB, annual revenue requirements and initial cost recovery account that applies to NBN Co.

In circumstances where the ACCC considered that NBN Co's reported costs do not comply with the methodologies in the SAU, the ACCC would consider rolling forward the RAB, and determining the value of the annual revenue requirements, based on amended values as decided by the ACCC.

...

In formulating a precise mechanism, the ACCC is seeking views on the following matters:

- *the particular mechanism that should be adopted and how it could be incorporated into the current drafting of the SAU;*
- *the timing of when the RAB, annual revenue requirements and initial cost recovery account should be calculated by the ACCC (for example, annually or at given intervals, such as every three or five years); and*
- *whether the ACCC should be constrained by any additional criteria to those currently in Module 1.*

NBN Co Response 43

NBN Co proposes changing the ex-post compliance approach in Module 1 so that the ACCC has a direct role in applying the LTRCM, including the determination of the prudence of capital expenditure and operating expenditure in accordance with the SAU. NBN Co proposes additional powers for the ACCC in relation to its ability to assess the prudence of capital expenditure and operating expenditure.

Analysis

The ex-post compliance approach in Module 1 relies on a set of self-executing arrangements that are intended to be objective in nature. Nonetheless, given the ACCC's stated concerns, NBN Co proposes that the SAU be amended to provide the ACCC with a direct role in applying the LTRCM subject to the following mechanism, timing, consultation and criteria.

- **Mechanism** – the ACCC would be required to apply the LTRCM to determine the ABBRR, ICRA and RAB values, including the values of all relevant inputs to those items, with reference to the information provided by NBN Co to the ACCC under Schedule 1G in respect of the relevant Financial Year. Part of the ACCC's role would be to conduct an ex-post review to check that Capital Expenditure and Operating Expenditure is prudently incurred by NBN Co in accordance with the criteria specified in Schedules 1E and 1F (see also below regarding those criteria).
- **Timing** – the ACCC would be required to make a determination in respect to each Financial Year within 12 months after the end of that Financial Year.
- **Consultation** - the ACCC would be required to consult with NBN Co to the extent that it intends determining any values that are different to those provided by NBN Co to the ACCC under Schedule 1G.

- Criteria – for capital expenditure and operating expenditure to be considered prudent and hence included in the RAB, the ACCC must be satisfied that the capital expenditure or operating expenditure falls within the categories of prudence set out in the SAU (including the deemed prudence categories). An additional criterion has been included in the capital expenditure and operating expenditure prudence provisions against which the ACCC is able to assess compliance. Because it is now the ACCC who will determine whether capital expenditure or operating expenditure falls within the SAU prudence categories, NBN Co also proposes that the ACCC is conferred with the ability to determine that particular expenditure is prudent on more general efficiency and prudence grounds but only if it does not fit within any of the specified categories.

NBN Co considers that these proposed amendments strike an appropriate balance between addressing the ACCC's stated concerns and protecting NBN Co's legitimate business interests of being able to recover its prudently incurred capital expenditure and operating expenditure. It should be noted that NBN Co faces the risk under this amended approach of potential disallowance by the ACCC of significant amounts of capital and operating expenditure up to 24 months after those amounts were incurred. Although NBN Co would seek, following any such disallowance, to make any necessary changes to its operating expenditure and capital expenditure practices, these may take some time to achieve, and in the meantime expenditure that is already in process may be also be subject to disallowance.

More generally, the annual determination approach proposed above is necessary because NBN Co has obligations to ensure that its pricing complies with the LTRCM. As such, NBN Co needs to know the ICRA balance within a reasonable amount of time of the end of each year, which means that the ACCC will need to determine the relevant values in a timely fashion if the SAU is to work as intended in Module 1.

Proposed SAU changes in Notice to Vary 28

Change the ex-post compliance approach so that the ACCC has a direct role – refer to the proposed drafting in Appendix C, section 5.

5.3.2.2 Capital expenditure

Network Design Rule changes – removal of minor expenditure limit

In the Draft Decision, the ACCC states that:¹⁵⁰

... 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.

NBN Co Response 44

The Minor Expenditure Limit category of Permitted Variation should be retained in the SAU, but with a reduced initial value of \$50 million.

¹⁵⁰ Draft Decision, p.145.

Analysis

It is not clear from the Draft Decision precisely what the ACCC's concern is with this particular permitted variation category, as there is no specific discussion on it, other than the conclusion that is stated on page 145. It is unclear whether the issue relates to the notion of a minor expenditure limit per se, or to the dollar value associated with it.

NBN Co notes that the minor expenditure limit permitted variation category is based on an adaptation of the regulatory investment test for transmission (RIT-T) set out in the National Electricity Rules (NER), which includes a minor spend threshold, albeit at a lower threshold than that in the SAU.

The use of a minor expenditure limit category is conventional regulatory practice, and is reasonable to include in the SAU.

Section 5.16.3(a)(2) of the NER, which contains the current RIT-T equivalent of the minor expenditure limit, provides that a network builder does not need to apply the RIT-T where "*the estimated capital cost of the most expensive option to address the identified need which is technically and economically feasible is less than \$5 million (as varied in accordance with a cost threshold determination)*". A network builder is also not required to apply the RIT-T where "*the maintenance or replacement expenditure also results in an augmentation to the network, and the estimated capital cost for the augmentation component of the proposed expenditure is less than \$5 million (as varied in accordance with a cost threshold determination)*" (section 5.16(a)(4)). The network builder is also exempt from drafting a "project assessment draft report" (a draft version of the equivalent of the NBN Prudency Implementation Paper) if the estimated capital cost of the proposed preferred option is less than \$35 million (as varied in accordance with a cost threshold determination).

These thresholds are subject to periodic adjustment by the AER by means of a "cost threshold determination". The most recent version of the AER's cost threshold determination was made in November 2012. The final determination recommended that the \$5 million threshold be maintained (after taking rounding down into account) and that the \$35 million threshold be adjusted upwards to \$38 million.

The AER also set out in its 2012 decision the factors it considered to be relevant in determining the appropriateness of the cost thresholds based on its review of explanatory material from the Australian Energy Market Commission (AEMC). These factors include:

- whether an increase in the cost threshold would exempt smaller scale projects which may have market impact;
- whether a decrease in the cost threshold would mean smaller scale projects which are not likely to have any material market impact are not exempt from the RIT-T; and
- the regulatory burden on transmission businesses and possible flow-on effects in terms of the timeliness of investments.

The AER summarised the overall views of the AEMC¹⁵¹ on the minor expenditure exemption in the following way:

The exemption would prevent a disproportionate use of resources and present unnecessary delays in the investment process.

¹⁵¹ Based on the AEMC's 2008 *National Transmission Planning Arrangements Final Report to the Ministerial Council on Energy* and its 2009 *Final Rule Determination, National Electricity Amendment (Regulatory Investment Test for Transmission)*.

NBN Co considers that the justifications that have been used in the context of \$5 million exemption threshold for the RIT-T are also readily applicable to NBN Co's case but notes that it is appropriate for that threshold to be set at a level that takes account of NBN Co's specific circumstances. In particular, it is arguable that an appropriately set Minor Expenditure Limit under Schedule 1D would ensure that:

- the regulatory burden on NBN Co is minimised and that small investments can proceed with relative efficiency; and
- the proposed prudency mechanism under clauses of 1E.7-1E.11 of the SAU is applied in relation to projects that will have a significant impact on NBN Co's cost structure and which are likely to be of greatest interest to Access Seekers.

NBN Co considers that the use of a higher threshold than \$5 million is justified in its context for a number of reasons, as articulated below:

1. The scale of NBN Co's annual capex program over Module 1 is significantly higher than that of transmission companies for which the \$5 million threshold was established. NBN Co's Corporate Plan for 2012-2015 estimates that the total capex over the period 2010 to 2021 will be \$37.4 billion¹⁵², peaking at over \$5 billion in FY2015, and will be above \$3 billion in each of the 9 Financial Years from FY2013 to FY2021. By contrast, the capex programs for electricity transmission companies which are subject to the RIT-T are an order of magnitude lower:
 - a. TransGrid (who owns and manages high-voltage transmission networks in New South Wales and the Australian Capital Territory) has an approved regulated capex allowance forecast for the period 2009/10 to 2013/14 of \$2.405 billion, with a peak annual value of \$549.7 million in 2011/12¹⁵³. TransGrid reports in its 2010/11 Annual report that its actual capital investment for 2010/11 was \$378.6 million.¹⁵⁴ Thus, the total capex for TransGrid over the 5-year regulatory period is only approximately half that of NBN Co in its peak investment year, and less in total than what NBN Co expects to invest in each Financial Year from FY2013 to FY2021.
 - b. SP AusNet (who owns and manages high-voltage transmission networks in Victoria), has an approved regulated capex allowance forecast for the period 2008/09 to 2013/14 of \$771.07 million, with a peak annual value of \$149.45 million in 2013/14¹⁵⁵. In its Statutory Annual Report for 2012, SP AusNet reports that its capital investment in electricity transmission networks was \$198.3 million¹⁵⁶, although this also includes capex associated with augmentation done under contract to VENCORP, which are outside SP AusNet's current revenue cap. Again, the annual regulated capex for SP AusNet is significantly lower than that expected for NBN Co in each year of Module 1 – by more than a factor of 10.

¹⁵² NBN Co Corporate Plan 2012-2015, Exhibit 1.6.

¹⁵³ AER, Final Decision – TransGrid transmission determination 2009-10 to 2013-14, p.xii.

¹⁵⁴ Transgrid Annual Report 2010/11, p.38.

¹⁵⁵ AER, Final Decision – SP AusNet transmission determination 2008-09 to 2013-14, p.10.

¹⁵⁶ SP Ausnet Statutory Annual Report 2012, p.203.

NBN Co notes that electricity distribution companies will also be subject to the same \$5 million threshold from 1 January 2014.¹⁵⁷ However, while electricity distribution companies typically have larger capex programs than electricity transmission companies, the capex profile of even the largest electricity distribution companies in Australia is notably less than NBN Co's anticipated capex program. For example, the approved capex allowance for Energy Australia's distribution business (now Ausgrid) for the period between 2009-2014 was approximately A\$6.6 billion.¹⁵⁸ The approved capex allowance is significantly less for smaller electricity distributors in each state. For example, the approved capex allowance for Integral Energy was approximately \$2.7 billion over the same 5 year regulatory control period and was \$3.8 billion for Country Energy.¹⁵⁹ It was significantly less for each of the five Victorian distribution businesses for the 2011-2015 regulatory control period.¹⁶⁰

2. Related to the previous point, electricity transmission and distribution companies either have a state based network, or in the case of NSW, Victoria and Queensland, a more limited geographic footprint within parts of each state. This means that the \$5m cost threshold applies separately to each transmission or distribution company in relation to a relatively narrow network footprint (i.e. a collective total of \$15 million for the three electricity distributors in NSW, \$25 million for five electricity distributors in Victoria, \$10 million for the two electricity distributors in Queensland, and \$5 million for each of the single electricity distributors in the ACT, SA and Tasmania). Therefore, when the threshold for electricity distributors for NSW, Victoria, Queensland, the ACT, South Australia and Tasmania is combined (this excludes WA and the NT), the aggregate threshold is \$65 million. By contrast, NBN Co is constructing a national network, and it is reasonable that any cost threshold applied to it would reflect this basic difference in scale.
3. As NBN Co is primarily building a distribution network, rather than a 'transmission' network (although its transit network can be considered to be analogous to electricity transmission networks), minor changes to the network may need to be replicated across multiple sites in the network (e.g. approximately 1000 Fibre Access Nodes and 121 Points of Interconnection). Thus, relatively minor and reasonable modifications to the network design which require 'deep change' in the network can readily result in total expenditure that would exceed the cost threshold in a single electricity transmission or distribution network.

Based on the above reasons, NBN Co considers that it is in its legitimate business interests to continue to include a minor expenditure limit category in its Permitted Variations to the Network Design Rules. This is consistent with the views expressed by the AER and the AEMC that:¹⁶¹

The exemption would prevent a disproportionate use of resources and present unnecessary delays in the investment process.

Reflecting the differences in the scale and nature of the NBN compared to state-based electricity transmission companies, NBN Co considers that the Minor Expenditure Limit should initially be \$50 million. This recognises the following factors:

¹⁵⁷ National Electricity Rules, Rule 5.17.3.

¹⁵⁸ AER, *Final Decision - New South Wales distribution determination 2009–10 to 2013–14*, 28 April 2009, page xxix.

¹⁵⁹ *Ibid*, page xxx.

¹⁶⁰ AER, *Final Decision – Victorian electricity distribution network service providers: Distribution Determination 2011–2015*, October 2010, page vi.

¹⁶¹ Based on the AEMC's *2008 National Transmission Planning Arrangements Final Report to the Ministerial Council on Energy* and its *2009 Final Rule Determination, National Electricity Amendment (Regulatory Investment Test for Transmission)*.

- NBN Co is building a national network, rather than a geographically limited electricity transmission or distribution network, and the Minor Expenditure Limit should, in NBN Co's view, reflect at least 6 times the current cost threshold currently applicable to the electricity sector;
- NBN Co's annual capex program in Module 1 is at least 10 times the scale of electricity transmission companies and also significantly larger than that of even the largest electricity distributors, and it is reasonable that the Minor Expenditure Limit reflects at least that relativity;
- NBN Co is primarily constructing a distribution, rather than a transmission network, which means that minor network design changes may need to be replicated across hundreds if not thousands of sites. Even though the incremental cost at each site may be immaterial; over the entire network, this may not be the case.

Proposed SAU changes in Notice to Vary 29

The definition of Minor Expenditure Limit in the SAU Dictionary should be decreased to \$50 million from the current value of value of \$100 million.

Network Design Rule changes – customer engagement provisions to apply for first 5 years only

In the Draft Decision, the ACCC states that:¹⁶²

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.

NBN Co Response 45

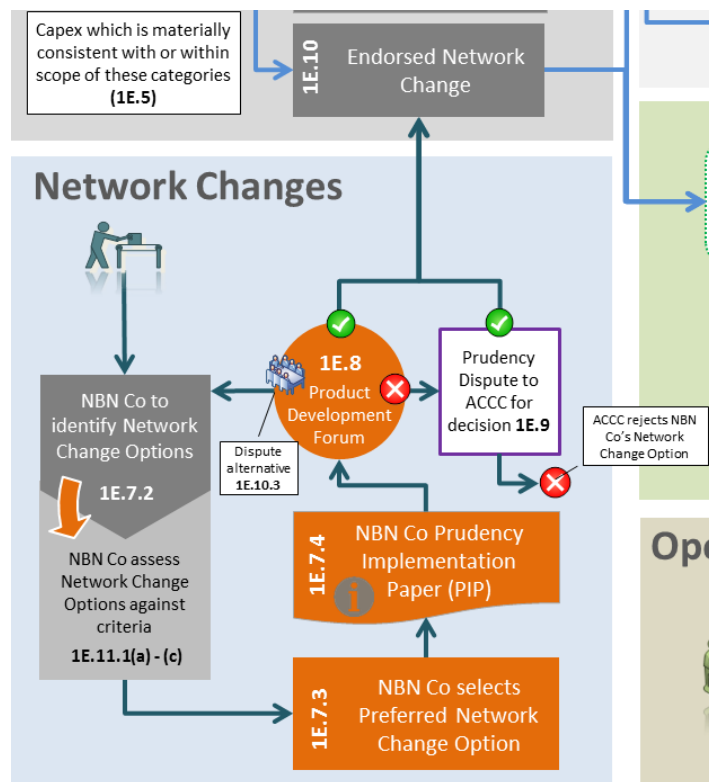
The customer engagement process in Schedule 1E should remain for the duration of Module 1.

Analysis

NBN Co does not support the ACCC's proposal that the customer engagement processes should only operate for the first five years of Module 1. Although the main focus of the relevant provisions in the SAU is on NBN Co's customer engagement and seeking customer endorsement of a proposed network change, there is also an important role for the ACCC in resolving prudency disputes if NBN Co and its Customers cannot reach agreement on the network change. This means that clauses 1E.7 to 1E.11 are more than just 'customer engagement' provisions, but rather are an integrated set of provisions that reserve a role for the ACCC in ensuring that network changes are made in an economically appropriate manner. This is captured in the diagram below, which is an extract from Figure C.1 in NBN Co's Supporting Submission on the SAU (lodged on 28 September 2012), highlighting the network change section of the overall prudency process.

¹⁶² Draft Decision, p.145.

Figure 2 - Network change section of overall prudency process



If the operation of the customer engagement provisions is restricted to the first five years of Module 1 and the ACCC does not accept a subsequent variation to include provisions for the second five years, NBN Co is concerned that certain provisions in schedule 1E may become ineffective and inoperable. That is, subsequent network changes may not be possible, or at least not capable of being incorporated into the network design rules that would be used in the prudency arrangements in Module 1. This uncertainty has the potential to reduce NBN Co's incentives to engage in efficient investment in the NBN, as it may be unclear whether even efficient investment would be permitted to be included in NBN Co's RAB.

Given the role reserved for the ACCC in resolving prudency disputes in clause 1E.9, NBN Co considers that the customer engagement provisions in Schedule 1E should remain in operation for the full 10 years of Module 1.

5.3.2.3 Rate of return

Risk free rate

In the Draft Decision, the ACCC states that it:¹⁶³

... 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.

¹⁶³ Draft Decision, p.153.

NBN Co Response 46

The current approach of using a 10 year risk-free rate in determining the nominal vanilla WACC should be maintained in Module 1.

Analysis

At the outset, NBN Co would highlight that the 350bp margin included in the LTRCM in Module 1 for determining the nominal vanilla WACC each year is inextricably linked to a 10 year risk free rate. NBN Co would have to reconsider the adequacy of that margin if any change were made to the basis of the risk-free rate to which it is applied. In this regard, the ACCC should be assessing the reasonableness of the LTRCM, and the SAU more generally, as a combined set of commitments, rather than considering each commitment or element individually.

In any event, Officer and Bishop support the use of a 10 year risk-free rate in their September 2012 expert report¹⁶⁴, and have recently prepared a supplementary report (as Bishop and Officer) that specifically addresses the ACCC's comments on this issue in the Draft Decision:¹⁶⁵

In our view, the NBN Co's approach to utilising a mean yield on 10 year CGS [Commonwealth Government Securities] to establish the risk free rate on an annual basis is both reasonable, having regard to the statutory criteria, consistent with commercial principles and practice and consistent with practice in other sectors and relevant jurisdictions.

We reject the notion that there should be any ". . . matching of the term of the risk free rate to the period during which it is applied . . ." i.e. the possibility of using a one year bond as proposed in the quote from the ACCC's Draft Decision above. Further we are of the view that an annual update of the WACC (using a 10 year CGS) reflects the reality of the asset roll-out over a long period of time than arguing that it ". . . should not be reset annually". - an argument that implicitly assumes the roll-out occurs at a point in time. [Emphasis added]

Consistent with Bishop and Officer's opinion, NBN Co notes that the use of a 10 year risk-free rate is consistent with practice both in telecommunications regulation and in other regulated sectors, and is not linked to the length of the period for which the WACC estimate will apply. Rather, it is justified by the long lived nature of the infrastructure being regulated and the empirical evidence regarding the observed financing practices of infrastructure businesses.

For example, in the telecommunications sector:

- In its Telstra Fixed Line Services FAD, the ACCC used a 10 year risk free rate to set prices for a three year period. In its Statement of Reasons, the ACCC states that:¹⁶⁶

As noted in the April 2011 Discussion Paper, Australian Commonwealth Government bonds are typically used as a proxy for the risk-free asset. The ACCC generally uses 10 year Commonwealth Government Securities (CGS) bonds.

- In its Wholesale ADSL FAD, the ACCC has again used a 10 year risk free rate and in this case it is to set prices for only a one year period. In its Statement of Reasons, the ACCC states that:¹⁶⁷

¹⁶⁴ Professor Bob Officer and Dr Steven Bishop, Report on WACC component of NBN Co's Special Access Undertaking, September 2012, p.20.

¹⁶⁵ Dr Steven Bishop and Professor Bob Officer, Supplementary report in relation to NBN Co's proposed Special Access Undertaking, 2 May 2013, p.2.

¹⁶⁶ ACCC, *Inquiry to make final access determinations for the declared fixed lines services*, Final Report July 2011, p.61.

¹⁶⁷ ACCC, *Public inquiry to make a final access determination for the Wholesale ADSL service*, Draft Report March 2013, p.54.

In updating its estimate of the risk free rate for the draft wholesale ADSL FAD, the ACCC has used the same Commonwealth Government Securities (CGS) bonds to calculate the risk free rate as adopted for the July 2011 FADs.

In its May 2009 Final Decision on the “Electricity transmission and distribution network service providers - Review of the weighted average cost of capital (WACC) parameters”, the AER adopted a 10 year risk free rate for use in the context of a 5 year regulatory period. The AER considered the arguments in favour of aligning the term of the risk free rate with the regulatory period, but concluded that:¹⁶⁸

In summary, having regard to all the relevant factors in the NER, the AER considers there is no persuasive evidence to depart from a 10-year term assumption for the risk-free rate.

In practice, infrastructure is not predominantly financed using short term debt, such as one or five year bonds. This is because a firm that relies on short term debt to finance long lived infrastructure exposes itself to high levels of refinancing risk.

That is, firms that rely on short term debt or have a lumpy debt maturity profile face increased risk of insolvency which imposes costs on both debt investors and equity investors. If a firm is required to raise all its debt in a few large lumps (or every year if it relied solely on one year bonds) then it would increase the likelihood that poor market conditions would threaten the viability of the business as a whole.

Existing debt holders could incur significant costs if the firm is cannot find new investors to borrow from to repay the existing debt. Therefore, if a firm adopts a debt management strategy that makes future debt raising more difficult, debt holders will expect a premium.

Similarly, equity investors will miss out on dividends, or need to participate in public equity raising, if a firm is close to insolvency because of poor debt management. This imposes cost on equity investors.

It is for these reasons that the observed debt management strategy of infrastructure businesses provides a guide as to efficient practices.

It is standard practice for infrastructure businesses to engage in staggered issuance of long term debt. This indicates that this approach minimises the cost of debt financing.

Australian and international infrastructure businesses of a similar nature to NBN Co tend to issue long-term debt, often maturing 10 years or more into the future. This is the case both for telecommunications based infrastructure businesses and for other infrastructure based businesses.

This is evident from Table 6 below, which shows the weighted average debt term at time of issue¹⁶⁹ for businesses operating in the following GICS¹⁷⁰ industries in Australia, the United Kingdom or the United States: Electric utilities, gas utilities, multi utilities, water utilities and highways & rail-tracks. Rather than use the GICS industry for integrated telecommunications services, Table 6 uses Bloomberg’s BI functionality to identify incumbent telecommunication operators (labelled ‘Telecoms infrastructure’), as this better captures businesses of a similar nature to NBN Co. The number of businesses in each category is given in brackets.

¹⁶⁸ AER, *Electricity transmission and distribution network service providers - Review of the weighted average cost of capital (WACC) parameters*, Final Decision, 2009, p.173.

¹⁶⁹ The weighted average debt term at time of issue represents the average number of years between the issue date and maturity date weighted by the total amount outstanding for all currently active bonds and loans issued by the business and its subsidiaries according to Bloomberg.

¹⁷⁰ GICS stands for Global Industry Classification System, <http://www.msci.com/products/indices/sector/gics/>

Table 6 demonstrates that the weighted average debt term from the date of issue for all 108 companies in this sample is 17.4 years. The average for the 13 businesses in Australia is 10.7 years. The average for the 9 telecommunications infrastructure businesses is 16.2 years.

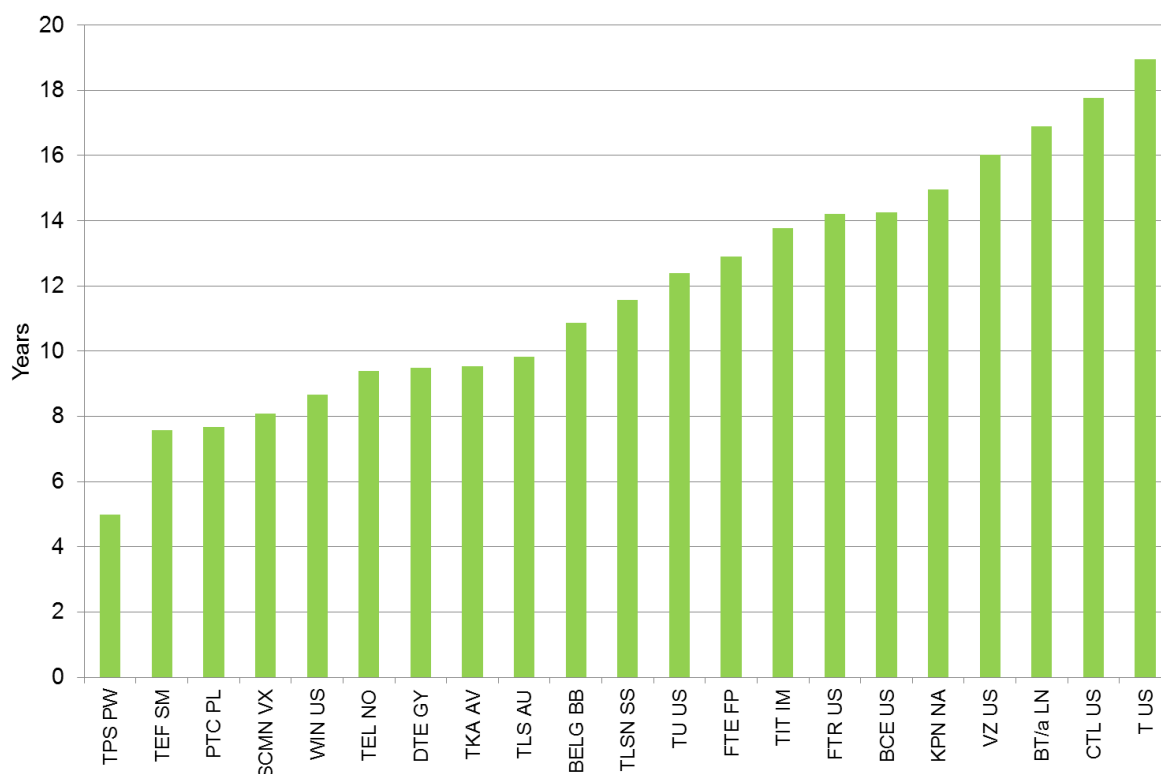
Table 6 - Weighted average debt term from date of issue

Years (# businesses)	AU	GB	US	AVERAGE
Electric Utilities	8.4 (2)	15.9 (2)	18.1 (31)	17.7 (35)
Gas Utilities	14.2 (2)	N/A	15.1 (22)	14.9 (24)
Multi Utilities	9.2 (3)	18.3 (2)	18.9 (21)	18.4 (26)
Water Utilities	N/A	22.5 (4)	21.5 (10)	22.2 (14)
Highways & Rail-tracks	13.1 (3)	N/A	N/A	13.1 (3)
Telecoms infrastructure	9.8 (1)	16.9 (1)	16.7 (4)	16.2 (6)
AVERAGE	10.7 (11)	18.8 (9)	17.7 (88)	17.4 (108)

Source: Bloomberg

In an expanded sample of 21 telecommunications infrastructure businesses - which includes incumbent telecoms operators from around Europe and also Canada (listed in the US) - the weighted average debt term at time of issue is 11.9 years. This is illustrated in Figure 3 below.

Figure 3 - Weighted average debt term at time of issue



Source: Bloomberg

In light of the above, NBN Co submits that it is appropriate to use a 10 year risk-free rate in determining the nominal vanilla WACC in Module 1.

5.3.2.4 Depreciation

In the Draft Decision, the ACCC states that:¹⁷¹

... 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.

NBN Co Response 47

The current approach of not specifying the asset lives to be used in Module 1 should be maintained; noting that the asset lives used must be consistent with NBN Co's statutory accounts (and so must be consistent with relevant accounting standards in any event).

Analysis

As a practical matter, NBN Co is not in a position to specify all relevant asset lives for Module 1 because many aspects of the network are still being built. The overall approach of Module 1, calculating the ABBRR at the end of each year based on prudently incurred opex and capex, is intended to avoid the need to use forecasts, including in relation to asset lives.

Although this approach is unconventional, it has little practical consequence, and (as discussed below) the asset lives used must be consistent with relevant accounting standards in any event. As noted by the ACCC, there is no contemporaneous link between prices and the ABBRR until the ICRA is extinguished. Under NBN Co's Corporate Plan, the ICRA is not expected to be extinguished by the end of the SAU term, and even if conditions were significantly more favourable than forecast in the Corporate Plan, it is highly unlikely that the ICRA would be extinguished by the end of Module 1. As a consequence, any changes in asset lives during Module 1 are highly unlikely to affect prices over that period – the most likely effect would be a reallocation between the values of the RAB and the ICRA (the sum of the RAB and the ICRA would be unchanged).

NBN Co notes that the SAU requires that the asset lives used in the LTRCM be determined in a manner consistent with NBN Co's audited accounts. In preparing its audited accounts, NBN Co has to follow the relevant accounting standards, including in relation to asset lives. As discussed in section 5.3.2.1, NBN Co proposes amending the SAU so that the ACCC, rather than NBN Co, will be responsible for applying the LTRCM during Module 1, so the ACCC would have a direct role in ensuring that the asset lives used in that context were consistent with the requirements in the SAU.

In view of these various factors, it is appropriate for the SAU to not specify the asset lives to be used to depreciate NBN Co's capital expenditure during Module 1. It should be noted that in Module 2, the SAU provides for a more conventional approach, with asset lives specified as part of each replacement module, for review and assessment by the ACCC (but still consistent with NBN Co's audited accounts, which is appropriate in any event and in NBN Co's legitimate business interests).

¹⁷¹ Draft Decision, p.154.

5.3.2.5 Annual construction in progress allowance

In the Draft Decision the ACCC states:¹⁷²

... 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 prudency requirements.

Even if it was clear that the capital expenditure prudency 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 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.*

NBN Co Response 48

NBN Co proposes to amend the SAU to clarify that construction in progress will only be included in the LTRCM in Module 1 to the extent that it is prudently incurred. NBN Co has separately proposed that the ACCC have a direct role in applying the LTRCM in Module 1.

Analysis

The intention of the SAU is that only construction in progress that has been prudently incurred (consistent with the SAU) should be included in any calculations. This is reflected in clause 1E.2.4(a), which refers to "Prudently incurred Capital Expenditure that has not been Placed in Service (Construction in Progress or CIP)". However, to further clarify that this is how the SAU actually operates, NBN Co proposes a number of drafting amendments as set out below.

In respect of the proposal by the ACCC that it should calculate the values of the annual construction in progress allowance that is included in NBN Co's annual revenue requirements, this is addressed in NBN Co's proposed amendments to the ex-post compliance approach, as discussed in section 5.3.2.1.

¹⁷² Draft Decision, pp.154-155.

Proposed SAU changes in Notice to Vary 30

Include new clause 1E.2.4(c):

“(c) Construction in Progress will be considered to be Prudently incurred if the ACCC is satisfied that the Capital Expenditure incurred in connection with the relevant asset not yet Placed in Service meets the requirements of clauses 1E.3 to 1E.11 (with all references to Capital Expenditure in those clauses considered to be references to Capital Expenditure in connection with the relevant asset not yet been Placed in Service).”

Insert in clause 1E.2.4(b) after the words “Prudently incurred” the following “as determined by the ACCC under clause 1E.2.4(c)”

(Note, this is captured in the proposed drafting in relation to the ex-post compliance approach in Module 1 - refer to Appendix C, section 5.)

5.3.2.6 Tax allowance

Gamma

In the Draft Decision, the ACCC states:¹⁷³

... 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.

NBN Co Response 49

NBN Co proposes that the value of gamma, where relevant for a given Financial Year, should be determined based on the most recent regulatory precedent. NBN Co notes that it may not be necessary to determine such a value for any Financial Year during Module 1.

Analysis

NBN Co submits that the gamma value proposed in the SAU of 0.25 is a reasonable value at this point in time, and reflects recent relevant regulatory decisions. However, NBN Co notes that it may not be necessary to apply a gamma value in any Financial Year during Module 1 given that NBN Co is unlikely to be in a tax paying position until sometime during Module 2. NBN Co proposes that, if required, the value of gamma should be determined at the time the ABBRR is calculated by incorporating the most recent regulatory decision that was made prior to the commencement of the relevant Financial Year. This is consistent with the approach taken in determining the WACC in Module 1, which uses a risk free rate established just prior to the commencement of the relevant Financial Year.

¹⁷³ Draft Decision, p.157.

Proposed SAU changes in Notice to Vary 31

Clause 1F.8.5(a) to be replaced with the following:

- (a) Impact of dividend imputation franking credits (“gamma”): will be updated to be equal to the value of the gamma parameter Finally Determined by a Relevant Regulatory Body in its most recent consideration, prior to the commencement of each Financial Year after the First Financial Year in the Initial Regulatory Period, under Part IIIA or Part XIC of the Competition and Consumer Act. As at the SAU Commencement Date, and until the end of the First Financial Year, the gamma will be 0.25.

The following definitions to be included in the SAU Dictionary

Relevant Regulatory Body means the ACCC, the Australian Energy Regulatory (AER) or the Australian Competition Tribunal (ACT) (to the extent that the ACT is exercising the powers of the ACCC or AER)

Finally Determined means a decision, determination or other direction which is final and in respect of which all appeals and avenues for review have been exhausted or the timeframe for an appeal or review has expired.

(Note, this is captured in the proposed drafting in relation to the ex-post compliance approach in Module 1 - refer to Appendix C, section 5.)

Alignment of LTRCM with relevant tax law

In the Draft Decision, the ACCC states:¹⁷⁴

... 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.

NBN Co Response 50

NBN Co has considered Telstra’s comments and proposes some amendments to the calculation of the tax allowance in Module 1 relating to capital gains, capital losses, items not tax deductible and the treatment of assets received for nil consideration.

Analysis

After reviewing the calculation of the tax allowance in Module 1, NBN Co has identified some refinements that are necessary to more closely align the calculation with relevant tax treatments so as to avoid over or under-compensation for corporate taxation. Although the calculation of the tax allowance as set out in Module 1 is appropriate in general, the calculation of taxable profit should be subject to:

¹⁷⁴ Draft Decision, p.157.

- the inclusion of any capital gains and the inclusion of any capital losses only to the extent that they are offset by any capital gains – this is consistent with a point raised by Telstra in its submission¹⁷⁵. NBN Co considers it unlikely that capital gains and losses will be a factor in Module 1, but the LTRCM should nonetheless be capable of treating them appropriately should they occur;
- the exclusion of any items to the extent that they are not deductible - this is again consistent with a point raised by Telstra in its submission¹⁷⁶. At this stage, NBN Co does not envisage that this would be a factor in Module 1, but the LTRCM should nonetheless be capable of treating non-deductible items appropriately should they occur; and
- the treatment of assets received by NBN Co for nil consideration – NBN Co receives pit and pipe assets from developers in greenfields estates and, although ascribed a zero value in the RAB, the tax treatment of these assets may be somewhat different, involving the fair value of the assets being treated as taxable income in the year in which the assets are received and a commensurate flow of tax depreciation being allowed in future years. Given the significant volume of assets that NBN Co is likely to receive on this basis over the course of Module 1, it is important for the LTRCM to make appropriate provision for the associated tax treatment or else the calculation of taxable profit may be subject to material distortion.

Proposed SAU changes in Notice to Vary 32

In Clause 1F.8.3, after

“Taxable Profit_t is the calculated profit which is subject to taxation calculated as follows”
insert

“, but subject, for the purposes of corporate taxation: (i) to the inclusion of any capital gains; (ii) the inclusion of any capital losses (but only to the extent that they are offset by any capital gains); (iii) the exclusion of any items to the extent that they are not deductible; and (iv) to the treatment of assets received by NBN Co for nil consideration”

(Note, this is captured in the proposed drafting in relation to the ex-post compliance approach in Module 1 - refer to Appendix C, section 5.)

5.3.3 LTRCM – Module 2

The ACCC has identified a number of specific issues with the operation of the Long Term Revenue Constraint Methodology (LTRCM) in Module 2, primarily relating to the level of detail that is appropriate to include in the SAU drafting now, as compared to at a later date via a variation.

5.3.3.1 Criteria and methodologies for determining forecasts

Capital expenditure and Operating expenditure

In the Draft Decision, the ACCC states that, in relation to capital expenditure, it:¹⁷⁷

... 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).

...

¹⁷⁵ Telstra Submission, January 2013, p.78.

¹⁷⁶ Telstra Submission, January 2013, p.78.

¹⁷⁷ Draft Decision, p.163.

In light of these issues, the Consultation Paper on the Notice to Vary proposes that the SAU be varied to remove the criteria.

The ACCC goes on to state that, in relation to operating expenditure:¹⁷⁸

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).

NBN Co Response 51

NBN Co proposes to remove the capital expenditure and operating expenditure forecasting criteria, but retain recognition of the deemed prudent expenditure categories from Module 1.

Analysis

Although it expects that they would prove to be relatively robust and flexible over time, NBN Co is nonetheless, subject to one exception, willing to remove the capital expenditure and operating expenditure forecasting criteria from the SAU. The one exception relates to the treatment of certain categories of Operating Expenditure and Capital Expenditure that are deemed prudent in Module 1. Although many of those deemed prudent categories are unlikely to be relevant in Module 2 (such as expenditure in relation to the interim solution for the NBN Co Satellite Network), other categories will be both relevant and ongoing throughout the SAU (such as expenditure in relation to the Telstra Arrangements, which in Module 2 will relate to ducts, dark fibre, exchange space and tower access).

NBN Co notes that in the Draft Decision the ACCC has accepted the use of the deemed prudent categories in Module 1:¹⁷⁹

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.

Proposed SAU changes in Notice to Vary 33

- Clause 2.6.1(a) – delete existing provisions and substitute “Operating Expenditure forecasts must be based on the expected value of prudent and efficient Operating Expenditure, and any amounts to be incurred in the categories of Operating Expenditure of the same type referred to in clause 1F.7.2 will be deemed to reflect prudent and efficient costs.”
- Clause 2.6.1(b) – delete existing provisions and substitute “Capital Expenditure forecasts must be based on the expected value of prudent and efficient Capital Expenditure, and any amounts to be incurred in the categories of Capital Expenditure of the same type referred to in clause 1E.3.2 will be deemed to reflect prudent and efficient costs.”

¹⁷⁸ Draft Decision, p.163.

¹⁷⁹ Draft Decision, p.148.

Revenue

NBN Co notes that the ACCC made no comments in the Draft Decision or in the Consultation Paper in regard to the criteria for Revenue forecasts as set out in clause 2D.6.1(c) of the SAU. In view of this, NBN Co proposes no changes to these criteria.

In any event, NBN Co notes that the criteria for Revenue forecasts are intended to provide broad guidance only and should allow adequate latitude for the revenue forecasting approach to develop as required over time.

Cost of capital

In the Draft Decision, the ACCC states that:¹⁸⁰

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 away business-specific risk and therefore investors will only require compensation for bearing non-diversifiable or systematic risk.*
- *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.

The ACCC goes on to state that:

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.

¹⁸⁰ Draft Decision, pp.164-165.

NBN Co Response 52

NBN Co proposes to maintain the current references in the SAU to the nominal vanilla WACC, but greatly reduce the level of detail in clause 2D.2.1(a)(iii)(A) regarding how the nominal vanilla WACC should be forecast. At the same time, NBN Co's proposed amendments provide appropriate assurance to NBN Co that it will have the opportunity to earn a normal commercial rate of return on its investment.

Analysis

NBN Co is surprised by many of the ACCC's comments in relation to the WACC principles included in Module 2 and is concerned that the ACCC's proposed changes to the SAU are a disproportionate response to the issues raised in the Draft Decision, and are inconsistent with NBN Co's legitimate business interest of having an appropriate degree of investment certainty.

In relation to the ACCC's comments in relation to the WACC principles included in Module 2, NBN Co makes the following observations.

- **Nominal vanilla WACC** – Given that the specified elements of the ABBRR include an operating expenditure component, a return on capital component, a regulatory depreciation component and a separate (corporate income) tax allowance component, it logically follows that the rate of return applied to the RAB to calculate the return on capital component should not include any compensation in respect of corporate income tax. This is why the rate of return is specified in Module 2 of the SAU to be a "vanilla WACC". The rate of return is further specified as a "nominal" vanilla WACC because this is consistent with how the regulatory depreciation component is calculated; specifically, that it is net of the CPI indexation of the RAB.

The ACCC's comment that the nominal vanilla WACC may not always reflect best practice in commercial and regulatory contexts is directly contradicted by Bishop and Officer in their supplementary report.¹⁸¹

It is well accepted that a regulated business should be able to earn a fair rate of return on its investment in assets. Unless this is so it will be unable to raise capital to refresh and build assets as well as finance working capital. The RAB captures the investment in long term assets and provides a basis for estimating the fair rate of return in dollar terms. This investment is independent of the manner of financing. An estimate of the WACC is then applied as the final step to reflect the financing mix.

There are numerous forms for the WACC usually differing in the way tax is treated e.g. before tax, after notional tax on operations, after actual tax. For each form of the WACC there is a corresponding 'consistent' definition of cash flows. A particularly attractive feature of the nominal vanilla WACC is that it does not contain a tax term and thereby assigns all tax calculations to the cash flow estimates. This enables separate modelling of annual tax estimates to reflect the tax regime and the tax rates anticipated to apply in the future.

While we cannot foresee the future with absolute certainty, we are confident that a nominal vanilla WACC will continue to be best practice in a regulatory environment and a nominal WACC (or its real counterpart) will be best practice in a commercial environment for the term of the SAU.

¹⁸¹ Dr Steven Bishop and Professor Bob Officer, Supplementary report in relation to NBN Co's proposed Special Access Undertaking, 2 May 2013, pp.5-6.

...

The use of the nominal vanilla WACC (and its' real counterpart) is best suited to circumstances where the amount of interest payable in the future is 'known' or estimable. This is certainly the case in the regulatory environment in which, importantly, the NPV = 0 principle equates book and market values, making the amount of debt and interest well defined for cash flow modelling.

We cannot envisage what concern the ACCC may have about the use of a nominal vanilla WACC over the term of the SAU. [Emphasis added]

- **Risks rather than “systematic risks”** – NBN Co draws the ACCC’s attention to clause 6.5.2(c) of the National Electricity Rules (NER), which refers to “risks” rather than “systematic risks” in regard to how it states the allowed rate of return objective for Distribution Network Service Providers.

The allowed rate of return objective is that the rate of return for a Distribution Network Service Provider is to be commensurate with the efficient financing costs of a benchmark efficient entity with a similar degree of risk as that which applies to the Distribution Network Service Provider in respect of the provision of standard control services (the allowed rate of return objective). [Emphasis added]

Although NBN Co understands the ACCC’s comments in regard to the distinction between risk and systematic risks, as with the NER clause above, the drafting of the WACC clause in Module 2 would not lead to NBN Co being unduly compensated in regard to the risks it faces.

- **Effect on systematic risk if NBN Co provides services that fall outside the definitions of the NBN Access Service, Ancillary Services or Facilities Access Service** – If NBN Co were to provide services such as a Layer 1 unbundled service then all revenue and expenditure associated with the provision of that service would be captured by the LTRCM. To the extent that there is any uncertainty regarding the ability to appropriately set the nominal vanilla WACC to account for the provision of such a service, this can be addressed by amending clause 2D.2.1(iii)(A) to refer to “the provision of services using the Relevant Assets”, instead of “providing the NBN Access Service, Ancillary Services and Facilities Access”. (This is part of the amendment proposed below.)
- **Benchmarking approach** – The only reference to benchmarks in the Module 2 WACC principles is in relation to financing structure. Unless the ACCC anticipates basing the rate of return on NBN Co’s actual financing structure, then the only option (consistent with close to 2 decades of Australian regulatory practice) is to use some form of benchmark financing structure.

In relation to the ACCC’s proposed changes to the SAU, NBN Co is concerned that, despite stating that it “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”¹⁸², the only assurance that the ACCC proposes including in Module 2 is that the ABBRR should include a “return on capital”. This is manifestly inadequate in terms of providing NBN Co with an appropriate degree of investment certainty and would be unacceptable in any regulatory context.

¹⁸² Draft Decision, p.165.

Although NBN Co considers that the existing WACC principles remain appropriate (subject to potentially making the change noted above in regard to expanding the range of services relevant when considering risks) and noting that the level of the WACC proposed according to those principles would be subject to ACCC review, NBN Co nonetheless proposes some amendments to the SAU in light of the ACCC's concerns. These changes would maintain the current references in the SAU to the nominal vanilla WACC, but greatly reduce the level of detail in clause 2D.2.1(a)(iii)(A) regarding how the nominal vanilla WACC should be estimated. NBN Co's proposed amendments are intended to provide some assurance to NBN Co that it will have the opportunity to earn a normal commercial return on its investment.

Proposed SAU changes in Notice to Vary 34

Replace existing clause 2D.2.1(a)(iii)(A) with "a nominal vanilla WACC, estimated for the Regulatory Cycle and commensurate with the efficient financing costs for an entity with a similar degree of risk as that which applies to NBN Co in respect of the provision of services using the Relevant Assets."

Depreciation

In the Draft Decision, the ACCC states that:¹⁸³

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 is most relevant once the initial cost recovery period has concluded and depreciation directly affects the annual revenues that NBN Co may earn ...

...

The ACCC is therefore not satisfied that:

- *locking in a straight-line depreciation approach for the duration of Module 2; and*
- *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.

NBN Co Response 53

NBN Co proposes to maintain the treatment of depreciation in Module 2.

Analysis

Having reviewed the ACCC's comments in the Draft Decision, NBN Co does not consider the SAU needs to be changed in relation to the treatment of depreciation in Module 2. There are a number of reasons for this.

¹⁸³ Draft Decision, pp.165-166.

First, that treatment is in NBN Co's legitimate business interests because it avoids the risk of arbitrary changes in the regulatory depreciation profile that may, once the ICRA is extinguished, directly affect operating cash flows in a significant and unexpected manner. Were NBN Co exposed to such a risk (as would be possible under the ACCC's proposed changes, which include no provisions to guide or to place limits on the ACCC's decision in this regard), it could lead to NBN Co being unable to establish and maintain efficient financing arrangements.

Second, the ACCC's concerns in regard to the Module 2 depreciation approach are in response to an unexplained set of possible future "circumstances". The hypothetical nature of these "circumstances" does not justify the significant change to the SAU proposed by the ACCC.

Third, there is no reason to believe that straight line depreciation will not be appropriate in the future and indeed every reason to consider that it will be appropriate. As concluded by Synergies in its expert report:¹⁸⁴

Synergies considers that straight line depreciation can reasonably be expected to be efficient based on the following:

- *the approach is widely adopted in financial markets, corporate accounting and regulatory practice;*
- *there are considerable complexities involved in the application of alternative approaches and variants of straight line depreciation, which reflect factors such as technological obsolescence and stranding. These offset the advantages they may have; and*
- *none of the alternatives in the context of the NBN is demonstrably superior to straight line depreciation such that they can reasonably be expected to result in more efficient outcomes.*

Fourth, the ACCC appears to have confused revenue and pricing in considering how the SAU would promote efficient use of the NBN. Efficient use of the NBN is directly related to NBN Co's pricing, but is only indirectly related to NBN Co's revenue even once the ICRA is extinguished. For any given level of revenue to be recovered there are always more and less efficient ways to structure prices to recover that revenue, and the more sophisticated the pricing approach the more efficient the outcome will be, all else the same, in terms of use of the network. In this context, NBN Co's pricing structure is relatively sophisticated, being built at a high level around a two part tariff approach (AVC and CVC), and combined with a multitude of different AVC speed tiers, different traffic classes and additional product features such as multicast.

In view of this, unless the ACCC is contemplating something radical (and noting Synergies' comments above in regard to the complexities involved in applying alternatives to straight line depreciation), any effect on the efficient use of the network from of any change in depreciation approach during Module 2 would be second order in nature.

Fifth, in regard to how asset lives are determined, NBN Co considers that the SAU already makes appropriate provision for changes in depreciation rates to deal with changing circumstances and involves an appropriate role for the ACCC in approving asset lives:

- as in Module 1, the SAU requires the asset lives used in Module 2 to be consistent with NBN Co's audited accounts, so the asset lives would have to be consistent with relevant accounting standards;

¹⁸⁴ Synergies Expert Report, September 2012, p.79.

- if there is a change in circumstances, due perhaps to a change in technology or to a competitive threat, then NBN Co may (and, indeed, may be required to), consistent with relevant accounting standards, make some changes to the asset lives in its audited accounts; and
- the asset lives proposed by NBN Co in Module 2 are subject to ACCC approval as part of the Replacement Module Application Process discussed in section 2.5 above.

Taken together, NBN Co considers the treatment of depreciation in Module 2 is appropriate – it will promote the efficient use of the NBN and is also consistent with NBN Co's legitimate business interests.

Tax allowance

In the Draft Decision, the ACCC states that:¹⁸⁵

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.

...

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.

NBN Co Response 54

NBN Co proposes to remove the tax allowance factors in Module 2 and make a change to require consistency with other elements of the LTRCM.

Analysis

As discussed in relation to the cost of capital above, NBN Co does not agree with the ACCC's comments and proposed SAU changes in regard to the use of a nominal vanilla WACC, and likewise NBN Co does not accept the ACCC's overall comments in regard to the tax allowance provisions in Module 2.

In their supplementary report, in response to the ACCC's comments, Bishop and Officer:¹⁸⁶

¹⁸⁵ Draft Decision, pp.166-167.

¹⁸⁶ Dr Steven Bishop and Professor Bob Officer, Supplementary report in relation to NBN Co's proposed Special Access Undertaking, 2 May 2013, p.7.

A key advantage of using a plain vanilla WACC is that it is agnostic with regard to taxes. All taxes are dealt with in the cash flow component of the building block approach rather than the WACC. This enables actual taxes to vary from year to year rather than assuming some representative tax rate across the overall time period as would be necessary to use a WACC adjusted for taxes. Consequently modelling different tax scenarios is far more flexible with the use of a plain vanilla WACC than with the alternative definitions of WACC. Put another way, it is much easier (the only real way) to obtain consistency between the cash flow components of the building block approach and definition of the WACC.

These comments also apply to any changes in the tax regime itself i.e. away from the current corporate tax, imputation tax and deduction environment.

Nonetheless, NBN Co proposes to remove the factors set out in clause 2D.2.1(a)(iv), and to make a change to the introduction to the list of factors to ensure that the tax allowance is set consistent with the other elements of the LTRCM.

Proposed SAU changes in Notice to Vary 35

Replace existing clause 2D.2.1(a)(iv) (including the factors in (A) to (G)) with “a forecast tax allowance for year t, which is determined consistent with the other elements of the Long Term Revenue Constraint Methodology.”

5.3.3.2 Length of Regulatory Cycle

In the Draft Decision, the ACCC states that:¹⁸⁷

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.

NBN Co Response 55

NBN Co has proposed, as part of the amended Replacement Module Application process, to confer a power on the ACCC to determine the length of each Regulatory Cycle.

Analysis

As discussed in section 2.5 above, NBN Co proposes changes to the SAU that would confer a power on the ACCC to determine the length of each Regulatory Cycle (referred to in the SAU as the Replacement Module Term). This addresses the ACCC’s comments in the Draft Decision and does so in a manner that is integrated with NBN Co’s proposed approach for the Replacement Module Application process.

¹⁸⁷ Draft Decision, p.167.

5.3.3.3 Rolling forward the RAB

In the Draft Decision, the ACCC states that it is:¹⁸⁸

... 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'.

...

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.

NBN Co Response 56

NBN Co proposes amendments to the SAU to avoid locking in the aspects of the RAB roll forward that are of concern to the ACCC, but will require that a RAB Roll Forward Arrangement is put in place (either through an accepted Replacement Module Application or ACCC Replacement Module Determination) prior to the commencement of each Regulatory Cycle.

Analysis

NBN Co understands the issues raised by the ACCC, which are based in part on recent developments in electricity network regulation.

As discussed in section 2.5 above, NBN Co proposes to amend the Replacement Module Application process so that any application must include a RAB Roll Forward Proposal that sets out the detailed roll forward provisions proposed to apply for the next Regulatory Cycle and will be subject to review and, possible determination, by the ACCC.

To give effect to this, NBN Co proposes amending clause 2D.7.1(b) of the SAU so that it links to a set of RAB Roll Forward Arrangements for a given Regulatory Cycle. The proposed drafting defines RAB Roll Forward Arrangements in such a way that it takes up either NBN Co's RAB Roll Forward Proposal, if accepted by the ACCC as part of a Replacement Module Application, or in the event of non-acceptance by the ACCC, the ACCC Replacement Module Determination.

The RAB Roll Forward Proposal may specify one of two options for how capital expenditure can be rolled into the RAB:

- Actual capital expenditure; or
- Actual capital expenditure up to the forecast used to set the ABBRR, with any amount beyond that level subject to prudence assessment by the ACCC (subject to acceptable prudence criteria being set out in the varied SAU (i.e. where a Replacement Module Application is accepted by the ACCC) or as part of the ACCC Replacement Module Determination).

In relation to depreciation, the RAB Roll Forward Proposal may specify one of two options:

- the value of forecast real straight line depreciation used in forecasting the ABBRR; or

¹⁸⁸ Draft Decision, pp.168-169.

- the straight line depreciation applicable to the opening real value the RAB in the current Financial Year, determined using asset lifetimes consistent with those used in forecasting ABBRR),

In relation to disposals, the RAB Roll Forward Proposal does not provide alternative options. Instead, the RAB Roll Forward is based on the value of assets actually disposed in a given Financial Year. This is appropriate given the nature of disposals, which are expected to be of relatively limited value as compared to capital expenditure over the course of the SAU.

NBN Co's proposed amendments avoid locking in the aspects of the RAB roll forward that are of the greatest regulatory concern; namely the use of actual capital expenditure and actual depreciation. At the same time, NBN Co's legitimate business interests are appropriately recognised by ensuring that the details of the RAB roll forward (including in relation to an ex-post prudency assessment) are specified *in advance* for any given Regulatory Cycle and are consistent with the expected NPV=0 criterion. NBN Co's proposed changes are also consistent with its comments above in relation to the use of the nominal vanilla WACC and the straight line depreciation method (in that the RAB roll forward still involves the use of straight line depreciation and a half WACC adjustment).

Proposed SAU changes in Notice to Vary 36

Incorporate the RAB Roll Forward Arrangement approach in Module 2 – refer to proposed drafting in Appendix C, section 6. (This should be read together with the proposed drafting for the amended Replacement Module process – refer to Appendix C, section 1.)

5.4 Additional price-related variations

As discussed in section 1 NBN Co has identified a small number of areas in the SAU that it considers should be varied in order to provide increased clarity as to the intended operation of the SAU. Those that are associated with pricing-related clauses are tabulated below, along with NBN Co's rationale for suggesting that they be included in a Notice to Vary the SAU. In most cases, these are simple drafting amendments that more explicitly define the Non-Reference Offers, which should avoid ambiguity in future, and also better aligns with drafting in NBN Co's Wholesale Broadband Agreement.

Table 7 - Price-related variations proposed by NBN Co

Ref	SAU clause reference	Variation proposed by NBN Co	Rationale for proposed variation
1	1C.1.2(a)(ii) – new clause inserted, does not replace existing clause.	Introduce a new clause which states: “in respect of the Connectivity Virtual Circuit Offer (TC-1 or TC-4), from the date that each Connectivity Virtual Circuit Offer (TC-1 or TC-4) is available for supply by NBN Co”	A number of these CVC tiers have not yet been introduced by NBN Co. The intention is that once introduced, the tiers described in this Schedule would become Reference Offers at the same Maximum Regulated Price as other CVC tiers, and not be withdrawn. This clause clarifies that they may not be available as at the Commencement Date of the SAU but that once introduced they will be Reference Offers.
2	1C.2.5	Separate out the different traffic classes in this table so that they each have their own row. In addition, change the name of the reference offer from “Connectivity Virtual Circuit Offer (TC-1 and TC-4)” to “Connectivity Virtual Circuit Offer (TC-1 or TC-4)”	Ensures that there is no doubt about the fact that each line item is a separate offer and that it does not imply that “TC-1 (CIR) and TC-4 (CIR)” means that this combination is an offer in its own right. This ensures that each Reference Offer is uniquely defined and removes any ambiguity in definition.

Ref	SAU clause reference	Variation proposed by NBN Co	Rationale for proposed variation
3	Schedules 1C, 1D	150kbps (TC-1) be changed to 0.15Mbps (TC-1).	WBA Price list has been modified to 0.15Mbps, and this definition is more technically correct.
4	1D.2.4	Separate out the different traffic classes so that they each have their own row, similar to the approach adopted currently in 1D.3.1(c)	Ensures that there is no doubt about the fact that each line item is a separate offer and that it does not imply that "TC-1 and TC-2" means that this combination is an offer in its own right. This ensures that each Non-Reference Offer is uniquely defined and removes any ambiguity in definition.
5	1D.2.6	Separate out the different traffic classes so that they each have their own row/column, similar to the approach adopted currently in 1D.3.1(e)	Ensures that there is no doubt about the fact that each line item is a separate offer and that it does not imply that "TC-2 and TC-3" means that this combination is an offer in its own right. This ensures that each Non-Reference Offer is uniquely defined and removes any ambiguity in definition.
6	1D.2.7	Change to "Multicast AVC Offers"	Ensures that there is no doubt about the fact that each line item in the price table is a separate Non-Reference Offer, consistent with other tables in this Schedule.
7	1D.2.8	Change to "Multicast Domain Offers"	Ensures that there is no doubt about the fact that each line item in the price table is a separate Non-Reference Offer, consistent with other tables in this Schedule.
8	1D.2.9 [NEW clause]	<p>Include separate section for "Multicast Media Stream Offers".</p> <p>This would be implemented by:</p> <ul style="list-style-type: none"> • creating a new clause 1D.2.9, which will define the "Multicast Media Stream Offers"; • including the new defined term in the SAU Dictionary; • deleting the reference to "Media Streams" from the Multicast Domain Offer in clause 1D.2.8 (as these will now be separate offers) 	Ensures that each price tier for media streams is a separate Non-Reference Offer, and ensure that that there is only one price point for each Multicast Domain Offer.
9	1D.3.1(f)	Change to "Multicast AVC Offers"	Aligns with proposed change to 1D.2.7.
10	1D.3.1(g)	Change to "Multicast Domain Offers", and do not include part (ii).	Aligns with proposed change to 1D.2.7.
11	1D.3.1(h) [NEW clause]	Include separate section for "Multicast Media Stream Offers"	Aligns with proposed addition of new clause 1D.2.9.
12	1D.3.2(a)	Change the Subsequent Installation charge to "Hourly Labour Rate plus cost of materials, charged for a minimum amount equivalent to 3.67 hours".	Subsequent Installation is currently subject to a minimum charge of \$270, which translates to 3.67 hours at the current Hourly Labour Rate of \$75 per hour.
13	1D.3.2(a)	Change price of NNI 1000BaseT setup from "\$,1000" to "\$1,000"	Typographical error.
14	1D.3.2(b)	Change the name of the activity "Rearrangement/Modification" to "Equipment modification (attendance at Premises required)"	Reflects change made in WBA Price List, and ensures SAU charge is appropriately aligned.
15	1D.3.2(a) to (c)	In the tables, remove the column headed "Chargeable unit".	The information in the column is redundant. It is not relevant for how the charges are applied.

Ref	SAU clause reference	Variation proposed by NBN Co	Rationale for proposed variation
16	1D.3.2(a) to (d)	In the tables, change the column heading to "Chargeable activity".	This accounts for the fact that not all of the charges listed are for a set amount. Some are based on the Hourly Labour Rate, or the Hourly Labour Rate plus cost of materials.
17	1F.8.1	In the formula for <i>Net Real Capex_{i,k}</i> , change the subscript on the nominal vanilla WACC from "t" to "k".	This is to correct a typographical error in the formula.
18	2D	Change "forecast nominal vanilla WACC" to "estimated nominal vanilla WACC".	This is to correct a slight technical mischaracterisation – the nominal vanilla WACC in Module 2 will be estimated rather than forecast in respect of each Regulatory Cycle. In any formulas in respect of Module 2, there will still be a superscript "F" applied to the WACC and this will differentiate the WACC as calculated in Module 2 from the WACC as calculated in Module 2.
19	Section 1 of Attachment C to the main body	Change the definition of Hourly Labour Rate to "Hourly Labour Rate means, at the SAU Commencement Date, \$75 per hour, rounded up to the next full hour required to perform the relevant activity".	This is to align with how the Hourly Labour Rate applies under the WBA.

6 Non-Price matters

6.1 Inclusion of non-price terms and conditions in the SAU

In the Draft Decision¹⁸⁹, the ACCC states:

...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 wellfounded 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.

...

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.

NBN Co Response 57

NBN Co will remove the non-price terms and conditions from the SAU. NBN Co will also remove the Confidential Information and Intellectual property provisions (clauses 5 and 6 of Annexure 1 (PDF Processes) to Schedule 1I of the SAU) from the SAU. These terms and conditions will be finalised via commercial engagement with customers and included in the next WBA.

Analysis

The detailed non-price term that were included in the Annexures to Schedule 1H of the SAU were the product of extensive consultation with industry via the Contract Development Process (CDP) on the Wholesale Broadband Agreement (WBA). NBN Co considers that these terms represent a reasonable and appropriate set of non-price terms given the state of development of NBN Co's systems and operating capabilities. NBN Co also considers that it was appropriate that the ACCC had the opportunity to assess these terms and settle them for a period of time to provide certainty to NBN Co and its customers on these specific non-price terms.

However, as it is clear that the ACCC is not satisfied that these terms are appropriate at this point in time and that it considers further commercial negotiation is required to settle these terms, NBN Co will adopt the proposed approach in the Consultation Paper, and remove them from the SAU.

Proposed SAU changes in Notice to Vary 37

Delete clauses 1H.5, 1H.6 and 1H.7 from Schedule 1H of the SAU.

Delete Annexures 1, 2 and 3 to Schedule 1H of the SAU.

¹⁸⁹ Draft Decision, p.174.

6.2 Service Levels

In the Draft Decision, the ACCC states that it is not satisfied that:¹⁹⁰

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.

NBN Co Response 58

NBN Co will remove the service level clauses from the SAU and finalise these arrangements for the next WBA via commercial engagement.

Analysis

As detailed in section 1 of Appendix B, NBN Co considers that Annexure 1 of Schedule 1J of the SAU provided an appropriate set of initial service levels for NBN Co's current set of products, and that those service levels would encourage efficient use of and investment in the NBN, and appropriately balance the interests of NBN Co, Customers and end-users. NBN Co also considers that it was appropriate that the ACCC had the opportunity to assess these service levels and settle them for a period of time to provide certainty to NBN Co and its customers on the initial service levels that NBN Co was committing to, noting that the SAU committed NBN Co to at least maintain those service levels over the term of the SAU.

However, as it is clear that the ACCC is not satisfied that these service levels are appropriate at this point in time, for the period of time that NBN Co proposed they would apply, and that it considers further commercial negotiation is required to settle these terms, NBN Co will adopt the proposed approach in the Consultation Paper, and remove them from the SAU.

While NBN Co intends to remove the service level commitments from the SAU, NBN Co also wishes, to:

- provide further information as to why the service level commitments made in the December 2012 SAU are appropriate at this stage of NBN Co's development, including indicating where these commitments represent an improvement over NBN Co's current service level offerings; and
- address specific comments by the ACCC in the Draft Decision.

This additional information is provided in section 1 of Appendix B to this submission. .

¹⁹⁰ Draft Decision, p.181.

Proposed SAU changes in Notice to Vary 38

Delete Schedule 1J (including Annexure 1).
Delete Schedule 2F.
Delete any references to these Schedules in the SAU.

6.3 Role of the ACCC in Dispute Management Rules

In the Draft Decision, the ACCC states that:¹⁹¹

...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.*
- In relation to expert determinations, the expert is nominated by the resolution advisor, who in turn has been nominated by NBN Co. 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. 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.*

NBN Co Response 59

NBN Co proposes to include a replacement Annexure 1 to Schedule 1H of the SAU that expands the oversight role of the ACCC in the operation of the Dispute Management Rules that will be included in NBN Co's SFAA, while still removing the Dispute Resolution Rules themselves from the SAU.

Analysis

As discussed in section 2 of Appendix B, while NBN Co will remove the Dispute Management Rules from the SAU and include them in its SFAA, NBN Co proposes that changes should be introduced into the SAU to provide a greater role for the ACCC in relation to the Dispute Management Rules that will be negotiated between NBN Co and Access Seekers.

¹⁹¹ Draft Decision, p.188.

The proposed approach detailed in section 2 of Appendix B is intended to ensure that Access Agreements focus on the *mechanism* of dispute resolution, and the Dispute Management Rules in the SAU cover areas where it is reasonable for the ACCC to be involved to help ensure the impartial implementation of the dispute resolution mechanisms. NBN Co considers that this promotes the LTIE, as it promotes regulatory certainty in respect of the efficient, consistent and unbiased resolution of disputes.

Section 2 of Appendix B provides further information as to the rationale behind the terms that are currently included in the SAU and addresses specific comments in the Draft Decision.

Proposed SAU changes in Notice to Vary # 39

A replacement Annexure 1 to Schedule 1H of the SAU that addresses the ACCC's role in relation to Dispute Management should be included. Proposed drafting for this replacement Annexure is shown in section 7 of Appendix C to this submission.

6.4 Confidential Information, Intellectual Property and Risk Management

While NBN Co intends to remove the terms relating to Confidential Information, Intellectual Property and Risk Management from the SAU, NBN Co also wishes to:

- provide further information as to the rationale behind the terms that were included in the December 2012 SAU; and
- address specific comments by the ACCC in the Draft Decision.

This additional information is provided in Appendix B - section 3 (Confidential Information – Supply context), section 4 (Intellectual Property – Supply context), section 5 (Confidential Information and Intellectual Property – Product Development Forum) and section 6 (Risk Management).

6.5 Other non-price issues

6.5.1 Change Management of Access Agreements

In the Draft Decision, the ACCC states¹⁹²:

...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. 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.

NBN Co has carefully considered the ACCC view, and while NBN Co understands the ACCC's concern around the breadth of change management rights, NBN Co is at a relatively early point in its roll out and operation and requires some, appropriately bounded, unilateral change rights in order to manage the ongoing development and introduction of its products and operational processes efficiently.

¹⁹² Draft Decision, p.175.

NBN Co plans to finalise the change management regime for the next WBA via commercial engagement with customers.

NBN Co is simplifying the regime and will limit it (compared to the approach in the current WBA) so that it operates to facilitate the introduction of new Products, Product Components and Product Features (and associated pricing), as well as the ongoing development of operational processes. This approach will better align with the ACCC's Model Terms where unilateral change rights are confined to operational documents. While NBN Co does not intend to introduce a specific dispute resolution right in relation to the change management regime, changes will be subject to an appropriate level of consultation with Customers prior to being notified. Changes to the Head Terms in the WBA will only be made by agreement.

6.5.2 Retail-level regulatory requirements

In the Draft Decision, the ACCC states:¹⁹³

...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 are Access Agreements are inconsistent with such requirements.

And then goes on to conclude that:¹⁹⁴

...a general commitment to support retail-level regulatory requirements would promote the long-term interests of end-users.

However, the ACCC does not actually propose that a change should be made to the SAU.

NBN Co Response 60

NBN Co considers that no such general commitment should be included in the SAU.

Analysis

It is unclear what benefit would be derived by Access Seekers from a general commitment to support retail-level regulatory requirements of third-parties, as neither NBN Co, the ACCC nor Access Seekers would have any certainty about what such a commitment may cover in the future.

Given this uncertainty with what the commitment actually covers, issues could also arise about how NBN Co could ensure compliance with such a commitment. NBN Co may, in good faith, seek to ensure that it is appropriately supporting what it considers to be the retail-level service requirements of its customers, and the ACCC or Access Seekers may have a different view. NBN Co could then be found to be in breach of the SAU by seeking to address retail-level obligations in a *bona fide* way but which is ultimately found to be incorrect. Accordingly, NBN Co considers there is a high compliance risk associated with the ACCC's proposal.

It is not in NBN Co's legitimate business interests to be required to address third-party regulatory obligations in a way which may result in NBN Co being in breach of the SAU if it does so incorrectly. It is difficult to see how it is also in Access Seeker's interests to have this burden placed on NBN Co or indeed that it would promote the LTIE.

¹⁹³ Draft Decision, p.176.

¹⁹⁴ Draft Decision, p.176.

6.6 POI related matters

6.6.1 Interconnection at listed POIs

The Consultation Paper proposes:¹⁹⁵

the insertion of a commitment that NBN Co will only offer [fibre and wireless network] interconnection for a particular CSA at the POI which is generally closest to the end-users in that CSA, but that is consistent with the network planning and dimensioning rules devised to identify the location of the listed POIs to the NBN. This variation would have the effect of ensuring that the SAU supports and is consistent with the intended purpose of the POI list—that is, that interconnection is offered at locations which promote the long-term interests of end-users.

The ACCC's rationale for this proposal appears to be a concern that NBN Co may provide interconnection in such a way that a de facto consolidated POI network architecture is introduced¹⁹⁶:

... the SAU states only that NBN Co will offer interconnection and specify a POI for each CSA. 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.

No explanation is offered as to why the proposal would apply for fibre and wireless services only.

NBN Co Response 61

NBN Co considers this proposed variation is premature and unnecessary, and that interconnection at NBN Co's listed POIs and the availability of competitive backhaul services from those POIs should continue to be carefully monitored as anticipated in NBN Co's Statement of Expectations.

Analysis

NBN Co has a number of concerns in relation to this proposal for a 'nearest POI interconnection rule':

- Insufficient account has been taken of the Government's intentions for NBN Co and the anticipated role of the ACCC, as described in the Shareholder Ministers' Statement of Expectations (SoE);¹⁹⁷
- There is only quite limited experience on interconnection to date, due to the relatively early stage of the NBN roll-out and service uptake, with many listed POIs yet to be activated and interim POIs still being utilised;¹⁹⁸
- The ACCC has not yet completed a number of inquiries and reviews directly relevant to this issue; and
- The commitment has the potential to unnecessarily and prematurely limit NBN Co's operational efficiency, and wider market efficiency.

Accordingly, while appreciating and sharing the ACCC's interest in stimulating robust backhaul competition, NBN Co's view is that the proposal is premature and unnecessary.

¹⁹⁵ Consultation Paper, p.36.

¹⁹⁶ Draft Decision, pp.203-204.

¹⁹⁷ NBN Statement of Expectations, letter from Shareholder Ministers to NBN Co dated 17 December 2010, p.7.

¹⁹⁸ As at 30 April 2013, interconnection is available at 30 listed POIs, although not all POIs currently have attached access network infrastructure.

Statement of Expectations (SoE) – roles of NBN Co and the ACCC

In relation to interconnection, Government has noted that:¹⁹⁹

the Australian Competition and Consumer Commission (ACCC) and NBN Co have consulted with the industry and the ACCC has provided advice to inform the Government's consideration of the initial number and location of the points of interconnect (POIs) to the NBN that the Company will provide

The Government also stated that it:²⁰⁰

... 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.

... 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.

... recognises that NBN Co will only control the network from the customer premises to a POI where competitive backhaul, identified with the ACCC's guidance, is available. NBN Co may extend its connectivity service in those areas where it can demonstrate that to do so would lead to improved backhaul price outcomes, but each such proposal should be referred to Government for consideration

The Government's expectations are that the ACCC will:²⁰¹

... use its new scrutiny and pricing determination powers to declare prices to ensure that any backhaul routes do not become the new choke point preventing effective retail competition – particularly in regional Australia.

... have the necessary powers to regularly monitor and review transmission pricing and to set wholesale access charges for regulated transmission services.

... regularly monitor the level of competition in transmission services by other wholesale providers to NBN Co POIs and its access determinations will effectively be benchmarks, as appropriate, for competitive transmission services.

Both NBN Co and ACCC are in the process of delivering on these expectations. While significant progress has been made in this regard, it is still clearly early days. Other considerations aside, it is not reasonable for NBN Co to commit to the nearest-POI operating rule, or for the ACCC to require such a commitment which would appear to foreclose (or at least is difficult to reconcile with) the ACCC's ongoing role in monitoring and regulating backhaul pricing. The SoE acknowledges the possibility that experience over time may prove that implementation of a semi-distributed POI approach is not the optimum (or only) approach.

Limited experience with NBN interconnection

There has been insufficient practical experience with NBN interconnection to meaningfully inform judgment at this point in time on optimal interconnection arrangements for the proposed term of the SAU. Much of the interconnection provided to date has been at interim POIs, not listed POIs. However, NBN Co is actively encouraging interconnection at the listed/ permanent POIs as soon as they become available.

¹⁹⁹ NBN Statement of Expectations, letter from Shareholder Ministers to NBN Co dated 17 December 2010, p.3.

²⁰⁰ Ibid, p.7.

²⁰¹ Ibid, p.7.

NBN Co, having designed its network to serve all 121 POIs, and developed network planning rules for efficient network deployment and operations, has no incentive to engage in network “scope creep” or to limit strong competition in backhaul provision. If the ACCC should, in the future, form the view that NBN Co is acting anti-competitively in relation to how it provides interconnection, the ACCC has existing powers it could utilise under the CCA (for example to issue a Competition Notice and/or a binding rule of conduct) to deal with any such behaviour.

NBN Co currently has every incentive to provide interconnection in the manner which achieves maximum network efficiency—and hence economic productive efficiency. NBN Co is required to provide uniform national wholesale pricing, and must refer any proposal to extend NBN Co’s services into backhaul to the Government for consideration.

Relevant ACCC inquiries

The ACCC is currently conducting a review of the policies and procedures relating to identifying the listed POIs and has foreshadowed a review of DTCS pricing later this year. Furthermore, the Government has indicated in the SoE that it anticipated the ACCC having an ongoing role in monitoring and reviewing transmission pricing and the level of competition in transmission services by wholesale providers to NBN Co POIs.

POI process review: In February this year the ACCC released the discussion paper: *ACCC review of the policies and procedures relating to the identification of listed POIs*. In addition to seeking feedback from stakeholders in regard to the policies and procedures relating to the identification of the listed POIs, this review is surveying the current level of interconnection to the listed POIs. Submissions were due by 22 March 2013, and the ACCC is currently considering these submissions.

Given this inquiry, it is clearly premature to require NBN Co to make the sort of commitment the ACCC proposes.

DTCS declaration inquiry: The ACCC is required under the CCA to conduct an inquiry into the need or otherwise for ongoing declaration of currently regulated services before the current declaration is expired. The current DTCS declaration expires on 31 March 2014, which means that there will be an ACCC inquiry later this year.

This imminent inquiry also has obvious potential to uncover issues relevant to NBN Co’s provision of interconnection at the current 121 listed POIs, indicating it is premature to require NBN Co to commit to a nearest POI interconnection rule.

Ongoing monitoring and review: The ACCC’s regular monitoring and reviewing of prices and competition for backhaul (as anticipated in the SoE) may also turn up findings relevant to the assessment of whether the availability of competitively priced backhaul is, and will remain, adequate to support the SoE objectives.

6.6.2 Changes to the locations of POIs over time

In section 6.7.2.1 of the Draft Decision, the ACCC assesses the commitments made in clause 1H.4 of the SAU in relation to processes around the closure, relocation and establishment of new points of interconnect. The ACCC is states that it:²⁰²

²⁰² Draft Decision, p.204.

... 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 has identified two issues that it believes may impose requirements on how the ACCC exercises its functions and powers. NBN Co's response to these two issues is detailed in this section.

6.6.2.1 Timeframes for ACCC decisions

In the Draft Decision, the ACCC states that:²⁰³

... 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. Otherwise, the request is deemed to be accepted. 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.

.....

... the Consultation Paper on the Notice to Vary proposes that the ACCC be given additional flexibility to extend the period for its decision

NBN Co Response 62

NBN Co proposes to amend the SAU to remove the 20 day extension limit on ACCC decisions, and allow the ACCC to extend its decision-making timeframe.

Analysis

NBN Co's rationale for including definite time frames in this clause was to provide a level of certainty for industry and NBN Co about when changes would be finalised, which in turn would likely assist in investment decisions by Access Seekers. NBN Co still considers that certainty around the decision-making process is of benefit to both Access Seekers and NBN Co, and does not accept that having an essentially open-ended process with no certainty as to when it will be concluded will promote the LTIE.

However, NBN Co understands the ACCC's concerns in relation to its ability to make decisions on potentially complex proposals, for example in relation to multiple POI location changes. Rather than simply removing the words "by a further 20 Business Days" from clause 1H.4.3(b) of the SAU, NBN Co proposes that the ACCC should be able to extend its decision making period to allow it to properly consider a request from NBN Co and make a decision that promote the LTIE. This alternative to the ACCC's proposed variation strikes an appropriate balance between the ACCC's legitimate desire to be comfortable that it has sufficient time to make an appropriate decision, and industry's and NBN Co's legitimate interests in knowing when a decision can expect to be finalised.

Proposed SAU changes in Notice to Vary 40

Clause 1H.4.3(b) of the SAU should be replaced with the following:

²⁰³ Draft Decision, pp.204-205.

The ACCC may extend the period referred to in clause 1H.4.3(a) by notifying NBN Co and Access Seekers of the additional time required to make an informed decision prior to the end of the period referred to in clause 1H.4.3(a), and providing the reasons for the extension in time that is required.

6.6.2.2 Updating the POI list

In the Draft Decision, the ACCC states that:²⁰⁴

...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.

NBN Co Response 63

NBN Co proposes to remove clause 1H.4.4.

Analysis

Clause 1H.4.4 of the SAU specifies that the ACCC must amend the POI list to reflect changes made as a result of clause 1H.4.3. NBN Co included this clause to provide certainty to industry and NBN Co as to what the actual POI list was at any point in time, and to remove the potential for any ambiguity as to the outcomes of changes that occurred as a result of the ACCC's consideration of changes to POIs. NBN Co considered that this certainty would promote co-investment by Access Seekers, result in efficient use of the NBN and more generally promote the LTIE.

NBN Co does not accept the ACCC's comment that clause 1H.4.4 "purports to impose a requirement on how the ACCC exercises its functions and powers under section 151DB of the CCA."

Nonetheless, NBN Co proposes that clause 1H.4.4 be removed from the SAU.

Proposed SAU changes in Notice to Vary 41

Remove clause 1H.4.4.

6.6.3 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 states:²⁰⁵

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.

The Draft Decision also states:²⁰⁶

In relation to the period of notice, the conduct provides for 12 months notice for opening new POIs and making changes to established POIs. However, it only provides six months' notice for temporary POIs.

The Consultation Paper proposes to amend the notice period for changes to temporary POIs noting:²⁰⁷

²⁰⁴ Draft Decision p.205.

²⁰⁵ Draft Decision, p.205.

²⁰⁶ Draft Decision, p.205.

amendment of clause 1H.4.5(b) of Schedule 1H of the SAU so that NBN Co will provide access seekers with at least 12 months' notice of the migration of end-users from the temporary POI to an established POI — this would have the effect of ensuring that access seekers will have sufficient notice to undertake the planning and investment required to interconnect at the established POI, and ensures that notice will be provided even if the temporary POI will remain in use for other end-users.

NBN Co Response 64

NBN Co considers that a 'for the avoidance of doubt' clause is unnecessary and may create uncertainty.

NBN Co proposes that the notification period for migration of end-users from a temporary POI to an established POI is 12 months, rather than 6 months.

Analysis

As acknowledged by the ACCC, the drafting of clause 1H.4 is a general commitment to providing Access Seekers with notice of changes to POIs and it does not create any ambiguity in relation to the effectiveness of an AD or BROCC requiring NBN Co to provide additional information.

As such NBN Co submits that a 'for the avoidance of doubt' clause is not necessary. Further, NBN Co submits that such a clause of that nature may in fact create uncertainty as to intended role for ADs and BROCC in other areas of the SAU where such an explicit clarification is not made.

NBN Co submits that the existing drafting in clause 1H.4 is unambiguous and permits the intended operation of Part XIC. NBN Co notes that this approach is consistent with NBN Co's proposed approach to regulatory recourse (as discussed in section 2.3.1).

In relation to the notification period for migration of Customers from temporary POIs, NBN Co does not have an issue with this period of notice. NBN Co is prepared to give 12 months notice of migration of end-users (or more accurately, premises) from a temporary POI to an established POI.

Proposed SAU changes in Notice to Vary 42

Clause 1H.4.5(b) should be replaced with the following: "*NBN Co will provide Access Seekers with at least 12 months' prior notice of a closure or relocation of a Temporary POI.*"

6.7 Rollout Information

Clauses 1H.2 and 1H.3 of the SAU set out NBN Co's commitments regarding publication of rollout information. The ACCC states:²⁰⁸

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.

²⁰⁷ Consultation Paper, p.36.

²⁰⁸ Draft Decision, p.207.

Despite this view the ACCC states:²⁰⁹

Nonetheless, the ACCC considers that the insertion of a clause to this effect for the avoidance of doubt would be beneficial.

NBN Co Response 65

NBN Co considers that a 'for the avoidance of doubt' clause is unnecessary and may create uncertainty.

Analysis

As acknowledged by the ACCC the drafting of clauses 1H.2 and 1H.3 does not create any ambiguity in relation to the effectiveness of an AD or BROC requiring NBN Co to provide additional information.

NBN Co notes that for similar reasons the ACCC considers that a 'for the avoidance of doubt' clause would be beneficial in relation to the POI changes notification under clause 1H.4.²¹⁰

For the reasons outlined in section 6.6.3 above, NBN Co submits that the inclusion of a 'for the avoidance of doubt' clause is not necessary and may itself create uncertainty.

6.8 Additional variations proposed by NBN Co

As discussed in section 1, NBN Co has identified a small number of areas in the SAU that it considers should be varied in order to provide increased clarity as to the intended operation of the SAU. These are tabulated below, along with NBN Co's rationale for suggesting that they be included in a Notice to Vary the SAU.

Table 8 - Additional variations proposed by NBN Co

Ref	SAU clause reference	Variation proposed by NBN Co	Rationale for proposed variation
1	Dictionary – Aggregation Node Site	SAU uses “POI” (covering both Established POI & Temporary POI). WBA uses “Established POI”. Need to align definitions.	Should have consistent terminology between documents.
2	Dictionary – Temporary POI	Introduce concept of “emergency POI” into the definition, consistent with WBA.	Need to deal with the possibility of emergency POIs in the SAU, for consistency.
3	1A.2.5	Change NNI description to align with WBA.	Alignment with WBA.
4	1G.1.2	Change the term “Forecast Information” at the end of this clause to “Forecast Financial Information”. Make consequential changes to other sections of SAU to reflect this change.	This change in terminology is to align the defined term with the change proposed below in clause 1G.1.3(a).

²⁰⁹ Draft Decision, p.207.

²¹⁰ Draft Decision, p.205.

Ref	SAU clause reference	Variation proposed by NBN Co	Rationale for proposed variation
5	1G.1.3(a)	Change the term "Actual Cost Information" to "Actual Financial Information". Make consequential changes to other sections of SAU to reflect this change.	The information described here contains more than just cost information, and the proposed term more accurately describes the nature of the information.
6	1G.2.1(a)	Delete this clause.	This clause duplicates what is already required in 1G.1.3, as that clause refers to 1G.1.2 which requires capex by asset type.
7	1G.2.3(a)	Change this clause to: <i>"By 31 October after the end of each Financial Year during the Initial Regulatory Period, NBN Co will submit to the ACCC a report signed by the Chief Procurement Officer that that, in relation to that Financial Year, the Procurement Rules satisfied the requirements in Clause 1E.4.3."</i>	This change ensures that the period covered by the Procurement Compliance Report is aligned with the Expenditure Compliance Report. Currently, they are not given for the same period of time. The change here reflects the drafting in clause 1G.2.1

7 Fixed Principles

7.1 Fixed Principle in the Varied SAU

In section 7.1 of the Draft Decision, the ACCC states that its preliminary view is that the proposed fixed principles term and condition in the SAU (i.e. the terms and conditions set out in Modules 0 and 1) should not be a fixed principles term or condition.

The ACCC states that it is not satisfied that some of the terms and conditions in Module 0 and 2 promote the LTIE and are reasonable. In particular, the ACCC states that the following clauses in Modules 0 and 2 should not be specified as part of the fixed principles term and condition:²¹¹

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.*

Module 2:

- *aspects of the implementation of the NBN Access Service, the Facilities Access Service and the Ancillary Services [although the Draft Decision does not specify which aspects];*
- *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.*

The ACCC states:²¹²

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.

²¹¹ Draft Decision, p.209.

²¹² Draft Decision, p.209.

NBN Co Response 66

All of the terms and conditions of Modules 0 and 2, as proposed to be varied by NBN Co in this submission, should be accepted as a fixed principles term and condition, and should be subject to the notional fixed period specified and the qualifying circumstances set out in clauses 5.2 and 5.3 of the SAU respectively.

Analysis

NBN Co submits that:

- the terms and conditions of Modules 0 and 2 (as proposed to be varied by NBN Co in this submission) promote the LTIE and are reasonable (see sections 2-6 and 8);
- the terms and conditions are fundamental to the overall objective of the SAU and are required to provide NBN Co with certainty regarding its long-term cost recovery – this is especially important for the Subsequent Regulatory Period, as NBN Co will rely upon SAU variations as a way of implementing Replacement Module Applications. NBN Co needs to be confident that key elements of the SAU will continue to be carried over into subsequent undertakings (See section 7.2 below).
- the notional fixed period specified in clause 5.2 of the SAU and the qualifying circumstances in clause 5.3 are appropriate for the reasons outlined in NBN Co's Supporting Submission.²¹³

7.2 Scope of Fixed Principles term and condition

As a general proposition, the ACCC states that it considers that only those matters which are reasonably necessary for providing certainty about long-term cost recovery should be specified as fixed principles.²¹⁴

NBN Co Response 67

NBN Co does not agree with the ACCC's position that only those matters which are reasonably necessary for providing certainty about long-term cost recovery should be specified as fixed principles. In any event, even if the ACCC's general approach is adopted, NBN Co submits that all the terms and conditions in Modules 0 and 2, as proposed to be varied by NBN Co in this submission, are necessary to provide certainty to NBN Co that the key elements of the SAU framework for providing long-term cost recovery will not be changed.

Analysis

There is nothing in Part XIC of the CCA (or the explanatory material that underpins fixed principles in the CCA) that limits the 'scope' of matters that may be accepted as fixed principle terms and conditions in an SAU to items specifically concerning long-term cost recovery, although NBN Co notes that this would be the most important area of focus for fixed principles.

The concept of fixed principles was first introduced into Part IIIA of the then *Trade Practices Act 1974* (TPA) in 2009 to provide regulatory certainty to investors with regard to access terms and conditions.

The 2009 Explanatory Memorandum which accompanied the Bill to introduce 'fixed principles' into Part IIIA of the TPA, states that:²¹⁵

²¹³ Supporting Submission, p.183.

²¹⁴ Draft Decision, p.209.

²¹⁵ 'Fixed principles' were first introduced into the trade practices regulatory regime to apply to Part IIIA access undertakings s.44ZZAAB of the CCA.

Regulatory risk for infrastructure investors would be reduced if access undertakings were allowed to contain fixed principles, which apply to subsequent access undertakings for that infrastructure service. When important variables are fixed, service providers and access seekers can more easily extrapolate the terms and conditions for access under future access arrangements and have more certainty in their investment and business planning.²¹⁶

The Explanatory Memorandum underscores the flexibility Parliament had in mind when it provided for access providers to seek fixed principles expressly referring to “parameters”²¹⁷, “formulas”²¹⁸, “obligations”²¹⁹ and “procedures”²²⁰.

Fixed principles may cover a broad range of matters to reduce regulatory risk for an access provider. The parliamentary intent clearly provides for access providers to seek certainty relating to future access arrangements in a more general sense than that suggested by the ACCC and any proposed fixed principle should be assessed accordingly.

Nevertheless, even if the ACCC’s general approach to fixed principles is adopted, NBN Co considers that by virtue of the design of the SAU (in particular, the replacement module process as proposed to be varied by NBN Co), all of the terms and conditions set out in Modules 0 and 2 (varied according to NBN Co’s proposed drafting amendments in this Submission) are necessary to provide NBN Co with sufficient certainty regarding long-term cost recovery.

The acceptance of an SAU would ordinarily provide an Access Provider with certainty of the ‘rules of the game’ until the expiry of the SAU. However, to achieve the appropriate balance between certainty and flexibility over the term of the SAU, NBN Co has designed the SAU with a limited level of detail in Module 2 such that NBN Co is periodically required to submit SAU variations (in the form of Replacement Module Applications) to ensure that there are no significant regulatory ‘gaps’ which could introduce uncertainty.

The fact that NBN Co will submit SAU variations on a recurring basis throughout the Subsequent Regulatory Period introduces a degree of uncertainty with regards to the terms and conditions in Modules 0 and 2, as without fixed principles in place, each SAU variation submitted by NBN Co would require the re-assessment of the terms and conditions that have already been accepted by the ACCC. This is in contrast to the operation of an SAU containing fixed principles terms and conditions that were accepted for the term of the SAU. These fixed principles would not be subject to reassessment at the time that NBN Co submits an SAU variation application.

For this reason, it is appropriate, and entirely consistent with the modular design of the SAU, to specify the terms and conditions of Module 0 and 2 as a fixed principles term and condition (and therefore not subject to a reassessment) to ensure that NBN Co has certainty that the SAU framework for providing long-term cost recovery will not be changed.

²¹⁶ Explanatory Memorandum to the *Trade Practices Amendment (Infrastructure Access) Bill 2009*, p.55.

²¹⁷ For example an asset value.

²¹⁸ For example a formula or methodology such as an efficiency benefit sharing formula (where the service provider’s net efficiency gains in expenditure under the current access undertaking are shared between the access provider and Access Seekers in any subsequent access undertaking).

²¹⁹ For example an obligation such as the standard at which the service is to be provided.

²²⁰ A process such as a procedure that the service provider will follow before undertaking new investment in the relevant facility.

7.3 For a reason that concerns

In section 6.2.2 of the Draft Decision, the ACCC discusses its views on service level commitments. In providing its views, the ACCC notes that they are part of the fixed principles terms and conditions and states:²²¹

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.

The ACCC has made similar observations about a number of other terms and conditions in Module 2 including criteria for determining:

- forecasts;²²²
- whether capital expenditure is prudent and efficient;²²³
- whether operating expenditure is prudent and efficient;²²⁴
- WACC;²²⁵ and
- tax allowance.²²⁶

NBN Co Response 68

NBN Co submits that a purposive approach should be used to interpret the fixed principles provisions in Part XIC. In any event, NBN Co proposes to include drafting to clarify that the fixed principle in the SAU, is only intended to cover the subject matter to the extent of the level of granularity specified in SAU.

Analysis

Under section 152CBAA of Part XIC of the CCA, an SAU may provide that a term or condition specified in the undertaking is a ‘fixed principles term or condition’ for a period that, under the undertaking, is expressed to be a longer period than the period of the SAU.

Under this regime, the ACCC may not reject a variation to the SAU which contains an identical fixed principles term or condition for ‘a reason that concerns’ that fixed principles term or condition.²²⁷

²²¹ Draft Decision, p.185.

²²² Draft Decision, p.165.

²²³ Draft Decision, p.163.

²²⁴ Draft Decision, p.164.

²²⁵ Draft Decision, p.165.

²²⁶ Draft Decision, p.166.

²²⁷ Section 152CBAA(6) of the CCA.

NBN Co understands that, from the ACCC's perspective, the phrase 'for a reason that concerns' could be perceived as importing a level of potential uncertainty into the operation of fixed principles provisions in relation to an SAU, including because the ACCC has not previously needed to interpret the phrase and actually assess an SAU containing fixed principles terms and conditions. However, this is not an appropriate reason to reject NBN Co's proposed fixed principle. NBN Co submits that established approaches to statutory interpretation (a purposive approach) will operate to alleviate this uncertainty.

The ACCC's concern appears to be that it may be prevented from rejecting a Replacement Module for a specific reason on the basis that a more generalised fixed principles term or condition 'covers the field' and therefore operates to prevent the ACCC from rejecting the SAU on the basis that such a rejection would be construed as being "for a reason that concerns" the fixed principle term or condition. NBN Co considers that it is difficult to see how any fixed principle(s) could ever be accepted if this approach were followed.

NBN Co submits that this outcome would be unlikely to eventuate if a purposive approach is used to interpret the fixed principles provisions. Such an interpretation is also inconsistent with how similar phrases have been interpreted judicially in Australia.

The fixed principles regime under the CCA is intended to provide certainty for investors and industry participants in relation to the operation of specific, pre-determined matters. The Explanatory Memorandum to the Bill which introduced the fixed principles regime for the purposes of an SAU does provide some assistance in this regard. The Explanatory Memorandum states that:²²⁸

The effect of specifying that a provision is a fixed principles term or condition is to permit the person submitting the undertaking to 'lock in' the matters dealt with in that term or condition for a period.

Further, while there has been no direct judicial consideration of the phrase 'for a reason that concerns' in a fixed principles context, case law on the words 'by reason of' has been considered to imply a relationship of cause and effect.²²⁹

Adopting a purposive approach, NBN Co submits that the fixed principles regime does not operate to constrain the ACCC in areas beyond those matters identified specifically within the relevant fixed principles term or condition.

The ACCC's jurisdiction to consider a specific element of a Replacement Module is not affected by the existence of a general fixed principles term or condition on the same subject matter because there is no causal connection between the ACCC's consideration of a specific element and the generally expressed fixed principles term or condition. Just because the subject matter is the same does not mean that there is a causal link between those two things, or that a decision to reject an SAU term would be "for a reason that concerns" a fixed principle term or condition where the reasons for the rejection were not specifically linked to the fixed principle term or condition.

For example, the ACCC would not be prevented from rejecting a variation to the SAU if it did not accept the expenditure values submitted by NBN Co as part of the Forecast Nominal ABBRR simply because the proposed variation established a requirement that the Forecast Nominal ABBRR include a number of specified elements (as it currently does under 2D.2.1(a) of the SAU).

²²⁸ Explanatory Memorandum to the *Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010* p.181.

²²⁹ (1993) 46 FCR 301 Per Lockhart at 321- 2.

In any event, NBN Co proposes to include drafting to clarify that the intended coverage of the fixed principle in the SAU is that it only covers the subject matter to the extent of the level of granularity specified in SAU. This will have the effect of clarifying that specific provisions of the SAU that are not directly or specifically inconsistent with the fixed principle term or condition will not be construed as being “for a reason that concerns” the fixed principle term or condition.

Proposed SAU changes in Notice to Vary 43

Amend clause 5.3 of the SAU as follows:

“Every term and condition in Module 0 and Module 2 (collectively) is a fixed principles term and condition of this Special Access Undertaking, but only to the extent specified in each term and condition in Module 0 and Module 2, and not to the extent that specific matters that arise in connection with a term and condition in Module 0 and Module 2 are not specifically covered by that term and condition.”

8 Assessment of the SAU

Section 8 of the Draft Decision sets out the ACCC's preliminary assessment of the SAU against the statutory criteria in section 152CBD of the CCA.

The ACCC states that the SAU has a number of features which, when having regard to the statutory criteria, have merit, including the modular design, the initial prices set out in the SAU, the adoption of a long-term revenue constraint methodology with an 'initial cost recovery account', long-term commitments about price levels and commitments to provide and consult with customers on various matters.²³⁰

Despite this, however, the Draft Decision states:²³¹

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.*

The following sections provide NBN Co's response to section 8 of the Draft Decision.

8.1 Categorisation of SAU clauses

Section 152CBA of the CCA permits an access provider to specify a range of matters in an SAU, including:

- terms and conditions relating to compliance with Category B SAOs (section 152CBA(3A));
- conduct in relation to access and related terms (section 152CBA(3B)); and
- conduct relating to ancillary matters (section 152CBA(3C)).²³²

In section 8 of the Draft Decision the ACCC has identified clauses of the SAU it considers falls within each of the above categories. The consequence of this identification is that, in considering whether to accept the SAU, the ACCC must apply a different statutory test for each category.

Table 9 sets out the ACCC's categorisation of clauses of the SAU in section 8 of the Draft Decision. NBN Co notes that the ACCC has not set out its categorisation of all clauses in the SAU (e.g. the ACCC has not provided its views on schedule 1G).

²³⁰ Draft Decision, p.211.

²³¹ Draft Decision, p.211.

²³² Ancillary matters include conduct in relation to developing a new eligible service, enhancing a declared service, extending or enhancing the capability of a facility or telecommunications network by means of which a declared service is, or is to be, supplied, planning for a facility or telecommunications network by means of which a declared service is, or is to be, supplied, an activity that is preparatory to the supply of a declared service; or giving information to service providers about any of these activities.

Table 9 – ACCC categorisation of SAU clauses

Category under the CCA	Applicable statutory test	SAU clauses
<p>Terms and conditions specified in the SAU in relation to compliance with Category B SAOs – referred to in section 152CBA(3A)</p> <p>referred to hereafter as ‘SAO’ category</p>	<p>Section 152CBD(2)(b):</p> <p>The terms and conditions:</p> <ul style="list-style-type: none"> • would be consistent with Category B SAOs in section 152AXB; and • are reasonable. 	<p>Schedule 1A:</p> <ul style="list-style-type: none"> • The provisions in Schedule 1A, clause 1A.3 which NBN Co describes as ‘terms and conditions relating to supply of Product Components’. • 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.
<p>Conduct specified by the SAU in relation to access – referred to in section 152CBA(3B)</p> <p>referred to hereafter as ‘Conduct in relation to access’ category</p>	<p>Section 152CBD(2)(ca):</p> <p>The conduct will promote the LTIE and the terms and conditions in relation to that conduct are reasonable.</p>	<p>Conduct in the SAU relating to:</p> <ul style="list-style-type: none"> • ADs and BROCs (including the ‘regulatory recourse’ mechanism); • the ‘explicit interaction’ between the SAU and SFAA (including terms and conditions relating to prices (including the long-term revenue constraint methodology and the non-price terms and conditions relating to service levels, dispute management, confidential information and intellectual property and risk management); • changes to the SAU that occur through the ‘replacement module’ approach and the ‘midpoint review’ of Module 1.
<p>Conduct specified by the SAU in relation to ancillary matters – referred to in section 152CBA(3C)</p> <p>referred to hereafter as ‘Conduct in relation to ancillary matters’ category</p>	<p>Section 152CBD(2)(cb)</p> <p>The conduct will promote the LTIE.</p>	<p>Conduct in the SAU relating to:</p> <ul style="list-style-type: none"> • Schedule 1I and 2E- product development; • Schedule 1H – POIs; the locations of POIs, closure of temporary POIs; and the provision of information about POIs; and • Schedule 1H- the provision of information about the rollout.

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NBN Co considers that all of the terms and conditions set out in the SAU (as amended in accordance with NBN Co's proposed variations under this submission) fall within the 'SAO' category, that is, they are all terms and conditions in relation to compliance with Category B SAOs.

Even if the ACCC's categorisation of the SAU clauses is adopted, NBN Co submits that it has addressed the issues expressed in the ACCC's preliminary assessment set out in section 8 of the Draft Decision and under either approach to categorisation (whether NBN Co's, or the ACCC's) will satisfy the applicable statutory criteria under section 152CBD of the CCA.

Analysis

In its Supporting Submission, NBN Co took the view that all the terms and conditions of the SAU fell within the 'SAO' category. NBN Co also canvassed the view that certain conduct in Schedule 11 (Product development and withdrawal) may fall within the conduct in relation to ancillary matters category.²³³ Importantly, NBN Co considered that under either approach the applicable test under section 152CBD was satisfied. This position was reiterated in NBN Co's response to the ACCC's letter in October 2012.²³⁴

However, as noted above, in the Draft Decision the ACCC has set out its own categorisation of the SAU clauses and this is different to NBN Co's categorisation.

NBN Co remains of the view that the terms and conditions in the SAU (as amended in accordance with NBN Co's proposed variations in this Submission) may be appropriately characterised in the 'SAO' category, and accordingly should be assessed against the criteria in section 152CBD(2)(b) of the CCA.

NBN Co notes that, as discussed by the ACCC, the difference between the 'SAO' category and the 'Conduct in relation to access' category is that in the latter case:

- **conduct** specified in accordance with subsection 152CBA(3B) must promote the LTIE;
- whilst the **terms and conditions** on which that conduct will be performed needs to be reasonable, that is, the terms and conditions must satisfy the same criteria as the SAO Category.²³⁵

With regard to the 'Conduct in relation to ancillary matters' category, the applicable test is that the conduct must promote the LTIE, which forms one of the criteria under the overall reasonableness test under the 'SAO' category.

Despite NBN Co's view as to the appropriate categorisation of the terms and conditions in the SAU, for ease of reference in this section, NBN Co has used the ACCC's identification of the terms and conditions in the Draft Decision to set out its assessment of the SAU under section 152CBD of the CCA, except in relation to the following provisions (which the ACCC has categorised as part of the 'Conduct in relation to access' category):

- **SFAA provisions:** the terms and conditions in the SAU under which NBN Co commits to include particular terms in any SFAA (e.g. the specification of prices in an SFAA must not exceed the Maximum Regulated Price (including the long-term revenue constraint methodology)); and

²³³ Supporting Submission, pp.179 -180.

²³⁴ Letter from ACCC to NBN CO, *NBN Co SAU request for clarification*, 26 October 2012, p.1 and Letter from NBN Co to ACCC, 1 November 2012, p.1.

²³⁵ Draft Decision, p.213.

- **Non-price terms and conditions:** the terms and conditions in the SAU relating to service levels, dispute management, confidential information and intellectual property and risk management.²³⁶

SFAA provisions

In terms of the first group of provisions, NBN Co proposes to remove all references to SFAAs in these provisions (see section 2.2). NBN Co submits that the amendments will remove the 'conduct' element in these clauses and as such the remaining terms and conditions should be categorised as part of the 'SAO' category. NBN Co notes that the ACCC supports this view:²³⁷

The effect of amending the SAU in this way [removing references to SFAAs] would be that NBN Co must comply with Category B Standard Access Obligations (SAOs) on the terms and conditions as set out in the undertaking. That is, the SFAA terms and conditions would be specified by the SAU in relation to subsection 152CBA(3A) (that is, terms and conditions in relation to compliance with the Category B SAOs) so NBN Co would be required to supply services on these terms upon request to access seekers.

Accordingly, NBN Co considers these provisions fall within the 'SAO' category provisions for the purpose of assessment in section 8.2.

Non-price terms and conditions

With regards to the second group of provisions relating to non-price terms and conditions, NBN Co proposes to delete these provisions from the SAU (see section 6). As such these terms and conditions will not need to be assessed by the ACCC, and so will not be considered in this section.

8.2 Terms and conditions in relation to compliance with SAOs

The following sections provide NBN Co's responses to section 8 of the Draft Decision which sets out the ACCC's preliminary assessment of the SAU against the statutory criteria. NBN Co notes that these sections do not provide a comprehensive assessment of the SAU (as varied in accordance with NBN Co's proposed variations in this Submission) under section 152CBD of the CCA.²³⁸

8.2.1 Services to which the SAU relates

Section 3 of the Draft Decision notes a number of issues in relation to services to which the SAU relates.

Section 3 of this submission sets out in detail NBN Co's views in relation to the issues raised by the ACCC.

In section 8.1 of the Draft Decision, the ACCC has categorised these provisions (Schedule 1A and Attachments A and C) as relating to compliance with the Category B SAOs, and set out its preliminary assessment of these provisions against the statutory criteria.²³⁹

8.2.1.1 Consistency with SAOs

The ACCC's main concern in relation to consistency with SAOs is the use of the language 'offer to supply' in the SAU, the ACCC states in section 8.2.1 of the Draft Decision:²⁴⁰

²³⁶ Draft Decision, p.213.

²³⁷ Consultation Paper, p.11.

²³⁸ The section does not discuss all the applicable criteria under section 152CBD. Fixed Principles is discussed in section 7 of this submission.

²³⁹ Draft Decision, p.215.

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.

NBN Co submits that the ACCC’s concerns relating to consistency with SAOs has been addressed by NBN Co’s acceptance of the ACCC’s proposal to replace the terms ‘offer to supply’ with ‘supply’.

8.2.1.2 Reasonableness of the terms and conditions

In section 8.2.2.1 of the Draft Decision, the ACCC states:²⁴¹

.. 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.

As discussed in detail in sections 5.1 above, NBN Co considers that the provisions referred to by the ACCC are terms and conditions of the SAU, rather than limitations.

The ACCC has not provided reasons for stating that these terms and conditions are not reasonable.

As discussed in section 3.1, NBN Co considers that there is no ambiguity as to how the SAU interacts with a service that may be declared by the ACCC. NBN Co’s obligation to supply future declared services is clearly captured by the SAOs under section 152AXB as they may apply to such services in the future, and the terms and conditions relating to such services should be determined in accordance with Part XIC at the relevant time. However, NBN Co has no objection to including an acknowledgement of the ACCC’s ability to declare eligible services under section 152AL(8A) of the CCA, and in addition NBN Co proposes to amend clauses 1A.1.2, 1A.1.3, 1A.4.1, 1A.4.2 and clauses 2A.1.3 and 2A.1.5 (as drafted in section 3.2) to clarify that NBN Co may also fulfil its SAOs with respect to the NBN Access Service by supplying services declared by the ACCC or as specified in an AD /BROC. NBN Co submits that these drafting proposals most directly address the ACCC’s concerns as stated in the Draft Decision.

The ACCC also states:²⁴²

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. The ACCC is therefore not satisfied that this term and condition is reasonable.

NBN Co has addressed the ACCC’s concern by proposing to delete clause 1A.3.1(b)(iii).

²⁴⁰ Draft Decision, p.215.

²⁴¹ Draft Decision, p.215.

²⁴² Draft Decision, p.215.

The ACCC considers that clause 1A.3.2 does not promote the LTIE, the ACCC states:²⁴³

“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. The ACCC considers that this goes beyond the limited authorisation for bundling in section 151DA of the CCA.

A detailed discussion relating to the reasonableness of clause 1A.3.2 is at section 3.4.3.

With regards to interconnection at POIs, the ACCC states:²⁴⁴

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 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.

As outlined in section 6.6.1, NBN Co considers that the variation is premature and unnecessary at this time and that interconnection at NBN Co's listed POIs and the availability of competitive backhaul services from those POIs should continue to be carefully monitored as anticipated in NBN Co's Statement of Expectations.

As detailed in section 6.4, NBN Co is able to make the other POI related changes proposed by the ACCC.

8.2.2 Price related terms and conditions

Section 5 of the Draft Decision sets out the ACCC's views in relation to the price terms and conditions of the SAU.

Section 5 of this submission sets out in detail NBN Co's views in relation to the issues raised by the ACCC.

In section 8.3 of the Draft Decision, the ACCC has categorised the price related terms and conditions as being the 'terms and conditions' aspect of 'Conduct in relation to access' category (with the relevant conduct being a commitment to include terms and conditions in an SFAA), and set out its preliminary assessment against the statutory criteria.

As discussed above, given the removal of SFAA references in the price-related terms and conditions of the SAU, NBN Co has considered these provisions of the SAU as part of the 'SAO' category.

²⁴³ Draft Decision, p.215.

²⁴⁴ Draft Decision, p.21.

8.2.2.1 Promoting competition

In the Draft Decision, the ACCC states that:²⁴⁵

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.

During Module 1, NBN Co considers that it will face a high degree of revenue sufficiency risk and hence its interests are aligned with Access Seekers to set prices at levels which will promote competition – see section 5.1.1.

NBN Co addresses the ACCC's concern to preserve future flexibility in relation to price and non-price terms in this submission, in particular:

- the proposed inclusion in the SAU of the Integrated Price Review Mechanism in Module 2, to allow the ACCC to intervene if and when required in Module 2 in relation to both new product pricing and general price rebalancing – see section 5.2.3; and
- the proposed removal from the SAU of non-price terms and service levels from the SAU, and the ACCC will be able to use its powers under Part XIC to intervene as and when required on these matters – see section 6.

8.2.2.2 Economically efficient use of an investment in infrastructure used to supply listed services

Economically efficient use of infrastructure used to supply listed services – Initial prices

In the Draft Decision, the ACCC states that:²⁴⁶

... the ACCC generally considers that the initial prices set out in the SAU are likely to encourage efficient use of the NBN ...

This general conclusion is welcome. Elsewhere in the Draft Decision²⁴⁷ the ACCC identifies a small number of specific services (Standard Business Offer, Symmetric Access Capacity (TC-1) 0.15Mbps to 2Mbps, and Restoration charge) for which it is not satisfied that the initial prices are reasonable and requests submissions in regard to these initial prices. NBN Co has provided further details regarding the appropriateness of each of these initial prices in the context of its overall product and pricing suite (see section 5.2.2). NBN Co considers that this should address any residual concerns that the ACCC may have in regard to whether the initial prices set out in the SAU are likely to encourage efficient use of the NBN.

²⁴⁵ Draft Decision, p.220.

²⁴⁶ Draft Decision, p.222.

²⁴⁷ Draft Decision, p.115.

Economically efficient use of infrastructure used to supply listed services – Changes to prices over time, including setting new prices

In the Draft Decision, the ACCC states that:²⁴⁸

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.

NBN Co considers that the ACCC's concerns in regard to changes to price over time, including setting new prices, are appropriately addressed in this submission, in particular:

- the proposed inclusion in the SAU of the Integrated Price Review Mechanism in Module 2 to allow the ACCC to intervene if and when required in Module 2 in relation to both new product pricing and general price rebalancing. As discussed above, no such mechanism is required in Module 1 because of the strong pricing efficiency incentives faced by NBN Co during that period. See section 5.2.3; and
- the proposed inclusion in the SAU of a disallowance power in regard to Zero-Priced Reference Offers and Zero-Priced Other Charges associated with the supply of a Reference Offer, which applies in both Module 1 and Module 2 – see section 5.2.3.2; and
- the proposed inclusion in the SAU of a disallowance power in regard to product withdrawals, which applies in both Module 1 and Module 2 – see section 4.3.

Economically efficient investment in infrastructure used to supply listed services – Whether the terms and conditions allow NBN Co to recover its costs and a normal commercial return, given the risks of the investment

In the Draft Decision the ACCC states that:²⁴⁹

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.

...

²⁴⁸ Draft Decision, p.223.

²⁴⁹ Draft Decision, p.226.

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).

...

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.

NBN Co considers that the ACCC's concerns in regard to whether the terms and conditions allow NBN Co to recover its costs and a normal commercial return, given the risks of the investment, are appropriately addressed in this submission, in particular:

- the cash flow timing assumptions in Module 1 are appropriate because they are consistent with practice in telecommunications regulation and in energy regulation and, in any event, the LTRCM should be considered as a whole. The 350bp WACC margin was proposed by NBN Co for use within the LTRCM as set out in Module 1 and any changes to the details of how the LTRCM operates would require NBN Co to reassess the adequacy of the current WACC approach – see section 5.3.1;
- the cash flow timing assumptions in Module 2 are already subject to the NPV=0 criterion in clause 2D.2.1(b), which provides appropriate flexibility in regard to how the issue can be addressed in each Regulatory Cycle;
- the proposed change to the SAU to provide for the ACCC to administer the LTRCM ex-post compliance arrangements in Module 1, which includes determination of the values of prudent operating and capital expenditure – see section 5.3.2.1;
- the proposed change to the SAU so that, during Module 2, RAB Roll Forward Arrangements will be put in place, subject to ACCC review and possible determination, for each Regulatory Cycle, and those arrangements can change over time if required to provide NBN Co with appropriate incentives to incur capital expenditure prudently – see section 5.3.3.3;
- the proposed change to the SAU to remove from Module 2 the capital expenditure and operating expenditure forecasting criteria but retain recognition of the deemed prudent expenditure categories from Module 1 – see section 5.3.3.1;
- in regard to the Module 1 WACC, the use of a 10 year risk free rate is appropriate because it is consistent with practice in telecommunications regulation and in energy regulation and there is strong empirical evidence to show that infrastructure businesses similar to NBN Co do, in practice, rely on long term financing even though the underlying regulatory cycles may be considerably shorter. In any event, the LTRCM should be considered as a whole. The 350bp WACC margin was proposed by NBN Co for use within the LTRCM as set out in Module 1 and any changes to the details of how the LTRCM operates would require NBN Co to reassess the adequacy of the current WACC approach – see section 5.3.2.3;

- in regard to the Module 2 WACC:
 - defining the rate of return as a nominal vanilla WACC is appropriate for the reasons articulated by Officer and Bishop²⁵⁰; and
 - flexibility in regard to how the nominal vanilla WACC will be estimated over time is provided by the proposed change to remove the existing cost of capital factors and replace them with a broad assurance to NBN Co that it will have the opportunity to earn a normal commercial rate of return on its investment – see section 5.3.3.1;
- the proposed change to the SAU so that the tax allowance in Module 1 applies a gamma factor in each Financial Year based on the most recent regulatory precedent – see section 5.3.2.6;
- the proposed change to the SAU to remove the tax allowance factors in Module 2 and require consistency with other elements of the LTRCM – see section 5.3.3.1.

Economically efficient investment in infrastructure used to supply listed services – Whether the terms and conditions create incentives for NBN Co to invest efficiently

In the Draft Decision²⁵¹, the ACCC states that:

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.

NBN Co considers that the ACCC's concerns in regard to whether the terms and conditions create incentives for NBN Co to invest efficiently are appropriately addressed in this submission, in particular:

- the proposed change to the SAU to provide for the ACCC to administer the LTRCM ex-post compliance arrangements in Module 1, which includes determination of the values of the RAB, ICRA and ABBRR and for the ACCC to be satisfied that operating and capital expenditure meets the prudency requirements specified in the SAU – see section 5.3.2.1;

²⁵⁰ Dr Steven Bishop and Professor Bob Officer, Supplementary report in relation to NBN Co's proposed Special Access Undertaking, 2 May 2013, p.2.

²⁵¹ Draft Decision, p.227.

- the proposed change to the SAU to remove from Module 2 the capital expenditure and forecasting criteria but retain recognition of the deemed prudent expenditure categories from Module 1 – see section 5.3.3.1; and
- the proposed inclusion in the SAU of a disallowance power in regard to product withdrawals, which applies in both Module 1 and Module 2 – see section 4.3.

8.2.2.3 The legitimate business interests of NBN Co and its investment in facilities

In the Draft Decision, the ACCC states that:²⁵²

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.

NBN Co considers that the ACCC's concerns in regard to whether the SAU will over-compensate NBN Co relative to its efficient costs and a normal commercial return are appropriately addressed in this submission. This is for the same reasons set out above in regard to the economically efficient investment in infrastructure used to supply listed services, and in particular whether the terms and conditions allow NBN Co to recover its costs and a normal commercial return, given the risks of the investment.

8.2.2.4 The interests of persons who have rights to use the declared services

NBN Co notes that the ACCC did not raise any concerns in relation to the effect of the SAU's price-related terms on the interests of persons who have rights to use the declared services. NBN Co considers that NBN Co's proposed amendments to the SAU as set out in this submission should advance the interests of person who have rights to use the declared services, in particular:

- the proposed inclusion in the SAU of the Integrated Price Review Mechanism in Module 2 to allow the ACCC to intervene if and when required in Module 2 in relation to both new product pricing and general price rebalancing – see section 5.2.3; and
- the proposed inclusion in the SAU of a disallowance power in regard to Zero-Priced Reference Offers and Zero-Priced Other Charges associated with the supply of a Reference Offer, which applies in both Module 1 and Module 2 – see section 5.2.3.2; and
- the proposed inclusion in the SAU of a disallowance power in regard to product withdrawals, which applies in both Module 1 and Module 2 – see section 4.3.

8.2.2.5 The direct costs of providing access to the declared services

In the Draft Decision, the ACCC states that:²⁵³

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:

²⁵² Draft Decision, pp.227-228.

²⁵³ Draft Decision, p.229.

- *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.

NBN Co considers that the ACCC's concerns in regard to whether the SAU could allow NBN Co to be compensated for more than the direct costs of providing access to the declared service are appropriately addressed in this submission. This is for the same reasons set out above in regard to the economically efficient investment in infrastructure used to supply listed services, and in particular whether the terms and conditions allow NBN Co to recover its costs and a normal commercial return, given the risks of the investment.

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

In the Draft Decision, the ACCC states that:²⁵⁴

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.

NBN Co welcomes this general conclusion and considers that it should be unaffected by NBN Co's proposed amendments to the SAU as set out in this submission.

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

In the Draft Decision, the ACCC states that:²⁵⁵

... 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.

NBN Co considers that the ACCC's concerns in regard to whether the SAU may allow NBN Co to recover more than the efficient costs of operating the NBN and to circumvent the CPI-1.5% price control by withdrawing non-reference offers are appropriately addressed in this submission. See in particular the proposed inclusion in the SAU of a disallowance power in regard to product withdrawals, which applies in both Module 1 and Module 2 – see section 4.3. Refer also to the discussion above in section 8.2.2.2.

²⁵⁴ Draft Decision, p.229.

²⁵⁵ Draft Decision, p.229.

8.3 Conduct relating to access

Section 2 of the Draft Decision discusses the interaction of the SAU with Part XIC of the CCA, and notes a number of issues relating to the interaction between the SAU and the SFAA as well as SFAA and ADs and BROCs.

Section 2 of this submission sets out NBN Co's views in relation to the issues raised by the ACCC.

In the Draft Decision, the ACCC has categorised these provisions as 'Conduct in relation to Access' category and set out its preliminary assessment of these provisions against the statutory criteria.

8.3.1 Conduct relating to SFAAs

In section 8.3.1.1 of the Draft Decision the ACCC states:²⁵⁶

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.

The ACCC also sets out a list of 'conduct' in the SAU that refers to SFAAs. The ACCC states:²⁵⁷

... 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.

NBN Co submits that the variations proposed in section 2 of this submission address the ACCC's concerns in this area by removing any potential uncertainty about the operation of Part XIC.

Specifically, NBN Co proposes to adopt the ACCC's second option in respect of regulatory recourse by removing the existing regulatory recourse mechanism, thus allowing terms and conditions of supply to be determined according to the normal operation of Part XIC; and to remove references in the SAU to obligations to include certain terms and conditions in an SFAA.

In addition, NBN Co's proposal to retain SAU and SFAA alignment in clause 6 of the SAU will ensure that Access Seekers will continue to have the option of taking supply by entering into an Access Agreement based on SFAAs, but are not required to do so. As acknowledged in the ACCC's Draft Decision, NBN Co submits that retaining NBN Co's commitment to maintain alignment between the SAU and SFAA will promote the LTIE (as acknowledged in the Draft Decision).²⁵⁸

NBN Co proposes to retain the Multilateral SFAA Forum for the duration of Module 1, but will remove the clauses relating to process as proposed by the ACCC. NBN Co submits that the Multilateral SFAA Forum will promote the LTIE by facilitating the development of appropriate terms and conditions of supply. The ACCC agrees with this position and states:²⁵⁹

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.

²⁵⁶ Draft Decision, p.217.

²⁵⁷ Draft Decision, p.217.

²⁵⁸ Draft Decision, p.218.

²⁵⁹ Draft Decision, p.52.

8.3.2 Conduct relating to changes to the SAU

In Section 8.3.1.3 of the Draft Decision, the ACCC states:²⁶⁰

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.

NBN Co submits that it has addressed the above concerns by removing the mid-term review process.

The ACCC also states:²⁶¹

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,²⁶² 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. 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 section 2.5, NBN Co has proposed an amended replacement module process.

First, NBN Co notes that the amended process removes the 'deeming' of a replacement module application and addresses the ACCC's concerns regarding uncertainty as to the operation of ADs and BROCs by conferring a power on the ACCC to make a decision within a set time period.

Second, NBN Co submits that the proposed replacement module process promotes the LTIE by removing the potential for a regulatory gap and providing certainty to Access Seekers about the continued operation of Reference Offers, and NBN Co in relation to its long-term cost recovery arrangements.

8.4 Conduct relating to ancillary activities

In section 8.4 of the Draft Decision, the ACCC has categorised a number of clauses relating to Product development and POIs as 'Conduct in relation to ancillary matters' category, including conduct in relation to Schedule 1I (Product Development) and conduct in relation to Schedule 1H (changing of POI locations).

The ACCC states:²⁶³

The ACCC is not satisfied that the conduct about changing the location of POIs and produce development will promote the LTIE.

The following sections provide NBN Co's response to the ACCC's preliminary assessment of these provisions, consistent with NBN Co's responses in section 4 (Product Development) and section 6.6 (Changing of POI locations).

²⁶⁰ Draft Decision p.218.

²⁶¹ Draft Decision, p.218.

²⁶² NBN Co, *Special Access Undertaking*, 18 December 2012, Main Body, clause 4.10(c).

²⁶³ Draft Decision, p.230.

8.4.1 Product development

8.4.1.1 Promoting Competition

In the Draft Decision, the ACCC states that:²⁶⁴

... 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 11 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.

NBN Co has addressed the ACCC's concern that Access Seekers could be discouraged from participating in the PDF due to the SAU provisions in relation to confidential information and intellectual property rights through the proposed removal of the confidential information and intellectual property rights provisions from the PDF Processes (see section 4.2.3). These provisions will be set out in NBN Co's SFAA.

8.4.1.2 Economically efficient use of an investment in infrastructure used to supply listed services

In the Draft Decision, the ACCC states that:²⁶⁵

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.

...

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.

NBN Co considers that the ACCC's concerns expressed in the Draft Decision in relation to efficient use of infrastructure used to supply listed services are appropriately addressed in this submission, in particular:

- The proposed removal from the SAU of the exclusion of products in the Initial Product Roadmap from the operation of the Product Development Forum (PDF), and the proposed refinement of this to the Initial Products, would only exclude from the PDF those products that have already gone through significant levels of customer engagement and development – see section 4.2.4.1;

²⁶⁴ Draft Decision, p.230.

²⁶⁵ Draft Decision, p.231.

- The proposed inclusion of a commitment that those aspects of a new product required as a result of a licence condition which are not specified in the licence condition should be subject to the product development process – see section 4.2.4.3;
- The proposed inclusion of drafting amendments in the SAU to clarify that both ancillary services and NBN Co-initiated product developments are subject to the product development process – see sections 4.2.4.4 and 4.2.4.5.
- The proposed inclusion in the SAU of an acknowledgement that the ACCC may declare services and amendments to a number of specific clauses – see sections 5.1, 5.2 and 6.2.5.

8.4.1.3 Changing the locations of POIs

In section 8.4.2 of the Draft Decision, the ACCC states:²⁶⁶

... 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.

In recognising the ACCC's concerns about whether the POI process will promote the LTIE, NBN Co proposes to vary the SAU to enable the ACCC to extend the decision making timeframe. As discussed above in section 6.6.2.1, the ACCC can nominate an appropriate extension period (once-off) and must provide reasons for the extension.

NBN Co submits that this approach addresses the ACCC's stated concerns, whilst promoting the LTIE, by striking an appropriate balance between:

- the ACCC having sufficient time to make decisions that enable efficient investment and promotion of competition; and
- the making of timely decision that will promote investment certainty to Access Seekers and NBN Co, thereby encouraging the efficient use of and investment in infrastructure.

The ACCC also states:²⁶⁷

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.

NBN Co submits that the variations proposed in section 6 address the ACCC's concerns – see section 6.6.

²⁶⁶ Draft Decision, p.231.

²⁶⁷ Draft Decision p.232.

Appendix A - Summary of NBN Co's response to ACCC Issues

In the Draft Decision on the SAU and the Consultation Paper on the Notice to Vary the SAU, the ACCC has identified a number of specific issues on which it has sought input from interested parties. These issues are summarised in the table below, along with a summary of NBN Co's response and a cross-reference to the relevant section of this submission that address each issue.

Item	ACCC reference	ACCC Proposal/Issue	NBN Co Response
1	2 – Consultation Paper p. 10 (General)	[The ACCC also welcomes views on] -in light of the proposed variations, whether any further variations should be made to clause 5 of the main body of the SAU (which establishes that every term and condition in Module 0 and Module 2, collectively, is a fixed principles term and condition);	See NBN Co Responses 66, 67 and 68
2		[The ACCC also welcomes views on] - whether there are any consequential or other variations that may be necessary to address the matters raised by the Draft Decision or in this Consultation Paper.	
3	2.1.1.1 – Consultation Paper p.11 (Need to sign access agreements)	Removal of the clauses of the SAU that require NBN Co to include particular terms and conditions set out in the SAU in any SFAA and to maintain such terms in any SFAA — instead, the SAU should state that NBN Co will comply with these particular terms and conditions as specified in the SAU.	See NBN Co Response 1
4		Amendment of the clauses of the SAU that require NBN Co to ensure that a term or condition in any SFAA has specified characteristics — instead the SAU should state that the term or condition has the specified characteristics, and is specified in the undertaking.	See NBN Co Response 1
5		Example Clause 1C.1.4 of Schedule 1C would be varied from: NBN Co will ensure that, from the SAU Commencement Date until 30 June 2017, the Price for a Reference Offer specified in any SFAA is no higher than the Maximum Regulated Price for that Reference Offer, subject to clauses 1C.3, 1C.4.3 and 1C.5. to: from the SAU Commencement Date until 30 June 2017, the Price for a Reference Offer will be no higher than the Maximum Regulated Price for that Reference Offer, subject to clauses 1C.3, 1C.4.3 and 1C.5.	See NBN Co Response 1
6	2.1.1.2 – Consultation Paper p.13 (Regulatory Recourse provisions)	[ACCC is still considering the precise form of variation to address how SFAA interacts with ADs and BROCs] One option is for the following amendments to the SAU to be made: removal of the clauses that creates uncertainty about the scope and availability of ACCC regulatory determinations (that is, clauses 1B.1.1, 1B.1.2 and 1B.2.2 of Schedule 1B); and amendment of clauses 6.1 and 6.2 of the main body of the SAU (that is, NBN Co's commitments to ensure consistency between the SAU and SFAAs it publishes throughout the SAU term) to provide that NBN Co will also ensure that SFAAs are consistent with Access Determinations and Binding Rules of Conduct.	See NBN Co Response 2
7		Another option is that amendments to the SAU be made to remove linkages between SFAAs and the SAU, and SFAAs and Access Determinations and Binding Rules of Conduct. The intended effect of such amendments would be to remove uncertainty about the extent to which NBN Co must comply with Part XIC under its normal operation, and in turn about the ACCC's ability to respond effectively to changing circumstances over the SAU term.	See NBN Co Response 2

Item	ACCC reference	ACCC Proposal/Issue	NBN Co Response
8	2.1.1.3 – Consultation Paper p.14 (<i>Facilities Access Decisions</i>)	Removal of clause 1B.2.3 of Schedule 1B.	See NBN Co Response 3
9	2.1.1.4 – Consultation Paper, p.14 (<i>Maintenance of SFAAs</i>)	Removal of the second sentence in clause 6.3 of the main body (that is, the commitment that NBN Co <i>may</i> include terms and conditions about the Facilities Access Service in SFAAs).	See NBN Co Response 4
10	2.1.1.5 – Consultation Paper p.15 (<i>Multilateral forum</i>)	Removal of clauses 1B.3.1(b) and 1B.3.1(e)-(l) of Schedule 1B (that is, the commitments about the procedural requirements for conducting the forum, and the commitments about how NBN Co will implement the outcomes of the forum in SFAAs).	See NBN Co Response 5
11	2.1.2.1 – Consultation Paper p.16 (<i>Replacement Modules</i>)	Removal of clauses 4.5 to 4.11 of the main body (that is, the commitments about submission and assessment of replacement module applications).	See NBN Co Response 6
12	2.1.2.2 – Consultation Paper p. 17 (<i>Midpoint Review</i>)	Removal of Schedule 1K.	See NBN Co Response 7
13	2.1.3.1 – Consultation Paper p.18 (<i>Extension of initial regulatory period</i>)	Removal of clause 4.3 of the main body (that is, the mechanism providing for automatic extension of Module 1).	See NBN Co Response 8
14	2.1.3.2 – Consultation Paper (<i>Extension of SAU term</i>)	Amendment of clause 7.3(b) of the main body 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.	See NBN Co Response 9
15	2.2.1 – Consultation Paper pp.19-20 (<i>ACCC's ability to set terms & conditions</i>)	The inclusion of explicit statements in the SAU which acknowledge that: <ul style="list-style-type: none"> • 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. 	See NBN Co Response 10
16		variation of clause 1A.1 to include the following new clause 1A.1.4: <i>NBN Co will supply services declared by the ACCC or specified in Access Determinations or Binding Rules of Conduct that fall within the service description of the NBN Access Service, on the terms and conditions specified by the ACCC, to the extent that those terms and conditions are not inconsistent with the SAU.</i>	See NBN Co Response 11

Item	ACCC reference	ACCC Proposal/Issue	NBN Co Response
17		variation of clause 1A.4 to include the following new clause 1A.4.3: <i>NBN Co will supply services declared by the ACCC or specified in Access Determinations or Binding Rules of Conduct that fall within the service description for Ancillary Services, on the terms and conditions specified by the ACCC, to the extent that those terms and conditions are not inconsistent with the SAU.</i>	See NBN Co Response 11
18		variation of clause 3 of Attachment A to the main body of the SAU to include the following: The Ancillary Services are the services supplied by NBN Co that facilitate the supply of, and are necessary for Access Seekers to acquire, the NBN Access Service, including: <ul style="list-style-type: none"> (a) a service supplied by NBN that supports an Access Seeker to perform activation and assurance related transactions; (b) a test and verification service supplied by NBN Co that enables an Access Seeker to prepare for, and perform, certain network and operational interoperability testing in relation to the NBN Access Service and development and implementation by that Access Seeker of Carriage Services, Content Services and operational platforms that utilise components and functionality of the NBN Access Service, but excludes the Facilities Access Service, and (c) <i>services declared by the ACCC or specified in Access Determinations or Binding Rules of Conduct.</i> 	See NBN Co Response 11
19		variation of the dictionary definitions in Attachment C to the main body of the SAU for the following terms to read: Product Component means: <ul style="list-style-type: none"> (a) the UNI; (b) the AVC; (c) the CVC, (d) the NNI; or (e) any new or varied product components introduced by NBN Co pursuant to Schedule 1I (Product Development and Withdrawal) or Schedule 2E (Product Development and Withdrawal), <i>or declared by the ACCC or specified in Access Determinations or Binding Rules of Conduct</i> including any associated Product Features, but excluding the Ancillary Services and the Facilities Access Service. Product Feature means a feature of a Product Component that is made available by NBN Co <i>or declared by the ACCC or specified in Access Determinations or Binding Rules of Conduct</i> and which is selectable by the Customer in connection with that Product Component (for example, data transfer rate of an AVC).	See NBN Co Response 11
20	2.2.2 – Consultation Paper p.21 (“Offer to supply”) (<i>Bundling</i>)	All references to “offer to supply” services in the SAU be replaced with a commitment to “supply” services. This amendment would apply to clauses 1A.1, 1A.2, 1A.3, 1A.4 of Schedule 1A and clause 2A.1 of Schedule 2A.	See NBN Co Response 13
21		clause 1A.3.1(b)(iii) should be deleted;	See NBN Co Response 14
22		all references to “Customer” be substituted with references to “Access Seeker” (and that consequential amendments also be made).	See NBN Co Response 14
23		Lastly, the ACCC proposes that clause 1A.3.2 be deleted from the SAU in order to preclude NBN Co from bundling products beyond the authorisation provided by section 151DA of the CCA	See NBN Co Response 15

Item	ACCC reference	ACCC Proposal/Issue	NBN Co Response
24	2.2.3 – Consultation Paper p.22 (<i>Layer 3 awareness</i>)	The words in clause 1A.2.6 be varied to state: the AVC may incorporate some limited Layer 3 awareness to the extent required to support the following services	See NBN Co Response 16
25	2.3.1.1 – Consultation Paper p.22 (<i>PDF Processes</i>)	The PDF Processes (contained in Annexure 1 to Schedule 1I) should only operate for the first five years of Module 1.	See NBN Co Response 17
26	2.3.1.2 – Consultation Paper p.23 (<i>PDF Consultation</i>)	The SAU be varied in such a way that membership and participation in the Product Development Forum is extended to include consumer advocacy groups. In particular, this would require: <ul style="list-style-type: none"> • definition of the term “Consumer Advocacy Group”; and • amendment of each reference to the word “Customer” in these provisions, except clause 11.3.1(b), to also refer to a Consumer Advocacy Group or consumers in general. <p>This would require amendments throughout Schedule 1I, including Annexure 1 to Schedule 1I.</p>	See NBN Co Response 18
27	2.3.1.3 – Consultation Paper p.23 (<i>PDF confidential information</i>)	Removal of clause 5 of the PDF Processes; and Removal of clause 6 of the PDF Processes.	See NBN Co Response 19
28	2.3.1.4 – Consultation Paper p.24	Removal of the provisions that exclude products covered by, or contemplated within, the Initial Product Roadmap;	See NBN Co Response 20
29	<i>(Application of PDF processes)</i>	Removal of the provisions that exclude minor product variations;	See NBN Co Response 21
30		Removal of the provisions that exclude products that NBN Co is obliged to offer as a result of a licence condition;	See NBN Co Response 22
31		Amendments to make it clear that the product development, variation and withdrawal provisions apply to all Ancillary Services;	See NBN Co Response 23
32		Amendments to make it clear that the product development and variation provisions apply to NBN Co-initiated development and variation.	See NBN Co Response 24
33		2.3.1.5 – Consultation Paper p.24 (<i>ACCC’s ability to declare services</i>)	Inclusion of explicit statements in the SAU which acknowledge that: <ul style="list-style-type: none"> • 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.
34	2.3.2 – Consultation Paper p.25 (<i>Product Withdrawal</i>)	In addition to the proposed amendments outlined in section 2.3.1.5 above, the SAU be varied to include: <ul style="list-style-type: none"> • a commitment that NBN Co provide the same amount of written notice to the ACCC of its intention to withdraw a product, as it provides to its customers; • a conferral of power on the ACCC to disallow the withdrawal of a currently supplied product component, product feature, Ancillary Service or Facilities Access Service by NBN Co. 	See NBN Co Response 26
35	2.3.2 – Consultation Paper p.25 (<i>Product Withdrawal- Consumer advocacy groups</i>)	A commitment that NBN Co provide the same amount of written notice to consumer advocacy groups of its intention to withdraw a product, as it provides to its customers, be made.	See NBN Co Response 27

Item	ACCC reference	ACCC Proposal/Issue	NBN Co Response
36	4.2.2.4 – Draft Decision p. 94 (Product withdrawal)	Optus and Telstra’s submissions note that 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 commitment in the SAU, and concerns with the transitional arrangements for withdrawing products.	See NBN Co Response 28
37	2.4.1.1 – Consultation Paper p.26 (ACCC role in pricing of new products)	To address this [<i>NBN Co not having incentives over time to price in a manner which encourages efficient use of the network</i>], the ACCC proposes variations to the SAU which provide for the ACCC to be able to determine prices for new products, and previously zero-priced products. There are a range of clauses throughout the price-related schedules of the SAU that are likely to require amendment in order to achieve this effect. For example, amendments to any clauses which state that prices “will be determined by NBN Co” will be necessary, as these clauses may otherwise result in Access Determinations or Binding Rules of Conduct being inconsistent with the SAU, and thus of no effect.	See NBN Co Response 29 and NBN Co Response 30
38	2.4.1.2 – Consultation Paper p.27 (Price review and rebalancing)	The SAU be varied to provide for NBN Co’s prices to be subject to periodic revenue neutral price rebalancing that is conducted by the ACCC. Following on from the revenue neutral price rebalancing — that is, for the period of time between revenue neutral price reviews — the rebalanced prices would continue to be subject to the CPI-1.5 per cent price control. The ACCC is still considering the precise form of this variation. Matters that the ACCC is seeking views on include: <ul style="list-style-type: none"> • whether the SAU should specify when such rebalancing should occur, and if so, at what times — for example, rebalancing could occur every five years throughout the SAU term; and how revenue neutrality would be determined. 	See NBN Co Response 38
39	5.4.2.1 – Draft Decision p.115 (Ensuring current consumers are not worse off over the term of the SAU)	“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. While 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.” “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.”	See NBN Co Response 37

Item	ACCC reference	ACCC Proposal/Issue	NBN Co Response
40	5.1 – Draft Decision p.96 <i>(Price related matters)</i>	<p>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:</p> <ul style="list-style-type: none"> • 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. <p>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.</p>	See NBN Co Response 32
41	5.4.1 and Attachment B Draft Decision p.104 <i>(Initial price levels)</i>	<p>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.</p>	See NBN Co Response 33
42	5.4.1.4 – Draft Decision pp. 11-112 <i>(Business services with a current copper equivalent)</i>	<p>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 submission have identified the lowest cost of 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 the charges (for the Standard Business Offer and Symmetric Access Capacity TC-1 from 0.15Mbps to 2Mbps) are reasonable. This is particularly the case because there is a 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).</p>	See NBN Co Response 34 and NBN Co Response 35
43	5.4.1.6 – Draft Decision p.115 <i>(Other charges and other services)</i>	<p>In the case of the restoration charge, 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.</p>	See NBN Co Response 36

Item	ACCC reference	ACCC Proposal/Issue	NBN Co Response
44	5.3.3 – Draft Decision p.102 <i>(Principles for regulating NBN Co's Pricing)</i>	<p>Firstly, end-users should not be made worse off by virtue of their migration to the NBN — this means that:</p> <ul style="list-style-type: none"> • 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. <p>Second principle - 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.</p> <p>Thirdly - 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).</p>	See NBN Co Response 31
45	5.4.2.2 – Draft Decision p.117 <i>(Incentives to set new prices at levels that encourage efficiency and promote competition)</i>	<p>"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."</p> <p>"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."</p> <p>ACCC proposed to remove the clauses in the SAU about setting of initial prices and who sets them (and include clauses about price rebalancing).</p>	See NBN Co Response 38
46	5.4.3 – Draft Decision p.126 <i>(Tax change events)</i>	<p>ACCC notes that the SAU does not provide for consideration tax increases and decreases and more generally notes that in certain circumstances NBN Co may not have appropriate incentives in regard to how it passes on tax changes in some circumstances.</p> <p>"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."</p>	See NBN Co Response 41
47	2.4.2.1 – Consultation Paper p.30	The removal of clause 1E.6.2(a)(viii) [Minor Expenditure Limit]; and	See NBN Co Response 44
48	<i>(Network design rule changes)</i>	That the customer engagement process operate only for the first five years of Module 1.	See NBN Co Response 45
49	2.4.2 – Consultation Paper p.28 <i>(LTRCM – cash flow timings)</i> 5.5 – Draft Decision p.133 <i>(Long term revenue constraint)</i>	<p>In the event that NBN Co cannot satisfy the ACCC that the assumptions relating to the timing of cash flows reflect its actual circumstances, the ACCC proposes that the long-term revenue constraint methodology be amended to achieve internal consistency with respect to the timing of cash flows.</p> <p>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.</p>	See NBN Co Response 42

Item	ACCC reference	ACCC Proposal/Issue	NBN Co Response
50	<p>2.4.2.1 – Consultation Paper p. 29</p> <p><i>(Calculation of RAB, ICRA, ABBRR – ACCC role)</i></p> <p>5.5.1.2 – Draft Decision p.136 <i>(Capex – module 1)</i></p> <p>5.5.1.3 – Draft Decision p.149 <i>(Opex – Module 1)</i></p>	<p>The ACCC proposes that it be given a role to 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.</p> <p>...</p> <p>The ACCC is currently considering how precisely such a role for the ACCC in calculating the values of the long-term revenue constraint could be incorporated into the SAU.</p> <p>For example, one option is to retain the current approach in Module 1 whereby the methodologies for calculating each building block component are set out and NBN Co is required to submit information under Schedule 1G. However, the ACCC would be responsible for determining the final values of the RAB, annual revenue requirements and initial cost recovery account that applies to NBN Co.</p> <p>...</p> <p>In formulating a precise mechanism, the ACCC is seeking views on the following matters:</p> <ul style="list-style-type: none"> • the particular mechanism that should be adopted and how it could be incorporated into the current drafting of the SAU; • the timing of when the RAB, annual revenue requirements and initial cost recovery account should be calculated by the ACCC (for example, annually or at given intervals, such as every three or five years); and • whether the ACCC should be constrained by any additional criteria to those currently in Module 1. <p>The adoption of any proposal such as this will likely require consequential changes throughout Schedule 1E and Schedule 1F to ensure that the methodologies for calculating each building block component are consistent with the mechanism adopted.</p> <p>ACCC wants to apply the prudence commitments.</p> <p>As for capex</p>	See NBN Co Response 43
51	<p>2.4.2.1 – Consultation Paper p.31 <i>(Construction in progress)</i></p>	<p>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.</p> <p>The ACCC calculate the values of the annual-construction-in-progress allowance that will be included in NBN Co's annual revenue requirements.</p>	See NBN Co Response 48
52	<p>2.4.2.1 – Consultation Paper p.31 <i>(Gamma)</i></p>	<p>The value of gamma in Module 1 should be as determined at the time the annual revenue requirement is calculated.</p>	See NBN Co Response 49

Item	ACCC reference	ACCC Proposal/Issue	NBN Co Response
53	5.5.1.4 – Draft Decision p.153 (Bond rate) 5.5.1.4 – Draft Decision p.150 (WACC – Module 1)	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 calculate 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 terms of the risk-free rate to the period during which it is applied – the ACCC is seeking views in formulating the Notice to Vary. "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."	See NBN Co Response 46
54	5.5.1.4 – Draft Decision p.154 (Asset lives)	The ACCC notes that the 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.	See NBN Co Response 46
55	5.5.1.7 – Draft Decision p.157 (Tax allowance – Module 1)	In light of other issues identified with the tax allowance, 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 tax provisions for tax deductions under the 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.	See NBN Co Response 50
56	2.4.2.2 – Consultation Paper p.32 (LTRCM – Module 2)	To address this issue, the ACCC proposes that the methodologies [that the ACCC is not satisfied will reflect best regulatory practice in future] be removed from the SAU. These include: <ul style="list-style-type: none"> • The principles on which capital and operating expenditure forecasts must be based. (Removal of clause 2D.6.1(a) and (b); and removal of clause 2D.8). 	See NBN Co Response 51
57		<ul style="list-style-type: none"> • The matters that will be had reference to in calculating the return on capital (clause 2D.2.1(a)(iii)(A)), and the specification that the return on capital will be calculated as a nominal vanilla WACC (removal of clause 2D.2.1(a)(iii)(A), replacement with the following clause: "a return on capital".) 	See NBN Co Response 52
58		<ul style="list-style-type: none"> • The specification in clause 2D.2.1(a)(ii) which sets out that forecast regulatory depreciation is calculated as forecast straight-line depreciation as applied to the forecast opening value in the RAB, where the remaining life of each asset type is calculated based on the remaining asset lifetime for each asset types determined in a manner consistent with NBN Co's audited accounts and the number of years since the relevant capital expenditure was incurred. (Removal of clause 2D.2.1(a)(ii)(A), replacement with the following clause: "forecast nominal regulatory depreciation for year t"; and amendments to ensure that the calculation of the RAB roll-forward refer to 'depreciation' rather than 'straight line depreciation'.) 	See NBN Co Response 53

Item	ACCC reference	ACCC Proposal/Issue	NBN Co Response
59		<ul style="list-style-type: none"> The range of factors that clause 2D.2.1(a)(iv) sets out will be taken into account in determining the tax allowance. (Removal of clause 2D.2.1(iv) — replacement with the following clause: "a tax allowance".) 	See NBN Co Response 54
60	2.4.2.2 – Consultation Paper p.33 (<i>LTRCM – Module 2 Regulatory Cycle</i>)	To address this issue, the ACCC proposes that NBN Co's discretion to decide the length of the regulatory cycle be removed. Depending on any other variation made to the SAU as a result of the Notice to Vary, this amendment could include the SAU being silent on the length of the regulatory cycle.	See NBN Co Response 55
61	2.4.2.2 – Consultation Paper p.33 (<i>LTRCM – Module 2 RAB Roll forward</i>)	The SAU be varied to remove the requirement that the RAB will be rolled-forward within Module 2 based on <i>actual</i> capital expenditure, <i>actual</i> depreciation and asset disposals; andThe SAU be varied to require that the RAB be rolled forward based on <i>prudent</i> additional capital expenditure, depreciation and asset disposals.	See NBN Co Response 56
62	2.5.1 – Consultation Paper p.35 (<i>Service Levels</i>)	The service level commitments included in the SAU should be removed. This would require the deletion of Schedule 1J (including Annexure 1) and Schedule 2F, and references to these provisions.	See NBN Co Response 58
63	2.5.2 – Consultation Paper p.35 (<i>SFAA Non-Price Terms</i>)	To address this [that the ACCC considers the NPTC to not be reasonable], the ACCC proposes the following amendments to the SAU: <ul style="list-style-type: none"> · deletion of clauses 1H.5, 1H.6 and 1H.7 from Schedule 1H of Module 1 of the SAU; and · deletion of Annexures 1, 2 and 3 to Schedule 1H of Module 1 of the SAU. 	See NBN Co Response 57 and NBN Co Response 59
64	2.5.3 – Consultation Paper p.36 (<i>POI related matters</i>)	Deletion of clause 1H.4.4 of Schedule 1H of the SAU	See NBN Co Response 63
65		Deletion of the words "by a further 20 Business Days" from clause 1H.4.3(b) of Schedule 1H of the SAU	See NBN Co Response 62
66		Amendment of clause 1H.4.5(b) of Schedule 1H of the SAU so that NBN Co will provide access seekers with at least 12 months' notice of the migration of end-users from the temporary POI to an established POI	See NBN Co Response 64
67	2.5.3 – Consultation Paper p.36 (<i>POI related matters</i>)	The ACCC is also proposing the insertion of a commitment that NBN Co will only offer interconnection for a particular CSA at the POI which is generally closest to the end-users in that CSA, but that is consistent with the network planning and dimensioning rules devised to identify the location of the listed POIs to the NBN.	See NBN Co Response 61
68	6.7.2.2 – Draft Decision p.205 (<i>Notification of access seekers about changes to POI locations</i>)	The conduct in the SAU [in relation to providing notification to access seekers about changes to POI locations] is not drafted in such a way as to result in any Access Determination of 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.	See NBN Co Response 64

Item	ACCC reference	ACCC Proposal/Issue	NBN Co Response
69	6.8.2 – Draft Decision p.207 (Rollout information)	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. 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.	See NBN Co Response 65
70	5.5.2.2 – Draft Decision p.161 (Fixed principles)	The ACCC notes that 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.	See NBN Co Response 68
71	7 – Draft Decision p.208	<p>“ 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”</p> <p>“ 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.”</p> <p>“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.”</p> <p>“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.”</p> <p>“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.”</p>	See NBN Co Response 66 and NBN Co Response 67

Appendix B - Service Levels and Non-Price Terms and Conditions included in WBA

[Attached separately]

Appendix C - Proposed Drafting of SAU Changes

[Attached separately]