

# Response to SAU Industry Roundtable Framing Paper

July 2021





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# 1 Exec Summary

We refer to the ACCC's SAU Industry Roundtable Framing Paper (**Framing Paper**) and the roundtable hosted by the ACCC on 18 June 2021 (**Roundtable**), as well as **nbn's** SAU Variation 2021 Discussion Paper (**Discussion Paper**) published on 7 June 2021.

The Roundtable provided industry with a valuable opportunity to discuss the immediate and long-term priorities of stakeholders regarding **nbn's** pricing and regulatory settings. Together with RSP feedback on **nbn's** Discussion Paper, outputs from the initial Roundtable and subsequent workshops planned by the ACCC will be critical considerations in **nbn's** proposed SAU Variation – which is currently planned to be lodged in December 2021.

In addition to providing feedback to assist the ACCC in its consideration of the issues in its Framing Paper, a key purpose of **nbn's** response is to ensure continued alignment between **nbn's** engagement with RSPs under the Discussion Paper and the ACCC's parallel industry consultation.

Our response is set out in two parts:

**PART 1: Price controls:** This sets out **nbn's** view on the proposed price control principles and proposals in the Framing Paper – along with responses to the specific questions raised by the ACCC.

**PART 2: Revenue constraints:** This sets out **nbn's** view on the ACCC's identified objectives in relation to revenue constraints – along with responses to the specific questions raised by the ACCC.

While **nbn** has sought to provide our response in line with the structure of the Framing Paper and questions raised by the ACCC, we have summarised below 5 key themes that are reflected in our feedback.

- (1) Shared objective in relation to efficient investment in the nbn™ network:** While stakeholders may place different emphasis on the various objectives underpinning the SAU, a clear outcome of the Roundtable was that the ACCC, industry and **nbn** appear aligned that the SAU and regulatory framework should continue to encourage efficient use of, and efficient investment in, the **nbn™** network. This common understanding provides a solid foundation from which the parties can consider the remaining objectives of the SAU – and how the proposed variation best balances these objectives.
- (2) nbn agrees with ACCC's outlined principles / objectives:** The price control principles and revenue constraint objectives outlined by the ACCC are consistent with **nbn's** identified SAU objectives. However, two additional objectives that are central to the SAU from **nbn's** perspective and which are not stated expressly in the ACCC's paper are: (1) Supporting the delivery of Government policy objectives for **nbn**; and (2) Providing **nbn** with the flexibility to respond to market dynamics in an increasingly competitive industry impacted by ongoing technological change and evolving consumer preferences.
- (3) Price construct and controls that meet all industry stakeholder needs:** As outlined in its Discussion Paper, **nbn** is willing to consider any proposed pricing constructs that meet the SAU's objectives – including the three models proposed in **nbn's** Discussion Paper. However, any construct that removes **nbn's** ability to generate usage based revenue in order to provide greater price certainty for RSPs will likely require price controls that allow prices to increase at or above inflation (noting that **nbn** is currently under-recovering its prudently incurred costs and the current price construct in the SAU is deliberate in providing the opportunity to improve cost recovery over time) – to ensure **nbn** is not constrained by regulation from earning sufficient cash flows to operate the network, servicing its financing commitments, maintaining an investment grade credit rating appropriate for its business and funding future investments.



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- (4) **Ongoing LTRCM engagement:** nbn acknowledges that the current value of the ICRA means that standard revenue constraints may not be triggered during the term of the SAU, and is open to further engagement on this. However, it is important to note that the lack of any immediate revenue constraint does not drive nbn’s pricing behaviour – as evidenced by the fact that nbn is currently under-recovering its costs and has implemented significant discount arrangements (which, for example, have significantly lowered the effective price of CVC).
- (5) **Product diversity, certainty, and low-income offerings:** nbn considers that the existing SAU, pricing construct, product suite and product development requirements already enable diversity at the retail level and are accompanied by strong product withdrawal constraints on nbn. In the proposed absence of CVC, however, nbn shares the ACCC’s interest in understanding how RSPs will differentiate in terms of service quality. If the SAU is used to incorporate a low income offering this will have consequential impacts on “full price” services given the need to recoup the revenue dilution incurred by a broad-based low-income offer.



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## PART 1 – PRICE CONTROLS

The ACCC has outlined three key design principles that it considers could guide the development of future SAU measures. As discussed in further detail below, **nbn** considers that these principles are consistent with several of the objectives that underpin the existing SAU – though there are additional objectives which were central to the existing SAU framework and which **nbn** has noted in its Discussion Paper. For each of the key principles and proposals the ACCC has identified, **nbn** has considered how these are either already addressed under the existing framework or planned to be addressed under the proposals in **nbn**'s Discussion Paper.

### Principle 1: Access arrangements should support a range of retail service offerings that represent value to different categories of end-user

We support this principle, which is aligned closely with the objective 2 of the SAU as set out in our Discussion Paper:

- **Enabling a sustainable and competitive retail environment:** *In addition to providing Australians with access to high speed broadband services, **nbn** was established as a vehicle for market reform; a wholesale-only provider created to foster a vibrant and sustainable retail market in which end-users could access innovative products from competing retailers at affordable prices.*

The core CVC/AVC construct and range of speed tiers included in the SAU were designed to enable RSPs to provide a diverse range of retail offerings at the same time as enabling **nbn** to recover the costs of the network over time under a “user-pays” model. By allowing RSPs to determine the level of CVC provisioning – and associated cost – the wholesale product and pricing construct enables RSPs to provide services with varied capacity commitments and at different retail price points. Coupled with the mELB, the model enables RSPs to supply end-users with low bandwidth and data requirements with entry level services at prices comparable to legacy services, thus facilitating the migration of these services to the **nbn**<sup>™</sup> network. Beyond this entry level service, the model delivers RSPs with a spectrum of speed options and the ability to construct a variety of products at appropriate price points based on end-users’ speed and data requirements.

Since the commencement of the SAU, **nbn** has introduced a large range of products and product features via the SAU’s Product Development Forum (**PDF**) processes. These processes have been adopted whether or not the particular product developments are covered by the SAU. In addition to those new products driven by the Multi Technology Mix (e.g. FTTN/B/C & HFC) (**MTM**), **nbn** has introduced new products, product changes, service levels and product features to respond directly to RSP and consumer needs. Key examples include enhanced service levels, Higher Speed Tiers that incorporate lower upload speeds at lower price points, Enterprise Ethernet and SkyMuster Plus.

Combined with the malleability of the initial product set, the continual evolution of **nbn**'s product suite via the PDF demonstrates the role that the SAU already plays in supporting a range of retail offerings designed to respond to RSP and end user needs.



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The ACCC has suggested a number of potential measures in its Framing Paper to meet its Principle 1:

- i. *Commitments to offer a range of specified wholesale products, and to not effectively withdraw them from the market. One way a product offer can effectively be withdrawn is for its price to be increased relative to alternatives so that it no longer represents value to the purchaser*

For those access technologies covered by the SAU, the original product set together with new products and product features introduced via the PDF are subject to: (1) PDF consultation in relation to material product changes; and (2) product withdrawal requirements if **nbn** seeks to amend a product so that it is no longer reasonably capable of delivering at least the same functionality, performance or features. The ACCC has certain objection rights under this withdrawal process. These same commitments would apply to the MTM products under **nbn**'s proposed SAU Variation.

In response to the concern that products could be withdrawn through price increases, Maximum Regulated Prices (**MRP**) under the existing SAU directly address this concern – and would continue to do so under the proposed SAU Variation. For example, under Construct 1 in **nbn**'s Discussion Paper (which maintains the existing CVC/AVC structure) the MRPs attached to TC-4 services would in fact be reduced to reflect bundles comparable to the TC-4 bundles discount currently offered under **nbn**'s current Wholesale Broadband Agreement (**WBA**).

- ii. *Measures that allow access seekers to control various quality dimensions though selectable product features...*

The Framing Paper outlines how AVC speed tiers, optional product features, CVC and NNI capacity decisions have provided RSPs with control of the level of operational quality and performance of their services. **nbn** supports this view. While it is clear that RSPs maintain concerns over CVC from a cost and complexity perspective, the existing product framework and offerings clearly reflect this principle. The question, we believe, is whether there is an alternative that also gives RSPs the necessary control, in a way that is efficiently priced and less complex to manage for all parties.

One specific suggestion the ACCC has made under this principle is that, if CVC is removed, **nbn** could develop additional product features such as busy hour selectable speeds or AVC 'speed bolt-ons' to allow further differentiation. **nbn** is considering feedback on its proposed pricing constructs and is equally considering how issues such as congestion, speed, and other forms of retail differentiation would work in an AVC-only context.<sup>1</sup> However, it is not clear at this stage how replacing CVC with technical add-ons such as busy hour selectable speeds or AVC speed bolt-ons would lead to reduced complexity from an RSP perspective. We will be interested to hear RSP views on these suggestions.

Additionally, if the industry transitioned to AVC-only prices and end-users/RSPs identified that additional features are required, as a wholesale-only provider **nbn** is incentivised to respond to the market and the PDF provides an appropriate mechanism to do this.

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<sup>1</sup> In this paper, the term 'AVC-only' pricing is used to refer to a pricing construct in which RSPs would pay a single flat recurring charge each month for the AVC and CVC product components of each TC-4 service, with the associated variable (overage) charge set at \$0/Mbps.

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iii. *Price control measures – these are measures that keep access prices oriented towards efficient and competitive levels...*

**nbn** agrees that price controls should guide efficient and competitive pricing. Such price controls must ensure that **nbn** has the opportunity to recover its build, operation, maintenance, financing, and efficient upgrade costs over the long term. Additionally, price controls should accommodate the diverse needs of users and values placed on the network over time, and not lead to inefficient use of the network or inefficient investment in it. For example, if **nbn**'s entry level prices are too high this could lead to inefficient bypass of the network from those end users who do not place significant value on the services offered. Conversely, if prices are not appropriately calibrated to enable appropriate signalling on user capacity requirements, unconstrained usage could lead to inefficient investment in the network. As identified in **nbn**'s Discussion Paper, the current AVC-CVC pricing construct means that as end-users use the network more, and derive greater value from the capability provided by it, **nbn** is afforded a share of the value delivered through increasing revenue. This is a key component of **nbn**'s approach to long-term recovery of our initial costs.

Over the term of the SAU to date, **nbn** has not used the flexibility afforded by the price controls in the SAU to increase any MRP. As outlined in our Discussion Paper, **nbn** proposes that new price controls be incorporated in any varied SAU, as appropriate for the new pricing constructs.

Given the significant range of issues raised by the ACCC in relation to costing and pricing matters in their Framing Paper and Roundtable, and that we are seeking feedback from RSPs on our Discussion Paper, **nbn** considers that it is too early to propose definitive solutions at this stage. However, we reiterate our earlier comments that any move to a pricing construct that removes usage-based charges would need to be accompanied by price controls that retained a degree of flexibility for **nbn** to increase prices at or above inflation (noting that **nbn** is currently under-recovering its prudently incurred costs), given the ongoing increase in value that will be derived by end-users as network demand increases. As noted in response to question 6 below, **nbn** considers that a weighted average price control based on an evolving product set could support efficiency objectives given this would lessen the risks of individual prices diverging from market demand.

iv. *Product and pricing measures that respond to entrenched market failure, such as the ongoing potential for overselling of fibre to the node speeds to occur, and the lack of a commercial pathway for improving fibre to the node speeds to meet customer demand. For example, the adoption of suitability priced AVC 'speed bolt-ons' could allow access seekers and their customers to more closely match access product speed and price to the attainable speed of the line. This in turn would provide a stronger incentive to fix poor fibre to the node connections where efficient to do so.*

As with measure (ii) above, it is unclear how replacing CVC pricing with speed bolt-ons would reduce concerns in relation to product and pricing complexity. In relation to concerns regarding the overselling of fibre to the node speeds, **nbn** (via WBA 4 service levels) faces substantial incentives to ensure that FTTN service speeds meet agreed performance thresholds. Similarly, RSPs (via consumer law obligations) already face substantial incentives to ensure that service speeds are comparable to the headline rate under which they are sold. Fundamental changes to the **nbn** speed tier model will also impose significant complexity along with costly development and implementation costs onto RSPs.



There are already two key mechanisms that are designed to enable RSPs to represent services clearly at the point of sale. First, to support RSP sales activities, **nbn** provides appropriate information to RSPs (on placing a connect order) about typical service speeds of the line. Further, since WBA4 and following the ACCC's inquiries into **nbn** access pricing and service standards, **nbn** pays rebates to RSPs where accurate information is not available, if the line achieves less than 50 per cent of the maximum speed in the speed range profile selected by the RSP. RSPs have access to diagnostic tools provided by **nbn** that allow them to conduct live DSL Performance tests on their FTTN and FTTB AVCs, allowing them to manage any end user issues that arise. These tools, in conjunction with the now daily reports available to RSPs via APIs, provide RSPs with appropriate information on the wholesale network component of their end-user service speeds.

Second, the ACCC has provided industry with the *Broadband Speed Claims – Industry Guidance* in order to 'assist retail service providers (RSPs) in providing consumers with reliable and clear information about the performance of their fixed-line broadband services.' Together with the speed reporting information that **nbn** makes available to RSPs, the industry guidance serves a critical function in providing a set of well-defined principles to guide sales and post-sales practices. **nbn** therefore considers that there are already appropriate measures in place to address the ACCC's concerns, and that the product development processes that exist in the SAU provide a mechanism for any future development of product capability.

## Principle 2: Access seekers should have reasonable certainty over access costs over time for a given level of quality.

We also support this principle, which aligns with the SAU objectives articulated in **nbn**'s Discussion Paper – in particular Objective 2 which recognises that **nbn** was created to foster a vibrant and sustainable retail market in which end-users could access innovative products from competing retailers at affordable prices.

The price controls in the existing SAU were implemented for the precise reason of ensuring RSPs have certainty over access costs over time. **nbn** set out initial product sets with MRPs that could only increase by a maximum of CPI -1.5% annually on a 'use it or lose it' basis. Those products introduced via the PDF (if covered by the SAU) are subject to the same price controls. In the MTM variation we are likewise proposing to submit the proposed bundle construct to an MRP, with a price cap allowing an annual increase on a 'use it or lose it' basis.

We appreciate the ACCC and RSPs maintain concerns in relation to **nbn**'s use of discounting, and the fact that current effective charges under **nbn**'s TC-4 Bundles Discount are well below the MRPs established under the SAU. **nbn** maintains that, while there is a substantial gap between current effective charges under the TC-4 Bundles Discount in the WBA and the associated MRPs under the SAU, this does not suggest that current price controls have been ineffective or that current MRPs are incorrect. Rather, it demonstrates that **nbn** has responded to the market; **nbn** is charging well below its regulated price points because of its incentives to enable sustainable retail operations and to promote the efficient use of its network.

Nonetheless, we have heard the concerns from RSPs and the ACCC and are proposing to address this as part of the SAU variation. As outlined in the Discussion Paper, **nbn** will seek to include whichever pricing construct results from the current consultation as a regulated offer under the SAU, potentially replacing the existing "Basic" AVC/CVC (TC-4) offers in the SAU.

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This will be done with a view to increasing price certainty, as the new pricing construct will be subject to the SAU's price controls and product withdrawal provisions. This commitment, combined with the reduction (or removal) of variable, usage-based charges from our pricing construct, would provide RSPs with a significant uplift in both price and cost certainty. We look forward to hearing feedback from RSPs on the extent to which these proposals address the concerns that have been raised.

Under Principle 2 in the Framing Paper, the ACCC makes a specific suggestion in relation to technical quality commitments that could be introduced to replace the role that is currently performed by CVC:

- ii. *The specification of a minimum technical quality of service including for attributes that are no longer able to be controlled by the access seeker via volumetric product or pricing elements such as CVC and NNI. That is, access products could have a specified maximum tolerance for speed reductions during busy hours and/or for higher latency or packet loss during times of heavy network utilisation. As discussed above, access seekers could also be offered the choice of quality over these product elements for an additional fixed monthly fee to preserve downstream product differentiation. Measures that specify when NBN Co would augment network capacity as utilisation triggers are met could also be considered, similar to those that are presently specified only in operations manuals.*

**nbn** agrees that an AVC-only model would need to consider how issues such as congestion are managed. However, it is important that the proposed transition to an AVC only model, while looking to provide greater price certainty for RSPs, does not drive increased costs for **nbn**. The proposal in relation to maximum speed tolerances or increased choice in relation to the quality of product elements raises concerns in this respect. Not only would changes to the existing product construct involve significant time and complexity, therefore delaying the proposed benefits of increased price certainty sought by RSPs, but such changes will likely drive greater costs into **nbn** – which costs would then need to be recovered through increased prices which we understand is counter to RSPs concerns.

These proposals relating to a 'minimum technical quality of service' also highlight that one of the functions of the existing CVC model is not only to recover the costs of network investment to date, but to enable efficient investment in capacity upgrades and to share the cost of those upgrades with those access seekers directly benefiting from the upgrades. For example, if **nbn** is required to upgrade capacity at a particular POI today, and this upgrade is driven by RSPs with higher capacity requirements per user, then those RSPs will have contributed proportionately through increased CVC charges at the relevant POI. In an AVC-only world, however, **nbn**'s ability to recover this direct contribution to network upgrade costs is not possible - and all upgrade costs are required to be borne by all RSPs through average prices that account for nation-wide network investments. In addition to low demand users bearing the costs of high demand users, low demand RSPs will be required to bear a greater proportion of network upgrade costs.

### **Principle 3: The access provider should have a reasonable opportunity, but not the guarantee, to earn an appropriate return on its efficient investment and recover its efficient operating costs.**

**nbn** also supports this principle, which is aligned with Objectives 3, 4 and 5 of the SAU as captured in **nbn**'s Discussion Paper. The current SAU is designed to provide **nbn** with the opportunity to recover the significant investments and operational expenditure (including an appropriate return on investment) that **nbn** has prudently and efficiently incurred to deliver enhanced broadband capability across the country – as well as provide incentives and certainty for continued efficient investment in the network.



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At its core, **nbn** requires sufficient cash flows to operate and maintain the network, service its financing commitments, maintain an investment grade credit rating appropriate for its business and fund future investments. If **nbn** does not maintain the opportunity to earn these required cash flows it would lead to a reduced quality of the network and services, increased cost of debt and an inability to upgrade the network to meet changing consumer needs.

Given **nbn**'s policy mandate to provide high speed broadband to all Australians, a significant component of the costs that it incurs include investment in, and maintenance of, loss making networks and services (specifically fixed wireless and satellite). Cross subsidisation of loss-making services from the fixed line network was a founding principle of the **nbn** network and policy framework, and a critical input to the current price construct and regulated price levels captured in the SAU. As **nbn**'s mandate to ensure high speed broadband access for all Australians has not changed, and has been cemented through Statutory Infrastructure Provider legislative obligations, **nbn**'s future cash flows will need to continue to account for these substantial operating and capital costs.

The complementary arrangements established in the SAU by the initial price construct, price controls and revenue controls were designed to ensure **nbn** has the opportunity to generate these cash flows, while providing an appropriate level of pricing certainty to access seekers. Any change to the pricing construct that removes **nbn**'s ability to generate revenue from increased use of the network raises questions over **nbn**'s ability to generate required cashflows and continue to invest efficiently in the network, and hence the existing CPI-1.5% price controls will likely be incompatible with a change in the pricing construct to an AVC-only model. This appears to be reflected in the following comments from the Framing Paper:

*That said, a mismatch between current price levels and those required to generate an appropriate revenue on the forecast demand profile will have implications for setting the price control measures. An important consideration in this circumstance is whether to permit a disconnect between existing prices and those established on commencement of the new arrangements, or to put in place transitional arrangements such as a glide path to avoid such a price shock. This could take the form of a CPI +/- X adjustment to the prices caps established on commencement.*

*Similarly, even if there is no initial mismatch in current and required prices initially, a suitable price path would need to apply over the duration of a regulatory period due to ordinary fluctuations in costs and revenues. In this regard, NBN Co may face increasing costs over time to meet increasing labour or other input costs, or as financing costs fluctuate. This will become increasingly relevant in circumstances where the potential for revenue growth via volumetric charges or adding more services to the network is significantly reduced.*

**nbn** is aligned with the ACCC's holistic approach to price levels and controls in this respect, and the fact that **nbn**'s requirement for the opportunity to generate appropriate revenues is a critical factor in determining the appropriate price points and associated price controls.



**nbn** believes that the pricing constructs proposed in its Discussion Paper will create different incentives for access seekers as well as consumers, particularly in terms of distribution of end-users across different products.

Therefore, the pricing construct will have implications for the price level needed for each product in order to generate the appropriate overall revenue. To the extent that these prices represent a mismatch to the current price levels, **nbn** believes that a transitional arrangement either through a regulated glide path or contractual rebate mechanism may be appropriate, and **nbn** is open to industry views on how this could be best managed. In addition, to the extent that the pricing construct reform impacts a large number of consumers (e.g. end-users on data capped plans) or requires significant migration effort by **nbn** and industry, it may be appropriate to consider an interim pricing construct to minimise market disruption.

It is important to note that, in relation to the forecast demand profile, **nbn** is reliant on RSP insights to ascertain likely end user behaviour and speed tier demand profiles under alternative pricing constructs proposed. This is a key area on which **nbn** has sought feedback in its Discussion Paper.

## Price Control questions

*1) We have outlined three high level principles to use in assessing whether particular NBN access product and pricing arrangements would promote the long term interests of end-users. What additions, deletions or refinements would you recommend?*

The three principles set out in the Framing Paper are consistent with those objectives underpinning the current SAU – particularly Objectives 2-5 as set out in **nbn**'s Discussion Paper. The following additional objectives are also central to the SAU and need to be addressed in any proposed variation:

- **Objective 1: Supporting the delivery of Government policy objectives for nbn.** In establishing **nbn**, Government laid out a number of key policy objectives that **nbn** was expected to deliver, including speed and network coverage requirements. These requirements have been updated in successive Statements of Expectations from our Shareholder Ministers, and include a requirement to deliver the Government's broadband policy objectives at least cost to taxpayers. The SAU is designed to support the delivery of these objectives and to allow **nbn** to recover its costs over time from end-users.
- **Objective 6: Providing nbn with the flexibility to respond to market dynamics.** **nbn** operates in an increasingly competitive telecommunications infrastructure market, and requires the ability to respond to evolving market dynamics. It is important that **nbn** retains sufficient pricing flexibility (including through the targeted use of discounts) to allow it to innovate its pricing, respond to specific end-user requirements, and maximise efficient use of its network.

**2) What ideas do you have so that NBN Co and access seekers can have reasonable certainty over their wholesale average revenues per user and access costs respectively?**

**nbn** has proposed three alternative pricing constructs in its Discussion Paper, each of which provides an enhanced degree of certainty for RSPs in relation to wholesale average revenues per user and access costs. **nbn** considers all three constructs are worth consideration (in addition to any alternative models proposed by stakeholders that meet the identified objectives of the SAU). Contrary to initial feedback, the Accenture paper that accompanied **nbn**'s Discussion Paper was not intended to dismiss Construct 3 (all services offered under an "AVC-only" construct) as a viable alternative. Rather, it was intended to provide greater insight into the potential issues associated with this construct – which warrant detailed analysis and consideration given this construct represents the greatest departure from the existing pricing construct.

The Accenture report demonstrates two key challenges of the wholesale price averaging that takes place under an AVC-only construct. First, this averaging would likely impact the affordability of services for low usage customers. For **nbn** to maintain the opportunity to recover its efficient costs while removing the user-pays model, all price points in an AVC-only construct are impacted. Second, the averaging would financially benefit RSPs with customer bases that have above average usage profiles (as their average wholesale input costs would reduce for the same end-user demand) whilst adversely impacting RSPs with predominantly below average usage customers (as their average wholesale input costs would likely increase). This would likely result in a narrowing of price ranges and reduced product and price differentiation in the retail market, reducing end-user choice.

Each Construct has relevant advantages and disadvantages as summarised in the table below. **nbn** considers that each of these criteria are relevant to determining an efficient price construct:

	Construct 1	Construct 2	Construct 3
Affordability, penetration for lower utility end-users	+++ Usage based charging provides the best way (of the three options) to match <b>nbn</b> wholesale pricing to underlying broadband demand, satisfying the needs of all customer segments.	++ Usage charging on the lower speed tiers provides a path to ensure affordable broadband plans to the majority of end-users	+ Higher prices on the lower speed tiers reduces affordability and choice for end-users with lower utility for broadband
Enabling retail differentiation	+++ Usage charges enable retail product differentiation across the entire market	++ Enables differentiation on lower speed tiers	+ Reduces retail differentiation due to fixed input costs
Wholesale cost certainty	+ Two-year inclusions roadmap provides certainty on input cost to RSPs. Overage rate reduction of 25% reduces usage growth risks for RSPs	++ Higher inclusions on standard bundles and \$0 overage on higher speed tiers allows RSPs to optimise their fixed and variable input costs to the level of certainty that they need	+++ Fixed input costs provide certainty across all speed tiers.

**nbn** is hopeful that RSP feedback to the Discussion Paper will provide insight into the potential impacts of each construct and forecast demand profiles to further inform a pricing model that provides this increased certainty to RSPs while balancing the other objectives of the SAU.

**3) *What suggestions do you have to preserve the breadth of retail products that are in market in the event that volumetric CVC charges were to be withdrawn or scaled back? Please consider how support for unique maximum speed products, diverse busy hour speeds, voice only and low data quota products could best be provided in such a wholesale pricing model.***

**nbn** agrees that CVC provides a clear lever for differentiation between retail products. In addition to providing Australians with access to high speed broadband services, **nbn** was established as a vehicle for market reform; a wholesale-only provider created to foster a vibrant and sustainable retail market in which end-users could access innovative products from competing retailers at affordable prices.

One of the original principles behind **nbn**'s use of CVC in the product construct was to enable performance-based differentiation for RSPs. The removal of CVC would remove this existing point of differentiation and would also impact the affordability of the **nbn** broadband network for low usage customers due to the need to increase fixed charges in an AVC-only model (by averaging across all users).

Feedback from multiple stakeholders to previous pricing consultations has questioned the role that CVC plays as an enabler of differentiation. While **nbn** considers this position is open to challenge, the question of how **nbn** – with its own commercial sustainability requirements – supports a sustainable, competitive and innovative retail market remains.

**nbn** shares the ACCC's interest in understanding RSP views on how differentiation at the retail level will be delivered if CVC charges were no longer applicable. Specifically, we would like to understand how **nbn** could best facilitate differentiation and innovation in the absence of CVC - particularly given **nbn**'s non-discrimination obligations can place significant constraints on its ability to develop bespoke products or offerings to enable the differentiation strategies of individual or groups of RSPs.

**4) *Should we consider regulatory controls to safeguard against discounts again becoming the principal means by which NBN access products and pricing are implemented? What form could these take?***

The proposal to safeguard against discounts appears to suggest that **nbn**'s approach to discounting is contrary to the long-term interests of end users. However, if the current SAU constrained **nbn**'s ability to implement discounts, RSPs would potentially be paying minimum CVC charges higher than the current effective rate of \$8 per Mbps. This is because the ability to discount prices for a period of time, rather than lock them in as new MRPs, affords **nbn** with greater ability to test lower price points than would otherwise be the case. While RSPs have raised issues in relation to **nbn**'s ability to potentially increase CVC prices as a result of their effective charge being significantly below the MRP in the SAU, this issue only arises because **nbn** has in fact charged significantly below that MRP for a sustained period of time. The effective price of CVC has not increased, and only ever decreased, for the duration of the SAU. As demonstrated in practice over the past decade, it is **nbn**'s underlying incentives to deliver sustainable outcomes for RSPs and end-users that have been the predominant driver of **nbn**'s pricing, not the MRPs that could be charged as set out in the SAU.



**nbn** understands, however, the potential uncertainties that discounting can introduce, and the challenges that it can create for long-term commercial planning by RSPs. Each of the pricing constructs put forward in **nbn**'s Discussion Paper are designed to address this potential uncertainty. Construct 1 in particular (and Construct 2 for some speed tiers) would incorporate bundles comparable to the TC-4 Bundle Discounts offered today under the SAU – establishing new MRPs and addressing concerns over potential price shocks if **nbn** reverted to its current regulated price points. If the key area of uncertainty is CVC more generally, constructs 2 and 3 would minimise or remove the role of variable CVC charges.

In each of the proposed constructs the potential for **nbn** to offer discounts on the scale offered today via the TC-4 Bundles Discounts is vastly reduced. As discussed in relation to Principle 3 above, **nbn** needs to earn sufficient revenues to cover operating costs, service debt and continue to invest in the network. However, the ability to discount would still be beneficial to RSPs and end-users by enabling **nbn** to respond to competition and market behaviour, particularly as **nbn** cannot perfectly predict RSP and end-user demand with respect to speed tier take-up and usage.

**5) Do you support a cheaper broadband product for low income earners? What form should it take and how should it be funded?**

**nbn** is supportive of ensuring that all Australians have access to affordable high-speed broadband. In this respect, **nbn** has sought to improve broadband affordability for more vulnerable cohorts of end-users through a range of measures:

- **nbn** has implemented a number of measures designed to improve affordability of our Entry Level Bundle, including discounting the AVC charge to \$22.50, and making WBA4 commitments to offer sufficient CVC inclusions at a \$35 effective wholesale charge to support the provision of “unlimited” 12/1Mbps retail plans at a \$60 price point;
- In the past year, **nbn** also launched the COVID-19 relief package to support remote learning for low-income families, as well as provided the “Illuminate” rebate, which sought to lower wholesale costs for unconnected households, a significant proportion of which are low-income and/or elderly; and
- **nbn** has conducted co-design workshops with interested industry stakeholders to address the needs of older Australians. As an outcome, and the next step of these initiatives, **nbn** is committed to working with the industry in developing solutions to further address the needs of low-income households.

In crafting a low-income offer, the biggest challenge is how to create a commercially sustainable business case for **nbn** and RSPs. By definition, low-income offers require lower retail and wholesale prices, so that they provide meaningful benefits to the target segments. This challenges the economics of supply for both **nbn** and RSPs.

In the 2021 Pricing Consultation, **nbn** proposed targeted eligibility criteria to minimise significant financial exposure, such as a single wholesale speed tier (25/5 Mbps), a data cap (150GB) and a requirement for the premises to be currently disconnected from the network. Feedback from RSPs and the wider industry was supportive of **nbn** bringing a low income offer to market, but with less targeting (i.e., broader eligibility), and lower prices across a broader set of products. A broad-based low-income offer made available to a large eligible cohort would be financially challenging for **nbn** and the industry. As an example, **nbn** believes that, based on Age Pension and Disability Support Pension recipients alone, there would be over 1 million eligible premises, or over 8% of total premises in Australia.

**nbn** therefore considers there are two main options moving forward, which **nbn** has sought feedback on in its Discussion Paper:

- **Option 1: Broader eligibility – requiring SAU variation:** To broaden the low-income eligibility conditions as per the industry’s feedback while still recovering efficiently incurred costs, **nbn** would require the ability to adjust prices on “full price” services to recoup the revenue dilution incurred by a broad-based low-income offer.
- **Option 2: Targeted Solutions - outside of SAU Variation:** **nbn** will continue progressing its efforts in lifting the digital capability of Australia by progressing targeted approaches to reach low-income households, including exploring the options put forward in the 2021 Pricing Consultation.

*6) Regulatory controls can conceivably take the form of direct controls over certain price related access terms, along with more flexible arrangements for other prices. For instance, some individual tariff items could be specified in a regulatory instrument while other tariff items could be included within a broad basket for which there is an overall regulatory control. In what circumstances (if any) should we consider providing greater flexibility for NBN access product and pricing commitments within a regulatory period? For which price related terms is certainty so important that we should not consider providing such flexibility?*

**nbn** has sought similar feedback from industry under its Discussion Paper – where both individual SAU price controls and basket price control options are being considered. In relation to the latter, **nbn** has proposed that the basket price control would be applied to the weighted average price across all applicable TC-4 products based on average Service in Operation (SIO) volumes of the preceding year.

**nbn** believes that such a broad basket price control could be a viable alternative to the existing SAU price control arrangements. A weighted average price control based on an evolving product set could deliver greater pricing certainty in the long-term, and lessen the risks of individual prices diverging from market demand and relativities to other prices over time. Under such a control it may be appropriate to exclude some products from the overall basket – for example, it may be more appropriate to maintain a separate price control for the Entry Level Bundle.

*7) How often should the price related regulatory controls be reset?*

In order to assess the appropriate timeframes for resetting price related regulatory controls, it is preferable to first confirm the price model and the form that the associated price related regulatory controls will take. For example, in a context where CVC charging was removed, along with **nbn**’s ability to rely on usage-based revenue, the prospect that prices will need to rise above inflation is high (noting that **nbn** is currently under-recovering its prudently incurred costs). Recognising that any proposed price cap which allows **nbn** to increase prices above inflation would need to reflect efficient future network investments required to meet end-user demand, **nbn** considers that establishing the precise value of such a price cap would form part of the Replacement Module Application process that will take place under Module 2 of the SAU – and that such price controls would apply for each 3-5 year Regulatory Cycle that is contemplated under the SAU.

## PART 2 – REVENUE CONSTRAINTS

### Revenue Constraint objectives

The Framing Paper provides that it would be useful to have in place a meaningful revenue constraint under a sustainable long-term regulatory framework for **nbn**, and sets out two key objectives which should guide such a constraint:

- (1) *NBN Co should be able to recover efficiently incurred costs*
- (2) *NBN Co should face incentives for making efficient investments and have the ability to generate sufficient cash flows to support its ongoing operations and fund new investments*

**nbn** supports both of these objectives when considering forward looking revenue constraints that could apply under the SAU. In fact, the Long Term Revenue Constraint Methodology (**LTRCM**) in Module 2 of the SAU already provides for the ACCC to review **nbn**'s future investments for prudence *and efficiency* from July 2023.

The Framing Paper also refers to the fact that **nbn**'s historical costs have been accepted as prudent under the LTRCM in the SAU, but that an 'efficiency test... could entail a more rigorous assessment'. In this respect, **nbn** notes the following:

- That the ACCC's oversight of **nbn**'s costs in the Initial Regulatory Period is limited to a prudence analysis reflects a range of factors – principally that **nbn**'s circumstances mean it is sufficiently incentivised in that initial period to ensure its expenditure is both prudent and efficient. **nbn**'s relevant circumstances included its status as a wholesale-only operator, its mandate from Government to build a national broadband network (within a limited cost envelope, without an existing customer base and with significant revenue sufficiency risks). Further relevant factors were the broader regulatory framework in which **nbn** operates, including its requirements as a GBE and oversight from Parliamentary committees.
- The ACCC recognised **nbn**'s incentives to invest efficiently in the Initial Regulatory Period when accepting the SAU in 2013, stating:

*...[as] NBN Co's required revenue is to be set using its actual costs, the ACCC needs to be satisfied that NBN Co has sufficient incentives to ensure its costs are prudent and efficient. These incentives are created through the pricing and revenue provisions in the SAU in Module 1...*

*...In the event that NBN Co does not respond to the incentive to incur only efficient costs, the revenue provisions in Module 1 provide for ACCC oversight of NBN Co's operating and capital expenditure, to help ensure this is prudent. This should provide additional protection to ensure end-users only pay for NBN Co's efficient costs...*

*...The ACCC considers that NBN Co will face a high degree of revenue sufficiency risk for most, if not all, of Module 1. This is due to NBN Co's initial prices and the expected low initial take-up of NBN services. This should provide incentives for NBN Co to invest efficiently...*

*... The ACCC therefore considers that, during Module 1, NBN Co's allowed revenues in each year will reflect NBN Co's prudent and efficient costs.<sup>2</sup>*

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<sup>2</sup> ACCC, NBN Co Special Access Undertaking – Final Decision, December 2013, pp 11 – 12, 96 –98.



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- The Framing Paper also states that some of **nbn**'s activities and services are a direct result of government policies or pre-existing contractual arrangements which 'may not reflect competitive outcomes'. However, when considering the efficiency of such activities (e.g. prioritising rollout in regional areas, Telstra and Optus subscriber payments, deployment of fixed wireless and satellite networks) it is not possible to ignore **nbn**'s unique mandate from Government: to bridge the digital divide and ensure that all Australians have access to affordable high speed broadband as soon as possible. These costs have had the effect of (1) bringing high speed broadband access sooner to underserved areas, generating benefits to consumers, and (2) bringing forward the deployment of the network and migration of services to it, thus bringing forward revenue. In both cases, these costs have delivered increased competition for broadband services earlier, and facilitated the transformation of the telecommunications industry structure from one dominated by a vertically integrated incumbent to one served by an open-access, wholesale-only national provider. The ACCC applied such an **nbn**-specific analysis when considering **nbn**'s SAU in 2012 and 2013, including when considering **nbn**'s incentives to invest efficiently. Any SAU variation put forward by **nbn** must continue to be assessed by reference to **nbn**'s particular circumstances and its unique policy mandate.
  - Issues similar to those raised by the ACCC were considered recently in New Zealand, where Chorus and Local Fibre Companies raised concerns about the use of a 'backward-looking' efficiency test to establish their opening Regulated Asset Bases (**RAB**) and assess their initial losses, including in circumstances in which they had been required to roll out fibre networks in specific ways to meet government policy objectives (such as passing schools and hospitals first). In that context, the then Minister of Communications noted that a backwards-looking efficiency test is an unorthodox element in building block model regulation and would arguably result in a simple transfer of value from suppliers to consumers with no efficiency impact. The Government agreed not to apply such a test and required the Commerce Commission, in determining the opening RAB for such companies, to have regard to the government's policy objectives and to include certain costs and financial losses incurred to meet those objectives.<sup>3</sup>

That said, **nbn** acknowledges the consequential magnitude of the ICRA – and potential that a standard revenue cap may not be triggered under the existing SAU – and is open to further constructive engagement with the ACCC and our stakeholders on this. This is discussed further below.

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<sup>3</sup> See, for example, the relevant Cabinet Paper and Cabinet Minute of April 2017, here: <https://www.mbie.govt.nz/dmsdocument/1310-telco-review-cabinet-paper-may-2017-pdf>; <https://www.mbie.govt.nz/dmsdocument/1113-review-telecommunications-act-2001-cabinet-minute-pdf>

## Revenue Constraint questions

### 1) Do you have any views on the ACCC's objectives for the SAU revenue control mechanism? Are there any other objectives that should be considered?

nbn supports the two key objectives that the ACCC has outlined:

- (1) NBN Co should be able to recover efficiently incurred costs;
- (2) NBN Co should face incentives for making efficient investments and have the ability to generate sufficient cash flows to support its ongoing operations and fund new investments.

In addition, we consider the following objective that underpins the SAU is equally relevant:

- (3) **Supporting the delivery of Government policy objectives for nbn:** When assessing the efficiency of nbn's investments (either historical or prospective), it is critical that this is assessed in the context of nbn's policy mandate. nbn was tasked to rollout a national broadband network in a mandated time with national speed and coverage requirements. In addition to meeting evolving consumer demand, nbn's role to deliver both economic and social benefits for all Australians will continue to inform its activities going forward.

### 2) What do you think would be an appropriate approach for incorporating ICRA in a BBM for the SAU?

The Framing Paper states that it would be useful to have in place a meaningful revenue constraint under a sustainable long-term regulatory framework for nbn, and in that context, asks what an appropriate approach would be for 'incorporating ICRA in a BBM for the SAU'.

The ICRA is a key part of the LTRCM and overall BBM framework established under the SAU. The rationale for the ICRA and an explanation of how it sits within the LTRCM is set out in nbn's SAU Discussion Paper of June 2021.

As noted in that paper, nbn is not yet in a position to start 'paying down' the ICRA. This is an expected and natural outcome, reflecting the scale of the nbn network and the significant investments made over the past five or so years by nbn.<sup>4</sup> However, as noted above, nbn appreciates that the current position of the ICRA means that standard revenue constraints may not be triggered during the term of the SAU, and is open to further engagement on this. For example, nbn's SAU Discussion Paper notes that:

- the current SAU does not govern the rate at which nbn should be permitted to recover the ICRA once nbn's actual revenue exceeds its Annual Building Block Revenue Requirement; and
- it may be appropriate to introduce either detailed terms, or at least principles, that address the rate of recovery of the ICRA, which in turn would impact the revenue constraint methodology in nbn's SAU.

In considering any such changes which may form part of an SAU variation, nbn will be driven by the objectives referred to above in response to Question 1 and the statutory criteria by which SAU variations are assessed, which in turn are informed by the principles of regulatory economics. Those objectives, criteria and principles are

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<sup>4</sup> This expectation that the ICRA would not be extinguished in the short-term was described by nbn when lodging the SAU: 'NBN Co anticipates that the ICRA will grow significantly for at least the next 10 years, and it will take a further extended period for these initial costs to be fully recovered.' See: Supporting Submission, NBN Co Special Access Undertaking, 28 September 2012, page 114.



reflected in the LTRCM in **nbn**'s current SAU, which constrains **nbn** over time to recovering no more, on an expected NPV basis, than **nbn**'s prudently incurred costs, including an appropriate return on capital. This reflects what is known as the 'financial capital maintenance' or 'FCM' principle, also referred to as the 'NPV=0' principle, which must continue to underpin **nbn**'s LTRCM in any varied SAU.

**nbn** also makes the following points in relation to the LTRCM generally:

- It is important to note that the lack of any immediate revenue constraint does not drive **nbn**'s pricing behaviour – evidenced by **nbn**'s significant discount offerings such as the current effective price of CVC. As discussed in relation to price controls above, **nbn**'s pricing is driven by its position as a commercial entity in an increasingly competitive market, and a wholesale-only provider entirely reliant on RSPs to market and sell our products.
- In addition to the current quantum of the ICRA, the Framing Paper also raises a question in relation to those costs **nbn** incurs in 'market segments where NBN Co may face competition, e.g. enterprises services.' and whether these costs should be captured in the ICRA. **nbn** is open to the conversation on the applicability of the SAU and **nbn**'s bespoke competition framework to enterprise market services; however, it is important that the regulatory framework applying to any such competitive markets is considered in its totality. That is, if there is a view that the costs of providing these services should be considered differently under the LTRCM due to their competitive nature, the same logic should extend to the SAU as a whole (price constraints, product development etc.) and the Part XIC access regime more broadly (e.g. SAOs, NDO).

### 3) *What would be an appropriate approach to ensure NBN Co has appropriate incentives to upgrade its network in a timely and efficient manner?*

**nbn** already faces substantial incentives to upgrade its network and to do so in a timely and efficient manner. In addition to its policy mandate of ensuring that all Australians have access to high speed broadband services, **nbn** faces significant competition in the enterprise, business, and new developments markets from existing infrastructure providers, and also faces increasing competition from 4G, 5G and fixed wireless services in the residential market.

There are at least three key factors which will ensure that **nbn**'s continued investment in the network is undertaken on an efficient basis:

1. **Commercial incentives:** Irrespective of whether the ICRA is extinguished in the term of the SAU, **nbn** will continue to face normal commercial incentives to invest efficiently to allow us to recover our operating costs, service our financing commitments and fund future investments. We will still need to generate revenues sufficient to do this, and undertaking commercially sound investments is a necessary part of doing so.
2. **Debt funding:** **nbn** is required to source private debt funding in the market to replace Government debt funding. This means that **nbn** is incentivised to be able to demonstrate efficient investment that supports the servicing and repayment of debt, both to attract that funding and to lower its cost of debt.
3. **Module 2 of the SAU:** Module 2 provides for review of **nbn**'s investments for prudency *and efficiency* by the ACCC from July 2023. The incentives for continued investment would be blunted by any regulatory framework that does not provide **nbn** the opportunity to earn sufficient returns on proposed investment.

**4) *Could elements of the arrangements that are currently intended to apply from 2023 under the current SAU provide a good blueprint for considering arrangements for new investment and expenditure proposals in a revised SAU?***

We consider that the Module 2 arrangements intended to apply from 2023 under the SAU provide an appropriate mechanism for new investment and expenditure proposals. The Module 2 arrangements reflect standard regulatory practice and, subject to the below proposed amendment to accommodate potential changes to existing SAU price controls, we consider these arrangements already provide the ACCC with sufficient opportunity to assess and approve **nbn**'s forward looking capex and opex in relation to **nbn**'s LTRCM.

Under the current regime, at periodic intervals, **nbn** will be required to provide 3-5-year forecasts of the inputs to the LTRCM, including capex and opex. These LTRCM Proposals will be assessed by the ACCC, and if accepted, will form the basis for the inputs to the LTRCM for each 3-5-year Regulatory Cycle. As part of that process, we propose that the SAU could be varied to require **nbn** to propose the specific price control that would apply to any products where real price increases were permitted. This means the specific price controls would be established for each Regulatory Cycle, reflecting the revenue required by **nbn** to make the planned efficient investments in the network during that Regulatory Cycle, and subject to ACCC review and approval.

**5) *What reporting or transparency requirements should be established to support arrangements under a revised SAU?***

**nbn** is open to considering appropriate reporting requirements with the ACCC and stakeholders as part of the continued engagement with industry on the SAU variation.