

14 January 2013

Mr Andrew Sheridan  
Head of Interconnect and Economic Regulation  
SingTel Optus Limited  
1 Lyon Park Road  
Macquarie Park NSW 2113

Dear Andrew,

### **NBN Co Special Access Undertaking**

We refer to the 16 November 2012 letter from Optus to the ACCC in regard to NBN Co making available financial data and modelling of the Long Term Revenue Constraint Methodology (LTRCM) over the 30 years of the SAU.

Optus' assertion that relevant information has not been made available seems to result from a number of basic misunderstandings of NBN Co's SAU. These relate to:

- The relationship between the SAU and NBN Co's Corporate Plan;
- The relevance of modelling to the ACCC's task of assessing the reasonableness of NBN Co's SAU; and
- The relevance, for the SAU's reasonableness, of the possibility that the LTRCM may not bind before the SAU ends in 2039-40.

A key aspect of the base case forecasts set out in NBN Co's 2012-2015 Corporate Plan is significant assumed decreases in nominal prices over time, as average access speeds and average data usage increase. These decreases will benefit Australians in terms of the affordability of NBN-based retail voice and broadband services.

It is well known (and has been acknowledged by the ACCC) that the NBN is subject to a range of supply side and demand side uncertainties, leading to a range of possible upside and downside scenarios over the period to 2039-40. That is, it is possible that NBN Co's financial returns could be higher than, or lower than, those currently presented in the Corporate Plan base case.



If the Corporate Plan forecasts and assumptions are applied to the LTRCM as set out in the SAU, the revenue constraint does not come into effect by 2039-40. The information in the Corporate Plan enables access seekers who are so minded to check this outcome.

It would seem bizarre if an access seeker were concerned about a scenario, such as the Corporate Plan base case, in which the LTRCM does not come into effect. After all, what this scenario implies is that for 30 years access seekers have been able to purchase NBN Co's services for supply to end users at prices that have not yet enabled NBN Co to recover its prudently incurred costs of supply (inclusive of an appropriate return on capital).

The ACCC's assessment of the SAU will presumably consider whether the LTRCM, in combination with NBN Co's structure and context, provides an appropriate incentive for efficient expenditure and operation over time. NBN Co assumes that the ACCC's assessment will include considering whether the SAU is reasonable in any event, rather than seeking to determine, at this point in time, precisely when or if the LTRCM will come into effect over the period to 2039-40 - by definition, it is not possible to know this now, with certainty.

In previous access undertakings (for example, as referenced by Optus in its letter), access providers have submitted modelling to the ACCC through which they have sought to explicitly link proposed prices to forecasts or estimates of costs and demand, either at a point in time, or over a set period.

NBN Co, as a Government Business Enterprise with an explicitly stated aim of reducing wholesale prices as rapidly as possible while providing an acceptable return to the Government, has taken a different approach with its SAU. That approach doesn't rely on modelling in this way and modelling of possible scenarios is not necessary to 'understand and verify the likely operation of the price control arrangements in the proposed SAU' as Optus has claimed in its letter. NBN Co's approach is described in the supporting submission to the SAU, and is summarised as follows:

- The initial prices (as set out in the SAU) were developed in consultation with access seekers so as to enable a smooth transition for end users from legacy networks to the NBN. As such, the initial prices are not the result of modelling of NBN Co's costs and demand, and NBN Co has been very clear on this in its consultation with access seekers.
- The CPI-1.5% limit on any future individual price increases (applied on an annual 'use it or lose it' basis) is included in the SAU to provide stability and predictability to access seekers regarding the prices of individual services, and operates regardless of whether or when the LTRCM comes into effect. It leaves NBN Co with some (limited) ability to change price relativities over time but, again, was not the result of modelling of NBN Co's costs and demand. NBN Co's Corporate Plan actually assumes prices decreasing in nominal terms over time, rather than increasing at CPI-1.5%.
- The LTRCM is a methodology that constrains NBN Co to recovering no more than its prudently incurred costs of supply (inclusive of an appropriate return on capital). By its nature, being a methodology, this constraint is also not the result of modelling of NBN Co's costs and demand.



Taken together with the other elements of the SAU, these commitments will promote the long term interests of end users, and the SAU is capable of being accepted as reasonable by the ACCC based on the information that NBN Co has already submitted (including a range of expert reports that do not rely on modelling and do not assume that the LTRCM comes into effect at any particular point in time). NBN Co does not believe that the modelling information sought by Optus will assist the ACCC in assessing the SAU, and NBN Co notes that the ACCC's Consultation Paper on the SAU does not refer to any such information.

The LTRCM appropriately recognises that NBN Co should have the opportunity to recover its prudently incurred costs over time (inclusive of an appropriate return on capital), and it provides for a utility-style annual revenue capping approach to apply once the Initial Cost Recovery Account is extinguished. Importantly, the LTRCM provides assurance to access seekers that NBN Co cannot over-recover its prudently incurred costs.

The SAU has been designed with a combination of commitments such that, when considered together with NBN Co's structure and context, the reasonableness of the overall package of terms and conditions does not depend on whether the LTRCM is certain to come into effect within a particular timeframe.

That is, the SAU's terms and conditions will be reasonable regardless of whether an upside, a downside or the Corporate Plan base case scenario eventuates over the next 30 years. This design approach means that there is no need to seek to reach a conclusive view at the outset on when the LTRCM will come into effect, or even the likelihood of it occurring.

For completeness, NBN Co notes that if the ICRA is extinguished, prices would need to be reduced to ensure that NBN Co only earns revenue consistent with the LTRCM. In particular, the SAU commits NBN Co to notify the ACCC and its customers 5 years prior to the time that the LTRCM is ultimately expected to come into effect, and then to provide more detailed information 3 years prior to extinguishment, including:

- Forecast average price change across all products;
- Expected impact on individual prices of each product; and
- Transitional arrangements that will be put in place.

The SAU also commits NBN Co to update this information each year so that access seekers will have appropriate visibility and certainty about the likely impact on prices well in advance of any changes that are made.

In view of the matters discussed above, NBN Co does not see any utility in providing financial data and modelling of the LTRCM as part of the ACCC's assessment of the SAU.

As always, we would be pleased to discuss this or any other SAU issue with you.

Yours sincerely,



Caroline Lovell  
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Copy to:

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Australian Competition and Consumer Commission