

# nbn Special Access Undertaking Variation: Response to ACCC Draft Decision

## Floor and Ceiling – Modified Pricing Options

July 2023





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# 1 Executive Summary

The key remaining unresolved issue from the SAU variation lodged by **nbn** on 29 November 2022 (**November Variation**) is the residual cost uncertainty faced by Retail Service Providers (**RSPs**) for **nbn**'s 50 Mbps<sup>1</sup> and lower speed tiers. RSPs have highlighted this cost uncertainty as introducing material commercial risk for them.

**nbn** proposed an initial 'floor and ceiling' pricing approach in June 2023 (**Initial Floor and Ceiling Proposal**) directly responding to feedback from the ACCC Draft Decision (**Draft Decision**) and RSPs. This approach eliminated residual cost uncertainty for RSPs by capping the price charged by **nbn** for individual services supplied to RSPs. It also sought to place RSPs on a level competitive playing field by reducing any potential advantage some RSPs may have as a result of either their scale or characteristics of their customer base. As identified in feedback to the pricing proposed in the November Variation, "RSPs that are less able to perfectly migrate customers will be at a competitive disadvantage to those that can. This would harm the competitive process."<sup>2</sup>

Feedback from RSPs regarding the Initial Floor and Ceiling Proposal has been mixed. Some RSPs have raised concerns about the removal of national CVC pooling and potential impacts on 12Mbps and 25Mbps pricing, while others have been supportive of the proposal, citing the greater pricing certainty it would provide and the cost disadvantage they would otherwise face under the November Variation pricing arrangements.

Recognising this feedback, **nbn** has developed further floor and ceiling proposals (**Modified Floor and Ceiling Proposals**) for consideration by RSPs.

The options in the Modified Floor and Ceiling Proposal include:

1. Either reducing the floor price of the 50 Mbps service; or
2. Reducing the CVC overage charges; or
3. A combination of both.

In all cases, **nbn** will also provide increased CVC inclusions for the 50 Mbps bundled offer.

Further, **nbn** proposes to offer a transitional credit to RSPs.

As RSPs do not have the same mix of retail customers, the impact of each of these options will be different. However, for all options, the Modified Floor and Ceiling Proposals lead to a narrowing in the variation of outcomes between different types of RSPs relative to the November Variation pricing, resulting in a more level competitive playing field. Importantly, these options are expected to result in lower wholesale costs for RSPs than forecast under the November Variation at the time it was lodged, and are expected to result in no material change in wholesale costs from FY23 to FY24 as **nbn** transitions to the new pricing construct.

As a wholesale-only network operator established to promote retail competition, **nbn** is acutely aware of the need to ensure its price and non-price terms do not favour particular RSPs. Since the release of **nbn**'s Initial Floor and Ceiling Proposal, a number of RSPs have indicated they are now planning, since the November Variation, to optimise their wholesale speed tiers to reduce cost, which would have the effect of placing them at an advantage relative to RSPs who do not have the same opportunity or capability to do so. In particular, **nbn**'s analysis reveals

<sup>1</sup> Note: In this paper, **nbn** uses the terms "50/20 Mbps" or "50 Mbps" to collectively refer to the 50/20 Mbps services provided over Fibre, HFC and FTTC networks, the 25-50/5-20 Mbps services provided over FTTN and FTTB networks, and the Wireless Plus services provided over the Wireless network.

<sup>2</sup> Telstra, *Submission to the ACCC NBN Co Special Access Undertaking Draft Decision*, 2 June 2023, p. 9.



that larger RSPs will be able to lower their costs relative to smaller RSPs. This may distort retail competition by creating an uneven playing field between RSPs, as well as resulting in inefficient use of **nbn**'s network, as end-users will not receive the benefit of the higher wholesale speeds they are migrated to.

In addition, based on the level of wholesale optimisation now anticipated to be undertaken by RSPs, the pricing proposed in the November Variation would create substantial commercial risk for **nbn**, impacting its commercial sustainability and ability to invest in improving the performance and capability of the network. Accordingly, and noting the November Variation does not address the pricing certainty concern identified by the ACCC in the Draft Decision, this paper does not propose a return to the price settings in the November Variation.

As RSPs have noted, the SAU variation process has been running for two years, and the industry requires certainty of **nbn**'s regulatory settings so that all parties can move to implement the significantly enhanced arrangements proposed in the SAU and focus on delivering improved outcomes for end-users.

Developing fair and sustainable wholesale pricing involves balancing the views of RSPs, industry stakeholders such as the ACCC and Government, and consumer and industry representatives, while at the same time recognising **nbn**'s commercial interests. This is a complex process and given the long-term implications for the SAU's price settings, it is important for all stakeholders that we get this right and deliver the best outcomes for end-users.

It is also noteworthy that the current regulatory process is atypical – the SAU variation is tantamount to a major resetting of the regulatory framework that governs **nbn** until 2040 and not a standard utility-style regulatory proposal under a defined set of regulatory rules and processes. **nbn** is also not in the same position as utilities that are typically subject to this form of regulation, as we have not yet reached a cost-recovery position (and are unlikely to do so for at least two regulatory cycles), and face considerable competition from other networks.

Therefore, **nbn** considers that the appropriate and necessary amount of time is being afforded to industry and **nbn** to work through the level of change to implement the substantially updated regulatory framework until 2040. Given the central role that **nbn** plays in the telecommunications industry and the wider economy, taking the required time up-front to get these settings correct is time well spent.

However, **nbn** has heard clearly from RSPs that the time it is taking to get an accepted SAU variation in place is impacting them financially and that they are seeking some interim relief via increases to CVC inclusions under the current TC-4 Bundled Discounts.

In response, and driven by the urgency of bringing the SAU variation process to a timely close and delivering on the intended benefits to all Australians<sup>3</sup> (including RSPs), **nbn** proposes to offer \$12 million in total of transitional credits to RSPs to reflect the extended nature of the consultation prior to implementation of the SAU.

Following feedback from RSPs on the Modified Floor and Ceiling Proposals, **nbn** envisages that it will be able to withdraw its November Variation and lodge an amended SAU Variation shortly thereafter.

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<sup>3</sup> For example, immediate AVC-only pricing on higher speed tiers, enhanced ACCC regulatory oversight, increased certainty and transparency of **nbn**'s service performance, and increased visibility and consultation on **nbn**'s expenditure.

## 2 Residual cost uncertainty concern with nbn's November SAU Variation

### 2.1 November Variation responded to ACCC and RSP feedback

The November Variation contained mechanisms designed to provide cost certainty to RSPs, including the weighted average price control (WAPC), individual price controls, automatic CVC inclusion adjustment, the Statement of Pricing Intent and Pricing Roadmap. These measures responded to feedback from RSPs and the ACCC throughout the SAU variation process, including in response to the variation lodged by nbn in March 2022.

The November Variation also provided for:

- Immediate transition to AVC-only charges for high-speed tiers (100 Mbps and higher)
- A committed 3-year transition glidepath to AVC-only for sub-100 Mbps speed tiers. nbn has maintained that immediate transition to AVC-only on sub-100 Mbps speed tiers would result in higher wholesale prices for its services, potentially leading to some end-user cohorts being priced out of the market, in order to maintain the revenue required to put nbn on a pathway to recovering its prudent and efficient costs.

Throughout the pre-November Variation lodgement process, and then in response to the ACCC Consultation Paper in January 2023 and Draft Decision in May 2023, RSPs maintained that wholesale cost certainty was of paramount importance to them, and that their ability to optimise their wholesale costs was constrained by the cost and complexity of doing so.

### 2.2 Residual cost uncertainty in respect of 50 Mbps and below speed tiers was the key pricing concern in the ACCC's Draft Decision

The Draft Decision provided the Commission's views on key aspects of pricing and cost certainty in respect of the 50 Mbps service:

- **Wholesale price level** – it was *“satisfied that the proposed increase in the bundled charge for 50 Mbps wholesale offer would not provide a basis to reject the SAU variation as it is necessary to provide NBN Co a reasonable opportunity to recover its efficient costs.”*
- **Price controls and transparency built into the SAU** – it considered that *“the proposed price controls and transparency measures for the subsequent regulatory period strike an appropriate balance between giving flexibility to price efficiently in the wholesale market and providing the degree of cost certainty that retailers require to offer competitive services to the household and businesses that use the NBN.”*
- **Residual cost certainty concern** – in response to feedback from industry stakeholders on cost certainty, the ACCC expressed **residual concerns** [emphasis added] for cost certainty on the 50 Mbps speed tier, as *“combined AVC and CVC charges for services acquired under the 50 Mbps wholesale offer could fall within a very broad range under the proposed pricing model for the first regulatory cycle”*. Hence, the ACCC encouraged nbn to further consider this issue, and put forward the option that nbn ‘cap’ charges for the 50/20 Mbps service, such that *“...a service acquired under the 50 Mbps wholesale offer would not exceed the monthly cost of the residential grade 100 Mbps wholesale offer...”*.
- **Revenue neutrality** – the ACCC noted that nbn should be able to do so *“...in a way that would lead to the same revenue outcomes as if its CVC reporting proposal was to work as intended, but mean that retailers would not need to incur the systems development and ongoing costs that NBN Co's method would require.”*

## 3 nbn's Initial Floor and Ceiling Proposal revealed many RSPs' preference and priority for cost optimisation over cost certainty

### 3.1 nbn responded to the ACCC Draft Decision by proposing the floor and ceiling approach to resolve residual cost certainty concerns

nbn sought to address ACCC and RSP concerns with an Initial Floor and Ceiling Proposal, which bounded the combined charge for any bundled service between its bundle price and the 100 Mbps price (\$55 in FY24), via a submission provided to the ACCC on 2 June 2023 and subsequently published on the ACCC's website.

nbn's Initial Floor and Ceiling Proposal introduced a hard cap on an individual AVC's maximum overage cost such that no Bundled TC-4 Offer would cost more than the 100/20 Mbps flat-rate offer. The proposal would provide a significant increase in cost certainty and price simplicity, as RSPs would no longer need to conduct what they have told nbn is complex and resource intensive wholesale optimisation to manage their wholesale input costs.<sup>4</sup>

The removal of national pooling of CVC inclusions (via the 'floor' price) was required to ensure that nbn's wholesale prices were not distorted by the ceiling, so that nbn can achieve a revenue neutral outcome relative to the financial projections in the November Variation and would move nbn's pricing on 50 Mbps and below speeds much closer to AVC-only (and could therefore be seen as playing a positive role in the transition to AVC-only).

The floor and ceiling pricing construct would still enable differential pricing of low and high usage customers on key speed tiers, and in particular the 25 Mbps tier. However, it would also make the price for a service simpler and more efficient (as the average price for an RSP of acquiring services on a given speed tier does not depend on the CVC inclusions that the RSP accumulates on other speed tiers), and put RSPs on a more level competitive playing field, whether or not they have the resources and capability to undertake targeted optimisation of their base, therefore promoting competition.

### 3.2 RSPs' responses to the Initial Floor and Ceiling Proposal were mixed

In response to the consultation by the ACCC that concluded on 16 June, feedback from RSPs on nbn's Initial Floor and Ceiling Proposal included:

Support for floor and ceiling proposal:

- Launtel "broadly supports" the floor and ceiling proposal and notes that the removal of CVC pooling is worth it for the pricing certainty provided by floor and ceiling.
- Launtel understands that without floor and ceiling it was feared larger RSPs would have a competitive advantage over smaller RSPs that could not optimise to the same extent. Without floor and ceiling, Launtel was strongly considering exiting 50/20 (although it may still consider doing so even with 'floor and ceiling').

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<sup>4</sup> For example, in its submission to the ACCC's Draft Decision, Telstra submitted that without a cap on the price of the 50/20 Mbps service, "RSPs are likely to carry out costly and complex arrangements to migrate 50/20 customers that individually cost more than \$55 to a 100/20 plan (and back down again if their usage falls). That will require complex analysis and predictive tools built and maintained by all RSPs." (see Telstra, *Submission to ACCC NBN Co Special Access Undertaking Draft Decision*, 2 June 2023, p. 8).

- X Integration welcomes the floor and ceiling proposal and believes it will address many of the concerns around pricing complexity that smaller RSPs would face under the November Variation.
- While IAA said that it could not definitively support our proposal given the diversity of its membership, it observed that the floor and ceiling approach may be more favourable for smaller RSPs that may be disadvantaged under the current model and provides a solution for RSPs that lack the capacity to design systems to ingest large volumes of data needed to optimise.

Concerns raised in respect of the floor and ceiling proposal included:

- Risks that it would result in higher prices for end-users.
- A desire to maintain national CVC pooling as it benefits lower speed tier customers.
- Views that CVC pooling encourages “innovation” by RSPs to smooth CVC costs and neither size nor scale are a barrier to this type of “innovation” – it is “unfair” to RSPs who have invested in these innovations based on the November Variation to make a change at this late stage.
- A concern that it could lead some RSPs to exit serving lower speed tier customers.
- A general preference to revert to the pricing in the November Variation.
- Claims that the floor and ceiling proposal is not revenue neutral for **nbn**.
- Concerns about the operational complexity of floor and ceiling compared to operating under the arrangements in the November 2022 Variation.

Alternatives suggested by RSPs in response to **nbn**’s Initial Floor and Ceiling Proposal included reducing AVC prices and reducing overage charges.

### 3.3 Retail Plan Optimisation vs Wholesale Optimisation

The pricing framework envisioned by **nbn** in the November Variation encourages RSPs to assist consumers with their retail plan choices by providing incentives (in the form of overage savings) to perform optimisation of their wholesale plans by upgrading end-users to high-speed tiers (supplied on AVC-only pricing). This incentive for retail plan optimisation was predicated on RSPs engaging with their end-users based on their long-term usage profile and future expected usage, and the end-user receiving superior network experience from that plan upgrade based on their usage profile.

However, following publication of **nbn**’s Initial Floor and Ceiling Proposal, which was intended to deliver the cost certainty outcomes sought by RSPs and the ACCC, some RSPs have now indicated they are undertaking this optimisation activity only at the wholesale layer by performing daily upgrade/downgrade operations to manage end-users between key speed tiers, whilst providing the same retail speed tier to end-users. Thus, rather than delivering speed and/or performance outcomes for end-users at the retail level, RSPs have focused more on wholesale plan optimisation.

This disconnect between retail plan optimisation and wholesale optimisation is neither forecast in **nbn**’s revenue projections submitted to the ACCC, nor the previously disclosed level of wholesale optimisation. It is an unintended outcome of **nbn**’s pricing framework proposed in the November Variation and would result in inefficient investment of resources in industry whilst potentially delivering little to no improvement in the speed or performance of the service supplied to end-users.

A key point of difference between retail and wholesale optimisation is that speed tier migrations at the retail level are gradual and predictable, as end-users would need to be notified and the overall speed profile for RSPs cannot



fluctuate wildly on a daily basis. In contrast, wholesale optimisation can result in sudden and unpredictable movements of large end-user cohorts, which can cause significant distortions to **nbn**'s end-user distributions and in turn to the Average Combined Charge of each speed tier, which is a key input into the pricing regulation framework in the November Variation, thereby undermining the appropriateness of the pricing certainty measures in the November Variation.

Given that not all RSPs are in the position to devote the resources required to implement such wholesale optimisation, its selective adoption by some RSPs can result in distortionary impacts on retail competition.

### 3.4 Assessment of the impact of wholesale optimisation

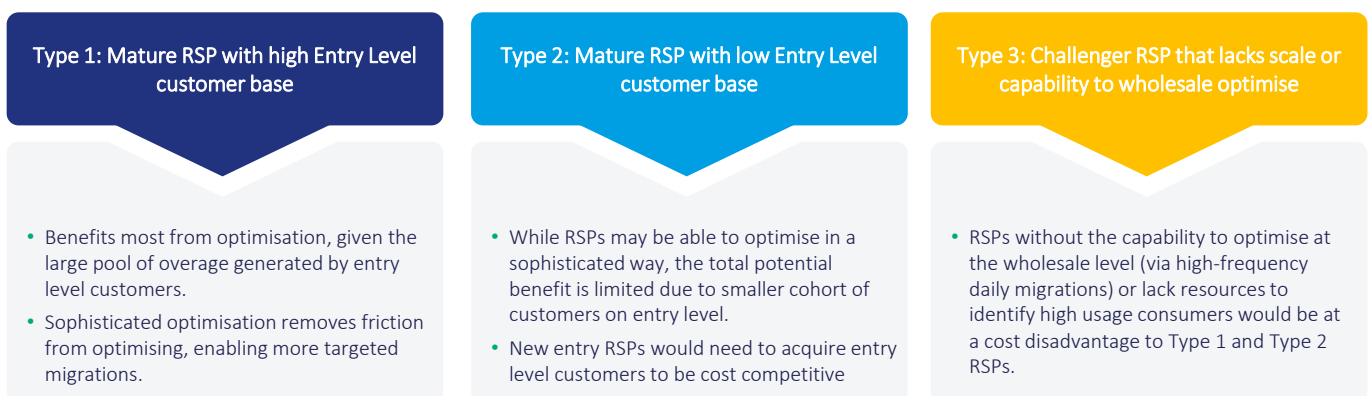
The impact of wholesale optimisation on the industry's competitive dynamics will of course depend on the degree of optimisation that each RSP is planning to undertake. In considering the issue of cost certainty, and developing our initial floor and ceiling proposal, it is now clearer to **nbn** that some RSPs are seeking opportunities to minimise the wholesale costs they face under the November Variation pricing. **nbn** has analysed the impact this wholesale optimisation may have on competitive outcomes for industry, and in particular how different types of RSPs may gain advantage over other RSPs as a result of their ability to leverage their scale and strategic market position.

**nbn** notes that the pricing framework in the November Variation was intended to implement gradual price increases over the First Regulatory Cycle to support **nbn**'s ability to move to a cost recovery position in the medium-term and to minimise price shocks for end users. Instead, the wholesale optimisation now planned by RSPs poses a serious revenue risk to **nbn**, contrary to the objective of achieving revenue neutrality in the First Regulatory Cycle, placing at risk objectives that are in the LTIE such as attainment of cost-reflective prices in the medium term, and **nbn** achieving a stand-alone credit rating in the future.

#### 3.4.1 RSP 'archetypes' considered in this assessment

To assess the potential impact of wholesale optimisation on the competitive dynamic across the industry, **nbn** has grouped RSPs into 3 'archetypes':

- **Type 1:** Mature RSPs with high proportion of entry level customers. Capable of managing high frequency wholesale optimisation.
- **Type 2:** Mature RSP with low proportion of entry level customers. Capable of managing high frequency wholesale optimisation.
- **Type 3:** Challenger RSPs that lack the capability or scale to perform high frequency wholesale optimisation.





For each RSP archetype, **nbn** has modelled three wholesale optimisation scenarios (low-25%, medium-50% and high-75%), where the percentages reflect the proportion of overage costs removed due to optimisation at the wholesale level, and assuming that the optimisation is able to be performed in a highly targeted manner. As an example, under a 25% wholesale optimisation scenario, RSPs would on a daily basis migrate customers exhibiting the heaviest data usage to AVC-only tiers, such that their total overage costs are reduced by 25% compared to a do-nothing steady-state scenario.

**nbn** also notes that the impacts on 12/1 Mbps, 25/5 Mbps and 25/10 Mbps have been assessed as a single group in the analysis that follows, as these services are part of the same TC-4 Bundle Offer Group, and are intended to be at price parity (noting that 12/1 Mbps has a slightly lower fixed charge but with lower CVC inclusions).

### 3.4.2 Wholesale optimisation impact on cost to serve under the November Variation

The financial value of wholesale optimisation to RSPs is limited by the total amount of potential overage charges generated by the RSP’s portfolio of end-users on 50 Mbps and below plans.

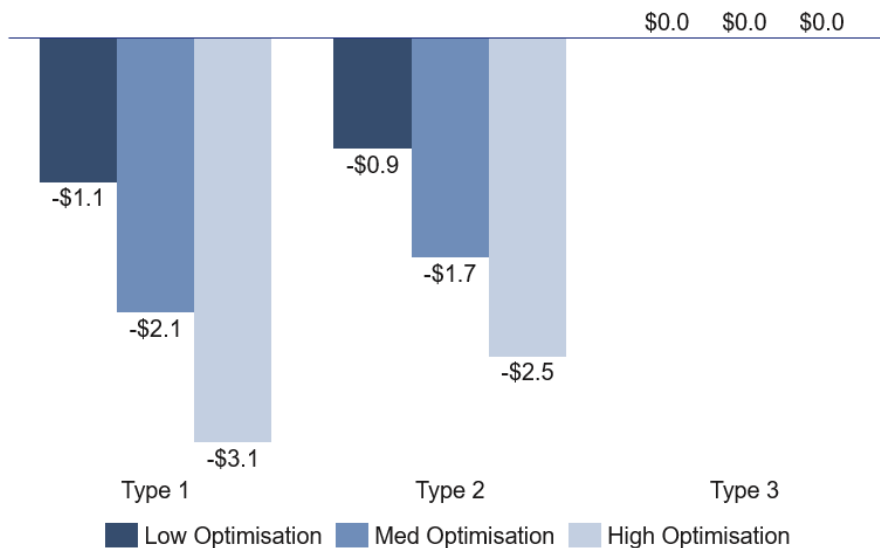
The pricing structure proposed by **nbn** under the November Variation is such that 50 Mbps end-users will be exposed to very marginal amounts of overage charges on average (due to CVC inclusions), and that ~30% of the average wholesale price faced by an end-user on 12 Mbps and 25 Mbps plans would be overage. This pricing framework is designed to encourage RSPs to provision low-cost plans to end-users with lower usage on the entry level offers.

A consequence of this framework is a material difference in the potential optimisation opportunity across the industry depending on each RSP’s exposure to entry level plans, and the usage of customers on those plans.

**nbn**’s analysis shows that:

- Type 1 RSPs would benefit the most from wholesale optimisation, which provides them with a cost advantage over other RSP types, potentially reducing the average cost to serve of sub-50 Mbps customers by between \$1.1-\$3.1/SIO/Month
- Type 2 RSPs savings would be next highest between \$0.9-\$2.5, and
- Type 3 RSPs would expect little to no benefit due to lack of optimisation capability.

**Figure 1 - \$ Saving/SIO/Month relative to no optimisation under November Variation (Sub-50 Mbps)**



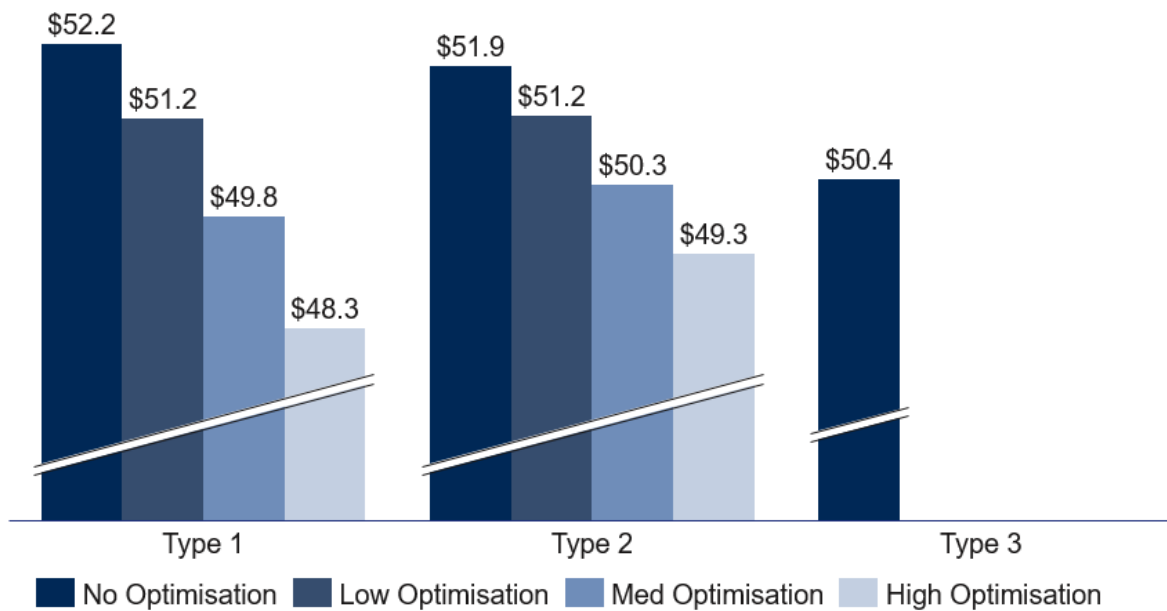
### 3.4.3 Wholesale optimisation impact on wholesale prices under the November Variation

The optimisation savings across the sub-50 Mbps cohort will directly translate to differences in average wholesale prices for key speed tiers across the different types of RSPs.

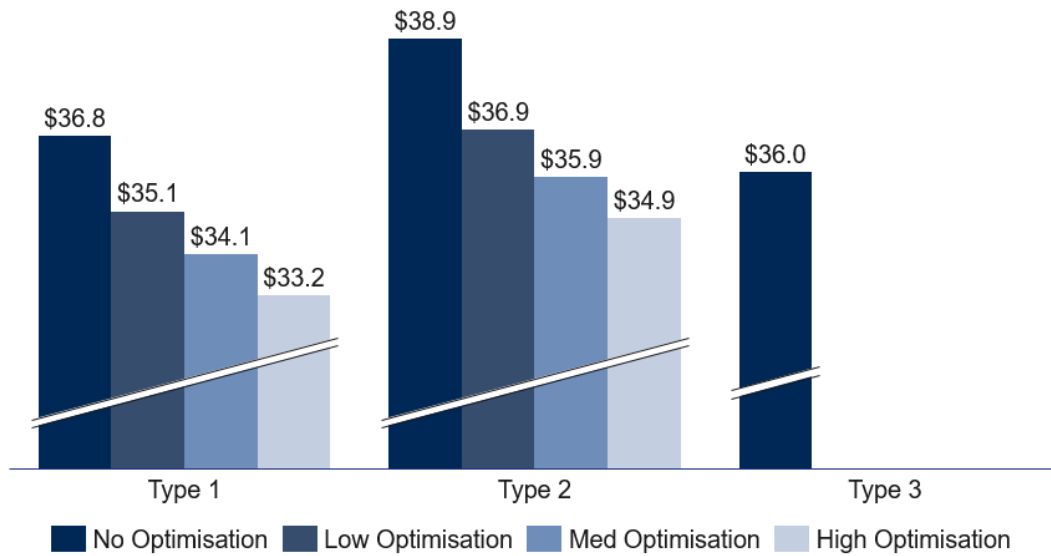
nbn's analysis shows that, under the November Variation, wholesale optimisation could see Type 1 RSPs reduce their average cost to serve 50 Mbps end-users by up to \$3.9 (\$52.2 to \$48.3) and 25 Mbps by up to \$3.4 (\$51.9 to \$49.3) creating a significant cost advantage relative to other RSP types. In particular, Type 3 RSPs would face substantial higher cost to serve for the most popular product in market (50 Mbps) compared to the larger Type 1 and Type 2 RSPs, entrenching the competitive advantage of those Type 1 and Type 2 RSPs. This impact is shown in Figure 2 below.

Figure 3 below shows nbn's analysis of the implications for 12 and 25 Mbps wholesale prices for the different Types of RSPs under the various optimisation scenarios assumed.

Figure 2 – Average 50 Mbps wholesale prices by RSP type and potential optimisation activity



**Figure 3 - Average 12 and 25 Mbps wholesale prices by RSP type and potential optimisation activity**



## 4 nbn has developed three Modified Floor and Ceiling Proposals in response to RSP feedback

### 4.1 nbn has taken into account a range of objectives in developing the Modified Floor and Ceiling Proposals

In responding to both the Draft Decision and further feedback from RSPs on nbn's Initial Floor and Ceiling Proposal, there are a number of objectives nbn needs to balance:

- **Wholesale cost certainty for RSPs** – nbn recognises that wholesale cost certainty for RSPs plays an important role in enabling RSPs to better plan their future marketing and pricing strategies and make necessary investments to support delivery of nbn services to end-users. By supporting RSPs' ability to develop these strategies, wholesale cost certainty promotes efficient use of nbn's network in terms of both uptake of new services and ensuring end-users are on plans that best meet their needs. As nbn is a wholesale-only provider of services and relies on RSPs as its only channel to market, nbn has strong pre-existing incentives to ensure all RSPs can effectively market and sell broadband services.
- **Promotion of competition in downstream markets** – While nbn supplies products at the same price to all RSPs, consistent with its non-discrimination obligations, nbn recognises that there can nonetheless be differential outcomes for RSPs, depending on their scale, go-to-market strategy, degree of pre-existing investment, etc. To the extent that nbn's wholesale prices provide a more level playing field between RSPs, this should promote efficient investment by, and competition between, existing RSPs and entry by new RSPs, to the benefit of end-users in terms of greater choice and value (lower price and/or higher quality). In turn, this should promote efficient use of nbn's network and, through increased adoption of nbn services, support nbn's ongoing ability to efficiently invest in the quality and capability of its network.
- **Impact on consumer choice and retail prices** (in particular on 12 and 25 Mbps services) – A feature of nbn's wholesale pricing to date is that CVC charging allows RSPs to provide 'capped' data plans for lower-usage customers at a lower retail price point than for the more widely used 'uncapped' plans. This is one of the reasons that nbn has not proposed immediately moving to AVC-only pricing for all speed tiers. Doing so would have the effect of increasing prices for lower-usage customers on 12, 25 and 50 Mbps plans, which would have detrimental impacts on these end-user cohorts, likely lead to customers leaving the nbn network (thus reducing the efficient use of the network), and require nbn to recover a greater share of its fixed network costs from remaining customers.
- **Improving economically efficient outcomes** – As nbn supplies a range of different products (based on speed tier, level of CVC inclusions, etc), it is open to RSPs to seek to 'optimise' their customer base to reduce their overall costs or level of potential cost uncertainty by seeking to move end-users to different speed tiers, or by providing different quality services (e.g., the level of CVC supplied in peak hour, backhaul provisioning, etc.). Price levels and structures at the wholesale layer may provide greater incentives for RSPs to seek to optimise the services they supply. This results in transaction costs generated purely by the structure of nbn's pricing. A high degree of wholesale optimisation, where RSPs do not pass on higher speeds to end-users, may lead to allocative inefficiency in the sense that the capacity and capability of nbn's network is not being flowed through to end-users, and hence not putting nbn's investment in the network to the highest value use.

- **Promoting efficient investment in nbn’s network** – A key objective of regulation is to promote efficient use of, and investment in, networks that are subject to regulation. One factor that impacts **nbn**’s ability to efficiently invest in the performance and capability of its network is the degree of revenue predictability afforded by its pricing construct. **nbn** acknowledges that there will always be an element of revenue forecast uncertainty as a result of evolving end-user behaviour and preferences, competitive market dynamics, and broader economic factors that may change willingness to pay for particular services. However, if aspects of **nbn**’s pricing lead to greater instability or ability to forecast future revenue, this is likely to reduce **nbn**’s ability to invest with confidence in future network upgrades, reducing the overall level of investment in the network, or introducing delays to enhanced performance and capability outcomes for end-users.
- **nbn revenue neutrality** – Consistent with the ACCC Draft Decision, where the ACCC indicated its draft view that **nbn**’s overall revenue outcomes over the First Regulatory Cycle were reasonable, any changes to the pricing construct must lead to the same revenue outcomes as if **nbn**’s CVC reporting proposal was to work as intended.

In this context, **nbn** notes that the November Variation and subsequent 3-year Pricing Roadmap published on 24 May provide for **nbn**’s prices to increase by up to CPI on an annual weighted-average basis over the period where **nbn** has not achieved cost recovery. Indeed, the ACCC has explicitly recognised the need for such price increases: “...it would be reasonable for the cost of wholesale offers to progressively increase in nominal terms over the medium term, and for CVC charges to be phased out over the first regulatory cycle as NBN Co has proposed.”<sup>5</sup>

## 4.2 nbn proposes three variants to the Initial Floor & Ceiling Proposal

### 4.2.1 Modified Floor and Ceiling Proposals respond to RSP feedback

In recent submissions, RSPs have argued that the loss of national pooling of CVC inclusions that arises from the introduction of floor and ceiling pricing would remove the ‘cross subsidy’ between the 50 Mbps and lower speed tiers, which would lead to an increase in retail prices for 12 and 25 Mbps services.

**nbn** does not agree with this view, and considers that all else being equal, floor and ceiling pricing produces lower wholesale prices on the 12 and 25 Mbps tiers due to the operation of the ceiling placing a limit on the maximum effective price that is charged (approximately 10% of customers on these tiers will benefit from wholesale price cap), with the floor price remaining approximately the same as the fixed bundle price in **nbn**’s November Variation (due to the low level of inclusions for these speed tiers), in particular, the price for 12Mbps is identical between the two pricing frameworks (\$24.40/Month).

While the initial floor and ceiling proposal generated a slight increase in the industry average price for 50 Mbps services, this was offset by a commensurate decrease in the price of 12 and 25 Mbps services. After considering RSP feedback, **nbn** has developed three new variants of floor and ceiling pricing to further address any adverse price impacts, by either reducing the price of 12 and 25 Mbps services further via a reduction to the CVC coverage rate (option 2), reducing the price of 50 Mbps services (option 1), or both (option 3). As with the initial floor and ceiling proposal, each of the three options will necessitate the removal of national CVC pooling in order to balance and offset the commercial downside faced by **nbn** as a result of introducing the ‘ceiling’ construct.

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<sup>5</sup> ACCC Draft Decision, p. 5.

## 4.2.2 Modified Floor and Ceiling Proposals

Following the RSP feedback described above and ongoing assessment of the pricing certainty issues that have been raised, **nbn** is now seeking feedback on three different variants of **nbn**'s initial floor and ceiling proposal. In all options, the ceiling price remains the same as the 100/20 Mbps flat-rate offer (\$55 in FY24), for the 12, 25 and 50 Mbps bundled offers. **nbn** considers that these variants continue to deliver the wholesale cost certainty described in our June discussion paper (and requested by the ACCC in the Draft Decision), but which also provide RSPs with improved commercial outcomes relative to the initial floor and ceiling proposal.

- **Option 1** – Reducing the bundle price for the 50 Mbps service (and hence the 'floor') from \$50 to \$48 and increasing the CVC inclusion from 2.5 Mbps to 2.6 Mbps from the date by which **nbn** implements the new pricing in FY24 (the 'Price Transition Date').
- **Option 2** – Retaining the same bundle price for the 50 Mbps service (\$50) and reducing the CVC overage rate from \$8/Mbps to \$5.50/Mbps and increasing the CVC inclusion for 50 Mbps services from 2.5 Mbps to 3.5 Mbps from the Price Transition Date in FY24 (with the overage rate reducing to \$4.50 and \$3.50 in future years).
- **Option 3** – Reducing the bundle price for the 50 Mbps service (and hence the 'floor') from \$50 to \$49, increasing the CVC inclusion for 50 Mbps services from 2.5 Mbps to 2.6 Mbps and reducing the overage rate from \$8/Mbps to \$6/Mbps (reducing to \$5 and \$4 in future years), each from the Price Transition Date in FY24.

## 4.3 The Modified Floor and Ceiling Proposals provide a more level playing field across industry

Each of **nbn**'s proposed floor and ceiling variants remove the need for RSPs to perform wholesale optimisation and balances the wholesale pricing outcomes across the different Types of RSPs in a similar manner to that delivered by AVC-only pricing.

In particular, **nbn's** analysis shows that the Modified Floor and Ceiling Proposals materially narrows the range of potential wholesale pricing outcomes on the 50 Mbps speed tier within a very narrow band for all floor and ceiling options for all RSPs. The differences in outcomes for each RSP Type primarily arise from the distribution of end-user usage for these RSP archetypes.

Figure 4 - Average 50 Mbps wholesale prices for Modified Floor and Ceiling variants

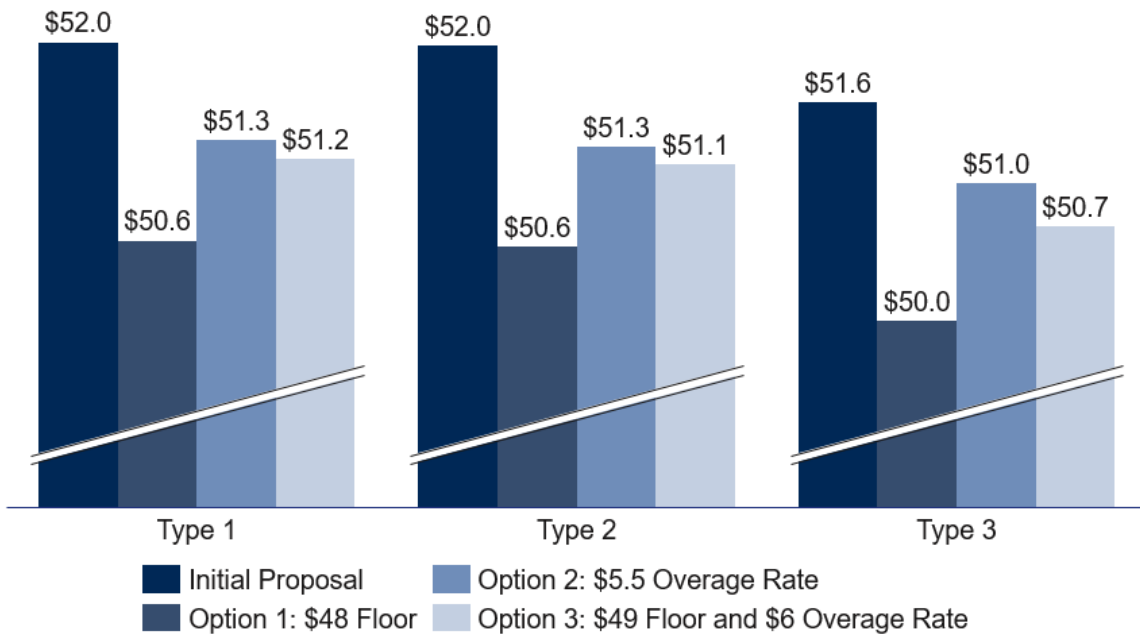
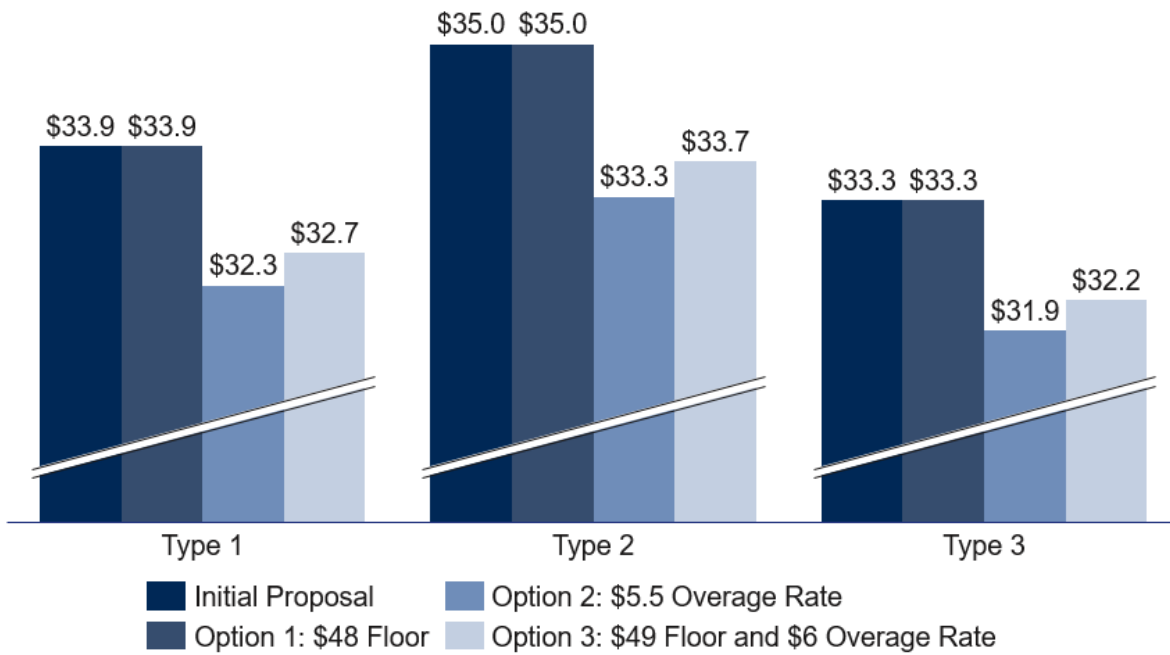


Figure 5 - Average 12 Mbps and 25 Mbps wholesale prices for Floor and Ceiling Option



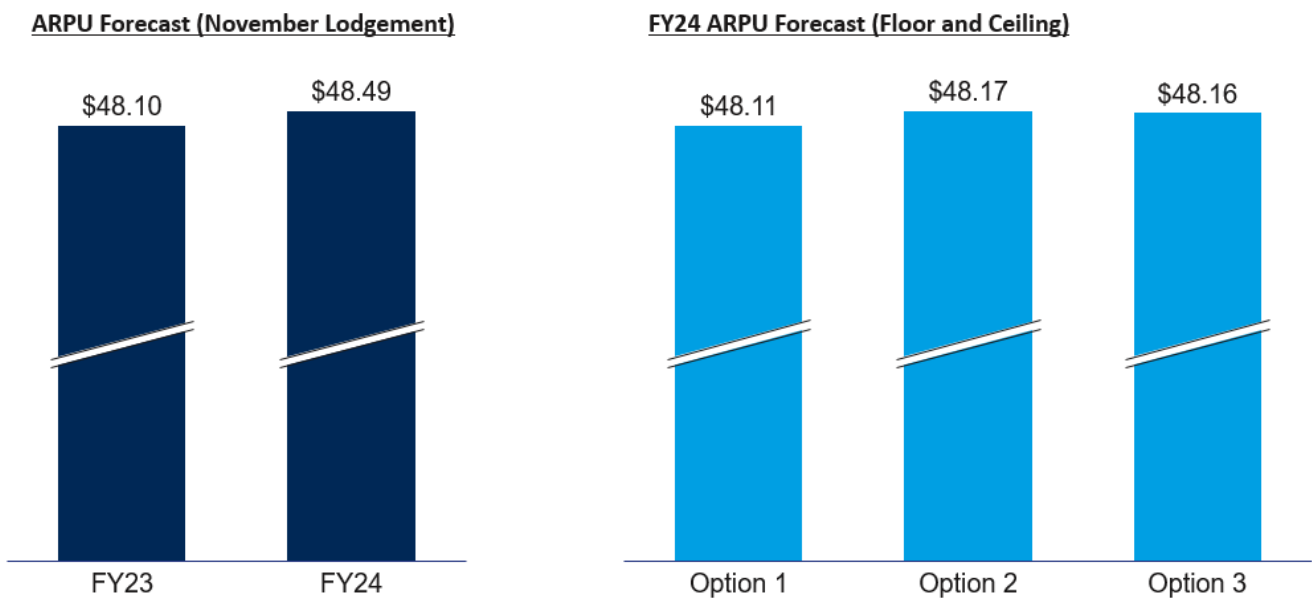


## 4.4 Impact on overall wholesale cost outcomes for RSPs

As indicated in the charts above, the Modified Floor and Ceiling Proposals have the effect of reducing the wholesale cost of 12, 25 and 50 Mbps services for each RSP Type relative to the initial floor and ceiling proposal. As these services currently reflect approximately 80% of all TC-4 services supplied by RSPs, the obvious consequence of these proposals is that the total wholesale costs for RSPs will lower under any of these options. These lower wholesale prices should translate to lower retail prices and likely higher uptake of and use of the **nbn** network, maximising the benefits of the investment in the **nbn** network. These wholesale price reductions come at a period when there are significant inflationary pressures in the wider economy, and where **nbn** faces CPI escalations for the price of key inputs to its network.

Equivalently, this reduction in wholesale costs translates to lower Average Revenue Per User (ARPU) for **nbn** under these options relative to the Initial Floor and Ceiling proposal, and also lower than previously anticipated under the pricing put forward in the November Variation. The impact of each of these options is shown below:

**Figure 6 – nbn forecast ARPU comparison of Floor and Ceiling options**



While these new options have the effect of reducing **nbn**'s expected ARPU and revenue, **nbn** is putting forward these options as a means of demonstrating its commitment to reaching a timely resolution on this key remaining issue in the SAU variation process so that a new variation can be lodged with the ACCC sooner rather than later.

## 4.5 Assessment of Modified Floor and Ceiling Proposals against pricing objectives

As discussed in section 4.1, **nbn** has taken into account a range of objectives in developing the floor and ceiling variants described above. In this section we describe how the Modified Floor and Ceiling Proposals satisfy these objectives, and the implications for competition and consumer outcomes.

### *Wholesale cost certainty for RSPs*

As noted in section 4.1, wholesale cost certainty for RSPs plays an important role in enabling RSPs to better plan their future marketing and pricing strategies and make necessary investments to support delivery of services to end-users, thus promoting efficient use of **nbn**'s network (in terms of both uptake of new services and ensuring customers are on plans that best meet their needs).

While the November Variation included a broad package of price and cost certainty measures, the Draft Decision expressed concerns about the ability of RSPs to manage the residual cost uncertainty they faced under these pricing arrangements. This was in part due to the effort required by RSPs to optimise their customer base to manage that residual cost uncertainty.

While **nbn** considers the price and cost certainty measures proposed in the November Variation provide a significant and sufficient level of cost certainty to RSPs, we have listened to feedback from the ACCC and industry and believe each of the Modified Floor and Ceiling Proposals described in this paper directly address the cost certainty concerns that have been raised.

By ensuring that no Bundled TC-4 Offer would cost an RSP more than the 100/20 Mbps flat rate offer, each of the Modified Floor and Ceiling Proposals provide a high degree of cost certainty to all RSPs, regardless of whether they have the ability or willingness to closely monitor and optimise their customer base on an active and ongoing basis, as well as their exposure to overage cost on entry level offers.

**nbn** also recognises feedback from RSPs that the November Variation pricing would create pressure for RSPs to migrate heavy usage customers onto high-speed tiers, and that **nbn** should not benefit from windfall gains if RSPs are unable to migrate those customers to higher speed tiers due to network constraints. The Modified Floor and Ceiling Proposals ensure that the wholesale cost to serve heavy network users is constrained and that RSPs can continue to serve these users on bundled speed tiers without feeling the need to migrate end-users.

### *Promoting competition in downstream markets*

For the same level of **nbn** revenue, greater wholesale cost certainty and a more level playing field between RSPs would promote efficient investment by, and competition between, existing RSPs and entry by new RSPs to the benefit of end-users in terms of greater choice and value (lower price and/or higher quality).

The extent to which RSPs will be able to take advantage of wholesale optimisation under the November Variation framework varies significantly across the industry. We understand that some RSPs have the capability to wholesale optimise to a significant extent, while others simply do not have the resources or IT capability to undertake such extensive optimisation. It has become apparent that the pricing arrangements proposed in the November Variation are likely to give larger RSPs a significant cost advantage over smaller RSPs due to their ability to optimise end-user wholesale plans in a highly targeted and frequent manner.

The additional reporting and tools that **nbn** has proposed to provide RSPs to support them in managing their costs and customer base will help to level the playing field to some extent. However, we have heard from some RSPs

that effectively utilising the daily and monthly AVC utilisation reports **nbn** is proposing will be resource intensive and in some cases cost prohibitive.

The Modified Floor and Ceiling Proposals provide a much more level competitive playing field for RSPs by avoiding this situation where smaller RSPs are put at a cost disadvantage because they do not have the resources required to optimise costs in such a targeted way.

As noted by Telstra in its submission to the ACCC's Draft Decision, under the November Variation pricing arrangements, *"RSPs that are less able to perfectly migrate customers will be at a competitive disadvantage to those that can. This would harm the competitive process"*.<sup>6</sup>

By creating a more level competitive playing field for RSPs, the Modified Floor and Ceiling Proposals will also lower barriers to entry for new RSPs, as the degree of residual cost uncertainty they face will be reduced, and they will not need to attempt to optimise their initially small customer base.

As described above, the pricing arrangements in the November Variation created a situation where smaller RSPs would be put at a cost disadvantage because they may not have the IT capability or resources to optimise costs by frequently moving customers between speed tiers in such a targeted way. Given that these smaller RSPs naturally have a smaller number of end-users, their ability to perform wholesale optimisation will be subject to the distribution of speed tiers and usage of their smaller customer base, which will be less predictable and more prone to unexpected variations. This scenario also puts potential new market entrants at a significant cost disadvantage to existing players, especially the larger RSPs, and may discourage them from entering the market where it would otherwise be efficient for them to do so.

As outlined in section 3.2, Launtel raised this issue in its submission citing concerns that, without floor and ceiling pricing, larger RSPs would gain a competitive advantage over smaller RSPs that could not optimise. Launtel points to this as one of the key reasons it was considering exiting the market for 50/20 Mbps services completely.

### ***Improving economically efficient outcomes***

A high degree of wholesale optimisation under the November Variation framework, where RSPs do not pass on the benefits of higher speeds to end-users (i.e., where wholesale optimisation is disconnected from retail plan optimisation), may result in RSPs devoting a material level of resources in terms of the time, money and effort to undertake the optimisation.

It is not an efficient use of resources (i.e., involves some allocative inefficiency) for RSPs to expend these material resources on wholesale optimisation where the retail product actually sold to the end-user does not change, and the capabilities of the network are not put to their highest value usage.

Telstra made this point very clearly in its submission to the Draft Decision:<sup>7</sup>

*"RSPs are likely to carry out costly and complex arrangements to migrate 50/20 customers that individually cost more than \$55 to a 100/20 plan (and back down again if their usage falls). That will require complex analysis and predictive tools built and maintained by all RSPs. It would also require multiple orders for plan migrations to NBN Co, moving customers up and down speed tiers so that RSPs ensure their 50/20 customers don't cost more than the 100/20 plan. Those migrations would need to occur daily to minimise overage... The effort involved in ensuring*

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<sup>6</sup> Telstra, *Submission to the ACCC NBN Co Special Access Undertaking Draft Decision*, 2 June 2023, p. 9.

<sup>7</sup> *Ibid*, p. 8.

*no individual 50/20 customers cost more than \$55, and no 100/20 customer would cost less on a 50/20 plan, could involve tens of thousands of customer migration orders each day.”*

If RSPs are employing significant resources to carry out “costly and complex arrangements”, as described by Telstra, to minimise their costs at the expense of delivering higher speeds to end-users, those resources are not being directed to other activities that may more directly benefit end-users. The floor and ceiling proposals described by **nbn** reduce the need for RSPs to perform such inefficient optimisation.

### ***Impact on consumer choice and retail prices for 12 and 25 Mbps services***

Under the November Variation pricing arrangements, national CVC pooling enables RSPs to effectively ‘cross-subsidise’ the usage of customers on lower speed tiers with inclusions from the 50 Mbps service.

As described in section 4.2.1, some RSPs have raised concerns about the impact of the initial floor and ceiling proposal on the price and availability of 12 and 25 Mbps services due to the removal of national CVC pooling under the floor and ceiling proposal.

However, **nbn**’s analysis suggests that the extent to which RSPs currently ‘cross-subsidise’ the usage of their lower speed customers with inclusions from 50 services is relatively limited. In fact, based on data from the month of May 2023, only one RSP would be in ‘underage’ on the 50 Mbps (with average usage below the CVC inclusion of 2.5 Mbps), meaning they are the only RSP that would have been able to use inclusions from 50 Mbps services to offset the cost of usage on 25 Mbps services.

**nbn** has designed two of the modified floor and ceiling options to directly address this feedback. In particular, reducing the overage price to either \$5.50 or \$6 would reduce the effective price of 12 and 25 Mbps services, where those services are in overage, without sacrificing the additional cost certainty provided by the floor and ceiling framework.

### ***Promotes efficient investment in nbn’s network***

Although some RSPs may hold the view that the loss of the ability to engage in wholesale optimisation via national pooling leads to higher wholesale costs, in fact **nbn**’s expected ARPU in FY24 under the Modified Floor and Ceiling Proposal is essentially flat compared to FY23, as described in section 4.4, under the three options described in the Modified Floor and Ceiling Proposal. In this context, **nbn** notes that the Modified Floor and Ceiling Proposal actually promotes economic efficiency for a number of reasons, as described below.

The Proposal avoids **nbn** having invested in network capability and performance that will not ultimately be enjoyed by end-users, as a result of the wholesale cost optimisation by RSPs, while also promoting a level playing field and competition, as outlined above.

Further, unlike the November Variation, the Modified Floor and Ceiling Proposal delivers **nbn** an opportunity to earn the level of revenue **nbn** needs to offer broadband services on a sustainable basis over time. Additionally, they reduce the uncertainty faced by **nbn** in relation to plan usage and forecasting revenue, and accordingly create a more predictable environment conducive to efficient debt-raising and robust business cases for ongoing investment. If aspects of **nbn**’s pricing lead to greater instability or impacts **nbn**’s ability to forecast future revenue, this will impact **nbn**’s ability to invest with confidence in future network upgrades, reducing the overall level of investment in the network, or introducing delays to enhanced performance and capability outcomes for end-users.

### Maintaining nbn revenue neutrality

nbn notes that the November Variation and subsequent 3-year Pricing Roadmap published on 24 May provide for nbn’s prices to increase by up to CPI on an annual weighted-average basis over the period where nbn has not achieved cost recovery.

The three new variants included in the Modified Floor and Ceiling Proposals in this paper are intended to deliver nbn a reasonable glidepath towards cost recovery over the medium-term.

## 4.6 Assessment of Modified Floor and Ceiling Proposals against ACCC key outcomes

During the second half of 2021 the ACCC convened a series of industry working groups to consider an appropriate regulatory framework for wholesale access to the nbn. These working groups informed the development of nbn’s SAU variations during 2022. As a result of these working group discussions, the ACCC identified five “key outcomes”<sup>8</sup> that it considered would help guide the development of an appropriate regulatory framework for nbn, and which nbn has had regard to throughout the SAU variation process. In this section we provide a brief assessment of how the Modified Floor and Ceiling Proposals align with the ACCC’s key outcomes.

| ACCC Key Outcome  | Floor and Ceiling Feature  | Alignment with Key Outcome   |
|---|--|--|
| nbn has the opportunity to earn the minimum revenues it needs to meet its legitimate financing objectives, including to transition to a stand-alone investment grade credit rating. | Floor price  | nbn has greater certainty of the average charge that will apply to each Bundled TC-4 Offer, and increased ability to forecast the Average Combined Charge (ACC) for these services.  |
|   | Increased stability of ACC, as a result of the combination of floor and ceiling prices.                              | Under the November Variation, an increased adoption of wholesale optimisation by RSPs could produce unstable ACCs due to factors outside nbn’s control or ability to forecast. This has the potential to introduce materially adverse outcomes for nbn under the SAU’s price certainty mechanisms, particularly the price relativity restriction, which could have the effect of requiring nbn to significantly reduce prices across the board, even though there has been no change in underlying end-user demand or behaviour. The Modified Floor and Ceiling Proposals significantly reduce the degree of uncertainty in the ACC for the Bundled TC-4 Offers. |
| nbn end-users are protected from price shocks and from prices that are higher than necessary in later years.  | Increased stability of ACC, as a result of the combination of floor and ceiling prices.                              | By ensuring a more stable pricing framework is in place, with more predictable ACCs, nbn will have a more clearly defined path to cost recovery in the medium term, facilitating a smoother transition to a stand-alone investment-grade credit rating without price shocks.   |
| The regulatory framework provides incentives for nbn to operate efficiently and promote use of the nbn.   | Increased stability of ACC, as a result of the combination of floor and ceiling prices.                              | The Modified Floor and Ceiling Proposals described in this paper reduce the uncertainty faced by nbn in relation to forecasting revenue, which creates a more predictable environment conducive to efficient debt-raising and robust business cases for ongoing investment.  |
|   | Reduced need for RSPs to perform wholesale optimisation by place a ceiling on the price paid for Bundled TC-4 Offers | Currently planned wholesale optimisation by RSPs does not necessarily result in end-users receiving the benefits of higher speed or performance from higher speed tiers. Floor and ceiling pricing will provide nbn with increased incentives to promote the use of higher speed tiers (and thus, increase the efficient use of the network) without the risk that RSPs will choose not to pass on these higher speeds to end-users.   |

<sup>8</sup> ACCC, NBN Co Special Access Undertaking: Summary of industry working group outcomes, December 2021, p. 1.

| ACCC Key Outcome   | Floor and Ceiling Feature            | Alignment with Key Outcome   |
|--|--------------------------------------|--|
| nbn access seekers have greater certainty over the costs that they will face when using the nbn.   | Ceiling price                        | RSPs have certainty that no Bundled TC-4 Offer would cost more than the 100/20 Mbps flat-rate offer. There will be a particularly significant increase in cost certainty for those RSPs that do not have the resources or capability to engage in wholesale optimisation under the November Variation. |
|  | Increased CVC inclusions for 50 Mbps | A greater proportion of 50 Mbps services would experience no overage, meaning that the 'floor' price would apply.  |
|  | Reduced CVC Overage price            | Two of the Modified Floor and Ceiling Proposals described in this paper include material reductions in the CVC overage charge, reducing the cost exposure of RSPs to increased usage by customers.   |
| There is a clear and robust quality of service framework so access seekers and end-users know what to expect from nbn services, including a review mechanism so that service standards remain fit for purpose. | n/a                                  | n/a – Floor and Ceiling pricing does not relate to this Key Outcome  |

## 4.7 Transitional relief for RSPs

It is noteworthy that the current regulatory process is atypical – the SAU Variation is tantamount to a major resetting of the regulatory framework that governs nbn until 2040 and not a standard utility-style regulatory proposal under a defined set of regulatory rules and processes. nbn is also not in the same position as utilities that are typically subject to this form of regulation, as we have not yet reached a cost-recovery position (and are unlikely to do so for at least two regulatory cycles), and face considerable competition from other networks.

Thus, nbn considers that the appropriate and necessary amount of time is being afforded to industry and nbn to work through the level of change to implement the substantially updated regulatory framework until 2040. Given the central role that nbn plays in the telecommunications industry and the wider economy, taking the required time up-front to get these settings correct is time well spent.

However, nbn has heard clearly from RSPs that the delay in getting an accepted SAU variation in place is impacting them financially and they are seeking some interim relief via increases to CVC inclusions under the current TC-4 Bundled Discounts.

In response, and driven by the urgency of bringing the SAU variation process to a timely close and deliver on the intended benefits to all Australians, nbn is proposing to offer RSPs a transitional credit to help alleviate the costs associated with delays to implementation of the new pricing arrangements, as well as the costs of implementation itself. The transitional credit would come into effect post-SAU variation acceptance and is proposed to have a total value of \$12 million across all RSPs.



## 5 Reverting to November Variation pricing is no longer possible

The ACCC's Draft Decision makes clear that the issue of residual cost uncertainty for RSPs was a significant factor in its reason for making a draft decision to reject **nbn's** November Variation, and that the pricing in the November Variation would run the risk of impeding efficient use of **nbn's** network in the First Regulatory Cycle.

What has become clear through the engagement process with the industry in the last few weeks is that the level of wholesale optimisation by RSPs that was forecast by **nbn** when developing the November Variation, and RSPs' actual/planned optimisation are now significantly different. As described in section 3.4, this level of wholesale optimisation has potential adverse implications for competition, efficient use of **nbn's** network and **nbn's** commercial sustainability.

As a wholesale-only network operator established to promote retail competition, **nbn** is acutely aware of the need to ensure its price and non-price terms do not favour particular RSPs. The extent to which some RSPs have indicated they are planning to optimise their wholesale speed tiers to reduce costs, would have the effect of placing them at an advantage relative to those RSPs that do not have the same opportunity or capability to do so. In particular, **nbn's** analysis reveals that larger RSPs will be able to lower their costs relative to smaller RSPs. This may distort retail competition by creating an uneven playing field between RSPs and giving rise to additional barriers to entry for new market entrants. Such extensive wholesale optimisation may also result in inefficient use of **nbn's** network, as end-users will not receive the benefit of the higher speeds they are migrated to.

In addition to the competition and efficiency impacts, the level of wholesale optimisation now anticipated to be undertaken by RSPs under the November Variation pricing arrangements would create substantial commercial risk for **nbn**, impacting its commercial sustainability and ability to invest in improving the performance and capability of its network.

In addition to direct **nbn** revenue impacts arising from wholesale optimisation, the high-volume, high-frequency changes in wholesale plans (in the absence of consumer interaction at retail level) that RSPs have indicated they are planning to undertake, would create significant pricing distortions and uncertainty in the November Variation pricing framework by creating significant fluctuations in average usage by speed tier. This could cause sharp and impactful movements in the Average Combined Charge, which was not envisaged when developing the framework in the November Variation.

An unstable Average Combined Charge due to factors outside **nbn's** control or ability to forecast could materially undermine the SAU's price certainty mechanisms, particularly the relativity controls, which could have the effect of requiring **nbn** to significantly reduce prices across the board, even though there has been no change in underlying end-user demand or behaviour.

Based on the above considerations, **nbn** is concerned that simply reverting to the November Variation proposal (with additional reporting tools) will result in unintended and distorted pricing outcomes, create an uneven playing field between RSPs, provide less pricing certainty for RSPs and result in significant adverse revenue implications for **nbn**.

Reverting back to the November Variation in light of this new information means **nbn** would be unable to achieve a revenue neutral outcome and move **nbn** further away from the path to delivering cost-reflective pricing or, at the very least, lead to significant delays in **nbn's** ability to achieve cost recovery. In combination with the price

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controls included in the November Variation, the level of optimisation now anticipated by RSPs would also put at risk **nbn**'s ability to achieve a stand-alone investment grade credit rating and to continue to invest in ongoing improvements to the performance and capability of its network. As **nbn** faces increasing competition from other network providers (e.g., fixed wireless and LEO satellite<sup>9</sup>), there is the risk that as a result of the revenue uncertainty **nbn** now faces under the November Variation arrangements, **nbn** would not be able to invest in its network to the level required to respond to the competitive threats it faces.

Should these risks to **nbn**'s future revenue and ability to compete eventuate, **nbn** could enter a downward quality/price spiral that would not be in the LTIE, nor in the national interest. It would also not be in the interest of those RSPs whose businesses rely on **nbn**'s network, and would be inconsistent with Government policy for **nbn** and the sector.

As a result, **nbn** no longer considers that the November Variation is capable of delivering the financial outcomes that **nbn** needs to support its ongoing investment and financing objectives. However, we remain committed to addressing the concerns that have been raised by the ACCC and RSPs about the cost uncertainty that arises from the November Variation and the recent feedback provided on our initial floor and ceiling proposal. The modified floor and ceiling options **nbn** proposes in this paper respond to these concerns, and deliver pricing that supports sustainable outcomes for RSPs and **nbn** during the transition to AVC-only pricing by no later than 1 July 2026.

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<sup>9</sup> In addition to direct competition from operators such as Starlink, there are also emerging partnerships between existing RSPs and Starlink, which increase the modes of competition RSPs face. See for example: <https://exchange.telstra.com.au/were-working-with-starlink-to-connect-more-people-in-remote-australia/>

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