



Joint submission to the ACCC's Industry Roundtable Framing Paper

22 July 2021

Minimum requirements for the future regulatory framework of NBN Co

We welcome the ACCC's proactive efforts in facilitating the industry roundtable held on 18 June 2021 and agree that now is an opportune time to revisit the principles which underpin the regulatory framework of NBN Co and its Special Access Undertaking. We believe this process must be led by the ACCC and it is the ACCC's role to determine the scope and terms of the future regulatory framework. We ask the ACCC to steer this process, particularly in circumstances where it appears the ACCC's view of the scope of matters to be considered in this process is at odds with NBN Co, which seeks a more limited variation of the SAU.

The communications sector has undergone a great deal of transformation over the last decade, since the Special Access Undertaking was first accepted in 2013, and these changes have amplified over the last year. A significant impact of the COVID pandemic has been the accelerated digitisation of Australian society, with Australians continuing to work and study from the places that are most convenient to them. Businesses and governments have adapted services and products to meet the demands of a much more dispersed population at heightened risk of ongoing disruption. Customers generally expect so much more from their communications infrastructure and services than they did pre-COVID, and at prices that remain affordable.

While these changes in the market present a great opportunity to turn Australia into a leading digital economy, it places even more focus on the fundamental problem of the wholesale pricing model of NBN Co services.

During the industry roundtable, the ACCC heard that almost all RSPs supported the removal of the CVC construct. We strongly believe that any conversation related to a future wholesale pricing model must be approached with the starting presumption that AVC-only wholesale pricing is the default and preferred position. Globally, the prevailing approach has been to adopt flat rate pricing for regulated fixed broadband telecommunication, including in New Zealand and the United Kingdom.

The telecommunications industry has been operating for an extended period under a regulated pricing regime that provides no constraint on NBN Co's price levels, and has led to ever increasing and uncertain costs for RSPs to meet customers' expectations. The focus for the past decade has been on NBN Co's cash flows, with the consequence of NBN Co's prices being too high, artificially restricting customers' use of the NBN. The current regulatory framework also allows for cross subsidies from less competitive residential markets, that harm other participants in competitive markets. This has led to substantial challenges for RSPs and end users and, without substantial change, the outlook for the market and Australia's digital economy more broadly is bleak.

Unfortunately, NBN Co's proposed consultation on its SAU variation is a continuation of the last decade of satisfying 'revenue neutrality' for NBN Co, and gives no recognition to what RSPs and end customers need. It seeks immediate and ongoing price increases, with no justification on the basis of what costs NBN Co needs to recover in the future. It seeks to lock in prices, without any discussion of its existing or any new Building Block Model. Further, NBN Co procured a report from Accenture claiming that removal of CVC pricing will result in increased prices and consumer detriment, particularly for low speed tier consumers, however this contradicts the near industry consensus that customers will be better off with wholesale prices that do not include a variable charge. The proposal would give NBN Co a great deal of regulatory protection against future ACCC decisions, which it doesn't have today, with no benefit to end users. NBN Co has been given an opportunity to develop a Building Block Model in an open and transparent way, but has not yet done so.

The challenge for industry, including NBN Co, is to openly and transparently discuss what is needed in a future regulatory framework that promotes the long-term interests of end users and meets the legitimate needs of RSPs, NBN Co and Government. We need to develop a solution that can be endorsed by all stakeholders and provide a stable basis for pricing well into the future. The measure of success should be how many more Australians can we **connect to the NBN** and how much more can we encourage them to **use the NBN**.

The ACCC proposed workshops

We strongly support the proposal put forward at the industry forum that the best way forward is to carry out a series of workshops to discuss and design the future regulatory framework.

In support of that approach, we would like to put forward what we consider are critical principles for the future regulatory framework:

1. NBN Co must have the opportunity to earn a commercial return on efficiently incurred investments.
 - NBN Co should have incentives to undertake future investments to improve service quality for end users, where those investments are economically efficient.
 - The commercial return must be commensurate with the risks involved and NBN Co's costs of sourcing capital.
 - Efficient costs should be transparently allocated, to prevent inefficient cross-subsidisation between competitive and monopoly services.
2. Like any commercial enterprise, NBN Co should not be guaranteed a return on or recovery of costs that were or become economically inefficient.
 - The current regime provides incentives for NBN Co to over invest, and under-recover costs in competitive markets.
 - No commercial enterprise is guaranteed the recovery of inefficient costs or accumulated losses.
 - The existing regulatory asset base (and accumulated loss) needs to be reassessed to ensure it does not include costs that no efficient commercial enterprise would expect to recover.
 - For the future regime, there must be a gating mechanism, or otherwise strong incentives, to ensure only efficient costs are allowed in the cost base.
 - The regulatory asset base should also be assessed against contemporary valuations of NBN Co's assets.
 - There are high social and tax benefits associated with taxpayers' investment in the NBN that should be explicitly recognised, and justify NBN Co's non-commercial costs.
3. The long-term horizon of NBN Co's business activities must be considered appropriately.
 - NBN Co's business will exist beyond the current SAU term and this should be recognised.
 - NBN Co's payback period for costs is exceptionally long and covers a period over which NBN Co might be privatised and there are significant demand opportunities.
 - Prices in the immediate regulatory periods should account for NBN Co's opportunities and regulatory protections to recover costs well into the future and beyond the term of the SAU.

4. Prices must be determined over a reasonable future period, in a predictable manner to remove uncertainty as to the future costs of carriage services, and with a structure consistent with end user demand.
 - The existing revenue cap has led to significant uncertainty with respect to price levels and structures.
 - The future regulatory regime should set binding price caps.
 - Prices need to be set at an economically efficient level and in a predictable manner to remove uncertainty.
 - The wholesale price structure should support retail offerings including a single 'all in' tariff for each speed tier/product type.

5. Pricing levels and appropriate regulatory controls should be determined after setting allowable revenue targets during the regulatory period. It is important that any regulated price level is consistent with the determined efficient costs and allowable revenue targets.
 - Price structure should be a key immediate focus of the discussions. Industry is in broad agreement that the existing price structure is inefficient and unsustainable in the long term.
 - Access seekers agree there should be reasonable certainty over access costs over time for a given level of quality. Reasonable certainty over access costs allows Access Seekers to plan efficient investment in their retail offerings and to best meet their customer's needs, including as these offerings may change over time.

6. The process should be forward-looking with a discussion around historic costs:
 - A forward-looking approach is common across other regulated industries (for example, electricity). In considering regimes in other regulated industries, where appropriate, regard should be had to the extent that common features should be incorporated into the telecommunications industry approach.
 - Particular consideration should be given to issues such as:
 - a. How to treat historic costs - these should be considered against the LTIE.
 - b. What should be the relationship between contestable and non-contestable revenue/services? What should be the approach to cross-subsidisation?

These critical principles may be met by the proper development of a Building Block Model. But to do so requires considerable discussion on a wide range of concepts and considerations. We have set out below what we consider are the critical inputs into a Building Block Model that will serve investors, industry and customers well into the future. We would like to suggest that the workshops proposed at the industry forum consider each of the inputs below.

We look forward to discussing further as the consultation progresses.

Overview of a future Building Block Model – concepts and considerations

	Historic Sunk Costs & Losses	Capital Requirement	Operating Costs	Regulated v non-regulated base
Efficient Costs	<ul style="list-style-type: none"> • What is the value of asset base of the NBN? <ul style="list-style-type: none"> ○ Capital valuation v ICRA value ○ Should the ACCC write down capital investment to commercial value? ○ Should subscriber migration payments be excluded or included? ○ Corporate network investment • Status of ICRA / Review of ICRA value • Should there be an ex-post efficiency review of investment already undertaken? Is past investment efficient investment? 	<ul style="list-style-type: none"> • Should this include an efficiency review – what kind of efficiency mechanism would be best • How will the ACCC ensure gold plating does not occur in ongoing maintenance costs, and has not occurred? • What capital is included? Should capital for non-regulated services in competitive markets be excluded? • Should regional RBS investments be excluded? • Should capital requirements take into account efficiency considerations for technology choices? eg, build or lease existing infrastructure like satellites? 	<ul style="list-style-type: none"> • How will the ACCC ensure operating costs are efficient? What sort of efficiency review of operating costs should be included? • Will operating costs be benchmarked? • Should recovery of operating costs be linked to productivity and/or service level targets? 	<ul style="list-style-type: none"> • How should assets be allocated for contestable and non-contestable services • In considering what assets should be included in the regulated base, what factors about the services used by those assets should be taken into account? E.g. How should assets be allocated for Enterprise v protected residential services? • Should NBN Co be able to recover costs for non-regulated activities such as satellites on planes etc. • How will the ACCC ensure that regulated prices are not used to recover costs for non-regulated services or services the market would otherwise provide?

Annual Revenue Requirement

- Rate of return
- Non-commercial assets WACC = IRR / Govt debt rate
- Commercial assets = commercial WACC or govt debt rate
 - Competitive neutrality

	Product Mix	Price Structure	Price Level	Contestable services
Revenue Recovery	<ul style="list-style-type: none"> • There should be a multi-product approach – ensure total costs reviewed across all products • Anchor pricing has not worked historically in Australian telecommunications • One approach could be to have a core number of regulated services <ul style="list-style-type: none"> ○ 25/50/100 ○ Default market offer ○ NBN Co free to price other products 	<ul style="list-style-type: none"> • How should prices be structured to maximise usage and consumer benefit? • Fixed v variable costs • Fixed cost economics – marginal pricing 	<ul style="list-style-type: none"> • Over what time period should regulated prices apply? • Break down into ongoing capex/opex recovery and sunk cost recovery • Under/over recovery across time period • There should be an incentive scheme for service levels <ul style="list-style-type: none"> ○ Penalties if service levels not achieved ○ Fines and remediation costs should not be included in the regulated base (or at least only a proportion) 	<ul style="list-style-type: none"> • What can be learnt from international experience or other markets regarding the relationship between contestable and non-contestable revenue/services? • What should be the approach to cross subsidisation?