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Competition &
Consumer
Commission

Variation of NBN Co Special Access Undertaking — response to submissions

July 2013

Australian Competition and Consumer Commission
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Contents

Glossary	1
Preface	5
Next steps.....	6
1. Summary and background	7
1.1. Proposed variations in relation to the operation of the SAU and its interaction with Part XIC	7
1.2. Proposed variations in relation to price matters	8
1.3. Proposed variations in relation to non-price matters.....	9
1.4. Newly proposed variations	9
1.5. Background to Notices to Vary.....	9
2. Reasons for specified variations	12
2.1. Interaction between the SAU and the telecommunications access regime	12
2.2. Services to which the SAU relates	34
2.3. Product development, product withdrawal and reference offers.....	42
2.4. Price-related terms and conditions.....	62
2.5. Non-price terms and conditions.....	122
2.6. Fixed Principles	130
Attachment A: NBN Co proposed minor variations	137
Attachment B: List of Initial Products exempt from Schedule 1I and 2E	138
Attachment C: Price re-balancing process	141
Attachment D: ACCC assessment of prudent capital expenditure in Module 1	142
Attachment E: ACCC assessment of prudent operating expenditure in Module 1	143
Contacts	144

Glossary

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

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

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

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

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

ACCC – Australian Competition and Consumer Commission.

AER – Australian Energy Regulator.

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

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

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

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

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

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

CCA – *Competition and Consumer Act 2010*.

CPI – Consumer Price Index.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

NBN Co – NBN Co Limited and NBN Tasmania Limited.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Preface

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

On 4 April 2013, the ACCC released a Draft Decision setting out its preliminary view that it is not satisfied that the SAU lodged by NBN Co on 18 December 2012 meets the criteria specified in Part XIC of the CCA for acceptance of an SAU.

In light of this, the ACCC is going to give NBN Co a notice specifying variations to the SAU ('Notice to Vary'). This notice is given in order to facilitate NBN Co being able to lodge an amended SAU that is capable of meeting the statutory criteria.¹ On 4 April 2013, the ACCC released a Consultation Paper which sought views on the variations to the 18 December 2012 SAU that the ACCC was proposing to include in a notice to NBN Co.

Submissions to the Consultation Paper were received from AAPT, the Australian Communications Consumer Action Network (ACCAN), the Australian Communications and Media Authority (ACMA), the Competitive Carriers' Coalition (CCC), the Department of Broadband, Communications and the Digital Economy (DBCDE), Herbert Geer (on behalf of iiNet), John de Ridder, Macquarie Telecom, NBN Co, Optus, Telstra and Vodafone Hutchison Australia (VHA). These submissions can be found on the ACCC's website, along with information about how to access confidential submissions.

The ACCC has had regard to these submissions in developing the draft notice that is attached to this document. For convenience and clarity, the draft notice is in the form of a marked-up version of the 18 December 2012 SAU. This document sets out the ACCC's reasons for including particular variations in the notice and addresses the views put forward in submissions to the ACCC's Consultation Paper.

The ACCC is seeking views on the draft notice. Submissions on the draft notice are sought by **Friday 26 July 2013**. Submissions should:

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

All submissions should be forwarded by email to:

General Manager (acting)
NBN Engagement and Group Coordination Branch
Australian Competition and Consumer Commission

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

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Email: Isolde.Lueckenhausen@acc.gov.au
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Please copy any email correspondence to: analena.gilhome@acc.gov.au

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

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

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

Next steps

The ACCC will continue to make editorial amendments to the draft Notice to Vary during the consultation period. Following receipt of submissions on the draft notice, the ACCC will take into account the views expressed in submissions in finalising the Notice to Vary, prior to formally issuing it to NBN Co.

When the ACCC is able to issue the notice to NBN Co will depend on the volume and nature of submissions to this consultation process.

NBN Co will then have the time specified by the ACCC in the notice to respond to the notice by lodging a varied SAU.² This does not preclude NBN Co from lodging a varied SAU prior to the specified time.

If NBN Co gives the ACCC a varied undertaking in response to the notice, the ACCC must consider the varied undertaking as if it had been given to the ACCC instead of the original undertaking.³ If the ACCC does not consider that the varied undertaking is given "in response to" the notice, the ACCC would continue to consider and then make a final decision on the original 18 December 2012 undertaking.

The ACCC intends to undertake a short consultation on any varied undertaking that is given by NBN Co in response to the notice.⁴

If NBN Co does not give the ACCC a varied undertaking at all, then the ACCC will proceed to make a final decision on the original 18 December 2012 undertaking.⁵

² CCA, s. 152CBDA(2)(b).

³ CCA, s. 152CBDA(3).

⁴ Subsections 152CBDA(3), 152CBD(2)(d), and 152CBD(6) of the CCA require that the ACCC consult on the varied undertaking unless the variations are of a minor nature and are not likely to have a material adverse effect on the legitimate commercial interests of any person.

⁵ The ACCC must accept or reject the undertaking under subsection 152CBC(2) of the CCA.

1. Summary and background

A draft of the notice that the ACCC is proposing to give to NBN Co is attached to this document. A number of features of the SAU lodged by NBN Co on 18 December 2012 are proposed to be retained:

- The 'modular' design of the SAU, which allows for different matters to be 'locked in' for different periods of time.
- The majority of the initial prices set out in the SAU.
- The adoption of the long-term revenue constraint methodology, with an 'initial cost recovery account'.
- The long-term commitments not to raise prices above the levels allowed by the CPI-1.5 per cent price control (subject to any revenue neutral rebalancing by the ACCC).
- Commitments to provide information to, and consult with, customers about various matters, including the 'multilateral SFAA forum', in relation to product development and withdrawal, in relation to network changes and upgrades, about the appointment of decision-makers for dispute management processes, and the provision of rollout information and information about changes to Points of Interconnection.

On the other hand, variations are proposed in relation to the operation of the SAU and its interaction with the Part XIC telecommunications access regime, as well as to price and non-price terms. The intent of proposing that the SAU be varied in the manner set out in the draft notice is as follows.

1.1. Proposed variations in relation to the operation of the SAU and its interaction with Part XIC

Variations are proposed which reduce the complexity of the SAU and clarify its operation — these are intended to create certainty about when and how NBN Co must comply with its obligations under the Part XIC telecommunications access regime.

In particular, variations are proposed with the intention of making it clear that matters that are not directly dealt with by the SAU would be subject to commercial negotiation in the first instance and then, in the event that commercial agreement cannot be reached, an obligation for NBN Co to comply under Part XIC with any Access Determinations and Binding Rules of Conduct ('regulatory determinations') made by the ACCC. This includes in relation to both price and non-price matters that are not currently dealt with by the SAU.

Further, variations are proposed which acknowledge the role of the ACCC in declaring services under Part XIC, in order to clarify that the ACCC is able to respond to circumstances (for example, during Module 2) where NBN Co may not face incentives to respond to evolving end-user demand with respect to the introduction of new products.

As noted in the Draft Decision, the ACCC considers that NBN Co may, for some of the SAU term, face greater incentives to operate, invest, develop products and price those products efficiently relative to other established utilities regulated by the ACCC. It may be unnecessary for the ACCC to make declarations and regulatory determinations whilst NBN Co faces such

incentives. The ACCC cannot however accept, solely on this basis, restrictions that explicitly preclude it from intervening. If NBN Co's observed behaviour indicates the desired impact of the incentives, the expectation is that it would be unnecessary for the ACCC to undertake these activities.

If circumstances do arise where it is necessary for the ACCC to intervene using its powers under Part XIC, it is required to take into account particular matters specified by Part XIC. These matters include (amongst others) NBN Co's legitimate business interests,⁶ whether efficient investment in the NBN is encouraged — which requires that regard be had to incentives for investment, including the risks involved in making investments⁷ — the direct costs associated with supplying services,⁸ and the interests of access seekers.⁹

1.2. Proposed variations in relation to price matters

The ACCC considers that if the variations in the draft notice are made, the price-related terms would encourage efficient investment in, operation of and use of the NBN, would allow NBN Co to recover the efficient costs of supplying services and would provide an appropriate balance of NBN Co's legitimate business interests with the interests of access seekers. In particular:

- Providing an opportunity for the ACCC to periodically review whether relative price levels should be rebalanced, and constraining this rebalancing to being revenue neutral in its effect, would ensure that relative prices are set to encourage efficient use of the NBN, whilst at the same time having appropriate regard for NBN Co's legitimate business interests.
- Allowing the ACCC to determine prices for new products and charges, and prices for products and charges that currently have a zero price, would ensure that the ACCC is able to maintain the integrity of the CPI-1.5 per cent price control in creating efficiency incentives and ensure that the ACCC is able to intervene in circumstances — such as once NBN Co no longer faces revenue sufficiency risk — where NBN Co may not face incentives to set new prices efficiently. The ACCC firstly, could only determine prices for two years following NBN Co commencing supplying the new product and secondly, in doing so, would have to have regard to the impact on existing demand and revenues.
- Similarly, in providing a greater role for the ACCC in relation to the withdrawal of products, the CPI-1.5 per cent price control would have greater integrity, and would be more likely to create incentives for NBN Co to invest and operate efficiently because NBN Co would face a higher degree of revenue sufficiency risk than otherwise.
- Amendments to the long-term revenue constraint methodology during Module 1 would enhance the perceived impartiality of the inputs to and outputs of the methodology, as well as the incentives created by the methodology for NBN Co to invest and operate efficiently. Amendments to the long-term revenue constraint methodology during Module 2 would allow for a greater degree of flexibility, and for usual regulatory practice to be mirrored, in the approach that is adopted to encourage efficient investment in and operation of the NBN during Module 2.

⁶ CCA, s. 152BCA(1)(b).

⁷ CCA, ss. 152BCA(1)(a) and 152AB(7A).

⁸ CCA, s. 152BCA(1)(d).

⁹ CCA, s. 152BCA(1)(c).

1.3. Proposed variations in relation to non-price matters

If the proposed variations are made in relation to non-price terms, a number of the terms which were proposed in the 18 December 2012 SAU, including those relating to service levels and risk management and liability, would continue to be commercially negotiated and could be the subject of later ACCC determinations in the event that agreement cannot be reached.

In the event that further examination of non-price terms was warranted through a separate regulatory process, however, the ACCC might need to prioritise those issues that most directly affect end-users in migration to the NBN, given that NBN Co is currently in the early stages of its rollout.

In addition, if the proposed variations are made, the SAU would provide assurances that the parties that arbitrate contractual disputes will be appointed in an independent fashion, enhancing the prospect that such disputes will be resolved in an unbiased manner.

1.4. Newly proposed variations

In the ACCC's development of the draft notice, some issues have arisen which were not canvassed in the Consultation Paper. These issues are expanded on throughout this document. The ACCC is seeking views on the issues prior to determining whether variations are required to address them. The issues are as follows:

- The additional variations to the product development and withdrawal provisions that are proposed by Telstra (as discussed in sections 2.3.1.5 and 2.3.2.2).
- The removal of the concepts of Reference Offers and Non-Reference Offers in favour of reliance on the product withdrawal conferral of power (as discussed in section 2.3.2.1).
- The mechanics of the ACCC's assessment of the long-term revenue constraint methodology (LTRCM) and issues in the transition from Module 1 to Module 2 and between regulatory cycles in the building block revenue period (as discussed in section 2.4.2.1).
- The set of minor variations proposed by NBN Co in its submission (included at Attachment A).

1.5. Background to Notices to Vary

Section 152CBDA of the CCA provides for the ACCC to give a written notice to NBN Co in respect of its SAU that invites NBN Co to make variations to the SAU in accordance with the notice. If NBN Co does so, the ACCC must consider the varied undertaking as if it had been given to the ACCC instead of the SAU.¹⁰ The purpose of such a notice is to streamline the SAU assessment process, as NBN Co does not need to submit a new SAU in order to address the matters set out in the notice.¹¹

A section 152CBDA notice must:

¹⁰ CCA, s. 152CBDA(3).

¹¹ Explanatory Memorandum to the *Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010*, p. 210.

- specify variations to the SAU;¹²
- specify a period in which NBN Co may give a varied undertaking to the ACCC;¹³ and
- state that the ACCC will consider the varied undertaking as if it had been given instead of the SAU.¹⁴

The ACCC giving NBN Co a notice under section 152CBDA will have the following immediate effects:

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

The length of the ‘clock-stopper’ will ultimately however depend on whether NBN Co gives a varied undertaking, and the significance of the variations.¹⁵ If NBN Co does not give a varied undertaking, the clock-stopper ends on the deadline specified by the ACCC for NBN Co to give a varied undertaking.¹⁶ If NBN Co does give a varied undertaking containing significant variations, the ACCC will publish the varied undertaking for public consultation and the clock-stopper will end at the close of the specified consultation period.¹⁷

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

- the ACCC will generally be required to publish the varied undertaking and invite submissions that it must consider when making a decision on the varied undertaking,¹⁸ and
- the ACCC will make a decision on a revised SAU without NBN Co being required to withdraw the SAU.¹⁹

If NBN Co chooses not to give a varied undertaking the ACCC will proceed to make a final decision in respect of the 18 December 2012 SAU.²⁰

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

The ACCC will generally issue a Notice to Vary under Part XIC where it has reached a preliminary view that the original undertaking does not meet the statutory criteria, and therefore cannot be accepted. The preliminary position in the ACCC’s Draft Decision was that the December 2012 SAU does not satisfy the criteria for acceptance of an undertaking.

¹² CCA, s. 152CBDA(2)(a).

¹³ CCA, s. 152CBDA(2)(b).

¹⁴ CCA, s. 152CBDA(2).

¹⁵ CCA, ss. 152CBC(6) and 152CBD(6).

¹⁶ CCA, s. 152CBC(6)(aa).

¹⁷ CCA, s. 152CBC(6)(ac). There is a third possibility, that is, if NBN Co gives the ACCC the varied undertaking, but the changes specified by the notice to vary were only minor in nature or unlikely to have a material adverse effect on the legitimate commercial interests of any person. However, this possibility is not relevant to the SAU, given the extent of the changes proposed by the ACCC in its draft notice.

¹⁸ CCA, s. 152CBD(6).

¹⁹ Explanatory Memorandum to the *Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010*, p. 210.

²⁰ The ACCC must accept or reject the undertaking under subsection 152CBC(2) of the CCA.

The variations included in the draft Notice to Vary are those that the ACCC considers necessary in order for the varied SAU that is given in response to the notice to be accepted. The ACCC has taken into account the views expressed in submissions in formulating these variations.

2. Reasons for specified variations

This section provides an explanation of why particular variations are included in the notice. In the interests of brevity, where appropriate, the document cross-refers to the Draft Decision and the Consultation Paper in order to provide reasons for particular variations.

This section also responds to the views put forward in submissions to the Consultation Paper.

2.1. Interaction between the SAU and the telecommunications access regime

The variations that are proposed in this section relate to the issues discussed in chapter 2 of the Draft Decision and section 2.1 of the Consultation Paper.

2.1.1. Conduct concerning elements of the telecommunications access regime

2.1.1.1. Conduct about including terms and conditions in SFAAs

NBN Co makes certain commitments in the 18 December 2012 SAU about the terms and conditions it will include in Standard Forms of Access Agreements (SFAAs), as follows:

- Commitments to include particular terms and conditions set out in the SAU in any SFAA and to maintain such terms in any SFAA (incorporation clauses);²¹ and
- Commitments to ensure that certain terms and conditions in any SFAA have specified characteristics. For example, clause 1C.1.4 of Schedule 1C prevents NBN Co from including a price for a reference offer in an SFAA that is higher than the maximum regulated price determined under the SAU.

In the Consultation Paper, the ACCC proposed the following variations to the SAU:

- Removal of the clauses that require NBN Co to include particular terms and conditions in SFAAs — instead, the SAU should state that NBN Co will comply with these particular terms and conditions as specified in the SAU.
- Amendment of the clauses that require NBN Co to ensure that certain terms and conditions in SFAAs have specified characteristics — instead, the SAU should state that the term or condition of supply has the specified characteristics, and is specified in the SAU.²²

The effect of varying the SAU in this way is outlined in section 2.1.1.1 of the Consultation Paper.

Submissions

²¹ For example, clauses 1H.5.1, 1H.6 and 1H.7 of Schedule 1H of the 18 December 2012 SAU requires NBN Co to incorporate the non-price terms and conditions set out in the Annexures to Schedule 1H into any SFAA.

²² ACCC, *Consultation paper – variation of NBN Co Special Access Undertaking*, April 2013, p. 11. (ACCC Consultation Paper)

NBN Co agrees with the ACCC in principle, and proposes to implement the variations as follows:

- For the ‘first category’ of clauses — removal of the clauses that require NBN Co to include particular terms and conditions set out in the SAU in SFAAs, *and* removal of these particular terms and conditions from the SAU altogether.²³
- For the ‘second category’ of clauses — amendment of the clauses that require NBN Co to ensure that certain terms and conditions in SFAAs have specified characteristics by removing the reference to “an SFAA” in the relevant clauses.²⁴ However, NBN Co considers that references to SFAAs should be maintained in some circumstances — it provides the example of clause 1D.1.6 of Schedule 1D of the 18 December 2012 SAU, submitting that references to SFAAs are necessary in this clause to ensure that ‘other charges’ that are contained in SFAAs at the SAU commencement date will be designated as a non-reference offer under the SAU.²⁵

Some interested parties agree with the ACCC’s proposal,²⁶ noting that:

- it would promote the long-term interests of end-users;²⁷
- it would preserve the ability of access seekers to avail themselves of regulated terms and conditions without having to agree to other conditions;²⁸ and
- it provides clarity on the basis on which the SFAA terms and conditions (that is, the terms and conditions that NBN Co will include in SFAAs) are specified in the SAU, thereby removing a potential obstacle to market participation by access seekers.²⁹

Optus and Telstra agree with the intent of the ACCC’s proposal, but consider that it is unclear how the proposed amendments will enable access seekers to, in practice, obtain access without entering into an SFAA-based Access Agreement — that is to, in practice, obtain access on the SAU terms on a standalone basis.³⁰

- Optus therefore considers that the SAU should include a commitment to include a clause in SFAAs (and ideally in each Access Agreement) providing that NBN Co must offer each access seeker a variation of its Access Agreement to flow-through regulatory determinations that are made during the term of the parties’ Access Agreement (unless the parties agree to exclude these rights).³¹
- Telstra therefore considers that it is important that the ACCC actively encourages NBN Co’s engagement with industry on the terms of the SFAA, and that where required, the

²³ NBN Co, *Submission to ACCC consultation paper on variation of NBN Co SAU*, May 2013, pp. 7-8. (NBN Co Submission)

²⁴ *Ibid.*

²⁵ *Ibid.*, p. 7.

²⁶ AAPT, *Submission on ACCC consultation paper – variation of NBN Co Special Access Undertaking and related draft decision*, 2 May 2013, p. 4 (AAPT Submission); Competitive Carriers’ Coalition, *Response to ACCC consultation paper on variation of the NBN Co SAU*, 3 May 2013, p. 2 (CCC Submission); Macquarie Telecom, *Variation of NBN Co Special Access Undertaking*, 2 May 2013, p. 2 (Macquarie Telecom Submission); Vodafone Hutchison Australia, *Variation to the NBN Co Special Access Undertaking: Submission to the ACCC*, April 2013, p. 6. (VHA Submission)

²⁷ AAPT Submission, p. 4.

²⁸ CCC Submission, p. 2.

²⁹ Macquarie Telecom Submission, p. 2.

³⁰ Optus, *Submission to the ACCC in response to the consultation paper on proposed variation of the NBN Co Special Access Undertaking*, May 2013, p. 10 (Optus Submission); Telstra, *NBN Co 2012 Special Access Undertaking: Telstra’s response to the ACCC Consultation Paper – variation of NBN Co Special Access Undertaking*, 2 May 2013, p. 11. (Telstra Submission).

³¹ Optus Submission, p. 11.

ACCC must be willing to use its regulatory determination powers to provide alternative terms and conditions that are in the long-term interests of end-users.³²

(The views expressed by Telstra and Optus are also relevant in the context of the 'regulatory recourse' provisions and the 'multilateral SFAA forum', discussed in sections 2.1.1.2 and 2.1.1.5 below.)

Other interested parties did not provide views on these proposed variations.

ACCC response

In relation to the 'first category' of clauses, in line with the ACCC's proposal in the Consultation Paper, NBN Co proposes to remove the incorporation clauses which require it to include particular terms and conditions set out in the SAU in its SFAAs. However, these particular terms and conditions (non-price terms and conditions and service levels) are also proposed to be removed from the SAU almost entirely (and will therefore be subject to continuing commercial negotiations between NBN Co and access seekers, or regulatory determination in the event that agreement cannot be reached). (The variation to remove these terms and conditions is discussed further in section 2.5.1).

In relation to the 'second category' of clauses, the ACCC maintains the view that all references to "SFAAs" in clauses requiring NBN Co to ensure that certain terms in SFAAs have particular characteristics should be removed from the SAU; instead, these terms and conditions should be specified directly in the SAU. In contrast to the ACCC's proposal, NBN Co does not consider that amendments should be made to remove references to SFAAs in all of these clauses.³³ NBN Co provides one example of this, submitting that references to SFAAs in clause 1D.1.6 should be maintained to ensure that 'other charges' that are contained in SFAAs as at the SAU commencement date will be designated as a non-reference offer under the SAU.³⁴ Adopting NBN Co's approach for this particular clause raises the question of how the ACCC, in making its decision on the SAU, could be satisfied that these 'other charges' in SFAAs are reasonable, because NBN Co could change them (or add new ones) at any point up to the SAU commencement date. The ACCC therefore does not propose to adopt NBN Co's suggestion relating to this clause.

In relation to the issue raised by Telstra and Optus (that it is unclear how the proposed amendments will enable access seekers to, in practice, obtain access without entering into an SFAA-based Access Agreement — that is, to obtain access on the SAU terms on a standalone basis) the ACCC notes that this issue arises as a function of the Part XIC access regime itself. The ACCC considers that making variations to the SAU would not necessarily address this issue entirely, and that it may not be appropriate for the SAU to do so. Rather, if access seekers were to face difficulties in obtaining access on the SAU terms on a standalone basis, this would be an issue more appropriately dealt with via a reconsideration of the operation of the regime itself.

Therefore, in the draft Notice to Vary, the ACCC has included the following amendments:

- removal of the incorporation clauses (that is, clauses 1H.5.1 (dispute management), 1H.6 (information & rights management) and 1H.7 (risk management) of Schedule 1H and clause 1J.2(a) (Service levels) of Schedule 1J, which require the inclusion of the associated terms and conditions in SFAA);³⁵ and
- removal of all references to SFAAs in clauses requiring NBN Co to ensure that certain terms in SFAAs have particular characteristics.

³² Telstra Submission, p. 11.

³³ NBN Co Submission, p. 7.

³⁴ Ibid.

³⁵ The ACCC notes that in any event, it is generally proposing to delete these associated terms and conditions from the SAU (discussed further in section 2.5.1 of this document).

2.1.1.2. Conduct about updating SFAAs in response to Access Determinations and Binding Rules of Conduct ('regulatory recourse')

Schedule 1B of Module 1 of the 18 December 2012 SAU contains commitments about how NBN Co will make new SFAAs consistent with regulated terms that are established by the ACCC in Access Determinations and Binding Rules of Conduct ('regulatory recourse').

As noted in the Draft Decision, the ACCC considers that the SAU commitments could mean that SFAAs become the *only* practical means to obtain access to services on the terms included in the SAU, Access Determinations or Binding Rules of Conduct — that is, that an access seeker *must* enter into an SFAA-based Access Agreement to obtain access on regulated terms.³⁶ This creates uncertainty about the extent to which NBN Co must comply with the SAU and the ACCC's regulatory determinations under the normal operation of Part XIC.

Put another way, the SAU commitments could be interpreted as changing the obligations of NBN Co and the rights of access seekers under Part XIC. Under Part XIC:

- NBN Co *must* comply with an access seeker's request to supply services on regulated terms in an SAU, Access Determinations or Binding Rules of Conduct (to the extent they are not inconsistent with its Access Agreement);
- access seekers do *not* have to enter into an Access Agreement to obtain access on regulated terms (however, NBN Co and access seekers can commercially agree to include regulated terms in an Access Agreement if they wish to do so); and
- NBN Co, an access seeker or the ACCC can enforce the terms in Access Determinations and Binding Rules of Conduct.³⁷

In the Consultation Paper, the ACCC was still considering the precise form of variation to address this issue, and proposed two options. The first option was for the following variations to the SAU to be made:

- removal of the clauses that create uncertainty about the scope and availability of ACCC regulatory determinations (that is, clauses 1B.1.1, 1B.1.2 and 1B.2.2 of Schedule 1B); and
- amendment of clauses 6.1 and 6.2 of the Main Body of the SAU (that is, NBN Co's commitments to ensure consistency between the SAU and SFAAs it publishes throughout the SAU term) to provide that NBN Co will also ensure that SFAAs are consistent with Access Determinations and Binding Rules of Conduct.³⁸

The second option was that variations to the SAU be made to remove linkages between SFAAs and the SAU, and SFAAs and Access Determinations and Binding Rules of Conduct. This would involve:

- removal of the clauses that create uncertainty about the scope and availability of ACCC regulatory determinations (that is, clauses 1B.1.1, 1B.1.2 and 1B.2.2 of Schedule 1B); and

³⁶ ACCC, *Draft Decision on the Special Access Undertaking lodged by NBN Co on 18 December 2012*, April 2013, pp. 44-45. (ACCC Draft Decision)

³⁷ For example, under sections 152BCQ and 152BDH of the CCA, access seekers have private rights to seek Federal Court orders to enforce compliance with Access Determinations and Binding Rules of Conduct. In addition, under section 152EG, the ACCC or access seekers can seek Federal Court orders about conduct engaged in for the purpose of preventing or hindering the fulfilment of a requirement imposed by an Access Determination or Binding Rules of Conduct.

³⁸ ACCC Consultation Paper, p. 13.

- removal of clauses 6.1 and 6.2 of the Main Body of the SAU (that is, NBN Co's commitments to ensure consistency between the SAU and SFAAs it publishes throughout the SAU term).

The effect of varying the SAU in this way is outlined in section 2.1.1.2 of the Consultation Paper, and discussed further below.

Submissions

NBN Co proposes to adopt the second option, with modifications — specifically, NBN Co proposes to *retain* the clauses requiring it to make SFAAs consistent with the SAU (that is, clauses 6.1 and 6.2 of the Main Body).³⁹ NBN Co submits that:

- This “provides the ACCC with the necessary flexibility to respond to changing circumstances over the SAU term” and that “the ACCC retains the power to intervene arising from changing circumstances through issuing an AD/BROC which will have effect to the extent to which it is not inconsistent with an Access Agreement or the SAU.”⁴⁰
- It remains appropriate (indeed necessary) to keep parts of clause 6 of the SAU as it will serve as an additional commitment by NBN Co that everything that is available for access seekers pursuant to the SAU will also be available via NBN Co's SFAA in a consistent manner.⁴¹
- Retaining this linkage does not create any uncertainty in relation to the operation of Part XIC, as access seekers could still seek to access the terms and conditions of the SAU, Binding Rules of Conduct or Access Determinations in addition to those same terms being available in SFAAs.⁴²

AAPT, the CCC, Telstra and VHA support the first option, and cite the following reasons for doing so:

- AAPT considers that “it would allow an access seeker to request NBN Co to immediately comply with ACCC regulatory determinations”.⁴³
- The CCC considers that an explicit commitment by NBN Co to pass regulatory decisions into its SFAAs “is the most simple, effective and efficient means of ensuring that access seekers enjoy the benefit of regulatory decisions”.⁴⁴
- Telstra does not explicitly explain why it supports this option, but notes that:
 - Regulatory determinations should offer comprehensive alternative terms of supply, submitting that “if ACCC Regulatory Decisions are to be available independently of the SFAA, they must necessarily be fully developed, and be able to operate, on a “standalone” basis”; and
 - The potential for discrimination should be addressed, because retail service providers (RSPs) under an SFAA-based Access Agreement can only obtain regulated terms upon expiry of its Access Agreement, whereas “the benefit of ACCC Regulatory Decisions will be immediately available to new access

³⁹ NBN Co Submission, pp. 13-14.

⁴⁰ Ibid, p.10.

⁴¹ Ibid, p. 13.

⁴² Ibid.

⁴³ AAPT Submission, p. 4.

⁴⁴ CCC Submission, pp. 1-2.

seekers (either from the then current SFAA or some alternative regulated terms of supply).⁴⁵

- VHA considers that “[t]o not allow this option would result in potentially unfair, discriminatory and anti-competitive outcomes.”⁴⁶

On the other hand, Macquarie Telecom prefers the second option.⁴⁷ It submits that it understands that there is little practical difference between the two options,⁴⁸ however, it favours the second option because:

- any form of words to be included in the SAU under the first option “will inevitably be controversial and would be unlikely to be resolved on a timely basis”; and
- the second option allows legislative processes to operate without any other concurrent processes which “should expose any practical weakness which may provide a basis for possible legislative amendment”.⁴⁹

While the CCC appears to support the first option (as outlined above), it also submits that the choice between the options “should be guided by the Commission’s judgement as to which would provide the most effective and speedy redress”.⁵⁰

Some interested parties consider that the SAU should include a commitment requiring NBN Co to flow-through regulated terms into Access Agreements.⁵¹ For example, some submissions state that:

- The ACCC should be able to direct NBN Co to amend all Access Agreements to include regulated terms.⁵²
- A pass-through clause should be included in SFAAs, or there should be a commitment regarding NBN Co’s compliance with the SAOs that replicates the legislative hierarchy, with SFAAs at the bottom of the hierarchy.⁵³
- NBN Co must offer to vary Access Agreements where amendments are made to regulated terms in SFAAs.⁵⁴
- Access seekers should have the option to vary Access Agreements to ensure consistency with regulatory determinations.⁵⁵

Finally, Telstra considers that further amendments are required to the SAU to address the following issues:

- that RSPs under an SFAA-based Access Agreement are not forced to migrate to an updated SFAA-based Access Agreement (either at the end of its term or in order to get the benefit of any regulatory determinations) — they should have the right to elect to transition or to extend supply under current terms,⁵⁶

⁴⁵ Telstra Submission, pp. 11-12.

⁴⁶ VHA Submission, p. 6.

⁴⁷ Macquarie Telecom Submission, pp. 2-3.

⁴⁸ Ibid, p. 2.

⁴⁹ Ibid, p. 3.

⁵⁰ CCC Submission, pp. 1-2.

⁵¹ AAPT Submission, p. 4; Herbert Geer on behalf of iiNet Ltd, *Consultation paper: variation of NBN Co Special Access Undertaking: submission by Herbert Geer Lawyers on behalf of iiNet Limited*, 2 May 2013, pp. 3-9 (iiNet Submission); Optus Submission, p. 12; VHA Submission, p. 6.

⁵² AAPT Submission, p. 4.

⁵³ iiNet Submission, pp. 3-9.

⁵⁴ Optus Submission, p. 12.

⁵⁵ VHA Submission, p. 6.

⁵⁶ Telstra Submission, p. 12.

- that regulatory determinations are not bundled with other changes to the SFAA such that RSPs under an SFAA-based Access Agreement are obliged to take other NBN Co unilateral amendments in order to get the benefit of regulatory determinations — that is, the new SFAA should distinguish between these “regulatory changes” and “unilateral changes”,⁵⁷ and
- that NBN Co’s overall compliance with the SAU should be objectively measured and assessed by the ACCC — that is, there should be a commitment in the SAU to implement a compliance reporting regime.⁵⁸

ACCC response

Both of the ACCC’s proposed options are ultimately aimed at creating certainty that Part XIC will continue to operate in its normal way following acceptance of the SAU — that is, at creating certainty that NBN Co must comply with the SAU and any regulatory determinations made by the ACCC (to the extent that they are not inconsistent with Access Agreements⁵⁹) regardless of whether or not the terms are included in SFAAs. Specifically, under both options, an access seeker would be able to request NBN Co to supply on regulated terms on a standalone basis, as envisaged by Part XIC (alternatively, NBN Co and access seekers could commercially agree to include those terms in Access Agreements if they wished to do so).

The key difference(s) between the two options is that the first option explicitly requires NBN Co to ensure that SFAAs are consistent with regulatory determinations and the SAU, whereas the second option removes the explicit links between SFAAs, and the SAU and regulatory determinations.

Under the first option, access seekers may have the *choice* of accessing regulated terms in the SAU, Access Determinations or Binding Rules of Conduct via an SFAA-based Access Agreement. This would be the case if NBN Co chose to make the SFAA consistent by including the regulated terms in the SFAA and an access seeker subsequently chose to enter into an SFAA-based Access Agreement with NBN Co.

However, NBN Co could also make SFAAs consistent with regulated terms by *removing* the inconsistent terms from the SFAA. In practice therefore, the first option may not offer any additional certainty that NBN Co will include regulated terms in SFAAs. Similarly, the ACCC notes that NBN Co proposes that it continue to be required to make SFAAs consistent with the SAU. Whilst in the Draft Decision the ACCC noted that this alignment commitment may give access seekers the *choice* to access the terms and conditions specified by the SAU by entering into an SFAA-based Access Agreement,⁶⁰ NBN Co could choose to make SFAAs consistent with the SAU by removing inconsistent terms from the SFAA. Retaining the alignment commitment would therefore not necessarily mean that access seekers have additional certainty that NBN Co will include the SAU terms in SFAAs.

Further, the ACCC considers that the first option would add an additional layer of process and obligations to the normal operation of Part XIC, by creating linkages between regulatory determinations and the SFAA. It therefore creates a risk of unintended consequences, particularly given the relatively new and untested nature of the amended Part XIC regime itself.

Under the second option, the SAU would no longer *explicitly* require NBN Co to make SFAAs consistent with regulated terms (that is, to provide access seekers with the option to access terms in the SAU and regulatory determinations via SFAA-based Access Agreements, or to have inconsistent terms removed from the SFAA). As there will be no commitments linking

⁵⁷ Ibid.

⁵⁸ Ibid, p. 15.

⁵⁹ Where the ACCC has referred to inconsistency between ACCC regulatory determinations and Access Agreements, this specifically relates to the circumstance in which an access seeker enters into an Access Agreement with NBN Co, and any Access Determinations or Binding Rules of Conduct subsequently having no effect between that access seeker and NBN Co to the extent of inconsistency with their Access Agreement.

⁶⁰ ACCC Draft Decision, p. 49.

SFAAs to the legislative hierarchy, NBN Co's obligations to comply with regulated terms will be determined solely by the normal operation of Part XIC.

The ACCC considers that any issues that arise with respect to gaining access to regulated terms under the normal operation of Part XIC would, under the second option, be more clearly attributable to the regime itself than under the first option.

The ACCC notes access seekers' concerns that the terms and conditions in regulatory determinations would not amount to a complete or comprehensive agreement. However, as noted in section 2.1.1.1, the possibility that regulated terms will not be comprehensive is a function of the Part XIC regime, and occurs in both the legacy network and NBN contexts. Further, as noted above, the adoption of first option would not necessarily address the concerns of access seekers in this regard, if NBN Co chooses to make SFAAs consistent with regulated terms by removing the inconsistent terms from the SFAA.

In light of the above considerations, in the draft Notice to Vary, the ACCC has included the following variations:

- deletion of clauses 1B.1.2 (Pricing not subject to regulatory recourse) and 1B.2 (Regulatory recourse) of Schedule 1B; and
- deletion of clauses 6.1 (Obligation to align SFAA with Special Access Undertaking to the extent inconsistent) and 6.2 (On-going obligation to ensure consistency of SFAA with Special Access Undertaking) of the Main Body of the SAU.

In relation to the concern raised by Telstra that RSPs under an SFAA-based Access Agreement could be forced to migrate to an SFAA-based Access Agreement which has been updated to include regulated terms, the ACCC considers that if the above variations are adopted, the SAU would not preclude RSPs from either electing to obtain access on the regulated terms or to obtain access by extending supply under current terms. Similarly, in relation to its concern that regulatory determinations would be bundled with other changes to the SFAA (such that RSPs under an SFAA-based Access Agreement are obliged to take other NBN Co unilateral amendments in order to get the benefit of regulatory determinations) the ACCC considers that if its proposed variations are adopted, the SAU would not in and of itself give rise to this issue. That is, as noted above, NBN Co's obligations to comply with regulated terms will be determined solely by the operation of Part XIC — access seekers could request supply on regulated terms to the extent they are not inconsistent with Access Agreements (alternatively, NBN Co and access seekers could commercially agree to include those terms in Access Agreements if they wished to do so).

In relation to Telstra's concern that there is the potential for discrimination because RSPs under an SFAA-based Access Agreement would need to wait until the expiry of their Access Agreements to obtain regulated terms, whereas new access seekers could immediately obtain regulated terms, the ACCC notes that this is a normal aspect of commercial arrangements, and that RSPs under an existing agreement could seek to commercially negotiate with NBN Co to obtain regulated terms earlier. The ACCC also notes that Telstra considers that it would be beneficial for the ACCC to clarify how it will take into account NBN Co's non-discrimination obligations during an inquiry about a proposal to make an Access Determination.⁶¹ Under Part XIC, the ACCC must not make an Access Determination that has the effect (direct or indirect) of discriminating between access seekers.⁶² As outlined in the Draft Decision, the ACCC is of the view that it would be suitable for the matter of whether an Access Determination has the effect (direct or indirect) of discriminating between access seekers (including in relation to the timing of such a determination taking effect) to be considered at the time of the inquiry into making the determination, taking into account the circumstances which exist at that time.⁶³

⁶¹ Telstra Submission, p. 12.

⁶² CCA, s. 152BCB(4A).

⁶³ ACCC Draft Decision, p. 45.

In relation to Telstra's proposal that the SAU should include a commitment to implement a compliance reporting regime, the ACCC notes that it has information gathering powers under the CCA, in the form of record-keeping rules under section 151BU. The ACCC could exercise this power to make rules requiring NBN Co to keep and retain records and prepare reports to be given to the ACCC if it considered it necessary to do so.

In relation to the arguments of interested parties that additional commitments should be included in the SAU to allow for flow-through of regulated terms into Access Agreements, the ACCC does not propose to allow for regulatory intervention on disputed terms in an executed Access Agreement. This is because requiring regulated terms to be incorporated into Access Agreements would conflict with the primacy of commercial agreement that is established by Part XIC.

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

Clause 1B.2.3 of Schedule 1B of the 18 December 2012 SAU confers a power on the ACCC to make 'Facilities Access Decisions' about terms and conditions for the 'Facilities Access Service' in accordance with a specified process. In the Consultation Paper, the ACCC proposed to remove clause 1B.2.3 of Schedule 1B from the SAU.⁶⁴ The effect of this variation is outlined in section 2.1.1.3 of the Consultation Paper.

Submissions note the following views in relation to this variation:

- NBN Co agrees with the ACCC's proposal to remove clause 1B.2.3 from the SAU to maintain a consistent approach with its proposal to remove the 'regulatory recourse' mechanism from the SAU.⁶⁵
- Some interested parties agree with the ACCC's proposal, because they consider it will allow the ACCC to use its Part XIC powers to establish terms for the Facilities Access Service, rather than constraining the ACCC's existing regulatory powers.⁶⁶

Other interested parties did not provide views on this proposed variation.

The ACCC maintains the view that the Facilities Access Decision should be removed from the SAU. Therefore, in the draft Notice to Vary, the ACCC has included a variation to delete clause 1B.2.3 (Facilities Access Decision) of Schedule 1B.

2.1.1.4. Conduct about production and maintenance of SFAAs

NBN Co makes certain commitments in the 18 December 2012 SAU about producing and maintaining SFAAs. For example, clause 6.3 of the Main Body provides that:

- NBN Co will publish and maintain SFAAs in relation to the supply of the NBN Access Service and the Ancillary Services; and
- NBN Co *may* include terms and conditions in relation to the supply of the Facilities Access Service in SFAAs.

In the Consultation Paper, the ACCC proposed to remove the second sentence in clause 6.3 of the Main Body (that is, the commitment that NBN Co *may* include terms and conditions about the Facilities Access Service in SFAAs).⁶⁷ The effect of this variation is outlined in section 2.1.1.4 of the Consultation Paper.

⁶⁴ ACCC Consultation Paper, p. 14.

⁶⁵ NBN Co Submission, p. 11.

⁶⁶ AAPT Submission, p. 5; Macquarie Telecom Submission, p. 3; Optus Submission, p. 12; VHA Submission, p. 6.

⁶⁷ ACCC Consultation Paper, p. 14.

Submissions note the following views in relation to these variations:

- NBN Co states that it does not understand the precise nature of the ACCC's concerns; however, it agrees to adopt the ACCC's proposal and remove the second sentence of clause 6.3 of the Main Body from the SAU.⁶⁸
- A small number of interested parties agree with the ACCC's proposal, citing the view that it would ensure that the ACCC could address any issues via regulatory determinations concerning the Facilities Access Service.⁶⁹

Other interested parties did not provide views on this proposed variation.

The ACCC maintains the view that the second sentence in clause 6.3 of the Main Body (that is, the commitment that NBN Co *may* include terms and conditions about the Facilities Access Service in SFAAs) confers discretion on NBN Co as to the scope of the terms and conditions that may be included in SFAAs in relation to the Facilities Access Service.⁷⁰ This creates uncertainty about whether regulatory determinations about the Facilities Access Service would be inconsistent with the SAU and of no effect. Following further consideration, the ACCC is proposing an amendment to clause 6.3 to clarify the ACCC's objectives — the ACCC now considers that the first sentence of clause 6.3, which provides that NBN Co will publish and maintain SFAAs "in relation to the supply of the NBN Access Service and Ancillary Services" should be amended to include the Facilities Access Service.

Therefore, in the draft Notice to Vary, the ACCC has included the following variations:

- amendment of the first sentence of clause 6.3 (Obligation for NBN Co to produce and maintain SFAA) of the Main Body to read "in relation to the supply of the NBN Access Service and the Ancillary Services *and the Facilities Access Service*"; and
- deletion of the second sentence of clause 6.3 (Obligation for NBN Co to produce and maintain SFAA) of the Main Body (the commitment that NBN Co may include terms and conditions about the Facilities Access Service in SFAAs).

2.1.1.5. Conduct about development of SFAAs ('Multilateral SFAA forum')

Clause 1B.3 of Schedule 1B of the 18 December 2012 SAU provides that NBN Co will establish and conduct a 'multilateral SFAA forum' to engage with industry on possible future changes to the terms of an SFAA. The SAU sets out processes for conducting the forum, as well as the processes for how NBN Co may make changes to SFAAs arising out of the forum.

In the Consultation Paper, the ACCC proposed to remove clauses 1B.3.1(b) and 1B.3.1(e)-(l) of Schedule 1B from the SAU (that is, the commitments about the procedural requirements for conducting the forum, and the commitments about how NBN Co will implement the outcomes of the forum in SFAAs).⁷¹ The effect of varying the SAU in this way is outlined in section 2.1.1.5 of the Consultation Paper.

Submissions

NBN Co agrees with the ACCC's proposal to remove clauses 1B.3.1(b) and 1B.3.1(e)-(l) of Schedule 1B from the SAU, noting that the remaining provisions promote the long-term interests of end-users for the duration of Module 1.⁷²

Some interested parties agree with the ACCC's proposal.⁷³

⁶⁸ NBN Co Submission, pp. 13-14.

⁶⁹ AAPT Submission, p. 5; Macquarie Telecom Submission, p. 3.

⁷⁰ ACCC Draft Decision, p. 49.

⁷¹ ACCC Consultation Paper, p. 15.

⁷² NBN Co Submission, pp. 14-15.

On the other hand, Telstra and Herbert Geer (on behalf of iiNet Ltd) consider that retention of the process, but with some amendments, would facilitate an effective engagement model.⁷⁴

Herbert Geer (on behalf of iiNet Ltd) proposes that the following should be retained:

- the requirement that the forum be available to all access seekers, regardless of whether it has an Access Agreement with NBN Co, and that access seeker participation is voluntary;⁷⁵ and
- the timeframes for conducting the forum.⁷⁶

It also proposes that the forum should conclude at least one month before the publication of the SFAA.⁷⁷

Telstra proposes that that the following should be added to the SAU:

- a commitment that consultation processes should begin as early as feasible;
- a commitment that NBN Co will consult with RSPs on all changes to SFAAs;
- an avenue for RSP-initiated engagement; and
- an ACCC role in incorporating changes to SFAAs.⁷⁸

ACCC response

Having taken into account the views expressed in submissions, the ACCC now considers that the following commitments should be retained:

- The commitment that the forum will be available to all access seekers, irrespective of whether they have an Access Agreement with NBN Co, and that access seeker participation will be voluntary such that each access seeker can engage as they deem appropriate given their level of interest and/or resources (clause 1B.3.1(i)).
- The commitment that NBN Co is not precluded from conducting bilateral consultation with access seekers in relation to any SFAA in a manner that is consistent with NBN Co's non-discrimination obligations (clause 1B.3.1(l)).

Retaining the first of these commitments would ensure that access seekers who have not entered into an Access Agreement with NBN Co are able to contribute to the development of future contracts. Retaining the second commitment would facilitate ongoing engagement between NBN Co and industry to develop the terms and conditions of SFAAs.

In addition, the ACCC now proposes to include a commitment that NBN Co will convene the forum no later than 12 months prior to the expiration of the current SFAA term — the ACCC notes interested parties' concerns that the removal of the specified timeframes would give NBN Co discretion in this respect.⁷⁹ The ACCC considers that this requirement will provide all parties with certainty that there is an avenue for ongoing commercial negotiations about the next SFAA, and that there will be at the least a 12 month period for conducting these negotiations. The ACCC expects that NBN Co and access seekers would commercially agree

⁷³ AAPT Submission, p. 5; Macquarie Telecom Submission, p. 4; Optus Submission, pp.12-13; VHA Submission, p. 6.

⁷⁴ iiNet Submission, pp. 9-10; Telstra Submission, pp. 13-14.

⁷⁵ iiNet Submission, pp. 9-10.

⁷⁶ Ibid.

⁷⁷ Ibid.

⁷⁸ Telstra Submission, pp. 13-14.

⁷⁹ iiNet Submission, pp. 9-10; Telstra Submission, pp. 13-14.

to commence and conclude negotiations within a sufficient period of time to ensure that mutually agreed terms and conditions are available and to ensure that continuity of supply is not interrupted during the transition between SFAAs.

The ACCC does not propose to adopt Telstra and Herbert Geer's (on behalf of iiNet Ltd) suggestions to:

- include further commitments about the processes and timeframes for conducting the forum — the ACCC considers that these matters could, if necessary, be covered by procedural directions under Part XIC (discussed below); or
- vary the SAU to include an ACCC role in the implementation of the forum outcomes — consistent with the legislative intent of Part XIC, the ACCC considers that industry should be free to determine the nature and extent of commercial negotiations, with ACCC intervention occurring only where agreement cannot be reached.

The ACCC notes that NBN Co “intends to consult with Access Seekers on the terms of reference and procedures for the Multilateral SFAA Forum in due course.”⁸⁰

More broadly, the ACCC notes that it has the ability to give procedural directions in relation to access negotiations under section 152BBA of the CCA. This power is intended to allow the ACCC to facilitate appropriate access arrangements where there may be attempts to delay or frustrate negotiations on terms of access.⁸¹ The ACCC considers that it could exercise this power to make directions about the procedural requirements for conducting contractual negotiations if it is necessary to do so.⁸²

The ACCC is also proposing to include a commitment to allow consumer advocacy groups to participate in the multilateral SFAA forum. This is because the ACCC considers that consumer advocacy groups are likely to have an interest in participating in negotiations about SFAA terms that may have direct impacts on downstream customer or end-user contracts (for example, risk management and liability clauses, mandated clauses for downstream contracts). By allowing these groups to participate, they could raise any concerns directly with NBN Co and/or retail service providers and facilitate the early resolution of any issues with these terms.

In summary, in the draft Notice to Vary, the ACCC has included the following variations:

- deletion of clauses 1B.3.1(e)-(h) and (j)-(k) of Schedule 1B;
- amendments to clause 1B.3.1 to allow Consumer Advocacy Groups to participate in the multilateral SFAA forum; and
- amendments to clause 1B.3.1(c) to include a commitment that NBN Co will convene the forum no later than 12 months prior to the expiration of the current SFAA term.

The ACCC notes that, under the 18 December 2012 SAU, the multilateral SFAA forum commitments would have been reviewed as part of the midpoint review of Module 1.⁸³ As outlined in section 2.1.2.2, the ACCC is proposing that the midpoint review be removed from the SAU. The multilateral SFAA forum commitments will therefore be specified for the term of Module 1. The ACCC considers that specifying these commitments in the SAU for the term of Module 1 is likely to be reasonable, because the detailed processes — the effectiveness of which in generating constructive engagement would have been untested — will have been removed from the SAU. The remaining commitments broadly relate only to the establishment of the multilateral SFAA forum, who can participate and when it will be conducted.

⁸⁰ NBN Co Submission, p. 15.

⁸¹ Explanatory Memorandum to the *Telecommunications Legislation Amendment Bill 1998*; *Telecommunications (Universal Service Levy) Amendment Bill 1998*; *NRS Imposition Amendment Bill 1998*, pp. 31-32.

⁸² CCA, s. 152BBA(3).

⁸³ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1K, clause 1K.2.1.

2.1.2. Conduct concerning changes to the SAU over time

2.1.2.1. Conduct about submitting variations to the SAU ('replacement modules')

Clauses 4.5 to 4.11 of the Main Body of the 18 December 2012 SAU set out processes for the submission and assessment of SAU variation applications following the expiry of Module 1 ('replacement modules').⁸⁴ In the Consultation Paper, the ACCC proposed to remove these clauses from the SAU.⁸⁵ The effect of amending the SAU in this way is outlined in section 2.1.2.1 of the Consultation Paper.

Submissions

NBN Co disagrees with the ACCC's proposal, stating that it "adopts a 'scorched earth' approach that may lead to a significant regulatory gap during Module 2 with unintended consequences for both NBN Co and Access Seekers."⁸⁶ Specifically, NBN Co is concerned that:

- "the LTRCM would not operate as intended (and the ICRA may become indeterminate) because it relies on *forecasts* of opex, capex, disposals, revenue, taxation and WACC, which need to be established *prior* to the start of each Regulatory Cycle";⁸⁷
- "the method for rolling forward the RAB for that Regulatory Cycle would be unknown given the ACCC's proposal to remove the detail of the RAB roll forward in Module 2";⁸⁸
- "all current Reference Offers would become Non-Reference Offers";⁸⁹ and
- "there would be substantial erosion of the incentive properties of forecasts, as they would either not exist, or may be established too late to have any value as an incentive. Further, if the ABBRR has not been set during the Building Block Period, NBN Co will not know what revenues it can earn. NBN Co would not know what the allowed revenues were prior to the start of the regulatory cycle thus leading to difficulty in the appropriate calculation of the ABBRR."⁹⁰

NBN Co instead proposes a revised replacement module approach via the following amendments:

- removal of the specific aspects about which the ACCC has expressed concern (that is, the deemed application of rejected replacement modules, and the clauses setting out when ACCC regulatory determinations will "apply" instead);⁹¹ and
- conferral of a power on the ACCC to make its own decision about replacement terms if the ACCC does not accept NBN Co's replacement module applications, in accordance with a specified process.⁹²

NBN Co's revised approach comprises:

- The process for submission of replacement module applications — the ACCC will provide NBN Co with at least 12 months written notice to provide a replacement

⁸⁴ NBN Co will submit 'Replacement Module Applications', which must include proposals about reference offers, long-term revenue constraint methodology elements, and service levels for a 'regulatory cycle' (a period of 3, 4 or 5 years specified by NBN Co in its application).

⁸⁵ ACCC Consultation Paper, p. 16.

⁸⁶ NBN Co Submission, p. 15.

⁸⁷ *Ibid.*, pp. 15-16.

⁸⁸ *Ibid.*

⁸⁹ *Ibid.*

⁹⁰ *Ibid.*

⁹¹ *Ibid.*, pp. 15-17.

⁹² *Ibid.*, pp. 17-18.

module application, specifying the length of the 'regulatory cycle' for which the replacement module will apply (three, four or five years) and the due date for NBN Co to provide a replacement module application.⁹³ The replacement module application must contain proposals as to reference offers,⁹⁴ the long-term revenue constraint methodology (LTRCM),⁹⁵ and the RAB roll-forward.⁹⁶

- The assessment of replacement module applications — the ACCC must assess the replacement module application against the criteria specified for assessment of an SAU in section 152CBD of the CCA.⁹⁷
- The conferral of a power on the ACCC to make 'replacement module determinations' — if the ACCC does not accept the replacement module application, the ACCC is required to issue a replacement module determination at least 20 business days prior to the end of the module in force.⁹⁸ The determination must cover matters relating to reference offers, LTRCM and RAB roll-forward.⁹⁹ NBN Co is required to comply with the terms of the determination, unless the ACCC decides to accept the replacement module application (or an updated version submitted by NBN Co) prior to the end of the module in force.¹⁰⁰

Under this proposed revised replacement module process, the ACCC would be required to concurrently engage in the process for the assessment of the replacement module application and the process of making of a replacement module determination.

NBN Co submits that "the proposed replacement module process promotes the LTIE by removing the potential for a regulatory gap and providing certainty to Access Seekers about the continued operation of Reference Offers, and NBN Co in relation to its long-term cost recovery arrangements."¹⁰¹

Several interested parties agree with the ACCC's proposal to remove the replacement module process,¹⁰² noting that:

- Commercially agreed terms and conditions would be the default, subject to ACCC regulatory recourse.¹⁰³
- Removal of the process would better balance the interests of NBN Co and access seekers by enabling commercial negotiations in the first instance, and if this fails, allowing the parties to have recourse to the ACCC.¹⁰⁴
- The use of existing statutory processes rather than the processes proposed by NBN Co simplifies the SAU and ensures that its relevance over time is tested against the statutory criteria.¹⁰⁵
- The SAU does not need a self-contained procedure for replacing modules and the mechanism set out in Part XIC is appropriate for the ACCC to ensure that modules remain fair and reasonable.¹⁰⁶

⁹³ NBN Co, *Submission to ACCC consultation paper on variation of NBN Co SAU: Appendix C – proposed drafting of SAU changes*, May 2013, clause 4.5. (NBN Co Submission, Appendix C)

⁹⁴ *Ibid*, clause 4.6.

⁹⁵ *Ibid*, clause 4.7.

⁹⁶ *Ibid*, clause 4.8.

⁹⁷ *Ibid*, clause 4.4(a).

⁹⁸ *Ibid*, clause 4.9(a).

⁹⁹ *Ibid*, clause 4.9(b).

¹⁰⁰ *Ibid*, clause 4.9(e).

¹⁰¹ NBN Co Submission, p. 143.

¹⁰² AAPT Submission, p. 5; Macquarie Telecom Submission, p. 4; Optus Submission, p. 13; Telstra Submission, p. 14; VHA Submission, p. 6.

¹⁰³ AAPT Submission, p. 5.

¹⁰⁴ Macquarie Telecom Submission, p. 4.

¹⁰⁵ Telstra Submission, p. 14.

ACCC response

Having taken into account the views expressed in submissions, the ACCC now considers that a replacement module process may be retained in the SAU, based on NBN Co's revised proposal. As noted in the Draft Decision, the ACCC has no objection in principle to the SAU specifying SAU variation applications that NBN Co must make.¹⁰⁷

However, the ACCC considers that there are three key aspects of NBN Co's revised proposal that must be amended:

- determination of the length of the regulatory cycle;
- the proposed content of the replacement module application; and
- the proposed criteria which constrain the ACCC's decision making for the replacement module determination.

These aspects are discussed below.

Length of the regulatory cycle

NBN Co's proposed approach would require the ACCC to determine the length of the regulatory cycle when it first gives NBN Co notice of the date by which NBN Co must submit the replacement module application. The length of the regulatory cycle could not then be changed during the replacement module application assessment process, or in the replacement module determination made by the ACCC.

The ACCC considers that it should not be obliged to determine the length of the regulatory cycle when it first gives NBN Co the notice — rather, it considers that it should retain discretion to decide the length of the regulatory cycle (whether three, four or five years) *after* considering the information submitted by NBN Co in the replacement module application and in any submissions received during public consultation.

This is because the length of the regulatory cycle will be a factor in determining NBN Co's efficiency incentives, and therefore a component of the ACCC's assessment of whether a replacement module promotes the long-term interests of end-users — the length of the regulatory cycle would therefore need to be assessed as part of the ACCC's assessment of replacement modules. Generally speaking, longer regulatory cycles (for example, five years) create stronger incentives to invest and operate efficiently. This is because a longer period means that cost overruns would be absorbed by NBN Co for a longer period, thereby reducing NBN Co's incentives to incur these cost overruns — and similarly, the additional revenues associated with reduced costs would also be retained by NBN Co for a longer period. Conversely, shorter regulatory cycles would reduce the level of expenditure risk to NBN Co, but would reduce the length of time NBN Co would be allowed to keep additional revenues or absorb cost overruns, in turn reducing the strength of the incentive created for NBN Co to spend efficiently.

The ACCC therefore considers that:

- NBN Co should propose the length of the regulatory cycle in its replacement module application; and
- if the replacement module application is not accepted, the ACCC should select the length of the regulatory cycle when making the replacement module determination.

¹⁰⁶ VHA Submission, p. 6.

¹⁰⁷ ACCC Draft Decision, p. 56.

In order to facilitate this, it will be necessary for NBN Co to submit five-year forecasts with its replacement module application, even if it proposes a shorter replacement module period.

Content of the replacement module application

The ACCC considers that amendments are required to the clauses which govern the terms and conditions that NBN Co proposes will be determined through the replacement module processes.

Firstly, under NBN Co's variations, NBN Co would propose in a replacement module application that, at the end of the regulatory cycle, one of the two approaches that are specified in the SAU should be used for rolling forward the RAB (in relation to both the treatment of capital expenditure and regulatory depreciation). Broadly, this RAB roll-forward proposal would then be accepted or rejected by the ACCC as a variation to the SAU under Part XIC. If the proposal is rejected, the ACCC could make a replacement module determination its preferred approach to rolling forward the RAB at the end of the regulatory cycle. This process is explained further in section 2.4.2.3 of this document.

Whilst the ACCC considers it acceptable in concept that RAB roll-forward arrangements in Module 2 be determined through the replacement module process, the ACCC has two concerns about NBN Co's proposed variations, which are outlined in further detail in section 2.4.2.3 of this document. The ACCC proposes to make the amendments to NBN Co's proposed variations that are outlined in section 2.4.2.3, in order to address these issues.

Secondly, the ACCC has proposed amendments to NBN Co's proposed variations in relation to how tax change events in the LTRCM proposal are treated (discussed further in section 2.4.1.4).

Criteria for making the replacement module determination

As noted, if the ACCC does not accept NBN Co's replacement module application, the ACCC is required to issue a replacement module determination at least 20 business days prior to the end of the module in force.¹⁰⁸

NBN Co's submissions suggest that its primary objective in including a replacement module process is to compel the ACCC to make a determination on particular matters in the event that NBN Co's SAU variations are not accepted (in order to avoid the prospect of a 'regulatory gap').¹⁰⁹ Under Part XIC, the ACCC cannot be compelled to make Access Determinations or Binding Rules of Conduct. The replacement module determination power is therefore intended by NBN Co as a substitute for the ACCC's power to make Access Determinations or Binding Rules of Conduct under Part XIC.

The ACCC considers that the operation of the power conferred on the ACCC should therefore be consistent with these Part XIC powers, except to the extent necessary for NBN Co to achieve its primary objective. In order to achieve its primary objective, NBN Co seeks to compel the ACCC to make the replacement module determination by a specified time, and to include specified content in the determination.¹¹⁰

However, in making the replacement module determination, NBN Co proposes that the ACCC also be required to:

- be satisfied that the terms and conditions in the determination are reasonable, having regard to the criteria in section 152AH of the CCA;

¹⁰⁸ NBN Co Submission, Appendix C, clause 4.9(a).

¹⁰⁹ NBN Co Submission, p. 16.

¹¹⁰ Ibid, pp. 15-16.

- not make a determination that would have the effect of preventing NBN Co from engaging in conduct that is reasonably necessary for uniform national pricing;
- make a determination that is consistent with, and does not alter or remove, the fixed principles term and condition; and
- publish the reasons for the decision on its website.¹¹¹

These constraints are similar to some of the considerations that the ACCC must take into account in making an Access Determination.¹¹² They are also similar to some of the considerations that the ACCC must take into account in assessing a variation to the SAU.¹¹³

The ACCC considers that it is inappropriate to customise criteria in the SAU in this way for a power that is intended to substitute the ACCC's regulatory determination powers under Part XIC. NBN Co has itself submitted (in relation to another part of the SAU) that:

it is unnecessary and potentially dangerous to reflect statutory drafting in a regulatory instrument when the legislative obligation is not properly or completely reflected in the drafting. Further, the operation of the legislation may change through interpretation and refinement over time. Inconsistencies may then arise between the statutory obligation and the obligation in the SAU.¹¹⁴

Instead, the ACCC considers that the SAU should merely state that the ACCC must have regard to the matters that the ACCC will take into account in making an Access Determination under section 152BCA and be subject to the restrictions under section 152BCB of the CCA. These provisions would address the first two constraints identified by NBN Co's proposed approach and ensure consistency between the power conferred by the SAU and the ACCC's regulatory determination powers under Part XIC.

The ACCC considers that the third constraint noted above should not be included in the replacement module determination process. There are two parts to this constraint:

- a requirement that a replacement module determination be consistent with fixed principles terms and conditions in the SAU; and
- a prohibition against a replacement module determination altering or removing the fixed principles term and condition from the SAU.¹¹⁵

The ACCC notes that, under Part XIC, fixed principles terms and conditions are only intended to ensure that the ACCC cannot refuse to accept a variation to the SAU or a new SAU on certain grounds.¹¹⁶

In relation to the first part of the constraint, the ACCC considers that this is unnecessary because the requirement for consistency between parts of the SAU is fundamental to the modular structure proposed by NBN Co. This part requires the ACCC to make a replacement module determination that is consistent with the fixed principles terms and conditions in the SAU. However, those fixed principles will merely be a subset of the provisions in Module 2.¹¹⁷ Under the modular structure of the SAU, a replacement module determination must always be consistent with all the provisions in Modules 0 and 2, since it would not be in the long-term interests of end-users or reasonable for parts of the SAU to be inconsistent with each other — an inconsistent regulatory arrangement would create ambiguity and a lack of regulatory certainty. In particular, if such inconsistency was possible, NBN Co might be placed in the invidious position of being required to comply with contradictory provisions in the SAU. As a

¹¹¹ NBN Co Submission, Appendix C, clause 4.9(c).

¹¹² CCA, s. 152BCA(1).

¹¹³ CCA, s. 152CBD(2).

¹¹⁴ NBN Co Submission, p. 26.

¹¹⁵ NBN Co Submission, Appendix C, clause 4.9(c)(iii).

¹¹⁶ CCA, s. 152CBD(4).

¹¹⁷ The scope of the fixed principles terms and conditions are discussed in section 2.6 of this document.

result, the ACCC considers that this part of the constraint should be omitted, since its inclusion might suggest that inconsistency between replacement modules and other provisions in Modules 0 and 2 is permitted under the modular structure.

In relation to the second part of the constraint, the ACCC considers that this part of the constraint is also unnecessary because the modular structure provides that Modules 0 and 2 of the SAU would be accepted for the full term of the SAU — 27 years. It appears that NBN Co is intending to replicate subsection 152BCD(g) of the CCA, which prevents the ACCC from varying a previous Access Determination in a way that alters or removes a fixed principles provision; this type of clause is referred to as an “entrenching provision”.¹¹⁸ In addition, NBN Co has added a further constraint which does not appear in subsection 152CBD(g) — this constraint also prohibits the ACCC from making a determination that has “the effect of altering ... any fixed principles term and condition”.¹¹⁹ NBN Co’s concern appears to be that the fixed principles terms and conditions (or other parts of Modules 0 and 2) could be varied by the ACCC through the replacement module process. The ACCC considers that this concern is unfounded. The ACCC does not have any ability to vary the SAU independently of NBN Co — under Part XIC only NBN Co is able to propose variations to the SAU.¹²⁰ By contrast, the entrenching provisions operate to constrain the ACCC in the context of the ACCC’s broad powers to vary Access Determinations under section 152BCN. Further, in the context of the replacement module determination process, the ACCC is required (and permitted) only to determine specific matters. There is no provision for the ACCC to specify any other matters in the determination, nor to propose other variations to the SAU. The ACCC therefore does not have any ability to vary provisions in Modules 0 and 2, including the fixed principles terms and conditions. The ACCC considers that this part of the constraint should be omitted, since its unnecessary inclusion might otherwise create uncertainty about the modular structure.

It is proposed that NBN Co’s approach will be accepted with respect to:

- the ACCC’s ability to determine the period for consideration of the replacement module application; and
- the practical implication of the approach being that the ACCC would need to concurrently consider a replacement module determination whilst making a decision on the replacement module application.

However, consistent with the ACCC’s regulatory determination powers under Part XIC, the ACCC considers that there should be an explicit acknowledgement that the ACCC may consult as it sees fit during the process of making the determination.

In summary, in the draft Notice to Vary, the ACCC has included the following amendments in relation to replacement modules:

- the inclusion of a replacement module process that includes a commitment by NBN Co to make a replacement module application and an obligation for the ACCC to make a replacement module determination if it does not accept the application;
- the inclusion of NBN Co’s proposed drafting for the matters that must be addressed via the replacement module process, but with some variations as outlined above; and
- the inclusion of NBN Co’s proposed drafting in relation to the criteria that the ACCC will have regard to when exercising its replacement module determination power, but with some amendments to be consistent with the legislative criteria for the making of an Access Determination.

¹¹⁸ Explanatory Memorandum to the *Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010*, p. 190.

¹¹⁹ NBN Co Submission, Appendix C, clause 4.9(c).

¹²⁰ CCA, s. 152CBG(2).

2.1.2.2. Conduct about the midpoint review of Module 1

Schedule 1K of Module 1 of the 18 December 2012 SAU confers a power on the ACCC to review various multilateral processes and non-price terms at the midpoint of Module 1 in accordance with a specified process. In the Consultation Paper, the ACCC proposed to remove Schedule 1K from the SAU, and proposed that the matters that would have been reviewed would operate for the period of time specified at the time of SAU acceptance (for example, five years or ten years).¹²¹ The effect of varying the SAU in this way is outlined in section 2.1.2.2 of the Consultation Paper.

Submissions

NBN Co considers that the ACCC's concerns in relation to the midpoint review could have been addressed by drafting changes; however it nevertheless agrees with the ACCC's proposal to remove Schedule 1K.¹²² NBN Co proposes that the matters that would have been reviewed will be specified for a 10-year period, noting that "there would be a reduced number of provisions subject to the full-term of Schedule 1K because many of the aspects of the SAU that were to be subject to the mid-term review are to be removed".¹²³ Further, NBN Co submits that "reducing the duration of the terms and conditions (that would otherwise be subject to the mid-term reviews) would be inconsistent with the Modular approach".¹²⁴

Several interested parties agree with the ACCC's proposal.¹²⁵ On the other hand, a small number of interested parties propose that some aspects of the midpoint review should be retained as follows:

- AAPT considers that a midpoint review mechanism that is less prescriptive should be retained — it submits that, given the dynamic nature of the market and the fact that non-price and service level provisions are yet to be settled with industry, it would be inappropriate to lock in these terms without a review mechanism.¹²⁶
- Herbert Geer considers that the commitments requiring NBN Co to provide the ACCC with information about engagement processes (that is, the customer engagement processes, the PDF Processes, Dispute Management and the multilateral SFAA forum) should be retained — it submits that this is because this information will be relevant to the ACCC's assessment of any SAU variation proposed by NBN Co, or its consideration of whether to make regulated terms in respect of these matters, at the midpoint of Module 1.¹²⁷

Telstra considers that the matters that would otherwise have been subject to the midpoint review should be specified for a three-year period only.¹²⁸

ACCC response

The ACCC maintains the view that the midpoint review mechanism should be removed from the SAU, for the reasons outlined in the Draft Decision.¹²⁹

In the absence of the midpoint review, the aspects of Module 1 that the ACCC is satisfied are reasonable for a particular period of time will therefore operate for the period specified at the time of acceptance. Effectively, this means that the matters that remain in Module 1 and which operate only until year five can be reviewed via the normal operation of Part XIC (as opposed

¹²¹ ACCC Consultation Paper, p. 17.

¹²² NBN Co Submission, p. 18.

¹²³ Ibid, pp. 17-18.

¹²⁴ Ibid, p. 18.

¹²⁵ CCC Submission, pp. 2-3; Macquarie Telecom Submission, pp. 4-5; Optus Submission, p.13; Telstra Submission, p. 14; VHA Submission, p. 6.

¹²⁶ AAPT Submission, p. 5.

¹²⁷ iiNet Submission, pp. 11-12.

¹²⁸ Telstra Submission, p. 11.

¹²⁹ ACCC Draft Decision, pp. 58-61.

to via a bespoke process in the SAU). That is, industry could address these matters by means of commercial negotiation, NBN Co could use the SAU variation processes to seek ACCC approval to renew or replace these terms, or the ACCC could make regulatory determinations to establish terms and conditions for these matters if it considered it necessary to do so.

In relation to the argument made by AAPT, the ACCC notes that the examples of terms and conditions provided by AAPT — non-price terms and service levels — are proposed to be removed from the SAU (as discussed in further detail in section 2.5.1).

In relation to the argument made by Herbert Geer, if NBN Co sought a variation to the SAU to extend the operation of terms that are only specified as operating in the SAU for five years (or if the ACCC were to make regulated terms on these matters after five years) information that would be relevant to the ACCC's decision-making process could be provided to the ACCC at the time of these processes. In addition, the ACCC has information gathering powers under the CCA, in the form of record-keeping rules under section 151BU and mandatory information gathering powers under section 155.

Following removal of the midpoint review, the residual issue is for how long the terms and conditions that were to be reviewed should operate (that is, five years or ten years). According to the 18 December 2012 SAU, the terms and conditions would operate for ten years.

In contrast to NBN Co's submissions, the ACCC does not consider that the removal of the midpoint review necessitates that all the terms and conditions that would have been reviewed should be specified for a 10-year period instead.

Rather, the ACCC considers that the terms and conditions should only be in operation for the period for which the ACCC is satisfied that it is in the long-term interests of end-users and that it is reasonable for them to do so.

In light of other proposed amendments to the terms and conditions that would have been reviewed (as discussed throughout this document), the ACCC considers that it is likely to be reasonable for some of the terms and conditions to operate for 10 years, while others should only operate for five years, as follows:

- The Multilateral SFAA Forum — 10 years (discussed in section 2.1.1.5);
- The Product Development Forum (PDF) Processes — 5 years (discussed in section 2.3.1.1);
- The Customer Engagement Processes (part of the prudency provisions) — 5 years (discussed in section 2.3.1.2);
- The schedule which provides for the provision of regulatory information to the ACCC — 10 years (discussed in section 2.4.2.2); and
- The dispute management provisions — 5 years (discussed in section 2.5.1).

The ACCC's views about the duration of the operation of these matters are discussed in the relevant sections, as identified above. Broadly however, in reaching these views the ACCC has generally considered the level of prescription of the particular terms and the degree of discretion they confer on NBN Co. Where there is a high level of detail prescribed in the processes or where the processes confer a high degree of discretion on NBN Co, the ACCC considers that there is uncertainty about whether the processes will operate in a manner that is likely to lead to reasonable outcomes over the duration of Module 1, particularly where the processes are novel and untested. The ACCC considers that there should be the opportunity for such processes to be revisited after five years time in light of operational experience. In the event that, in five years time, it has been demonstrated that the processes lead to outcomes that promote the long-term interests of end-users and the ACCC still considers them to be

reasonable, the ACCC would be able to accept their continued operation by NBN Co seeking to vary the SAU as such.

The ACCC has considered the argument put forward by NBN Co that “reducing the duration of the terms and conditions (that would otherwise be subject to the mid-term reviews) would be inconsistent with the Modular approach”.¹³⁰ The ACCC notes that in NBN Co’s supporting submission to the 18 December 2012 SAU, NBN Co submitted that:

- “...the modular structure, balances NBN Co’s requirement for certainty on long-term cost recovery with the need to undertake regular reviews of the detailed terms of access, to ensure that they can remain appropriate as the circumstances of NBN Co and Access Seekers evolve.”¹³¹
- “Given the bespoke and untested nature of some of the processes and terms and conditions...it is appropriate for NBN Co to undertake a review of the effectiveness of these terms and conditions in the SAU and for the ACCC to have a key oversight role in shaping the ongoing terms and conditions offered for the duration of Module 1.”¹³²

It is therefore unclear to the ACCC why reducing the terms of the matters that would have been reviewed by the ACCC at the midpoint review, such that they may instead be considered by the ACCC via Part XIC processes, is inconsistent with the modular approach. While the midpoint review processes were not an assessment of a variation to the SAU under Part XIC, the outcomes of the review were also intended to change the SAU commitments if necessary.

In summary, in the draft Notice to Vary, the ACCC has included the following variations:

- deletion of Schedule 1K (Reviews); and
- specification of the PDF Processes, the Customer Engagement Processes and the dispute management provisions for a five-year period.

2.1.3. SAU extension mechanisms

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

Clause 4.3 of the Main Body of the 18 December 2012 SAU provides that there will be an automatic 12 month extension of Module 1 (the 'extended initial regulatory period') in certain circumstances. In the Consultation Paper, the ACCC proposed to remove clause 4.3 of the Main Body from the SAU.¹³³ The effect of varying the SAU in this way is outlined in section 2.1.3.1 of the Consultation Paper.

Submissions note the following views in relation to these variations:

- NBN Co proposes to implement the ACCC’s proposal to remove clause 4.3, provided that NBN Co’s proposed amendments to the replacement module process is adopted.¹³⁴ NBN Co submits that this mechanism was intended to address the possibility of a regulatory gap at the end of Module 1.¹³⁵

¹³⁰ NBN Co Submission, p. 18.

¹³¹ NBN Co, *Supporting Submission: NBN Co Special Access Undertaking*, 28 September 2012, p. 51.

¹³² *Ibid.*, p. 151.

¹³³ ACCC Consultation Paper, p. 18.

¹³⁴ NBN Co Submission, p. 19.

¹³⁵ *Ibid.*

- Some interested parties agree with the ACCC's proposal and agree with the ACCC's reasons for the proposed variation.¹³⁶

Other interested parties did not provide views on this proposed variation.

The ACCC considers that the mechanism for extending the operation of the initial regulatory period should be removed from the SAU, irrespective of the ACCC's views on NBN Co's revised replacement module approach.

Given that the mechanism for the automatic extension of Module 1 was intended to support NBN Co's original replacement module approach, NBN Co's proposal to remove that original approach means that this mechanism is no longer necessary.

Therefore, in the draft Notice to Vary, the ACCC has proposed the deletion of clause 4.3 (Extension of initial regulatory period) of the Main Body.

2.1.3.2. Extension of the SAU term

Clause 7.3 of the Main Body of the 18 December 2012 SAU concerns extension of the operation of the SAU. In the Consultation Paper, the ACCC proposed to amend clause 7.3(b) of the Main Body to provide that the criteria for ACCC consideration of an NBN Co extension application will be the same as section 152CBD of the CCA.¹³⁷ The effect of varying the SAU in this way is outlined in section 2.1.3.2 of the Consultation Paper.

Submissions note the following views in relation to these variations:

- NBN Co agrees with the ACCC's proposal to adopt all of section 152CBD of the CCA as criteria for an SAU extension.¹³⁸
- Some interested parties agree with the ACCC's proposal and agree with the ACCC's reasons for the proposed amendment.¹³⁹ One interested party proposes the following variation instead:
 - Deletion of the extension mechanism from the SAU, and rely on section 152CBE of Part XIC instead.¹⁴⁰

Other interested parties did not provide views on this proposed variation.

The ACCC does not propose to adopt the proposal to delete the extension mechanism from the SAU and rely on section 152CBE of Part XIC instead. This is because section 152CBE does not include a standalone SAU extension mechanism — it provides that an SAU given by NBN Co may provide for NBN Co to extend the expiry time of the undertaking.¹⁴¹ That is, Part XIC itself does not provide for the ACCC to consider an NBN Co application to extend the SAU term.

The ACCC maintains the view that the criteria for the SAU extension mechanism should be amended to be the same as the statutory criteria for assessing a new undertaking or a variation to an undertaking. Therefore, in the draft Notice to Vary, the ACCC has included a variation to clause 7.3(b) (Extension of the SAU term) of the Main Body to provide that the criteria to be applied by the ACCC in deciding whether to approve the extension will be reflective of the statutory criteria that the ACCC must consider when assessing a new undertaking or a variation to an undertaking.

¹³⁶ AAPT Submission, p. 6; Macquarie Telecom Submission, p. 5; Optus Submission, p. 13.

¹³⁷ ACCC Consultation Paper, p. 19.

¹³⁸ NBN Co Submission, p. 19.

¹³⁹ AAPT Submission, p. 6; Macquarie Telecom Submission, p. 5; Optus Submission, p. 13.

¹⁴⁰ VHA Submission, p. 6.

2.2. Services to which the SAU relates

The variations that are proposed in this section relate to the issues discussed in chapter 3 of the Draft Decision and section 2.2 of the Consultation Paper.

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

As discussed in the Draft Decision, the ACCC considers that the broad service descriptions for the 'NBN Access Service' and 'Ancillary Services' — when read in conjunction with the drafting of other provisions in the SAU — may create uncertainty as to how the SAU interacts with the powers conferred on the ACCC by the CCA to declare services and set terms and conditions for declared services.¹⁴² This creates uncertainty about whether the ACCC could use its existing powers under Part XIC to declare services and set terms and conditions for those services in circumstances where NBN Co does not face incentives to respond to evolving end-user demand — such circumstances could arise during Module 2 of the SAU in particular.

In the Consultation Paper, the ACCC proposed to include statements in the SAU to acknowledge that:

- the CCA allows the ACCC to declare services; and
- the means by which NBN Co will fulfil its obligations under Part XIC in relation to the broad service descriptions for the NBN Access Service and Ancillary Services include through the supply of services declared by the ACCC.¹⁴³

A range of specific variations were proposed. The effect of varying the SAU in this way is outlined in section 2.2.1 of the Consultation Paper.

Submissions

NBN Co submits that:

- it has no objection to the SAU acknowledging that the ACCC may declare services even if the service is, to any extent, covered by the NBN Access Service and Ancillary Services, pursuant to section 152AL(8A);¹⁴⁴
- it does not agree that the SAU should include an obligation to supply services that fall within the scope of the NBN Access Service and Ancillary Services declared by the ACCC in future (because this is captured by the SAOs under section 152AXB) — however, it is prepared to include amendments to clarify that it may also fulfil its Category B Standard Access Obligations (SAOs) by supplying services declared by the ACCC or as specified in Access Determinations or Binding Rules of Conduct;¹⁴⁵ and
- it does not agree that the ACCC should always determine the terms and conditions of supply of future declared services, because this is contrary to the operation of section 152AY(2).¹⁴⁶

¹⁴¹ CCA, s. 152CBE(1).

¹⁴² ACCC Draft Decision, pp. 69-70.

¹⁴³ ACCC Consultation Paper, pp. 19-20.

¹⁴⁴ NBN Co Submission, pp. 23-24.

¹⁴⁵ *Ibid.*, pp. 25-27.

¹⁴⁶ *Ibid.*, pp. 27-28.

DBCDE submits that it would be concerned if the ACCC's proposal "was seen as a substitute for the regulatory service declaration process set out in Part XIC."¹⁴⁷

Most other interested parties agree with the ACCC's proposal and agree with the ACCC's reasons for the proposed variation.¹⁴⁸

Telstra in addition submits that it is concerned about the lack of clarity regarding NBN Co's Network Termination Device responsibilities, but notes that if this is not addressed in the SAU, the ACCC would be able to intervene (unconstrained by the SAU) if satisfactory commercial resolution cannot be reached with NBN Co.¹⁴⁹

ACCC response

Having considered the views of submissions, the ACCC proposes to adopt NBN Co's variation to include a commitment acknowledging that the ACCC may declare services (as opposed to the variations that the ACCC proposed in the Consultation Paper).

This variation would clarify that the services that NBN Co will supply under the SAU (specifically, through the products specified in the SAU or developed in accordance with the processes set out in the SAU) are not the *only* services that NBN Co will supply to fulfil its SAOs under section 152AXB. That is, as contemplated by Part XIC, if the ACCC declares a service that is to any extent covered by the service descriptions in the SAU, NBN Co will be subject to the SAOs in respect of the service and will be obligated to supply the service on request.

The ACCC notes NBN Co's argument that since the obligation to supply ACCC-declared services is already captured by the SAOs, such an obligation should not be replicated in the SAU.¹⁵⁰ Consequently, the ACCC proposes to change its drafting from a direct commitment to supply such services under the SAU to an acknowledgement that the SAU does not affect NBN Co's obligations under the SAOs (including the obligation to supply) in respect of ACCC-declared services.

The ACCC also notes that NBN Co agrees to include amendments acknowledging that the ACCC may make regulatory determinations setting terms and conditions in respect of ACCC-declared services; but submits that the SAU should not require NBN Co to supply all future declared services on terms and conditions specified by the ACCC because this is potentially contrary to subsection 152AY(2).¹⁵¹ (That is, the legislative hierarchy in Part XIC specifies that terms and conditions of access in Access Agreements and Special Access Undertakings will take precedence over those made by the ACCC under its regulatory powers.) NBN Co submits that the drafting proposed by the ACCC in the Consultation Paper might have required NBN Co to supply on the terms and conditions specified by the ACCC *even if* inconsistent with the SAU.¹⁵²

The ACCC agrees with NBN Co's submission and proposes to clarify its previously proposed drafting so that terms and conditions in any regulatory determinations in relation to an ACCC-declared service will apply only to the extent that they are not inconsistent with the SAU.¹⁵³

The ACCC also proposes to include drafting which clarifies that regulatory determinations are not rendered inconsistent with the SAU where they require a product to be supplied that is not required to be supplied under the SAU.

¹⁴⁷ Department of Broadband, Communications and the Digital Economy, *ACCC's Draft Decision on NBN Co Limited's Special Access Undertaking*, 6 May 2013, p. 3. (DBCDE Submission)

¹⁴⁸ AAPT Submission, p. 6; iiNet Submission, pp. 12-13; Macquarie Telecom Submission, p. 6; Optus Submission, p. 14; Telstra Submission, pp. 16-17; VHA Submission, p. 7.

¹⁴⁹ Telstra Submission, p. 17.

¹⁵⁰ NBN Co Submission, pp. 25-27.

¹⁵¹ *Ibid.*, pp. 25-28.

¹⁵² *Ibid.*, pp. 27-28.

¹⁵³ Inconsistency with Access Agreements will not be problematic because they automatically override the provision in the SAU.

Consequential amendments to clauses in the SAU that refer to the fulfilment of obligations under the SAU and the SAOs will subsequently also be required, because these references might otherwise be inconsistent with the variations discussed above.

Therefore, in the draft Notice to Vary, the ACCC has included the following variations:

- an acknowledgement that the ACCC may declare services;
- an acknowledgement that the SAU does not affect NBN Co's obligations under the SAOs in respect of ACCC-declared services;
- an acknowledgement that regulatory determinations are not rendered inconsistent with the SAU to the extent that they relate to a service that falls within the SAU service descriptions but is not an Offer that NBN Co is required to supply under this Special Access Undertaking; and
- the amendment of clauses referring to the fulfilment of obligations under the SAU and SAOs that might otherwise be inconsistent with the above.

The ACCC notes Telstra's concern about Network Termination Device responsibilities and agrees with Telstra that this may be addressed via other processes, where appropriate, if the SAU remains silent on this matter.

2.2.2. Compliance and consistency with the SAOs

2.2.2.1. Offers to supply

The SAU states that NBN Co will fulfil its commitments under the SAU and the Category B SAOs by making "offers to supply" the NBN Access Service, Ancillary Services, and the Facilities Access Service.¹⁵⁴ In the Consultation Paper, the ACCC proposed that all references to "offer to supply" services in the SAU be replaced with a commitment to "supply" services.¹⁵⁵ The effect of varying the SAU in this way is outlined in section 2.2.2 of the Consultation Paper.

Submissions note the following views in relation to these variations:

- NBN Co does not object to the ACCC's proposal, provided that its preference for how the second option for regulatory recourse is implemented is adopted (discussed further in section 2.1.1.2 above).¹⁵⁶ NBN Co submits that:
 - the "offer to supply" language was intended to reflect that access seekers would acquire the services covered by the SAU by entering into an SFAA-based Access Agreement; and
 - when the obligation to "offer to supply" is viewed in the context of the SAU-SFAA alignment commitments in the SAU, "the combined effect of these provisions was that the SFAA would provide the primary mechanism through which NBN Co's commitments in the SAU were to be implemented."¹⁵⁷

¹⁵⁴ NBN Co, *Special Access Undertaking*, 18 December 2012, NBN Access Service: clause 1A.1.2; Ancillary Services: clause 1A.4.1; Facilities Access Service: clause 1A.6.

¹⁵⁵ ACCC Consultation Paper, p. 21.

¹⁵⁶ NBN Co Submission, p. 31.

¹⁵⁷ *Ibid.*

- Several interested parties agree with the ACCC's proposal and agree with the ACCC's reasons for the proposed variation.¹⁵⁸

The ACCC considers that all references in the SAU to "offer to supply" should be substituted with "supply", irrespective of the ACCC's views on which option is implemented for regulatory recourse. As noted in the Draft Decision, the ACCC must not accept an SAU unless the terms and conditions contained in the SAU are consistent with the SAOs under section 152AXB of the CCA.¹⁵⁹ This obligation requires, amongst other things, that NBN Co supply services on request.¹⁶⁰ A commitment to "offer to supply" falls short of a direct commitment enforceable under the SAU that NBN Co supply on request the services that are declared by acceptance of the SAU. It may be satisfied by, for example, making an offer in an SFAA. The ACCC's proposed amendments would mean that NBN Co is committing to supply services on request, consistent with the SAOs, rather than only offering to supply the service.

The ACCC notes that in some parts of the SAU, the simple removal of the words "offer to" might have placed an obligation to supply services in circumstances where NBN Co would not have an obligation to supply under Part XIC. For example, as NBN Co notes in relation to ACCC-declared services, "the SAOs are drafted and operate in a particular way and there are exceptions which may apply".¹⁶¹ The ACCC has therefore proposed slightly different drafting in some cases to avoid imposing a blanket obligation to supply services.

Therefore, in summary, in the draft Notice to Vary the ACCC is proposing that all references to "offer to supply" be replaced with "supply", or drafting that refers to the implementation of obligations through the supply of services.

2.2.2.2. Conditions prior to supply

As noted in the Draft Decision, some parts of the SAU appear to purport to require an access seeker to have entered into, or be subject to, an Access Agreement with NBN Co in order to obtain supply of declared services in accordance with regulated terms in the SAU.¹⁶²

First, clause 1A.3.1 of Schedule 1A of the SAU specifies conditions that must be met before NBN Co will supply product components. Clause 1A.3.1(iii) states that one of these conditions is that the access seeker has satisfied "any other terms and conditions specified in an Access Agreement to be able to acquire the Product Component".

Second, in some instances, the SAU makes references to "Customers" (as opposed to "Access Seekers").¹⁶³

The ACCC proposed in the Consultation Paper that:

- clause 1A.3.1(iii) should be deleted; and
- all references to "Customer" be substituted with references to "Access Seeker" (and that consequential amendments also be made).¹⁶⁴

The effect of these variations is outlined in section 2.2.2 of the Consultation Paper.

¹⁵⁸ AAPT Submission, p. 6; iiNet Submission, p. 13; Macquarie Telecom Submission, pp. 6-7; Optus Submission, p. 14; VHA Submission, p. 7.

¹⁵⁹ ACCC Draft Decision, p. 72.

¹⁶⁰ CCA, s. 152AXB(2).

¹⁶¹ NBN Co Submission, p. 26.

¹⁶² ACCC Draft Decision, p. 72.

¹⁶³ Examples of this include definitions in Attachment C to the Main Body of the SAU, various clauses in Schedule 1A, clause 1E.9.1 (b)(i) of Schedule 1E, and clause 1I.3.1 of Schedule 1I. This issue does not apply to the drafting of terms and conditions in Annexures 1, 2 and 3 to Schedule 1H and Annexure 1 to Schedule 1J, which would only have effect under an Access Agreement.

¹⁶⁴ ACCC Consultation Paper, p. 21.

Submissions noted the following views in relation to these variations:

- In relation to the deletion of clause 1A.3.1(iii), NBN Co submits that “the ACCC’s proposed approach is aligned with NBN Co’s proposed changes to the regulatory recourse mechanism”, that is, for the link between the SAU and SFAAs to be removed from the SAU.¹⁶⁵ NBN Co therefore agrees to this amendment.
- In relation to the substitution of “Customer” with “Access Seeker”, NBN Co agrees to the amendment but submits that the use of “Customer” should be retained “in some limited instances to address the fact that some SAU commitments are intended to apply to Customers only”.¹⁶⁶ As an example, NBN Co refers to the right to raise disputes in relation to prudence in its submission.¹⁶⁷
- Some interested parties support the ACCC’s proposed variations.¹⁶⁸

Other submissions did not provide views about the variations.

As discussed in the Consultation Paper, the objective of these variations is to remove any requirement for access seekers to enter into an Access Agreement with NBN Co in order to obtain the benefit of commitments in the SAU.¹⁶⁹ In particular, the ACCC is seeking to ensure that access seekers are also able to obtain access to the NBN Access Service and Ancillary Services through the normal operation of Part XIC of the CCA.

The ACCC notes the submission by NBN Co that there should be SAU commitments that only apply to customers who have signed Access Agreements. In particular, NBN Co’s submission that “it will only be Customers that are ultimately responsible for paying charges” is necessarily based on an assumption that NBN Co would not supply services to access seekers who have not entered into an Access Agreement.¹⁷⁰ As discussed in the Draft Decision, such a limitation would neither be reasonable nor promote the long-term interests of end-users, because it would mean that NBN Co would not comply with its obligations to provide access to declared services through regulated terms made under Part XIC.¹⁷¹

However, the ACCC does consider that references to “Customers” rather than “Access Seekers” are appropriate in the context of NBN Co’s proposal to confer powers on the ACCC in relation to the appointment and termination of decision makers for dispute management processes (discussed in further detail in section 2.5.1). This exception is acceptable because commitments in relation to the management of disputes arising under Access Agreements will, by their very nature, relate solely to access seekers who have entered into Access Agreements.

The ACCC therefore considers that:

- clause 1A.3.1(iii) should be deleted; and
- all references to “Customer” be substituted with references to “Access Seeker” (and that consequential amendments also be made), except in the proposed new Annexure 1 to Schedule 1H in relation to dispute management.

¹⁶⁵ NBN Co Submission, p. 31.

¹⁶⁶ Ibid, p. 33.

¹⁶⁷ Ibid.

¹⁶⁸ Macquarie Telecom Submission, p. 6; iiNet Submission, p. 13; Optus Submission, p. 14.

¹⁶⁹ ACCC Consultation Paper, p. 21.

¹⁷⁰ NBN Co Submission, p. 33.

¹⁷¹ ACCC Draft Decision, pp. 37-38.

2.2.2.3. Product component bundling

Clause 1A.3.2 of the SAU gives NBN Co the right to make supply of the UNI, AVC, CVC or NNI conditional on the acquisition of one or more of these components. In the Draft Decision, the ACCC's preliminary view was that this clause did not promote the long-term interests of end-users.¹⁷² The ACCC therefore proposed that clause 1A.3.2 be deleted from the SAU in order to preclude NBN Co from bundling products beyond the authorisation provided by section 151DA of the CCA.¹⁷³

Submissions note the following views in relation to these variations:

- NBN Co submits that the requirement to acquire each of the Product Components is not a "bundle" because the Product Components are technically dependent on each other as integral components of a single end-to-end service.¹⁷⁴
- NBN Co further submits that clause 1A.3.2 is reasonably necessary to ensure NBN Co is permitted to engage in conduct that is expressly permitted by the CCA to support uniform national pricing.¹⁷⁵
- DBCDE's submission questioned the need to prevent NBN Co from supplying the four components as a bundle.¹⁷⁶
- Submissions from some interested parties support the proposed variation.¹⁷⁷

Other submissions did not provide views on this variation.

Having taken into account the views expressed in submissions, the ACCC is now proposing that:

- clause 1A.3.2(a) should be retained, but varied to permit NBN Co to require purchase of a UNI, a CVC and an NNI in conjunction with the purchase of an AVC, provided that NBN Co must not require purchase of a CVC or an NNI if the purchasing access seeker already has an existing CVC or NNI appropriate for use with the relevant AVC; and
- clause 1A.3.2(b), which states that nothing in Schedule 1A prevents NBN Co from bundling Product Components, should be deleted.

The effect of the first amendment would be to provide NBN Co with the ability to require the purchase of the four Product Components, as technically necessary for supply of the NBN Access Service. Unlike the original clause, the amended clause would not expressly allow NBN Co to be able to force the purchase of *multiple* components (for example, in order to increase take-up or revenues).

The ACCC accepts NBN Co's argument that it should be permitted to require the purchase of a bundle where this is necessary from a technical perspective for supply of the NBN Access Service. An AVC and UNI are required for every service supplied to particular premises, and one CVC and NNI are required in the relevant CSA and POI related to the premises. The initially proposed deletion of clause 1A.3.2 was not intended to prevent NBN Co from requiring access seekers to purchase all four Product Components technically necessary for supply of the NBN Access Service. Rather, its deletion was proposed because the ACCC considered that the drafting of clause 1A.3.2, which refers to "one or more" Product Components, might

¹⁷² Ibid, pp. 72-73.

¹⁷³ ACCC Consultation Paper, p. 21.

¹⁷⁴ NBN Co Submission, p. 36.

¹⁷⁵ Ibid.

¹⁷⁶ DBCDE Submission, p. 3.

¹⁷⁷ iiNet Submission, p. 7; Macquarie Telecom Submission, pp. 6-7; Optus Submission, p. 14; Telstra Submission, pp. 17-18.

allow NBN Co to require access seekers to purchase extra Product Components that are not required from a technical perspective for the supply of the NBN Access Service (for example, to acquire a certain number of AVCs per CVC acquired).

The effect of the second amendment is to ensure that the SAU is consistent with the authorisation in subsection 151DA(3) of the CCA, and therefore that the authorisation operates as intended by Parliament. Clause 1A.3.2(b) would otherwise give NBN Co a general right to bundle product components, which is a wider authorisation than that provided by subsection 151DA(3). That is, unlike the statutory authorisation set out in subsection 151DA(3), which is limited to bundling of the four Product Components that is reasonably necessary to achieve uniform national pricing (and only for the purposes of subsection 51(1) of the CCA), clause 1A.3.2 purports to grant NBN Co the right to engage in such conduct without any limitations. This would include the right to do so in a way that would otherwise be prohibited by the CCA because the conduct is anti-competitive and falls outside the authorisation under subsection 151DA(3). Expansion of the right to bundle beyond the limited authorisation would not be in the long-term interests of end-users nor reasonable, because it could in effect authorise anti-competitive conduct which might otherwise be a breach of the CCA.

2.2.2.4. Layer 3 awareness

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

In the Draft Decision, the ACCC considered that while some Layer 3 functionality is required for the supply of voice and multicast services, it is important that NBN Co's service description does not give it discretion to offer a broader range of Layer 3 products than is required.¹⁷⁸ The ACCC considered that the Layer 3 functionality should be limited to that specified in clause 1A.2.6. In the Consultation Paper, the ACCC therefore proposed that the words in clause 1A.2.6 be varied to state:

the AVC may incorporate some limited Layer 3 awareness to the extent required to support the following services¹⁷⁹

The effect of this variation was described as being that the SAU would not give NBN Co the discretion to offer Layer 3 awareness greater than that required in order to support the specified services; the SAU would therefore not allow NBN Co to enter downstream markets for aggregation and wholesale services that operate at Layer 3 of the OSI model.¹⁸⁰

Submissions note the following views in relation to these variations:

- NBN Co acknowledges that Layer 3 services are beyond its current remit and competitive issues would arise if NBN Co entered into this segment of the wholesale market.¹⁸¹ However, NBN Co submits that there are more appropriate mechanisms that could be utilised to address any attempt by NBN Co to become vertically integrated.¹⁸²
- NBN Co also submits that the NBN Access Service is clearly identified as a Layer 2 service, and that Layer 3 awareness in the network "does not necessarily mean that NBN Co is providing Layer 3 wholesale services".¹⁸³

¹⁷⁸ ACCC Draft Decision, p. 74. This is because it could result in access seekers competing with NBN Co in the supply of Layer 3 capability — if this were to occur, NBN Co may have an incentive and the ability to discriminate against access seekers in its supply of Layer 2 services (in favour of supplying to itself), with subsequent implications for competition.

¹⁷⁹ ACCC Consultation Paper, p. 22.

¹⁸⁰ In turn, the SAU would not expressly allow NBN Co to compete on a vertically integrated basis with existing suppliers in those markets.

¹⁸¹ NBN Co Submission, p. 38.

¹⁸² *Ibid.*, p. 39.

¹⁸³ *Ibid.*, p. 38.

- DBCDE's submission questioned the need for this amendment, and noted that the Minister had the power to prohibit supply of services by NBN Co under section 41 of the *NBN Companies Act 2011*.¹⁸⁴
- All interested parties that are access seekers support the proposed variation, which they consider would prevent NBN Co from engaging in the supply of Layer 3 services.¹⁸⁵

Having taken into account the views expressed in submissions, the ACCC is now proposing that the words in clause 1A.2.6 be varied to state that:

- the AVC and CVC may incorporate some limited Layer 3 awareness, including:
 - voice telephony services provided using a UNI-V;
 - multicast services provided over the NBN Co Fibre Network; and
 - the following optional features on the AVC:
 - DSCP for priority encoding;
 - DHCP Option 82 support; and
 - PPOE Intermediate Agent support.
- the Layer 3 awareness must only be to the extent required to support the supply of a Layer 2 service and must not extend to the routing or forwarding of Access Seeker traffic using public Internet Protocol addresses.

In coming to this view, the ACCC accepts NBN Co's argument that limited Layer 3 *awareness* does not constitute a Layer 3 *service*, and that Layer 3 awareness is required for the supply of some Layer 2 services. The effect of the proposed amendment is that the SAU would allow NBN Co to supply Layer 2 services that require Layer 3 awareness.

However, the above clause places constraints on the Layer 3 awareness that NBN Co is permitted to incorporate into the AVC and CVC. Since the permitted Layer 3 awareness is only for the purpose of supporting the supply of a Layer 2 service and does not extend to routing or forwarding of traffic, clause 1A.2.6 does not provide for the NBN Access Service to include the supply of Layer 3 services. In this way, the proposed amendment would clarify that the SAU does not expressly *give* NBN Co the discretion to supply Layer 3 services. The ACCC cannot be satisfied that the SAU providing NBN Co with this discretion would in all cases be reasonable and promote the long-term interests of end-users, given the potential competition concerns, as acknowledged by NBN Co in its submission.

Having said this, the SAU would not explicitly *preclude* NBN Co from supplying Layer 3 services. It is a matter for Government whether it considers that NBN Co should be allowed to or precluded from entering downstream wholesale aggregation markets. As noted by NBN Co and DCBDE, there are mechanisms outside of the SAU that can be used to implement these policy objectives.¹⁸⁶

¹⁸⁴ DBCDE Submission, p. 3.

¹⁸⁵ AAPT Submission, p. 7; iiNet Submission, p. 13; Macquarie Telecom Submission, p. 7; Optus Submission, p. 14; Telstra Submission, p. 17; VHA Submission, p. 7.

¹⁸⁶ DBCDE Submission, p. 3; NBN Co Submission, p. 39.

2.3. Product development, product withdrawal and reference offers

The variations that are proposed in this section relate to the issues discussed in chapter 4 of the Draft Decision and section 2.3 of the Consultation Paper.

2.3.1. Product development and variation

Schedule 1I of Module 1, and Schedule 2E of Module 2, contain provisions relating to development and variation of an NBN Co Product, Product Component, Product Feature, Ancillary Services or type of Facilities Access Service (collectively referred to as 'products' for the remainder of this section). These Schedules require that NBN Co establishes a Product Development Forum (PDF).¹⁸⁷ Module 1 includes the 'PDF Processes' that specify terms and conditions which determine how consultation and decision-making about whether to develop a new product or vary an existing product will occur via the PDF.¹⁸⁸ The PDF Processes will operate for the term of Module 1, but will be reviewed at the mid-point review.¹⁸⁹

2.3.1.1. Term of operation of the PDF Processes

In light of the ACCC's proposed variation that removes the mid-point review provisions from the SAU, section 2.3.1.1 of the Consultation Paper proposed that the PDF Processes should only operate for the first five years of Module 1, rather than the full term of Module 1. The effect of varying the SAU in this way is outlined in section 2.3.1.1 of the Consultation Paper.

NBN Co considers that:

- the PDF Processes should continue to operate for the full term of Module 1, rather than the five years proposed by the ACCC in the Consultation Paper;¹⁹⁰
- its proposed changes to the PDF processes (including the removal of the confidentiality and intellectual property provisions, as discussed further below) mean that they can robustly operate for the full term of Module 1 and that this will promote the long-term interests of end-users;¹⁹¹
- as the network build will continue throughout Module 1 and it is likely that NBN Co will face demand and revenue sufficiency risks throughout that period, the PDF Processes should be maintained throughout Module 1 to provide certainty for customers as to how NBN Co will engage with them in relation to product development;¹⁹²
- the exclusion of the PDF Processes in the SAU after only the first five years of Module 1 is likely to introduce an unnecessary level of uncertainty, for both access seekers and NBN Co, into the product development process at that time;¹⁹³ and
- the certainty created by including the PDF Processes for Module 1 is in the interests of NBN Co and access seekers, and will promote co-investment by access seekers.¹⁹⁴

¹⁸⁷ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1I, clause 1I.3.1; Schedule 2E, clause 2E.4.1.

¹⁸⁸ *Ibid.*, Annexure 1 to Schedule 1I.

¹⁸⁹ *Ibid.*, Schedule 1K, clause 1K.2.

¹⁹⁰ NBN Co Submission, p. 40.

¹⁹¹ *Ibid.*, p. 41.

¹⁹² *Ibid.*

¹⁹³ *Ibid.*

¹⁹⁴ *Ibid.*

Industry submissions generally support reducing the term of the PDF Processes to five years.¹⁹⁵ However, AAPT considers that the long-term interests of end-users would be better promoted if a PDF process was also mandated, but the terms were to be commercially agreed (subject to ACCC intervention where agreement cannot be reached).¹⁹⁶ VHA notes that, while it agrees with the ACCC's proposed variation, it strongly supports the need for a long-term PDF process.¹⁹⁷

The SAU requires NBN Co to establish and operate a PDF for the duration of the SAU.¹⁹⁸ As noted in the draft decision, the ACCC considers that the requirement to conduct a PDF is likely to encourage economically efficient investment in and use of the NBN.¹⁹⁹

However, the ACCC is unable to be satisfied that the proposed PDF Processes will promote the long term interest of end-users for the term of Module 1. This is because the processes are novel — their effectiveness in promoting engagement and information sharing between NBN Co and access seekers is therefore untested. This was recognised by NBN Co in its supporting submission for the 18 December 2012 SAU in which it argued that that, given the bespoke and untested nature of some of these processes in the SAU (including the PDF Processes), it is appropriate to undertake a review of their effectiveness during Module 1.²⁰⁰ In addition, the PDF Processes are described at a level of prescription which would be likely to preclude any future regulatory determinations. Therefore, if they were in operation for ten years and it was established after five years that they were not effective, there would be no scope for regulatory intervention to address any issues that have arisen.

The ACCC considers therefore that there should be the opportunity for such processes to be revisited after five years time in light of operational experience.

In the event that, in five years' time, NBN Co demonstrates that the processes lead to outcomes that promote the long term interests of end-users, the ACCC would be able to accept their continued operation were NBN Co to seek to extend their operation via an SAU variation. Processes that apply to the PDF could also be agreed between NBN Co, Access Seekers and Consumer Advocacy Groups. In the event that agreement could not be reached, the ACCC could make an Access Determination or Binding Rule of Conduct in relation to the PDF Processes.

The ACCC considers that these mechanisms are able to provide the certainty to NBN Co and access seekers that is required in relation to NBN Co's engagement on product development activities.

In light of these views, the ACCC proposes variations that reduce the term for which the PDF Processes will operate to the first five years of Module 1. This proposal requires consequential changes throughout Schedule 1I.

2.3.1.2. Commitments by NBN Co to consult with consumer advocacy groups

Schedule 1I, the PDF Processes and Schedule 2E of the SAU contain a number of commitments about how NBN Co will share information and consult with its customers about the development of new products and the variation of existing products.²⁰¹ As noted in the Draft Decision, the ACCC considers that the effectiveness of these commitments in reducing information asymmetries, and in turn in promoting the long-term interests of end-users, would be enhanced if there was a role for consumer advocacy groups in NBN Co's consultation

¹⁹⁵ AAPT Submission, p. 7; iiNet Submission, p. 7; Optus Submission, p. 15; Telstra Submission, p. 18.

¹⁹⁶ AAPT Submission, p. 7.

¹⁹⁷ VHA Submission, p. 7.

¹⁹⁸ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1I, clause 1I.3.1; Schedule 2E, clause 2E.4.1.

¹⁹⁹ ACCC Draft Decision, p. 82.

²⁰⁰ NBN Co, *Supporting Submission NBN Co Special Access Undertaking*, 28 September 2012, pp. 151-153.

²⁰¹ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1I, clauses 1I.2, 1I.3.2, 1I.3.5 and 1I.3.6; Schedule 2E, clauses 2E.3, 2E.4.1, 2E.4.4 and 2E.4.5.

processes.²⁰² The Consultation Paper therefore proposed that the SAU be varied in such a way that membership and participation in the PDF is extended to include consumer advocacy groups.

Submissions

NBN Co:

- states that it is not clear whether there will be material benefits from extending membership and participation in the PDF to consumer advocacy groups, given the nature of the products NBN Co actually provides and will be developing over time;²⁰³
- notes that its product development will be in relation to Layer 2 Ethernet bitstream services, which will be at least one layer below those ultimately offered to consumers by RSPs, and that it had assumed that RSPs would be representing the needs of their customers in the PDF;²⁰⁴
- nonetheless accepts the ACCC's recommendation that consumer advocacy groups be able to participate in the product development process;
- proposes a conferral of power on the ACCC to approve a consumer advocacy group to be a member of the PDF;²⁰⁵ and
- considers that there should not be a default position that would allow any group or individual to seek access to the PDF (it did not elaborate on the reasons for this view).²⁰⁶

Herbert Geer (iiNet), Macquarie, Telstra and ACCAN support the proposal to extend membership and participation in the PDF to include consumer advocacy groups.²⁰⁷ Telstra proposes that NBN Co establish and maintain a register of consumer advocacy groups that can participate in the PDF.²⁰⁸

While AAPT states that it does not oppose the proposed variation, it notes that there may be certain circumstances where end-user input may not be appropriate or relevant in the context of negotiations between supplier and customer.²⁰⁹ AAPT did not provide examples of these circumstances.

Optus states that it does not see the need for the inclusion of consumer groups in discussions between NBN Co and RSPs in the PDF,²¹⁰ arguing that:

- consumer interests will be well represented by RSPs because RSPs that develop innovative products that consumers demand will gain market share in the retail markets;²¹¹ and
- it is not clear what benefits flow from having a formal role for consumer advocacy groups in wholesale discussions — the PDF is the forum to assess new technical solutions, including the commercial and technical viability of new products, and with

²⁰² ACCC Draft Decision, p. 82.

²⁰³ NBN Co Submission, p. 42

²⁰⁴ Ibid.

²⁰⁵ Ibid.

²⁰⁶ Ibid.

²⁰⁷ Macquarie Telecom Submission, pp. 7-8; Telstra Submission, pp. 26-27; ACCAN, *Consultation paper – variation of NB Co Special Access Undertaking*, 2 May 2013, p. 1 (ACCAN Submission); iiNet Submission, p. 14.

²⁰⁸ Telstra Submission, p. 26.

²⁰⁹ AAPT Submission, p. 7.

²¹⁰ Optus Submission, pp. 15-17.

²¹¹ Ibid, p.16.

increased competition flowing from a structurally separated industry, RSPs ought to be better able to provide solutions that are demanded by consumers.²¹²

Optus notes two potential concerns with the ACCC's proposal:

- it potentially contradicts NBN Co's wholesale-only status and may bring discussion of retail-specific proposals into wholesale discussions — there is a risk that the inclusion of lobby groups within the PDF may lead to operational creep from NBN Co on the basis that a party within the PDF has requested it.²¹³
- it could result in a lessening of competition in the retail market by reducing the potential of retail product differentiation. It argues that this is because in a retail market supplied with the same wholesale products, vigorous retail competition is expected to come from RSPs developing different products using different mixes of product components – consumer lobby groups would necessarily focus on retail products and would then lobby for development of wholesale-products to support them. Optus considers that once such a discussion occurs within the PDF, the opportunity for retail differentiation might be reduced.²¹⁴

VHA considers that the inclusion of consumer advocacy groups may render the PDF unwieldy and ambiguous as consumers are not directly acquiring services from NBN Co.²¹⁵ VHA did not elaborate further on this point. VHA also argues that consumer interests will be addressed by the views of NBN Co's customers.²¹⁶

DBCDE's submission notes the apparent inconsistency of end-user involvement in wholesale commercial negotiation.²¹⁷ It states that retail service providers must necessarily engage with end-users and it would seem more appropriate to encourage effective engagement at this level.²¹⁸

ACCC response

The ACCC considers that the benefit of consumer advocacy groups participating in the PDF is that the needs of consumers and small businesses that purchase telecommunications services, and the issues that impact them, can be communicated to NBN Co and access seekers throughout the process for designing new products. Consumer advocacy groups will also be able to distil key issues and information to their constituents, consult with them on these key issues and provide feedback to the PDF in response. This would reduce information asymmetries between end-users, service providers and NBN Co, which would increase the extent to which access seekers develop NBN-based retail products which end-users want and are willing to pay for, and the extent to which NBN Co develops the access products to support that. This would promote efficient use of, and investment in, the NBN.

More generally the ACCC and the AER are developing and implementing policies to ensure that regulation meets the needs of end-users through collaboration between end-user representatives, service providers and the ACCC/AER, as well as policies to improve communications between these parties. Indeed, the National Electricity Rules require service providers to engage with consumer representatives and to demonstrate to the AER the extent to which it has done so in its regulatory proposals.²¹⁹ These requirements were introduced by

²¹² Ibid.

²¹³ Ibid.

²¹⁴ Ibid, pp. 15-17.

²¹⁵ VHA Submission, p. 7.

²¹⁶ Ibid.

²¹⁷ DBCDE Submission, p. 3.

²¹⁸ Ibid.

²¹⁹ *National Electricity Rules*, Chapter 6, Clause 6.8.2(c1); Chapter 6A, clause 6A.10.1(g).

the Australian Energy Market Commission to address concerns that there is a lack of opportunity for meaningful customer engagement in regulatory processes.²²⁰

In contrast to the views put in some submissions, the ACCC does not consider that involving consumer advocacy groups in product development discussions in the PDF contradicts NBN Co's wholesale-only status. NBN Co is limited to *supplying* services to downstream carriers, service providers and utilities on a wholesale-only basis.²²¹ This does not prevent NBN Co from consulting with and providing information to groups that represent the interests of consumers about the products that it supplies to retail service providers. Indeed, NBN Co's website provides a range of information targeted at consumers and small businesses.²²²

The ACCC also does not consider that the interests of access seekers and end-users will in all circumstances necessarily be aligned. The Australian Consumer Law (ACL), for example, applies to all companies in the Australian economy, including those in competitive markets. The law includes protections for consumers against such as things as unfair contract terms, false or misleading representations and other unfair business practices.²²³ In developing the ACL, the Ministerial Council on Consumer Affairs considered that the operational objectives for Australian consumer policy are "to improve consumer wellbeing through consumer empowerment and protection, fostering effective competition and enabling the confident participation of consumers in markets in which both consumers and suppliers trade fairly."²²⁴ This demonstrates an acceptance from legislators that consumer interests will not always be perfectly aligned with the businesses they trade with, even in competitive markets.

Further, the ACCC considers that it is difficult to see how involving consumer advocacy groups in product development discussions would lead to a lessening of competition in retail markets. While the ACCC recognises that product differentiation is one factor that will lead to increased competition in retail markets, it does not consider that consumer advocacy groups lobbying for particular retail products (which require a wholesale product from NBN Co), will necessarily lead to a reduction in product differentiation in retail markets. This is primarily because the development of a particular wholesale product does not prevent NBN Co from development other wholesale products to support other retail products. Furthermore, it is likely that a particular wholesale product (for example, a Product Feature) will support a variety of retail products, thereby not discouraging product differentiation.

Regarding Optus' argument that there is a risk that the inclusion of "lobby groups" within the PDF could lead to operational creep from NBN Co on the basis that the group has requested a particular product, it is not clear to the ACCC why this risk is any greater for consumer groups than it is for any other party to the PDF. For example, access seekers could similarly request that NBN Co provide a product that offers interconnection on a consolidated Point of Interconnection basis, or a product which provides transmission to mobile base stations.

It is also not clear to the ACCC why involving consumer advocacy groups in product development discussions may render the PDF process unwieldy and ambiguous.

Lastly, the ACCC considers that limiting end-user representation to a single representative group might mean that the views of a diverse range of consumers (including small businesses) are not represented. The ACCC does not necessarily consider that membership should be open to any individual or group, or that participation should be unconstrained. However, the ACCC considers that the requirements set out by NBN Co in the SAU to join the PDF (for

²²⁰ Australian Energy Market Commission, *Rule Determination National Electricity Amendment (Economic Regulation of Network Service Providers) Rule 2012 and National Gas Amendment (Price and Revenue Regulation of Gas Services) Rule 2012*, 29 November 2012, pp. 32 and 148-167.

²²¹ *National Broadband Network Companies Act 2011*, Division 2, s. 9.

²²² See <http://www.nbnco.com.au/nbn-for-business.html> and <http://www.nbnco.com.au/nbn-for-home.html>; accessed on 25 June 2013.

²²³ CCA, Schedule 2, Chapters 2, 3 and 4.

²²⁴ Joint Communiqué, *Ministerial Council on Consumer Affairs Meeting*, 23 May 2008, p. 3; available at http://www.consumerlaw.gov.au/content/mcca/mcca_meetings/downloads/Meeting_19_23_May_08.pdf; accessed on 25 June 2013.

example, that interested parties register an authorised representative with NBN Co and must contain up-to-date contact information, and agree to the terms and conditions which are set out in the PDF Processes) would ensure that NBN Co is aware of which consumer groups are members of the PDF. The PDF Processes themselves would then determine the circumstances in which NBN Co would be required to consult with these groups and consider their feedback (for example, the consultation plan contained within an Idea Development Plan, and other workshops and forums initiated at NBN Co's discretion).

In light of these views, the ACCC proposes the following variations to the SAU:

- amendment of each reference to the word “Customer” or “Access Seeker” in Schedule 1I and 2E to also refer to Consumer Advocacy Groups; and
- definition of the term ‘Consumer Advocacy Group’ — “Consumer Advocacy Group means a body or association that represents the interests of consumers”.

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

The PDF Processes include clauses which establish rights for and obligations on NBN Co and its customers about the treatment of confidential information and intellectual property associated with new product ideas.²²⁵ As noted in the Draft Decision, the ACCC considers that these particular confidentiality and intellectual property terms and conditions may discourage customers from participating in the Product Development Forum.²²⁶

To address this issue, the Consultation Paper proposed the following variations to the SAU:

- removal of clause 5 of the PDF Processes (confidential information); and
- removal of clause 6 of the PDF Processes (intellectual property).

The effect of varying the SAU in this way is outlined in section 2.3.1.3 of the Consultation Paper.

Submissions

NBN Co agrees to remove the confidentiality and intellectual property provisions from the PDF Provisions.²²⁷ However, it considers that the SAU will still need to include a requirement that participation in the PDF will be conditional on access seekers and consumer advocacy groups having entered into appropriate confidentiality and intellectual property arrangements with NBN Co.²²⁸

Telstra and Optus support the ACCC's proposed variation.²²⁹

AAPT and VHA agree with the proposed variation in principle; however, AAPT considers that pre-determined terms and conditions on confidentiality and intellectual property will facilitate participation in the PDF,²³⁰ and VHA submits that the ACCC should determine the relevant processes in an Access Determination or Binding Rule of Conduct as soon as practicable.²³¹

²²⁵ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1I, clause 1E.3.2(a) and (b); Schedule 2E, clause 2E.4.2(a) and (b); Schedule 1I, Annexure 1, clause 2(a) to (d), 5 and 6.

²²⁶ ACCC Draft Decision, pp. 82-83.

²²⁷ NBN Co Submission, p. 43.

²²⁸ *Ibid.*, p. 44.

²²⁹ Telstra Submission, p. 18; Optus Submission, p. 17.

²³⁰ AAPT Submission, p. 7.

²³¹ VHA Submission, p. 7.

Macquarie argues that requiring the terms and conditions on confidentiality and intellectual property to be commercially negotiated could be a stumbling block for all but a few of the largest access seekers.²³²

Herbert Geer considers that the SAU should contain high-level commitments which would require NBN Co to enter into meaningful negotiations about confidentiality and intellectual property.²³³

ACCC response

In the absence of terms and conditions about confidentiality and intellectual property in the SAU, the ACCC considers that there is merit in including a requirement that access seekers and consumer advocacy groups enter into appropriate confidentiality and intellectual property arrangements. This would provide NBN Co and access seekers with certainty that their confidential information and intellectual property rights will be protected in some way, which would encourage participation in the PDF by these parties, thereby encouraging efficient investment in and use of the NBN, for the reasons outlined in the draft decision.

Because the SAU, as varied, would be silent on the terms and conditions about confidentiality and intellectual property themselves, these terms would, in the first instance, be commercially negotiated between NBN Co and interested parties (both access seekers and consumer advocacy groups). The ACCC recognises that, to the extent that agreement cannot be reached, this could impose a barrier to participation in the PDF.

As noted in the consultation paper however, the removal of confidentiality and intellectual property terms from the SAU would mean that, in the event of disagreement between parties, the terms could be the subject of later ACCC regulatory determinations. In the context of Part XIC, the ACCC would be able to specify terms and conditions about confidentiality and intellectual property in an Access Determination or Binding Rule of Conduct.²³⁴ This is because an Access Determination can specify terms and conditions relating to access, as well as impose requirements on NBN Co or deal with any other matter relating to access.²³⁵

However, an issue that could arise with this approach is that access to services under the Category B Standard Access Obligation (which NBN Co will comply with on the terms and conditions in an Access Determination or Binding Rule of Conduct) can only be requested from NBN Co by a service provider.²³⁶ The definition of service provider is provided under the *Telecommunications Act 1997* to be a 'carriage service provider' or a 'content service provider'.²³⁷ In most cases, it is unlikely that a consumer advocacy group would meet these definitions.²³⁸ In light of this, the ACCC considers that there is some uncertainty as to whether a consumer advocacy group could request or enforce compliance with the terms and conditions in an Access Determination.

The ACCC therefore proposes the following variations:

- removal of clause 5 of the PDF Processes (confidential information);
- removal of clause 6 of the PDF Processes (intellectual property);

²³² Macquarie Telecom Submission, p. 8.

²³³ iiNet Submission, pp. 14-15.

²³⁴ CCA, s. 152BC(3).

²³⁵ CCA, s. 152BCC(3).

²³⁶ CCA, s. 152AXB(2).

²³⁷ *Telecommunications Act 1997*, s. 86.

²³⁸ For example, a 'carriage service provider' is defined as person that supplies, or proposes to supply, a listed carriage service to the public using a network unit owned by one or more carriers, or a network unit in relation to which a nominated carrier declaration is in force. See *Telecommunications Act 1997*, section 87.

- addition of a clause in Module 1 and Module 2 that allows NBN Co to require access seekers and consumer advocacy groups to enter into confidentiality and intellectual property rights agreements prior to participating in the PDF; and
- addition of a power conferred on the ACCC in Module 1 and Module 2 to determine the terms and conditions of these confidentiality and intellectual property rights agreements, in the event of disagreement between the parties.

In the context of this proposed conferral of power, the ACCC does not propose to adopt Herbert Geer's suggestion that the SAU should contain high-level commitments which would require NBN Co to enter into meaningful negotiations about confidentiality and intellectual property terms. The prospect of regulatory intervention via the conferred power should enhance the incentives to engage in meaningful negotiations.

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

Schedule 1I, Schedule 2E and the PDF Processes (which are only in Module 1) of the SAU include provisions which establish that NBN Co does not have to consult with customers on the development or variation of products in particular circumstances.²³⁹ As noted in section 4.1.1.2 of the Draft Decision, the ACCC considers that these provisions reduce the extent to which the product development commitments promote competition and encourage the economically efficient use of and investment in infrastructure.²⁴⁰

To address these issues, the Consultation Paper proposed the following variations to the SAU:

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

The effect of varying the SAU in this way is outlined in section 2.3.1.4 of the Consultation Paper.

NBN Co submits the following views on these proposed variations — it argues that:

- initial products that have been developed with customers through a consultative and collaborative process, and that NBN Co is now building and testing, should be excluded from the product development provisions, because it would be inefficient and costly (e.g. for changes to IT systems) to further consult on and re-design these products.²⁴¹ It submitted a proposed list of Initial Products that it considers should be exempt.²⁴²
- the removal of the minor product variations exemption could mean that the making of positive, customer-enhancing minor enhancements could be delayed, which would not be in the long-term interests of end-users.²⁴³ NBN Co does not elaborate on what 'customer-enhancing minor enhancements' are. It also submits that the draft decision

²³⁹ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1I, clauses 1I.1.2 and 1I.1.3; Schedule 1A, clauses 1A.4.1 and 1A.6(e); Schedule 1E, clause 1D.1.2(a); Schedule 2E, clauses 2E.1.2 and 2E.1.3; Schedule 1I, Annexure 1, clause 4.

²⁴⁰ ACCC Draft Decision, pp. 84-85.

²⁴¹ NBN Co Submission, pp. 44-48.

²⁴² *Ibid.*, pp. 48-49.

²⁴³ *Ibid.*, p. 51.

does not examine the actual drafting of the definition of minor product variations in the SAU.²⁴⁴

- the exemption for the introduction of products imposed by a licence condition should remain, but with a modification to make it clear that the exemption only applies to those elements of the new product or feature that are not already specified by the licence condition.²⁴⁵
- in support of the ACCC's proposed variations to make it clear that ancillary services and NBN Co-initiated product ideas are subject to the product development and variation provisions.²⁴⁶

A number of other submissions supported the ACCC's variations proposed in the consultation paper.²⁴⁷

Having considered NBN Co's arguments about the ACCC's proposed variations to the minor product variations exemptions, the ACCC is satisfied that the provisions will only apply to minor variations that update or improve the functionality or performance of a product and have no material impact on customers. These minor product variations are unlikely to be detrimental to the objective of promoting the long-term interests of end-users. However, the clause allows NBN Co to make minor product variations if, acting reasonably, it determines they will have no material impact on customers. The ACCC considers that the decision as to whether the minor variation will have no material impact on customers should not be determined solely by NBN Co, even in circumstances where it considers it is acting reasonably. This is because it may not give confidence to affected parties that the decision has been made in an impartial manner.

The ACCC is also satisfied that excluding from the product development processes those product attributes that NBN Co is required to supply under its licence condition is unlikely to be detrimental to the objective of promoting the long-term interests of end-users. The ACCC therefore proposes to adopt NBN Co's suggested drafting for these provisions.

Finally, having considered NBN Co's arguments about excluding Initial Products from the product development processes, the ACCC considers that subjecting products to further consultation and potential re-design that have already been through extensive consultation, and for which NBN Co is in the process of (or has completed) building and testing, may indeed be inefficiently costly. In some circumstances this may not encourage efficient investment by NBN Co or have appropriate regard to its legitimate business interests. The ACCC also considers that it may delay the commercial supply of products that would otherwise promote the long-term interests of end-users.

In light of these views, the ACCC proposes the following variations to the SAU:

- amendments to the provisions which exclude minor product variations to remove the words "acting reasonably, NBN Co determines";
- amendments of the provisions that exclude products that NBN Co is obliged to offer as a result of a licence condition — the SAU will now exclude only those product attributes that are specified in the licence condition;
- amendments to make it clear that the product development and variation provisions apply to all Ancillary Services, types of Facilities Access Services and NBN Co-initiated product ideas; and

²⁴⁴ Ibid, p. 50.

²⁴⁵ Ibid, p. 51.

²⁴⁶ Ibid, pp. 52-53.

²⁴⁷ AAPT Submission, p. 7; Telstra Submission, p. 18; iiNet Submission, p. 16; Optus Submission, p. 17; Macquarie Telecom Submission, p. 18; VHA Submission, p. 7.

- amendments to the provisions that exclude products covered by, or contemplated within, the Initial Product Roadmap — the SAU will now exclude ‘Initial Products’ that are specified in the SAU (these products are specified in Attachment B to this document).

The proposed list of initial products that are exempt from Schedule 1I and 2E (as specified in Attachment B) are intended to reflect those Products, Product Components and Product Features that have already been through a significant level of customer engagement and which are under development by NBN Co. In deciding which products should be included on this list, the ACCC has selected products that are specified in NBN Co’s existing product documents (or other documents that set out the terms and conditions of supply). This includes the 18 December 2012 SAU, the current WBA, the December 2011 Product and Pricing Overview document,²⁴⁸ and the Business and Enterprise Fibre Access Services Consultation paper from December 2011.²⁴⁹ Products that are not specified in these documents are not proposed to be exempt from Schedule 1I and 2E and are not included in Attachment B.

The ACCC is seeking further views on whether the products listed are appropriate to exclude from the product development and variation provisions in Schedule 1I and 2E.

2.3.1.5. Additional variations proposed by Telstra

Telstra’s submission to the Consultation Paper proposes the following variations to Schedule 1I, 2E and the PDF Processes in addition to those proposed by the ACCC:

- The Product Ideas register must contain additional information and updates about the status of product ideas under consideration and development.²⁵⁰
- NBN Co should be required to consult with the PDF on its initial assessment on whether to development a product idea (in particular when NBN Co decided not to proceed with developing a product idea).²⁵¹
- A ‘Product Construct Paper’ should contain proposed price-related terms.²⁵²
- The consultation process proposed in an ‘Idea Development Plan’ should be subject to over-riding principles.²⁵³
- Each product idea must satisfy a ‘PASS’ test before it is introduced as a commercial proposition.²⁵⁴
- NBN Co must publish and maintain an Integrated Roadmap that outlines how IT support and operational support are being developed for new products under development.²⁵⁵

The ACCC considers that the proposed variations relating to additions to the product ideas register, the Integrated Roadmap and the PASS test appear to have the potential to increase the extent to which the product development and variation provisions reduce information asymmetries between NBN Co, access seekers and end-users in the development and variation of products. In addition, the requirement to consult on NBN Co’s initial assessment of proposed products, the inclusion of price-related terms in a Product Construct Paper and the

²⁴⁸ NBN Co, *NBN Co Wholesale Access Service — Products and Pricing Overview for Service Providers*, December 2011, Appendix A to D.

²⁴⁹ NBN Co, *NBN Co Consultation Paper — Proposed Business and Enterprise Fibre Access Services*, 23 December 2011, pp. 10-48.

²⁵⁰ Telstra Submission, pp. 19-20.

²⁵¹ Ibid.

²⁵² Ibid, p. 20.

²⁵³ Ibid, pp. 20-21.

²⁵⁴ Ibid, pp. 21-22.

²⁵⁵ Ibid, pp. 22-23.

inclusion of over-riding principles for the consultation process in an Idea Development Plan may facilitate a higher and/or more effective degree of consultation between NBN Co and participants in the PDF.

The ACCC is however seeking further submissions on Telstra's proposed variations, to facilitate its consideration of whether variations to implement its proposals should be included in the final notice to vary.

2.3.2. Product withdrawal and reference offers

According to the 18 December 2012 SAU, Products, Product Components, Product Features, Ancillary Services or types of Facilities Access Service may be either 'Reference Offers' or 'Non-Reference Offers'.²⁵⁶ (In addition, NBN Co may apply a range of 'other charges' to the supply of Reference Offers and Non-Reference Offers.)²⁵⁷

A key difference between Reference Offers and Non-Reference Offers is that the Products, Product Components, Product Features, Ancillary Services or types of Facilities Access Service that compose the Reference Offers cannot be withdrawn.²⁵⁸ On the other hand, NBN Co may withdraw Non-Reference Offers in accordance with Schedule 1I and Schedule 2E of the SAU.²⁵⁹

Schedule 1I and Schedule 2E set out that NBN Co may withdraw Products, Product Components, Product Features, Ancillary Services or types of Facilities Access Service and will:

- provide no less than 24 months written notice to customers of its intention to withdraw a Product, Product Component, Ancillary Service or type of Facilities Access Service and not less than 12 months written notice for a product feature — as well as notice of any arrangements to migrate customers to alternate services;²⁶⁰
- when considering whether to withdraw a Product, Product Component, Product Feature, Ancillary Service or types of Facilities Access Service, have regard to a number of factors such as the level of existing demand, the cost of maintaining and supplying the service and the feasibility, commercial viability and price of alternatives;²⁶¹
- discuss and consider in good faith any feedback received from its customers, and access seekers in some circumstances,²⁶² in relation to the withdrawal;²⁶³ and
- provide written notice of the transitional arrangements that NBN Co may put in place (if any) to migrate its customers from the relevant Product, Product Component, Product Features, Ancillary Services or type of Facilities Access Service to an alternative Product, Product Component, Product Features, Ancillary Services or type of Facilities Access Service.²⁶⁴

NBN Co may withdraw 'other charges' in any circumstance.²⁶⁵

²⁵⁶ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1C, clause 1C.2; Schedule 1D, clause 1D.2.

²⁵⁷ Ibid, Schedule 1C, clause 1C.1.3(a); Schedule 1D, clause 1D.1.3(a).

²⁵⁸ Ibid, Schedule 1C, clause 1C.1.

²⁵⁹ Ibid, Schedule 1I, clause 1I.5; Schedule 2E, clause 2E.6.

²⁶⁰ Ibid, Schedule 1I, clause 1I.5.2; Schedule 2E, clause 2E.6.3.

²⁶¹ Ibid, Schedule 1I, clause 1I.5.2(b); Schedule 2E, clause 2E.6.3(b).

²⁶² Ibid, Schedule 1I, clause 1I.3.1(b); Schedule 2E, clause 2E.4.1(b).

²⁶³ Ibid, Schedule 1I, clause 1I.5.2(c); Schedule 2E, clause 2E.6.3(c).

²⁶⁴ Ibid, Schedule 1I, 1I.5.2(a); Schedule 2E, clause 2E.6.3(a).

²⁶⁵ Ibid, Schedule 1C, clause 1C.1.3(b); Schedule 1D, clause 1D.1.3(b). Note that clause 2E.6 (Withdrawal) does not refer to the withdrawal of 'other charges'.

During Module 1, the composition of the Reference Offers cannot be changed.²⁶⁶

However, during Module 2, NBN Co will (as part of each replacement module application) “propose to include Reference Offers, and the composition of each Reference Offer in accordance with a set of criteria, within that Replacement Module.”²⁶⁷ The criteria that the composition of each Reference Offer must be proposed in accordance with include (for example):

- “The Basic Access Offer (BAO) in respect of each NBN Co Network will comprise a UNI and an AVC...with the lowest data transfer rate which is likely to be acquired over the regulatory cycle by a material number of end-users...”²⁶⁸
- “The Enhanced Access Offer (EAO) in respect of the NBN Co Fibre Network will comprise a UNI and an AVC...with the data transfer rate which is likely to be most frequently acquired over the regulatory cycle...”²⁶⁹
- “The Connectivity Virtual Circuit Offer...will comprise all Data Transfer Rates on CVC traffic classes TC-1 and TC-4 that are reasonably necessary for an Access Seeker to acquire and use the Access Reference Offers...”²⁷⁰

The ACCC would then assess the proposed new Reference Offers as part of its assessment of the replacement module²⁷¹ — this assessment would be undertaken as an SAU variation assessment in accordance with section 152CBG of the CCA.²⁷² The terms and conditions about the submitting of Reference Offer proposals, and the criteria/relevant considerations for determining the composition of Reference Offers, are fixed principles terms and conditions.²⁷³ This means that the ACCC could not reject a replacement module ‘for a reason concerning’ the terms and conditions about the submitting of Reference Offer proposals, and the criteria/relevant considerations for determining the composition of Reference Offers.²⁷⁴

If the ACCC accepted the SAU variation, the composition of the Reference Offers would change in accordance with NBN Co’s proposal. The SAU includes clauses which govern what would ‘replace’ the non-accepted Reference Offers (as well as other non-accepted replacement module terms) in the event that the ACCC did not accept NBN Co’s proposed changes to the Reference Offers.²⁷⁵

Once the composition of a Reference Offer changes, the Product Components and Product Features, and the components of the Ancillary Services and the the Facilities Access Service which are no longer Reference Offers become Non-Reference Offers.²⁷⁶ They may then be withdrawn in accordance with Schedule 2E.

In the Draft Decision, the ACCC considered that the SAU providing NBN Co with discretion to withdraw Non-Reference Offers would not in all circumstances promote the long term interests of end-users and be reasonable.²⁷⁷ The Consultation Paper proposed that the SAU be varied to include:

²⁶⁶ Ibid, Schedule 1C, clause 1C.2.1(a).

²⁶⁷ Ibid, Main Body, clauses 4.6(b)(ii) and 4.7. NBN Co is not required to specify Non-Reference Offers as part of a Replacement Module Application, but the Product Components and Product Features, the components of the Ancillary Services and the components of the Facilities Access Service which were Non-Reference Offers at the end of the previous regulatory cycle will continue to be Non-Reference Offers for the subsequent regulatory cycle (unless they become Reference Offers), see Schedule 2B, clause 2B.1.2 of the 18 December 2012 SAU.

²⁶⁸ Ibid, Schedule 2B, clause 2B.2.1.

²⁶⁹ Ibid, Schedule 2B, clause 2B.2.2.

²⁷⁰ Ibid, Schedule 2B, clause 2B.2.4.

²⁷¹ Ibid, Main Body, clause 4.7.

²⁷² Ibid, Main Body, clause 4.5.

²⁷³ Ibid, Main Body, clause 5.3.

²⁷⁴ CCA, s. 152CBAA(6).

²⁷⁵ NBN Co, *Special Access Undertaking*, 18 December 2012, Main Body, clause 4.10.

²⁷⁶ Ibid, Schedule 2B, clause 2B.1(d).

²⁷⁷ ACCC Draft Decision, pp. 89-93.

- a conferral of power on the ACCC to disallow the withdrawal of a product component, product feature, Ancillary Service or Facilities Access Service by NBN Co; and
- a commitment that NBN Co provide the same amount of written notice to the ACCC of its intention to withdraw a product, as it provides to its customers.²⁷⁸

The effect of varying the SAU in this way is outlined in section 2.3.2 of the Consultation Paper.

The ACCC did not propose any variations in relation to the composition of the initial Reference Offers. It did however propose that the replacement module process (and in turn the process for changing the composition of Reference Offers over the course of Module 2) be removed from the SAU.²⁷⁹

The remainder of this section is structured as follows:

- Section 2.3.2.1 discusses the variations that the ACCC is proposing in order to provide an ACCC role to disallow the withdrawal of Non-Reference Offers, including the implications of this role for the Reference Offer – Non-Reference Offer distinction.
- Section 2.3.2.2 discusses variations relating to product withdrawal required by law or Shareholder Minister and other variations proposed by submissions.

2.3.2.1. Product withdrawal notification and disallowance

Submissions note the following views in relation to the proposed variation to confer a power on the ACCC to disallow the withdrawal of a Non-Reference Offer:

- NBN Co does not agree with the ACCC's characterisation of the issue of product withdrawal in the draft decision — that NBN Co may withdraw Non-Reference Offers, and thus require end-users to move to higher data-rate services (at higher prices), leading to a reduction in incentives for NBN Co to price efficiently and demand risk.²⁸⁰ However, NBN Co submits that adopting an enhanced product withdrawal process should allow the ACCC to reconsider its comments about NBN Co's ability to reduce its revenue sufficient risk by withdrawing products.²⁸¹ NBN Co also proposes a product withdrawal disallowance power, which is outlined in further detail below.²⁸²
- NBN Co accepts the proposed variation that it be required to notify the ACCC and consumer advocacy groups, in addition to customers, of its intention to withdrawal a product.²⁸³
- Telstra considers that the SAU should not confer a power on the ACCC to disallow the withdrawal of products, and that the ACCC should instead rely on its statutory powers to declare products.²⁸⁴

Submissions from AAPT, ACCAN, Herbert Geer (on behalf of iiNet Ltd), Optus, Macquarie Telecom and VHA support the ACCC's proposal.²⁸⁵ The remaining submissions did not comment on the ACCC's proposal.

NBN Co's proposed product withdrawal disallowance power

²⁷⁸ ACCC, Consultation Paper, p. 25.

²⁷⁹ Ibid, p. 16.

²⁸⁰ NBN Co Submission, p. 55.

²⁸¹ Ibid, p. 56.

²⁸² Ibid, pp. 15-18.

²⁸³ Ibid, p. 58.

²⁸⁴ Telstra Submission, p. 23.

²⁸⁵ AAPT Submission, p. 8; ACCAN Submission, p. 2; iiNet Submission, p. 17; Optus Submission, p. 18; Macquarie Telecom Submission, p. 18; VHA Submission, p. 7.

Under NBN Co's proposed product withdrawal disallowance, in the event that NBN Co notifies the ACCC that it wants to withdraw a product, NBN Co will also propose whether it considers the product falls within one of two product withdrawal categories.²⁸⁶ The first category is a "Category A Product Withdrawal" — this is when NBN Co considers that the product withdrawal satisfies one or more of the following criteria:²⁸⁷

- The 'Cost Criterion' — the avoidable costs of continuing to supply the product exceed the expected revenue from the product over the next five years.²⁸⁸
- The 'Technical Criterion' — the product needs to be withdrawn because NBN Co's networks and/or systems can only cost-effectively support a limited number of products. Not withdrawing the product would result in NBN Co being faced with the choice of either withdrawing other existing products or not introducing new products currently on the Product Roadmap for introduction over the next five years. The product that is to be withdrawn has lower demand than the alternative products.²⁸⁹
- The 'No Material Disadvantage Criterion' — NBN Co has already introduced a product (or products collectively) that is functionally equivalent or superior to the existing product and has a price that is the same or lower than the product that is intended to be withdrawn.²⁹⁰

NBN Co may alternatively propose that the product it intends to withdraw is a "Category B Product Withdrawal" if it considers that it does not satisfy any of the above criteria.²⁹¹

Upon receiving NBN Co's proposal for the product withdrawal, the ACCC must decide whether the notified product is a 'Category A' or 'Category B' product withdrawal.²⁹² To classify the product as a 'Category A' product withdrawal, the ACCC must be satisfied that one or more of the above three criteria are met.²⁹³ The ACCC must make a decision within 60 business days upon receiving the notice from NBN Co, which may be extended for a further three months.²⁹⁴

If the ACCC classifies the product withdrawal as a 'Category A' product withdrawal, NBN Co may withdraw the relevant product at any time after the expiry of the product withdrawal notice (e.g. 24 months for a Product, Product Component, Ancillary Service or type of Facilities Access Service or 12 months for a Product Feature).²⁹⁵

If the ACCC classifies the product withdrawal as a 'Category B' product withdrawal, the ACCC may make a decision to disallow the withdrawal of the product by NBN Co.²⁹⁶ In making a decision to disallow the withdrawal of a 'Category B' product, the ACCC:²⁹⁷

- must be satisfied that the product withdrawal does not promote the long-term interests of end-users, having regard to the criteria in section 152AB of the CCA;
- must have regard to the factors set out in clause 11.5.2(b) of the SAU;²⁹⁸

²⁸⁶ NBN Co Submission, Appendix C, pp. 15-16.

²⁸⁷ Ibid, p. 16.

²⁸⁸ NBN Co Submission, p. 57.

²⁸⁹ Ibid,

²⁹⁰ Ibid, p. 58.

²⁹¹ NBN Co Submission, Appendix C, p. 16.

²⁹² Ibid.

²⁹³ Ibid, p. 17.

²⁹⁴ Ibid, p. 16.

²⁹⁵ Ibid, p. 17.

²⁹⁶ Ibid, p. 18.

²⁹⁷ Ibid.

²⁹⁸ These factors are: Existing demand for the Product, Product Component, Product Feature, Ancillary Service or Facilities Access Service; the cost of the Product, Product Component, Product Feature, Ancillary Service or Facilities Access Service; the functionality offered by an alternative Product, Product Component, Product Feature, Ancillary Service or Facilities Access Service; the technical feasibility of an alternative Product, Product Component, Product Feature, Ancillary Service or Facilities Access Service; the commercial viability of an

- may invite people to make submissions;
- must issue its decision within 60 business days;
- must publish its reasons on its website; and
- must specify the length of time that the disallowance will apply, which must not exceed a maximum of two years from the expiry of date of the withdrawal notice.

If the ACCC's decides to disallow the withdrawal of a 'Category B' product, NBN Co must not undertake to withdraw this product for the duration of the disallowance, as specified by the ACCC in its decision (which can be a maximum of two years).²⁹⁹

ACCC response

The ACCC considers that the matters that it must be satisfied of when making a decision under NBN Co's proposed approach about whether to disallow the withdrawal of a 'Category B' product (that is, the factors set out in clause 11.5.2(b) of the SAU) generally reflect the types of matters that the ACCC would need to consider in determining whether the long-term interests of end-users are promoted by a product withdrawal.

Similarly, the matters that the ACCC must be satisfied of when making a decision under NBN Co's proposed approach about whether to categorise the product withdrawal as 'Category A' or 'Category B' also generally reflect the types of matters that the ACCC would need to consider in determining whether the long-term interests of end-users are promoted by a product withdrawal.

However, in contrast to what is allowed for under NBN Co's proposed approach, a decision on whether the long-term interests of end-users are promoted is typically one in which the ACCC takes into account a range of factors that affect efficient use of, and investment in, infrastructure and the promotion of competition, and balances its consideration of those factors. On the other hand, the categorisation decision under NBN Co's proposed approach (in which the ACCC must be satisfied of one or more of the three criteria) may prevent the ACCC from being able to make a decision in which it balances a range of factors. This could result in products being withdrawn in circumstances where it does not promote the long-term interests of end-users for them to be withdrawn.

In addition, the requirement to categorise a product under NBN Co's proposed approach appears to potentially add an additional, unnecessary layer of process to the ACCC's decision making about whether to disallow the withdrawal of a product — the ACCC is required to make two decisions if it considers that a product withdrawal should be disallowed (first the categorisation decision, and second the disallowance decision).

In light of these views, the ACCC is proposing to only partially adopt NBN Co's proposed approach. The ACCC is proposing the following variations to the SAU:

- inclusion of a commitment that NBN Co provide written notice to the ACCC and Consumer Advocacy Groups of its intention to withdraw a product (in addition to the commitment currently in the SAU to do so for customers); and
- the inclusion of a conferral of power on the ACCC to disallow the withdrawal of a currently supplied Product, Product Component, Product Feature, Ancillary Service or type of Facilities Access Service.

alternative Product, Product Component, Product Feature, Ancillary Service or Facilities Access Service; and the Price of an alternative Product, Product Component, Product Feature, Ancillary Service or Facilities Access Service.

²⁹⁹ NBN Co Submission, Appendix C, p. 18.

This conferral of power is proposed to operate as follows:

- The ACCC may object to the withdrawal of a product upon receiving notice from NBN Co of its intention to withdraw the product.
- In making a decision on whether to object to the product withdrawal, the ACCC must have regard to the long-term interests of end-users and may have regard to the factors set out in clause 11.5.2(b) of the SAU (set out above).
- If the ACCC decides to object to the product withdrawal, it must publish its decision within 60 business days of receiving the notice from NBN Co, with an ability to extend the decision by an additional 40 business days.³⁰⁰
- If the ACCC publishes an objection, NBN Co may not withdraw the product for the period of time specified by the ACCC in its decision (which may be a maximum of five years).
- If NBN Co seeks to withdraw the product after the time specified by the ACCC, the ACCC may further object and disallow the product withdrawal by following the steps described above.

This proposed conferral of power is broadly equivalent to NBN Co's proposed process for disallowing a Category B product withdrawal. The primary changes from NBN Co's proposal are that:

- the ACCC may disallow the withdrawal of a product for a maximum of five years (as compared to a maximum of two years as proposed by NBN Co).
- the ACCC can extend the time period in which it can make a decision to disallow the product withdrawal by an additional 40 business days.
- the ACCC is not required to categorise the products that NBN Co wants to withdraw as either Category A or Category B.

Regarding Telstra's argument that the ACCC should rely on its statutory powers to declare products (as opposed to a conferral of power), the ACCC considers that there is a benefit to adopting a product withdrawal conferral of power which is absent from the declaration provisions under Part XIC. This benefit is that the inclusion of sub-criteria that the ACCC may have regard to (that is, the factors set out in clause 11.5.2(b)) when deciding whether to disallow the withdrawal provides NBN Co with greater certainty than declaration under Part XIC about the matters that the ACCC will consider in making its decision.

Interaction between product withdrawal disallowance power and Reference Offer – Non-Reference Offer distinction

Given that whether a product component, product feature, or component of the ancillary services or the facilities access service is a Reference Offer or a Non-Reference Offer impacts upon whether or not it can be withdrawn, these concepts and the product withdrawal disallowance power are clearly related.

In the Draft Decision, the ACCC noted the following in relation to Reference Offers — that the combined implications of the following aspects of the SAU:

³⁰⁰ According to the current SAU, NBN Co must provide 24 months written notice of its intention to withdraw a product, product component, Ancillary Service or type of Facilities Access Service and not less than 12 months written notice before it is proposing to withdraw a product feature.

- the exclusion of particular services from the specification of Reference Offers during Module 1;
- provisions in Module 2 which allow NBN Co to redefine the services which make up the Reference Offers (albeit subject to ACCC approval);
- provisions in Module 1 and Module 2 which allow NBN Co to withdraw services once they are no longer Reference Offers;

mean that the SAU will not ensure that:

- NBN Co has incentives to price its services in such a way as to promote take-up of higher functionality services and in turn promote efficient use of the NBN;
- NBN Co will face significant demand risk, and in turn (in combination with the proposed price controls) revenue sufficiency risk — which in turn calls into question the efficacy of the proposed price controls as a mechanism for creating incentives for NBN Co to invest and operate efficiently; or
- current consumers of services provided over copper and HFC networks will not be made worse off as a result of the transition to the NBN — and that in turn those consumers that desire and are willing to pay for services that offer greater functionality than currently available over copper and HFC contribute more to the recovery of the costs of the NBN upgrade than those that do not desire such services.³⁰¹

The Draft Decision noted that the 50/20Mbps and 100/40Mbps asymmetric offers are not defined as Reference Offers in Module 1, and hence could be withdrawn during Module 1.³⁰² These offers are likely to represent broadly equivalent services to those that facilitate the purchase by end-users of services over HFC networks today.³⁰³ In turn, current consumers of services provided over HFC networks may not be guaranteed that if they do not wish to purchase higher data rate or quality services to what they purchase today, they will not have to.³⁰⁴ In turn, the SAU may not ensure that only those consumers that desire and are willing to pay for services that offer greater functionality than currently available over HFC contribute more to the recovery of the costs of the NBN upgrade than those that do not desire such services.³⁰⁵

A similar point was made in respect of changing the composition of Reference Offers during Module 2.³⁰⁶ That is, that because during Module 2, the AVC data rate tiers which make up the Basic Access Offer (BAO) and Enhanced Access Offers (EAO) Reference Offers must be:

- (for the BAO) 'the UNI and an AVC...with the lowest data transfer rate which is likely to be acquired over the regulatory cycle by a material number of end-users...'; and³⁰⁷
- (for the EAO) 'a UNI and an AVC...with the data transfer rate which is likely to be most frequently acquired over the regulatory cycle...'.³⁰⁸

AVC data rate tiers which:

- have a lower data rate than the BAO but which are not anticipated to have a 'material number of end-users' acquiring them; and

³⁰¹ ACCC Draft Decision, pp. 88-90.

³⁰² Ibid, p. 91.

³⁰³ Ibid, p. 92.

³⁰⁴ Ibid.

³⁰⁵ Ibid.

³⁰⁶ Ibid, p. 91.

³⁰⁷ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 2B, clause 2B.2.1.

³⁰⁸ Ibid, Schedule 2B, clause 2B.1.2, Schedule 2B, clause 2B.2.2.

- have a data rate which is not anticipated to be the most frequently acquired data rate;

would be able to be withdrawn.³⁰⁹ The SAU therefore may not guarantee the ongoing supply of these services.³¹⁰

The ACCC considers that the proposed product withdrawal disallowance power would be sufficient to ensure that these Product Components and Features will continue to be supplied where it promotes the long-term interests of end-users for them to continue to be supplied.

Given that the intent of the product withdrawal disallowance power is to allow the ACCC to ensure that products are only withdrawn when promotion of the long term interests of end-users would not be adversely affected — and that whether a product is defined as a Reference Offer or a Non-Reference Offer also defines whether or not a product may be withdrawn — this raises the question of whether the product withdrawal disallowance power could be used as a substitute for the concepts of Reference Offers and Non-Reference Offers. Put another way, it raises the question as to the ongoing rationale for the concepts of Reference Offers and Non-Reference Offers, particularly in light of some of the variations proposed in relation to pricing outlined below.³¹¹

The ACCC's preliminary view is that removal of the concepts of Reference Offers and Non-Reference Offers in favour of reliance on the product withdrawal conferral of power could vastly simplify the operation of the SAU. The ACCC is seeking views on this matter.

2.3.2.2. Other product withdrawal related issues

Product withdrawal required by law or Shareholder Minister

Under Schedule 1I and 2E, NBN Co can withdraw a product without satisfying the requirements under clause 1I.4.2 and 2E.6 (e.g. to notify customers, to take into account certain factors, and consider in good faith feedback received from customers and access seekers) if NBN Co is required by law or a Shareholder Minister to withdraw the product, or NBN Co is prohibited from providing the product under section 41(3) of the *National Broadband Network Companies Act 2011*.³¹²

The ACCC did not propose a variation to these clauses in the consultation paper, but sought further submissions on the issue.

Submissions note the following views in relation to these clauses:

- NBN Co's submission considers that it is appropriate that those products which NBN Co is no longer able to provide as a matter of law should not be subject to the full operation of the product withdrawal commitments.³¹³ However, it states that there are some legitimate issues raised by Optus and Telstra, and that it would be reasonable for NBN Co to notify and consult with customers, to the extent permitted by law.³¹⁴ NBN Co proposes variations to this effect.
- Telstra submits that the exemption should be limited so that it only applies to the extent that NBN Co is prevented by law from complying with the product withdrawal commitments.³¹⁵

³⁰⁹ ACCC Draft Decision, p. 91.

³¹⁰ Ibid, p. 92.

³¹¹ See section 2.4.1 about the pricing of individual products.

³¹² NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1I, clause 1I.5.3; Schedule 2E; clause 2E.6.4.

³¹³ NBN Co Submission, p. 59.

³¹⁴ Ibid.

³¹⁵ Telstra Submission, p. 25.

- Optus submits that these exemptions mean that NBN Co may remove these products without notification from NBN Co or oversight from the ACCC.³¹⁶

Having considered these submissions, the ACCC proposes the following variations to the SAU — in the event that NBN Co intends to withdraw a product, NBN Co will, to the extent permitted by law:

- provide Access Seekers, Consumer Advocacy Groups and the ACCC with written notice of such withdrawal within 20 business days of NBN Co being notified of its requirement to withdraw, subject to that timeframe being consistent with the timing requirements placed on NBN Co to withdraw; and
- consult with and consider any feedback received from its Access Seekers, Consumer Advocacy Groups and the ACCC in relation to the impending withdrawal and related issues, such as migration.

These variations reflect those proposed by NBN Co. The ACCC considers that the variations will address the concerns raised by Telstra and Optus, while having appropriate regard to NBN Co's legitimate business interests.

Additional variations proposed by Telstra

Telstra's submission proposes additional variations to the provisions about the transitional arrangements that NBN Co will put in place when it withdraws a product,³¹⁷ and the 'anti-circumvention' product withdrawal provisions.³¹⁸

On the transitional arrangements, Telstra proposes that NBN Co should be required to provide the following minimum information in respect of a product to be withdrawn:³¹⁹

- NBN Co's assessment of each of the matters that it is required to have regard to when considering the withdrawal (that is, the factors set out in clause 11.5.2(b) of the SAU);
- the following minimum information about NBN Co's proposed transitional arrangements for migration to an alternative product:
 - NBN Co's proposed 'go to' product;
 - NBN Co's proposed timeframes for transition to the 'go to' product;
 - details of testing of the 'go to' product; and
 - details about trials and phasing-in processes for transition to the 'go to' product; and
- NBN Co's proposal to consult with RSPs and consumer advocacy groups in respect of these matters and reasons why NBN Co considers this proposal to be reasonable and appropriate in the circumstances.

The ACCC considers that these variations appear to have the potential to increase the extent to which access seekers can plan for making changes to their business models and other downstream investments as a result of NBN Co's decision to withdraw a product. This would increase the extent to which the product withdrawal provisions encourage efficient investment in, and use of, the NBN.

³¹⁶ Optus Submission, p. 18.

³¹⁷ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 11, clause 11.5.2(a).

³¹⁸ *Ibid*, Schedule 11, clause 11.5.1.

³¹⁹ Telstra Submission, p. 24.

The ACCC is seeking further submissions on Telstra's proposed variations, to facilitate its consideration of whether variations to implement its proposals should be included in the Notice to Vary.

On the 'anti-circumvention' provisions, Telstra proposes that these provisions should apply to all commitments in the SAU, and not just the individual price increase limits. Telstra states that this is because the SAU does not prevent NBN Co from withdrawing a product for the purposes of circumventing other commitments in the SAU.³²⁰

The ACCC does not propose to adopt Telstra's proposed variation to the 'anti-circumvention' provisions. While the ACCC does not disagree with the variation in principle, the ACCC considers that the issue raised by Telstra is addressed via the ACCC's proposed product withdrawal disallowance power.

³²⁰ Ibid, p. 25.

2.4. Price-related terms and conditions

The variations that are proposed in this section relate to the issues discussed in chapter 5 of the Draft Decision and section 2.4 of the Consultation Paper.

Section 2.4.1 sets out the ACCC proposed variations to the pricing of individual products and section 2.4.2 sets out the ACCC's proposed variations to the long-term revenue constraint methodology.

As a general comment in relation to the submissions made by NBN Co in response to the ACCC's Draft Decision and the Consultation Paper on these matters, the ACCC re-iterates that it considers that NBN Co may, for some of the SAU term, face greater incentives to operate, invest and price efficiently relative to other established utilities regulated by the ACCC. It may therefore be unnecessary for the ACCC to intervene in relation to price matters whilst NBN Co faces such incentives.

The ACCC cannot however accept, solely on this basis, restrictions that explicitly preclude it from intervening in circumstances where the desired impact of such incentives is not evident.

It is possible that NBN Co will face different incentives at different times during the SAU term, and it is not possible at this time to precisely identify when its incentives may change. Consequently, the ACCC considers that the SAU must be sufficiently flexible to address uncertainty about the precise times that NBN Co will face desirable incentives.

If NBN Co's observed behaviour indicates the desired impact of the incentives, the expectation is that it would be unnecessary for the ACCC to intervene in relation to price matters.

2.4.1. Pricing of individual products

The 18 December 2012 SAU contains initial prices for all product components, product features, ancillary services, types of facilities access services and other activities (referred to as 'other charges') for which prices were known at the time of SAU lodgement (some of which are priced at \$0).³²¹

It also establishes long-term commitments about how NBN Co will price these individual products and charge for various activities over time.³²² Specifically, all NBN Co prices are subject to price controls that generally prevent individual prices from increasing by more than CPI-1.5 per cent each year.³²³ The price controls are an important aspect of the SAU, as they should provide incentives for efficient investment in and operation of the NBN, and price stability, which may promote competition in markets for listed services.

The 18 December 2012 SAU generally provides NBN Co with the right to determine initial prices for items that are not currently specified in the SAU (including in relation to the unique concepts of a 'Zero-Priced' item and an 'Other Charge').³²⁴ If these new prices could not be commercially agreed between NBN Co and access seekers, and if they were not reasonable, many of the clauses in the SAU appear to have the effect of *precluding* the ACCC from determining the prices.³²⁵

³²¹ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1C, clause 1C.3; Schedule 1D, clause 1D.3.

³²² Ibid, Schedule 1C, clause 1C.4; Schedule 1D, clause 1D.4; Schedule 2C, clause 2C.2; Schedule 2C, clause 2C.4.

³²³ Ibid, Schedule 1C, clause 1C.4; Schedule 1D, clause 1D.4; Schedule 2C, clause 2C.2.

³²⁴ Ibid, Schedule 1D, clause 1D.4.3; Schedule 1D, clause 1D.6; Schedule 2C, clause 2C.4; Schedule 2C, clause 2C.5.

³²⁵ Ibid, Schedule 1D, clause 1D.4.3; Schedule 1D, clause 1D.6; Schedule 2C, clause 2C.4; Schedule 2C, clause 2C.5.

The clauses establishing the pricing commitments in the SAU are complex. Primarily, these clauses are contained in Schedules 1C, 1D and 2C, but there are other clauses in the SAU that support the pricing commitments contained in these schedules. Many of the clauses among these schedules are substantially similar to others, or otherwise duplicate or interact with each other.

In the Draft Decision, the ACCC identified a number of issues with the pricing commitments in the SAU that the proposed variations in the draft Notice to Vary seek to address.³²⁶

In the draft Notice to Vary, the ACCC has sought to maintain the existing structure of the SAU as much as possible whilst still addressing all the issues raised in the Draft Decision. This has meant that there are many consequential variations that the ACCC has had to propose in order to ensure that prices determined in accordance with the SAU are reasonable.

It has also meant that, overall, the pricing commitments in the SAU are not as simple as they might otherwise be to achieve the same outcomes. That said, the ACCC recognises that a level of complexity is somewhat unavoidable in commitments of this nature.

One aspect of the SAU that seems to make the pricing commitments particularly complex is the Reference Offer – Non-Reference Offer distinction. As discussed in section 2.3.2, the ACCC queries whether there is an ongoing rationale for the concepts of Reference Offers and Non-Reference Offers (in light of the inclusion in the SAU of a product withdrawal disallowance power), and considers that there may be scope for substantial simplification of the pricing commitments if this distinction was not made in the SAU.³²⁷

There are also consequential variations that are proposed to the pricing commitments — for example, removing references to SFAAs and extending commitments to access seekers more generally (rather than only to access seekers who have Access Agreements), and some variations to other parts of the SAU in support of changes to the pricing commitments. An example of this latter category is a change to the contents of replacement modules as a result of changes to the pricing commitments in Module 2 so as to establish necessary processes and procedures relating to tax change events during this period.

An important aspect of the proposed variations is the role of ‘Maximum Regulated Prices’. The ‘Maximum Regulated Price’ concept performs a more substantial role in the ACCC’s proposed variations than it has previously in the SAU. As the proposed variations permit the ACCC to determine prices in some circumstances, the variations also ensure that the SAU would recognise these prices as Maximum Regulated Prices. The importance of ‘Maximum Regulated Prices’ in the proposed variations is reflected in the following sections about pricing of individual products:

- **Incentives to set new prices at levels that promote efficiency and competition** — this section concerns how initial Maximum Regulated Prices are to be determined for products and charges that are not currently included in the SAU, and for currently zero-priced products and charges.
- **Ability for relative price levels to change in response to unforeseen circumstances** — this section concerns how Maximum Regulated Prices may be changed if prices cease to promote competition and efficient use of and investment in infrastructure as circumstances change over the term of the SAU.
- **Tax Change Events** — this section concerns how changes in taxes should be accounted for in Maximum Regulated Prices.

³²⁶ ACCC Draft Decision, pp. 104-129.

³²⁷ The ACCC notes that drafting to implement such a change should still be able to maintain the specific pricing commitments that are made until 30 June 2017 in respect of those products that are currently classed as Reference Offers.

This section of the document commences with the ACCC's response to submissions about the initial Maximum Regulated Prices for certain products that are included in the SAU, and then proceeds to discuss the above three matters in turn.

2.4.1.1. Initial price levels

In the Draft Decision, the ACCC identified a small number of prices set out in the SAU where the ACCC could not be satisfied on the information before it that these prices were reasonable (the Standard Business Offer, symmetric access capacity TC-1 AVCs (0.15Mbps-2Mbps) and the Restoration charge).³²⁸ As the Draft Decision sought further information from interested parties about these prices, it did not propose specific variations to the SAU in the Consultation Paper.

John de Ridder and Telstra also made submissions to the Consultation Paper about the initial price for the Connectivity Virtual Circuit product component, and the initial prices for multicast functionality, respectively.³²⁹ This section therefore also considers these submissions.

Traffic Class 1 Access Virtual Circuits – 2 megabits per second and under

The SAU specifies pricing for access virtual circuits (AVCs) with equal upstream and downstream data rates (symmetric access capacity AVCs, from 0.15Mbps to 100Mbps).³³⁰

In the Draft Decision, the ACCC noted that some of the symmetric access capacity AVCs (specifically those with data transfer rates between 0.15 Mbps and 2 Mbps) appear to be broadly equivalent to those that may be able to be supplied with copper and HFC-based services.³³¹

The ACCC stated that there is the possibility — depending on the assumptions about how some existing services would be supplied using the NBN — that at least some of these prices may mean that end-users are not able to obtain comparable services at comparable prices over the NBN.³³² The ACCC considered that, whilst it was not clear whether submissions that raised concerns over these prices had identified the lowest cost means of providing comparable services over the NBN, in the absence of further information about these prices, it was not satisfied that they were reasonable.³³³

The ACCC sought further information from interested parties about whether these prices would allow end-users to obtain comparable services to those supplied over copper and HFC networks at broadly equivalent prices over the NBN.³³⁴

In response to the Draft Decision, NBN Co submits that:

- In relation to multi-line voice services, the NBN input costs for providers would be consistent with the input costs faced by providers on legacy fixed-line networks (NBN Co provides example multi-line voice scenarios and input costs to support this submission).³³⁵
- There are opportunities for access seekers to offer innovative multi-line voice service solutions using TC-2 or TC-3 product components rather than TC-1. This would result

³²⁸ Note ACCC Draft Decision, Attachment B.

³²⁹ John de Ridder, *CVC pricing discriminates*, 1 May 2013, pp. 1-4 (John de Ridder Submission); Telstra Submission, pp. 28-29.

³³⁰ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1D, clause 1D.3.1(c).

³³¹ ACCC Draft Decision, p. 112.

³³² *Ibid.*

³³³ *Ibid.*

³³⁴ *Ibid.*

³³⁵ NBN Co Submission, p. 68.

in lower input costs (however this would be traded off against the different technical specifications of these traffic classes).³³⁶

- It is important to ensure that the lowest cost means of providing comparable products over the NBN is identified. As NBN Co's products are sold in discrete steps of data transfer rate, it may be the case that some legacy multi-line voice offerings would benefit from small changes to the number of voice lines that are provided, to effectively manage the capacity available from each product component.³³⁷
- In addition to existing multi-line voice services, the NBN provides the ability for access seekers to supply integrated voice and data services over the same access link, which is generally not the case on legacy networks.³³⁸

The ACCC has not received additional submissions from other interested parties about the prices of the TC-1 AVCs.

The ACCC considers that, based on NBN Co's submission, NBN input costs for providers to supply multi-line products using TC-1 appear to be broadly consistent with the input costs faced by providers on legacy fixed-line networks. The ACCC also recognises the potential for access seekers to offer multi-line voice services using TC-2 or TC-3 product components that may provide sufficient quality for some end-users at a lower input cost than is the case on legacy fixed-line networks.

Consequently, the ACCC concludes that, on the information available to it, the symmetric access capacity AVC charges are likely to enable end-users to obtain comparable NBN services at prices that are broadly equivalent to the prices of existing services supplied over copper and HFC networks.

Therefore, the ACCC considers that the charges for symmetric access capacity AVCs are reasonable, and does not propose any variations to these charges in the draft Notice to Vary.

Standard Business Offer

The SAU specifies a reference offer (the Standard Business Offer) that NBN Co submits is intended to provide business grade broadband connectivity to the NBN for voice and broadband services.³³⁹ This offer consists of access to a UNI-D, an AVC with 25/10 Mbps upstream peak data rates, and 500 kbps of TC-1 symmetric access capacity.³⁴⁰

In the Draft Decision, the ACCC noted that it is not clear that the standard business offer is intended to provide equivalent functionality to the services to which it was compared in submissions to the November 2012 Consultation Paper.³⁴¹ The ACCC noted that there may be multiple bundles of NBN products that could be used to supply a comparable service to those that are currently supplied to businesses over the copper network.³⁴²

However, the ACCC noted it was not satisfied that the price for the standard business offer was reasonable because it considered, on the information available at the time, that at least some of the symmetric access capacity AVC charges may mean access seekers face higher prices to supply a comparable service to those that are currently supplied to businesses over the copper network.³⁴³

In response to the Draft Decision, NBN Co submits that:

³³⁶ Ibid, p. 70.

³³⁷ Ibid.

³³⁸ Ibid.

³³⁹ Ibid, p. 7.

³⁴⁰ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1C, clause 1C.2.4.

³⁴¹ ACCC Draft Decision, p. 111.

³⁴² Ibid, pp. 111-112.

³⁴³ Ibid, p. 112.

- The SBO is not intended (or required) to be the base component of every business service. Rather, the intention is that access seekers will construct business services by using a combination of NBN Co products appropriate to the needs of their business end-users.³⁴⁴
- The proposal for the ACCC to have a product withdrawal disallowance power means that it is not necessary to rely on the standard business offer to anchor the prices of NBN Co's business grade products.³⁴⁵

NBN Co provides a comparison to the example provided in Optus' submission to the ACCC's November 2012 Consultation Paper, which it submits highlights the importance of using the most appropriate product components to construct NBN-based products that are at least functionally equivalent to existing legacy products.³⁴⁶

There were no other submissions from interested parties on this issue.

The further information provided by NBN Co about the symmetric access capacity AVC offers has allowed the ACCC to conclude that those prices should support the supply of NBN services that are broadly equivalent to existing services supplied over copper and HFC networks at comparable prices. This means that issues about whether the SBO supports access seekers doing so no longer arise. In any event, it may be more cost efficient for access seekers to supply business services by using a combination of NBN Co products that is not necessarily based on the SBO.

As the ACCC is satisfied that each of the individual prices of the products comprising the SBO are reasonable, the ACCC is satisfied — in the absence of any information to the contrary — that the overall SBO price for this bundle of products is reasonable.

Consequently, the ACCC does not propose any variations to this price in the draft Notice to Vary.

Restoration charge

The SAU specifies a price for 'restoration' of \$50 per ordered product.³⁴⁷ The SAU defines restoration as "the restoration of the supply of an ordered product after the cessation of an ordering freeze, service reduction or suspension in respect of or in connection with the ordered product, except where the event or reason giving rise to the suspension was not contributed to by any act or omission of a customer".³⁴⁸ That is, restoration is a charge that NBN Co may impose where, broadly speaking, it has taken actions relating to a dispute between itself and an access seeker.³⁴⁹

In the Draft Decision, the ACCC stated that, in the absence of further information, it was not satisfied that the price of the restoration charge (which suggests certain rights and obligations should exist between NBN Co and access seekers) was reasonable.³⁵⁰ It also noted that the restoration charge appears to be related to the dispute management clauses that NBN Co has included in the SAU (and which the ACCC stated it was not satisfied are reasonable).³⁵¹

The consultation paper did not propose specific changes to address the issues identified in the Draft Decision with respect to the restoration charge.

³⁴⁴ NBN Co Submission, p. 66.

³⁴⁵ Ibid.

³⁴⁶ Ibid, pp. 67-68.

³⁴⁷ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1C, clause 1C.2.7; Schedule 1D, clause 1D.3.1(c).

³⁴⁸ Ibid, Schedule 1C, clause 1C.2.7; Main Body, Attachment C.

³⁴⁹ NBN Co has rights to impose an ordering freeze, service reduction, suspension or disconnection in some circumstances: NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1H, Annexure 1, clause 10.1(b).

³⁵⁰ ACCC Draft Decision, p. 115.

³⁵¹ Ibid, pp. 114-115.

In response to the Draft Decision, NBN Co submits that:

- the inquiry should be whether the level of the charge is appropriate, given the purpose of the charge;³⁵²
- NBN Co needs to undertake activities to restore the supply of products;³⁵³
- Telstra's \$59 charge for in-place connection is an industry benchmark charge for a connection that is made remotely by a service provider; and³⁵⁴
- the restoration charge is consistent with current industry practice and will not introduce an issue in transition from legacy networks to the NBN.³⁵⁵

After considering NBN Co's submission, the ACCC is not satisfied that NBN Co has established that this charge, and its associated definitions, are reasonable.

Firstly, the ACCC is not satisfied that this charge could not be applied in circumstances where NBN Co should not have limited its supply of services to a customer (for example, if it was applied despite the fact a contractual dispute is resolved in favour of the customer). The possibility that a customer pursuing a dispute may face this charge irrespective of the merits of its dispute may create a disincentive for customers to pursue disputes under an agreement.

Secondly, NBN Co has provided no evidence to support its assertion that this charge is consistent with current industry practice. In particular, NBN Co has not identified other access providers that have the rights that this charge relates to in order to demonstrate that this is established industry practice.

Lastly, the ACCC has reservations about the chosen benchmark for the price, which appears to be only weakly linked to the costs associated with the activities that the ACCC understands NBN Co would be required to undertake for restoring services. Further, the cited Telstra charge is applied at the retail level, whereas the NBN Co charge is applied at the wholesale level, and the costs associated with restoration at the retail level are likely to be different to those associated with restoration at the wholesale level.

Therefore, the ACCC proposes that the restoration charge and its associated definitions be removed from the SAU, and be settled through commercial negotiation between NBN Co and access seekers.

Connectivity Virtual Circuit

The SAU specifies prices for a range of different CVC 'capacity tiers' and traffic classes.³⁵⁶ All CVC capacity tiers and traffic classes specified by the SAU adopt a monthly \$20 per megabit per second price.³⁵⁷ Importantly, the SAU specifies monthly prices for blocks of CVC capacity in terms of 'data rates', rather than as a volume of data.

The SAU also specifies that NBN Co will provide 'transitory' CVC pricing, whereby NBN Co will credit each customer with 150Mbps CVC (traffic class 4) capacity until the earlier of the end of the initial regulatory period or such time that the number of premises that are NBN serviceable in a connectivity serving area exceeds 30,000.³⁵⁸

³⁵² NBN Co Submission, p. 71.

³⁵³ Ibid.

³⁵⁴ Ibid.

³⁵⁵ Ibid.

³⁵⁶ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1C, clause 1C.3.1(d); Schedule 1C, clause 1C.3.1(e); Schedule 1D, clause 1D.3.1(e).

³⁵⁷ Ibid.

³⁵⁸ Ibid, Schedule 1C, clause 1C.4.2.

In the Draft Decision, the ACCC noted that, based on analysis of current wholesale and retail prices, it considered that the price specified by the SAU for TC-4 CVC capacity should result in end-users obtaining services over the NBN at prices that are broadly equivalent to comparable services supplied over copper and HFC networks.³⁵⁹

The ACCC received one submission (from John de Ridder) regarding initial CVC pricing in the SAU. John de Ridder submits that:

- CVC pricing discriminates against small access seekers;³⁶⁰
- NBN Co's approach has the same effect as volume discounting. Since CVC capacity must be purchased in blocks [charged in Mbps], the more customers an access seeker has, the lower the unit cost per GB (or per customer);³⁶¹
- if the CVC charge was per GB (that is, not sold in blocks and in Mbps), there would be no discrimination between access seekers;³⁶²
- despite the transitory CVC credits introduced by NBN Co, CVC pricing is still a significant barrier to entry for new and smaller access seekers;³⁶³ and
- the difference in the cost of CVC capacity for different access seekers is not in the long-term interests of end-users.³⁶⁴

In response to this submission, the ACCC notes the following.

Firstly, the SAU specifies a price for CVC capacity (expressed as a data rate, rather than a quantity of data) that is the same for all access seekers, regardless of size. Selling CVC capacity in terms of a data rate, rather than data quantity (per MB), means that the price reflects the capacity consumed on the network at any given point in time. In turn, prices send signals that should lead to efficient use of and investment in the network in a way that a price per MB would not. This is because data rate-based pricing gives access seekers an incentive to manage consumption of capacity at any given time on the NBN network, which should promote efficient use of and investment in capacity when there are significant fluctuations in end-user demand.

Secondly, the transitory CVC pricing commitments are likely to reduce any barriers to directly connecting to the NBN that could be created by CVC pricing for smaller access seekers. To the extent that access seekers have insufficient economies of scale to make it profitable for them to directly connect to the NBN, it may be more efficient for them to connect to the NBN through a wholesale provider.

Thirdly, it is not clear that a per Mbps CVC price would have the same effect as a volume discount.

The ACCC acknowledges that for a given CVC capacity tier, the lower the number of customers an access seeker has, the greater the CVC cost per customer. However, it remains to be seen whether the granularity of the CVC tiers will act as a barrier to entry for new or smaller access seekers. For example, the CVC tiers may be sufficiently granular to enable smaller access seekers to purchase a small enough amount of CVC capacity to serve their customers at a price per customer that is not materially different from that of an access seeker with a larger number of customers. Further, the ACCC notes that each CVC link can only serve a maximum of 4000 AVCs, which indicates that an access seeker would have to have a very

³⁵⁹ ACCC Draft Decision, p. 108.

³⁶⁰ John de Ridder Submission, p. 1.

³⁶¹ Ibid.

³⁶² Ibid, p. 2.

³⁶³ Ibid, pp. 3-4.

³⁶⁴ Ibid, pp. 2-4.

small number of customers per connectivity serving area for the CVC tiers to act as a barrier to directly connect to the NBN.³⁶⁵

In addition, the ACCC considers that for CVC pricing to have the effect of a volume discount, the price of CVC capacity per Mbps would have to decrease as the volume of CVC purchased increased. This is not the case with NBN Co's proposed CVC pricing.

Consequently, the ACCC does not propose any variations to the SAU regarding initial CVC pricing.

Multicast

The SAU specifies a number of prices for multicast functionality. Specifically, the SAU specifies prices for the Multicast AVC offer, the Multicast Domain offer, and media streams associated with the Multicast Domain offer.³⁶⁶

Submissions to the November 2012 Consultation Paper on the SAU suggested that these prices may inhibit the development of multicasting.³⁶⁷

In the Draft Decision, the ACCC noted that the initial pricing for multicast services was likely to be efficient due to a number of factors that were likely to constrain or 'anchor' NBN Co's multicast pricing.³⁶⁸ The ACCC concluded that in the absence of additional information about why the initial prices for multicast functionality were not reasonable, its preliminary view was that multicast initial prices were reasonable.³⁶⁹

The ACCC also noted that NBN Co could, at a future time, reduce multicast prices to encourage take-up if it so chose (and that if it did so, the price control path would also lower in response).³⁷⁰ The SAU therefore would not preclude NBN Co from responding to future market conditions in relation to multicast pricing, while still providing some certainty about pricing of the product over time.³⁷¹

In response to the Draft Decision, Telstra submits that:

- At present, NBN Co's pricing of multicast services is unlikely to lead to significant take-up of the capability.³⁷²
- Although it may be possible for multicast prices to be reduced in the future, the adverse impact on end-users and the long-term efficient use of the NBN may be significant. This is because RSPs are currently determining their product offerings and making the necessary investments in their own networks to offer services over the NBN.³⁷³

The ACCC notes that Telstra's submission has not provided any additional information that was not considered in the Draft Decision about why the initial prices for multicast functionality are not reasonable.

Consequently, the ACCC considers that the initial prices for multicast are reasonable, and does not propose any variations to initial multicast pricing in the draft Notice to Vary.

³⁶⁵ NBN Co, *NBN Co Ethernet bitstream service product technical specification*, 18 June 2013, p. 49.

³⁶⁶ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1D, clause 1D.3.1(f); Schedule 1D, clause 1D.3.1(g).

³⁶⁷ Optus, *Submission to the ACCC Consultation Paper: NBN Co Limited 2012 Special Access Undertaking*, 18 January 2013, pp. 97-98.

³⁶⁸ ACCC Draft Decision, p. 113.

³⁶⁹ *Ibid.*

³⁷⁰ *Ibid.*

³⁷¹ *Ibid.*

³⁷² Telstra Submission, p. 28.

³⁷³ *Ibid.*, p. 29.

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

In the 18 December 2012 SAU, NBN Co makes commitments about the processes for setting the initial prices of new products and new 'other charges', and for introducing prices for currently zero-priced offers and 'other charges', during the SAU term.³⁷⁴

NBN Co can determine the price of any new product, new 'other charge' zero-priced non-reference offer or zero-priced 'other charge' associated with a non-reference offer that it introduces during the SAU term (with no scope for the ACCC to determine the price), subject to it:

- having regard to a number of pricing principles set out in the SAU;³⁷⁵
- publishing a pricing rationale statement on how the new price has been calculated in accordance with the pricing principles;³⁷⁶ and
- consulting with customers on the price of any new product introduced through the Product Development Forum, where applicable.³⁷⁷

If NBN Co introduces a new price for a currently zero-priced reference offer or a currently zero-priced 'other charge' that is associated with a reference offer, the SAU provides for the ACCC to determine prices in certain circumstances.³⁷⁸

In the Draft Decision, the ACCC recognised that NBN Co is likely to have incentives to set new prices efficiently, particularly whilst it faces revenue sufficiency risk.³⁷⁹ However, it also noted that it is possible that during the 27 year term of the SAU these incentives will not always prevail.³⁸⁰ The circumstances in which these incentives may not prevail were outlined as being if the 'anchoring' effect of existing products is not effective in constraining new prices, and/or when it has become more clear that NBN Co will be able to recover its initial cost recovery account and therefore no longer faces revenue sufficiency risk.³⁸¹ Consequently, the ACCC was not satisfied that the pricing approaches proposed in the SAU would in and of themselves ensure that NBN Co sets new prices in a manner that encourages efficient use of the network at all times throughout the SAU term.³⁸²

In the Consultation Paper, the ACCC therefore proposed variations to the SAU which would ensure that the ACCC was not precluded by the SAU from using its existing powers under Part XIC to determine new prices.³⁸³ The purpose of these variations is primarily to (in combination with the proposed variations relating to product withdrawal) ensure the efficacy of the CPI-1.5 per cent price controls in creating incentives for NBN Co to act in an efficient manner. The variations would allow for, in circumstances where NBN Co cannot reach agreement with its customers about new prices and has weak incentives to set new prices in a manner that encourages efficient use of the network, the ACCC to determine prices. In doing so, the ACCC would be required to take into account the matters specified by Part XIC (including NBN Co's legitimate business interests) that the ACCC must have regard to in making an Access Determination.³⁸⁴

³⁷⁴ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1C, clause 1C.4.5; Schedule 1D, clause 1C.4.3; Schedule 1D, clause 1D.6; Schedule 2C, clause 2C.4; Schedule; Schedule 2C, clause 2C.5.

³⁷⁵ *Ibid.*, Schedule 1D, clause 1D.6(a); Schedule 2D, clause 2C.5(a).

³⁷⁶ *Ibid.*, Schedule 1D, clause 1D.6(b); Schedule 2C, clause 2C.5(b).

³⁷⁷ *Ibid.*, Schedule 1I, clause 1I.3.5(a); Schedule 2E, clause 2E.4.4.

³⁷⁸ *Ibid.*, Schedule 1D, clause 1D.4.3(b); Schedule 2C, clause 2C.4(b).

³⁷⁹ ACCC Draft Decision, p. 120.

³⁸⁰ *Ibid.*, p. 121.

³⁸¹ *Ibid.*

³⁸² *Ibid.*

³⁸³ ACCC Consultation Paper, p. 26.

³⁸⁴ *Ibid.*

Whilst this variation would *allow* the ACCC to exercise its existing powers under Part XIC to determine new prices, as noted in the Draft Decision, the ACCC considers that there are likely to be only limited circumstances in which it would choose to do so.

Submissions

Access seekers that made submissions in response to the Consultation Paper about the ACCC's ability to determine prices for new products support the ACCC being able to determine new prices that are not agreed.³⁸⁵ Herbert Geer also suggests variations to the SAU treatment of zero-priced offers so as to provide the ACCC with the ability to extend the timeframe within which it may determine some of these prices.³⁸⁶

NBN Co submits a detailed proposal, known as the 'Integrated Price Review Mechanism', that — amongst other things — confers a power on the ACCC to determine new prices during Module 2.³⁸⁷

In order to determine a price for a new product in accordance with NBN Co's proposal, the ACCC would broadly need to:

- give a notice to NBN Co that sets out why its prices, taken in aggregate, are not reasonable;
- provide NBN Co with an opportunity to propose prices in response to the notice;
- exercise a power conferred by the SAU to make a decision about NBN Co's proposed prices, or make an ACCC determination of prices; and
- be satisfied that its decision made about these prices satisfies each of the outcomes specified in the 'price review criteria' set out in the SAU (which include a requirement that any decision satisfies a number of 'net revenue neutrality' requirements).³⁸⁸

(The 'Integrated Price Review Mechanism' is discussed further in section 2.4.1.3 below).

NBN Co also proposes an ACCC 'disallowance power' that allows the ACCC to prevent the introduction of new prices for zero-priced Reference Offers or zero-priced 'other charges' associated with the supply of a Reference Offer in certain circumstances.³⁸⁹

NBN Co makes a number of submissions in support of its approach to pricing of new products.

Firstly, NBN Co submits that new prices should generally be addressed through the 'Integrated Price Review Mechanism' because NBN Co is otherwise exposed to a risk of its current and future revenue streams being undermined by a new price determined by the ACCC.³⁹⁰

Secondly, NBN Co submits that the ACCC should not review prices in Module 1 because it is not necessary or useful for addressing retail price shock during migration, and is inconsistent with NBN Co's legitimate business interests³⁹¹ Specifically, NBN Co submits that the ACCC should not have a role in relation to pricing of new products in Module 1 because such a role is:

- *Not necessary* — NBN Co has incentives to manage pricing for both new and existing products to ensure a smooth transition (and cites ACCC conclusions in the Draft Decision about NBN Co facing a high degree of revenue sufficiency risk for Module 1);

³⁸⁵ Optus Submission, p. 19; Macquarie Telecom Submission, p. 9; iiNet Submission, pp. 17-18.

³⁸⁶ iiNet Submission, p. 18.

³⁸⁷ NBN Co Submission, pp. 75-78.

³⁸⁸ Ibid, p. 76-77.

³⁸⁹ Ibid, p. 78.

³⁹⁰ Ibid, p. 75.

³⁹¹ Ibid, p. 72.

- *Not useful* — the review is likely to have unintended consequences for some groups of end-users, as some users would benefit from a review and rebalancing (such as a rebalance between AVC and CVC charges), whereas others would be disadvantaged; and
- *Inconsistent with NBN Co's legitimate business interests* — the review creates additional pricing uncertainty when NBN Co already faces considerable revenue sufficiency risk (and it may be difficult during the rollout to determine whether a review is revenue neutral).³⁹²

Thirdly, NBN Co submits that the ACCC's analysis of NBN Co's incentives is incomplete, and that it is likely to face appropriate incentives to invest, operate and price efficiently over the SAU term. It nonetheless proposes the 'Integrated Price Review Mechanism' as a framework that provides certainty over long-term cost recovery arrangements, in order to address the ACCC's concerns in Module 2.³⁹³

Finally, in relation to its proposed 'disallowance' power, NBN Co submits that:

- providing an oversight arrangement for some kinds of new prices recognises the significance of certain Zero-Priced items, such as the Platform Interfacing Offer and Initial Standard Installations;
- the power simplifies the decision made by the ACCC and provides more time for the ACCC to make its decision than in comparison to the similar mechanism that is included in the December 2012 SAU; and
- providing this power in the SAU is simpler than adapting the 'Integrated Price Review Mechanism' to perform this function.³⁹⁴

ACCC response

In formulating the draft Notice to Vary, the ACCC has considered NBN Co's proposed approach to pricing of new products, and the issues raised by NBN Co in its submission about this matter.

The preliminary view of the ACCC is that a variation which is different to that proposed by NBN Co is necessary to address the issues identified in the Draft Decision in relation to the initial pricing of new products.

In addition, the ACCC proposes that its ability to determine new prices (in the event that commercial agreement cannot be reached and NBN Co's proposed new prices are not reasonable) should be extended to include new 'other charges' (associated with both reference offers and non-reference offers) and the introduction of any new price for currently zero-priced offers or 'other charges'.

That said, in formulating its draft variations, the ACCC has sought to address the issues that have been raised by NBN Co in its submission.

By way of background, the ACCC notes that its ability to determine prices that are not commercially agreed or specified in the SAU arises due to the normal operation of Part XIC. The variation canvassed in the Consultation Paper was aimed at reconciling the drafting of the SAU that provides for price controls to apply for the term of the SAU with the ACCC maintaining its existing oversight role under Part XIC for prices that are not specified in the SAU and cannot be agreed. In the absence of a variation to do this, the SAU may otherwise preclude the ACCC from ever being able to determine initial prices for any new product or

³⁹² Ibid, pp. 72-73.

³⁹³ Ibid, p. 74.

³⁹⁴ Ibid, p. 78.

'other charge', or currently zero-priced non-reference offer or 'other charge' associated with a non-reference offer, for the 27 year term of the SAU, despite the fact that these prices may not be able to be agreed or may otherwise be set by NBN Co at levels that are not reasonable.

Variation in relation to prices for new products

In contrast to NBN Co's submission, the ACCC proposes its draft variations in relation to both Module 1 and Module 2. While the ACCC recognises the potential for NBN Co to face positive incentives at certain stages during the proposed SAU term, this does not mean that, solely on this basis, the ACCC can accept restrictions that preclude it from determining prices where it is conceivable that circumstances could warrant the ACCC doing so. In this respect, if NBN Co's observed behaviour during Module 1 indicates the desired impact of these positive incentives, the ACCC expects that it would not be necessary for it to undertake this activity.

Also in contrast to NBN Co's submission, the ACCC considers that the issue of initial prices for new products and the issue of how prices change over time are likely to involve different issues. The ACCC therefore does not consider that these issues should be addressed through a single mechanism, such as the 'Integrated Price Review Mechanism'. Given the procedural requirements of the Integrated Price Review Mechanism proposed by NBN Co (and the mechanism that is proposed by the ACCC in section 2.4.1.3 below), such a mechanism might impede the timely determination of a reasonable price if it cannot be agreed.

The ACCC also considers that applying the Integrated Price Review Mechanism to determine the initial prices of new products creates a conceptual difficulty in determining the 'baseline' against which net revenue neutrality requirements can be assessed for an ACCC decision. In the circumstances where the ACCC would consider making a determination, there would not be an appropriate scenario to compare revenues and costs against in order to apply such a constraint. Put another way, there would be no baseline against which revenue neutrality could be measured, other than one which is the issue under examination.

Consequently, the draft variation proposed by the ACCC is for the SAU to permit (in circumstances where commercial agreement cannot be reached and the price proposed by NBN Co is not reasonable) the Maximum Regulated Price for a new product to be set at the level that is specified in an Access Determination or Binding Rules of Conduct that has particular characteristics.

The first required characteristic of an ACCC determination is that the SAU would explicitly require that the ACCC has regard to the characteristics, revenues, costs and demand for other existing products supplied by NBN Co when making a determination. This is intended to provide NBN Co with an explicit commitment from the ACCC that it will consider how a regulated price for a new product could impact upon NBN Co's existing and future revenue streams. While the ACCC does not consider that it is strictly necessary for the SAU to require this (given the matters that the ACCC is required by Part XIC to take into account when making a determination under Part XIC), the ACCC nevertheless understands NBN Co's concerns that it had sought to address with the proposed net revenue neutrality requirements in the 'Integrated Price Review Mechanism'. Given the problems identified above with using the integrated mechanism and net revenue neutrality requirements in respect of new prices, the ACCC has proposed this characteristic in order to give NBN Co additional certainty that impacts on its revenues from existing products and prices will be taken into account. This proposed characteristic is therefore in addition to the existing requirements under Part XIC for the ACCC to take into account NBN Co's legitimate business interests and its investment in facilities when making a determination under Part XIC.

The second required characteristic of an ACCC determination is that it must be made within two financial years after NBN Co commences supplying the new product. After this time, any issues about the pricing of such a product would be more appropriately addressed through a revenue neutral price review.

The ACCC considers that a key advantage of this variation is that it requires minimal changes to the SAU, because it employs existing ACCC powers under Part XIC. At the same time, it accommodates the issues raised by NBN Co in its submission about the potential effects of a determined price on NBN Co's existing revenue streams.

New prices for zero-priced reference offers and zero-priced other charges associated with the supply of reference offers

The ACCC has also considered NBN Co's proposed 'price disallowance' power for Zero-Priced Reference Offers and Zero-Priced Other Charges associated with the supply of a Reference Offer.

While the ACCC has no objection to NBN Co making an additional commitment to refrain from introducing new prices for zero-priced offers and zero-priced other charges unless certain conditions are met, the ACCC notes that the circumstances in which it is required to do so under the SAU (and under NBN Co's proposed variation) are restricted to only apply to zero-priced *reference offers* and zero-priced 'other charges' associated with *reference offers*.

A more fundamental issue however is the rationale for the difference in the ACCC's role in relation to a new price for an item that has been 'Zero-Priced', based on whether it is, or is associated with, a Reference or a Non-Reference Offer. The ACCC views the introduction of a new price for an item that has been 'Zero-Priced' as being analogous to the introduction of new prices more generally — that is, if a price is not included in the SAU, the principal means for establishing the price should be commercial agreement between NBN Co and access seekers, with the potential for the price to be determined by the ACCC if it cannot be agreed and is set by NBN Co at a level that is not reasonable.

Further, it is not clear to the ACCC when an 'Other Charge' would be 'associated with the supply of Reference Offers' versus 'associated with the supply of Non-Reference Offers', as it appears that most 'Other Charges' in the SAU relate to charges that could not clearly be attributed to the supply of Reference Offers or Non-Reference Offers. That is, they are 'common charges' that could relate to both Reference Offers and Non-Reference Offers simultaneously.³⁹⁵

Consequently, the ACCC considers that the SAU should be varied to provide for these new prices to be treated in the same way as new prices more generally. The ACCC therefore proposes that the SAU be varied to incorporate most aspects of NBN's proposed 'price disallowance power', but with the following modifications:

- **The power be extended to all other charges (associated with both reference offers and non-reference offers) and Zero-Priced items (including Non-Reference Offers and other charges associated with Non-Reference Offers)** — this would allow new prices for these items to be treated consistently with new prices more generally.
- **The ACCC determines whether a price may be introduced** — the ACCC determination is thus whether NBN Co has established the conditions to introduce a new price in accordance with the commitments about when such prices could be introduced. This means that if NBN Co is permitted to introduce a new price, the actual price is established separately – primarily as agreed between NBN Co and access seekers, and failing agreement, determined by the ACCC.

Whilst the ACCC considers this latter determination to be unobjectionable, the ACCC questions its necessity in light of the other variations that the ACCC is proposing.

³⁹⁵ As one example, a CVC Setup/Activation (Schedule 1D, clause 1D.3.2(a)) could be used for the supply of either Reference or Non-Reference Offers.

The ACCC considers that its proposed variations about new prices are consistent with the normal operation of Part XIC — that is, they ensure that prices are as agreed between NBN Co and access seekers, and failing agreement, determined by the ACCC.

Having said this, modifying the SAU so that the ACCC is not prevented from doing so does not necessarily mean that the ACCC should or must intervene on pricing, even if not commercially agreed.

The ACCC also re-iterates that, in addressing this issue through its existing Part XIC powers, the ACCC would be required to have regard to NBN Co's legitimate business interests in circumstances where it is necessary to determine prices.

As the proposed variations are designed to permit the ACCC to determine prices in certain circumstances, the ACCC also proposes consequential variations to the SAU to remove references to 'NBN Co determining' initial prices, to remove clauses that purport to allow NBN Co to apply 'Other Charges' at its discretion, and to remove the Initial Pricing Principles from the SAU.

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

The SAU states that prices for services that are reference offers will be subject to the CPI-1.5 per cent price control from year five of the SAU term onwards and prices for non-reference offers and other charges will be subject to the CPI-1.5 per cent price control from the first year of the SAU (or from the first year that NBN Co introduces them).³⁹⁶

In the Draft Decision, the ACCC considered that circumstances could arise over the term of the SAU which would suggest that prices for particular services are not promoting efficient use of the network and/or competition.³⁹⁷ To respond to such circumstances, under the approach proposed in the December 2012 SAU, the price of an individual service could not be increased by more than CPI-1.5 per cent from one year to the next; but NBN Co could of its own accord decrease prices by any amount.³⁹⁸ The ACCC considered that there may however be times throughout the SAU term (such as once NBN Co no longer faces revenue sufficiency risk) when NBN Co does not face incentives to lower prices of its own accord to address the need for prices to be rebalanced.³⁹⁹ In such circumstances, according to the 18 December 2012 SAU, the ACCC would not be able to determine that a higher or lower price should be charged.

To address this issue, the Consultation Paper proposed that the SAU be varied to provide for NBN Co's prices to be subject to revenue neutral price rebalancing that is conducted by the ACCC.⁴⁰⁰ The ACCC did not propose a precise form of variation, and sought views from interested parties on:

- whether the SAU should specify when such rebalancing should occur, and if so, at what times — for example, whether rebalancing could occur every five years throughout the SAU term; and
- how revenue neutrality would be determined.⁴⁰¹

The intended effect of this variation was to:

³⁹⁶ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1C, clause 1C.4.1; Schedule 1D, clause 1D.4.1; Schedule 2C, clause 2C.2.1. It should be noted that Other Charges that are provided on a "hourly labour rate" or "hourly labour rate plus cost of materials basis" are instead subject to indexing to the ABS Labour Price Index, and based on costs to NBN Co: Schedule 1D, clause 1D.4.2(d).

³⁹⁷ ACCC Draft Decision, p. 122.

³⁹⁸ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1C, clause 1C.1.6(a); Schedule 1D, clause 1D.1.7(a).

³⁹⁹ ACCC Draft Decision, p. 122-123.

⁴⁰⁰ ACCC Consultation Paper, p. 27.

⁴⁰¹ *Ibid.*

- allow for prices to be rebalanced in a manner not required or allowed for by the CPI-1.5 per cent price control, in the event that price structures and relative price levels were not promoting efficient use of the network;
- provide for price rebalances that would be revenue neutral for NBN Co, in order to ensure that NBN Co is not precluded by the price review from recovering its prudent costs, including a normal commercial return (given the risks of its investments); and
- ensure that the CPI-1.5 per cent price control continued to create incentives for NBN Co to invest and operate efficiently throughout the SAU term.⁴⁰²

Submissions

There was broad support from access seekers for the ACCC to be able to undertake revenue neutral price reviews throughout the term of the SAU. Access seekers identify a range of specific features for a revenue neutral price review mechanism, and submit that:

- the ACCC should perform a public review, and be able to make a determination of prices;⁴⁰³
- a review could or should occur about every 3 to 5 years;⁴⁰⁴
- the ACCC should consider the long-term interests of end-users when performing a review;⁴⁰⁵
- the ACCC should consider the legitimate business interests of NBN Co when performing a review;⁴⁰⁶
- a review should be able to reduce prices where related new non-zero prices are introduced;⁴⁰⁷
- a review should be revenue neutral for the remaining period of the SAU, measured by reference to forecasts of revenue and expenses or present value of future revenues, without the SAU restricting ACCC analysis of this.⁴⁰⁸

DBCDE submits that NBN Co should be afforded an opportunity to review and restructure its own pricing prior to ACCC intervention, which should only occur in relation to the balance between access charges and usage charges if the ACCC is satisfied that there is a material distortion in the market.⁴⁰⁹

VHA submits that NBN Co could be permitted to exceed price limits if directed in writing to do so by the ACCC.⁴¹⁰ VHA also suggests additional NBN Co should be required to obtain ACCC approval for pricing exceeding floor and ceiling limits in particular circumstances.⁴¹¹

Telstra suggests that a regular review of CVC charges should occur separately from any revenue neutral rebalance review so as to provide transparency about the costs of CVC

⁴⁰² Ibid.

⁴⁰³ Telstra Submission, pp. 30-31.

⁴⁰⁴ Optus Submission, p. 20; Macquarie Telecom Submission, p. 10; AAPT Submission, pp. 8-9.

⁴⁰⁵ Macquarie Telecom Submission, p. 10; AAPT Submission, pp. 8-9.

⁴⁰⁶ Telstra Submission, pp. 30-31.

⁴⁰⁷ Optus Submission, pp. 6, 19-20.

⁴⁰⁸ Optus Submission, pp. 6, 21; Macquarie Telecom Submission, p. 10; AAPT Submission, pp. 8-9.

⁴⁰⁹ DBCDE Submission, p. 2.

⁴¹⁰ VHA Submission, p. 8.

⁴¹¹ Ibid.

capacity.⁴¹² Telstra submits that a revenue neutral rebalance could implement the findings of such a review if NBN Co does not voluntarily adopt these findings.⁴¹³

NBN Co submitted a detailed proposal, known as the 'Integrated Price Review Mechanism', that — amongst other things — confers a power on the ACCC to review NBN Co's prices during Module 2.⁴¹⁴ This same mechanism is proposed for conferral of a power on the ACCC to determine new prices during Module 2 (as discussed above).

As the 'Integrated Price Review Mechanism' is a conferral of power on the ACCC through the SAU, the submission details how the review would be conducted, which is broadly as follows:

- The proposed mechanism provides for a review to commence by the ACCC forming a reason to believe that Maximum Regulated Prices, in aggregate, are not reasonable, and issuing a notice to NBN Co, or by NBN Co giving a notice to the ACCC.
- Once a review has commenced, NBN Co must give a 'Price Review Proposal' to the ACCC in accordance with procedures set out in the SAU.
- The ACCC must then assess NBN Co's proposal in accordance with criteria that are set out in the SAU ('Price Review Criteria'), and if the ACCC rejects NBN Co's proposal, it may make a determination of the Maximum Regulated Prices that will apply.
- If the ACCC accepts a 'Price Review Proposal' or rejects an NBN Co proposal and makes its own determination, a 'Price Review Arrangement' comes into effect and specifies Maximum Regulated Prices for up to five years.⁴¹⁵

The 'Price Review Criteria' establish a number of matters that the ACCC must be satisfied of in order to accept an NBN Co proposal, or to make its own determination following the rejection of an NBN Co proposal. Effectively, these are that the ACCC must be satisfied that:

- Maximum Regulated Prices, in aggregate, are reasonable, having regard to the matters set out in section 152AH (that is, the same matters as what must be considered for the purposes of determining whether a thing is 'reasonable' under Part XIC);
- the present value of forecast 'Net Revenue' with the 'Price Review Arrangement' is the 'same or higher' than it would be without the 'Price Review Arrangement' for each of three defined periods,⁴¹⁶ as determined in accordance with a prescribed formula;
- the degree of variability or risk associated with forecasts with the 'Price Review Arrangement' is the 'same or lower' for each of three periods discussed above as it would be without the 'Price Review Arrangement';
- no Basic Access Offer will increase in price as a result of the 'Price Review Arrangement'; and
- any proposal is based on forecasts that are consistent with those used in the current regulatory cycle.⁴¹⁷

⁴¹² Telstra Submission, pp. 34-35.

⁴¹³ Ibid, p. 34.

⁴¹⁴ NBN Co Submission, pp. 75-78.

⁴¹⁵ NBN Co Submission, Appendix C, p. 23-27.

⁴¹⁶ The three periods proposed by NBN Co are broadly as follows: firstly, from when the rebalance comes into effect to the end of the current replacement module; secondly, if the first period is less than five years, from the start of the first period to five years later; thirdly, from when the rebalance comes into effect to the end of the SAU – see NBN Co Submission, Appendix C, p. 28.

⁴¹⁷ NBN Co Submission, Appendix C, pp. 27-30.

The ACCC is also required to publish NBN Co's proposal or its proposed determination and take into account any submissions that are received before a time specified by the ACCC.⁴¹⁸ In addition, the ACCC must not reject an NBN Co proposal for a reason concerning uniform pricing, or make a determination that prevents NBN Co from engaging in conduct that is reasonably necessary to achieve uniform pricing.⁴¹⁹

NBN Co made a number of submissions in support of its proposed approach to the revenue neutral price review (as well as for new prices for new products, as set out above, since the 'Integrated Price Review Mechanism' is designed to perform both functions).⁴²⁰

Firstly, NBN Co submits that its proposal has a number of practical benefits:

- the prospect of ACCC intervention in certain circumstances provides positive incentives for NBN Co;
- the flexible timing for intervention allows the ACCC to choose an appropriate time for intervention (for example, in light of experience, or when data is available);
- the ability to commence a review before the end of Module 1 means that the outcomes of a review could take effect from the start of Module 2; and
- the provision for 'glide paths' allow transitional pricing issues to be managed.⁴²¹

Secondly, NBN Co submits that the Integrated Price Review Mechanism strikes an appropriate balance between promoting efficient use of the network and protecting NBN Co's legitimate business interests.⁴²² Specifically, NBN Co submits that it is in NBN Co's legitimate business interests to be able to price its existing services within a framework that provides certainty over long term cost recovery arrangements.⁴²³

Thirdly, NBN Co submits that the ACCC should not review prices in Module 1 because it is not necessary or useful for addressing retail price shock during migration, and because it would be inconsistent with NBN Co's legitimate business interests for the same reasons that the ACCC should not have a role in relation to pricing of new products in Module 1.⁴²⁴

Finally, NBN Co submits that the periods that must be considered by the ACCC for the purposes of the net revenue neutrality requirements contained in the 'Price Review Criteria' are for a number of different purposes:

- the first proposed period is to preserve the incentive properties of using forecast values for determining revenues during replacement modules;
- the second proposed period is to provide stability in cash flows to assist NBN Co in raising debt in a cost-effective manner; and
- the third proposed period is to ensure that value is preserved over the term of the SAU.⁴²⁵

ACCC response

Having considered NBN Co's proposed integrated price review mechanism, the ACCC is proposing to adopting significant aspects of the mechanism. These aspects include:

⁴¹⁸ Ibid, p. 29-30.

⁴¹⁹ Ibid, p. 30.

⁴²⁰ NBN Co Submission, pp. 77-78.

⁴²¹ Ibid, p. 77.

⁴²² Ibid, p. 78.

⁴²³ Ibid, p. 74.

⁴²⁴ Ibid, pp. 72-73.

⁴²⁵ Ibid, p. 76.

- the conferral of a power on the ACCC under the SAU to perform the review;
- the inclusion of an explicit opportunity for NBN Co to propose prices to address ACCC concerns;
- the ability to adopt Maximum Regulated Price 'glide paths' where appropriate;
- the proposal for a price review to begin prior to the expiry of Module 1 and to, if it results in a re-balancing, take effect from the start of Module 2; and
- most procedural aspects of the proposed power.

However, in the absence of the modifications to NBN Co's proposal that are discussed below, the ACCC is not satisfied that the mechanism would adequately address the issues raised in the Draft Decision. In formulating the six features of the proposed review mechanism that are discussed below, the ACCC has sought to ensure that the review will firstly, provide the positive incentives that NBN Co acknowledges a pricing review can deliver, secondly, accommodate the issues raised by NBN Co in its submission in relation to protecting NBN Co's legitimate business interests, while also promoting efficient use of the network, and lastly, reflect the views expressed by access seekers.

The ACCC proposes variations to give the review the following six features for the reasons set out below. A flowchart of the operation of the proposed price re-balancing process is included at Attachment C.

Firstly, the ACCC proposes that **a single review may occur in Module 1**.

As is the case with pricing of new products, the ACCC recognises the potential for NBN Co to face positive incentives at certain stages during the proposed SAU.

However, this does not mean that, solely on this basis, the ACCC can be satisfied that prices set in accordance with the price controls will promote efficient use of and investment in infrastructure, and competition, until 1 July 2023. Put another way, the ACCC does not consider that the potential for these positive incentives is sufficient for the SAU to *preclude* the ACCC requiring NBN Co to address demonstrable issues with its pricing for this period. In this respect, if NBN Co's observed behaviour during Module 1 indicates the desired impact of these incentives, the ACCC expects that it would not be necessary for it to undertake such a review.

By limiting the review to only being able to take place in the second half of Module 1, NBN Co is given certainty that the prices set out in the SAU would apply for a substantial period of time, and that all parties would have the benefit of experience and data before a review occurs.

Secondly, the ACCC proposes that **there should be three criteria that must be satisfied for a review.**

The proposed variation requires the ACCC to be satisfied of three matters, as outlined in Box 1, that directly reflect the objectives of the price re-balancing mechanism — that is, ensuring prices remain reasonable and net revenue neutrality for NBN Co over the term of the SAU.

Box 1: Proposed criteria for revenue-neutral rebalance

The matters that the ACCC must be satisfied of under proposed Schedule 1H, clause 1H.3, and proposed Schedule 2F, clause 2F.3 when rebalancing prices are that:

1. The rebalanced prices are reasonable (1H.3.8(a) and 2F.2.8(a)):

- (i) the ACCC is satisfied that the Maximum Regulated Price of each Reviewed Offer for each Financial Year that is an Adjusted Financial Year for that Reviewed Offer is reasonable, having regard to the matters specified in section 152AH of the CCA.

This means that any Maximum Regulated Price that is changed through the revenue-neutral rebalance must be changed to a Maximum Regulated Price that is reasonable.

2. Net revenue neutrality is achieved (1H.3.8(a) and 2F.2.8(a)):

- (ii) the ACCC is satisfied that there is no material difference between:
 - (A) the present value of the difference between the expected Revenue and expected costs that would be inputs to the ABBRR, between the commencement of the Price Review Arrangement and the SAU Expiry Date, if the Price Review Arrangement were in operation,
 - and
 - (B) the present value of the difference between the expected Revenue and expected costs that would be inputs to the ABBRR, between the commencement of the Price Review Arrangement and the SAU Expiry Date, if the Price Review Arrangement were not in operation.

This means that NBN Co should not be expected to be worse off in present value terms as a result of the revenue-neutral rebalance occurring.

3. The ACCC has taken into account the effect of the rebalance on other offers (1H.3.8(b) and 2F.2.8(b)):

In deciding whether to accept or reject a Price Review Proposal and in making an ACCC Determined Price Review Arrangement, the ACCC must take into account:

- (i) the characteristics of the Reference Offers, Non-Reference Offers and Other Charges other than the Reviewed Offers (in this clause 1H.3.8(b), Other Offers);
- (ii) the costs associated with Other Offers;
- (iii) the Revenue associated with Other Offers; and
- (iv) demand for Other Offers.

This means that the ACCC must consider how rebalanced prices interact with other prices that were not rebalanced (which, in any event, the ACCC would be required to do in order for net revenue neutrality to be achieved).

The ACCC notes that, under NBN Co's proposed approach, it could be extremely difficult in practice to simultaneously achieve *all* the outcomes prescribed by the SAU in order for an ACCC decision to be valid. That is, NBN Co's criteria are not mere objectives that must be

considered by the ACCC — an ACCC decision would likely be invalid if the ACCC could not be satisfied of each and every outcome prescribed by NBN Co in the SAU.

Thirdly, the ACCC proposes that **net revenue neutrality should be assessed over the term of the SAU.**

Both NBN Co and access seekers considered that net revenue neutrality should be determined over the remaining term of the SAU (at least).

The ACCC considers that this, in addition to the requirement for the ACCC to take into account any potential effect of a rebalance on NBN Co's products more generally, should provide certainty to NBN Co that adequate regard will be had to its legitimate business interests. This is because net revenue neutrality must be expected for an ACCC decision to be made in accordance with the mechanism, and because the ACCC must also have regard to any potential effect of a rebalance on NBN Co's products more generally, such as expected substitution effects between products whose prices have been re-balanced and other products.

The ACCC proposes that revenue neutrality be determined as no material difference in the present value of net revenues if the price review is in operation, and if the price review is not in operation. The ACCC has adopted a simplified version of NBN Co's net present value approach so as to ensure that the mechanism accounts for any changes in costs incurred by NBN Co that are included in its regulated cost base, and to ensure that the review is focused on whether there is no material difference in net revenues, rather than on a particular means of calculating net present value.

The ACCC does not propose to adopt the multi-period approach proposed by NBN Co, as the specific *outcomes* mandated may be very difficult to simultaneously achieve in practice. Further, the ACCC considers that the factors identified by NBN Co in its submission as relevant to the shorter periods (that is, the incentives created by the SAU, and NBN Co's ability to raise debt cost-effectively) are matters that the ACCC would consider as one aspect of NBN Co's legitimate business interests at the time a review may be conducted in any event.

In relation to the VHA proposal to allow NBN Co to increase prices to levels specified by the ACCC, the ACCC considers that in the absence of a revenue-neutrality requirement, the appeal of the simplicity of the approach is not sufficient to outweigh the greater uncertainty for NBN Co and access seekers that this proposal may create.

Consequently, the ACCC has sought to strike an appropriate balance between the simplicity of the VHA proposal and the prescription of the NBN Co proposal in formulating its proposed variation.

Fourthly, the ACCC proposes that **the review should consider the reasonableness of one or more Maximum Regulated Prices.** Considering the reasonableness of one or more Maximum Regulated Prices (rather than Maximum Regulated Prices in aggregate) ensures that the mechanism operates as contemplated by the Draft Decision — that is, that issues with a confined set of prices can be addressed without the requirement to revisit all other prices (beyond any revisitation required to ensure revenue neutrality, which would require the ACCC to take into account any potential effect of a rebalance on NBN Co's products more generally).

The requirement to consider the reasonableness of one or more Maximum Regulated Prices also means that the review considers the long-term interests of end-users, as proposed by access seekers who made submissions about the revenue-neutral price review.

Fifthly, the ACCC proposes that **the threshold to commence a review should be that the ACCC considers such a review should occur.**

In contrast, the ACCC considers that NBN Co's proposed 'reason to believe' threshold, that explicitly requires the ACCC to make findings regarding the reasonableness of NBN Co pricing

before a review has commenced, could create perceptions that the ACCC has prejudged the issues that it must subsequently consider in the review.

Finally, the ACCC proposes that **another review cannot occur until a previous review has been implemented**. As discussed in section 2.4.1.2 above, initial pricing for new products is not proposed by the ACCC to be addressed through the price review mechanism. If it were, this might give rise to the need for a price review to be able to occur at any point in time. On the other hand, given that initial pricing for new products will be addressed via the normal operation of Part XIC, there do not appear to be circumstances that would arise whereby the ACCC would need to conduct another price review before implementation of the previous review has concluded.

In relation to Telstra's submission about the ACCC having a formal role in reviewing CVC pricing over time, the ACCC notes that the revenue-neutral price review would not preclude the ACCC from undertaking a review of CVC pricing in the manner proposed by Telstra.

Further, if such a review would promote the long-term interests of end-users, the ACCC considers that its existing statutory powers (including making record-keeping rules under section 151BU of the CCA, and holding inquiries under Part 25 of the *Telecommunications Act 1997*) would accommodate such a review.

Consequently, no specific variation to the SAU is proposed in relation to Telstra's submission.

2.4.1.4. Tax change events

The SAU permits NBN Co to increase Maximum Regulated Prices above the levels permitted by the CPI-1.5 per cent price controls in circumstances that are defined as 'tax change events'.⁴²⁶ Of note, the definitions of 'tax' and 'tax change events' vary between Module 1 and Module 2, the SAU gives NBN Co discretion to apportion a tax increase amongst its products, and there is no corresponding decrease to Maximum Regulated Prices under the SAU where taxes are reduced (though NBN Co would need to adjust its pricing once it enters the building block period to account for its reduced costs).⁴²⁷

In the Draft Decision, the ACCC recognised that taxes imposed on NBN Co by Government agencies are a direct cost of doing business, and that allowing NBN Co to recover these costs from its customers would have appropriate regard to NBN Co's direct costs and legitimate business interests.⁴²⁸

However, the ACCC also recognised that strong commitments about individual prices could create incentives for NBN Co to both invest and operate efficiently and for it to encourage efficient use of the NBN — NBN Co's ability to increase prices above the price control could, depending on the size of the price increase applied, have implications for these efficiency incentives.⁴²⁹

In the Draft Decision, the ACCC suggested that issues with the proposed treatment of tax changes could be addressed through the revenue neutral price review.⁴³⁰ Given the fact that the ACCC was consulting broadly on the revenue-neutral price review, the ACCC did not seek specific views in the Consultation Paper in relation to tax change events.

Submissions from interested parties

NBN Co submits that a revenue-neutral price review would allow the ACCC to consider whether relative prices are efficient after tax events have occurred, and submits that NBN Co

⁴²⁶ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1D, clause 1D.5 and Schedule 2C, clause 2C.3.

⁴²⁷ *Ibid.*, Schedule 1D, clause 1D.5 and Schedule 2C, clause 2C.3.

⁴²⁸ ACCC Draft Decision, p. 127.

⁴²⁹ *Ibid.*

⁴³⁰ *Ibid.*

has incentives to pass through the effects of tax change events in an efficient manner.⁴³¹ NBN Co proposes that SAU clauses that refer to 'incremental tax effect' be varied to refer to 'net incremental tax effect' so that it would be required to net off the effect of any tax decreases against the effect of any tax increases when it changes prices after a tax change event.⁴³²

Other interested parties did not make submissions about tax change events in response to the Consultation Paper. However, access seekers have previously done so in response to the November 2012 Consultation Paper. Macquarie Telecom submitted that the nature of tax change events was uncertain.⁴³³ Telstra submitted that the SAU provides NBN Co with broad discretion to determine the manner in which it will pass through the effects of tax changes, and that this can be contrasted with tax pass through provisions applying to other regulated utilities, which are more clearly defined and subject to regulatory oversight.⁴³⁴ In relation to specific aspects of tax change events in the SAU, Telstra submitted that:

- the scope of tax change events should only include where NBN Co becomes liable to pay an amount of tax (whether directly, or as paid after passed through by suppliers);
- there should be clear time limits on when pass throughs for tax changes can occur;
- it is unclear what methodology would be applied by NBN Co in determining the pass through of a tax increase — there should be ACCC oversight of increases in Maximum Regulated Prices; and
- the definitions are not symmetrical, as NBN Co may pass through a tax increase, but is not required to pass through a decrease.⁴³⁵

ACCC response

In relation to the 'symmetry' of pass-through of tax change events to Maximum Regulated Prices, the ACCC has concerns with any mechanism that does not account for reductions in taxes imposed on NBN Co.

This is because, in establishing a relationship between costs and revenues (for a given demand profile), the price controls in the SAU (ie. Maximum Regulated Prices) are a primary source of incentives for NBN Co.

The ACCC acknowledges that if Maximum Regulated Prices were not reduced in order to take account of a reduction in taxes, the initial cost recovery account balance would be reduced — all other things being equal — by the additional revenue that results from keeping Maximum Regulated Prices constant when NBN Co's tax costs decrease. In turn, the initial cost recovery account may be recovered sooner than if Maximum Regulated Prices were reduced in response to the decrease in taxes.

However, keeping Maximum Regulated Prices constant in these circumstances could also reduce the incentives that NBN Co faces to price, operate and invest efficiently, as these incentives are likely to be affected by the level of the initial cost recovery account and NBN Co's expectations about when it will be able to recover its costs. The incentives to behave efficiently with respect to pricing, investment and operations derive from the prospect that NBN Co may not be able to recover its costs — incentives are in turn created for it to price in such a manner as to increase demand and revenues, and to operate and invest in such a way that only efficient costs are incurred. To the extent that the prospect of NBN Co being able to recover its costs is enhanced by virtue of a decrease in one element of those costs not having

⁴³¹ NBN Co Submission, p. 81.

⁴³² Ibid.

⁴³³ Macquarie Telecom, *Submission to the ACCC in relation to the NBN Co Limited 2012 Special Access Undertaking*, 18 January 2013, p. 15.

⁴³⁴ Telstra, *NBN Co 2012 Special Access Undertaking: Telstra's response to the ACCC Consultation Paper*, 18 January 2013, p. 81.

⁴³⁵ Ibid, pp. 81-82.

to be reflected in the price controls, these incentives may be dulled. In other words, keeping Maximum Regulated Prices constant following a reduction in taxes may instead mean that additional costs are incurred and included in the initial cost recovery account, rather than the initial cost recovery account being reduced sooner.

Allowing Maximum Regulated Prices to remain constant following a reduction in NBN Co's tax costs therefore does not merely result in the initial cost recovery account being expected to be recovered more quickly. It may also impact upon the integrity of the incentives for NBN Co to price, operate and invest efficiently that are created by the price controls. Consequently, reducing Maximum Regulated Prices in the event of negative tax change events ensures that these incentives will not be weakened.

The ACCC considers that NBN Co's proposed variation that would require it to 'net off' reductions in taxes does not address the underlying issues with the treatment of tax change events in the SAU that are identified above. While this variation would provide for a more accurate reflection of the change in costs incurred by NBN Co in some circumstances, the ACCC considers that this variation would need to be incorporated into a package of variations that address these issues.

The ACCC therefore proposes variations in the draft notice to vary that provide for the treatment of tax change events to be symmetric for the term of the SAU. The ACCC has proposed specific variations to achieve this during Module 1, and variations that provide for this to be achieved through the replacement module process during Module 2.

The ACCC also has concerns about the implications of NBN Co administering how it changes Maximum Regulated Prices in response to a tax change event, particularly because it is effectively an exception from the price controls. Related to the above point, placing primary responsibility with NBN Co for deciding how much it should increase or decrease Maximum Regulated Prices by in light of tax change events would provide NBN Co with a measure of control over the strength of its efficiency incentives.

Further, were NBN Co to administer its response to tax change events, it may increase the need to undertake a revenue-neutral price rebalance if relative prices are able to be changed in ways that impact upon efficient use of the NBN where this would not otherwise occur.

Although the ACCC considered in the Draft Decision that tax change events *could* be considered during a revenue-neutral price rebalance, upon further consideration, it is apparent that it would be difficult to use such a mechanism to change Maximum Regulated Prices to account for tax change events without adding significant complexity. For example, if NBN Co has not reduced Maximum Regulated Prices to reflect reductions in taxes, a review that is designed to achieve this result should not, by definition, be revenue neutral, and this would therefore need to be accounted for in the design of the revenue-neutral price review. Rather than add complexity to a mechanism that has been designed to fulfill a different purpose, the ACCC now considers that the better approach is to create a mechanism that deals with the issues that are specific to tax change events.

The ACCC therefore proposes in the draft notice to vary that Module 1 include a role for the ACCC to determine changes to Maximum Regulated Prices in response to tax change events if the tax change events or their pricing impacts cannot be agreed between NBN Co and Access Seekers. The ACCC has proposed variations that provide for this to occur during Module 2, with the specific manner in which this occurs to be determined through the replacement module process.

In addition to the issues identified above, the ACCC notes that the asymmetric treatment of tax changes and an absence of regulatory approval to change regulated price levels would contrast with how these matters are normally addressed in other regulatory regimes (for example, in the National Electricity Rules).

Lastly, the ACCC agrees with Telstra that the definitions of 'tax' and 'tax change events' are complex and require some variation, as follows:

- As defined in the December 2012 SAU, a decrease in a tax would not constitute a 'tax change event', so this definition must be varied in order to provide for Maximum Regulated Prices to be reduced in these circumstances.
- Changes to taxes imposed on third parties do not normally constitute tax changes for regulatory purposes, and the ACCC consequently proposes that these be removed from the definitions in the SAU.

The ACCC acknowledges that changes to income, profit or capital gains taxes do not normally constitute tax changes for regulatory purposes, in contrast to NBN Co's proposed definition of tax change events for Module 2. The ACCC has therefore proposed that the definitions relating to tax change events be limited in application to Module 1, which corresponds with the period during which NBN Co has not proposed that these matters would constitute tax change events. During the replacement module process, definitions for tax change events during Module 2 would be established, and the ACCC could consider whether there are any persuasive reasons for employing a different approach to tax change events under the SAU during Module 2 than that which is employed in other regulated industries.

The ACCC proposal therefore involves the SAU being varied in the following ways.

Firstly, the definitions relating to tax change events would be varied to limit their application to Module 1, and to make the application of the tax change event symmetrical so that a tax change event occurs if taxes increase or decrease. The ACCC proposes that the SAU should define a 'positive tax change event' and a 'negative tax change event' for this purpose. Proposed variations to provide for tax change events to be addressed through replacement modules provide for definitions to be established during Module 2.

Secondly, variations would provide for the ACCC to oversee changes to the price controls for tax change events during Module 1 to address circumstances where NBN Co and Access Seekers cannot agree on the impact of tax change events to Maximum Regulated Prices.⁴³⁶ Proposed variations to the required contents of replacement modules provide for equivalent oversight to be established during Module 2.

Thirdly, variations to related aspects of the long-term revenue constraint methodology in Module 2 provide for implementation of the tax change event arrangements concerning this methodology that will be established through replacement modules.

The effect of the variations proposed by the ACCC is that during Module 1, NBN Co would be able to notify the ACCC if a tax change event that changes NBN Co's costs occurs. The purpose of these notifications is, firstly, for the ACCC to determine a total change in NBN Co's costs ("how much") and, secondly, to determine changes in Maximum Regulated Prices that are reasonable and will change NBN Co's revenues to reflect the change in costs ("how achieved").

The mechanism envisages that changes to Maximum Regulated Prices may primarily be achieved through agreement between NBN Co and Access Seekers. However, if agreement cannot be reached on this matter, the mechanism envisages NBN Co first proposing the total change in its costs and changes to Maximum Regulated Prices that reflect this change in costs, and the ACCC making a determination in accordance with a power conferred under the SAU.

⁴³⁶ The drafting proposed to implement this is structured as follows. Firstly, the processes and procedures about tax change events in Module 1 that are contained in both Schedule 1C (prices for reference offers) and Schedule 1D (prices for non-reference offers) are proposed to be moved into a single schedule so that the SAU contains a single, streamlined set of obligations, processes and decisions for tax change events in Module 1. Secondly, the replacement module process would provide for equivalent clauses to be contained in replacement modules during Module 2.

This would then result in Maximum Regulated Prices changing in accordance with the ACCC determination. Consequently, the price controls explicitly recognise that Maximum Regulated Prices change in accordance with this determination. If NBN Co does not propose changes to Maximum Regulated Prices as a result of a negative tax change event, the proposed variations provide for the ACCC to make a determination that changes Maximum Regulated Prices. Variations to the replacement module provisions in the SAU that would allow for the same outcomes to be achieved during Module 2 are also proposed, which allow for the specific arrangements to be determined through the replacement module process.

The preliminary view of the ACCC is that the above variations firstly, have adequate regard to NBN Co's legitimate business interests by providing a means for its prices to reflect certain tax costs, secondly, are sufficient to address the issues that have been identified by the ACCC, and thirdly, address the concerns about tax change events that have been raised by access seekers in previous submissions.

2.4.2. Long-term revenue constraint

The 18 December 2012 SAU contains a long-term revenue constraint methodology (LTRCM) that is used to calculate the amount of revenue that NBN Co will be able to recover through its prices over the term of the SAU. The methodology includes a regulatory asset base (RAB), annual revenue requirements based on building block components, and an initial cost recovery account (ICRA) that will allow NBN Co to defer the recovery of initial revenue shortfalls.⁴³⁷

According to the 18 December 2012 SAU, for the term of the SAU the RAB would be determined by NBN Co by adding actual capital expenditure to the RAB, and subtracting actual depreciation and disposals of assets.⁴³⁸

During Module 1, the annual revenue requirements would be determined annually by NBN Co on an ex-post basis, by it applying the methodologies set out in the SAU for calculating the individual building block components (operating expenditure, a return on capital, regulatory depreciation, a tax allowance and an annual construction-in-progress allowance). During Module 2, NBN Co's annual revenue requirements would be determined 'upfront' based on forecast annual revenue requirements approved by the ACCC as part of the replacement module process. Module 2 includes methodologies specified at varying levels of detail and prescription that would be used to calculate the values of the individual building block components that comprise the annual revenue requirements.

In the draft Notice to Vary, the ACCC has sought to maintain the existing structure of the long-term revenue constraint as much as possible, including the adoption of a RAB, an ICRA and the use of building block components to determine annual revenue requirements. The key variations that the ACCC has proposed to the long-term revenue constraint methodology are as follows:

- In Module 1, the RAB, ICRA and annual revenue requirements will continue to be determined on an ex-post basis by applying the methodologies set out in the SAU. However, the draft Notice to Vary proposes that the ACCC will determine these values, rather than NBN Co, including the values of capital and operating expenditure. The draft Notice to Vary also includes variations to the methodologies for calculating capital and operating expenditure, the tax allowance and the annual construction-in-progress allowance.
- In Module 2, the annual revenue requirements will continue to be determined based on forecasts approved by the ACCC. However, the draft Notice to Vary proposes that most of the detailed methodologies for calculating the forecasts of the individual

⁴³⁷ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedules 1E, 1F and 2D.

⁴³⁸ *Ibid*, Schedule 1E, clause 1E.2.1(b); Schedule 2D, clause 2D.7.1(b).

components should be removed. The draft Notice to Vary also proposes that the process for rolling forward the RAB should be determined for each regulatory cycle as part of the replacement module process, rather than being locked in based on actuals for the term of the SAU.

The rest of this section sets out the variations that the ACCC is proposing in relation to the long-term revenue constraint methodology:

- section 2.4.2.1 sets out some overarching issues with the long-term revenue constraint methodology (in particular, the interaction between the price controls described above and the long-term revenue constraint methodology, the mechanics of the ACCC's assessment of LTRCM components and the assumptions made with respect to the timing of cash-flows);
- section 2.4.2.2 sets out the ACCC's proposed variations to the long-term revenue constraint methodology in Module 1; and
- section 2.4.2.3 sets out the ACCC proposed variations to the long-term revenue constraint methodology in Module 2.

2.4.2.1. Overarching issues with the long-term revenue constraint methodology

Interaction between the price controls and the long term revenue constraint methodology

As outlined above, the 18 December 2012 SAU provides for CPI-1.5 per cent price controls to apply in relation to individual prices of reference offers, non-reference offers, and other charges during both Module 1 and Module 2; it also contains a long-term revenue constraint methodology, which is based on the building block methodology often adopted in regulating utilities, but which also includes an 'initial cost recovery account'.

In section 5.1 of the Draft Decision, the ACCC considered that it was not clear whether the CPI-1.5 per cent price controls or the regulated revenue allowance determined using the long term revenue constraint methodology would take precedence at different stages during the SAU term. Specifically, the ACCC considered that it was not clear that the price controls and the annual revenue requirements interacted as it understood NBN Co intended them to, namely that whilst NBN Co is in:

- the loss accumulation and loss recovery phases, even if setting prices up to the maximum allowed by the price controls prevented NBN Co from earning enough revenue to recover its accumulated revenue shortfalls, NBN Co would still not be able to increase prices above the price controls; and
- the revenue cap phase, its prices will be set to only allow it to recover its annual revenue requirements — so, if setting prices up to the maximum level allowed by the price controls were to allow NBN Co to earn more than its annual revenue requirements, NBN Co would be required to reduce prices below those allowed for by the price controls in order to reduce its revenues and comply with the revenue requirements.

Submissions

NBN Co submits that the SAU is clear on this matter.⁴³⁹ However, NBN Co proposes a variation in response to include an interpretation provision in Attachment C (Dictionary and Interpretation) to Module 0. This variation provides for every provision in the SAU to apply

⁴³⁹ NBN Co Submission, p. 64.

separately and independently, with provisions not to be read down by reference to any other provision unless provided otherwise.⁴⁴⁰

Other submissions did not address this issue.

ACCC response

The ACCC considers that it is necessary for the SAU to be absolutely clear about this matter.

In contrast to most other regulatory regimes, the CPI-1.5 per cent price control is intended to operate for the term of the SAU, including across regulatory cycles during Module 2. In other regulatory regimes, a price reset before the start of a new regulatory period (that is, before a new regulatory cycle) may provide for price caps to be increased or decreased so that the access provider expects to earn revenues during the forthcoming regulatory period that are determined in accordance with a building block methodology.

Under the SAU, the ACCC understands that NBN Co is not intended to be able to *increase* Maximum Regulated Prices (that is, the CPI-1.5 per cent price control) in order to expect to be able to earn revenues calculated in accordance with the long term revenue constraint methodology; but is intended to have to *decrease* prices below Maximum Regulated Prices in order to expect to *only* earn revenues calculated in accordance with the long term revenue constraint methodology, once the building block period commences.

The ACCC does not consider that NBN Co's proposed variation is an appropriate means of providing clarity on this issue.

Firstly, the variation is not specifically directed at the interaction between the price controls and the long term revenue constraint methodology. The variation therefore would not provide greater clarity that the SAU operates somewhat differently to more conventional regulatory approaches — specifically, that NBN Co is always subject to the CPI-1.5 per cent price controls and must lower prices if Maximum Regulated Prices would otherwise mean NBN Co is expected to earn more than its allowed revenues (with no corresponding right to raise prices).

Secondly, the proposed variation applies to every provision in the SAU, which raises the potential for unintended consequences to result from its inclusion.

Consequently, the ACCC has proposed variations to ensure absolute clarity over this specific matter. These specific variations are required in order to ensure that these sections of the SAU operate as intended, and will be understood to operate in this manner by those considering the terms of the SAU in the future.

Mechanics of ACCC assessment of LTRCM components and transitional issues

A key difference between the draft Notice to Vary and the 18 December 2012 SAU is the inclusion of an ACCC role in determining LTRCM components during Module 1 (this is discussed in section 2.4.2.2). After giving further consideration to the implications of this change and how the mechanics of the ACCC's assessments will operate in practice, the ACCC has identified some practical issues that may require further variations to the SAU.

These issues relate mainly to the transition between firstly, Modules 1 and 2 and secondly, the transition between regulatory cycles in the building block revenue period in Module 2.

Regarding the first category of 'transitions', in Module 1 the ACCC would assess LTRCM components on an ex-post basis while in Module 2 it would assess forecasts of the LTRCM components as part of the replacement module process before the relevant regulatory cycle begins. In the transition from Module 1 to Module 2, it is likely that certain components of the LTRCM that are required under the SAU to be assessed as part of a replacement module

⁴⁴⁰ Ibid.

application will not have been finalised by the ACCC in its ex-post assessment of those LTRCM components in the final year of Module 1. This ex-post assessment may not be completed until up to one year into Module 2.

The opening RAB and ICRA balances in Module 2 are two LTRCM components which provide an example of how this could occur. These balances are based in part on values for capital expenditure and unrecovered cost in the last year of Module 1, which would not be known until the ACCC completes its ex-post assessment of these values. To address this specific issue, the ACCC has included clauses in the draft Notice to Vary that allow for the opening RAB and ICRA balances in Module 2 to be determined based on estimated amounts for periods where actual information is not known.

Although these proposed variations appear to address this specific issue, the remaining issue is how any differences between the estimates and the actuals should be addressed.

Another key transitional issue relates to amounts carried forward between regulatory cycles during the building block revenue period in Module 2. In each regulatory cycle, NBN Co's allowable revenues would be based on forecast nominal allowable revenues approved by the ACCC as part of the replacement module process.⁴⁴¹ Clause 2D.5 provides for these allowable revenues to be adjusted for amounts carried forward from either module 1 (in the case of the first regulatory cycle in Module 2) or the previous regulatory cycle.⁴⁴² However, these carry-forward amounts would not be known until the regulatory cycle begins. There is therefore an issue about whether a provision for these amounts should be made (in the form of an estimated amount) as part of the ACCC's assessment of replacement modules, and if so, whether any explicit mechanism is required to address any deviation between the estimates and the actual values of the carry forward amounts.

The ACCC is giving further consideration to these matters and welcomes views from interested parties in response to the draft Notice to Vary.

Half-WACC adjustment to capital expenditure

In regulation that involves the application of a Building Block Methodology, assumptions need to be made about 'when' throughout a year the cash flows associated with capital expenditure, operating expenditure and revenues occur. This is because whilst in reality these cash flows are likely to occur throughout a year, it would be impractical to apply the Building Block Methodology on an 'as occurs' basis. Typically, for the purposes of applying the Building Block Methodology, it is assumed that these cash flows occur either in the middle of the year, or at the end of the year.

In the 18 December 2012 SAU, the long-term revenue constraint equations in Module 1 are based on the assumption that capital expenditure is incurred evenly throughout the year, and half-way through the year on average. On the other hand, the long-term revenue constraint methodology assumes that operating expenditure is incurred, and revenues received, at the end of the year.⁴⁴³

This difference in the assumptions about the timing of cash flows is reflected in a 'half-WACC adjustment' to capital expenditure in the LTRCM. That is, when capital expenditure is rolled into the RAB, it is inflated by the equivalent of half a year's return on that capital expenditure. The proposed rationale for this adjustment is to compensate NBN Co for the average half-year delay between when an asset associated with an amount of capital expenditure comes into

⁴⁴¹ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 2D, clause 2D.5.1(a).

⁴⁴² The amounts carried forward are under-recovered or over-recovered amounts under the revenue constraint in the building block revenue period or the carry forward revenue adjustment from the last period of the ICRA period.

⁴⁴³ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1E, clause 1E.2.1.

service (assumed to be in the middle of the year) and when that expenditure is rolled into the RAB (at the end of the year).⁴⁴⁴

In both Module 1 and Module 2, the half-WACC adjustment is reflected in the RAB roll-forward formulas.⁴⁴⁵ The adjustment is also reflected in Module 1 in the calculation of the annual construction-in-progress allowance.⁴⁴⁶ The adjustment is also reflected in Module 2 by the inclusion of an 'NPV=0 criterion' which states that forecast regulated revenues over a regulatory cycle must be calculated in such a way as to result in the Net Present Value of expected future cash flows (with adjustments as required to account for timing assumptions) being zero during the regulatory cycle and across regulatory cycles.⁴⁴⁷

In section 5.5 of the Draft Decision, the ACCC noted that if the long-term revenue constraint methodology establishes an expectation that NBN Co will be able to recover the prudent cost of its investment (including a normal commercial return) over time and no more, then the net present value of expected future cash flows should be zero. The ACCC's assessment indicated that the methodology as proposed in the SAU can result in a net present value of zero, however this result only occurs when it is assumed that cash flows associated with capital expenditure occur in the middle of the year, and cash flows associated with operating expenditure and revenues occur at the end of the year.

It was noted in section 5.5 of the Draft Decision that the ACCC had not been provided with information from NBN Co which supported the making of these assumptions. In section 2.4.2 of the Consultation Paper, the ACCC stated its preliminary view that, in the absence of further information about the assumptions, the ACCC could not be satisfied that they are reasonable. The ACCC further noted that, in the event that NBN Co could not satisfy the ACCC that the assumptions are reasonable, it would be proposing that the long-term revenue constraint equations be varied in such a way as to achieve internal consistency with respect to the assumptions that are made about the timing of cash flows associated with capital expenditure, operating expenditure and revenues.

Submissions

NBN Co's submission to the Consultation Paper notes the following views:

- The cash flow timing assumptions in Module 1 are consistent with the Fixed Line Services Model (FLSM) used by the ACCC to set prices for Telstra's fixed-line services, and the Post Tax Revenue Model (PTRM) used by the AER to set revenue and price caps for energy network businesses.⁴⁴⁸ As such, NBN Co submits that the cash flow timing assumptions reflect current regulatory practice in relevant infrastructure sectors.⁴⁴⁹
- The mid-year capital expenditure assumption is a reasonably robust and realistic assumption, with the value of assets placed in service expected to be relatively evenly distributed throughout the year.⁴⁵⁰
- The NPV=0 criterion in Module 2 addresses the issue of cash flow timing and provides flexibility in regard to how it can be addressed in each regulatory cycle.⁴⁵¹
- The ACCC should be assessing the LTRCM as a whole, rather than individual elements; if cash flow timing assumptions were adjusted there may need to be

⁴⁴⁴ The half-WACC adjustment is also applied to the construction-in-progress account, which reflects the assumption that expenditure is added to, and deducted from, the account in the middle of the year on average.

⁴⁴⁵ Ibid, Schedule 1F, clause 1E.2.1(b) and Schedule 2D, clause 2D.7.1(b).

⁴⁴⁶ Ibid, Schedule 1F, clause 1F.9.1(b).

⁴⁴⁷ Ibid, Schedule 2D, clause 2D.2.1(b).

⁴⁴⁸ NBN Co Submission, p. 83.

⁴⁴⁹ Ibid.

⁴⁵⁰ Ibid, p. 82.

⁴⁵¹ Ibid.

adjustments made elsewhere in the LTRCM, for example to the 350 basis point margin used in the WACC.⁴⁵²

Submissions from other interested parties note the following:

- Optus submits that it agrees with the ACCC's proposed variation, and it agrees that the WACC should be applied at the same time irrespective of whether expenditure is classified as capital or operating — with a preference for an end-of-year application.⁴⁵³
- VHA submits that it agrees with the ACCC's proposal to vary the SAU so as to achieve internal consistency with respect to assumed cash flow timing.⁴⁵⁴

Other submissions did not provide views on this matter.

ACCC response

The ACCC has considered these submissions, and notes the following.

Firstly, whilst a half-WACC adjustment has been implemented in previous regulatory decisions in the context of the FLSM and the PTRM, in those contexts, the ACCC is able to review the FLSM's cash flow timing assumptions and the National Electricity Rules provide for the PTRM to be amended "from time to time".⁴⁵⁵ The AER has indicated that it reserves the right to review cash flow timing assumptions for the purposes of the PTRM in the future.⁴⁵⁶ In contrast, in the current context, acceptance of the SAU in its current form would mean that the half-WACC adjustment, and hence the inconsistent cash flow timing assumptions, would be 'locked in' for the SAU term. That is, the ACCC would have no scope to review or amend the cash flow timing assumptions in the LTRCM for the SAU term, and only NBN Co would be able to initiate a change.

In addition, the ACCC has previously expressed its views in relation to inconsistent cash flow timing assumptions in the context of the Australian Rail Track Corporation's (ARTC) Hunter Valley Access Undertaking (HVAU). In its June 2011 final decision on this undertaking, the ACCC expressed the view that the implementation of a building block model should not result in a regulated firm expecting to achieve a non-zero net present value from its investment.⁴⁵⁷ The ACCC considered that a lack of precision in relation to cash flow timing when calculating ARTC's allowed revenues may provide for undesirable incentives that may not promote economically efficient investment in infrastructure.⁴⁵⁸

Whilst the HVAU and associated cash flow timing assumptions were ultimately accepted by the ACCC, this was because the ACCC was of the view that, overall, the HVAU provided an appropriate constraint on revenues, and because the Hunter Valley Rail Network had at the time been subject to regulation under the NSW Rail Access Undertaking for some time.⁴⁵⁹ A degree of imprecision in the mechanics of the financial model in the HVAU was considered tolerable in the context of the transition to a new regulatory framework.⁴⁶⁰ Further, the term of the HVAU is five years (from the date of acceptance). In contrast, in the current context:

⁴⁵² Ibid, p. 83.

⁴⁵³ Optus Submission, p. 25.

⁴⁵⁴ VHA Submission, p. 9.

⁴⁵⁵ In accordance with consultation procedures which must be followed to implement such an amendment. See *National Electricity Rules*, Chapter 6, clause 6.4.1.

⁴⁵⁶ AER, *Electricity transmission network service providers: Post-tax revenue model – Final decision*, September 2007, pp. 5-6.

⁴⁵⁷ ACCC, *Decision in relation to Australian Rail Track Corporation's Hunter Valley Rail Network Undertaking*, June 2011, p. 42.

⁴⁵⁸ Ibid, p. 43.

⁴⁵⁹ Ibid.

⁴⁶⁰ Ibid.

- the ACCC does not consider that the LTRCM as a whole will provide an appropriate constraint on NBN Co's revenues, as a result of the inconsistencies in the assumptions made about cash flow timing;
- acceptance of the SAU would provide for the establishment of a new regulatory regime, not a transition from an existing one — assumptions that are made about the timing of cash flows should be reasonable from the commencement of the new regulatory regime; and
- the SAU proposed by NBN Co has a term of 27 years — as noted, acceptance of the SAU in its current form would lock in inconsistent cash flow timing assumptions for 27 years.

Secondly, whilst NBN Co submits that the mid-year capital expenditure assumption is a reasonably robust and realistic assumption, it does not provide any economic arguments to support this assertion, nor does it provide any economic arguments in support of why the inconsistency with its assumptions about when operating expenditure and revenue cash flows occur is reasonable.

Thirdly, with respect to NBN Co's submission that the NPV=0 criterion in Module 2 addresses the issue of cash flow timing and provides flexibility in regard to how it can be addressed in each regulatory cycle, the ACCC notes that:

- The proposed RAB roll-forward mechanism in Module 2 includes a half-WACC adjustment to capital expenditure⁴⁶¹ — it therefore appears that NBN Co intends for the same inconsistent treatment of cash flows to apply in Module 2.
- Building Block models, such as the LTRCM, that make inconsistent assumptions about the timing of cash flows will be capable of producing a zero net present value result if the same inconsistent assumptions are made when calculating the net present value of future cash flows. The ACCC's analysis indicates that if the inconsistent assumptions in the SAU are made when calculating revenue requirements, but if *consistent* assumptions are made when calculating the net present value of future cash flows (and all cash flows are assumed to occur at the end of the year), the LTRCM results in a positive net present value. The NPV=0 criterion in Module 2 will therefore not necessarily ensure that NBN Co will be compensated for only its efficient costs.

The ACCC therefore does not consider that the NPV=0 criterion in Module 2 addresses the issue of inconsistent assumptions about cash flow timing. Further, the ACCC considers that the same assumptions that are made in Module 1 in relation to cash flow timing should also be made in Module 2.

Finally, in response to NBN Co's submission that if the cash flow timing assumptions are to be adjusted there may need to be adjustments made elsewhere in the LTRCM (for example, to the rate of return in Module 1), the ACCC:

- again notes that NBN Co has not provided any arguments to support why its assumptions that capital expenditure occurs in the middle of the year, but operating expenditure and revenues occur at the end of the year are a reasonable reflection of its actual circumstances — it has therefore also not provided any arguments or evidence to support the claim that it should be compensated in some other form if cash flow timing assumptions are adjusted.
- re-iterates that its analysis has indicated that the half-WACC adjustment results in the net present value of NBN Co's expected future cash flows being positive (using consistent end-of-year cash flow timing assumptions in the calculation of net present

⁴⁶¹ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 2D, clause 2D.7.1(b).

value). If the LTRCM establishes an expectation that NBN Co will not be over-compensated relative to efficient costs, then the net present value of expected future cash flows should be zero. If the half-WACC adjustment were to be removed from the SAU, the net present value of expected future cash flows would be zero. The inclusion of the half-WACC adjustment in the SAU therefore over-compensates NBN Co relative to its efficient costs. Any alteration elsewhere in the LTRCM that would have the effect of offsetting the removal of the half-WACC adjustment would therefore similarly over-compensate NBN Co relative to its efficient costs.

In summary, the ACCC is not satisfied that assuming that the cash flows associated with capital expenditure, operating expenditure and revenues occur at different times of the year on average will lead to NBN Co being compensated for only its efficient costs (including a normal commercial return).

The ACCC therefore proposes in the draft Notice to Vary that, in both Module 1 and Module 2, it be assumed that all of these cash flows occur at the end of the year on average, and therefore that the half-WACC adjustment be removed.

The ACCC would also consider it reasonable to consistently assume that cash flows occur in the middle of the year on average. However, the ACCC notes that the formulas required to implement this approach are more complex than for implementing an approach that assumes end-of-year cash flows. Hence, the ACCC has proposed in the draft notice that consistent end-of-year assumptions be made.

2.4.2.2. Long-term revenue constraint methodology in Module 1

This section sets out the variations that the ACCC is proposing in relation to the following terms and conditions of the long-term revenue constraint methodology in Module 1:

- the administration of the long-term revenue constraint methodology;
- capital expenditure — the primary test, the minor expenditure limit, and the customer engagement process;
- operating expenditure;
- rate of return;
- tax allowance;
- regulatory depreciation; and
- annual construction-in-progress allowance.

Administration of long-term revenue constraint methodology

Under Schedule 1E and Schedule 1F of the 18 December 2012 SAU, the RAB, initial cost recovery account and the annual revenue requirements will be calculated annually by NBN Co by applying methodologies as set out in these schedules.⁴⁶² In the Draft Decision, the ACCC considered that the operation of the ex-post approach, if administered by NBN Co, in practice will likely reduce NBN Co's incentives to invest and operate efficiently.⁴⁶³ In particular, the ACCC noted that this could allow NBN Co to overstate its costs relative to an efficient level.⁴⁶⁴ The ACCC was therefore not satisfied that NBN Co's administration of the long-term revenue constraint methodology would ensure that it is only able to earn revenues that reflect efficient

⁴⁶² Ibid, Schedule 1E, clause 1E.2.1(b); Schedule 1F, clause 1F.3.1.

⁴⁶³ ACCC Draft Decision, pp. 135-136.

⁴⁶⁴ Ibid, p. 136.

costs.⁴⁶⁵ Further, the ACCC considered that NBN Co administering the application of the methodology could give rise to perceptions that the outputs of the methodology are not impartial.⁴⁶⁶

In the Consultation Paper, the ACCC proposed that it be given a role to calculate the values of the building block components that are inputs to the annual revenue requirements, as well as the roll-forward of the RAB and initial cost recovery account. The Consultation Paper also discussed and sought views from stakeholders on:

- the particular mechanism that should be adopted and how it could be incorporated into the current drafting of the SAU;
- the timing of when the RAB, annual revenue requirements and initial cost recovery account should be calculated by the ACCC (for example, annually or at given intervals, such as every three or five years); and
- whether the ACCC should be constrained by any additional criteria to those currently in Module 1.

In its submission to the Consultation Paper, NBN Co agrees with the ACCC's position that it should have a direct role in applying the LTRCM.⁴⁶⁷ NBN Co also provides revised SAU drafting that would give effect to this role. Under NBN Co's proposed drafting, the ACCC's role would comprise the following features:⁴⁶⁸

- that the ACCC would be required to apply the LTRCM to determine the Annual Building Block Revenue Requirement (ABBRR), ICRA and RAB values, including the values of all relevant inputs to those items, with reference to the information provided by NBN Co to the ACCC under Schedule 1G in respect of the relevant Financial Year;
- that the ACCC would conduct an ex-post review to check that capital expenditure and operating expenditure is prudently incurred by NBN Co in accordance with the criteria specified in Schedules 1E and 1F;
- that the ACCC would be required to make a determination on the ABBRR, ICRA and RAB values in respect to each Financial Year, within 12 months after the end of that Financial Year;
- that the ACCC would be required to consult with NBN Co to the extent that it intends determining any values that are different to those provided by NBN Co to the ACCC under Schedule 1G; and
- additional criteria for capital expenditure and operating expenditure that the ACCC could have to have regard to in its assessment.⁴⁶⁹

Telstra and Optus both indicate support for the ACCC's position and provide some suggested drafting for giving effect to the ACCC's role in administering the LTRCM in Module 1.⁴⁷⁰ iiNet, AAPT and Macquarie Telecom also indicate support for the ACCC's position.⁴⁷¹

Other submissions did not provide views on this matter.

⁴⁶⁵ Ibid.

⁴⁶⁶ Ibid.

⁴⁶⁷ NBN Co Submission, p. 84.

⁴⁶⁸ Ibid, pp. 84-85. See also NBN Co Submission, Appendix C, pp. 40-86.

⁴⁶⁹ See capital expenditure and operating expenditure sections below for further discussion.

⁴⁷⁰ Telstra Submission, pp. 35-36; Optus Submission, pp. 25-27.

⁴⁷¹ iiNet Submission, p. 18; Macquarie Telecom Submission, p.10; AAPT Submission, p. 9.

The ACCC considers that the mechanism proposed by NBN Co reflects the ACCC's intention in the Consultation Paper that there should be an ACCC role in determining the values of the LTRCM. In particular, the mechanism requires the ACCC, rather than NBN Co, to determine whether NBN Co's proposed values satisfy the methodologies in the SAU, including for capital and operating expenditure. In the event that the ACCC did not consider that the values submitted by NBN Co satisfy the methodologies, it would be able to determine substitute values (including zero values) for inclusion in the ABBRR, ICRA and RAB. This would enhance the prospect that the SAU will encourage efficient investment in and use of the NBN.

In the draft notice, the ACCC therefore proposes a mechanism which reflects the drafting in NBN Co's submission; however, the ACCC also proposes some amendments to the methodologies for calculating the individual components of the LTRCM. These are discussed in the following sections.

The ACCC considers that this drafting will achieve similar outcomes to the drafting proposed for implementing the ACCC's role by Telstra and Optus in their submissions.

Capital expenditure (primary test)

Under Schedule 1E of the 18 December 2012 SAU, NBN Co would be allowed to include into its RAB all actual capital expenditure that:

- satisfies the 'Prudent Design Condition' — capital expenditure that is materially consistent with or within the scope of NBN Co's Network Design Rules;⁴⁷²
- satisfies the 'Prudent Cost Condition' — capital expenditure incurred using competitive tendering and procurement processes that comply with the NBN Co Procurement Rules, or comply with a number of other provisions;⁴⁷³ or
- is deemed to have been prudently incurred in accordance with specified 'deemed prudent' categories of expenditure.⁴⁷⁴

Schedule 1E also allows NBN Co to vary the Network Design Rules under a number of circumstances, including when the change is a 'permitted variation'⁴⁷⁵ or (if not a permitted variation) when the change is endorsed through a customer engagement process (discussed separately below).

As noted in the Draft Decision, the ACCC considered that the prudent design condition and prudent cost condition may allow NBN Co to overstate its efficient costs during Module 1.⁴⁷⁶ It further noted that, to the extent that the ACCC is unable to prevent NBN Co from recovering

⁴⁷² NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1E, clause 1E.3.4.

⁴⁷³ Ibid. Capital expenditure satisfies the Prudent Cost condition when it is incurred: in accordance with NBN Co's Procurement Rules; or using competitive tendering and procurement processes; or pursuant to arrangements which are on arm's length terms; or in respect of a good or service in open and competitive market; or in order to comply with a Shareholder Minister, legal, policy, regulatory or administrative requirement; or when NBN Co's CEO is satisfied that (a) there is only one potential supplier of a particular good or service, or (b) such capital expenditure is incurred on exceptionally advantageous terms, or such capital expenditure falls within a comparable range of benchmarks that would be incurred by a prudent operator in the same or similar position to NBN Co, or it is in the best interests of the company to incur such capital expenditure with that particular supplier or in those circumstances having regard to the lifetime cost of acquisition and operation of the assets involved.

⁴⁷⁴ Ibid, Schedule 1E, clauses 1E.3.1(b) and 1E.3.2.

⁴⁷⁵ Ibid, Schedule 1E, clauses 1E.6.2(a) and (b). These permitted variations include network changes: as contemplated by, or made pursuant to, the Network Design Rules; that improve performance or functionality and result in the same total cost of ownership; that achieve savings in total cost of ownership; that are reasonably necessary to establish and maintain quality, reliability and security of supply; that are required in connection with a force majeure event; that are required in order to comply with the Government's Statement of Expectations, or any Shareholder Minister, legal, policy, regulatory or administrative requirement; that relate to maintenance, replacement or re-routing of assets that have the substantial primary purpose other than the augmentation or extension of the network; network changes within a minor expenditure limit (initially \$100 million); and required under urgent and unforeseen circumstances.

⁴⁷⁶ ACCC Draft Decision, pp. 141-147.

inefficiently incurred investments via ex-post enforcement, the incentives for NBN Co to invest efficiently will likely be significantly reduced.⁴⁷⁷

As discussed previously, section 2.4.2.1 of the Consultation Paper proposed that the ACCC be given a role to determine the value of capital expenditure that is included in the RAB, based on the methodologies in the 18 December 2012 SAU for determining prudent capital expenditure (the Prudent Design Condition, the Prudent Cost Condition and the deemed prudent categories). The ACCC also proposed to remove the minor expenditure limit permitted variation and reduce the term of the customer engagement provisions to five years (both discussed further below). The ACCC proposed no other specific amendments to the capital expenditure provisions.

Submissions

NBN Co proposes that the SAU be amended to provide the ACCC with a direct role to determine the RAB.⁴⁷⁸ It proposes that, for capital expenditure to be considered prudent and hence included in the RAB, the ACCC must be satisfied that the capital expenditure falls within the categories of prudence set out in the SAU (including the deemed prudence categories).⁴⁷⁹

NBN Co also proposes additional criteria against which the ACCC will assess compliance with the prudence conditions.⁴⁸⁰ It argues that, because the ACCC will determine whether capital expenditure falls within the SAU prudence categories, the ACCC should be conferred with the ability to determine that particular expenditure is prudent on more general efficiency and prudence grounds, but only if it does not fit within any of the specified categories.⁴⁸¹

Telstra argues that NBN Co should be subject to a more conventional incentive mechanism during Module 1 and does not consider that NBN Co's circumstances justify a weaker incentive mechanism.⁴⁸² However, it considers that in the absence of a more conventional incentive mechanism, the next best alternative would be for the ACCC to have an ex-post review power, allowing it to adjust the RAB, ABBRR and ICRA where it considers that expenditure has not been prudently incurred.⁴⁸³

Telstra also submits in relation to the prudence conditions:

- that they are overly reliant on the Network Design Rules, which it considers have not been shown to reflect prudent and efficient network design.⁴⁸⁴
- that the circumstances in which NBN Co can change the Network Design Rules are too broad (discussed separately below).⁴⁸⁵
- that the circumstances in which the prudent cost condition will be satisfied are very broad and would appear to leave scope for inefficiency — for example, where the NBN Co CEO is satisfied that incurring expenditure is in the best interests of the company, this may not mean that the expenditure is efficient or in the long-term interests of end-users.⁴⁸⁶

In light of these views, Telstra submits that the ACCC should propose variations that either:

⁴⁷⁷ Ibid, p. 141.

⁴⁷⁸ NBN Co Submission, p. 84.

⁴⁷⁹ Ibid, p. 85.

⁴⁸⁰ Ibid.

⁴⁸¹ Ibid.

⁴⁸² Telstra Submission, p. 37.

⁴⁸³ Ibid.

⁴⁸⁴ Ibid, p. 38.

⁴⁸⁵ Ibid.

⁴⁸⁶ Ibid, p. 39.

- replace the capital expenditure conditions with a simpler set of prudency criteria which could be modelled on those applied to other regulatory frameworks, such as the principles applying to review of Telstra's capital expenditure under the ACCC's access determinations for fixed-line services, or the National Gas Rules,⁴⁸⁷ or
- amend the prudent design condition to reduce the reliance on the Network Design Rules, instead requiring capital expenditure to reflect prudent network design, and reduce the scope of the prudent cost conditions, including removing the presumption of prudency where the NBN Co CEO is satisfied that incurring capital expenditure is in the best interests of the company.⁴⁸⁸

Optus submits that the prudency of capital expenditure should be assessed against the Part XIC criteria, as per other fixed-line services RAB assessments, and could be based upon similar techniques discussed in the AER Expenditure Forecast Assessment Guidelines for Electricity Distribution and Transmission Inquiry.⁴⁸⁹ It also argues that the SAU should not contain any restrictions on the ability for the ACCC to assess expenditure against these criteria, and therefore proposes that clauses 1E.3, 1E.4, 1E.5 be removed (that is, the deemed prudent categories, the prudent cost condition and the prudent design condition).⁴⁹⁰

Optus also considers that, where possible, benchmarking should be used to assess whether the expenditure incurred by NBN Co is within a range of reasonable comparators.⁴⁹¹ Examples provided of benchmarking metrics included capital expenditure benchmarking (for example, whether NBN Co's satellite programme was consistent with, or above, industry norms for building and launching a satellite), short term operating costs (for example, benchmarking of average wage levels or level of staffing against Australian telecommunications companies), the value of the 'bring forward' of contractual payments, and public statements of NBN Co such as annual reports and Corporate Plans.⁴⁹²

Other submissions did not provide views on this matter.

ACCC response

As discussed previously, the ACCC proposes that it should be responsible for applying the long-term revenue constraint methodology. For capital expenditure, this means that the ACCC will be responsible for determining whether NBN Co's capital expenditure satisfies the prudency conditions in the SAU and including capital expenditure that satisfies these conditions in the RAB.

After further considering the implications of this role and how it would operate in practice, and after considering the arguments made in submissions, the ACCC is not satisfied that determining prudent capital expenditure based on the methodologies in the 18 December 2012 SAU will be sufficient to resolve the concerns raised in the Draft Decision. As noted above, the Draft Decision argued that the prudent design condition and prudent cost condition may allow NBN Co to overstate its efficient costs during Module 1.⁴⁹³ It further noted that, to the extent that the ACCC is unable to prevent NBN Co from recovering inefficiently incurred investments, the incentives for NBN Co to invest efficiently will likely be significantly reduced.⁴⁹⁴

The ACCC therefore proposes to vary the conditions for determining whether capital expenditure can be included in the RAB. The primary variations are to the Prudent Cost Condition and the process for determining capital expenditure values when the ACCC is not satisfied that the Prudent Design Condition or the Prudent Cost Condition have been met. The

⁴⁸⁷ Ibid, pp. 39-40.

⁴⁸⁸ Ibid, p. 40.

⁴⁸⁹ Optus Submission, pp. 28-29.

⁴⁹⁰ Ibid, p. 29.

⁴⁹¹ Ibid, p. 30.

⁴⁹² Ibid, pp. 30-31.

⁴⁹³ ACCC Draft Decision, pp. 141-147.

⁴⁹⁴ Ibid, p. 141.

purpose of these variations is to allow the ACCC to include capital expenditure in the RAB that NBN Co has incurred as a result of appropriate procurement processes, and to allow the ACCC to adjust the level of capital expenditure it includes in the RAB if it considers that the Prudent Design Condition has not been met or appropriate procurement processes have not been followed.

The process for determining prudent capital expenditure under the ACCC's proposed variations would operate as follows, and is depicted in a flow-chart in Attachment D.

Step 1: assessment of deemed prudence

First, capital expenditure that the ACCC was satisfied is deemed to be prudently incurred in accordance with the deemed prudent categories would automatically be included in the RAB. This is equivalent to the 18 December 2012 SAU, except that the ACCC, rather than NBN Co, would be responsible for determining the value of the capital expenditure that is deemed prudent and automatically included in the RAB.

Step 2: assessment of whether consistent with the Network Design Rules, a permitted variation category or an endorsed network change

Second, for capital expenditure that is not deemed prudent, the ACCC would determine whether the capital expenditure is materially consistent with or within the scope of the Network Design Rules, a permitted variation category or an endorsed network change. This is equivalent to the 18 December 2012 SAU, except that the ACCC, rather than NBN Co, would be responsible for determining the value of the capital expenditure that satisfies these conditions.

If the ACCC was not satisfied that the capital expenditure met these conditions, NBN Co's proposed value of capital expenditure would not be included in the RAB and the ACCC could determine a substitute value in accordance with step 4 below (subject to the capital expenditure also passing one of the remaining two steps in the process).

If the ACCC was satisfied that the capital expenditure met these conditions, it would be included in the RAB, subject to it also passing one of the remaining two steps in the process.

Step 3: assessment of whether incurred in accordance with competitive tendering

The ACCC would determine whether the capital expenditure was incurred as a result of a competitive tendering and procurement process. The primary test the ACCC has proposed in this regard is whether the capital expenditure is incurred pursuant to a contract that has been let in accordance with a competitive tendering and procurement process and that includes a process for contract variations which provides:

- that reasonable consideration be given to managing the risk of such contract variations;
- for the provision of clear documentary evidence regarding the nature and reasonableness of any such contract variations; and
- that the design, engineering and construction of the Relevant Assets falls within the scope of such as process.

When assessing whether capital expenditure meets the above requirements of the primary test, the ACCC is proposing that it must have regard to the following factors:

- whether the contract was entered into in accordance with NBN Co's procurement processes, including in accordance with the Procurement Rules;
- whether the contract was entered into on arm's length terms;

- whether the contract entered into was in respect of a good or service in an open and competitive market (for example, a commodity market); and
- any other factor the ACCC considers relevant.

The capital expenditure will be included in the RAB if the ACCC is satisfied that the capital expenditure was incurred as a result of a competitive tendering and procurement process (having regard to the above factors). If the ACCC is not satisfied that the capital expenditure was incurred as a result of a competitive tendering and procurement process, the ACCC is proposing that capital expenditure can be included in the RAB if the ACCC is satisfied that competitive tendering and procurement processes were not followed due to exceptional circumstances, having regard to the following factors:

- the extent to which there is only one potential supplier of a particular good or service and there are no reasonable alternatives or substitutes;
- whether the relevant capital expenditure was incurred on exceptionally advantageous terms;
- whether it is in the best interests of NBN Co to incur the relevant capital expenditure with that particular supplier or in those particular circumstances having regard to the lifetime cost of acquisition and operation of the assets involved; and
- any other factor the ACCC considers relevant.

This step involves variations to the Prudent Cost Condition in the 18 December 2012 SAU, as follows:

- of the criteria listed under the Prudent Cost Condition, one has been adopted as the primary test for determining whether capital expenditure was incurred as a result of a competitive tendering and procurement process;
- the remaining criteria listed under the Prudent Cost Condition are now factors that the ACCC must have regard to when making its determination;
- the ACCC, rather than NBN Co's CEO, will be responsible for determining whether competitive tendering and procurement processes were not followed due to exceptional circumstances.

The ACCC has proposed these variations because it considers that the drafting of the Prudent Cost Condition in the 18 December 2012 SAU may have prevented the ACCC from disallowing capital expenditure that it considered was inefficiently incurred. This is because the Prudent Cost Condition is only satisfied to the extent that one or more of the listed criteria were met, including when competitive tendering and procurement processes were not followed due to exceptional circumstances.⁴⁹⁵ If the ACCC is responsible for determining whether capital expenditure satisfies the Prudent Cost Condition, the requirement that only one or more criteria be met would have prevented the ACCC from having regard to a range of relevant factors when considering whether NBN Co has incurred expenditure as a result of competitive tendering and procurement processes.

⁴⁹⁵ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1E, clauses 1E.4.1(a) to (f).

Step 4: if not incurred in accordance with competitive tendering — and no exceptional circumstances — assessment of value to include in the RAB

Finally, if the ACCC was not satisfied that the capital expenditure was incurred in accordance with the Network Design Rules (or a permitted variation or endorsed network change) or as a result of a competitive tendering and procurement process and there were no exceptional circumstances to justify this, the ACCC would determine a substitute value of capital expenditure to include in the RAB.

Broadly, the substitute value would be based on a 'benchmark value' that was consistent with comparable amounts of capital expenditure that the ACCC was previously satisfied were prudent; or if the ACCC had not previously considered the prudence of past capital expenditure, the amount of capital expenditure incurred by NBN Co from the Cost Commencement Date until the SAU Commencement Date. In this latter circumstance, regard would be had to any relevant differences in the scale and scope of the relevant capital expenditure; and any relevant legal, policy, regulatory or administrative requirement, or a requirement of the Shareholder Ministers.

This benchmarking approach to determining the capital expenditure to include in the RAB would only be applied by the ACCC when it was satisfied that:

- the particular amount of capital expenditure was *not* materially consistent with or within the scope of the Network Design Rules (and changes to these Rules) (regardless of whether it had or had not been incurred as a result of a competitive tendering and procurement process); or
- the particular amount of capital expenditure was materially consistent with or within the scope of the Network Design Rules (and changes to these Rules) but it was *not* incurred as a result of a competitive tendering and procurement process and there were no exceptional circumstances to justify this.

The ACCC has adopted this benchmarking approach in these cases because it would be unreasonable to exclude the entire amount of capital expenditure from the RAB. The benchmarking approach provides some guidance to NBN Co (and industry) about how the replacement value of capital expenditure will be determined.

Previous capital expenditure has been adopted as the benchmark rather than wider industry benchmarks. This is because the scale and scope of the NBN and the fact that it is a new network build and a start-up company, make the use of wider industry benchmarks inappropriate. In the current context, the use of industry benchmarks to update the RAB may discourage NBN Co from making otherwise efficient investments during the network rollout period.

Response to other issues raised in submissions

In relation to the additional criteria proposed by NBN Co,⁴⁹⁶ the ACCC considers that the effect of these additional criteria would be to expand the scope of allowable capital expenditure that the ACCC would include in the RAB. This may have the effect of reducing the risk that NBN Co's actual capital expenditure will not be included in the RAB. On the other hand, the ACCC considers that removing the prudence conditions altogether (as submitted by Optus) could have the potential to expose NBN Co to unreasonably high levels of risk that it will not be able to recover capital expenditure it incurs. This would likely reduce NBN Co's incentives to invest in otherwise efficient investments.

The ACCC considers that the prudence conditions as proposed by the ACCC provide NBN Co with sufficient certainty about which types of capital expenditure will be recoverable. This is

⁴⁹⁶ NBN Co Submission, p. 85.

because these conditions already address the issues of what is to be built (for example, the Network Design Rules and the changes to these rules), and how the expenditure is to be procured (for example, the result of a competitive tendering and procurement process). The ACCC also notes that it is the nature of an ex-post process for assessing the prudence of capital expenditure that NBN Co will be exposed to some risk.

In response to both Telstra and Optus' arguments that the SAU should reduce or remove altogether the reliance on the Network Design Rules to determine whether NBN Co's capital expenditure is prudent, the ACCC notes that the Network Design Rules must reflect the Government's design requirements for the NBN,⁴⁹⁷ but recognises that the Rules are otherwise designed and implemented by NBN Co.

As noted in the Draft Decision however, the ACCC considers that NBN Co is in the best position of all parties to develop the design and operational requirements necessary to implement the Government's requirements for the NBN.⁴⁹⁸

In addition, any changes to the initial Network Design Rules must either satisfy one of the permitted variation categories in the SAU, or be endorsed by NBN Co's customers (or the ACCC in the event of a dispute between the parties) (noting the ACCC's proposal to reduce the term of these customer engagement processes to five years, given their novel and untested nature and the subsequent need to review their effectiveness in light of operational experience).⁴⁹⁹

The ACCC therefore has not proposed to remove the Network Design Rules as something that must be satisfied for capital expenditure to be included in the RAB.

In response to Optus' argument that the deemed prudent conditions should be removed, as noted in the Draft Decision, the ACCC considers that if the deemed prudent categories were not included in the SAU, it may create uncertainty for NBN Co as to whether expenditure associated with these categories would satisfy the prudence conditions in the SAU. The ACCC does not consider that it would be appropriate for this to be the case, given that the expenditure associated with these categories was entered into without the prospect of this occurring. The ACCC therefore does not propose to vary the SAU to remove the deemed prudent categories.

Capital expenditure (minor expenditure limit)

Schedule 1E of the 18 December 2012 SAU specifies that network design changes that result in increases in capital expenditure of less than a Minor Expenditure Limit are not required to be consistent with the Network Design Rules. At the beginning of the SAU term this limit would be \$100 million and increased by CPI at the beginning of each financial year (this is one of the 'permitted variations' categories described above).⁵⁰⁰

In section 2.4.2.1 of the Consultation Paper, the ACCC proposed that the Minor Expenditure Limit permitted variation category be removed from the SAU, as it would increase the scope for the Network Design Rules to be changed to accommodate inefficient investments.⁵⁰¹

Submissions note the following views in relation to this variation:

- NBN Co submits that the Minor Expenditure Limit permitted variation category is based on an adaptation of the regulatory investment test for transmission (RIT-T) set out in the National Electricity Rules (NER), which includes a minor spend threshold.⁵⁰² NBN Co argues that the use of a minor expenditure limit is conventional regulatory practice,

⁴⁹⁷ NBN Co, *Special Access Undertaking*, Schedule 1E, clause 1E.6.1.

⁴⁹⁸ ACCC Draft Decision, p. 143.

⁴⁹⁹ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1E, clause 1E.6.4.

⁵⁰⁰ Ibid, Schedule 1E, clause 1E.6.2(a)(viii).

⁵⁰¹ ACCC Consultation Paper, p. 30.

⁵⁰² NBN Co Submission, p. 86.

and is reasonable to include in the SAU.⁵⁰³ NBN Co proposes to retain the Minor Expenditure Limit in the SAU, but with a reduced initial value of \$50 million.⁵⁰⁴

- Optus, VHA and Telstra agree with the ACCC's proposed variation.⁵⁰⁵ Telstra submits that the Minor Expenditure Limit contributes to a broadened scope for NBN Co to depart from the Network Design Rules.⁵⁰⁶

Other submissions did not provide views on this matter.

The ACCC acknowledges that the Minor Expenditure Limit serves a similar purpose to the thresholds in the RIT-T. Under the RIT-T, network service providers must undertake a public consultation process when deciding on investment options; but they are exempt from fulfilling certain requirements if the investment is below certain cost thresholds.⁵⁰⁷ The ACCC considers that requiring relatively minor network changes to be subject to the customer endorsement process would potentially be onerous and is therefore proposing to accept NBN Co's proposal to retain the Minor Expenditure Limit at a \$50 million threshold.

Capital expenditure (customer engagement processes)

Schedule 1E in Module 1 of the SAU includes provisions which establish a customer engagement process that NBN Co must follow to make certain types of changes to the Network Design Rules.⁵⁰⁸ These customer engagement provisions will operate for the term of Module 1, but will be reviewed at the mid-point review.⁵⁰⁹

In light of the ACCC's proposed variation that removes the mid-point review provisions from the SAU, section 2.4.2.1 of the Consultation Paper proposed that the customer engagement provisions should only operate for the first five years of Module 1, rather than the full term of Module 1. The ACCC did not propose any other variations to the customer engagement provisions.

NBN Co submits that:

- the customer engagement provisions in Schedule 1E should remain for the duration of Module 1, given that there is a role for the ACCC to resolve prudency disputes within the provisions;⁵¹⁰
- if the operation of these provisions is restricted to the first five years of Module 1 and the ACCC does not accept a subsequent variation to include provisions for the second five years of Module 1, it is concerned that subsequent network changes may not be capable of being incorporated into the network design rules that would be used in the prudency arrangements in Module 1;⁵¹¹ and
- this uncertainty has the potential to reduce NBN Co's incentives to engage in efficient investment in the NBN, as it may be unclear whether even efficient investment would be permitted to be included in NBN Co's RAB.⁵¹²

Optus proposes that clauses 1E.3 to 1E.11 (which include the customer engagement provisions) be removed altogether from the SAU.⁵¹³ Other submissions did not comment on the ACCC's proposal.

⁵⁰³ Ibid.

⁵⁰⁴ Ibid.

⁵⁰⁵ Optus Submission, p. 28; VHA Submission, p. 9; Telstra Submission, p. 39.

⁵⁰⁶ Telstra Submission, p. 39.

⁵⁰⁷ AER, *Regulatory investment test for transmission application guidelines*, June 2010, p. 43.

⁵⁰⁸ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1E, clause 1E.6.7 to 1E.6.11.

⁵⁰⁹ Ibid, Schedule 1K, clause 1K.2.

⁵¹⁰ NBN Co Submission, pp. 89-90.

⁵¹¹ Ibid, p. 90.

⁵¹² Ibid.

As noted in the Draft Decision, the ACCC acknowledges that customer engagement can play an important role in encouraging efficient investment, and considers that NBN Co's proposed customer engagement approach could play a role in doing so.⁵¹⁴ However, the ACCC is unable to be satisfied that the proposed customer engagement provisions will encourage efficient investment for the term of Module 1. This is because the processes set out in these provisions are novel — their effectiveness in promoting engagement between NBN Co and access seekers on network changes is therefore untested. This was recognised by NBN Co in its supporting submission for the 18 December 2012 SAU in which is argued that, given the bespoke and untested nature of some of these processes in the SAU (including the customer engagement processes for network changes), it is appropriate to undertake a review of their effectiveness during Module 1.⁵¹⁵

The ACCC considers that there should be the opportunity for the customer engagement processes to be revisited after five years in light of operational experience.

In the event that, in five years' time, NBN Co demonstrates that the processes lead to outcomes that promote efficient investment, the ACCC would be able to accept their continued operation were NBN Co to seek to extend their operation via an SAU variation. In the event that NBN Co does not submit a variation, or the ACCC does not accept NBN Co's variation, the ACCC will be able to specify a customer engagement process in an Access Determination or Binding Rule of Conduct.

In response to the issues raised by NBN Co, the only reasons why new customer engagement processes would not be established via an SAU variation after five years would be if NBN Co did not propose such a variation or if NBN Co proposed a variation that the ACCC was unable to accept. Hence, whether or not NBN Co receives the certainty that it desires, and whether or not the described situation would be created, are within NBN Co's control.

In light of these views, the ACCC proposes to reduce the term for which the customer engagement provisions relating to network changes will operate for the five years of Module 1. This proposal involves consequential changes in Schedule 1I (Product Development and Withdrawal).

The ACCC also proposes in the draft notice to vary that the SAU require NBN Co to engage with consumer advocacy groups on proposed network changes. This was not proposed by the ACCC in the Consultation Paper.

Consultation with consumers about investment decisions is not without precedent. Under the National Electricity Rules, service providers are required to engage with consumer representatives and, in their regulatory proposals to the AER, demonstrate the extent to which they have done so, including providing a description of the key risks and benefits of the regulatory proposal for electricity consumers.⁵¹⁶

Further, as discussed in section 2.3.1.2 of this document, the ACCC proposes variations to the SAU that will require NBN Co to consult with consumer advocacy groups about the development of new products; and there may be circumstances where the introduction of a new product will require subsequent changes to the network architecture. The ACCC considers that consumer advocacy groups should therefore also be consulted on such network changes.

Operating expenditure

Under Schedule 1F.7 of the 18 December 2012 SAU, NBN Co would be considered to have incurred operating expenditure on a prudent basis (and hence be able to include it in the ABBRR) to the extent that:

⁵¹³ Optus Submission, p. 28.

⁵¹⁴ ACCC Draft Decision, p. 145.

⁵¹⁵ NBN Co, *Supporting Submission NBN Co Special Access Undertaking*, 28 September 2012, pp. 151-153.

⁵¹⁶ *National Electricity Rules*, Chapter 6, clause 6.8.2(c1); Chapter 6A, clause 6A.10.1(g).

- the expenditure is deemed to have been prudently incurred;⁵¹⁷
- the expenditure is third party operating expenditure and satisfies the prudent cost condition,⁵¹⁸ and
- NBN Co:
 - ensures that the operating expenditure is incurred in a manner that seeks to achieve value for money and the lowest total cost of ownership; and
 - manages and controls operating expenditure in a manner consistent with the Statement of Expectations, any other legal, policy, regulatory or administrative requirements, or any requirements of the shareholder ministers, applicable to procurement by NBN Co.

In the Draft Decision, the ACCC considered that:

- the majority of, if not all, operating expenditure incurred during the network rollout would be likely to fall within the scope of the operating expenditure principles set out in Module 1; and
- if an independent party, such as the ACCC, were to determine whether operating expenditure was consistent with the principles, this would enhance the prospect that only efficient operating expenditure would be included in NBN Co's annual revenue requirements.⁵¹⁹

As discussed previously, the ACCC proposed in the Consultation Paper that it be given a role in determining the values of the building block components that are inputs to the annual revenue requirements, which includes operating expenditure.⁵²⁰ The ACCC did not propose specific amendments to the criteria by which operating expenditure would be considered to be prudently incurred.

Submissions

NBN Co proposes drafting that gives effect to the ACCC's role in determining whether the operating expenditure criteria in the SAU have been satisfied.⁵²¹ NBN Co also proposes additional provisions which would allow the ACCC to disallow operating expenditure which it considered did not satisfy the operating expenditure criteria and provisions for how the ACCC would determine a substitute value for operating expenditure.⁵²²

Optus does not make specific observations about operating expenditure, but argues that all possible techniques should be open for the ACCC to assess the prudence of expenditure and that the SAU should not contain any restrictions on the ability of the ACCC to assess expenditure.⁵²³ Similarly, Telstra does not make specific comments on the operating expenditure criteria in its submission. In relation to expenditure more generally during Module 1, it argues that its preference would be for NBN Co to be subject to a more conventional incentive regulation framework (that is, a framework based around ex ante approval of expenditure and revenue requirement) earlier in the term of the NBN Co SAU.⁵²⁴ It further

⁵¹⁷ The deemed prudent categories for operating expenditure are specified in clause 1F.7.2.

⁵¹⁸ Third party operating expenditure is operating expenditure that is contracted out to a third party. The prudent cost condition for operating expenditure is the same as it is for capital expenditure.

⁵¹⁹ ACCC Draft Decision, p. 150.

⁵²⁰ ACCC Consultation Paper, pp. 28-30.

⁵²¹ NBN Co Submission, pp. 84-85.

⁵²² NBN Co Submission, Appendix C.

⁵²³ Optus Submission, p. 7.

⁵²⁴ Telstra Submission, p. 37.

indicates that its next best alternative would be for the ACCC to have an ex-post review power.⁵²⁵

Other submissions did not provide views on this matter.

ACCC response

After considering in more detail how the ACCC's role in determining LTRCM components would operate in practice, the ACCC considers that this role would not be sufficient to resolve the concerns raised in the Draft Decision in relation to operating expenditure, and that variations to the operating expenditure criteria themselves are required.

The ACCC proposes in the draft Notice to Vary a varied operating expenditure test, which will operate as follows. (This process is depicted in a flow-chart in Attachment E).

First, operating expenditure will be considered to be prudently incurred if the ACCC is satisfied that it is associated with a deemed prudent category. This is equivalent to the 18 December 2012 SAU, except that the ACCC, rather than NBN Co, would be responsible for determining whether operating expenditure is deemed prudent.

Second, operating expenditure will be considered to be prudently incurred if the ACCC is satisfied that it is contracted out to a third party and was incurred in a manner consistent with the revised prudent cost condition (see previous discussion on capital expenditure). This is equivalent to the 18 December 2012 SAU, except for the revision to the prudent cost condition and that the ACCC, rather than NBN Co, would be responsible for determining whether this condition has been met. In addition to the criteria in the prudent cost condition, in determining whether exceptional circumstances exist for incurring operating expenditure, the ACCC may also have regard to whether the operating expenditure is incurred in a manner that seeks to achieve value for money and the lowest Total Cost of Ownership.

Third, for operating expenditure that does not fall within the above two categories, the expenditure will be considered to be prudently incurred if the ACCC is satisfied that it is consistent with NBN Co's past operating expenditure that has been included in the ABBRR or ICRA in a prior financial year. This approach is equivalent to the proposed benchmarking approach for capital expenditure. In undertaking its benchmarking assessment, the ACCC would be able to take into account any relevant differences in scale and any other matter the ACCC considers relevant.

In the absence of suitable industry benchmarks (see section above on capital expenditure for further discussion), the ACCC considers that previous operating expenditure that has been considered by the ACCC to be prudent or which has been deemed to be prudent provide appropriate benchmarks in this circumstance.

The key change resulting from the ACCC's proposed variations to the 18 December 2012 SAU is therefore to the third limb of the operating expenditure criteria. Under the 18 December 2012 SAU, operating expenditure would be considered prudent if NBN Co:

- ensures that the operating expenditure is incurred in a manner that seeks to achieve value for money and the lowest total cost of ownership; and
- manages and controls operating expenditure in a manner consistent with the Statement of Expectations, any other legal, policy, regulatory or administrative requirements, or any requirements of the shareholder ministers, applicable to procurement by NBN Co.⁵²⁶

⁵²⁵ Ibid, p. 38.

⁵²⁶ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1F, clause 1F.7.1.

The ACCC proposes to remove the second of the above two criteria. In the absence of removing this criterion, although the ACCC would have a role in determining whether operating expenditure meets the criterion, the ACCC would be required to allow all operating expenditure that satisfied the criterion to be recovered. The ACCC considers that the criterion could lead to inefficient expenditure being included in annual revenue requirements, notwithstanding the ACCC's approval role. The ACCC notes that its proposed criteria include an "any other matter that the ACCC considers relevant" factor — this would allow the ACCC to consider such matters as operating expenditure that is consistent with the Statement of Expectations, and other legal, policy and regulatory requirements (as opposed to the ACCC being required to approve operating expenditure simply because the operating expenditure is consistent with these requirements).

Rate of return

The SAU specifies that NBN Co's rate of return in Module 1 will be determined each year by adding a premium of 350 basis points to the risk-free rate.⁵²⁷ The risk-free rate will be updated annually and will be determined as the mean yield on ten-year Commonwealth Government Securities (CGS), averaged over the final 20 business days of the preceding financial year.⁵²⁸

The Draft Decision stated that, having regard to NBN Co's legitimate commercial and business interests, adopting an estimate of the rate of return that is 350 basis points above a risk-free rate was reasonable in the current context, considering NBN Co's unique circumstances.⁵²⁹

However, the ACCC sought views on whether the term of the risk-free rate used to determine the rate of return should match the period during which it is applied. The ACCC noted this may suggest that because a ten-year bond rate has been proposed, the risk-free rate should not be reset annually.⁵³⁰

Submissions

Key points from NBN Co's submission are as follows:

- The use of ten-year Commonwealth Government bonds to estimate the risk-free rate is not linked to the length of the period for which the rate of return estimate will apply, and is justified by the long-term nature of the regulated assets, and observed finance practices of infrastructure businesses.⁵³¹
- The ACCC does not use a risk-free rate that corresponds with the regulatory period for:
 - the Telstra Fixed Line Services Final Access Determination (3 year period), where it uses the ten-year Commonwealth Government bond rate.⁵³²
 - the Wholesale ADSL Draft Final Access Determination (1 year period), where it uses the ten-year Commonwealth Government bond rate.⁵³³
- The AER adopted a ten-year estimate of the risk-free rate for 5 year regulatory periods in the 2009 WACC review.⁵³⁴
- Infrastructure is not funded with short term debt, as it would be exposed to high levels of refinancing risk.⁵³⁵

⁵²⁷ Ibid, Schedule 1F, clause 1F.6.1(a).

⁵²⁸ Ibid, Schedule 1F, clause 1F.6.1(b).

⁵²⁹ ACCC Draft Decision, p. 152.

⁵³⁰ Ibid, p. 153.

⁵³¹ NBN Co Submission, p. 91.

⁵³² Ibid.

⁵³³ Ibid.

⁵³⁴ Ibid, p. 92.

⁵³⁵ Ibid.

- Australian and international infrastructure businesses tend to issue long-term debt.⁵³⁶ In particular, NBN Co provides data that indicates that the weighted average debt term for 13 businesses in Australia is 10.7 years.⁵³⁷
- Debt holders will expect to receive a premium, and equity holders will incur costs, if a firm adopts a debt management strategy that makes future debt raising more difficult.⁵³⁸
- Observed debt management strategies for infrastructure businesses indicate efficient practices, and show that these firms stagger issues of long term debt (often ten or more years).⁵³⁹

NBN Co provided a further expert report from Bob Officer and Steven Bishop in support of its proposed approach.⁵⁴⁰ Key points from the Officer and Bishop report are as follows:

- Updating the rate of return each year takes account of the fact that assets are rolled out over a period of time, not at a point in time.⁵⁴¹
- Using a ten-year Commonwealth Government bond for the risk-free rate on an annual basis is reasonable, consistent with commercial practice, and practice in other sectors and jurisdictions.⁵⁴²
- The duration of assets and funding for these assets should be matched to avoid roll over risk, transaction costs and interest rate changes, but since very long term debt is not available, risk minimisation strategies (such as spreading maturity of debt and hedging interest rate exposure) are employed.⁵⁴³
- Common commercial and regulatory practice in Australia is to estimate debt and equity premiums over ten-year Commonwealth Government bond rates, which is likely to underestimate opportunity costs for very long term assets (but less so than a one-year bond rate).⁵⁴⁴
- In theory, annual capital expenditure would be funded by raising capital in that year to fund these assets for their lives.⁵⁴⁵ A theoretically correct rate of return would be determined by reference to the costs of these annual capital raisings (for example, a weighted average rate of return could be determined and applied to total capital expenditure in previous years).⁵⁴⁶ An annual update of the rate of return using a fixed margin over a ten-year Commonwealth Government bond rate is a simplification of this process (and the authors, though not undertaking modelling, do not expect that this methodology would provide a biased outcome).⁵⁴⁷
- An annual update of the rate of return using a fixed margin over a ten-year Commonwealth Government bond rate better reflects the cost of capital when assets are being built.⁵⁴⁸

⁵³⁶ Ibid.

⁵³⁷ Ibid, p. 93.

⁵³⁸ Ibid, p. 92.

⁵³⁹ Ibid.

⁵⁴⁰ Officer and Bishop, *Supplementary report in relation to NBN Co's proposed Special Access Undertaking*, 2 May 2013. (Officer and Bishop Report)

⁵⁴¹ Ibid, p. 2.

⁵⁴² Ibid.

⁵⁴³ Ibid, p. 3.

⁵⁴⁴ Ibid.

⁵⁴⁵ Ibid.

⁵⁴⁶ Ibid, p. 4.

⁵⁴⁷ Ibid.

⁵⁴⁸ Ibid.

The only submission from other interested parties came from Optus. Optus submits that the WACC should be set between the long term cost of borrowing and 7% for all of Module 1, or until the point where NBN Co is no longer reliant on Government equity funding.⁵⁴⁹ Optus further submits that the government has “internalised” the market risk faced by a commercial entity and refers to a statement made by DBCDE as follows:

“The project is being financed by the government because it is best able to mobilise the capital required and manage the risks involved, rather than the private sector which would require an additional risk premium for risks controlled by government.”⁵⁵⁰

ACCC response

The ACCC considers that the reasons for acceptance of the 350 basis point risk premium have not changed since the Draft Decision. In accepting this margin, it is important to note that it is not possible currently to assess whether it will over- or under- compensate NBN Co relative to the actual cost of capital it will face (because its actual cost of capital cannot be foreseen). Further, it is difficult to assess whether it will over- or under- compensate NBN Co relative to traditional regulatory approaches used to determine a WACC. As discussed in the Draft Decision, the ACCC considers it is currently not possible to robustly apply the traditional regulatory approach to estimating a WACC for NBN Co (nor will it be possible to for some time) due to:

- a lack of appropriate benchmarks; and
- there being no observable actual parameters for NBN Co.⁵⁵¹

The key outstanding issue for consideration therefore relates to NBN Co’s proposed approach of adding this premium to a ‘risk free rate’ which is determined annually, and which is determined as the mean yield on ten-year Commonwealth Government Securities averaged over the final 20 business days of the preceding financial year.

In the current context, the ACCC is willing to accept NBN Co’s proposed approach of updating its regulated rate of return annually, based on contemporary rates of ten-year CGS, and is not proposing any variations in relation to the methodology in the draft notice.

The ACCC considers that possible alternatives (such as ‘locking in’ for ten years a ten-year CGS rate based on current levels, or ‘locking in’ for ten years the average rate over the past ten years of ten-year CGS, or annually re-estimating the 350 basis point risk margin in addition to annually re-estimating the ten-year CGS rate) are not in this context sufficiently robust to adopt.

Importantly, the ACCC is not satisfied, based on NBN Co’s submissions and expert report and our own analysis, that the traditional theoretical framework for estimating an appropriate cost of capital can be applied robustly in assessing NBN Co’s proposed approach. Given the unique circumstances of this project (including the demand uncertainty faced by NBN Co), in determining an appropriate rate of return the ACCC considers that rather than attempting to estimate a weighted average cost of capital, it is not unreasonable to accept a 350 basis point margin over the estimated prevailing yield on ten year CGS. That is, NBN Co’s proposed methodology is accepted as a practical approach to establishing a reasonable rate of return given unique circumstances and should not be taken as being reflective of an approach the ACCC would adopt in circumstances where appropriate benchmarks and/or observable risk premium were available.

To reflect this, the ACCC is proposing that references in the SAU to the “nominal vanilla WACC” in Module 1 be replaced with a “rate of return”. This reflects the fact that NBN Co’s

⁵⁴⁹ Optus Submission, p. 24.

⁵⁵⁰ Quoted by AGCNCO 2011, NBN Co, Investigation No. 14, Canberra, November, p. 32.

⁵⁵¹ ACCC Draft Decision, p. 152.

approach to determining the regulated rate of return diverges from the approach generally adopted in a regulatory context to estimating the regulated rate of return — that is, the approach does not determine the weighted average of a return on debt and a return on equity (that is, a ‘Weighted Average Cost of Capital’).

Regarding Optus’ submission, the ACCC notes that, in assessing the reasonableness of NBN Co’s approach to the rate of return, the ACCC is required (under s. 152AB(7) of the CCA) to take into account the risks that NBN Co faces in undertaking its investment. As a Government Business Enterprise (and consistent with competitive neutrality principles), NBN Co is required to act commercially, and therefore requires a commercial return on its investment (including a margin for risk).⁵⁵² The ACCC therefore considers that the rate of return during Module 1, as determined in accordance with SAU, takes into account the risks that NBN Co faces in undertaking its investment, in a manner that is consistent with the Part XIC and is reasonable.

Taxation allowance and gamma

In the Draft Decision, the ACCC stated that the method for calculating NBN Co’s tax allowance was unlikely to reflect NBN Co’s tax liabilities during Module 1, and consequently it was not satisfied that the tax allowance was consistent with the legitimate business interests of NBN Co and recovery of NBN Co’s direct costs.⁵⁵³

To address this issue, in the Consultation Paper, the ACCC proposed that the value of gamma in Module 1 should be “as determined at the time the annual revenue requirement is calculated”.⁵⁵⁴

The ACCC noted that its objective in proposing this variation was that, if NBN Co wishes to account for a tax liability, imputation credits should be valued at the same (or similar) value as is adopted across other sectors regulated by the ACCC and the AER at the time.⁵⁵⁵

Apart from the ACCC having a role in determining building block components in Module 1, the ACCC proposed no other variations regarding tax allowance.

However, in section 5.5.1.7 of the Draft Decision the ACCC noted comments from Telstra which suggested that the tax allowance should exclude amounts that NBN Co would not be entitled to treat as a tax deduction under tax law.⁵⁵⁶ The ACCC noted that it had not at that time formed a view in relation to this issue, and that it intended to engage with NBN Co on the issue.⁵⁵⁷

Submissions

It appears from submissions that the variations proposed by the ACCC in the Consultation Paper were not clear. Submissions appear to understand that the ACCC intended that the value for gamma would be determined each year, from the commencement of the SAU term.

In particular, NBN Co submits the following:

⁵⁵² The Australian Government Competitive Neutrality Guidelines state that “Over time, government businesses should earn a rate of return equal to the Commonwealth long-term bond rate, plus a margin for risk. In this way, the target rate of return should be equivalent to the average rate of return of the business’s competitors.”: Australian Government Department of Finance and Administration, *Australian Government Competitive Neutrality Guidelines for Managers*, February 2004, p. 30.

⁵⁵³ ACCC Draft Decision, p. 157.

⁵⁵⁴ ACCC Consultation Paper, p. 31.

⁵⁵⁵ *Ibid*, p. 32.

⁵⁵⁶ ACCC Draft Decision, p. 156.

⁵⁵⁷ *Ibid*, p. 157.

- For the first year of the SAU, gamma will be 0.25. Subsequently, the value of gamma will be annually determined based on the most recent regulatory precedent (based on final decisions made by the ACCC, AER or ACT).⁵⁵⁸
- A gamma value of 0.25 is reasonable because it reflects recent relevant regulatory decisions; however, it may not be necessary to determine a value for gamma for any financial year during Module 1, given that NBN Co is unlikely to be in a tax paying position until sometime during Module 2.⁵⁵⁹
- Determining gamma based on the most recent regulatory precedent is consistent with the approach taken in determining the WACC in Module 1, which uses a risk-free rate established just prior to the commencement of the relevant financial year.⁵⁶⁰

Submissions from other interested parties are as follows:

- Macquarie Telecom and Optus submit that they support the ACCC's proposal that the value of gamma should be set each year.⁵⁶¹ Macquarie Telecom states that this approach is consistent with that applied by the ACCC and AER in other regulated sectors.⁵⁶²
- VHA submits that it supports the ACCC's proposal that gamma should be determined "at the time, not pre-determined". To ensure certainty, VHA also notes that it would be comfortable if NBN Co proposed guiding principles that the ACCC must consider when determining gamma.⁵⁶³

Regarding the comments from Telstra which suggested that the tax allowance should exclude amounts that NBN Co would not be entitled to treat as a tax deduction under tax law, in its submission to the Consultation Paper, NBN Co states that it has considered these comments.⁵⁶⁴ To address the comments, NBN Co has proposed variations to the calculation of the tax allowance in Module 1 relating to items not tax deductible.⁵⁶⁵ Under NBN Co's proposed drafting, taxable profit would be subject to:

- the inclusion of any capital gains;
- the inclusion of any capital losses (but only to the extent that they are offset by any capital gains);
- the exclusion of any items to the extent that they are not deductible; and
- the treatment of assets received by NBN Co for nil consideration.⁵⁶⁶

ACCC response

The ACCC continues to consider that a value for gamma should not be specified in the SAU at this time. Gamma is applied to reduce the value of the allowed building block for taxation expenses to account for imputation credits. As NBN Co currently does not have tax liabilities, it is not clear why a value for gamma should be specified in the SAU at this time.

Further, the ACCC considers that it should be able to apply some discretion in determining a value for gamma at the time that NBN Co begins to incur tax liabilities, in order to ensure that

⁵⁵⁸ NBN Co Submission, p. 97.

⁵⁵⁹ Ibid, p. 96.

⁵⁶⁰ Ibid.

⁵⁶¹ Optus Submission, p. 32; Macquarie Telecom Submission, p. 11.

⁵⁶² Macquarie Telecom Submission, p. 11.

⁵⁶³ VHA Submission, p. 9.

⁵⁶⁴ NBN Co Submission, p. 97.

⁵⁶⁵ Ibid.

⁵⁶⁶ Ibid, p. 98.

the gamma that is adopted is reasonable in the context of the NBN. The ACCC subsequently does not propose to adopt NBN Co's suggested variation, because the value of gamma determined in the most recent regulatory precedent may not always be reasonable in the context of NBN Co. To illustrate, whilst the most recent AER decision determined a gamma of 0.25,⁵⁶⁷ the most recent communications decision determined a gamma of 0.45.⁵⁶⁸

The ACCC therefore proposes that a value for gamma not be specified in the SAU at this time. If a value for gamma is not specified in the SAU at this time, once NBN Co faces tax liabilities, it may propose and the ACCC will assess any proposal for gamma at the time the annual revenue requirement is calculated.

The ACCC proposes to accept NBN Co's changes in relation to non-tax deductible items. The ACCC considers that these variations will closer align the LTRCM with relevant tax law.

Regulatory depreciation

Clause 1F.8.1 of Schedule 1F sets out that regulatory depreciation in Module 1 will be calculated using a straight-line depreciation approach, with asset lives determined in a manner consistent with NBN Co's audited accounts. In section 5.5.1.5 of the Draft Decision, the ACCC noted that standard regulatory practice typically provides a role for the regulator to determine or approve the asset types and asset lives used to calculate regulatory depreciation. The ACCC sought the views of interested parties about whether the SAU should specify the asset lives that will be used to depreciate NBN Co's capital expenditure.

NBN Co submits that it is appropriate for the SAU to not specify the asset lives to be used to depreciate NBN Co's capital expenditure during Module 1, because:

- the SAU requires that asset lives be determined in a manner consistent with NBN Co's audited accounts — NBN Co has to follow the relevant accounting standards in determining these asset lives;⁵⁶⁹
- the ACCC, rather than NBN Co, will be responsible for applying the LTRCM during Module 1 — the ACCC will therefore have a direct role in ensuring that the asset lives used in that context were consistent with the requirements in the SAU;⁵⁷⁰ and
- there is no contemporaneous link between prices and the annual building block revenue requirements until the initial cost recovery account is extinguished, which is highly unlikely before the end of Module 1.⁵⁷¹

In light of NBN Co's submission, the ACCC does not propose that asset lives should be specified in the SAU.

However, despite the fact that the effect of NBN Co's depreciation profile on use of the NBN will be somewhat diminished during the initial cost recovery period (because depreciation will affect the balance of the initial cost recovery account rather than NBN Co's actual revenues), it is nonetheless standard regulatory practise for a regulator to have a role in assessing and approving a regulated business's proposed asset lives for the purpose of determining regulatory depreciation.

The ACCC is therefore proposing that it will consider the asset lives that are proposed by NBN Co at the time of conducting the annual LTRCM determination.

⁵⁶⁷ AER, *Access arrangement final decision – Envestra Ltd 2013-17 – Part 1*, March 2013, p. 45.

⁵⁶⁸ ACCC, *Public inquiry to make a final access determination for the Wholesale ADSL service – final report*, May 2013, p. 39.

⁵⁶⁹ NBN Co Submission, p. 94.

⁵⁷⁰ Ibid.

⁵⁷¹ Ibid.

In terms of the approach that the ACCC must apply in considering these asset lives, the ACCC considers that the asset lives used in NBN Co's audited accounts are likely to provide a sound basis for calculating asset lives for regulatory depreciation. However, the ACCC is not satisfied that the asset lives used for statutory accounting purposes will reflect appropriate asset lives for regulatory depreciation purposes in all circumstances during Module 1. The ACCC therefore proposes in the draft Notice to Vary that asset lives be determined 'having regard to' NBN Co's audited accounts, as opposed to 'in a manner consistent with'. This will provide some flexibility to adopt different asset lives for regulatory depreciation where it is appropriate to do so.

Annual construction in progress

Clauses in the SAU relating to construction-in-progress include:

- 1E.2.4(a) — this specifies that capital expenditure that has been *incurred* but not yet placed in service ('annual construction in progress') will be treated separately from capital expenditure that has been placed in service, and will be consistent with NBN Co's audited accounts.
- 1E.2.1(b) — this specifies that capital expenditure will be rolled into the RAB when the relevant asset is placed in service (as opposed to when the capital expenditure is incurred). Capital expenditure would be deducted from the construction-in-progress account at the time that it is placed into service (and rolled into the RAB).
- 1F.9.1(b) — this specifies how the allowance for annual construction-in-progress will be calculated.

Also of note, for capital expenditure to be included in the RAB, it must be prudently incurred in accordance with the prudent cost condition (that is, clause 1E.4) and the prudent design condition (that is, clause 1E.5).

In section 2.4.2.1 of the Consultation Paper, the ACCC noted that it is not clear whether only prudently incurred expenditure will be treated as construction-in-progress and thereby earn a return. To address this, the ACCC proposed that:

- the SAU clarify the process by which expenditure is classified as prudently incurred before it is included in NBN Co's audited accounts as construction-in-progress; and
- the ACCC calculate the values of the annual-construction-in-progress allowance that will be included in NBN Co's annual revenue requirements.

In its submission to the Consultation Paper, NBN Co states that the intention of the SAU is that only construction-in-progress that has been prudently incurred should be included in any calculations.⁵⁷² NBN Co has proposed drafting variations to further clarify that this is how the SAU will operate.⁵⁷³ Further, NBN Co has proposed that the ACCC will have a direct role in calculating the construction-in-progress allowance as part of the ACCC's role in the administration of the LTRCM in Module 1 (as discussed above).

Submissions from other interested parties note the following views:

- Optus submits that it agrees that the SAU should clarify the process by which expenditure is classified as prudent before it is included in the audited accounts as construction-in-progress.⁵⁷⁴ Optus also agrees that the ACCC should assess the

⁵⁷² Ibid, p. 95.

⁵⁷³ Ibid.

⁵⁷⁴ Optus Submission, p. 32.

values of construction-in-progress being included in NBN Co's revenue requirements.⁵⁷⁵

- Macquarie Telecom submits that it supports that the SAU be varied to clarify that only prudently incurred expenditure will be classified as construction-in-progress.⁵⁷⁶ In relation to the ACCC's role in calculating the values of construction-in-progress, Macquarie Telecom submits that the ACCC's role should be in the form of a review and, if appropriate, approval of NBN Co's calculations.⁵⁷⁷
- VHA submits that it agrees that it should be clarified whether expenditure is classified as prudent before it is classified as construction-in-progress.⁵⁷⁸

The ACCC is proposing to accept NBN Co's drafting (subject to some minor amendments) in relation to clarifying that only prudently incurred expenditure should be treated as construction-in-progress, and has incorporated these variations into the draft Notice to Vary.

The ACCC is satisfied that these variations will achieve the objectives identified in the Consultation Paper, namely firstly, that the ACCC should calculate the values of the annual construction-in-progress allowance that will be included in NBN Co's annual revenue requirements and secondly, ensuring that only prudently incurred capital expenditure (which has not yet been placed in service) is reflected in this allowance.

Under clause 1E.2.4 (c) of the draft Notice to Vary, any amounts included in NBN Co's construction-in-progress account would only be considered to have been prudently incurred (for the purposes of calculating the annual-construction-in-progress allowance) if the ACCC is satisfied that the capital expenditure incurred in connection with those assets not yet placed into service, meets the prudence conditions set out in the SAU for capital expenditure.

2.4.2.3. Long-term revenue constraint methodology in Module 2

This section sets out the variations that the ACCC is proposing in relation to the following terms and conditions in the long-term revenue constraint methodology in Module 2:

- firstly, the criteria and methodologies for determining forecasts; and
- secondly, the approach to rolling forward the RAB.

Another matter relevant to the long-term revenue constraint methodology in Module 2 is the length of regulatory cycles. This issue is discussed in section 2.1.2.1.

Criteria and methodologies for determining forecasts

Under Schedule 2D of the 18 December 2012 SAU, NBN Co's annual revenue requirements during Module 2 would be determined upfront based on forecasts approved by the ACCC as part of the replacement module assessment process.⁵⁷⁹ During the initial cost recovery period, the initial cost recovery account would be updated based on the difference between these forecast annual revenue requirements and the forecast revenues NBN Co expects to earn, which are also subject to ACCC approval.⁵⁸⁰

⁵⁷⁵ Ibid.

⁵⁷⁶ Macquarie Telecom Submission, p. 11.

⁵⁷⁷ Ibid.

⁵⁷⁸ VHA Submission, p. 9.

⁵⁷⁹ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 2D, clause 2D.2.1.

⁵⁸⁰ Ibid, Schedule 2D, clause 2D.4.4.

Schedule 2D includes methodologies and criteria that would be used to develop forecasts of the individual building block components that make up the forecast annual revenue requirements, and forecasts of revenues during the initial cost recovery period.⁵⁸¹

In section 2.4.2.2 of the Consultation Paper, the ACCC considered that the methodologies and criteria proposed to develop these forecasts may allow NBN Co to include in its annual revenue requirement forecasts above its efficient costs, which would in turn reduce the incentives to invest and operate efficiently created by the forecasting mechanism. Further, the ACCC noted that it was difficult to be satisfied that the methodologies and criteria would reflect best regulatory practice in all circumstances that may arise during Module 2.

To address these issues, the ACCC proposed in the consultation paper that the following methodologies be removed from the SAU:

- the principles on which capital and operating expenditure forecasts must be based (removal of clause 2D.6.1(a) and (b); removal of clause 2D.8);
- the matters that will be had reference to in calculating the return on capital (clause 2D.2.1(a)(iii)(A)), and the specification that the return of capital be calculated as a nominal vanilla WACC (discussed further in the following section);
- the specification in clause 2D.2.1(a)(ii) that forecast regulatory depreciation be calculated on a straight-line basis; and
- the range of factors that clause 2D.2.1(a)(iv) specifies will be taken into account in determining the tax allowance.⁵⁸²

The effect of amending the SAU in this way is outlined in section 2.4.2.2 of the Consultation Paper.

Submissions

In its submission to the Consultation Paper, NBN Co proposes to remove the capital and operating expenditure forecasting criteria from Module 2, with the exception of the deemed prudent categories.⁵⁸³ NBN Co submits that many of the deemed prudent categories, which are carried forward from Module 1, may be irrelevant during Module 2; however other categories, such as the Telstra and Optus arrangements, will be relevant throughout the SAU term.⁵⁸⁴

NBN Co submits that it does not consider that the SAU needs to be changed in relation to the treatment of depreciation in Module 2 for the following reasons:

- arbitrary changes in the regulatory depreciation profile, particularly when NBN Co's revenues are determined by the revenue requirement, may result in unexpected changes to cash flows, thereby exposing NBN Co to risk;
- the ACCC has not explained the set of possible circumstances which could arise during Module 2 which may require modification of the depreciation profile — the hypothetical nature of these circumstances does not justify the proposed variation;
- there is no reason to believe that straight line depreciation will not be appropriate in the future;
- efficient use of the NBN is only indirectly related to NBN Co's revenue — prices can always be structured to recover that revenue; and

⁵⁸¹ Ibid, Schedule 2D, clause 2D.6.

⁵⁸² ACCC Consultation Paper, p. 32.

⁵⁸³ NBN Co Submission, p. 99.

⁵⁸⁴ Ibid.

- in regard to how asset lives are determined, the SAU already provides for changes in depreciation rates to deal with changing circumstances and involves an appropriate role for the ACCC.⁵⁸⁵

In relation to the criteria for determining the rate of return, NBN Co proposes that the existing clause 2D.2.1(a)(iii)(A) be replaced with “a nominal vanilla WACC, estimated for the Regulatory Cycle and commensurate with the efficient financing costs for an entity with a similar degree of risk as that which applies to NBN Co in respect of the provision of services using the Relevant Assets.”⁵⁸⁶ In support of this proposal, it submits that:

- the ACCC’s proposed variations do not provide NBN Co with an adequate degree of investment certainty and would be unacceptable in any regulatory context;
- given that the ABBRR includes a separate (corporate income) tax allowance component, the return on capital should not include any compensation in respect of corporate income tax and therefore the rate of return should be specified as a vanilla WACC;
- unless the ACCC anticipates basing the rate of return on NBN Co’s actual financing structure, the only option is to use some form of benchmark financing structure; and
- referring to “risks” rather than “systematic risks” is consistent with the National Electricity Rules and would not lead to NBN Co being unduly compensated for the risks it faces.⁵⁸⁷

The Officer and Bishop report (submitted by NBN Co) states that Officer and Bishop are confident that a nominal vanilla WACC will continue to be best practice in a regulatory environment.⁵⁸⁸ In addition, Officer and Bishop argue that because the nominal vanilla WACC is an ‘identity’, any other specification of the WACC can be ‘mapped’ from the nominal vanilla WACC.⁵⁸⁹

NBN Co also proposes to remove the factors to be taken into account when determining the tax allowance in Module 2.⁵⁹⁰

Submissions from other interested parties note the following in relation to this proposed variation:

- VHA submits that it agrees with the ACCC’s proposals in relation to the criteria and methodologies for determining forecasts in Module 2.⁵⁹¹ It notes that, to ensure certainty it would be comfortable if NBN Co proposed guiding principles that the ACCC must consider for some of the issues outlined here.⁵⁹² In particular VHA does not consider ongoing debates on gamma in the WACC or depreciation methodologies should be completely open ended and the subject of extensive rework at the expiry of each module.⁵⁹³
- Telstra submits that it agrees with the ACCC’s view that the criteria and methodologies should be removed, as it is not clear that they will remain appropriate and reflect regulatory best practice over the entire term of the NBN Co SAU.⁵⁹⁴ Further, Telstra submits that given the long duration of Module 2, it would be unwise to lock in overly

⁵⁸⁵ Ibid, p. 104.

⁵⁸⁶ Ibid, p. 103.

⁵⁸⁷ Ibid, pp. 101-103.

⁵⁸⁸ Officer and Bishop Report, pp. 5-6.

⁵⁸⁹ Ibid.

⁵⁹⁰ NBN Co Submission, p. 106.

⁵⁹¹ VHA Submission, p. 9.

⁵⁹² Ibid.

⁵⁹³ Ibid.

⁵⁹⁴ Telstra Submission, p. 42.

prescriptive rules at this stage.⁵⁹⁵ It notes that, in other regulatory frameworks, these types of rules are either much less prescriptive, or are subject to change from time to time either by the regulator or an independent body.⁵⁹⁶ Telstra suggests that the rules currently in the SAU could potentially be replaced with a less prescriptive set of rules, similar to those currently applying as fixed principles in the ACCC's access determinations for fixed line services.⁵⁹⁷

- Optus submits that it agrees with the ACCC's proposed changes,⁵⁹⁸ because, given that all terms and conditions in Module 2 would be defined as fixed principles and subsequent replacement modules must be consistent with Module 2, it is important that Module 2 does not contain obligations which are likely to become out dated.⁵⁹⁹ Optus suggests three further amendments to Module 2:
 - include statements, consistent with those in Module 1, stating that the ACCC will determine the prudent costs that can be rolled-forward and included within the RAB, ICRA and ABBRR;
 - include statements, consistent with those in Module 1, stating that the ACCC will assess whether costs put forward by NBN Co reflect prudent costs; and
 - amend clause 2D.5.2(b) to allow the ACCC to determine the amount of the under recovery that can be recovered to next regulatory period — where the ACCC assesses that the under recovery was caused by excessive inefficient forecasting, the ACCC should not permit recovery in the next regulatory period.⁶⁰⁰
- Macquarie Telecom submits that the ACCC's proposed variations provide for the opportunity for Module 2 arrangements to be designed with the benefit of several years of NBN Co operational activity.⁶⁰¹ On this basis, Macquarie Telecom submits that it supports the ACCC's proposed variations.⁶⁰²
- iiNet submits that in general, the ACCC's proposed variations in relation to the long-term revenue constraint methodology are sensible and appropriate and necessary to ensure that the terms of the SAU that relate to pricing are reasonable.⁶⁰³
- AAPT submits that it agrees with the ACCC's proposed amendments in relation to the criteria and methodologies used when developing forecasts in Module 2.⁶⁰⁴

ACCC response

The ACCC has considered the views expressed in submissions, and is now proposing to retain some of the methodologies and criteria that are specified in the 18 December 2012 SAU. However, the ACCC continues to consider that some of the methodologies and criteria should be removed or varied.

Firstly, in relation to forecasting capital and operating expenditure for a regulatory cycle, in light of NBN Co's submission, the ACCC now proposes to retain the deemed prudent categories relating to the Telstra and Optus arrangements. Given that these are long-term arrangements entered into before the commencement of the SAU, the ACCC considers that having

⁵⁹⁵ Ibid, p. 41.

⁵⁹⁶ Ibid.

⁵⁹⁷ Ibid, p. 42

⁵⁹⁸ Optus Submission, p. 33.

⁵⁹⁹ Ibid.

⁶⁰⁰ Ibid.

⁶⁰¹ Macquarie Telecom Submission, p. 11.

⁶⁰² Ibid.

⁶⁰³ iiNet Submission, p. 18.

⁶⁰⁴ AAPT Submission, p. 9.

expenditure under these arrangements subject to ACCC review in the future would not be appropriate.

However, the ACCC continues to consider that the other deemed prudent categories should not be carried forward from Module 1. The ACCC agrees with NBN Co's submission that many of these categories are unlikely to be relevant in Module 2.⁶⁰⁵ The ACCC is therefore proposing in the draft Notice to Vary to remove all other criteria relating to capital and operating expenditure forecasts, in accordance with its stated positions in the Draft Decision.

Secondly, in relation to forecasting regulatory depreciation for a regulatory cycle, the ACCC accepts that straight line depreciation is likely to be appropriate for most circumstances throughout Module 2.

However, the ACCC maintains the view that unexpected circumstances may arise throughout Module 2 that would necessitate the modification of NBN Co's depreciation profile. For example, it may be appropriate to defer or bring forward recovery of capital expenditure to smooth out potential price shocks resulting from significant amounts of capital expenditure, or to ensure that NBN Co is able to comply with the price controls.

It is therefore proposed in the draft Notice to Vary that the method adopted for forecasting regulatory depreciation in Module 2 will be unspecified. The method to be adopted for a particular regulatory cycle may be proposed by NBN as part of the replacement module assessment process. This would allow NBN Co to propose a straight line approach whenever it chose to. The ACCC would then consider the proposed methodology as part of its assessment of the replacement module (that is, as a variation to the SAU, in accordance with the processes and statutory criteria set out in Part XIC of the CCA). If the ACCC was, at the time, satisfied that a straight line approach met the statutory criteria for acceptance of an SAU variation (that is, was satisfied that it was reasonable having regard to the matters set out in section 152AH of the CCA) it could accept NBN Co's proposal. If it was not satisfied that a straight line depreciation approach was reasonable (having regard to the matters set out in section 152AH of the CCA), it could reject the proposal and determine, via a replacement module determination, that another methodology must be used in its place for that regulatory cycle.

Thirdly, in relation to forecasting the return on capital, in light of submissions, the ACCC is satisfied that it is reasonable for NBN Co to specify that the regulated rate of return in Module 2 will always be a nominal vanilla WACC. This is because:

- it is necessary to choose a particular formulation of a return on capital (such as whether it includes or excludes the effects of tax and imputation credits) to draft some aspects of the SAU (such as what the building block components are);
- once the building block components have been specified (for example, that there will be a tax building block), it follows that a particular formulation of a return of capital would need to be used for consistency with the specified building block components (for example, to ensure that NBN Co is not under or over compensated for the effects of tax); and
- any outcome of a regulatory model that could be achieved using a different and consistent combination of building blocks and formulation of return on capital can be achieved if an appropriate translation of values is used in the combination of building blocks and formulation of return on capital that are specified by the SAU.

Since the SAU provides flexibility about the specific values that are included in the building blocks (which means that consistency with the rate of return can be maintained), the ACCC considers that specifying the use of a particular formulation of a return on capital (in this case, a

⁶⁰⁵ NBN Co Submission, p. 99.

nominal vanilla WACC) should not prevent NBN Co's return on capital and other building block components being set in accordance with best regulatory practice.

In relation to determining the value of the nominal vanilla WACC during Module 2, the ACCC considers that it is not objectionable for the SAU to specify that regard be had to the risks that NBN Co faces in investing. In reaching this view, the ACCC has considered the fact that it is required, under section 152AB(7A) of the CCA, to have regard to "the risks involved in making the investment". So, whilst the ACCC notes that it would be required to consider risks in accordance with section 152AB(7A) of the CCA in assessing NBN Co's proposed replacement module application even if this matter was not specifically set out in the SAU, the ACCC does not consider that its inclusion in the SAU raises any issues.

However, the ACCC — consistent with its position in the Draft Decision — is not satisfied that it is reasonable to specify that a benchmarking approach will always be adopted to determine NBN Co's financing costs. This is because a benchmarking approach to determining NBN Co's WACC parameters may not always be best regulatory practice.

The ACCC is also proposing some consequential amendments to allow it to specify some terms and conditions in relation to the rate of return in Module 2 as a fixed principle; but others not. In particular, the ACCC is proposing that the SAU be varied so that the term and condition that is a fixed principle is that which specifies that there will be a return on capital building block (the 'fixed principle component'); but that terms and conditions relating to *how* the value of the return on capital building block will be determined not be specified as a fixed principle. Put another way, the ACCC considers that the methodology for determining the value of the nominal vanilla WACC during Module 2 should not be a fixed principle. This is because there is scope for multiple interpretations of this clause when determining the value, such that it is not clear whether the ACCC would be unable to reject an unreasonable value for the return on capital because it may be for a reason that concerns a fixed principle

Lastly, in relation to forecasting the tax allowance in Module 2, the ACCC proposes in the draft Notice to Vary to adopt NBN Co's proposed variation which removes the factors to be taken into account when determining the forecast tax allowance.

In summary, the ACCC is proposing the following variations in the draft Notice to Vary:

- removal of the principles on which capital and operating expenditure forecasts must be based (removal of clauses 2D.6.1(a) and (b); removal of clause 2D.8), with the exception of the deemed prudent categories carried forward from Module 1 relating to the Telstra and Optus arrangements;
- amendments to clause 2D.2.1(a) to allow for the method to be adopted for forecasting regulatory depreciation in Module 2 to be determined at the time of the replacement module process;
- removal of the matters that will be had reference to in calculating the forecast return on capital (clause 2D.2.1(a)(iii)(A)), and the specification that the return of capital be calculated as a nominal vanilla WACC (described above as the 'fixed principle component');
- insertion of a new clause specifying that the forecasted rate of return in Module 2 must be a nominal vanilla WACC calculated having regard to the risks involved in making investments (described above as the non-fixed principle component); and
- removal of the factors to be taken into account when determining forecasts of the tax allowance in Module 2, specified in clause 2D.2.1(a)(iv).

Terms and conditions relating to rolling forward the RAB

Clause 2D.7 of Schedule 2D of the 18 December 2012 SAU sets out how the RAB will be rolled-forward over the duration of Module 2. This clause establishes that the RAB would be updated each year by adding the actual capital expenditure incurred by NBN Co in the previous year, and deducting asset disposals and forecast levels of depreciation.

In the Draft Decision, the ACCC noted that it could not be satisfied that efficient investment and expenditure would be encouraged over the term of Module 2 if it were prescribed that the RAB would always be updated based on actual capital expenditure.⁶⁰⁶ To address this, the ACCC proposed in the Consultation Paper that:

- the SAU be varied to remove the requirement that the RAB be rolled-forward during Module 2 based on *actual* capital expenditure, *actual* depreciation and asset disposals; and
- the SAU be varied to require that the RAB be rolled forward based on *prudent* additional capital expenditure, depreciation and asset disposals.⁶⁰⁷

The Consultation Paper noted that this would mean that the manner in which the RAB would be rolled forward (including the potential inclusion of additional efficiency incentive mechanisms) could be:

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

Submissions

In its submission to the Consultation Paper, NBN Co has indicated that it proposes to avoid locking in the aspects of the RAB roll forward that are of concern to the ACCC, and instead establish that RAB roll forward arrangements be put in place as part of the replacement module process.⁶⁰⁸ NBN Co proposes the following variations that would give effect to this process:⁶⁰⁹

- the replacement module application process would require NBN Co to include a RAB roll forward proposal that sets out the detailed roll forward provisions proposed to apply for the next regulatory cycle.
- The RAB Roll Forward Proposal may specify one of two options for how capital expenditure can be rolled into the RAB:
 - actual capital expenditure; or
 - actual capital expenditure up to the forecast used to set the ABBRR, with any amount beyond that level subject to an ex-post prudency assessment by the ACCC. In the event that the ACCC is conferred this power to assess capital expenditure in excess of forecast on an ex-post basis, the ACCC would be required to undertake that assessment according to a set of detailed criteria specified in the SAU.

(There appear to be minor differences between the proposed approach described by NBN Co in its submission for how capital expenditure is to be rolled forward in the RAB and in its proposed drafting of this approach. The proposed drafting by NBN Co requires RAB roll forward proposals to contain certain elements regarding capital expenditure — there may be some (albeit minor) flexibility in how these requirements

⁶⁰⁶ ACCC Draft Decision, p. 168.

⁶⁰⁷ ACCC Consultation Paper, pp. 33-34.

⁶⁰⁸ NBN Co Submission, p.107.

⁶⁰⁹ Ibid, pp.107-108; NBN Co Submission, Appendix C, pp. 89-90 and pp.116-117.

are reflected in the RAB roll forward proposal. As such, the proposed drafting does not strictly reflect the distinct binary choice as suggested in the submission. Under NBN Co's proposed drafting, it appears that the most significant choice to be made by NBN Co in its RAB roll-forward proposal is whether to confer a power on the ACCC to assess capital expenditure that exceeds forecast on an ex-post basis. If a power is not conferred, the effect of the RAB roll-forward proposal is that all actual capital expenditure will be rolled in.)

- In relation to the value of depreciation adopted in rolling forward the RAB, the RAB Roll Forward Proposal may specify one of two options:
 - the value of forecast depreciation that had been put in place for that regulatory cycle at the start of the regulatory cycle; or
 - the value of actual depreciation over the preceding regulatory cycle (calculated using the same depreciation method and asset lives that were used in forecasting depreciation at the start of that regulatory cycle).

Clause 2D.7.1(b) of the 18 December 2012 SAU would be amended to provide that the RAB will be rolled forward according to the 'RAB roll-forward arrangements', which are either the detailed roll forward provisions proposed by NBN Co and included in a replacement module accepted by the ACCC, or the equivalent provisions in a replacement module determination made by the ACCC in the event that it does not accept the replacement module application.

NBN Co submits that the proposed amendments avoid locking in the aspects of the RAB roll forward that are of the greatest regulatory concern; namely the use of actual capital expenditure and actual depreciation, and that its legitimate business interests are appropriately recognised by ensuring that the details of the RAB roll forward (including in relation to an ex-post prudency assessment) are specified in advance for any given regulatory cycle.⁶¹⁰

Optus submits that it agrees with the ACCC's proposed variations.⁶¹¹ It argues that, given the length of time before the start of Module 2, it is appropriate for the ACCC to ensure that there is flexibility as to how the RAB elements of Module 2 would operate, and that it is appropriate to allow the ACCC to approve, amend or disallow the value rolled-over into the RAB/ICRA and the ABBRR.⁶¹²

Telstra submits that it shares the concerns raised by the ACCC regarding NBN Co's proposal to update the RAB during Module 2 based on actual expenditure.⁶¹³ Telstra argues that one means of ensuring that only prudent expenditure is included in the RAB is to remove any "true-up" mechanism, and roll forward the RAB only on the basis of approved forecast expenditure, as currently adopted for Telstra's fixed-line services RAB, under the fixed principles in the ACCC's access determinations for these services.⁶¹⁴ Telstra further argues that if there is to be some form of "true-up" for actual expenditure, there should be an ex-post review power to ensure that this expenditure has been prudently incurred.⁶¹⁵

AAPT and Macquarie Telecom agreed with the variations proposed by the ACCC in the consultation paper.⁶¹⁶

ACCC response

Having considered the views expressed in submissions, the ACCC is of the view that it is not objectionable in concept for the SAU to specify that RAB roll-forward arrangements in Module 2

⁶¹⁰ NBN Co Submission, p. 108.

⁶¹¹ Optus Submission, p. 33.

⁶¹² Ibid, pp. 33-34.

⁶¹³ Telstra Submission, p. 41.

⁶¹⁴ Ibid, pp. 41-42.

⁶¹⁵ Ibid.

⁶¹⁶ AAPT Submission, p. 9, Macquarie Telecom Submission, p.12.

will be determined during the term of Module 2, through the replacement module process. Doing so would avoid locking in the matters that were raised as concerns by the ACCC in the Draft Decision and allow flexibility for RAB roll-forward arrangements to be adapted according to NBN Co's operating environment and the incentives it faces at the time.

In considering the implementation of this approach, the ACCC has adopted parts of NBN Co's proposed drafting. However, when considering the approach that NBN Co has proposed, the ACCC has the following concerns:

- Limiting the methods for how the RAB will be updated at the end of the regulatory cycle (in terms of how both capital expenditure and regulatory depreciation will be treated) may create a situation where the ACCC must adopt RAB roll-forward arrangements which it, at the time the assessment is made, considers to not be reasonable — under NBN Co's proposal, the ACCC would be prevented from imposing in a replacement module determination alternatives that it considered to be reasonable at the time the matters are being considered. Although the methods proposed by NBN Co would likely be considered reasonable now, and in the near future, they may not necessarily remain reasonable for the full term of the SAU.
- If the RAB roll-forward arrangements adopt a conferral of power whereby capital expenditure in excess of forecast is assessed ex-post by the ACCC, the ACCC would be required to perform this assessment against the detailed criteria set out in clause 4.8 (and in the definitions contained in the SAU dictionary). The proposed criteria would appear to require the ACCC to approve a wide range of expenditure, and this could result in capital expenditure that may otherwise have been considered inefficient being reflected in the RAB.

The key differences between NBN Co's proposed drafting and the draft Notice to Vary are therefore as follows.

Firstly, additional options for how capital expenditure and regulatory depreciation will be treated in rolling-forward the RAB have been included to allow capital expenditure and regulatory depreciation to be treated in accordance with other methods for the roll-in of capital expenditure to and roll-out of depreciation from the RAB. As noted above, the methods proposed by NBN Co may not necessarily remain reasonable for the full term of the SAU. Including these additional options would allow alternatives to be adopted in the event that the ACCC considered these methods to no longer be reasonable at the time of assessing a replacement module.

The ACCC notes that under this proposed variation, if NBN Co submitted a RAB roll-forward proposal that was consistent with the methods proposed by NBN Co above, the ACCC could accept the RAB roll forward proposal if it was satisfied at the time of assessing the proposal that it met the statutory criteria for acceptance of a variation to an undertaking under Part XIC. In deciding this, the ACCC must have regard to matters such as whether efficient investment is promoted and NBN Co's legitimate business interests. If the ACCC could not be satisfied that the proposal satisfied these statutory criteria, the ACCC would reject the proposal and make a replacement module determination specifying an alternative method for rolling forward the RAB.

Secondly, the detailed criteria by which the ACCC would be required to undertake its ex-post assessment of capital expenditure have been removed. This would not only address the issue outlined above, but would also allow NBN Co to include any criteria that it wanted the ACCC to have regard to in conducting its ex-post assessment in the replacement module application. The proposed criteria would then be assessed by the ACCC as part of its assessment of the replacement module (that is, as noted above, in accordance with the statutory criteria in Part XIC for assessment of a variation to an undertaking) in light of NBN Co's operating environment and the incentives it faces as the time. This would ensure that any criteria put in place would be adaptable in response to changing circumstances and would encourage efficient investment across a range of possible future scenarios.

A further structural variation is that the relevant clauses are proposed to be restructured so that all provisions relating to the content of RAB roll-forward proposals are included in schedule 2D (draft Notice to Vary clauses 2D.3 and 2D.4) consistent with the equivalent provisions for the LTRCM proposal.

Minor drafting variations have also been included in Schedule 2D to clarify that the return on assets to be included in the forecast nominal ABBRR, which is to be determined for each year of the regulatory cycle before the regulatory cycle starts as part of the replacement module process, is to be based on a forecast of the RAB roll-forward. The ACCC considers that this variation is required to remove a minor ambiguity in the 18 December 2012 SAU.

2.5. Non-price terms and conditions

The variations that are proposed in this section relate to the issues discussed in chapter 6 of the Draft Decision and section 2.5 of the Consultation Paper. Non-price matters are divided into two groups:

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

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

- the SFAA commitments; and
- the provisions relating to POI locations and changes to POI locations over time.

2.5.1. SFAA commitments

Under the SFAA commitments, NBN Co commits that it will include the terms and conditions specified in Annexures to Schedule 1H and Schedule 1J in its SFAAs. As discussed in the Draft Decision, the ACCC does not consider that the terms and conditions specified in the Annexures are reasonable.⁶¹⁷

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

- deletion of clauses 1H.5, 1H.6 and 1H.7 from Schedule 1H of Module 1 of the SAU;
- deletion of Annexures 1, 2 and 3 to Schedule 1H of Module 1 of the SAU; and
- deletion of Schedule 1J of Module 1 of the SAU.

The effect of these variations is that these matters will be left to further negotiation between access seekers and NBN Co. In the event that access seekers and NBN Co reach agreement on these terms, they can be incorporated into Access Agreements by the parties. In the event that agreement cannot be reached, the terms could be the subject of later regulatory determinations.

Submissions

⁶¹⁷ ACCC Draft Decision, pp. 176-200.

NBN Co submits that:

- the SFAA commitments “represent a reasonable and appropriate set of non-price terms given the state of development of NBN Co’s systems and operating capabilities”.⁶¹⁸ However, NBN Co nevertheless agrees to remove the clauses from the SAU and finalise these arrangements for the next WBA via commercial engagement.⁶¹⁹
- a power should be conferred upon the ACCC to approve the appointment and termination of decision makers in dispute management processes, and to approve guidelines for resolution of disputes.⁶²⁰ It submits that this is intended to address issues raised in relation to the independence of decision makers — specifically, the proposed amendment involves the replacement of Annexure 1 to Schedule 1H of the SAU with the drafting set out in Appendix C of NBN Co’s submission.⁶²¹

Some submissions wholly support the deletion of the SFAA commitments,⁶²² the majority support the deletion of service levels.⁶²³ A number of submissions state that the deleted SFAA commitments should be replaced with high-level principles to constrain NBN Co’s behaviour in negotiations.⁶²⁴

VHA submits that two additional clauses should be added to the SAU to constrain NBN Co’s behaviour during negotiations.⁶²⁵ The first clause would require NBN Co to act reasonably and in a manner consistent with the objectives of Part XIC in exercising rights and powers under the SAU or any SFAA-based Access Agreement.⁶²⁶ The second clause would amend clause 1H.5 to also require NBN Co to resolve disputes in compliance with its obligations under Part XIC and any directions given by the ACCC.⁶²⁷

ACCC response

Having considered the views expressed in submissions, the ACCC continues to be of the view that most of the SFAA terms should be removed from the SAU in their entirety, due to the ACCC’s assessment that the terms and conditions are not reasonable. The ACCC does not propose to address NBN Co’s arguments as to why the SFAA terms represent a reasonable and appropriate set of non-price terms. The ACCC would consider these arguments if they are submitted by NBN Co in any future regulatory statutory consultation process.

Further, for the reasons set out in section 2.5.2 of the Consultation Paper, the ACCC does not propose to substitute high-level principles for the detailed terms currently in the SAU, as suggested by a number of submissions.

In relation to VHA’s proposal to require NBN Co to act reasonably and in a manner consistent with the objectives of Part XIC in exercising rights and powers under the SAU or any SFAA-based Access Agreement, the ACCC considers that a varied SAU given in response to its notice to vary would greatly reduce the rights and powers given to NBN Co, and therefore reduce the necessity for such a clause. The ACCC considers that concerns about remaining discretions in the SAU should be addressed through the Notice to Vary rather than by adding an additional general obligation. The ACCC also notes that the part of the amendment relating to SFAA-based Access Agreements would be ineffective if the Access Agreement granted NBN

⁶¹⁸ NBN Co Submission, p. 111.

⁶¹⁹ Ibid.

⁶²⁰ Ibid, pp. 113-114.

⁶²¹ NBN Co Submission, Appendix C, pp. 93-113.

⁶²² CCC Submission, p. 3; Optus Submission, p. 35.

⁶²³ AAPT Submission, p. 10; ACCAN Submission, p. 2; ACMA Submission, pp. 1-2; CCC Submission, p. 3; Macquarie Telecom Submission, pp. 12-13; Optus Submission, p. 35.

⁶²⁴ AAPT Submission, p. 10; iiNet Submission, pp. 19-20; Macquarie Telecom Submission, p. 13; Telstra Submission, p. 44.

⁶²⁵ VHA Submission, pp. 3-5.

⁶²⁶ Ibid, p. 5.

⁶²⁷ Ibid.

Co wider discretion in exercising rights and powers (because the SAU term would not have effect to the extent it was inconsistent with the Access Agreement).

The ACCC also considers that it would not be beneficial to create an obligation for NBN Co to exercise discretions in a manner consistent with the objectives of Part XIC in the SAU. The objective of Part XIC, that is, the promotion of the long-term interests of end-users, requires consideration to be given to promoting competition, any-to-any connectivity, and efficient use of and investment in infrastructure.⁶²⁸ Given the competing factors that must be weighed up in each of these considerations, it is difficult to see how the ACCC could ever demonstrate that NBN Co had not complied with such an obligation.

In relation to the second of VHA's proposed amendments, the ACCC notes that NBN Co's proposed process for conferring powers on the ACCC includes provision for the ACCC to approve guidelines for the resolution of disputes that will be applied by the relevant decision makers.⁶²⁹ The ACCC will also have the power to direct resolution advisors in relation to their role in managing disputes and to direct NBN Co to terminate resolution advisors for failure to comply. Subject to the amendments to NBN Co's proposals about dispute management outlined below, and their subsequent inclusion in the SAU, the ACCC does not consider that it would be necessary for VHA's second proposed amendment to be made. The ACCC does not consider that it is beneficial to add an additional obligation for NBN Co to comply with its obligations under Part XIC in resolving disputes, as NBN Co is required to comply with these obligations in all circumstances under the CCA.

Dispute management processes

NBN Co has proposed to confer a new power upon the ACCC under the SAU to approve the appointment and termination of decision makers in dispute management processes, and to approve guidelines for resolution of disputes.⁶³⁰

The process proposed would require NBN Co to consult with customers and access seekers in nominating decision makers.⁶³¹ The ACCC would approve decision makers and terms of appointment of the chosen decision makers,⁶³² as well as guidelines to be applied by decision makers in resolving disputes.⁶³³ Notably, the guidelines may deal with any criteria for determining the eligibility of third parties to be joined to a dispute.⁶³⁴ In the event that the ACCC is not satisfied with nominations or proposals made by NBN Co, it may make its own determinations in relation to decision makers, terms of appointment, and guidelines.

In relation to terminations, the ACCC may direct NBN Co to terminate decision makers in the event that there are grounds for termination.⁶³⁵ The grounds for termination may be raised with the ACCC by either NBN Co or access seekers.⁶³⁶

The ACCC considers that these proposed amendments would ensure that decision makers would be independent and free from bias, and therefore promote the efficient, consistent and unbiased resolution of disputes.

However, the ACCC considers that some parts of the drafting in NBN Co's proposed conferral of power require clarification.

First, the ACCC considers that the status of the dispute resolution processes set out in Appendix 2 to the new Annexure 1 is unclear.⁶³⁷ The appendix sets out a process for resolution

⁶²⁸ CCA, s. 152AB.

⁶²⁹ NBN Co Submission, Appendix C, pp. 101-102.

⁶³⁰ NBN Co Submission, pp. 113-114.

⁶³¹ NBN Co Submission, Appendix C, p. 94 and 96, as set out in clauses 2.1(a) and 3.1(b).

⁶³² NBN Co Submission, pp. 94-98, as set out in clauses 2.1, 2.2, 3.1 and 3.2.

⁶³³ Ibid, pp. 101-102, as set out in clause 7.

⁶³⁴ NBN Co Submission, Appendix C, p. 101, as set out in clause 7(a).

⁶³⁵ Ibid, pp. 100-101, as set out in clause 6.2(d).

⁶³⁶ Ibid, pp. 100-101, as set out in clauses 6.2(a) and (b).

of disputes, but does not specify whether NBN Co intends or commits to include this process in Access Agreements or its SFAAs. Given that almost all Access Agreements will include dispute resolution processes ('Dispute Management Rules'), it seems unlikely that the provisions requiring decision makers to follow the process set out in the appendix would ever have effect, since the process would be inconsistent with the Access Agreements and thus ineffective under the legislative hierarchy in Part XIC.⁶³⁷ The ACCC also notes that the process included in NBN Co's submission is incomplete, that is, only certain parts of the Dispute Management Rules have been included.

The ACCC considers that if this appendix is intended to specify the dispute resolution process that NBN Co will use to resolve disputes under Access Agreements, NBN Co should provide the complete Dispute Management Rules and make a clear commitment in the SAU to comply with them. On the other hand, if NBN Co does not intend to make such a commitment, the process should be removed, and the obligations of the decision makers modified so that they must comply with the Dispute Management Rules.

The ACCC also considers that the SAU should contain a commitment from NBN Co that it will use the decision makers appointed through the SAU process for managing all disputes under Access Agreements.

Second, the ACCC considers that the 10 business day timeframe for the appointment of decision makers may not be sufficient for the ACCC to properly consider the candidates nominated by NBN Co, consult with access seekers, and approve the relevant terms of appointment. By comparison, there is no deadline for the ACCC's decision to approve an Independent Telecommunications Adjudicator under Telstra's Structural Separation Undertaking. The ACCC considers that it is unlikely that decision makers will be required immediately following acceptance of the SAU. For this reason, the ACCC proposes to extend the timeframe for its decision to 60 business days. This deadline may be further extended. The ACCC also proposes to extend or specify timeframes for a number of other process steps.

Lastly, NBN Co proposes that these provisions would be in operation for the duration of Module 1. However, the ACCC considers that they should only operate for five years, given the novel, detailed and untested nature of the processes under which the conferral of power operates. The ACCC considers that it is appropriate that their effectiveness be reviewed, and that the ACCC have a role in determining the ongoing provisions for the duration of Module 1 in the event that commercial agreement on the provisions cannot be reached. This role could be via the assessment of an extension to the provisions through an SAU variation at or around year five of the SAU term, or in making an Access Determination once the provisions cease to operate.

In summary in relation to the SFAA-terms, the ACCC considers that:

- Clauses 1H.6 and 1H.7 in Schedule 1H should be deleted;
- Clause 1H.5 and Annexure 1 to Schedule 1H should be replaced by an amended version of NBN Co's proposal as set out in the draft Notice to Vary;
- Annexures 2 and 3 to Schedule 1H should be deleted;
- Schedule 1J (including Annexure 1) should be deleted; and
- Schedule 2F should be deleted.

⁶³⁷ Ibid, pp.107-113.

⁶³⁸ Ibid, p. 98, as set out in clause 3.2(d)(iii).

2.5.2. POI related matters

The SAU sets out NBN Co's commitments in relation to offering interconnection for different Connectivity Serving Areas (CSAs), and the changing of POI locations (including a process for ACCC approval of proposed changes to POIs).⁶³⁹ The ACCC's concerns with these commitments are set out in chapter 6 of the Draft Decision. In the Consultation Paper, the ACCC proposed that the following variations to the SAU be made:

- deletion of clause 1H.4.4 of Schedule 1H of the SAU — this would remove the inconsistency with the discretion granted to the ACCC to update the list of POIs under section 151DB of the CCA;
- deletion of the words “by a further 20 Business Days” from clause 1H.4.3(b) of Schedule 1H of the SAU — this would have the effect of allowing the ACCC to extend the POI review process as required, depending on the complexity of the particular process;
- amendment of clause 1H.4.5(b) of Schedule 1H of the SAU so that NBN Co will provide access seekers with at least 12 months' notice of the migration of end-users from the temporary POI to an established POI — this would have the effect of ensuring that access seekers will have sufficient notice to undertake the planning and investment required to interconnect at the established POI, and ensures that notice will be provided even if the temporary POI will remain in use for other end-users; and
- the insertion of a commitment that NBN Co will only offer interconnection for a particular CSA at the POI which is generally closest to the end-users in that CSA, but that is consistent with the network planning and dimensioning rules devised to identify the location of the listed POIs to the NBN — this variation would have the effect of ensuring that the SAU supports and is consistent with the intended purpose of the POI list (that is, that interconnection is offered at locations which promote the long-term interests of end-users).⁶⁴⁰

Submissions

In relation to the first three variations noted above, NBN Co agrees to make the proposed variations.⁶⁴¹ Some submissions from interested parties agree with the proposed variations,⁶⁴² whilst others do not comment on them.

In addition, Telstra proposes that additional commitments should be made about the content of notifications and the timing of migrations from one POI to another.⁶⁴³

In relation to the variation about the locations for interconnection at a CSA, NBN Co submits that:

- the proposed variation is premature and unnecessary, because experience may demonstrate that the semi-distributed approach is not the optimum approach.⁶⁴⁴
- “NBN Co, having designed its network to serve all 121 POIs, and developed network planning rules for efficient network deployment and operations, has no incentive to engage in network “scope creep” or to limit strong competition in backhaul provision”.⁶⁴⁵

⁶³⁹ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1H, clause 1H.4.

⁶⁴⁰ ACCC Consultation Paper, p. 36.

⁶⁴¹ NBN Co Submission, pp. 118-121.

⁶⁴² iiNet Submission, p. 21; Macquarie Telecom Submission, pp. 13-14; Telstra Submission, p. 47.

⁶⁴³ Telstra Submission, p. 47.

⁶⁴⁴ NBN Co Submission, pp. 116-117.

⁶⁴⁵ *Ibid*, pp. 117-118.

- the ACCC has taken insufficient account of the Government’s intentions for NBN Co and the anticipated role of the ACCC, as described in the Shareholder Ministers’ Statement of Expectations (SoE).⁶⁴⁶
- the commitment may unnecessarily and prematurely limit NBN Co’s operational efficiency, and wider market efficiency.⁶⁴⁷

The majority of access seeker submissions support the proposed amendment.⁶⁴⁸ The CCC submits that the variations are “necessary to ensure that there is not the development of mega POIs over time in circumstances where the Commission has not applied the discipline of the LTIE test”.⁶⁴⁹

ACCC response

In relation to the first three variations noted above, and having taken into account the views expressed in submissions, the ACCC remains of the view that they should be made for the reasons described in the Consultation Paper.

The ACCC notes Telstra’s submission relating to the provision of additional information about migration processes and timeframes,⁶⁵⁰ and for the avoidance of doubt, has added a new clause 11.4.5 to clarify that the ACCC would be able to require NBN Co to provide such information through regulatory determinations. However, the ACCC does not consider that timing of notification of changes to POIs should be constrained in the way proposed by Telstra, that is, until the POI is established, available and ready for service.⁶⁵¹ The ACCC considers that it would not promote efficient use of infrastructure for migration to a new POI to be delayed for 12 months after it is ready for service.

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

- deletion of clause 1H.4.4 of Schedule 1H of the SAU;
- deletion of the approval process in clause 1H.4.3(b) of Schedule 1H of the SAU, except for parts relating to notification to access seekers; and
- amendment of clause 1H.4.5(b) of Schedule 1H of the SAU so that NBN Co will provide access seekers with at least 12 months’ notice of the migration of premises from the temporary POI to an established POI.

In addition, the ACCC continues to consider that amendment of clause 1A.3.5 of Schedule 1A of the SAU is required. Clause 1A.3.5 of Schedule 1A of the SAU provides that NBN Co will specify the POI for each CSA and may also utilise temporary POIs for providing interconnection to the NBN.

At this time, the ACCC continues to consider that POIs should be located where competitive transmission services are available or where there is evidence regarding the likelihood of competition — interconnection to NBN Co’s network should be permitted at locations which preserve existing competition in the provision of transmission services and where the potential for future competition is maximised (a ‘semi-distributed’ approach to POI location).⁶⁵² The

⁶⁴⁶ Ibid, p. 116.

⁶⁴⁷ Ibid.

⁶⁴⁸ AAPT Submission, p. 10; CCC Submission, p. 3; iiNet Submission, p. 21; Telstra Submission, p. 46; VHA Submission, p. 9.

⁶⁴⁹ CCC Submission, p. 3.

⁶⁵⁰ Telstra Submission, p. 47.

⁶⁵¹ Ibid.

⁶⁵² The ACCC developed criteria to determine where POIs should be located in order to achieve these objectives (‘the Competition Criteria’). Following the development of the Competition Criteria, it was necessary for NBN Co to develop a practical set of network planning rules that would allow the location of POIs to be identified and which were consistent with the criteria that had been specified. On 5 November 2012, the ACCC published a list (the List in Force) of POIs to the NBN as required under section 151DB of the CCA. This list contains the location of

ACCC continues to consider that this is the arrangement most likely to promote the long-term interests of end-users. The reasons for this are set out extensively in the ACCC's advice to Government on this issue in 2010.⁶⁵³ As such, the ACCC does not propose to repeat that reasoning here.

Whilst acknowledging the fact that the NBN is in its early roll-out stages, the ACCC is not persuaded by NBN Co's submission that the proposed variation is premature. As discussed in the Draft Decision, the semi-distributed approach was settled by the Statement of Expectations (SoE) in 2010, which sets out the Government's intentions for NBN Co in relation to this matter.⁶⁵⁴ The SoE clearly states that "[t]he Government has determined that a semi-distributed POI structure which extends the NBN Co network to meet with, but not overbuild competitive backhaul routes is the preferred outcome".⁶⁵⁵ NBN Co itself submits that the approach has also been incorporated into the network design of the NBN.⁶⁵⁶

The ACCC also acknowledges that, if transmission markets are to develop in particular ways, a different approach to POI locations may better promote the long-term interests of end-users than the semi-distributed approach. This was acknowledged in the ACCC's advice to Government in 2010.⁶⁵⁷ In this regard, the ACCC is currently undertaking a review of the policies and procedures relating to the identification of Listed POIs, as required by section 151DC of the CCA.⁶⁵⁸ Whilst this review does not re-consider the merits of the ACCC's 2010 advice to Government, a number of issues were raised in submissions to the review which are relevant to a consideration of the number and location of POIs.⁶⁵⁹ Some of the issues raised by submissions would likely be addressed as more POIs become active and customer demand increases. However, if these issues remain a concern as the NBN rollout proceeds, they may warrant further consideration or review.

In the event that developments in transmission markets are such that the semi-distributed approach no longer promotes the long-term interests of end-users, or in the event that NBN Co is directed by the Government to extend its role, the ability for NBN Co to seek to vary the SAU under section 152CBG of the CCA (to vary the commitment that is currently proposed by the ACCC) would provide a mechanism for such a review to take place. If it were the case that NBN Co's varied approach to POI locations promoted the long-term interests of end-users at the time of assessing the variation, it seems unlikely that the variation could be refused by the ACCC.

The ACCC also notes that the commitment that it is proposing refers to interconnection at the 'closest POI' on the POI list made by the ACCC under section 151DB of the CCA (the 'List in Force').⁶⁶⁰ This means that the commitment would be automatically modified by changes to the List in Force and would therefore be flexible to adapt to any developments in transmission markets that would lead to variation of the List in Force by the ACCC. Put another way, the

121 POIs where RSPs can connect with the NBN network. The ACCC's 2010 advice to Government is noted in the context of these policies and procedures adopted to ensure that the location of Listed POIs published under section 151DC was consistent with the semi-distributed approach adopted by government in relation to the number and location of POIs to the NBN and outlined in its Statement of Expectations for NBN Co.

⁶⁵³ ACCC, Advice to Government - National Broadband Network Points of Interconnect, November 2010, <http://transition.accc.gov.au/content/>

⁶⁵⁴ Letter from the Hon. Penny Wong MP, Minister for Finance and Deregulation and Senator the Hon. Stephen Conroy, Minister for Broadband, Communications and the Digital Economy to NBN Co, Statement of Expectations, 17 December 2010, Department of Broadband, Communication and the Digital Economy, Canberra, viewed 27 March 2013, http://www.dbcde.gov.au/_data/assets/pdf_file/0003/132069/Statement_of_Expectations.pdf (Statement of Expectations)

⁶⁵⁵ Ibid, p. 7.

⁶⁵⁶ NBN Co Submission, pp. 117-118.

⁶⁵⁷ Ibid, p. 4 and pp. 62-64.

⁶⁵⁸ ACCC, *Consultation Paper: Review of policies and procedures relating to the identification of listed NBN points of interconnect*, February 2013.

⁶⁵⁹ Submissions are available on the ACCC website at <http://transition.accc.gov.au/content/index.phtml/itemId/1110886>

⁶⁶⁰ On 5 November 2012, the ACCC published a list (the List in Force) of POIs to the NBN as required under section 151DB of the CCA. This list contains the location of 121 POIs where RSPs can connect with the NBN network. These locations were identified following a comprehensive consultation process undertaken between December 2010 and November 2012.

ability for the ACCC to vary the List in Force provides a further mechanism by which the locations of POIs are able to be reviewed and changed over time.

Regarding NBN Co's submission that a commitment in the SAU would be inconsistent with the SoE, the ACCC considers that its proposal is entirely consistent with the SoE. The SoE states that NBN Co may "extend its connectivity service in those areas where it can demonstrate that to do so would lead to improved backhaul price outcomes" but that "each such proposal should be referred to the Government for consideration".⁶⁶¹ As noted, the above two mechanisms could facilitate any changes that NBN Co is required to make to the SAU commitment or the List in Force in response to such a Government review.

The ACCC therefore proposes that clause 1A.3.5 of Schedule 1A be amended to require, for fibre and wireless access services, NBN Co to only offer interconnection for a particular CSA at the POI which is generally closest to the end-users in that CSA and consistent with the network planning and dimensioning rules devised to identify the location of the listed POIs to the NBN.⁶⁶²

An alternative variation to clause 1A.3.5 of Schedule 1A would be deletion of the clause. The effect of this would be that locations for interconnection for CSAs would be determined via commercial negotiation, or regulatory determination in the event that agreement could not be reached. Any competition issues that arise as a result of the agreed locations for interconnection could then be assessed under Parts IV and Parts XIB of the CCA. The key difference between this and the ACCC's currently proposed approach is that, if NBN Co were to offer interconnection on a consolidated POI basis, under the ACCC's currently proposed approach, this could constitute a breach of the SAU, in addition to possibly raising concerns under the competition law provisions of the CCA.

⁶⁶¹ Statement of Expectations, p. 7.

⁶⁶² The ACCC notes that this commitment does not apply for interconnection for satellite services, due to specific sectoral impacts on satellite service providers that are still being considered by the ACCC.

2.6. Fixed Principles

Clause 5.3 of the Main Body of the SAU provides that every term and condition in Module 0 and Module 2 (collectively) is a fixed principle term and condition for the full SAU term. The SAU also provides that the qualifying circumstances for the fixed principles term and condition are that the ACCC must be satisfied that:

- “there is not a manifest and material error in the fixed principles term and condition”,⁶⁶³ and
- “any information on which the fixed principles term and condition was based was not false and misleading in a material respect.”⁶⁶⁴

Under Part XIC, the ACCC must reject the SAU if it is not satisfied that the fixed principles term or condition meet certain criteria for the specified notional fixed period.⁶⁶⁵

The implications of the proposed fixed principles term and condition are as follows:

- if the SAU was accepted and NBN Co wanted to submit a new SAU or a variation to the SAU (for example, a variation in the form of a replacement module application) during the SAU term that contained the same fixed principles term and condition, it must include all of the terms and conditions in Module 0 and Module 2; and
- if it did so, the ACCC would not be able to reject the new SAU or proposed variation to the SAU for a reason concerning a term or condition specified in Module 0 and Module 2 (unless the specified qualifying circumstances exist).⁶⁶⁶

In the Draft Decision, the ACCC expressed the view that the proposed fixed principle should not be a fixed principle because it is not satisfied that some of the provisions in Module 0 and Module 2 promote the long-term interests of end-users and are reasonable.⁶⁶⁷

Further, it considered that only those matters which are reasonably necessary for providing certainty about long-term cost recovery should be specified as fixed principles.⁶⁶⁸

The ACCC also noted throughout the Draft Decision that where a term and condition proposed to be part of the fixed principle is a high level principle involving judgment and discretion.⁶⁶⁹ The ACCC considered that, in cases where a term and condition proposed to be part of the fixed principle is a high-level principle involving judgment and discretion, the ACCC was unable to be satisfied that the implementation of the principle will meet the statutory criteria in all circumstances.⁶⁷⁰ This is because one argument might be that the rejection would be characterised as being ‘for a reason that concerns’ the principles. As a result, there is uncertainty as to the ACCC’s ability to ensure that the SAU only includes terms and conditions which promote the long-term interests of end-users and are reasonable over the term of the SAU.

⁶⁶³ NBN Co, *Special Access Undertaking*, 18 December 2012, Main Body, clause 5.4(b)(i).

⁶⁶⁴ *Ibid.*, Main Body, clause 5.4(b)(ii).

⁶⁶⁵ CCA, s. 152CBD(4).

⁶⁶⁶ CCA, ss. 152CBAA(5) and 152CBAA(6). This would also apply if NBN Co proposes a variation at any other time.

⁶⁶⁷ ACCC Draft Decision, p. 209.

⁶⁶⁸ *Ibid.*

⁶⁶⁹ See, for example, ACCC Draft Decision, p. 185 and pp. 163-167.

⁶⁷⁰ *Ibid.*

In light of these issues, the Consultation Paper sought views on whether further amendments were required to the fixed principles term and condition following other amendments to the Module 0 and Module 2 provisions.⁶⁷¹

Submissions

NBN Co submits that, in relation to the types of terms and conditions that should be a fixed principle, there is nothing in Part XIC that limits the scope of matters that may be accepted as fixed principles in an SAU to those specifically concerning long-term cost recovery, although “NBN Co notes that this would be the most important area of focus for fixed principles.”⁶⁷²

It also submits that, by virtue of the design of the SAU, particularly the replacement module process, all the terms and conditions in Modules 0 and 2 are necessary to provide NBN Co with sufficient certainty regarding long-term cost recovery.⁶⁷³ In relation to why all the terms and conditions in Module 0 and 2 are necessary for long-term cost recovery, NBN Co:

- submits that the terms and conditions are fundamental to the overall objective of the SAU and are required to provide NBN Co with certainty regarding its long-term cost recovery — it submits that this is especially important for the subsequent regulatory period, as NBN Co will rely upon SAU variations as a way of implementing replacement module applications.⁶⁷⁴ It states that NBN Co needs to be confident that key elements of the SAU will continue to be carried over into subsequent undertakings.⁶⁷⁵
- considers that without fixed principles in place “each SAU variation submitted by NBN Co would require the re-assessment of the terms and conditions that have already been accepted by the ACCC”,⁶⁷⁶ and that this introduces a degree of uncertainty with regards to the terms and conditions in Modules 0 and 2.⁶⁷⁷ Therefore it is “entirely consistent with the modular design of the SAU, to specify the terms and conditions of Module 0 and 2 as a fixed principles term and condition (and therefore not subject to a reassessment) to ensure that NBN Co has certainty that the SAU framework for providing long-term cost recovery will not be changed.”⁶⁷⁸

In relation to the implications of fixed principles for the ACCC’s decision-making on SAU variations, NBN Co submits that:

- Adopting a purposive approach to interpreting fixed principles (that is, that fixed principles are intended to provide certainty in relation to the operation of specific pre-determined matters), “the fixed principles regime does not operate to constrain the ACCC in areas beyond those matters identified specifically within the relevant fixed principles term or condition.”⁶⁷⁹
- “The ACCC’s jurisdiction to consider a specific element of a Replacement Module is not affected by the existence of a general fixed principles term or condition on the same subject matter because there is no causal connection between the ACCC’s consideration of a specific element and the generally expressed fixed principles term or condition.”⁶⁸⁰
- “Just because the subject matter is the same does not mean that there is a causal link between those two things, or that a decision to reject an SAU term would be “for a

⁶⁷¹ ACCC Consultation Paper, p. 10.

⁶⁷² NBN Co Submission, p. 125.

⁶⁷³ *Ibid.*, p. 126.

⁶⁷⁴ *Ibid.*, p. 125.

⁶⁷⁵ *Ibid.*

⁶⁷⁶ *Ibid.*, p. 126.

⁶⁷⁷ *Ibid.*

⁶⁷⁸ *Ibid.*

⁶⁷⁹ *Ibid.*, p. 128.

⁶⁸⁰ *Ibid.*

reason that concerns” a fixed principle term or condition where the reasons for the rejection were not specifically linked to the fixed principle term or condition.”⁶⁸¹

NBN Co provides one example of this — “the ACCC would not be prevented from rejecting a variation to the SAU if it did not accept the expenditure values submitted by NBN Co as part of the Forecast Nominal ABBRR simply because the proposed variation established a requirement that the Forecast Nominal ABBRR include a number of specified elements (as it currently does under 2D.2.1(a) of the SAU).”⁶⁸²

NBN Co also proposes the following drafting amendment to “clarify that the fixed principle is only intended to cover the subject matter to the extent of the level of granularity specified in the SAU”:⁶⁸³

Every term and condition in Module 0 and Module 2 (collectively) is a fixed principles term and condition of this Special Access Undertaking, but only to the extent specified in each term and condition in Module 0 and Module 2, and not to the extent that specific matters that arise in connection with a term and condition in Module 0 and Module 2 are not specifically covered by that term and condition.⁶⁸⁴

Herbert Geer (on behalf of iiNet Ltd) agrees with the ACCC’s views in relation to limiting the scope of the fixed principle to matters that are reasonably necessary for providing certainty about long-term cost recovery because this would be consistent with the approach to fixed principles in the ACCC’s fixed-line services Access Determinations.⁶⁸⁵ It submits that “specifying all of modules 0 and 2 as fixed principles is unnecessary and is likely to lead to an unnecessary level of rigidity over the course of the SAU.”⁶⁸⁶

Telstra supports the ACCC’s preliminary views.⁶⁸⁷ It notes that in principle, it supports the use of fixed principles; however, it has concerns about locking in all the provisions of Modules 0 and 2 as fixed principles because “a number of these provisions are neither appropriate for the long term nor do they warrant the additional protection afforded to ‘fixed principles terms and conditions’”.⁶⁸⁸ It therefore considers that the fixed principle provision should be removed from the SAU entirely.⁶⁸⁹

Other interested parties did not provide views on this issue.

ACCC response

The ACCC has no objection in principle to the inclusion of a fixed principle in the SAU. However, the ACCC does not consider that all of the terms and conditions in Modules 0 and 2 (collectively) should be a fixed principle.

The ACCC notes that NBN Co’s proposed ‘modular’ structure for the SAU, with a term of close to 30 years, is unprecedented. The ACCC appreciates NBN Co’s desire for certainty as to its future regulatory arrangements, particularly its ability to recover its costs, over the term of the SAU, but does not consider that making all of the proposed terms fixed principles is necessary to deliver this certainty.

NBN Co argues against the ACCC’s view that only those matters necessary for long-term cost recovery should be fixed principles, quoting the Explanatory Memorandum to the Bill that inserted fixed principles provisions into Part IIIA and citing the fact that nothing in Part XIC limits the scope of what can be fixed principles.⁶⁹⁰ The ACCC notes that there are no fixed

⁶⁸¹ Ibid.

⁶⁸² Ibid.

⁶⁸³ Ibid, pp. 127-128.

⁶⁸⁴ Ibid, p. 129.

⁶⁸⁵ iiNet Submission, pp. 21-22.

⁶⁸⁶ Ibid, p. 21.

⁶⁸⁷ Telstra Submission, pp. 14-15.

⁶⁸⁸ Ibid, p. 14.

⁶⁸⁹ Ibid, pp. 14-15.

⁶⁹⁰ NBN Co Submission, p. 126.

principles in operation under section 44ZZAAB of Part IIIA; hence, it is difficult to draw conclusions at this point in time as to the types of matters that would be considered appropriate to be specified as fixed principles under that regime. In any event, the fixed principles provisions under Part IIIA are different to those under Part XIC — specifically, under Part IIIA, the ACCC cannot accept a future undertaking if it does not include the fixed principles,⁶⁹¹ whereas under Part XIC, the ACCC cannot reject a future undertaking if it does include the fixed principles.⁶⁹² That is, under Part IIIA, there is an obligation on the provider to include the fixed principles in order for the undertaking to be accepted; on the other hand, under Part XIC, there is an obligation on the ACCC to not reject an undertaking in which the provider has opted to include the fixed principles.

The ACCC also notes that in the energy context, the *National Gas Rules* provide that the gas access arrangements approved by the Australian Energy Regulator (AER) may contain fixed principles provisions.⁶⁹³ These fixed principles are approved for a five-year regulatory period — the service provider must seek AER approval to extend the operation of the fixed principles for the next regulatory period.⁶⁹⁴ Further, the matters that the AER has approved to be set as fixed principles relate to the regulatory asset base roll-forward mechanism.⁶⁹⁵

Further, according to the Explanatory Memorandum to the *Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010*, fixed principles terms and conditions included in Special Access Undertakings operate in a similar manner to fixed principles provisions in Access Determinations, which are intended “to provide greater regulatory certainty in certain circumstances”.⁶⁹⁶ The Explanatory Memorandum gives the example in the Access Determination context of where a utility pricing model for setting the access price for a declared service is adopted, the ACCC being able to lock in a regulated asset base for the requisite period.⁶⁹⁷

In the context of Access Determinations for the fixed-line services, the ACCC did not consider that sufficient consultation had been undertaken on particular terms and conditions for it to be satisfied that they should be made fixed principles.⁶⁹⁸ The ACCC noted that the ACCC may consider whether the provisions should be expanded during its consultation prior to the next regulatory period; and that at that time, the ACCC may also consider further whether fixed principles provisions should be made in respect of non-price issues.⁶⁹⁹ Nonetheless the ACCC was willing, in the context of the fixed-line services Final Access Determinations, to make terms and conditions relating to the following matters fixed principles provisions for ten years:

- the initial RAB value;
- the initial tax asset value;
- the RAB roll forward mechanism;
- what the components of the revenue requirement will be;
- that a vanilla WACC will be used for estimating the weighted average cost of capital, and a CAPM approach will be used for the cost of equity;
- that the tax rate will be the corporate tax rate for calculating tax liabilities;

⁶⁹¹ CCA, ss. 44ZZAAB(5) and 44ZZAAB(6).

⁶⁹² CCA, ss. 152CBAA(5) and 152CBAA(6).

⁶⁹³ *National Gas Rules*, Rule 99.

⁶⁹⁴ *Ibid.*

⁶⁹⁵ See for example AER, *SP AusNet 2008-2012 Access Arrangements*, clause 7.2.

⁶⁹⁶ Explanatory Memorandum to the *Telecommunications Legislation Amendment (Competition and Consumer Safeguards Bill) 2012*, p. 182.

⁶⁹⁷ *Ibid.*, p. 205 and p. 182.

⁶⁹⁸ ACCC, *Fixed-line Services Final Access Determinations 2011*, p. 129.

⁶⁹⁹ *Ibid.*

- rules around cost allocation;
- the factors the ACCC will take into account in assessing operating and capital expenditure forecasts; and
- the process for assessing demand forecasts — that the ACCC will take into account any forecasts provided by the provider and consider whether they meet certain criteria.⁷⁰⁰

The ACCC's position in the current context (that the only matters that should be specified as fixed principles are those relating to long-term cost recovery) is therefore consistent with that taken in the fixed-line services Final Access Determinations. It should also be noted that in making these fixed principles, the ACCC included a provision allowing it to modify or remove a fixed principle provision in certain specified circumstances (which are albeit intended to be a strictly limited set of circumstances).⁷⁰¹ In the SAU context, the ACCC is unable to modify or remove a fixed principle.

The ACCC also notes that a number of submissions to its November 2012 Consultation Paper expressed the view that only the matters necessary for NBN Co to achieve long-term cost recovery should be fixed principles.

Hence, the ACCC continues to consider that in the current context, the only matters in the SAU that should be specified as fixed principles are those relating to long-term cost recovery.

In relation to NBN Co's argument that all of the matters in Modules 0 and 2 are necessary for long-term cost recovery, it appears that NBN Co is concerned that:

- if Module 0 and Module 2 terms are not fixed principles, the ACCC could reject replacement module applications even if they are consistent with Modules 0 and 2; and
- the terms in Modules 0 and 2 could therefore be 're-opened' even though they have been accepted by the ACCC at the commencement of the SAU, thereby introducing uncertainty.⁷⁰²

NBN Co states that it is "entirely consistent with the modular design of the SAU, to specify the terms and conditions of Module 0 and 2 as a fixed principles term and condition (and therefore not subject to a reassessment) to ensure that NBN Co has certainty that the SAU framework for providing long-term cost recovery will not be changed."⁷⁰³

The ACCC has a different understanding of its role in assessing SAU variations to what it understands NBN Co's view to be. NBN Co appears to consider that if terms and conditions in Modules 0 and 2 are not fixed principles (and are simply SAU terms and conditions with an expiry date of June 2040), those terms and conditions will be re-assessed by the ACCC in its assessment of future SAU variations during the replacement module process. In contrast, the ACCC considers that if NBN Co lodges a variation to the SAU, the ACCC is only able to assess (and make a decision to accept or reject) the variation (and not the existing terms). Whilst the ACCC could decide that the variation is not reasonable by virtue of its interaction with a term or condition in Module 0 or 2 — and that the variation should therefore be rejected — the ACCC is unable to reject or amend the terms and conditions in Modules 0 and 2 that it has accepted in its initial assessment of the undertaking. The Module 0 and Module 2 terms will be in place for the term of the SAU — if the variation is rejected, those terms will remain unchanged. This means that although an SAU variation is assessed having regard to its interaction with the

⁷⁰⁰ Ibid, pp. 130-132.

⁷⁰¹ Ibid, p. 129.

⁷⁰² NBN Co, *Supporting Submission: NBN Co Special Access Undertaking*, 28 September 2012, p. 36; NBN Co Submission, p. 126.

⁷⁰³ NBN Co Submission, p. 126.

Module 0 and 2 terms, the ACCC cannot require NBN Co to change the terms that have been accepted at the outset.

NBN Co's concerns appear to be based on the premise that the ACCC will change its mind at a later date as to the reasonableness of terms and conditions accepted in its current assessment of the SAU. In its current assessment of the SAU, the ACCC can only accept terms and conditions which are proposed to operate for the term of the SAU if it is satisfied that those terms and conditions will be reasonable for that period of time. The ACCC therefore does not accept the premise that it would change its mind at a later date as to the reasonableness of terms and conditions accepted in its current assessment of the SAU.

By virtue of the modular structure of the SAU, an accepted replacement module will operate in conjunction with Module 0 and Module 2. It is through the replacement module process that NBN Co will be seeking to vary the SAU, and require the additional certainty of fixed principles for terms relating to long-term cost recovery. In this context, the ACCC considers that the only matters in the SAU that should be specified as fixed principles are those provisions relating to long-term cost recovery in Module 2 that govern the content of replacement modules (as discussed in section 2.1.2.1).

In relation to NBN Co's arguments about the effects of fixed principles on ACCC decision-making on SAU variations, as noted, specifying terms as fixed principles means that the ACCC cannot reject a variation application 'for a reason that concerns' these terms (unless the qualifying circumstances exist). Therefore, even if the ACCC does not consider that the variation is in the long-term interests of end-users and is reasonable, it cannot reject the variation 'for a reason that concerns' the fixed principles term or condition.

NBN Co asserts that:

- "the fixed principles regime does not operate to constrain the ACCC in areas beyond those matters identified specifically within the relevant fixed principles term or condition."⁷⁰⁴
- "The ACCC's jurisdiction to consider a specific element of a Replacement Module is not affected by the existence of a general fixed principles term or condition on the same subject matter because there is no causal connection between the ACCC's consideration of a specific element and the generally expressed fixed principles term or condition."⁷⁰⁵
- "Just because the subject matter is the same does not mean that there is a causal link between those two things, or that a decision to reject an SAU term would be "for a reason that concerns" a fixed principle term or condition where the reasons for the rejection were not specifically linked to the fixed principle term or condition."⁷⁰⁶

The ACCC is not clear as to the basis on which NBN Co has developed this interpretation of the implications of fixed principles for the ACCC's decision-making with respect to SAU variations. The fixed principles provision under section 152CBAA are yet to be tested and there is therefore not yet clear guidance as to the implications for the ACCC's decision-making.

In light of this uncertainty, the ACCC's primary concern is to ensure that it is not constrained in a way that prevents it from rejecting future SAU variations which it assesses as not meeting the statutory criteria at that time. The ACCC considers that this issue is particularly likely to arise where a fixed principle includes terms and conditions involving judgment and discretion. As noted throughout the Draft Decision, in cases where a term and condition proposed to be part of the fixed principle is a high-level principle involving judgment and discretion, the ACCC was unable to be satisfied that the implementation of the principle will meet the statutory criteria in

⁷⁰⁴ Ibid, p. 128.

⁷⁰⁵ Ibid.

⁷⁰⁶ Ibid.

all circumstances.⁷⁰⁷ The ACCC considered that if, in assessing a replacement module application, the ACCC is not satisfied that the proposed variation complies with the high-level principles, there is uncertainty as to whether the ACCC would be able to reject the application for the reason that the variation does not comply with these principles.⁷⁰⁸ This is because one argument might be that the rejection would be characterised as being ‘for a reason that concerns’ the principles. As a result, there is uncertainty as to the ACCC’s ability to ensure that the SAU only includes terms and conditions which promote the long-term interests of end-users and are reasonable over the term of the SAU.

The ACCC therefore considers that only the matters for which there is no scope for the term or condition to be implemented or operationalised in a future SAU variation in a manner which does not meet the statutory criteria should be a fixed principle. This tends towards an approach being adopted whereby matters over which there is a high degree of scope for multiple interpretations not being accepted as fixed principles.

In relation to NBN Co’s proposed drafting amendment, which is aimed at clarifying “that the fixed principle is only intended to cover the subject matter to the extent of the level of granularity specified in the SAU”,⁷⁰⁹ the ACCC considers that this would add an additional layer of interpretation of the implications of the fixed principles in its future decision-making. It therefore creates additional uncertainty, particularly given the new and untested nature of these provisions. The ACCC therefore does not propose to adopt NBN Co’s suggested drafting amendments.

In light of the above views, of the terms and conditions that NBN Co has proposed should be a fixed principle (that is, all of the terms and conditions in Module 0 and 2, collectively), the ACCC proposes that only the following terms and conditions (which are included in Module 2, not Module 0) should be specified as a fixed principle term or condition:

- the Regulatory Asset Base roll-forward equation;
- the fact that the annual revenue requirements will be calculated using the following building block components — a return on capital, depreciation, operating expenditure and tax allowance; and
- the deemed prudent expenditure categories relating to the Telstra and Optus arrangements.

Therefore, none of the matters in Module 0 will be specified as a fixed principle term or condition. Further, none of the matters in Module 1 will be specified as a fixed principle term or condition, though NBN Co has not proposed that they be so.

In addition, the ACCC proposes some minor drafting amendments to the specified qualifying circumstances in order to give effect to what it understands to be NBN Co’s intentions.

The ACCC appreciates NBN Co’s desire for certainty over its ability to recover its costs over the term of the SAU. The ACCC considers that this can be delivered by the acceptance of the terms and conditions in the SAU for the proposed SAU term and the proposed modular structure. Acceptance of terms in an undertaking with a duration of close to 30 years is in and of itself unprecedented, as is acceptance of the type of ‘modular structure’ that NBN Co has proposed. The ACCC does not consider that making all of the proposed terms fixed principles is necessary to deliver the certainty that NBN Co desires, and that instead, it would give rise to uncertainty as to the ACCC’s ability to ensure that NBN Co’s future variations to the SAU are reasonable and promote the long-term interests of end-users.

⁷⁰⁷ See, for example, ACCC Draft Decision, p. 185 and pp. 163-167.

⁷⁰⁸ Ibid.

⁷⁰⁹ NBN Co Submission, pp. 127-128.

Attachment A: NBN Co proposed minor variations

NBN Co has suggested a set of minor variations “to provide increased clarity as to the intended operation of the SAU”.⁷¹⁰ The ACCC has adopted some of these variations in the draft Notice to Vary (relating to changes in terminology in Schedule 1G),⁷¹¹ and is seeking views on whether to adopt the remaining proposals, as outlined below.

Item	December 2012 SAU clause reference	Variation proposed by NBN Co	NBN Co rationale for proposed variation
1	Dictionary – Aggregation Node Site	SAU uses “POI” (covering both Established POI & Temporary POI). WBA uses “Established POI”. Need to align definitions.	Should have consistent terminology between documents.
2	Dictionary – Temporary POI	Introduce concept of “emergency POI” into the definition, consistent with the WBA.	Need to deal with the possibility of emergency POIs in the SAU, for consistency.
3	1A.2.5	Change NNI description to align with WBA.	Alignment with WBA.
4	1G.2.1(a)	Delete this clause.	This clause duplicates what is already required in 1G.1.3, as that clause refers to 1G.1.2 which requires capex by asset type.

⁷¹⁰ Ibid, p. 122.

⁷¹¹ Ibid, pp. 122-123.

Attachment B: List of Initial Products exempt from Schedule 1I and 2E

The Initial Products comprise the following Product Components and Product Features:

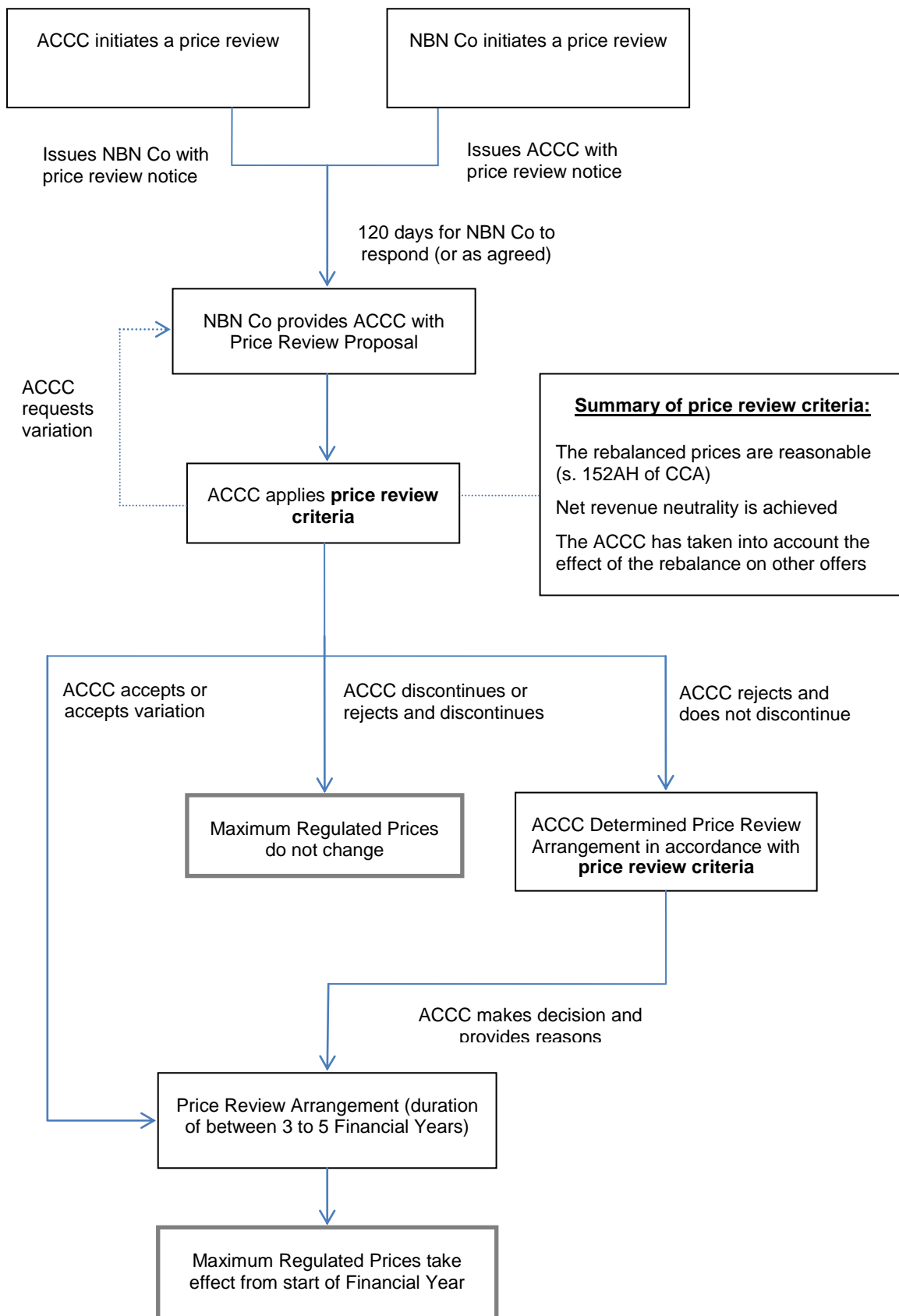
- all Product Components and Product Features provided over the NBN Interim Satellite Network, including 1000 Base T Network-Network Interface, TC-4 CVC, TC-1 CVC
- the Product Components and Product Features on each of the NBN Fibre, Fixed Wireless (FW) and Long Term Satellite (LTS) Networks shown in the table below:

Product Component	Product Feature	Fibre	FW	LTS
Network-Network Interface	1000BaseLX	✓	✓	✓
	10GBaseLR	✓	✓	✓
	1000BaseEX	✓	✓	✓
	10GBaseER	✓	✓	✓
	Multi-bearer Link Aggregation Groups for load sharing	✓	✓	✓
	Chassis diversity	✓	✓	✓
Connectivity Virtual Circuit	TC-4: up to 50Mbps for wireless or satellite-only.		✓	✓
	TC-4: 100, 200, 300, 400, 500, 600, 700, 800, 900, 100 Mbps	✓	✓	✓
	TC-1: 5, 10, 20 Mbps	✓	✓	✓
	TC-MC (Multicast): 100, 200, 300, 400, 500, 600, 700, 800, 900, 1000 Mbps	✓		
	TC-2: 50, 100, 150, 200, 250, 300, 400, 500, 600, 700, 800, 900, 1000 Mbps	✓	✓	✓
	TC-3: 50, 100, 150, 200, 250, 300, 400, 500, 600, 700, 800, 900, 1000 Mbps	✓	✓	✓
Access Virtual Circuit	TC-4: 12/1, 25/5 Mbps	✓	✓	✓
	TC-4: 25/10, 50/20, 100/40, 250/100, 500/200, 1000/400 Mbps	✓		

Product Component	Product Feature	Fibre	FW	LTS
	TC-1 : 60kbps			✓
	TC-1 : 0.15Mbps	✓	✓	
	TC-1: 0.3, 0.5, 1, 2, 5Mbps	✓		
	TC-2: 5 Mbps		✓	
	TC-3: 5 Mbps		✓	
	TC-2: 2, 5, 10, 20, 30, 40 Mbps	✓		
	TC-3: 10, 20, 30, 40, 1000 Mbps	✓		
	TC-MC: 5, 20, 30, 40, 50 Mbps	✓		
	Enterprise Ethernet: 50-1000Mbps symmetrical pipe model (but excluding product features, service levels and pricing)	✓		
	Enhanced Service Level guarantee: Business 7am-9pm; 7 days a week, 1 hour responses, 12 hour restoration (+ geographic factor)	✓		
	Additional Enhanced Service Levels: 24/7 fault rectification with 12, 8, 6, and 4 hour restoration	✓		
	Tagged and Priority Tagged Framing	✓		
	Customer Edge Virtual Local Area Network transparency	✓		
	Access Diversity	✓		
	Drop priority based on Class of Service markings	✓		
	Advanced OAM features for Enterprise Ethernet Services (but excluding pricing)	✓		
User Network Interface	Data (4 ports)	✓	✓	✓
	Voice with in-built Analogue Telephony Adaptor (1 or 2 ports)	✓		
	Battery backup capability available on both UNI-V and UNI-D	✓		
	Optional Battery Backup	✓		

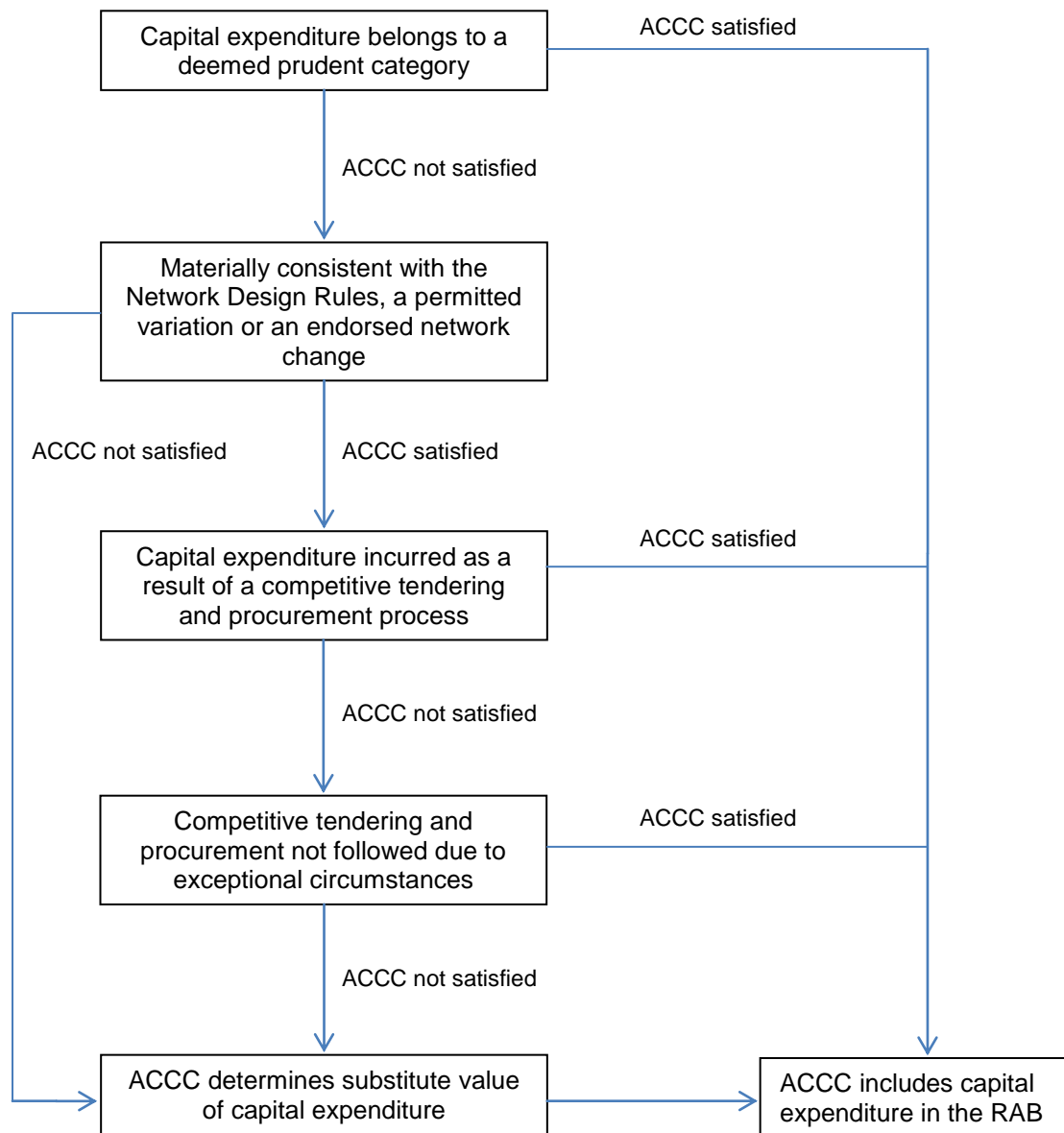
Product Component	Product Feature	Fibre	FW	LTS
	TR-69 configuration for UNI-V	✓		
	IPv6 for DHCP on UNI-D	✓	✓	
	Out of band DTMF and RTCP for UNI-V	✓		
	Business Grade NTD	✓		
Other Service Enhancements	Reporting Phase 1: SLA Fulfilment and Assurance	✓	✓	✓
	Reporting Phase 2 –Customer Management Reporting, including: <ul style="list-style-type: none"> • Service Performance • Usage • Availability • SLA violations 	✓	✓	✓

Attachment C: Price re-balancing process



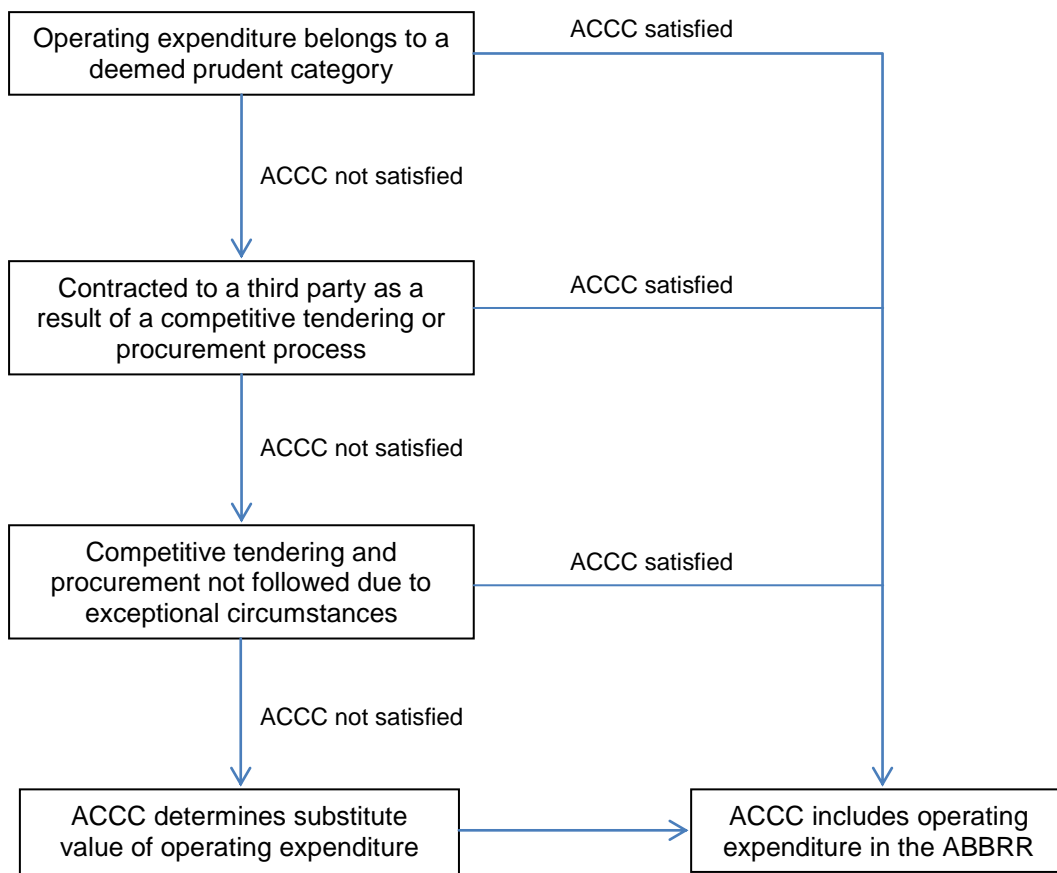
Attachment D: ACCC assessment of prudent capital expenditure in Module 1

This flow-chart demonstrates the steps that the ACCC would follow to determine the capital expenditure that may be included in NBN Co's RAB under the ACCC's proposed variation to the SAU.



Attachment E: ACCC assessment of prudent operating expenditure in Module 1

This flow-chart demonstrates the steps that the ACCC would follow to determine the operating expenditure that may be included in NBN Co's ABBRR under the ACCC's proposed variation to the SAU.



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