



Optus Submission

to the ACCC in response to the

Consultation paper on proposed variation of the NBN Co  
Special Access Undertaking

May 2013

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## Section 1. Overview

- 1.1 Optus welcomes the proposed variations to NBN Co's Special Access Undertaking (SAU). Optus agrees with the approach proposed to ensure that the SAU does not contain provisions that will have the effect of preventing the ACCC from intervening where necessary during the lifetime of the SAU.
- 1.2 Optus believes the ACCC should be guided by the following principles:
  - (a) Where there is uncertainty as to how provisions in the SAU will promote the long term interest of end-users (LTIE), flexibility should be afforded to the ACCC to assess the issue against the objectives of s.152AB of the Competition and Consumer Act (CCA) at the relevant time;
  - (b) Where the operation and implementation of provisions remain unclear, the ACCC should remove the provisions so as to ensure that the ACCC could intervene at a future time if necessary; and
  - (c) Regulatory determinations should apply to all existing and future Access Agreements (AAs), except in circumstances where both parties have explicitly agreed otherwise.
- 1.3 This does not mean that Optus expects the ACCC to intervene often; rather Optus believes the option to intervene will provide strong efficiency incentives to NBN Co. In conjunction with NBN Co's wholesale only status, this should reduce the need for ACCC intervention. The option to intervene will also likely overcome the historical information asymmetry problem of telecommunications regulation, where the regulator does not have sufficient information as to the level and efficiency of historic sunk costs.
- 1.4 Optus has used these general principles to guide its assessment of the proposed variations in the Consultation Paper. As such, Optus agrees with the majority of the variations proposed in the Consultation Paper which are designed to restore an appropriate form of ACCC oversight that is otherwise provided for by Part XIC of the CCA. However, some areas have been identified where further amendments should be made. Significant further amendments are discussed below. Optus' response to each specific variation is outlined in the following sections.

### **Further changes are needed to ensure Regulatory Determinations flow through to signed Access Agreements**

- 1.5 The Consultation Paper proposes a number of variations to the SAU, with the stated intention of creating certainty around 'when and how' NBN Co will be required to comply with its obligations under the CCA, including its obligations to comply with Regulatory Determinations. In particular, the ACCC has proposed variations to the SAU which:
  - (a) Remove a large proportion of non-price terms out of the SAU;

- (b) Clarify that NBN Co is subject to a *direct* obligation to comply with the Category B Standard Access Obligations (SAOs) in providing access to declared services, as opposed to an *indirect* obligation to ensure it includes the relevant provisions within its SFAA; and
  - (c) Remove qualifications and limitations around when and how NBN Co must ‘give effect’ to Regulatory Determinations.
- 1.6 Importantly the ACCC has also stated that where matters are not expressly dealt with by the SAU, the provisions of the CCA should continue to operate as intended. The ACCC’s proposed variations to the SAU are welcome since they will help to ensure that the ACCC has an appropriate oversight role in setting access terms to the NBN.
- 1.7 However, the ACCC has also indicated that it intends to ‘preserve the primacy’ of commercially negotiated Access Agreements (AAs) in the legislative hierarchy established by the CCA. As such, the terms of a signed AA have primacy over any subsequent conflicting Regulatory Determination terms. Access Seekers that have signed an AA may therefore not be able to have access to new or updated Regulatory Determination terms until after an existing AA expires. Only where AAs contain a provision for Regulatory Determinations to flow through will Access Seekers be able to obtain services on the terms of the Regulatory Determinations during the period of an existing AA.
- 1.8 To date NBN Co has not been prepared to countenance such a clause in its proposed Access Agreement, notwithstanding specific requests from RSPs. Given this position, there is a real prospect that the ACCC’s changes will be undermined through NBN Co’s unilateral control of any AA.
- 1.9 Optus suggests that the SAU be varied to place an additional commitment on NBN Co to address this issue within the SFAA and ensure that the ACCC’s proposed changes to the SAU cannot be undermined. Optus suggests the following wording:<sup>1</sup>

*“NBN Co will ensure that the terms of the SFAA will allow for the flow through to existing signed SFAAs of Access Determinations or Binding Rules of Conducts, unless otherwise agreed between the parties”.*

- 1.10 For clarity, such a clause is consistent with the legislative hierarchy as both parties could agree to exclude this clause in any signed AA. The benefit of including this clause in the SFAA is that it removes the ability of any one party to unilaterally exclude legislative rights.

### **Adjusting relative price levels in response to unforeseen circumstances**

- 1.11 Optus agrees that where the price structure and levels need to change to promote the LTIE, the ACCC should be able to make changes. It is important to provide the ACCC with flexibility so that it can determine the timing of rebalancing and assess whether revenue neutrality is achieved using its own expert opinion.

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<sup>1</sup> Optus suggests placing this clause within clause 1B.2 of the SAU.

- 1.12 As such, there should be no restriction on the ability of the ACCC to start an investigation. Optus further submits that a specific review of price levels and structures after a five year period would be beneficial. Although, this may not require any amendment to the SAU in so far as there is nothing in the SAU that prevents the ACCC from initiating a review.
- 1.13 The ability to rebalance existing prices should also be available where NBN Co introduces prices for zero-rated products or pricing for new products and in conjunction with the ACCC's assessment of the new pricing level. For example, the initial standard installation is zero-rated in clause 1D.3.2. The costs of installations are currently being recovered from existing service revenue from AVC. Should NBN Co introduce a price for this service, the value of the future expected revenue stream should be deducted from the expected future revenue stream from AVC products. This may necessitate a reduction in AVC charges to ensure that introduction of new prices have a revenue neutral impact.
- 1.14 Optus agrees that changes in price structures and levels should be assessed against a revenue neutral requirement. Revenue neutral should be defined as changes that have a zero impact in the net present value (NPV) of future total revenue over the remaining lifetime of the SAU. The ACCC should have responsibility for assessing whether the proposed change meets the revenue neutral test. Such assessment should be subject to industry consultation (on a confidential basis if required).
- 1.15 NBN Co has scope within the CPI-1.5% price increase limit to change prices to reflect demand changes. Optus submits that the price rebalancing powers should not be used to increase prices simply to recover foregone historic revenue, except where permitted by the individual price increase limit. The assessment of revenue neutral should be forward looking from the time at which the price review occurs.

#### **Further changes needed to ensure efficient expenditure included with LTRC**

- 1.16 The Consultation Paper proposes variations to the SAU that enable the ACCC to assess the values of the inputs into the LTRC (RAB, ICRA and ABBRR) each year — including return of capital; return on capital; operating costs; and tax. Optus agrees with such changes, but also believes that further changes to the prudency provisions are required.
- 1.17 First, with regards to specific drafting Optus recommends that amendments to the SAU could reflect relevant provisions in similar accepted SAUs, for example clause 4.10 in the ARTC Hunter Undertaking.<sup>2</sup> Any suggested changes should also be consistent with the recent advice of the AEMC that the regulator should be free to determine a substitute amount on the basis of the information it has.<sup>3</sup> Optus submits that LTRC proposals put forward by NBN Co should be the starting point of the analysis and should form only one of a number of inputs. The ACCC should not be limited in its ability to review expenditure; it should have reference to other

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<sup>2</sup> ARTC, Hunter Valley Coal Network Access Undertaking, as varied 17 October 2012.  
[http://www.artc.com.au/library/2012\\_HVAU\\_undertaking.pdf](http://www.artc.com.au/library/2012_HVAU_undertaking.pdf)

<sup>3</sup> AEMC, 2012, Economic Regulation of Network Service Providers, and Price and Revenue Regulation of Gas Services, Final Rule Determination, pp.96-7.

submissions, expert reports, and its own analysis when assessing what represents a reasonable value.

- 1.18 Second, Optus believes that the ACCC should vary the terms relating to prudence. While the ACCC will be able to review the extent to which incurred expenditure is recovered through the RAB at the end of Module 1, Optus sees merit in the ability of the ACCC to have the option to intervene earlier if in its expert opinion expenditure is above the prudent level. This is not to say that the ACCC has to intervene; rather Optus is advocating that the ACCC not be excluded from the opportunity to intervene. It will then be up to the ACCC whether it exercises this power, using its expert opinion and evidence at the relevant time, and whether it promotes the LTIE (including the legitimate commercial interest of NBN Co).
- 1.19 Further, reliance on a RAB adjustment at the end of Module 1, i.e. after ten years, may result in a significant shock to the value of the NBN asset. It would preclude NBN Co learning from earlier efficiency assessments and the benefits of NBN Co adopting more efficient practices during Module 1. Furthermore, the fundamental problem of telecommunications regulation in Australia has been how to estimate the efficient cost of historic sunk investments given the regulator's significant information asymmetry. The ACCC has a unique opportunity to overcome the traditional information asymmetry paradox since it will be present when spend is incurred and can verify the relative prudence of such spend. This would be achieved by reviews of the efficiency of NBN Co's expenditure. As noted above, this does not mean the ACCC will intervene — merely that the ACCC has the opportunity to intervene. The prospect of intervention alone should act as a strong incentive for NBN Co to operate efficiently. Optus notes that the ACCC has proposed that several provisions in the SAU would be reviewed after a five year period.<sup>4</sup> Optus sees merit in a similar review phase for the RAB. That is, the SAU mandates a full review of the RAB after the first five years of Module 1 and at the end of Module 1.
- 1.20 During Module 1, Optus submits that prudence should to be assessed against the Part XIC criteria, as per other fixed-line services RAB assessments. The current prudence provisions within the SAU that allow NBN Co to self-assess compliance should be removed. To this end, Optus recommends that clauses 1E.3 to 1E.11 and 1F.7 be removed from the SAU.
- 1.21 All possible techniques should be open for the ACCC to assess the prudence of expenditure. This implies that the SAU should not contain any restrictions on the ability of the ACCC to assess expenditure against s.152 criteria. Where the ACCC proposes to include specific factors that must be considered when assessing prudence, this should be done on a non-exhaustive basis. The SAU should not prevent the ACCC from applying benchmark analysis. Over time, such benchmarking will become more effective as more information becomes available. An important source of benchmark data would come from NBN Co's internal and public guidance, in the form of Corporate Plans and statements to Parliament. Optus believes benchmarking would be particularly useful in reviewing the efficiency of NBN Co's operating expenditure which totals more than \$26 billion, some 40% of total NBN Co expenditure during Module 1.
- 1.22 Optus has suggested specific drafting to deal with these issues in Section 5.

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<sup>4</sup> For example, the PDF processes and SFAA development process

## Estimating the value of WACC

- 1.23 Optus reiterates that the purpose of the WACC within the RAB is to estimate the return on capital required by the providers of capital to the regulated firm. During Module 1, the only provider of capital to NBN Co is the Australian Government through equity investments.<sup>5</sup> It is Government policy that NBN Co is required to make less than commercial returns. Indeed, a justification of a Government-owned monopoly provider of next generation fibre broadband networks is that private investors cannot receive the returns required to invest.<sup>6</sup> Given these arrangements, Optus questions the need for NBN Co to be compensated at the market rate, significantly above the actual costs of capital incurred.
- 1.24 It is clear from statements by the Government and NBN Co that 7% is the return on capital that will allow it to recover all its funding costs with interest.<sup>7</sup>
- 1.25 A proposal, therefore, to set the regulated WACC so that there is a long run expectation that the regulated WACC is above the actual cost of capital creates incentives for the regulated firm to over-invest. A higher WACC leads to a higher RAB and if the regulated WACC was sufficiently above the actual cost, over-investment may be profit-maximising.<sup>8</sup>
- 1.26 Optus reiterates that during Module 1 the regulated return on capital should reflect the actual cost of capital imposed on NBN Co by its equity holders — that is, between the long term cost of Government borrowing and 7%.

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<sup>5</sup> NBN Co and Australian Government entered into a funding arrangement on 22 June 2011 guaranteeing Government funding equity to fund the rollout of the NBN, with such funding being conditional on the annual appropriation process. See NBN Co, 2012, *Corporate Plan 2012-2015*, p.78.

<sup>6</sup> Quoted by AGCNCO 2011, NBN Co, Investigation No. 14, Canberra, November, p.32.

<sup>7</sup> Joint Media Release with the Hon Julia Gillard MP Prime Minister and Senator the Hon Penny Wong Minister for Finance and Deregulation and Senator the Hon Stephen Conroy Minister for Broadband, Communications and the Digital Economy, "Government release NBN Co Corporate Plan", 20 December 2010.

<sup>8</sup> Productivity Commission, 2012, *Electricity Network Regulatory Frameworks*, p.195.



## **Section 2. Interaction between the SAU of the access regime**

- 2.1 This section outlines the proposed changes put forward by the ACCC in relation to the interaction between the NBN Co SAU and the Part XIC access regime. Optus summarises the ACCC proposals and provides its responses on the following:
- (a) Conduct about including terms and conditions in SFAAs;
  - (b) Conduct about updating SFAAs in response to ADs and BROCs;
  - (c) Conduct about updating SFAAs in response to facilities access decisions;
  - (d) Conduct about production and maintenance of SFAAs;
  - (e) Conduct about development of SFAAs;
  - (f) Conduct about submitting variations to the SAU;
  - (g) Conduct about midpoint review of Module 1;
  - (h) Extension of the initial regulatory period in Module 1;
  - (i) Extension of the SAU term;
  - (j) Uncertainty in relation to the ACCC's ability to set terms and conditions;
  - (k) Compliance and consistency with the SAOs; and
  - (l) Layer 3 awareness.

### **Conduct about including terms and conditions in SFAAs**

- 2.1 Under the SAU, NBN Co's obligation to comply with SAOs in accordance with the terms of a Regulatory Determination is tied back to a broader commitment to incorporate an applicable Regulatory Determination into the next update of its SFAA. NBN Co then makes a secondary commitment to make 'offers to supply' services in accordance with the SFAA.
- 2.2 The ACCC has stated that NBN Co's obligation to supply declared services in accordance with the SAOs must apply independently, and that a commitment to include relevant terms in the SFAA, or to comply with certain obligations through the SFAA, is not sufficient.
- 2.3 The ACCC has also stated that it is not satisfied that the terms of the SAU which relate to compliance with the SAOs are consistent with the SAOs. In particular, the ACCC has stated that a commitment to 'offer to' supply *"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”.*<sup>9</sup>

- 2.4 The ACCC proposes that the SAU be amended to:
- (a) Remove clauses requiring NBN Co to include SAU terms and conditions in the SFAA. The SAU should just state that NBN Co will comply with SAU terms and conditions; and
  - (b) That the SAU should state that the term and condition has the specified characteristics and is specific in the undertaking.
- 2.5 The ACCC states that the effect of such amendments is that NBN Co must comply with the obligations as set out in the SAU. These amendments will give effect to s.152CBA(3A) of the CCA, which enables NBN Co to agree to be bound by the standard access obligations in the SAU and undertakes to comply with the terms and conditions specified in the SAU.
- 2.6 In effect, it appears that the ACCC wishes to make obligations set out in SAU to be defined as standard access obligations rather than obligations that apply only to the SFAA. The ACCC claims that this will provide access seekers with the ability to obtain access on the basis of the SAU and avoid the need to sign an SFAA before receiving services.

### Optus' response

- 2.7 Optus agrees with the intent of the amendments. However, it is not clear whether the amendments are sufficient to ensure that regulatory decisions flow through to Access Seekers that have signed AAs during the period of the signed AA.
- 2.8 The ACCC has expressed the view that Access Seekers should not be required to sign an 'SFAA-based AA' in order to obtain access on the SFAA terms and conditions.<sup>10</sup> It has proposed variations to the SAU to clarify that Access Seekers will be able to request supply on the terms set out in the SAU without being forced to enter into an agreement with NBN Co on the terms of the SFAA, or even being required to enter into an AA at all.<sup>11</sup>
- 2.9 It is not clear at this stage how the ACCC proposes that this approach will work in practice as it is unlikely that NBN Co will provide access to its services relying solely on the SAU given that key provisions are not included in the SAU. As such, any agreement to supply is likely to have to include some form of commercial negotiation with NBN Co. With NBN Co being the monopoly provider of fixed-line communications, and alternative investment effectively barred, Access Seekers will be in a weak negotiating position. Without an express obligation to

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<sup>9</sup> Section 8.2.1, Draft Decision.

<sup>10</sup> Section 2.1.1.1, Consultation Paper.

<sup>11</sup> At section 2.2.2 of the Consultation Paper, the ACCC proposes amendments to the SAU with the effect that the SAU 'would not *require* Access Seekers to enter into an Access Agreement with NBN Co' in order to benefit from regulated terms and conditions.

the contrary, Access Seekers may effectively be forced to accept the terms unilaterally proposed by NBN Co in order to gain access to fixed-line services.

- 2.10 Further, Optus notes that the ACCC's proposed variation to the SAU is likely to result in a situation where the terms of access offered by NBN Co in an SFAA will need to be updated immediately in response to any applicable Regulatory Determination. However, there is currently no obligation under the CCA, or the SAU, for the terms of a Regulatory Determination to 'flow through' to the benefit of an Access Seeker which is already party to an AA.
- 2.11 The logical result of this would be that Access Seekers would begin to be offered access to declared services by NBN Co on *different* terms, depending on the regulated terms which are in place when they enter into an AA. In practice, this could result in some Access Seekers being 'locked-in' to disadvantageous terms of supply until an AA expires, while other Access Seekers are able to access more favourable terms immediately.
- 2.12 The logical remedy to both of these issues is to include provisions in an AA that provide for the flow through of regulatory determinations that are made during the term of the AA. Whilst, the inclusion of such provisions within an AA should be a commercial decision between the parties, Optus notes that NBN Co has refused access seekers requests to include such provisions in its AA.
- 2.13 Optus acknowledges that where *both* parties (NBN Co and an Access Seeker) agree to exclude regulatory determinations from applying to an existing AA, then the AA ought to override any such determinations. But the exclusion of regulatory rights should be a joint commercial decision and not dependent on the unilateral view of one of the parties.
- 2.14 Optus submits that a further variation to the SAU is required, which provides that NBN Co must offer each Access Seeker a variation of its AA (e.g. a signed SFAA) where amendments are made to regulated terms. Ideally, adequate provision to adopt such an amended offer should also be provided for within the terms of each AA. Optus suggests the following wording:<sup>12</sup>

*"NBN Co will ensure that the terms of the SFAA will allow for the flow through to existing signed SFAAs of ACCC Access Determinations or Binding Rules of Conducts, unless otherwise agreed between the parties".*

- 2.15 For clarity, such a clause is consistent with the legislative hierarchy as both parties could agree to exclude this clause in any signed AA. The benefit of including this clause in the SFAA is that it removes the ability of any one party to unilaterally exclude legislative rights.

### **Conduct about updating SFAAs in response to ADs and BROCs**

- 2.16 The ACCC is concerned that the regulatory recourse provisions within the SAU are likely to mean that regulatory determinations may not have an impact until an SFAA expires. The ACCC is also concerned that the obligations within the SAU may only imply an obligation to amend

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<sup>12</sup> Optus suggests placing this clause within clause 1B.2 of the SAU.

an SFAA to reflect an ACCC determination rather than comply with the ACCC determination. The ACCC has proposed to remove the clauses that create such uncertainty and amend clauses to ensure that there will be consistency between SAU and SFAA throughout the term of the SAU. The ACCC anticipates that these changes will require NBN Co to supply services on regulated terms, where this is not inconsistent with an AA between the parties or a SAU in operation.

#### Optus' response

- 2.17 Optus agrees with the intent of the amendments. However, it is not clear whether the amendments are sufficient to ensure that regulatory decisions are flowed through to Access Seekers. Optus refers to its detailed comments above.

#### **Conduct about updating SFAAs in response to facilities access decisions**

- 2.18 The ACCC proposes removal of clause 1B.2.3.

#### Optus' response

- 2.19 Optus agrees with the proposed changes.

#### **Conduct about production and maintenance of SFAAs**

- 2.20 The ACCC is of the view that the commitment to produce SFAAs during the term of the SAU is in the LTIE. The ACCC also views that the commitment for SFAAs to have a two year term is in the LTIE, subject to how regulatory updates flow into SFAAs (see above). The commitment that NBN Co may include terms and conditions about the facilities access service will not promote LTIE.
- 2.21 The ACCC proposes to remove the second sentence in clause 6.3; that is, the commitment to include the facilities access service.

#### Optus' response

- 2.22 Optus agrees with the intent of the amendments. However, it is not clear whether the amendments are sufficient to ensure that changes to the SFAA flow through to signed SFAAs (i.e. AAs). See above for greater detail.
- 2.23 Optus submits that a further variation to the SAU is required, which provides that NBN Co must offer each Access Seeker a variation of its AA where amendments are made to regulated terms within the AA, unless agreed otherwise agree by both parties. Ideally, adequate provision to adopt such an amended offer should also be provided for within the terms of each AA.

#### **Conduct about development of SFAAs**

- 2.24 The ACCC proposes to remove clauses 1B.3.1(b) and 1B.3.1(e)-(l). That is, commitments on procedural requirements for conducting the forum, and commitments as to the implementation of the forum in SFAAs. The ACCC states that if terms cannot be agreed upon in

the forum, the ACCC may make regulatory determinations. The terms of which will be available through SFAA-based access agreements.

- 2.25 The ACCC states the other terms of the multilateral forum promote the LTIE for the period of Module 1. The ACCC notes that NBN Co' is able to propose these provisions apply for a five year period only.

Optus' response

- 2.26 Optus agrees with the proposed changes.

**Conduct about submitting variations to the SAU**

- 2.27 The ACCC proposes to remove clauses 4.5 to 4.11 in the main body of the SAU, which relate to commitments about the submission and assessment of replacement Module applications. As a result, at the expiry of Module 1, NBN Co would be free to use the SAU variation processes in the CCA to seek the ACCC's approval for any new (or amended) terms.

Optus' response

- 2.28 Optus agrees with the proposed changes.

**Conduct about midpoint review of Module 1**

- 2.29 The ACCC proposes to remove Schedule 1K. As an alternative, NBN Co could specify that Module 1 only applies for a five year period, and then use the SAU variation process under the CCA to seek the ACCC's approval to renew or replace terms.

Optus' response

- 2.30 Optus agrees with the proposed changes.

**Extension of the initial regulatory period in Module 1**

- 2.31 The ACCC does not consider that the SAU should provide for an automatic extension. As such, the ACCC recommends the removal of clause 4.3 in the main body of SAU. NBN Co could use the SAU variation process under the Act to seek the ACCC's approval to extend timeframe.

Optus' response

- 2.32 Optus agrees with the proposed changes.

**Extension of the SAU term**

- 2.33 The ACCC proposes to amend clause 7.3(b) of the main body to provide that the criteria to be applied by the ACCC will be the same as s.1252CBD of the CCA.

Optus' response

- 2.34 Optus agrees with the proposed changes.

### **Uncertainty in relation to the ACCC's ability to set terms and conditions**

- 2.35 The ACCC proposes to include explicit statements in the SAU that; acknowledge that the CCA allows the ACCC to declare services; and that the NBN access and ancillary services includes the supply of services declared by the ACCC.

#### Optus' response

- 2.36 Optus agrees with the proposed changes.

### **Compliance and consistency with the SAOs**

- 2.37 The ACCC proposes that clause 1A.3.1(iii) be deleted, and all references to customers be substituted to Access Seekers. The ACCC anticipates that the effect of these changes is that the SAU does not require Access Seekers to enter into an access agreement in order to benefit from regulated terms and conditions.

#### Optus' response

- 2.38 Optus agrees with the intent of the proposed changes. However, Optus refers to its comments above in relation to the practicality of obtaining access on the terms of the SAU alone.

### **Layer 3 awareness**

- 2.39 The ACCC recommends that clause 1A.2.6 to be amended to state: the AVC may incorporate some limited Layer 3 awareness "to the extent required to support the following services".

#### Optus' response

- 2.40 Optus agrees with the proposed changes.

## **Section 3. Product development and withdrawal**

- 3.1 This section outlines the proposed changes put forward by the ACCC in relation to the product development and withdrawal clauses within the NBN Co SAU. Optus summarises the ACCC proposals and provides its response on the following:
- (a) Term of operation of the PDF processes;
  - (b) Commitments by NBN Co to share information and consult;
  - (c) Provisions which establish rights for and obligations on NBN Co and its customers about how consultation will occur;
  - (d) Provisions which allow for consultation to not be undertaken in particular circumstances;
  - (e) Provisions which set out NBN Co's ability to make a decision about whether or not to develop, introduce or vary a product; and
  - (f) Product Withdrawal.

### **Term of operation of the PDF processes**

- 3.2 The ACCC proposes that the PDF processes within the SAU only apply for a five year period. After this, the processes would be subject to commercial negotiation and subject to regulatory determinations if required. NBN Co will be free to seek a variation to the SAU under Part XIC if it wishes to extend the period.

#### *Optus' response*

- 3.3 Optus agrees with the proposed changes.

### **Commitments by NBN Co to share information and consult**

- 3.4 The ACCC believes the PDF could be enhanced by the inclusion of consumer advocacy groups. This would require the inclusion of a definition of the term consumer advocacy group, and amendments to terms that refer to 'customer' so they also refer to advocacy groups or consumers.
- 3.5 The ACCC is seeking views on the appropriate definition of advocacy groups and how this group or consumers in general, could participate in the PDF.

#### *Optus' response*

- 3.6 Optus recognises that consumers will have a strong interest in the development of the NBN. That said Optus does not see the need for inclusion of consumer groups in discussions

between NBN Co and RSPs in the PDF process. There are two potential concerns with the ACCC's proposal:

- (a) First, it potentially contradicts NBN Co's wholesale-only status and may bring discussion of retail-specific proposals into wholesale discussions; and
  - (b) Second, it could result in lessening of competition in the retail market by reducing the potential of retail product differentiation.
- 3.7 The NBN Co is a wholesale-only provider and as such, retail end-users are not customers of NBN Co. NBN Co cannot offer any services to retail end-users and it does not produce retail products. Rather, it sells product components which RSPs combine to produce and supply products to retail customers. There is a risk that the inclusion of lobby groups within the PDF may lead to operational creep from NBN Co on the basis that a party within the PDF has requested it. For instance, NBN Co may be pressured to produce services with Layer 3 capabilities. Yet the wholesale-only nature of NBN Co requires that they supply Layer 2 service to RSPs, whom then add Layer 3 capabilities using their own infrastructure and investments.
- 3.8 In addition, the PDF is the forum to assess new technical solutions, including the commercial and technical viability of new products. It is not clear what additional benefits would be added by including consumer advocacy groups in such discussions given that these should be focused at the access layer only.
- 3.9 It is foreseeable, however, that a consequence of having retail-specific discussions within the wholesale-only PDF may result in a lessening of competition within the retail market. In a retail market supplied with the same wholesale products, vigorous retail competition is expected to come from RSPs developing different products using different mixes of product components. That is, product differentiation. RSPs may wish to discuss the development of new wholesale products without having to discuss retail market implications (i.e. without revealing that the RSP is developing a new retail proposition). Consumer lobby groups would necessarily focus on retail products and would then lobby for development of wholesale-products to support it. Once such a discussion occurs within the PDF, the opportunity for retail differentiation might be reduced.
- 3.10 It is not clear what benefits flow from having a formal role for consumer advocacy groups in wholesale discussions. Should consumers and groups wish for products to be developed they should contact RSPs. With the increased level of competition flowing from structurally separated industry, RSPs ought to be better able to provide solutions that are demanded by consumers. RSPs that do not develop retail products that end-users demand are to lose market share to RSPs that do respond to consumer demands.
- 3.11 Given the level of competition expected to develop through the deployment of a wholesale-only fixed network providing services on a non-discriminatory basis, Optus reiterates that consumer interests will be well represented by RSPs. RSPs that develop innovative products that consumers demand will gain market share in the retail. It is this incentive that will ensure retail end-users receive innovative products, and that their interests are promoted by RSPs in the PDF.



- 3.12 Optus notes that there will be opportunity for end-users and end-user lobby group to provide input to NBN Co through broader policy consultations and reviews undertaken by the DBCDE, regulatory and Parliamentary bodies. NBN Co could consider alternative for a to canvass the view of consumer groups.

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

- 3.13 The ACCC proposes to remove clauses 5 and 6 of the PDF processes. The effect would be that terms about confidential information and IPR would be subject to continuing commercial negotiations and subject to regulatory determinations if required.

#### Optus' response

- 3.14 Optus agrees with the proposed changes.

### **Provisions which allow for consultation to not be undertaking in particular circumstances**

- 3.15 The SAU contains exceptions to the requirement to consult. The ACCC is of the view that such provisions reduce the extent that product development promotes competition. Consequently, the ACCC recommends that:

- (a) Initial product roadmap exemptions be removed;
- (b) Minor product variations exemptions be removed;
- (c) Exclusion for products that nbn co is obliged to offer as a result of a licence condition be removed;
- (d) Product development, variation and withdrawal apply to all ancillary services; and
- (e) Amendments so that product development and amendments apply to NBN Co-initiated development and variations.

#### Optus' response

- 3.16 Optus agrees with the proposed changes.

### **Provisions which set out NBN Co's ability to make a decision about whether or not to develop, introduce or vary a product**

- 3.17 The ACCC proposes to include explicit statements in the SAU that; acknowledge that the CCA allows ACCC to declare service; and that NBN Co will fulfil its obligations includes the supply of services declared by the ACCC. This means that the decision to introduce a service will first be subject to commercial negotiation but absent agreement, the ACCC will be able to declare service and require NBN Co to provide.

### Optus' response

3.18 Optus agrees with the proposed changes.

### **Product Withdrawal**

3.19 The ACCC raises concerns with the processes that enable NBN Co to withdraw non-reference offers. The ACCC proposes to include a commitment to provide the ACCC with; the same level of notice it provides customers; and the ability of the ACCC to disallow the withdrawal of a currently supplied product component, feature, ancillary service or facilities access service by NBN Co. The ACCC also proposes the same level of notification be granted to consumer advocacy groups.

### Optus' response

3.20 Optus agrees with the proposed changes.

3.21 In addition, Optus submits that clause 1I5.3 and 2E.6.4 should be amended to remove reference to "or a Shareholder Minister". Optus notes that the ability of a Shareholder Minister to direct that NBN Co remove a product will have the potential to undermine the ACCC's proposed changes to the product withdrawal clauses. Further, the notification period does not apply to Shareholder Ministerial directions under clauses 1I5.3 and 2E6.4. This clause is counter to the proposed change to ensure that the ACCC, customers and consumers receive the same amount of adequate notice.

3.22 It is foreseeable that where NBN Co and the ACCC disagree as to the withdrawal of a product in the future, NBN Co could request its Shareholder Ministers to require NBN Co to withdraw product. The product would then be removed without any oversight from the ACCC or notification from NBN Co.

## Section 4. Price-related terms and conditions

- 4.1 This section outlines the proposed changes put forward by the ACCC in relation to the price-related terms and conditions within the NBN Co SAU, discussed in section 2.4.1 of the Consultation Paper. Optus summarises the ACCC proposals and provides its response on the following:
- (a) Incentives to set new prices at levels that promote efficiency and competition; and
  - (b) Ability for relative price level to change in response to unforeseen circumstances.

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

- 4.2 The SAU enables NBN Co to set prices for new product having regard to pricing principles, and after publishing a pricing rational and consulting with customers. The ACCC recognises that NBN Co may not always have an incentive to price in a manner which encourages efficient use of the network. The ACCC proposes to amend the SAU to allow the ACCC to determine prices for new products and zero-rated products. The ACCC notes that clauses stating “will be determined by NBN Co” will need to be removed.
- 4.3 The purpose of these changes is to enable the ACCC to determine new prices, or new zero-priced products, in line with Part XIC obligations.

### Optus’ response

- 4.4 Optus agrees with the proposed changes. Optus recommends that the intent of the amendment could be best achieved through:
- (a) Removal of clauses 1C.4.5, 1D.4.3, 1D.5, 1D.6, 2C.3, 2C.4, 2C.5, and any related clause, that have the effect of limiting the ability of the ACCC to issue regulatory determinations and make assessment as per Part XIC of the CCA.
  - (b) A new clause that allows NBN Co to introduce pricing for new products or zero-rated products through the PDF. Where approval from Access Seekers is granted through the PDF for new prices, the new prices should be deemed to be approved without the need for the ACCC’s oversight.
  - (c) Should there not be agreement in the PDF, the ACCC should be able to use BROCs or ADs to set new prices. There should be no limit on the timeframe of assessment, and the ACCC should be free to backdate the price to the start date of the new price (i.e. time at which pricing was introduced to the PDF). This will provide an incentive to NBN Co not to game the PDF process.
- 4.5 Further, upon the introduction of new prices for zero-rated existing products and new products, consideration should be given to the extent that prices for existing products should be re-balanced. So that NBN Co does not receive a windfall from introducing new prices

(above recovering the incremental costs directly attributable to the new product, if any).

Optus submits that this power is necessary given the fixed and common cost structure of fibre networks, where new products delivered over bitstream do not fundamentally alter the cost structure of providing fibre connections to premises. New products merely allow an additional product from which fixed and common costs can be recovered.

- 4.6 For example, the revenue that would be gained through zero-rated existing products is currently obtained through prices charged for other services. Prices for zero-rate products or new products are set to recover direct costs of the product and an allocation of fixed and common costs. The extent to which prices for new products recover fixed and common costs, prices for existing services should be rebalanced to reflect the decline in fixed and common costs allocated to those existing services. Revenue accrued from new prices or services should be offset by a decline in revenue from existing services so that the total sum of revenue received remains unchanged.

#### **Ability for relative price level to change in response to unforeseen circumstances**

- 4.7 The ACCC considers that circumstances could arise over the term of the SAU which would suggest prices are not promoting the LTIE. The ACCC proposes to vary the SAU to provide for NBN Co prices to be subject to periodic revenue neutral rebalancing conducted by the ACCC. The rebalanced prices would continue to be subject to the CPI-1.5% limit.
- 4.8 The ACCC is seeking views on the form of variation, including whether the SAU should specify when rebalancing should occur; and how revenue neutral would be determined.

#### **Optus' response**

- 4.9 Optus agrees with the intent of the proposed changes. Optus agrees that where price structure and levels need to change to promote the LTIE, changes should occur. It is important to provide the ACCC with flexibility so that it can determine the timing of rebalancing and assess whether the changes have a revenue neutral impact using its own expert opinion.

#### ***Timing of rebalancing***

- 4.10 Optus believes that the ACCC should have flexibility to respond to inefficient price structures when it becomes apparent that the prices are inefficient. As such, there should be no restriction on the ability of the ACCC to start an investigation.
- 4.11 Optus further submits that a specific review of price levels and structures after five year period would be beneficial. Although, this may not require any amendment to the SAU in so far as there is nothing in the SAU that prevents the ACCC from initiating a review.
- 4.12 As discussed above, the ability to rebalance existing prices should also be available where NBN Co introduces prices for zero-rated products or pricing for new products and in conjunction with the ACCC assessment of the new pricing level. For example, the initial standard installation is zero-rated in clause 1D.3.2. The costs of installations are being recovered from existing service revenue (e.g. AVC revenue). Should NBN Co introduce a price for this service, the value of the future expected revenue stream should be deducted from the expected future

revenue stream from AVC products. This may necessitate a reduction in AVC charges to ensure that there is no change in expected future NPV (ie, revenue neutral impact).

- 4.13 The ACCC should ensure that the SAU enables it to intervene where zero-rated products (like ancillary services) are used to increase revenue by NBN Co in a manner that is inconsistent with the LTIE.

#### *Definition of revenue neutral*

- 4.14 Changes in price structures and levels should be assessed as being revenue neutral where the changes have a zero impact in the net present value (NPV) of future total revenue over the remaining lifetime of the SAU. The ACCC should have responsibility for assessing whether the proposed change meets the revenue neutral test. Such assessment should be subject to industry consultation (on a confidential basis if required).
- 4.15 Estimating the NPV of the price change would involve assessing changes in revenue resulting from price changes to the relevant product components (e.g. CVC and AVC), and any change in incremental direct costs. The assessment of the change in revenue should reflect the change in demand as a result of the new price levels, using appropriate and evidence-based price elasticities. The assessment of costs should only assess the incremental costs directly attributable to the change in price structure (if any). The SAU should not contain any restrictions on the ability of the ACCC to undertake its analysis.
- 4.16 Optus notes recent statements by NBN Co as to their expected future price path, highlighting that it expects the wholesale price for a 12Mbps service to fall by 19% in real terms to FY2012, and a 100Mbps plan to fall by 26% in real terms to FY2021.<sup>13</sup> Optus submits that these forecasts, and the price decline expected in the Corporate Plan for CVC, be the revenue neutral future price path. Where NBN Co proposes CVC or other prices above this level, this should be a trigger for the ACCC's review of price levels to ensure price increase is truly revenue neutral. Importantly, where volumes are a trigger for lower prices (as is for CVC product), the ACCC should ensure that lower prices occur before assumed volume growth — that is, price declines results in volume increases, not volume increases lead to price declines.
- 4.17 Importantly, Optus submits that revenue neutral should not be used to increase prices to make current or future revenue equal to past expectations and forecasts, e.g. as set in the Corporate Plan. The ACCC should ensure that the rebalancing powers are not used to increase revenue where NBN Co is missing its targets. The forward-looking assessment of revenue neutral from the time at which the price review occurs should be designed to address this issue. This implies that an adjustment with the effect on increasing future revenue, even if the increase means future revenue is consistent with historic forecasts, would not be consistent with the revenue neutral requirement.

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<sup>13</sup> NBN Co, 2013, *Report to Parliamentary Joint Committee on the National Broadband Network: Financial and Rollout Data*, 19 April 2013, p.13.

## Section 5. Long Term Revenue Constraint

- 5.1 This section outlines the proposed changes put forward by the ACCC in relation to long term revenue constraint conditions within the NBN Co SAU, as discussed in section 2.4.2 of the Consultation Paper. Optus summarises the ACCC proposals and provides its response on the following:
- (a) Estimating the value of the WACC;
  - (b) Timing of cash-flows in the RAB;
  - (c) Adoption of ex-post compliance approach in Module 1;
  - (d) Terms and conditions relating to capex in Module 1;
  - (e) Terms and conditions relating to annual construction in progress allowance in Module 1;
  - (f) Terms and conditions relating to tax allowance in progress allowance in Module 1;
  - (g) LTRC in Module 2;
  - (h) Terms and conditions relating to the length of the regulatory cycle in Module 1; and
  - (i) Terms and conditions relating to rolling forward the RAB in Module 2.

### Estimating the value of the WACC

- 5.2 The ACCC's preliminary view is that:

*... the ACCC must have regard to the legitimate commercial and business interests of NBN Co and its investment in facilities used to supply declared services, as well as to the risks involved in making those investments. This means that NBN Co should be allowed to earn a normal commercial return on its investment in the infrastructure used to supply those services, given the risks associated with that investment.<sup>14</sup>*

- 5.3 The ACCC has not yet formed a view on the proposed approach to the WACC in the SAU. The ACCC is seeking views of interested parties as to the appropriate approach.

### Optus' response

- 5.4 Optus agrees that where NBN Co obtains funding through commercial channels, then that funding should earn a rate of return consistent with legitimate commercial return on similar investments. Where NBN Co issues debt, its rate of return on that debt should reflect the

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<sup>14</sup> ACCC, 2013, Draft Decision about the 2012 NBN Co Special Access Undertaking — April 2013, p.152.

actual return on that debt. But Optus reiterates that NBN Co does not have *any commercial funding*, nor is it expected to receive such funding during Module 1. During Module 1 the sole supplier of capital to NBN Co will be the Australian Government through equity investment. The return on capital allowed in the LTRC should therefore reflect the return on capital required to be achieved by NBN Co. Where the regulated rate of return differs from the actual rate of return faced by NBN Co, NBN Co investment decisions will be distorted.

- 5.5 NBN Co is a government-owned enterprise, with guaranteed government provided equity of \$30.4 billion, up from \$27.5 billion in the previous corporate plan.<sup>15</sup> NBN Co and Australian Government entered into a funding arrangement on 22 June 2011 guaranteeing Government funding equity to fund the rollout of the NBN, with such funding being conditional on the annual appropriation process.<sup>16</sup> During Module 1 there will be no other provider of capital.<sup>17</sup>
- 5.6 One policy reason for NBN Co is that the private sector would not be able to achieve Government's broadband objectives because it would not be able to receive an adequate commercial return. The Government has recognised that it does not require a commercial rate of return for the project. The DBCDE confirmed that the Government has internalised the market risk faced by a commercial entity:

*The project is being financed by the government because it is best able to mobilise the capital required and manage the risks involved, rather than the private sector which **would require an additional risk premium for risks controlled by government.***<sup>18</sup>  
[emphasis added]

- 5.7 Optus notes that no mention is made in the Consultation Paper of how the proposed SAU WACC compares to the actual cost of capital incurred by NBN Co. As noted above, the legitimate commercial interest of NBN Co will be met by ensuring its *actual* cost of capital is recovered through the SAU.
- 5.8 It is clear from statements by Government and NBN Co that 7% is the actual cost of capital faced by NBN Co:

*NBN Co's expected rate of return is 7.04 per cent, which compares favourably with the average 10 year bond rate (July 2009 to November 2010) of 5.39 per cent. The NBN Corporate Plan shows the Government can expect to recover all its funding costs with interest.*<sup>19</sup>

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<sup>15</sup> NBN Co, 2012, Corporate Plan 2012-2015, p.73.

<sup>16</sup> NBN Co, 2012, Corporate Plan 2012-2015, p.78.

<sup>17</sup> Optus notes that should NBN Co receive some form of non-Government funding during Module 1, the return on capital in the LTRC can reflect the necessary return.

<sup>18</sup> Quoted by AGCNCO 2011, NBN Co, Investigation No. 14, Canberra, November, p.32.

<sup>19</sup> Joint Media Release with the Hon Julia Gillard MP Prime Minister and Senator the Hon Penny Wong Minister for Finance and Deregulation and Senator the Hon Stephen Conroy Minister for Broadband, Communications and the Digital Economy, "Government release NBN Co Corporate Plan", 20 December 2010.

- 5.9 NBN Co recently re-stated its intention to meet this 7 per cent requirement: stating that its pricing structure was built to ensure UNWP and to provide “a 7 per cent return to the government on capital costs”.<sup>20</sup>
- 5.10 Where both the equity provider and NBN Co accept that 7% is the appropriate return, it is not clear why a higher rate is needed to meet the legitimate commercial interest of NBN Co. Optus questions the appropriateness of the proposed approach to WACC in the SAU and the Consultation Paper, since the expected rate of return represents a cost to consumers above the actual cost of building the network (including the required return on capital). Setting a lower return is likely to better deliver the Government objectives of providing affordable broadband to all Australians.
- 5.11 Further, having a WACC above the actual cost of finance creates an incentive to increase the size of the RAB above the efficient level. The impact on the efficient operation of the building block approach of having a WACC that differs from the actual cost of funding was discussed by the Productivity Commission (PC) in its recent Draft Report on Network Electricity Regulation.<sup>21</sup>
- 5.12 Where the regulated WACC is set above the actual cost of finance over a long period of time, it results in allocative inefficient transfers from consumers to NBN Co. The PC found that such divergence is not in the long term interest of consumers – or in Part XIC terms, it would not promote the LTIE.<sup>22</sup> The PC found that where there is a long run expectation that the regulated WACC is above the actual cost of finance, there are incentives for the regulated firm to over-invest. It was found that a higher WACC led to a higher RAB and if the regulated WACC was sufficiently above the actual cost, over-investment may be profit-maximising.<sup>23</sup> Optus further notes that this incentive may be stronger for NBN Co, where under the proposed LTRCM in Module 1, actual capex determines not only the RAB but also the yearly allowable revenue.<sup>24</sup>
- 5.13 Optus submits the WACC should be set between the long term cost of borrowing and 7% for all of Module 1, or until the point where NBN Co is no longer reliant on Government equity funding.

### Timing of cash-flows in RAB

- 5.14 The ACCC identifies inconsistencies in the applications of the WACC to capital costs and operating expenditures. The ACCC proposes to remove the inconsistencies to ensure that the WACC is applied at the same time for both capital costs and operating expenditures.

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<sup>20</sup> [http://afr.com/p/technology/remove\\_nbn\\_speed\\_limits\\_ex\\_telstra\\_OsikF0bBx8igR7gGvTH1RP](http://afr.com/p/technology/remove_nbn_speed_limits_ex_telstra_OsikF0bBx8igR7gGvTH1RP).

<sup>21</sup> PC, 2012, *Electricity Network Regulatory Frameworks*, section 5.3.

<sup>22</sup> PC, 2012, *Electricity Network Regulatory Frameworks*, p.195.

<sup>23</sup> PC, 2012, *Electricity Network Regulatory Frameworks*, p.195.

<sup>24</sup> Under the NER, forecasts are used, so that any actual over-spend on capex does not translate into higher allowable revenue during the current regulatory period. But since actual capex flowed into RAB, it resulted in higher allowable revenue in the next regulatory period.



### Optus' response

- 5.15 Optus agrees with the proposed changes. Optus agrees that the WACC should be applied at the same time irrespective of whether expenditure is classified as capital or operating. Optus' preference is for end-of-year application.

### **Adoption of ex-post compliance approach in Module 1**

- 5.16 Under the ex-post compliance approach the ACCC has no role in approving or overseeing the application of the LTRC methodologies. The ACCC believes this will likely reduce NBN Co's incentives to invest and operate efficiently. This is because NBN Co is given considerable discretion to determine what investments fall within the scope of the ABBRR.
- 5.17 The ACCC proposes that it be given a role to calculate the values of the building block components that are inputs to the ABBRR, as well as the roll-forward of the RAB and ICRA.

### Optus' response

- 5.18 Optus agrees with the intent of the proposed changes. Optus agrees that the ACCC should have the power to assess the values of the inputs into the components of the LTRC (RAB, ICRA and ABBRR) each year — including return of capital; return on capital; operating costs; tax and annual construction in progress. Specifically, Optus agrees with the option put forward in the Consultation Paper where:
- (a) 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; and
  - (b) In circumstances where the ACCC considers that NBN Co's reported costs do not comply with the methodologies in the SAU, the ACCC would consider rolling forward the RAB and ICRA, and determining the value of the annual revenue requirements, based on amended values as decided by the ACCC.
- 5.19 In addition under (b) above, the ACCC should have the power to amend values where the ACCC assesses that expenditure does not represent prudent expenditure (for both capital and operating expenditure). While the ACCC will be able to review the extent to which incurred expenditure is recovered through the RAB at the end of Module 1, Optus sees merit in the ability of the ACCC to have the option to intervene earlier if in its expert opinion expenditure is above the prudent level. This is not to say that the ACCC has to intervene; rather Optus is advocating that the ACCC not be excluded from the opportunity to intervene. It will then be up to the ACCC whether it exercises this power, using its expert opinion and evidence at the relevant time, and whether it promotes the LTIE (including the legitimate commercial interest of NBN Co). The assessment of prudence is discussed in paragraph 5.29 and below.

- 5.20 Optus notes that the ACCC has proposed that several provisions in the SAU would be reviewed after a five year period.<sup>25</sup> Optus sees merit in a similar review phase for the RAB. That is, the SAU mandates a full review of the RAB after the first five years of Module 1 and at the end of Module 1.
- 5.21 Optus recommends that amendments to the SAU should reflect relevant provisions in similar accepted SAUs, for example clause 4.10 in the ARTC Hunter Undertaking.<sup>26</sup> Such provisions would allow for the ACCC to determine whether NBN Co has undertaken roll-forward of the RAB and calculation of ABBRR and ICRA in accordance with the Undertaking. Where the roll forward is not in accordance with the Undertaking, determine what closing RAB, ICRA or ABBRR would be in accordance with the Undertaking. Further, there should be a specific obligation that NBN Co will revise the RAB, ICRA and ABBRR in accordance with any determination by the ACCC.
- 5.22 Optus suggests that a new clause 1E.2.6 could be added:

*The ACCC will determine whether NBN Co has undertaken:*

- i. roll-forward of the RAB, ICRA and ABBRR in accordance with the Undertaking and, where the roll forward is not in accordance with the Undertaking, determine what closing RAB, ICRA or ABBRR would be in accordance with the Undertaking;*
- ii. in determining whether NBN Co has complied with the provisions of [ref] in rolling forward RAB, ICRA or ABBRR, the ACCC may have regard to the submissions of relevant industry participants but if Capital Expenditure has been endorsed by the PDF [or equivalent customer fora] in, the ACCC will not consider whether that Capital Expenditure is Prudent;*
- iii. the ACCC will publish its findings on its website and/or circulate to Access Seekers in relation to the matters for its determination; and*
- iv. NBN Co will revise the closing RAB, ICRA and ABBRR in accordance with any determination by the ACCC.*

- 5.23 As discussed above, a broad power to assess the extent to which incurred expenditure can be included within the RAB, ICRA and ABBRR should be included in the SAU. Optus notes that the ARTC Hunter Valley Undertaking enables the ACCC to assess whether costs incurred are efficient, without prescriptive obligations placed upon the ACCC.<sup>27</sup> For example, clause 4.10(e) of the ARTC Hunter Valley Undertaking states:

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<sup>25</sup> For example, the PDF processes and SFAA development process

<sup>26</sup> ARTC, Hunter Valley Coal Network Access Undertaking, as varied 17 October 2012.  
[http://www.artc.com.au/library/2012\\_HVAU\\_undertaking.pdf](http://www.artc.com.au/library/2012_HVAU_undertaking.pdf)

<sup>27</sup> See clause 4.5(d) and 4.10(e).

*The ACCC will determine whether ARTC has incurred Efficient costs and Efficient operating expenditure in accordance with section 4.5(b), and determine the change (if any) to:*

*(i) the total unders and overs amount or allocation; and*

*(ii) closing RAB in section 4.4(a),*

*that results from Economic Cost under section 4.5(a) only including Efficient costs and Efficient operating expenditure determined in accordance with section 4.5(b).*

5.24 Where section 4.5(b) requires that costs are to be assessed on an efficient basis and efficient is defined in clause 14 of the Undertaking.

5.25 Optus recommends that a similar provision be included in NBN Co's SAU. Optus suggests the following be included within the main body of the SAU:

*"The ACCC will determine whether NBN Co has incurred Prudent costs and Prudent operating expenditure in accordance with Schedule 1E, and determine the change (if any) to:*

*i. closing RAB;*

*ii. closing ICRA;*

*iii. annual construction in progress allowance;*

*iv. annual tax allowance; and*

*v. the ABBRR*

*that results from expenditure only including Prudent costs and Prudent operating expenditure determined in accordance with clause [insert reference to Prudency clause]."*

5.26 In addition, Optus further suggests that the SAU requires NBN Co to appoint an independent auditor to audit its regulatory accounts and assess compliance with SAU obligations. The ACCC should have power to object to the proposed auditor. Such provisions could be based on clause 4.10(f) of the ARTC Hunter Valley Undertaking.

5.27 The ACCC should undertake an efficiency audit of the activities of NBN Co every three to five years, covering both capital costs and operating expenditure. Where it is found that NBN Co has incurred capital or operating expenses in an imprudent manner, the RAB should be adjusted accordingly.

5.28 The possibility of ex post assessment would encourage NBN Co to invest more efficiently. NERA Consulting highlighted that given the significant cost the NBN project, even a small increase in efficiency would have significant impacts on consumers.<sup>28</sup>

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<sup>28</sup> NERA Consulting, *Review of the Long Term Revenue Constraint in NBN Co's SAU: A report for Optus*, 18 January 2013.

## Terms and conditions relating to capex in Module 1

- 5.29 Under Schedule 1E, NBN Co can include into the RAB all actual capital expenditure that satisfies the prudent design condition and the prudent cost condition (prudency). The ACCC proposes to amend clauses relating to the ability to vary network design rules (minor expenditure limit) and the customer engagement process.
- 5.30 Optus notes that the ACCC made no specific comments, or recommendations, in relation to the prudent cost conditions.

### Optus' response

- 5.31 Optus agrees with the proposed changes. However, in addition Optus believes that the ACCC should vary the terms relating to prudency to ensure the NBN Co SAU is capable of being accepted. Prudency should be assessed against the Part XIC criteria, as per other fixed-line services RAB assessments. The current prudency provisions within the SAU that allow NBN Co to self-assess compliance should be removed. To this end, Optus recommends that clauses 1E.3 to 1E.11 and 1F.7 be removed from the SAU. This approach is also consistent with the recent changes to the NER and recommendations of the AEMC and AER.
- 5.32 While the ACCC will be able to review the extent to which incurred expenditure is recovered into the RAB at the end of Module 1, Optus sees merit in the ability of the ACCC to have the option to intervene earlier if in its expert opinion expenditure is above the prudent level. This is not to say that the ACCC has to intervene; rather Optus is advocating that the ACCC not be excluded from intervening. It will then be up to the ACCC whether it exercises this power, using its expert opinion and evidence at the relevant time, and whether it promotes the LTIE (including the legitimate commercial interest of NBN Co).
- 5.33 Further, reliance on a RAB adjustment at the end of Module 1, i.e. after ten years, may result in a significant shock to the value of the NBN asset. And, it precludes NBN Co from learning from earlier efficiency assessments and the benefits of NBN Co adopting more efficient practices at an earlier time. Furthermore, the fundamental problem of telecommunications regulation in Australia has been how to estimate the efficient cost of historic sunk investments given the regulator's significant information asymmetry. The ACCC has a unique opportunity to overcome the traditional information asymmetry paradox since it will be present when spend is incurred and can verify the relative prudency of such spend. This would be achieved by consistent reviews of the efficiency of NBN Co's expenditure. As noted above, this does not mean the ACCC will intervene — merely that the ACCC has the opportunity to intervene. The prospect of intervention alone should act as a strong incentive for NBN Co to operate efficiently.

### Prudency (1E.3 to 1E.5; 1F.7)

- 5.34 The ACCC should request the removal of provisions that allow NBN Co to assess capital and operating expenditure as prudent and hence include within the RAB, ICRA and ABBRR. That is, clauses 1E.3 to 1E.5 and 1F.7.

- 5.35 The assessment of prudence could be based upon similar techniques discussed in the AER Expenditure Forecast Assessment Guidelines for Electricity Distribution and Transmission Inquiry.<sup>29</sup> All possible techniques should be open for the ACCC to assess efficiency of expenditure. This implies that the SAU should not contain any restrictions on the ability of the ACCC to assess expenditure against s.152 criteria. The SAU should not prevent the ACCC from applying benchmark analysis. Over time, benchmarking will become more effective as more information becomes available. An important source of benchmark data would come from NBN Co's own internal and public guidance, in the form of Corporate Plans and statements to Parliament. For example, where NBN Co misses roll-out targets by 98% is it prudent to include all or only some proportion of the forecasted capital costs?
- 5.36 Optus refers to the recent guidance provided by the AEMC stating that the regulator should not be constrained by the capex and opex criteria from choosing the best substitute it can determine from all information before it.<sup>30</sup> The AEMC has made clear that the capex and opex proposal by the access provider is the starting point of the analysis. It should be only one of a number of inputs. The regulator can have reference to other submissions, expert reports, and its own analysis when assessing what a reasonable forecast is. The assessment of reasonable allowances is not restricted by the initial proposal.<sup>31</sup>
- 5.37 Optus strongly recommends that this be the guiding principle for recommending changes to the NBN Co SAU. The ACCC could propose specific factors that it would consider when assessing prudence. But this should be done on a non-exhaustive basis. Optus notes that the ARTC Hunter Valley Undertaking and fixed principle provisions within existing and proposed telecommunications FADs contain non-exhaustive lists.<sup>32</sup> Any criteria in the NBN Co SAU should not be exhaustive and should be secondary to the objective of promoting the LTIE.
- 5.38 An example form of words in place of clause 1E.4 could be:

*“Prudent” means, in respect to costs and operating expenditure, costs incurred by an efficient service provider managing the Network, acting efficiently, having regard to matters particular to the environment in which management of the Network occurs including:*

- (i) *the Statement of Expectations;*
- (ii) *requirement to make a return at the long term cost of Government borrowing, but no more;*
- (iii) *the extent to which capital and operating expenditures are consistent with NBN Co's Corporate Plans and other forward-looking metrics*

<sup>29</sup> <http://www.aer.gov.au/node/18864>

<sup>30</sup> AEMC, 2012, Final Rule Determination, p.96.

<sup>31</sup> AEMC, 2012, Final Rule Determination, section 8.5.

<sup>32</sup> See for example clause 6 of the fixed-line services FAD & proposed WADSL service FAD.

*supplied to relevant bodies (including the ACCC, Ministers, DBCDE, Parliamentary);*

- (iv) *the extent to which capital expenditure is consistent with national and international industry benchmark levels;*
- (v) *the extent to which operating expenditure is consistent with benchmarks in privately operated telecommunications firms;*
- (vi) *the extent to which capital and operating expenditure is at a level consistent with a hypothetical efficient operator with similar scale and scope of NBN Co;*
- (vii) *the need to ensure expenditure is at a level that promotes the long-term interest of end-users;*
- (viii) *NBN Co's obligation under law; and*
- (ix) *Any other factor considered relevant by the ACCC.*

*"Prudent Cost" does not include the extra costs incurred to comply with specific Government policies which would otherwise not be incurred by an efficient privately-owned company with similar scale and scope of NBN Co.*

5.39 Where possible, benchmarking should be used to assess whether the expenditure incurred by NBN Co are within a range of reasonable comparators. Such comparable industry metrics would include investments and financial metrics. Examples of benchmarking metrics include:

- (a) Capital cost benchmarking, for example, would include an assessment of the satellite programme agreed to by NBN Co. NBN Co paid \$300 million for the development of its satellite. The ACCC should investigate to see whether this is consistent with, or above, the industry norm for building and launching a satellite. Any disparity may indicate that NBN Co paid significant more than market rates. The ACCC should investigate the extent to which there are rational design or capability differences that would justify the difference.
- (b) Operating costs would need to be focus in the short term. NBN Co is forecasting significant operating expenditure of more than \$26 billion up to 2021 — up from \$23 billion in the 2010 Corporate Plan. Opex represents over 40% of total expenditure up to 2021. Small efficiency dividends from this would produce significant savings, for instance just a 1% reduction in opex would save over \$260 million. A benchmarking exercise could be taken against average wage levels, or level of staffing. The ACCC could assess relevant expenditure ratios against other Australian telecommunications companies.
- (c) The ACCC should also assess the 'bring-forward' of contractual payments (as recently announced for civil contractors to encourage increased number of premises passed) to assess whether such expenditure actually brings-forward value. The ACCC should only allow recover of these costs where the bring-forward produces commercial

benefit to NBN Co, and is not driven by non-commercial factors. The ACCC should also ensure that brought-forward payments are not replicated at a later time.

- (d) The ACCC should also benchmark costs against public statements of NBN Co such as annual reports and Corporate Plans. The Government reaffirmed in April 2013 that it still expects NBN Co to meet the forecasts put forward in the Corporate Plan and there is *“no reason to believe that the fundamental numbers will change substantially”*.<sup>33</sup> NBN Co has also confirmed that the Corporate Plan is a true statement of where NBN project is at as of April 2013.<sup>34</sup> Given these statements, it is reasonable to expect NBN Co will meet the statements in its Corporate Plan. Optus submits that NBN Co should be benchmarked against such forecasts, as private companies are. For example, where NBN Co misses roll-out targets by a large margin yet expenditure remains stable, questions should be raised over the prudence and effectiveness of expenditure. Should NBN Co increase expenditure to make-up for missed targets, the ACCC should not assess the increase in expenditure as prudent.

#### *Network design change (1E.6 to 1E.7, and 1E.9 to 1E.11)*

- 5.40 Optus accepts the ACCC’s comments that its assessment of efficiency and prudence is somewhat bounded by the policy decisions impacting on the NBN. For example, it would not be appropriate for the ACCC to analyse the efficiency of a FTTN roll-out within the context of a Government-mandated FTTP design. In saying that however, the ACCC certainly does have a role in assessing the efficiency of the implementation of government policy and whether NBN Co is incurring prudent expenditure (as discussed above).
- 5.41 Optus submits that any change to the network will involve a change in the level of expenditure, hence additions to the RAB. The inclusion of the costs of such changes in the RAB should be subject to the same oversight as per all RAB inclusions.
- 5.42 In addition, Optus submits that clauses 1E.9, 1E.10 and 1E.11 be removed. This would allow prudence disputes to be assessed by the ACCC with reference to the objectives of Part XIC and to issues regulatory determinations where appropriate. While the principle of customer endorsement is acceptable to Optus, clause 1E.10 relates more to methods through which NBN Co would avoid complying with prudence dispute provisions rather than stating that customers can approve network changes. Optus believes that since regulatory determinations would likely only commence after complaints to the ACCC, customer endorsement occurs by default absent complaints to the ACCC. There is no need for a specific customer endorsement provisions within the SAU.

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<sup>33</sup> Ms Mason, Joint Committee on the National Broadband Network Joint Committee Friday, 19 April 2013, Hansard Transcript, p.11

<sup>34</sup> Mr Quigley, Joint Committee on the National Broadband Network Joint Committee Friday, 19 April 2013, Hansard Transcript, p.12.

## **Terms and conditions relating to annual construction in progress allowance in Module 1**

- 5.43 The ACCC proposes that the SAU clarify the process by which expenditure is classified as prudent before it is included in the audited accounts as construction-in-progress. The ACCC proposes that it will determine the value of the annual construction in progress allowance that will be included in NBN Co's annual revenue requirement.

### Optus' response

- 5.44 Optus agrees with the intent of the proposed changes. Optus agrees that the ACCC assess the values of construction in progress included within the ABBRR. Where the value of construction in progress is assessed at a later time of being above the prudent level, the ACCC should be able to adjust the RAB/ICRA and ABBRR to discount the inefficient costs. The drafting suggested above may be sufficient.

## **Terms and conditions relating to annual tax allowance in Module 1**

- 5.45 The ACCC considers that the method for calculating NBN Co's tax allowance is unlikely to reflect NBN Co's tax liabilities during Module 1. To address this, the ACCC proposes that the value of gamma should be determined at the time the ABBRR is calculated.

### Optus' response

- 5.46 Optus agrees with the intent of the proposed changes. Optus agrees that the value of the gamma be determined at the time that the ABBRR is calculated.
- 5.47 Further, Optus recommends that the tax provisions reflect the provisions in cl.6.5.2 of the NER. That is, estimating the taxable income for the regulatory year that would be earned by a benchmark efficient entity. The SAU should allow the ACCC to alter actual taxable income to reflect its assessment of efficient level.
- 5.48 This may be covered by the amendments proposed above that require the ACCC to approve the individual components of the ABBRR for each year. This would allow the ACCC to adjust taxable income where it does not reflect the efficient level.

## **Terms and conditions relating to the criteria and methodology for determining forecasts in Module 2**

- 5.49 The ACCC believes that the methodologies contained in Module 2 may allow NBN Co to include costs above its direct costs. The ACCC proposes that the methodologies be removed from the SAU, including:
- (a) Clause 2D.6.1(a) and (b) and clause 2D.8;
  - (b) Matters in reference to return on capital (cl.2D.2.1(a)(iii)(A)) and remove reference to nominal vanilla WACC and insert a return on capital;
  - (c) Replace cl.2D.2.1(a)(ii)(A) with forecast nominal regulatory depreciation for year t; and



- (d) Replace factors in cl.2D.2.1(a)(iv) with 'a tax allowance'.

5.50 The purpose of these amendments is that Module 2 does not prescribe the methodology to be used. The ACCC highlights that any future methodology could be proposed as a variation to the SAU at the end of Module 1, or determined by the ACCC through ADs.

Optus' response

5.51 Optus agrees with the proposed changes. Optus notes that all of Module 2 is defined as fixed principles and subsequent SAUs must be consistent with Module 2. It is therefore important that Module 2 does not contain obligations which are likely to become out dated before the subsequent regulatory period begins.

5.52 For these reasons, Optus suggests three further amendments to Module 2:

- (a) Include statements, consistent with those in Module 1, stating that the ACCC will determine the prudent costs that can be rolled-forward and included within the RAB, ICRA and ABBRR;
- (b) Include statements, consistent with those in Module 1, stating that the ACCC will assess whether costs put forward by NBN Co reflect prudent costs; and
- (c) Amend 2D.5.2(b) to allow the ACCC to determine the amount of the under recovery that can be recovered to next regulatory period. Where the ACCC assesses that the under recovery was caused by excessive inefficient forecasting, the ACCC should not permit recovery in the next regulatory period.

**Terms and conditions relating to the length of the regulatory cycle in Module 1**

5.53 Clause 4.6(b)(i) allows NBN Co to determine the length of the regulatory cycle. The ACCC does not believe this in the LTIE. The ACCC suggests such discretion be removed. This means that the length of the regulatory cycle can be determined as a variation to the SAU at the end of Module 1, or determined by the ACCC through regulatory determinations.

Optus' response

5.54 Optus agrees with the proposed changes.

**Terms and conditions relating to rolling forward the RAB in Module 2**

5.55 The ACCC proposes that the SAU be varied to remove the requirement for the RAB to be rolled-forward on actual capex and actual depreciation. It is proposed to require that the RAB be rolled-forward on prudent additional expenditure, depreciation etc. This means that the manner in which the RAB can be rolled-forward can be determined as a variation to the SAU at the end of Module 1, or determined by the ACCC through ADs.

Optus' response

5.56 Optus agrees with the proposed changes.

- 5.57 Optus acknowledges that given the length of time before the start of Module 2 and the level of uncertainty as to the appropriate regulatory design, it is appropriate for the ACCC to ensure that there is flexibility as to how the RAB elements of Module 2 would operate. Given the significant amount of learning about the efficient design of regulatory oversight of the NBN through Module 1, it is appropriate that decisions on regulatory designs, like the need to include capital efficiency mechanisms, be made at a time closer to the start of Module 2.
- 5.58 In saying that, however, Optus sees benefits in amending the SAU so the ability to review in Module 2 is consistent with Module 1. This includes allowing the ACCC to approve, amend or disallow the value rolled-over into the RAB/ICRA and the ABBRR. And also for the ACCC to assess whether expenditure is prudent.
- 5.59 Optus further recommends that the ACCC propose amendments to the ICRA provisions (clause 2D.4) that make it consistent with the above comments. Optus submits that the calculation of the ICRA during Module 2 uses actual expenditure rather than forecasts. Specifically, the reference to *annual forecast revenue* in the calculation of unrecovered cost in clause 2D.4.3 should be amended to *annual nominal revenue*. Optus also submits that the roll-forward of the ICRA (clause 2D.4.4) allow for ACCC review and determination (if necessary) of rolled-forward value. Such an amendment ensures consistency with Module 1 powers.
- 5.60 Finally, clause 2D.5 should be amended to provide the ACCC with the same powers of review as it has under Module 1. Specifically, that:
- (a) 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; and
  - (b) in circumstances where the ACCC considered that NBN Co's reported costs do not comply with the methodologies in the SAU *or do not reflect prudent expenditure*, the ACCC would consider rolling forward the RAB and ICRA, and determining the value of the annual revenue requirements, based on amended values as decided by the ACCC.
- 5.61 Optus suggests a clause similar to that suggested to be inserted in Module 1 also be inserted in Module 2:

*“The ACCC will determine whether NBN Co has incurred Prudent costs and Prudent operating expenditure in accordance with Schedule 1E, and determine the change (if any) to:*

- i. closing RAB;*
- ii. closing ICRA;*
- iii. annual construction in progress allowance;*
- iv. annual tax allowance; and*
- v. the ABBRR*

*that results from expenditure only including Prudent costs and Prudent operating expenditure determined in accordance with clause [insert reference to Prudency clause].”*

## **Section 6. Non-price terms and conditions**

6.1 This section outlines the proposed changes put forward by the ACCC in relation to non-price terms and conditions within the NBN Co SAU. Optus summarises the ACCC proposals and provides its response on the following:

- (a) Service levels; and
- (b) Other SFAA non-price terms.

### **Service levels**

6.2 The ACCC has proposed to exclude the detailed non-price terms and conditions for the SAU. That is, the removal of Schedule 1J and Schedule 2F. This will provide the opportunity for such terms to be subject to a later ACCC determination if they cannot be settled commercially between the parties. Implicit in the ACCC's decision is a recognition that industry consensus has not been reached on all the non-price terms that were included in the SAU.

### **Optus' response**

6.3 Optus supports the ACCC's approach to varying the SAU in respect of the non-price terms.

6.4 Optus also welcomes the ACCC's commentary on the terms that were set out in the SAU, which should facilitate achieving industry consensus on those non-price terms of access to the NBN.

### **Other SFAA non-price terms**

6.5 The ACCC proposes that; clauses 1H.5, 1H.6, and 1H.7 from schedule 1H of Module 1 be deleted; and the removal of Annexures 1,2 and 3 to Schedule 1H of Module 1.

### **Optus' response**

6.6 Optus agrees with the proposed changes.