



Australian
Competition &
Consumer
Commission

Consultation Paper — variation of NBN Co Special Access Undertaking

April 2013

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

First published by the ACCC 2013

10 9 8 7 6 5 4 3 2 1

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Contents

Glossary	1
Preface	5
Next steps for the Notice to Vary	6
1. Overview	7
2. Proposed variations	10
2.1. Interaction between the SAU and the telecommunications access regime	10
2.2. Services to which the SAU relates	19
2.3. Product development and withdrawal	22
2.4. Price-related terms and conditions	26
2.5. Non-price terms and conditions.....	34
Contacts	37

Glossary

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

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

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

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

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

ACCC – Australian Competition and Consumer Commission.

AER – Australian Energy Regulator.

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

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

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

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

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

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

CCA – *Competition and Consumer Act 2010*.

CPI – Consumer Price Index.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Listed carriage service – A carriage service of the type listed in section 16 of the *Telecommunications Act 1997*, that is, a carriage service between two points where at least one point is in Australia.

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

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

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

NBN Access Service – NBN Co describes this as a Layer 2 service supplied on the NBN Co network between and including: a User Network Interface on a network termination device; and

the Network-Network Interface at the point of interconnect associated with the relevant network termination device, for the purpose of enabling an access seeker or another service provider that is a customer of an access seeker to supply carriage or content services.

NBN Co – NBN Co Limited and NBN Tasmania Limited.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Preface

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

Concurrent to the release of this Consultation Paper, the Commission released a Draft Decision setting out its preliminary view that it is not satisfied that the SAU lodged by NBN Co on 18 December 2012 meets the criteria specified in Part XIC of the CCA for acceptance of an SAU.

As noted in that Draft Decision, in light of the issues that have arisen in the ACCC's consideration of the SAU, the ACCC is proposing to give NBN Co a notice specifying variations to the SAU. This notice would be given in order to facilitate NBN Co being able to lodge an amended SAU that is capable of meeting the statutory criteria.¹

This Consultation Paper seeks views on the variations to the 18 December 2012 SAU that the ACCC is proposing to include in a written notice to NBN Co.

Submissions to this Consultation Paper should:

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

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

All submissions should be forwarded by email to:

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

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

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

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

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

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

Next steps for the Notice to Vary

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

NBN Co would then have the time specified by the ACCC in the notice to respond to the notice. This would not preclude NBN Co from lodging a varied SAU prior to the specified time.

The ACCC intends to invite submissions on any varied undertaking that is given by NBN Co in response to the Notice to Vary. The duration of the ACCC's consultation will depend on the level of compliance by NBN Co with the Notice to Vary.

The ACCC notes that it is not automatically required to accept a varied undertaking that is given in response to a section 152CBDA notice.

1. Overview

Section 152CBDA of the CCA provides for the ACCC to give a written notice to NBN Co in respect of its SAU that invites NBN Co to make variations to the SAU in accordance with the notice. If NBN Co does so, the ACCC must consider the varied undertaking as if it had been given to the ACCC instead of the SAU.² The purpose of such a notice is to streamline the SAU assessment process, as NBN Co does not need to submit a new SAU in order to address the matters set out in the notice.³

A section 152CBDA notice must:

- specify variations to the SAU;⁴
- specify a period in which NBN Co may give a varied undertaking to the ACCC;⁵ and
- state that the ACCC will consider the varied undertaking as if it had been given instead of the SAU.⁶

If the ACCC gives NBN Co a notice under section 152CBDA, the notice has the following immediate effects:

- it acts as a 'clock-stopper' (that is, the period of time specified in the notice is disregarded for the six month decision period in subsection 152CBC(5)); and
- it allows NBN Co to choose whether to give a varied undertaking in response to the notice.

The length of the 'clock-stopper' depends on whether NBN Co gives a varied undertaking, and the significance of the variations.⁷

If NBN Co decides to give a varied undertaking to the ACCC, it has the following effects:

- the ACCC will be generally be required to publish the varied undertaking and invite submissions that it must consider when making a decision on the varied undertaking;⁸
- the time between the giving of the notice and the time specified by the ACCC when publishing the varied undertaking is disregarded from the six month decision period (that is, this period of time is a 'clock-stopper');⁹ and
- the ACCC will make a decision on a revised Special Access Undertaking without NBN Co being required to withdraw the SAU.¹⁰

² CCA, s. 152CBDA(3).

³ Explanatory Memorandum to the Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010, p. 210.

⁴ CCA, s. 152CBDA(2)(a).

⁵ CCA, s. 152CBDA(2)(b).

⁶ CCA, s. 152CBDA(2).

⁷ CCA, ss. 152CBC(6) and 152CBD(6).

⁸ CCA, s. 152CBD(6).

⁹ CCA, s. 152CBC(6)(ac).

¹⁰ Explanatory Memorandum to the Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010, p. 210.

If NBN Co chooses not to give a varied undertaking, the 'clock-stopper' will be for the period specified in the notice,¹¹ and the ACCC will proceed to make a final decision in respect of the 18 December 2012 SAU.

Other than the mandatory elements of a section 152CBDA notice set out above, under Part XIC the ACCC may exercise its own judgment about when and how it issues a notice that will most effectively streamline the undertaking assessment process.

Of note though, and as discussed in further detail in the Draft Decision, the potential for changes over the 27 year SAU term in the incentives faced by NBN Co to operate, invest, develop products and set prices efficiently has been a contributing factor in developing the proposed variations. In the short to medium term NBN Co is likely to face incentives to take an innovative approach which aligns with the interests of its customers with respect to its products, pricing and investment. However, it is also possible that these incentives will change over the SAU term, particularly once any risks that NBN Co will not be able to recover its costs reduce.

The ACCC has taken the following broad approach to its proposed variations.

Firstly, a range of variations are proposed with the objective of reducing the complexity of the SAU and clarifying its operation. In particular, specific drafting amendments (including the deletion of particular clauses) are proposed with the objective of creating certainty about when and how NBN Co must comply with its obligations — including its obligations to comply with Access Determinations and Binding Rules of Conduct ('regulatory determinations') — under the Part XIC telecommunications access regime.

Secondly, variations, including to the price related provisions, are proposed with the objective of ensuring that the approach to regulation encourages efficient use of and investment in the NBN over the term of the SAU. Key proposed variations include:

- The inclusion in the SAU of an opportunity for the ACCC to periodically review whether price structures and relative price levels should be rebalanced (for example, every five years) — the outcomes of this rebalancing would be constrained by the principle that any changes to price structures or relative price levels must be revenue neutral in their effect.
- Amendments to acknowledge that there will be a role for the ACCC in the process of withdrawing products, in order for the ACCC to be able to ensure the effectiveness of the CPI-1.5 per cent price control in creating incentives for NBN Co to invest and operate efficiently.
- Amendments to acknowledge that the ACCC could, in circumstances where NBN Co does not face incentives to respond to evolving end-user demand with respect to the development of new products and their prices, declare services and set terms and conditions for new services.
- Amendments to the long-term revenue constraint methodology which would allow for a greater degree of flexibility, and for usual regulatory practise to be mirrored, in the approach that is adopted to encourage efficient investment in and operation of the NBN at various points in time throughout the SAU term.

Lastly, variations are proposed which would remove from the SAU a number of the proposed non-price terms, including those relating to service levels. The effect of the removal of these terms would be that they continue to be commercially negotiated. The ACCC recognises that the non-price terms have been the subject of ongoing disagreement between NBN Co and its customers. The removal of the terms from the SAU would mean that they could be the subject of later ACCC regulatory determinations. The ACCC notes that — in the event further examination of non-price terms was warranted through a separate regulatory process — the

¹¹ CCA, s. 152CBC(6)(aa).

ACCC might need to prioritise those issues that most directly affect end-users in migration to the NBN, given that NBN Co is currently in the early stages of its rollout.

A number of these proposals are directed towards clarifying that — for matters not currently directly dealt with by the SAU — Part XIC would continue to operate as intended. As stated in the *Explanatory Memorandum to the Telecommunications Legislation (National Broadband Network Measures — Access Arrangements) Bill 2010*, “the policy intention is that at all times NBN corporations are subject to the obligations under Part XIC – specifically the Category B SAOs...[a]s a consequence the supply of services by NBN corporations is always subject to oversight by the ACCC.”¹²

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

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

The ACCC considers that if the proposed variations are made, the SAU would deliver a framework for the regulation of NBN Co’s services which:

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

¹² Explanatory Memorandum to the Telecommunications Legislation (National Broadband Network Measures – Access Arrangements) Bill 2010, p. 136.

2. Proposed variations

This section of the Consultation Paper seeks views on the variations that the ACCC is proposing to include in a written notice to NBN Co.

The proposed variations are described at differing levels of detail and prescription.

For some matters, the ACCC is seeking stakeholder views on what conceptual approach would best address a particular issue.

For other matters, the ACCC has described its views on how it considers the issue would be most effectively addressed. For these matters, the ACCC is seeking stakeholder views on the effectiveness of the particular drafting amendments that it has proposed. Importantly, the drafting changes proposed in this Consultation Paper may not be comprehensive and consequential changes may be required to other parts of the SAU.

In order to provide a greater level of direction to NBN Co than is provided by this Consultation Paper and to assist it in preparing its revised SAU, the ACCC intends that the Notice to Vary when issued will outline all of the variations that it includes in a prescriptive manner.

The ACCC welcomes the views of interested parties on the variations proposed in this Consultation Paper. It 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); and
- 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.

2.1. Interaction between the SAU and the telecommunications access regime

The variations that are proposed in this section of the Consultation Paper relate to the issues discussed in chapter 2 of the Draft Decision on the SAU.

2.1.1. Conduct concerning elements of the telecommunications access regime

2.1.1.1. Conduct about including terms and conditions in SFAAs

NBN Co makes certain commitments in the SAU about the terms and conditions it will include in Standard Forms of Access Agreements (SFAAs), as follows:

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

- The SAU prevents NBN Co from including certain terms and conditions in SFAAs — for example, clause 1C.1.4 of Schedule 1C of the SAU prevents NBN Co from including a price for a reference offer in an SFAA that is higher than the maximum regulated price for that reference offer, as determined in accordance with the SAU.¹³

For convenience, terms and conditions of the kinds mentioned above will be subsequently referred to as **SFAA terms and conditions**.¹⁴

As noted in the Draft Decision, the ACCC is not satisfied that the conduct that is specified by the SAU in relation to SFAAs will promote the long-term interests of end-users, because it may mean that access seekers must sign an SFAA-based Access Agreement to obtain access on the SFAA terms and conditions.

To address this issue, the ACCC proposes the following amendments to the SAU:

- 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.
- 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.

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.

The effect of amending the SAU in this way would be that NBN Co must comply with the 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.

This would mean that an access seeker could request supply on the terms and conditions specified by the SAU on a standalone basis or via an SFAA-based Access Agreement (as NBN

¹³ For further information about the operation of the price controls applying to products supplied by NBN Co, please refer to the Draft Decision.

¹⁴ It should be noted that this refers to the terms and conditions that the SAU requires NBN Co to include (or not include) in an SFAA, and does not refer to any terms and conditions that are *actually included* in an SFAA (whether or not in accordance with NBN Co's obligations under the SAU).

Co may implement its obligation to ensure that SFAAs are consistent with the SAU, as required by clause 6 of the main body of the SAU, by incorporating these terms and conditions in its SFAAs).

As discussed in chapter 6 of the Draft Decision, the ACCC is not satisfied that some of the SFAA terms and conditions are reasonable and is hence proposing that these terms and conditions be removed from the SAU (see section 2.5.2 of this Consultation Paper).

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

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

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

- an Access Determination or Binding Rules of Conduct that relate to the NBN Access Service or the Ancillary Services (these are described as a 'regulatory determination' in the SAU);¹⁵ and
- a 'Facilities Access Decision' (which is a decision made by the ACCC pursuant to a power that is conferred on the ACCC by the SAU, and discussed further in section 2.2.3 of the Draft Decision).¹⁶

NBN Co will not be required to give effect to any regulatory determination or Facilities Access Decision by amending any existing published SFAA.¹⁷

When read in conjunction with clause 1B.1.3(a) (which requires any SFAA to include an expiry date that is no later than two years after the date it commences) this conduct provides for access seekers to obtain regulated terms in a new SFAA-based Access Agreement every two years when their current Access Agreements expire. Through its inclusion in Module 1 of the SAU, this conduct is specified for approximately 10 years (until 30 June 2023, unless Module 1 is extended in accordance with clause 4.3 of the main body of the SAU).

As noted in the Draft Decision, the ACCC is not satisfied that the 'regulatory recourse' provision will promote the long-term interests of end-users, because:

- it may mean that the ACCC's regulatory determinations may not have any impact upon the terms and conditions contained in an SFAA until the SFAA expires; and
- the drafting of the regulatory recourse provision in the SAU creates uncertainty about whether the effect of the ACCC's regulatory determinations is limited to NBN Co updating new SFAAs or whether NBN Co is also required to directly comply with the ACCC's regulatory determinations (that is, there could be uncertainty about whether, by operation of the hierarchy in Part XIC of the CCA, an obligation to comply directly with the ACCC's regulatory determinations would be inconsistent with the SAU, and in turn whether NBN Co is released from such an obligation).

The ACCC is still considering the precise form of variation to address this issue.

One option is for the following amendments to the SAU to be made:

¹⁵ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1B, clause 1B.2.2(b).

¹⁶ Ibid, Schedule 1B, clause 1B.2.3(e).

¹⁷ Ibid, Schedule 1B, clauses 1B.2.2(c) and 1B.2.3(f).

- 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.

The effect of amending the SAU in this way would be that NBN Co is required to ensure consistency between any SFAA and any Access Determination or Binding Rules of Conduct. This would ensure that access seekers have the option of being able to obtain access on regulated terms in an SFAA-based Access Agreement for the SAU term.

However, by removing the qualifications around how NBN Co will “give effect” to regulated terms in SFAAs, the uncertainty about when NBN Co is required to comply directly with ACCC determinations under Part XIC is removed. That is, as contemplated by Part XIC, an access seeker would be able to request NBN Co to comply with ACCC regulatory determinations and supply services on regulated terms set by the ACCC (where these instruments are not inconsistent with an Access Agreement between the parties or an SAU that is in operation).

Therefore, entering into SFAA-based Access Agreements could not be interpreted to be the *only* means for access seekers to obtain access to NBN Co's services if the parties are unable to reach commercial agreement.

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.

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

Clause 1B.2.3 of Schedule 1B confers a power on the ACCC to make ‘Facilities Access Decisions’ about terms and conditions for the ‘Facilities Access Service’. The SAU describes the process that must be followed by the ACCC.¹⁸ NBN Co commits to making new SFAAs consistent with the terms established by the ACCC under this power.¹⁹ The process for implementation of ACCC decisions in SFAAs is similar to NBN Co's commitments to implement Access Determinations and Binding Rules of Conduct in SFAAs (that is, the ‘regulatory recourse’ mechanism discussed in section 2.2.2 of the Draft Decision).²⁰

As noted in the Draft Decision, the ACCC is not satisfied that the Facilities Access Decision mechanism will result in NBN Co engaging in conduct that will promote the long-term interests of end-users, because:

- the limited availability of Facilities Access Decisions may not result in NBN Co supplying the Facilities Access Service on reasonable terms and conditions in all circumstances; and
- the conduct that NBN Co will subsequently engage in to “give effect” to ACCC decisions (that is, by ensuring that new SFAAs are consistent with these decisions) may not effectively implement such decisions.

¹⁸ Under clause 1B.2.3 of Schedule 1B, the ACCC must undertake consultation and may consider submissions in making its decision. Each Facilities Access Decision, and the reasons for the decision, must be published within 20 business days after making the decision.

¹⁹ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1B, clause 1B.2.3(e).

²⁰ *Ibid*, Schedule 1B, clause 1B.2.3(e)-(g).

To address this issue, the ACCC proposes the following amendments to the SAU:

- removal of clause 1B.2.3 of Schedule 1B.

The effect of amending the SAU in this way would be that the SAU does not contain a specific mechanism for the ACCC to make terms and conditions about the Facilities Access Service.

If it were necessary to do so, the ACCC could use its regulatory powers under Part XIC to establish terms and conditions about the Facilities Access Service. In conjunction with the ACCC's proposed amendments to the 'regulatory recourse' mechanism, as set out above in section 2.1.1.2, these ACCC regulatory determinations would be available to access seekers who enter into SFAA-based Access Agreements. Alternatively, an access seeker would be able to request that NBN Co supplies services directly on the terms and conditions set out in ACCC regulatory determinations (where they are not inconsistent with an Access Agreement between the parties or an SAU that is in operation).

2.1.1.4. Conduct about production and maintenance of SFAAs

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

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

Clause 1B.1.3 of Schedule 1B provides that NBN Co will ensure that the SFAAs it publishes during Module 1 will have an expiry date of no later than 2 years after the date on which the SFAA commences, and that these SFAAs may include the option to extend the term of the SFAA. NBN Co also commits to updating SFAAs in accordance with the 'regulatory recourse' mechanism, as discussed in section 2.2.2 of the Draft Decision.

As noted in the Draft Decision, the ACCC considers that:

- The first aspect of NBN Co's commitment in clause 6.3 (that is, that NBN Co will publish and maintain SFAAs for the supply of the NBN Access Service and Ancillary Services) will promote the long-term interests of end-users, because access seekers can choose to obtain supply of these services via SFAA-based Access Agreements for the term of the SAU.
- The second aspect of NBN Co's commitment in clause 6.3 (that is, that NBN Co *may* include terms and conditions about the Facilities Access Service in SFAAs) will not promote the long-term interests of end-users, because the scope of these terms and conditions may be unclear, which creates uncertainty about whether ACCC regulatory determinations about the Facilities Access Service would be inconsistent with the SAU and therefore have no effect.
- NBN Co's commitment to publish SFAAs with a two-year term during Module 1 in clause 1B.1.3 of Schedule 1B is likely to promote the long-term interests of end-users, subject to how NBN Co will give effect to ACCC regulatory determinations (that is, the 'regulatory recourse' mechanism) as set out above in section 2.1.1.2.

To address this issue, the ACCC proposes the following amendments to the SAU:

- 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).

The effect of amending the SAU in this way would be that the SAU does not address whether NBN Co will include terms and conditions in relation to the Facilities Access Service in SFAAs.

NBN Co and access seekers could commercially negotiate and agree on these terms, or if unable to be agreed, the ACCC would be able to address these terms through Access Determinations and Binding Rules of Conduct, because the uncertainty about the potential for inconsistency with the SAU would be removed.

In conjunction with the ACCC's proposed amendments to remove the Facilities Access Decision mechanism as set out above in section 2.1.1.3, and the amendments to the 'regulatory recourse' commitments, as set out above in section 2.1.1.2, these ACCC regulatory determinations would be available to access seekers who subsequently enter into an SFAA-based Access Agreements.

2.1.1.5. Conduct about development of SFAAs

Clause 1B.3 of Schedule 1B provides that NBN Co will establish and conduct a 'multilateral SFAA forum' to identify issues industry has with the SFAA and to develop possible solutions. The SAU sets out processes for conducting the forum, as well as the processes for how NBN Co may make changes to SFAAs arising out of the forum. Specifically, NBN Co may make changes to any SFAA "as NBN Co considers appropriate".²¹ These changes are subject to NBN Co's commitments to ensure consistency between the SAU and SFAAs (discussed in section 2.2.6 of the Draft Decision) and the 'regulatory recourse' mechanism (discussed in section 2.2.2 of the Draft Decision).²²

As noted in the Draft Decision, the ACCC is not satisfied that the multilateral SFAA forum processes contained in the SAU will result in NBN Co engaging in conduct that will promote the long-term interests of end-users, because:

- the procedural requirements may not operate in a manner that will allow the parties to identify issues with the SFAA and propose solutions for incorporation into new SFAAs in a timely manner; and
- the conduct that NBN Co will subsequently engage in to implement the outcomes of the multilateral SFAA forum (that is, to "give effect" to those outcomes in new SFAAs) may not effectively implement such outcomes.

To address this issue, the ACCC proposes the following amendments to the SAU:

- 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).

The effect of amending the SAU in this way would be that the SAU will only contain commitments to establish a multilateral forum to consult with access seekers on future changes to the terms and conditions of SFAAs.

If NBN Co and access seekers are unable to commercially agree to terms and conditions, the ACCC would be able to address these terms through regulatory determinations. In conjunction with the ACCC's proposed amendments to the 'regulatory recourse' commitments, as set out above, these ACCC regulatory determinations would be available to access seekers who subsequently enter into SFAA-based Access Agreements. Further, as noted in section 2.1.1 of the Draft Decision, an access seeker could alternatively request NBN Co to supply services directly on the terms and conditions set out in these regulatory determinations (where they are not inconsistent with an Access Agreement between the parties or an SAU that is in operation).

In conjunction with the ACCC's proposal to remove the midpoint review mechanism (discussed in section 2.1.2.2 below), the remaining provisions about the multilateral SFAA forum would

²¹ Ibid, Schedule 1B, clause 1B.3.1(e).

²² Ibid, Schedule 1B, clause 1B.3.1(e).

operate for the duration of Module 1. The ACCC's preliminary view is that the remaining provisions about the multilateral SFAA forum would promote the long-term interests of end-users for the duration of Module 1; however, it is a decision for NBN Co whether it wishes for these provisions to operate for five years instead.

2.1.2. Conduct concerning changes to the SAU over time

2.1.2.1. Conduct about submitting variations to the SAU

Clauses 4.5 to 4.11 of the main body of the SAU set out processes for the submission and assessment of SAU variation applications following the expiry of Module 1. NBN Co will submit 'Replacement Module Applications', which must include proposals about reference offers, long-term revenue constraint methodology elements, and service levels for a 'regulatory cycle' (a period of 3, 4 or 5 years specified by NBN Co in its application). The SAU provides that:

- if the ACCC accepts the proposed replacement modules in accordance with section 152CBG of the CCA, the SAU is varied to include the terms of the replacement module application (which would operate in combination with Module 0 and Module 2); and
- if the ACCC does not accept the proposed replacement modules, NBN Co's proposals are deemed to "apply" in certain circumstances, subject to specified circumstances about when and how any Access Determinations or Binding Rules of Conduct will "apply" instead.²³

As noted in the Draft Decision, the ACCC is not satisfied that the replacement module submission and assessment processes will operate in a manner that will promote the long-term interests of end-users, because:

- the deemed application of rejected replacement modules 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; and
- there is uncertainty about whether ACCC regulatory determinations would have effect outside of the specified circumstances, even where these determinations specify terms and conditions which are not addressed by the SAU (that is, even where there may otherwise be no inconsistency between these regulatory determinations and the SAU).

To address this issue, the ACCC proposes the following amendments to the SAU:

- removal of clauses 4.5 to 4.11 of the main body (that is, the commitments about submission and assessment of replacement module applications).

The effect of amending the SAU in this way would be that the SAU does not address how detailed terms and conditions are established following the expiry of Module 1. At the expiry of Module 1, NBN Co could use the SAU variation processes under section 152CBG of the CCA to seek ACCC approval to incorporate any terms and conditions in the SAU that it wished to have effect for whatever future period that it desired.

Alternatively, NBN Co and access seekers could commercially negotiate and agree to terms and conditions for these matters, or if unable to be agreed, the ACCC would be able to address these terms through Access Determinations and Binding Rules of Conduct, to the extent that these instruments are not inconsistent with Module 0 and Module 2 of the SAU.

²³ Ibid, Main Body, clauses 4.10(b), (d) and (e).

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

2.1.2.2. Conduct about the midpoint review of Module 1

Schedule 1K of Module 1 of the SAU sets out a process for the ACCC to review various multilateral processes and non-price terms in Module 1, around five years after the commencement of the SAU term. This process sets out:

- procedures that must be followed by the ACCC when exercising the review role conferred on it by the SAU (including timeframes and matters the ACCC must consider when making its decisions);²⁴ and
- commitments about how NBN Co will implement ACCC decisions for the remainder of Module 1.²⁵

NBN Co will submit proposed amendments to the multilateral processes and non-price terms described in section 2.3.2 of the Draft Decision.

The SAU confers a power on the ACCC to approve NBN Co's proposals or to reject NBN Co's proposals and make its own decisions for the operation of these multilateral processes and non-price terms for the remainder of Module 1.²⁶

As noted in the Draft Decision, the ACCC is not satisfied that the midpoint review mechanism will result in NBN Co engaging in conduct that will promote the long-term interests of end-users, because:

- the review role conferred on the ACCC by the SAU may not enable it to make decisions that are reasonable and promote the long-term interests of end-users in all circumstances; and
- the conduct that NBN Co will subsequently engage in to implement ACCC decisions may not effectively implement such decisions.

To address this issue, the ACCC proposes the following amendments to the SAU:

- removal of Schedule 1K.

The effect of amending the SAU in this way would be that the SAU does not contain a specific review mechanism.

NBN Co could specify the matters which would have been reviewed under the midpoint review of Module 1 for a five-year period instead, so that it is not necessary for the SAU to include such a mechanism.

At the end of the five-year period, if it wished to, NBN Co could use the SAU variation processes under section 152CBG of the CCA to seek ACCC approval to renew or replace these terms and conditions for a further five-year period.

²⁴ Ibid, Schedule 1K, clauses 1K.2.2-1K.2.4 and 1K.3.2-1K.3.4.

²⁵ Ibid, Schedule 1K, clauses 1K.2.5-1K.2.7 and 1K.3.5-1K.3.7.

²⁶ Ibid, Schedule 1K, clauses 1K.2.3-1K.2.7 and 1K.3.3-1K.3.7.

2.1.3. SAU extension mechanisms

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

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

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

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

As noted in the Draft Decision, the ACCC considers that the SAU should not provide for an automatic extension of Module 1 if the above conditions are satisfied. This is because 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.

To address this issue, the ACCC proposes the following amendments to the SAU:

- removal of clause 4.3 of the main body (that is, the mechanism providing for automatic extension of Module 1).

The effect of amending the SAU in this way would be that the SAU does not provide for the automatic extension of Module 1.

At the expiry of Module 1, NBN Co could use the SAU variation processes under section 152CBG of the CCA to seek ACCC approval to extend the operation of the terms and conditions in Module 1 for whatever period that it wished to. Those terms would then operate in combination with Module 0 and Module 2.

2.1.3.2. Extension of the SAU term

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

- NBN Co may request an extension of the SAU term at any time within the 12 month period ending at the date of the SAU term; and
- the ACCC must approve the extension if it is satisfied of the matters in:
 - subsection 152CBD(2)(b) – that is, the terms and conditions for compliance with the SAOs are consistent with those obligations and are reasonable; and
 - subsection 152CBD(2)(ca) – that is, any specified conduct will promote the long-term interests of end-users and the associated terms and conditions are reasonable.

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

As noted in the Draft Decision, the ACCC considers that the drafting of this aspect of the SAU does not appear to reflect NBN Co's intention that the criteria for the extension be consistent with section 152CBD of the CCA.

To address this issue, the ACCC proposes the following amendments to the SAU:

- 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.

The effect of amending the SAU in this way would be that the mechanism for ACCC consideration of an NBN Co application to extend the operation of the SAU would be consistent with the statutory criteria for ACCC assessment of an undertaking or a variation to an undertaking.

2.2. Services to which the SAU relates

The variations that are proposed in this section of the Consultation Paper relate to the issues discussed in chapter 3 of the Draft Decision on the SAU.

2.2.1. Uncertainty in relation to the ACCC's ability to set terms and conditions

As discussed in the Draft Decision, the broad service descriptions for the 'NBN Access Service' and 'Ancillary Services' — when read in conjunction with the drafting of other provisions in the SAU which narrow what is to be supplied by NBN Co under the SAU — create uncertainty as to how the SAU interacts with the powers conferred on the ACCC by the CCA to declare services and set terms and conditions for those services.

The ACCC therefore 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.

In particular, the ACCC proposes the following specific amendments to clauses 1A.1, 1A.4 of Schedule 1A; clause 3 of Attachment A to the main body of the SAU; and terms in the dictionary in Attachment C to the main body of the SAU:

- variation of clause 1A.1 to include the following new clause 1A.1.4:

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.

- variation of clause 1A.4 to include the following new clause 1A.4.3:

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.

- 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:

(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) services declared by the ACCC or specified in Access Determinations or Binding Rules of Conduct.

- variation of the dictionary definitions in Attachment C to the main body of the SAU for the following terms to read:

Product Component means:

(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 11 (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*

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 *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 (for example, data transfer rate of an AVC).

The effect of these amendments would be to remove the uncertainty as to how the SAU will interact with services declared by the ACCC and regulatory determinations made by the ACCC in respect of those services, and to clarify that any revenues earned from NBN Co's supply of services that have been declared by the ACCC are intended to be included in the long-term revenue constraint methodology established by the SAU.

2.2.2. Compliance and consistency with the SAOs

Firstly, the SAU states that NBN Co will fulfil its commitments under the SAU and the Category B SAOs by making “offers to supply” the NBN Access Service, Ancillary Services, and the Facilities Access Service.²⁷ As noted in the Draft Decision, the ACCC does not consider that these commitments are consistent with the Category B SAOs.

In light of this, the ACCC proposes that 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.

The effect of this amendment is that NBN Co will be making a commitment to comply with the Category B SAOs by actually supplying a service to a service provider on request, rather than simply by making an offer to supply the service.

Secondly, 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.

Related to this, in some instances, the SAU makes references to “Customers” (as opposed to “Access seekers”).²⁸ 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.

The ACCC proposes that:

- clause 1A.3.1(iii) should be deleted; and
- all references to “Customer” be substituted with references to “Access Seeker” (and that consequential amendments also be made).

The effect of these amendments would be 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 amendments would not however preclude NBN Co and access seekers from entering into Access Agreements of their own accord.

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.

2.2.3. Layer 3 awareness

Clause 1A.2.6 of Schedule 1A of the SAU provides that “the AVC may incorporate some limited Layer 3 awareness to support certain services, including” voice telephony services, multicast services and optional features.

²⁷ Ibid, NBN Access Service: clause 1A.1.2; Ancillary Services: clause 1A.4.1; Facilities Access Service: clause 1A.6.

²⁸ Examples of this include definitions in Attachment C to the main body of the SAU, various clauses in Schedule 1A, clause 1E.9.1 (b)(i) of Schedule 1E, and clause 11.3.1 of Schedule 1I. This issue does not apply to the drafting of terms and conditions in Annexures 1, 2 and 3 to Schedule 1H and Annexure 1 to Schedule 1J, which would only have effect under an Access Agreement.

As discussed in the Draft Decision, the ACCC considers that it is necessary to ensure that the service description for the NBN Access Service does not allow NBN Co to specify more Layer 3 awareness than is required for these services.

The ACCC therefore proposes that 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

The effect of this amendment is that the SAU would not give NBN Co the discretion to offer Layer 3 awareness greater than that required in order to support the specified services.

As a result, the SAU would not allow NBN Co to enter downstream markets for aggregation and wholesale services that operate at Layer 3 of the OSI model and in turn would not allow NBN Co to compete on a vertically integrated basis with existing suppliers in those markets.

2.3. Product development and withdrawal

The variations that are proposed in this section of the Consultation Paper relate to the issues discussed in chapter 4 of the Draft Decision on the SAU.

2.3.1. Product development and variation

This section sets out the variations that the ACCC is proposing in relation to the provisions in the SAU about product development and variation.

2.3.1.1. Term of operation of the PDF Processes

Clause 11.3 of Schedule 11 and clause 2E.4.1 of Schedule 2E of the SAU require that NBN Co establishes a Product Development Forum (PDF) for the term of the SAU. Module 1 includes 'PDF Processes' that specify processes which determine how consultation and decision-making about whether or not to develop or vary a product will occur.

The SAU provides that the PDF Processes (whilst applicable for the duration of Module 1) would be subject to review as part of the midpoint review of Module 1. As noted in section 4.1.1.2 of the Draft Decision, the ACCC is not satisfied that the processes and criteria set out in the SAU in respect of this review would lead to decisions that 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.

To address this issue, the ACCC proposes that the PDF Processes (contained in Annexure 1 to Schedule 11) should only operate for the first five years of Module 1.

The effect of varying the SAU in this way is that 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.

2.3.1.2. Commitments by NBN Co to share information and consult

Schedule 1I and Schedule 2E of the SAU contain a number of commitments about how NBN Co will share information and consult with its customers about the development of new products and the variation of existing products.

As noted in section 4.1.1.2 of the Draft Decision, the ACCC considers that the effectiveness of these commitments in reducing information asymmetries, and in turn in promoting the long-term interests of end-users, would be enhanced if there was a role for consumer advocacy groups in NBN Co's consultation processes.

To address this issue, the ACCC proposes that 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:

- definition of the term “Consumer Advocacy Group”; and
- amendment of each reference to the word “Customer” in these provisions, except clause 1I.3.1(b), to also refer to a Consumer Advocacy Group or consumers in general.

This would require amendments throughout Schedule 1I, including Annexure 1 to Schedule 1I.

The ACCC seeks the views of interested parties on the appropriate definition of ‘Consumer Advocacy Group’ and how this group, or consumers in general, could participate most effectively in the Product Development Forum.

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

Schedule 1I, Schedule 2E and the PDF Processes in Module 1 of the SAU establish rights for and obligations on NBN Co and its customers about how consultation will occur. The PDF Processes include clauses which establish rights and obligations on NBN Co and its customers about the treatment of confidential information and intellectual property associated with new product ideas.

As noted in section 4.1.1.2 of the Draft Decision, the ACCC considers that the obligations placed on customers about confidential information and intellectual property may discourage customers from participating in the Product Development Forum. This in turn could reduce the extent to which the product development commitments result in competition being promoted and the economically efficient use of and investment in infrastructure being encouraged.

To address this issue, the ACCC proposes the following variations to the SAU:

- removal of clause 5 of the PDF Processes; and
- removal of clause 6 of the PDF Processes.

The effect of this removal would be that terms and conditions about the handling of confidential information and intellectual property rights would be subject to continuing commercial negotiation between NBN Co and its customers. The removal of these terms from the SAU would also mean that they could be the subject of later ACCC regulatory determinations. In making such regulatory determinations, the ACCC would be required to take into account particular matters specified by Part XIC — such as NBN Co's legitimate business interests, the interests of access seekers and whether the determination would promote the long-term interests of end-users.

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

Schedule 1I, Schedule 2E and the PDF Processes in Module 1 of the SAU include provisions which establish that NBN Co does not have to consult with customers on the development or variation of products in particular circumstances. As noted in section 4.1.1.2 of the Draft Decision, the ACCC considers that these provisions reduce the extent to which the product development commitments result in competition being promoted and the economically efficient use of and investment in infrastructure being encouraged.

The ACCC therefore proposes the following variations to the SAU:

- removal of the provisions that exclude products covered by, or contemplated within, the Initial Product Roadmap;
- removal of the provisions that exclude minor product variations;
- removal of the provisions that exclude products that NBN Co is obliged to offer as a result of a licence condition;
- amendments to make it clear that the product development, variation and withdrawal provisions apply to all Ancillary Services; and
- amendments to make it clear that the product development and variation provisions apply to NBN Co-initiated development and variation.

The effect of varying the SAU in this way would be to ensure that all products that are not yet fully developed, and all variations to existing products (whether NBN Co considers that the variation is minor or otherwise) are able to be consulted on via the Product Development Forum and PDF Processes. For products that NBN Co is obliged to offer as a result of a licence condition, these variations are intended to ensure that NBN Co consults on the prices and service levels of those products. The overall effect of the variations 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.

These variations would not preclude NBN Co and its customers from agreeing to not develop a particular product, product component or product feature further via the Product Development Forum. As noted in chapter 2 of the Draft Decision, the SAU has no effect to the extent of any inconsistency with an Access Agreement.

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

As noted in chapter 3 and section 4.1.1.2 of the Draft Decision, the ACCC considers that the provisions in the SAU that narrow what is to be supplied by NBN Co under the SAU create uncertainty as to how the SAU interacts with the powers conferred on the ACCC by the CCA to declare services and set the terms and conditions about such services.²⁹ As noted in section 2.2.1 of this Consultation Paper, the ACCC therefore 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.

²⁹ The ACCC may declare NBN services under subsection 152AL(8A) of the CCA.

The effect of these variations would be to clarify how the SAU interacts with the powers that the CCA confers on the ACCC to declare services and set terms and conditions for those services. NBN Co's decisions about whether or not to introduce a new product would nonetheless in the first instance be subject to commercial negotiation and agreement between NBN Co and its customers. In the event that agreement could not be reached, and in circumstances where the ACCC considered that NBN Co did not face incentives to respond to evolving end-user demand, the ACCC could conduct an inquiry into whether the supply of the particular product would promote the long term interests of end-users, and following the inquiry, declare the product if it was satisfied that supply of the product would promote the long-term interests of end-users.

As noted in the Draft Decision though, 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.

2.3.2. Product withdrawal

Under Schedule 1C and Schedule 2B of the SAU, any service that is defined as a reference offer cannot be withdrawn for as long as it is defined as a reference offer. For all other services (that is, non-reference offers), NBN Co can withdraw these services at its discretion subject to:

- providing written notice to customers of its intention to withdraw the service;³⁰
- having regard to a number of factors when considering whether to withdraw the service;³¹ and
- discussing and considering in good faith any feedback received from its customers, and access seekers in some circumstances, in relation to the withdrawal.³²

As noted in the Draft Decision, the ACCC is not satisfied that withdrawing non-reference offers will in all circumstances encourage economically efficient use of and investment in the NBN, particularly if doing so reduces the effectiveness of the CPI-1.5 per cent price control in creating incentives for NBN Co to operate efficiently.

The ACCC therefore proposes that, in addition to the proposed amendments outlined in section 2.3.1.5 above, the SAU be varied to include:

- 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.

The effect of this variation is that if the ACCC considered that the withdrawal of a particular product would not promote the long-term interests of end-users (for example, because it would undermine the effectiveness of the price control) NBN Co would continue to be obligated to supply the product.

The ACCC also proposes that 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.

³⁰ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 11, clause 11.5.2; Schedule 2E, clause 2E.6.3.

³¹ Ibid, Schedule 11, clause 11.5.2(b); Schedule 2E, clause 2E.6.3(b).

³² Ibid, Schedule 11, clause 11.5.2(c); Schedule 2E, clause 2E.6.3(c).

2.4. Price-related terms and conditions

The variations that are proposed in this section of the Consultation Paper relate to the issues discussed in chapter 5 of the Draft Decision on the SAU.

2.4.1. Pricing of individual products

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

NBN Co makes commitments in the SAU about the processes for setting new prices during the SAU term. NBN Co can determine the price of any new product that it introduces during the SAU term (with no scope for the ACCC to determine the price), subject to:

- having regard to a number of pricing principles set out in the SAU;³³
- publishing a pricing rationale statement on how the new price has been calculated in accordance with the pricing principles;³⁴ and
- consulting with customers on the price of any new product introduced through the Product Development Forum, where applicable.³⁵

If NBN Co introduces a new charge for a currently zero-priced reference offer or a new 'other charge' for a reference offer, the SAU provides for the ACCC to determine prices in certain circumstances.³⁶

In the Draft Decision, the ACCC recognises that NBN Co is likely to have incentives to set new prices efficiently, particularly whilst it faces revenue sufficiency risk, but that it is possible that during the term of the SAU (proposed to expire on 30 June 2040) these incentives will not always prevail (for example, if the 'anchoring' effect of existing products is not effective, and/or when it has become more clear that NBN Co will reach its revenue cap phase). Hence, it is not clear that NBN Co will always have incentives to, of its own accord, price in a manner which encourages efficient use of the network as a result of incentives that may exist at the outset of the SAU.

To address this, 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.

The ACCC's objective in proposing this variation is that, in circumstances where NBN Co has weak incentives to set new prices in a manner that encourages efficient use of the network, the ACCC would be able to determine prices for new products (or previously zero-priced products). In determining the price in an Access Determination, the ACCC would be required by Part XIC to take into account particular matters specified by Part XIC — such as NBN Co's legitimate business interests, the interests of access seekers and whether the determination would promote the long-term interests of end-users.

³³ Ibid, Schedule 1D, clause 1D.6(a); Schedule 2D, clause 2C.5(a).

³⁴ Ibid, Schedule 1D, clause 1D.6(b); Schedule 2C, clause 2C.5(b).

³⁵ Ibid, Schedule 1I, clause 1I.3.5(a); Schedule 2E, clause 2E.4.4.

³⁶ Ibid, Schedule 1D, clause 1D.4.3(b); Schedule 2C, clause 2C.4(b).

Whilst this variation would provide the ACCC with the ability to determine new prices, as noted in the Draft Decision, the ACCC considers that there are likely to be only limited circumstances in which it would choose to exercise this ability.

2.4.1.2. Ability for relative price levels to change in response to unforeseen circumstances

The SAU states that prices for services that are reference offers will be subject to the CPI-1.5 per cent price control from year five of the SAU term onwards and prices for services that are non-reference offers and other charges will be subject to the CPI-1.5 per cent price control from the first year of the SAU (or from the first year that NBN Co introduces them).³⁷

The ACCC considers that circumstances could arise over the term of the SAU which would suggest that prices for particular services are not promoting efficient use of the network and/or competition. To respond to such circumstances, under the approach proposed in the SAU, the price of an individual service could not be increased by more than CPI-1.5 per cent from one year to the next; but NBN Co could of its own accord decrease prices by any amount. There may however be times throughout the SAU term when NBN Co does not face incentives to lower prices of its own accord to address the need for prices to be rebalanced. In such circumstances, the ACCC would not be able to determine that a higher or lower price should be charged for a particular service.

To address this issue, the ACCC proposes that 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:

- 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.

The effect of this variation would be to allow for prices to be rebalanced in a manner not required or allowed for by the CPI-1.5 per cent price control, in the event that price structures and relative price levels were not promoting efficient use of the network.

The rebalances would be revenue neutral for NBN Co, in order to ensure that NBN Co is not precluded by the price review from recovering its prudent costs, including a normal commercial return (given the risks of its investments). Revenue neutrality would also ensure that the CPI-1.5 per cent price control continued to create incentives for NBN Co to invest and operate efficiently.

2.4.2. Long-term revenue constraint

As noted in the Draft Decision, if NBN Co expects, over time, to recover the cost of its investments (including a risk-adjusted return on investment) and no more, this should imply that the net present value of its investment is zero. NBN Co has submitted that over the long-term, the annual revenue requirements determined with the long-term revenue constraint methodology would result in a zero expected net present value of all relevant cash flows.³⁸

³⁷ Ibid, Schedule 1C, clause 1C.4.1; Schedule 1D, clause 1D.4.1; Schedule 2C, clause 2C.2.1.

³⁸ NBN Co, Supporting submission: NBN Co Special Access Undertaking, 28 September 2012, p. 115.

The assumptions which underpin this expectation with respect to the timing of cash flows should be reflective of NBN Co's actual circumstances. The SAU implies that capital expenditure is incurred on average half-way through the year, and therefore a half-WACC is applied to this capital expenditure to compensate for the timing difference between the capital expenditure being incurred and being rolled into the RAB. On the other hand, it is assumed that operating expenditure is incurred, and revenues received, at the end of the year.

As noted in the Draft Decision, the ACCC's assessment of the long-term revenue constraint methodology has indicated that the methodology as proposed in the SAU results in a net present value of zero of expected future cash flows. However, this result depends on the assumptions regarding the timing of NBN Co's cash flows as implied in the SAU. Submissions from interested parties did not provide views or information in relation to the half-WACC applied to capital expenditure or the cash flow timing assumptions implied in the SAU. In the absence of further information about why these assumptions reflect NBN Co's actual circumstances, the ACCC's preliminary view is that it is unable to be satisfied that these cash flow timing assumptions are reasonable.

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.

The ACCC's objective in proposing this variation is that the application of the long-term revenue constraint methodology would result in a zero expected net present value of all relevant cash flows.

2.4.2.1. Long-term revenue constraint in Module 1

Adoption of ex-post compliance approach in Module 1

Under Schedule 1E and Schedule 1F of the SAU, the RAB, initial cost recovery account and the annual revenue requirements will be calculated annually by NBN Co by applying methodologies as set out in these schedules.

Under Schedule 1G of the SAU:

- NBN Co would be required to report the values of its RAB, annual revenue requirements and initial cost recovery account to the ACCC annually;³⁹
- NBN Co would be required to submit annual compliance reports that certify that NBN Co had complied with the prudency requirements in the SAU that apply to capital and operating expenditure;⁴⁰ and
- the ACCC could request additional information.⁴¹

Under this 'ex-post compliance approach', the ACCC would have no role in approving or overseeing the application of the methodologies in Schedule 1E and Schedule 1F on an ex-ante basis. Rather, the ACCC would monitor and enforce NBN Co's compliance with the methodologies on an ex-post basis, by using the information provided under Schedule 1G.

As noted in section 5.5.1.1 of the Draft Decision, the ACCC considers that the operation of the ex-post compliance approach in practice will likely reduce NBN Co's incentives to invest and operate efficiently. In particular, the ACCC considers that — given that NBN Co is given considerable discretion to determine what investments fall within the scope of the clauses for calculating the annual revenue requirements building block components — this could allow

³⁹ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1G, clauses 1G.1.2 and 1G.1.3.

⁴⁰ Ibid, Schedule 1G, clause 1G.2.1.

⁴¹ Ibid, Schedule 1G, clause 1G.2.2.

NBN Co to overstate its costs relative to an efficient level. The ACCC is therefore not 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 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. As noted in the Draft Decision, the ACCC considers that, if these calculations are performed by an independent party (rather than NBN Co), confidence would be provided to affected stakeholders that the outcomes have been calculated in an impartial manner. The ACCC also considers that efficient investment would be enhanced if the ACCC were to determine the values that roll into the RAB in accordance with the SAU methodologies.

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.

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. When considering whether NBN Co's reported costs comply with the methodologies in the SAU, the ACCC would consider such things as:

- whether NBN Co's investments are materially consistent with or within the scope of the Network Design Rules;
- whether the Network Design Rules have been updated in accordance with the permitted variations categories or customer engagement processes;
- whether NBN Co has procured expenditure in accordance with the Procurement Rules, or the other clauses in the prudent cost condition;
- any capital expenditure that should be deemed prudent;
- whether the values of the annual construction-in-progress allowance reflect capital expenditure that has been incurred in accordance with these criteria; and
- whether operating expenditure has been incurred in accordance with the operating expenditure principles.

The ACCC recognises that it reviewing whether NBN Co's expenditure complies with the methodologies in the SAU and calculating the RAB roll-forward and annual revenue requirements accordingly may involve a limited form of ex-post review of NBN Co's capital expenditure. However, the proposed variations are not intended to allow the ACCC to review NBN Co's expenditure in an unconstrained manner, nor to allow the ACCC to revalue or revisit the existing values of the RAB or initial cost recovery account, or change the depreciation profile of NBN Co's past capital expenditure throughout Module 1.

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.

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.

The ACCC also proposes some variations to the methodologies that are proposed for calculating the building block components in Module 1, as outlined in the following sections of this Consultation Paper.

Terms and conditions relating to capital expenditure in Module 1

Under Schedule 1E of the SAU, NBN Co would be allowed to include into its RAB all actual capital expenditure that satisfies:

- the 'Prudent Design Condition' — capital expenditure that is materially consistent with or within the scope of NBN Co's Network Design Rules;⁴² and
- the 'Prudent Cost Condition' — capital expenditure incurred using competitive tendering and procurement processes that comply with the NBN Co Procurement Rules, or comply with a number of other provisions.⁴³

Clause 1E.6.2 of Schedule 1E of the SAU allows NBN Co to vary the Network Design Rules under a number of circumstances, as set out in the clause.

The ACCC considers that the following aspect of the clause creates the potential for the Network Design Rules to be varied to accommodate inefficient investments:

- clause 1E.6.2(a)(viii) (one of the 'permitted variations' categories) allows NBN Co to update the Network Design Rules for changes that it expects will cost less than a minor expenditure limit (initially \$100 million and increased each financial year by CPI); and
- the customer engagement processes in clauses 1E.7 to 1E.11, which will operate for the full duration of Module 1.

To address this issue, the ACCC proposes that the following variations to the SAU:

- the removal of clause 1E.6.2(a)(viii); and
- that the customer engagement process operate only for the first five years of Module 1.

Terms and conditions relating to the annual construction-in-progress allowance in Module 1

Clause 1F.9.1(b) of Schedule 1F specifies the calculation of the annual construction-in-progress allowance (ACIPA), which allows NBN Co to recover the financing costs of the construction of assets prior to those assets being placed in service. 'Construction-in-progress'

⁴² Ibid, Schedule 1E, clause 1E.4.

⁴³ Ibid, Schedule 1E, clause 1E.5.

is defined in clause 1E.2.4, and states that the ACIPA will, provided it has been prudently incurred, be included in the annual revenue requirement.

For capital expenditure to be included in the RAB, it must be prudently incurred in accordance with the prudent cost condition (that is, clause 1E.4) and the prudent design condition (that is, clause 1E.5). However, in terms of what constitutes 'construction-in-progress' in any given year, clause 1E.2.4(a) specifies that construction-in-progress will be consistent with the values in NBN Co's audited accounts. It appears that NBN Co will classify expenditure as construction-in-progress in its audited accounts before it is classified as capital expenditure and thus before it is subject to the prudency conditions.

It is therefore not clear whether only prudently incurred expenditure is treated as construction-in-progress and thereby able to have a rate of return applied to compensate NBN Co for the financing costs associated with that expenditure. If imprudent expenditure is treated as construction-in-progress, this would allow NBN Co to be compensated for more than its efficient costs, which would not encourage efficient investment in the NBN.

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.

To address this issue, the ACCC 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.
- the ACCC calculate the values of the annual-construction-in-progress allowance that will be included in NBN Co's annual revenue requirements.

Terms and conditions relating to the tax allowance in Module 1

Clause 1F.8.1 of Schedule 1F sets out that the net tax allowance will be calculated as follows:

- a notional taxable profit is determined by subtracting nominal taxation expenses from nominal revenue; and
- any tax losses from previous years (as determined in accordance with the tax loss carried forward in clause 1F.8.3) are then added to this notional taxable profit for that year.

If this sum is negative, it becomes the new value of the tax loss carried forward (and will eventually be used to offset notional taxable profits that are earned by NBN Co).⁴⁴ If this sum is positive, the value is then multiplied by the statutory corporate tax rate, and then reduced by gamma (set at 0.25 for the duration of Module 1) to reflect the value of imputation credits.

As noted in section 5.5.1.7 of the Draft Decision, 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, and consequently it is not satisfied that the tax allowance is consistent with the legitimate business interests of NBN Co and recovery of NBN Co's direct costs.

To address this issue, the ACCC proposes that the value of gamma in Module 1 should be as determined at the time the annual revenue requirement is calculated.

⁴⁴ Ibid, Schedule 1F, clause 1F.8.3.

The ACCC's objective in proposing this variation is that, if NBN Co wishes to account for a tax liability, imputation credits are valued at the same (or similar) value as is adopted across other sectors regulated by the ACCC and the AER at the time.

2.4.2.2. Long-term revenue constraint in Module 2

Terms and conditions relating to the criteria and methodologies for determining forecasts in Module 2

During the term of Module 2, NBN Co's annual revenue requirements would be determined upfront based on forecast annual revenue requirements approved by the ACCC as part of the replacement module assessment process. During the initial cost recovery period, the initial cost recovery account will be updated based on the difference between these forecast annual revenue requirements and the forecast revenues NBN Co expects to earn, which is also subject to ACCC approval.

Schedule 2D includes methodologies and criteria, specified at varying levels of detail and prescription, that would be used in calculating the value of the forecasts of the individual building block components that make up the forecast annual revenue requirements, and forecasts revenues during the initial cost recovery period.

As noted in section 5.5.2.2 of the Draft Decision, the ACCC considers that the methodologies and criteria proposed in Module 2 may allow NBN Co to include in its annual revenue requirement forecasts above its direct costs, which will reduce the strength of the incentive created by the forecast mechanism for NBN Co to invest and operate efficiently. In addition, the ACCC considers that it is difficult to be satisfied that the methodologies and criteria will reflect regulatory best practice and the relevant circumstances faced by NBN Co in all circumstances that may arise for the duration of Module 2.

To address this issue, the ACCC proposes that the methodologies be removed from the SAU. These include:

- 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).
- 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".)
- 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'.)
- 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".)

The ACCC's objective in proposing these variations is that the SAU would not prescribe the methodologies used and factors that must be had regard to when calculating capital and operating expenditure forecasts, the return on capital, depreciation and tax allowances during Module 2.

This means that the methodologies and factors used to develop any forecast of capital and operating expenditure, the return on capital, depreciation and tax allowances could be:

- proposed in a variation to the SAU following the expiry of Module 1 — they would then be assessed with regard to the statutory criteria in Part XIC at that time; or
- determined by the ACCC in an Access Determination.

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

Under clause 4.6(b)(i) of the main body of the SAU, the length of the regulatory cycle is determined by NBN Co as between three, four or five years and submitted to the ACCC as part of a replacement module application. However, the effect of clauses 2A.3(b) and (c) of Schedule 2A is that the length of the regulatory cycle is not subject to ACCC approval.

As noted in section 5.5.2.2 of the Draft Decision, the ACCC does not consider that allowing NBN Co to determine the length of the regulatory cycle would necessarily encourage efficient investment and operating expenditure.

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.

The ACCC's objective in proposing these variations is that the length of the regulatory cycle will not be specified in the SAU.

This means that the length of the 'regulatory cycle' could be:

- proposed in a variation to the SAU following the expiry of Module 1 — the proposed term for the variation would then be assessed with regard to the statutory criteria in Part XIC at that time; or
- determined by the ACCC in an Access Determination.

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

Clause 2D.7 of Schedule 2D sets out how the RAB will be rolled-forward over the duration of Module 2. This clause establishes that the RAB would be updated each year by adding the actual capital expenditure incurred by NBN Co in the previous year, and deducting the actual levels of depreciation and asset disposals.

As noted in section 5.5.2.2 of the Draft Decision, the ACCC cannot be 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. It is unclear for how long during Module 2 NBN Co's revenue sufficiency risk will exist. It is possible that at some point during Module 2, absent additional efficiency incentive mechanisms, allowing NBN Co to roll-forward the RAB based on actual capital expenditure might not encourage NBN Co to invest efficiently.

To address this, the ACCC 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, *actual* depreciation and asset disposals; and
- the SAU be varied to require that the RAB be rolled forward based on *prudent* additional capital expenditure, depreciation and asset disposals.

This means that the manner in which the RAB will be rolled forward, and the inclusion of additional efficiency incentive mechanisms, could be:

- proposed in a variation to the SAU following the expiry of Module 1 — the proposal would then be assessed with regard to the statutory criteria in Part XIC at that time; or
- determined by the ACCC in an Access Determination.

For the avoidance of doubt, the ACCC is *not* proposing that the SAU should *not* adopt a RAB and RAB roll-forward methodology for the duration of Module 2. Also, to ensure that NBN Co is able to recover past expenditure incurred, the opening RAB at the beginning of Module 2 will still be the closing RAB from the end of Module 1.

2.5. Non-price terms and conditions

The variations that are proposed in this section of the Consultation Paper relate to the issues discussed in chapter 6 of the Draft Decision on the SAU.

As noted in that decision, the SAU addresses a range of non-price matters in Module 1. The only non-price matter addressed in Module 2 is service levels (in the form of general principles). The non-price matters in Module 1 are divided into two groups:

- **SFAA commitments** — commitments by NBN Co to include particular terms and conditions in any SFAAs that it publishes; and
- **Standalone commitments** — commitments by NBN Co set out on a standalone basis in the SAU.

Proposed variations to the SAU about these matters relate to Schedule 1H and Schedule 1J of Module 1, and Schedule 2F of Module 2. Specifically, they address:

- service levels;
- non-price terms and conditions to be included in SFAAs; and
- provisions relating to changes to POIs.

2.5.1. Service levels

The SAU contains service level commitments that will apply during the initial regulatory period. In Module 1, NBN Co commits to include all service levels specified in Annexure 1 in any SFAA.⁴⁵ In Module 2, NBN Co has included high level commitments about maintaining service levels for existing products and developing service levels for new products.⁴⁶

As discussed in the Draft Decision, the ACCC is not satisfied that the service level commitments included in the SAU will encourage efficient use of and investment in the NBN, or balance the legitimate business interests of NBN Co with the interests of access seekers. This is because the commitments fail to:

- give NBN Co strong incentives to meet the proposed service levels;

⁴⁵ Ibid, Schedule 1J, clause 1J.2(a).

⁴⁶ Ibid, Schedule 2F.

- provide for the proposed service levels to be independently reviewed annually; and
- ensure that service levels will be at least maintained over time.

In addition, there is a question about whether the ACCC could reject a variation to the SAU due to the manner in which the commitments are drafted in Module 2, which is part of the proposed fixed principle term and condition.

The ACCC therefore proposes that the service level commitments included in the SAU be removed. This would require the deletion of Schedule 1J (including Annexure 1) and Schedule 2F, and references to these provisions.

2.5.2. Other SFAA non-price terms

Under the SFAA commitments, NBN Co commits that it will include the terms and conditions specified in Annexures to Schedule 1H and Schedule 1J in its SFAAs. As discussed in the Draft Decision, the ACCC does not consider that the terms and conditions specified in the Annexures are reasonable.

To address this, the ACCC proposes the following amendments to the SAU:

- 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.

The effect of these amendments is that these matters will be left to further negotiation between access seekers and NBN Co. In the event that access seekers and NBN Co reach agreement on these terms, they can be incorporated into Access Agreements by the parties.

In the event that access seekers and NBN Co cannot reach agreement on these matters within a reasonable period of time, the ACCC might consider making an Access Determination or Binding Rules of Conduct. The ACCC notes that — in the event further examination of non-price terms was warranted through a separate regulatory process — the ACCC might need to prioritise those issues that most directly affect end-users in migration to the NBN, given that NBN Co is currently in the early stages of its rollout.

The ACCC notes that submissions from some interested parties suggested that the detailed terms in the Annexures should be replaced by high-level principles, or amended detailed terms and conditions. The ACCC's preliminary position is that it does not propose to substitute high-level principles for the detailed terms currently in the SAU, or to replace the detailed terms with amended terms, for the following reasons:

- The matters covered by the SFAA commitments have been the subject of considerable negotiation between the parties. Submissions also indicated a preference for terms to be set through commercial negotiations, which would then preserve the legislative hierarchy. The ACCC considers that it would be preferable for parties to agree on these matters to the extent possible, and for the ACCC to intervene only to the extent that agreement is not reached.
- The matters covered by the SFAA commitments are complex matters, for which complex drafting may be required. There are also interdependencies between the individual matters. Given the time limits within which the ACCC must make its decision on the SAU, the ACCC considers that it would not be possible to specify detailed replacement terms and conditions in the Notice to Vary without having to significantly extend the deadline for making its decision.

- There are some significant differences between the views expressed in submissions to the ACCC's Consultation Paper on the SAU. For example, Telstra submitted that alternative dispute resolution, with limited access to courts, is the preferable position.⁴⁷ However, Macquarie Telecom submitted the proposition that the parties should have full access to court proceedings to resolve disputes.⁴⁸

2.5.3. POI related matters

The SAU sets out NBN Co's commitments in relation to offering interconnection for different Connectivity Serving Areas (CSAs), and the changing of POI locations (including a process for ACCC approval of proposed changes to POIs).⁴⁹ The ACCC's concerns with these commitments are set out in chapter 6 of the Draft Decision.

The ACCC proposes that the following variations to the SAU be made:

- deletion of clause 1H.4.4 of Schedule 1H of the SAU — this would remove the inconsistency with the discretion granted to the ACCC to update the list of POIs under section 151DB of the CCA;
- deletion of the words “by a further 20 Business Days” from clause 1H.4.3(b) of Schedule 1H of the SAU — this would have the effect of allowing the ACCC to extend the POI review process as required, depending on the complexity of the particular process; and
- 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.

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. 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.

⁴⁷ Telstra, NBN Co 2012 Special Access Undertaking: Telstra's response to the ACCC Consultation Paper, 18 January 2013, p. 91.

⁴⁸ Macquarie Telecom, Submission to the ACCC in relation to the NBN Co Limited 2012 Special Access Undertaking, 18 January 2013, p. 24.

⁴⁹ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1H, clause 1H.4.

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