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Commission

Variation of NBN Co Special Access Undertaking — explanatory statement

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Australian Competition and Consumer Commission
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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 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.

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 revenue 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.

Draft Decision – A document published on 4 April 2013 that contained the ACCC’s preliminary views on the 18 December 2012 SAU.

Draft Notice to Vary – A document published on 4 July 2013 that contained the ACCC’s proposed variations to the 18 December 2012 SAU.

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).

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.

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 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.

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 industry 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.

Notice to Vary – A written notice given to NBN Co under section 152CBDA of the CCA that invites NBN Co to make variations to the SAU in accordance with the notice.

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 – These are 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 or any new or varied product components introduced by NBN Co that are Initial Products or Licence Condition Products.

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.

Regulatory Determination – A term used in the SAU to mean either an Access Determination or a Binding Rule of Conduct.

Response to Submissions – A document published on 4 July 2013 that provided the ACCC's reasons for the proposed variations contained in the draft Notice to Vary, and the ACCC's response to submissions on the Draft Decision on the 18 December 2012 SAU and the Consultation Paper on the Notice to Vary the SAU.

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.

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 initially released by the Australian Government on 17 December 2010, and any subsequent variations, 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.

The ACCC is giving 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 a varied 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 Vary to be given to NBN Co.²

On 4 July 2013, the ACCC released for consultation a draft of the Notice to Vary.³ Submissions to these processes can be found on the ACCC's website, along with information about how to access confidential submissions. The ACCC has taken into account submissions received from interested parties to both of these processes in developing the Notice to Vary which this Explanatory Statement accompanies.

This Explanatory Statement provides an explanation of the key changes that have been made to the draft Notice to Vary in finalising the notice, and the reasons why certain key amendments proposed by interested parties (including NBN Co) were not adopted. This document should be read in conjunction with the Response to Submissions released with the draft Notice to Vary.

The notice that the ACCC is giving to NBN Co is attached to this document. As noted in the Response to Submissions accompanying the draft Notice to Vary, a number of features of the SAU lodged by NBN Co on 18 December 2012 are proposed to be retained.⁴ 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.⁵ The overarching intent of proposing that the SAU be varied in the manner set out in the notice is set out in chapter 1 of the Response to Submissions accompanying the draft Notice to Vary. The Notice to Vary also includes minor non-material variations proposed by NBN Co in its submissions to the Consultation Paper on the Notice to Vary and to the draft Notice to Vary.⁶

For convenience and clarity, the Notice to Vary is in the form of a marked-up version of the 18 December 2012 SAU.

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

² 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).

³ Submissions to the draft Notice to Vary were received from AAPT, the Competitive Carriers' Coalition (CCC), Herbert Geer (on behalf of iiNet), John de Ridder, Macquarie Telecom, NBN Co, Optus and Telstra.

⁴ ACCC, *Variation of NBN Co SAU – response to submissions*, July 2013, p. 7. (ACCC Response to Submissions)

⁵ Ibid, pp. 7-9.

⁶ See Attachment D of this Explanatory Statement.

Next Steps

NBN Co has the time specified by the ACCC in the Notice to Vary to respond to the notice by lodging a varied SAU.⁷ The time specified by the ACCC is the period commencing 8 October 2013 and ending 19 November 2013. This does not preclude NBN Co from lodging a varied SAU prior to the end of 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.⁸ The ACCC intends to undertake a short consultation on any varied undertaking that is given by NBN Co in response to the notice, and to then proceed to make a final decision on the varied undertaking.⁹ The statutory deadline by which this final decision must be made will depend upon whether and when NBN Co lodges the varied undertaking and for how long the ACCC consults on the varied undertaking.¹⁰

If NBN Co does not give the ACCC a varied undertaking in response to the notice in accordance with the requirements in the CCA, the ACCC will proceed to make a final decision on the original 18 December 2012 undertaking.¹¹

In either of these cases, the ACCC must make its final decision by the statutory deadline for the original undertaking. This deadline was extended by three months on 4 July 2013, and has been extended by a further three months at the time of issuing this Notice to Vary.

⁷ CCA, s. 152CBDA(2)(b).

⁸ CCA, s. 152CBDA(3).

⁹ 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.

¹⁰ CCA, s. 152CBC(6)(ac).

¹¹ Under subsection 152CBC(2) of the CCA, the ACCC must accept or reject the undertaking.

1. 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.¹² 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.¹³

A section 152CBDA notice must:

- specify variations to the SAU;¹⁴
- specify a period in which NBN Co may give a varied undertaking to the ACCC;¹⁵ and
- state that the ACCC will consider the varied undertaking as if it had been given instead of the SAU.¹⁶

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));¹⁷ and
- it allows NBN Co to choose whether to give a varied undertaking in response to the notice.¹⁸

The length of the 'clock-stopper' will ultimately depend on whether NBN Co gives a varied undertaking, and the significance of the variations.¹⁹ 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.²⁰ 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.²¹

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,²² and

¹² CCA, s. 152CBDA(3).

¹³ Explanatory Memorandum to the Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010, p. 210. (EM to the CACS Bill)

¹⁴ CCA, s. 152CBDA(2)(a).

¹⁵ CCA, s. 152CBDA(2)(b).

¹⁶ CCA, s. 152CBDA(2).

¹⁷ CCA, s. 152CBC(6).

¹⁸ CCA, s. 152CBDA(3).

¹⁹ CCA, ss. 152CBC(6) and 152CBD(6).

²⁰ CCA, s. 152CBC(6)(aa).

²¹ 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.

²² CCA, s. 152CBD(6).

- the ACCC will make a decision on the varied undertaking without NBN Co being required to withdraw the SAU.²³

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.²⁴

Other than the mandatory elements of a section 152CBDA notice set out above, 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 April 2013 Draft Decision was that the 18 December 2012 SAU does not satisfy the criteria for acceptance of an undertaking.

The variations included in the 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 acceptable under the statutory criteria. The ACCC has taken into account the views expressed in submissions in formulating these variations.

²³ EM to the CACS Bill, p. 210.

²⁴ The ACCC must accept or reject the undertaking under subsection 152CBC(2) of the CCA.

2. Interaction between the SAU and the telecommunications access regime

The variations that are discussed in this section relate to the issues discussed in chapter 2 of the Draft Decision, section 2.1 of the Consultation Paper, section 2.1 of the Response to Submissions and the Main Body and Schedule 1B of the Notice to Vary.

2.1. Relationship between Standard Forms of Access Agreement, the SAU and regulatory determinations

In the draft Notice to Vary, the ACCC proposed to remove the ‘regulatory recourse’ commitments that link Standard Forms of Access Agreement (‘SFAAs’) to the Part XIC legislative hierarchy from the SAU — that is, the commitments requiring NBN Co to ensure “consistency” between:

- SFAAs and the SAU; and
- SFAAs and regulatory determinations (that is, Access Determinations and Binding Rules of Conduct).²⁵

In their submissions to the draft Notice to Vary, Telstra and Optus continue to consider that the SAU should include express ‘regulatory recourse’ commitments.²⁶ In contrast, NBN Co and other access seekers’ submissions support the ACCC’s proposed variation.²⁷

Telstra and Optus submit that practically, access seekers must enter into an SFAA-based Access Agreement to obtain supply of services, and by virtue of the operation of the Part XIC legislative hierarchy, these Access Agreements will prevail over the SAU and any regulatory determinations.²⁸ Therefore, to give access seekers certainty that they will be able to obtain access to regulated terms, Telstra and Optus consider that the SAU should include the following commitments:

- Telstra submits that NBN Co should ensure consistency between SFAAs and ACCC regulatory decisions.²⁹ Further, NBN Co should positively incorporate ACCC regulatory decisions into SFAAs, retail service providers (RSPs) should not be obliged to take any unilateral amendments to SFAAs to access ACCC regulatory decisions, and the ACCC should be involved in verifying “pull through” of regulated terms into SFAAs.³⁰

²⁵ ACCC Response to Submissions, pp. 15-16.

²⁶ Telstra, Telstra’s response to the ACCC draft Notice to Vary NBN Co’s SAU [Public version], 26 July 2013, pp. 6-9 (Telstra Submission); Optus, Submission in response to ACCC variation of NBN Co SAU [Public version], July 2013, pp. 6-9. (Optus Submission)

²⁷ NBN Co, Submission on ACCC draft Notice to Vary NBN Co SAU, 26 July 2013, p. 2 (NBN Co July 2013 Submission); AAPT, Submission to ACCC on draft Notice to Vary the NBN Co SAU, July 2013, pp. 3-4 (AAPT Submission); CCC, Draft Notice to Vary NBN Co SAU – CCC submission, 30 July 2013, p. 2 (CCC Submission); Macquarie Telecom, Variation of NBN Co SAU, 30 July 2013, p. 2. (Macquarie Telecom Submission)

²⁸ Telstra Submission, pp. 7-8; Optus Submission, pp. 7-9.

²⁹ Telstra Submission, p. 8.

³⁰ Ibid, pp. 8-9.

- Optus submits that NBN Co should “flow-through” regulated terms into Access Agreements.³¹ Specifically, access seekers should have the ability to sign an Access Agreement with “reservations” on provisions that are not agreed between the parties, which may later be overruled by ACCC regulatory determinations.³²

The ACCC considers that including ‘regulatory recourse’ commitments in the SAU would not necessarily address Telstra and Optus’ concerns. As discussed in the Response to Submissions, if the commitments requiring NBN Co to ensure that SFAAs are “consistent” with the SAU and regulatory determinations are retained, NBN Co could choose to make SFAAs consistent with regulated terms by including these terms in SFAAs *or* by removing inconsistent terms from SFAAs.³³ Therefore, access seekers may not have additional certainty that NBN Co will make regulated terms available via SFAAs.

Further, if there are commitments specifying the manner for incorporating regulated terms into SFAAs and/or Access Agreements, the SAU would create additional processes about the operation of the Part XIC hierarchy. These would operate concurrently with the normal operation of Part XIC, and could inadvertently create complexity and uncertainty about the obligations of NBN Co and the rights of access seekers. Given the new and untested nature of the Part XIC regime, this could lead to the risk of unintended consequences.

In light of the above, the ACCC has not adopted Telstra or Optus’ proposals, and has instead implemented its proposal to remove the explicit links between SFAAs and the SAU and regulatory determinations. As explained in the Response to Submissions, the ACCC’s proposal is intended to create certainty that Part XIC will continue to operate in its normal way following acceptance of the SAU, free from any ambiguity or unintended consequences that may arise from including such provisions in the SAU.³⁴ Specifically, under Part XIC:

- NBN Co *must* comply with an access seeker’s request to supply services on regulated terms (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 (although 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, the ACCC and access seekers can seek to enforce the terms in regulatory determinations.³⁵

The ACCC recognises that Part XIC establishes the primacy of commercial agreements; however, it also considers that access seekers should have the opportunity to seek an effective regulatory fallback in the absence of such agreement. In particular, the ACCC acknowledges access seekers’ concerns about the possible consequences of executing commercial agreements prior to regulated terms being established on matters that may not be agreed, and notes that ongoing negotiations between NBN Co and access seekers are occurring in this context.

Having regard to the current commercial and regulatory context, the ACCC considers that the following framework would adequately address the practical difficulties within the existing regulatory regime — the ACCC would expect that, in practice, NBN Co would incorporate the

³¹ Optus Submission, pp. 7-9.

³² *Ibid.*, p. 9.

³³ ACCC Response to Submissions, p. 18.

³⁴ *Ibid.*, pp. 15-20.

³⁵ 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.

terms of any regulatory determination (if and when established by the ACCC) into its SFAAs, and in particular:

- Consistent with the Part XIC legislative hierarchy, regulated terms would not override commercially agreed terms.
- Where the ACCC determines disputed terms prior to the execution of commercial agreements, the ACCC expects that NBN Co will make regulated terms available to parties via their incorporation into its SFAAs for subsequent inclusion in prospective Access Agreements.
- Where the ACCC has not yet determined disputed terms prior to the execution of commercial agreements, the ACCC expects that NBN Co will include disputed terms in commercial agreements on an interim basis only, pending the ACCC's determination of regulated terms. These regulated terms would then have their ordinary effect, in that access seekers can request access on these terms on a standalone basis, or NBN Co and access seekers can agree to include these terms in an Access Agreement.

In the event that this did not occur in practice, the ACCC would consider other options, such as requiring in an Access Determination that NBN Co incorporate the terms and conditions in an Access Determination in its SFAAs, or the making of more comprehensive Access Determinations.

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

In the draft Notice to Vary, the ACCC proposed to remove a number of detailed processes about the multilateral SFAA forum, and retain commitments relating to the establishment of the forum, who can participate, and when it will be conducted.³⁶

In their submissions to the draft Notice to Vary, iiNet and Telstra propose further variations to the multilateral SFAA forum provisions, as follows:

- iiNet submits that further commitments about the processes for conducting the forum are necessary because it is not efficient to seek procedural directions from the ACCC under section 152BBA of the CCA if issues arise in future.³⁷ In particular: NBN Co should inform access seekers as soon as reasonably practicable about whether it agrees with an access seeker request to vary the SFAA; confidentiality restrictions on NBN Co's negotiations with access seekers should not apply to the disclosure of information to the ACCC; and NBN Co must have regard to any regulatory determinations when considering future changes to SFAAs.³⁸
- Telstra submits that the multilateral SFAA forum should commence no later than 12 months after the SAU commencement date and continue for the first five years of the SAU term.³⁹ It considers that the timing of the forum should not be linked to SFAA expiry "on the assumption the ACCC is no longer endorsing a co-terminus SFAA regime", as RSPs will be on Access Agreements expiring at different dates.⁴⁰ However, it does not explain why the forum should only operate for five years.

³⁶ ACCC Response to Submissions, p. 23.

³⁷ iiNet, Variation of NBN Co SAU – submission by Herbert Geer Lawyers on behalf of iiNet Limited [Public version], 26 July 2013, p. 7. (iiNet Submission)

³⁸ Ibid, pp. 6-7.

³⁹ Telstra Submission, p. 9.

⁴⁰ Ibid.

The ACCC has not adopted the further procedural commitments proposed by iiNet. As noted in the Response to Submissions, the ACCC is of the view that industry should be free to determine the nature and extent of commercial negotiations, with ACCC intervention only if agreement cannot be reached.⁴¹ In particular, the ACCC notes that NBN Co has stated that it “intends to consult with Access Seekers on the terms of reference and procedures for the Multilateral SFAA Forum in due course.”⁴² Further, the ACCC reiterates that if necessary, its ability to give procedural directions under section 152BBA of the CCA will enable it to facilitate appropriate access arrangements where there may be attempts to delay or frustrate negotiations on the terms of access.⁴³

The ACCC also considers that it is not necessary to adopt Telstra’s proposal about the timing of the forum because the SAU still provides for a ‘co-terminus’ SFAA regime.⁴⁴ As explained in the Response to Submissions, the ACCC’s proposal about the timing of the forum is intended to 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.⁴⁵

In addition, the ACCC notes that NBN Co has proposed minor drafting amendments to clause 1B.3 to clarify that NBN Co publishes each SFAA under the CCA and will do so in accordance with clause 6 of the SAU.⁴⁶ NBN Co also proposes to include a transitional provision to clarify that the requirement to convene the forum at least 12 months prior to the expiry of each SFAA will not apply to SFAAs that expire within 12 months of the SAU commencement date.⁴⁷ The ACCC has included these drafting clarifications in the Notice to Vary.

2.3. Conduct about submitting variations to the SAU (‘Replacement Modules’)

In the draft Notice to Vary, the ACCC proposed to retain an amended version of the replacement module process in the SAU.⁴⁸

In their submissions to the draft Notice to Vary, NBN Co and Telstra propose a number of specific variations to the replacement module provisions, as follows:

- Length of the regulatory cycle — NBN Co submits that the SAU should explicitly state that the length of the regulatory cycle is limited to three, four or five financial years in duration.⁴⁹ In contrast, Telstra submits that regulatory cycles should be capped at three years, consistent with the regulatory periods adopted by the ACCC for previous Access Determinations.⁵⁰

⁴¹ ACCC Response to Submissions, p. 23.

⁴² NBN Co, Submission to ACCC consultation paper on variation of NBN Co SAU, May 2013, p. 15. (NBN Co May 2013 Submission)

⁴³ Explanatory Memorandum to the Telecommunications Legislation Amendment Bill 1999; Telecommunications (Universal Service Levy) Amendment Bill 1998; NRS Imposition Amendment Bill 1998, pp. 31-32.

⁴⁴ Specifically, clause 1B.2 provides that published SFAAs will expire no later than two years after the date the SFAA commences. This means that all Access Agreements based on these SFAAs will be ‘co-terminus’ because they will expire at the same time (however, the parties to an SFAA-based Access Agreement may agree to extend the term of that Access Agreement).

⁴⁵ ACCC Response to Submissions, p. 22.

⁴⁶ NBN Co July 2013 Submission, p. 3. Clause 6 of the Main Body requires NBN Co to publish and maintain SFAAs in relation to the supply of the NBN Access Service, Ancillary Services and the Facilities Access Service for the term of the SAU.

⁴⁷ NBN Co, *SAU Drafting refinements – cover letter*, 6 September 2013, p. 1. (NBN Co September 2013 Submission – cover letter)

⁴⁸ ACCC Response to Submissions, pp. 24-29.

⁴⁹ NBN Co July 2013 Submission, p. 4.

⁵⁰ Telstra Submission, p. 10.

- Content of the replacement module applications — NBN Co proposes amendments to the provisions relating to the RAB roll-forward arrangements (in the ‘RAB roll-forward Proposal’) and tax change events (in the ‘LTRCM Proposal’),⁵¹ as well as the removal of the ‘reference offer proposal’.⁵²
- Effect of replacement module determinations — NBN Co proposes the inclusion of a provision to clarify that section 152CBIA applies to a replacement module determination as if those determinations were Access Determinations.⁵³
- Replacement module determination process — Telstra submits that ACCC consultation during the process of making a replacement module determination should be mandatory, consistent with the process that applies to the making of an Access Determination.⁵⁴

In relation to the length of the regulatory cycle, the ACCC stated in the Response to Submissions 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”.⁵⁵ The ACCC considers that this strikes the right balance between regulatory certainty and flexibility, because the length of the regulatory cycle will be a factor in determining NBN Co’s efficiency incentives.⁵⁶ Therefore, the ACCC has not adopted Telstra’s proposal to limit regulatory cycles to three years. Instead, in the Notice to Vary, the ACCC has adopted NBN Co’s proposal to include drafting clarifications stating that regulatory cycles will be three, four or five years in duration.

The ACCC’s views on the content of the replacement module applications, that is, the RAB roll-forward arrangements, tax change events, and the removal of the concepts of reference offers and non-reference offers, are discussed in sections 6.3.1, 5.3.2 and 4.2.2 respectively.

The ACCC has not adopted NBN Co’s proposed variations in relation to clarifying the effect of replacement module determinations. NBN Co notes the ACCC’s views that a replacement module determination made by the ACCC must always be consistent with all the provisions in Modules 0 and 2; however, it submits that future interactions between replacement module determinations and the SAU may, in effect, give rise to consistency issues.⁵⁷ NBN Co therefore considers that the SAU should specify and preserve the Part XIC legislative hierarchy in the context of a conferral of power by referring to the application of the “inconsistency” provision in the CCA (that is, section 152CBIA), so that the SAU prevails to the extent of any inconsistency over a replacement module determination.⁵⁸ The ACCC considers that it is undesirable to replicate the operation of the Part XIC legislative hierarchy in the context of a conferral of power under the SAU, because it is unclear if “inconsistency” under the Part XIC hierarchy would have the same meaning in this context. Given the new and untested nature of the Part XIC regime, this could create complexity and uncertainty about how the ACCC will exercise its ‘replacement module determination’ power in future. Further, the ACCC does not accept that it would inadvertently make a replacement module determination that would be inconsistent with Modules 0 and 2. Consistency with Modules 0 and 2 will be an important consideration for the ACCC in making replacement module determinations, 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.

The ACCC also considers that it is not necessary to adopt Telstra’s proposal to make consultation mandatory during the replacement module determination process. As explained in the Response to Submissions, the replacement module process would, in practice, require the

⁵¹ NBN Co July 2013 Submission, p. 4.

⁵² Ibid, pp. 16-17.

⁵³ Ibid, p. 5.

⁵⁴ Telstra Submission, p. 10.

⁵⁵ ACCC Response to Submissions, p. 26.

⁵⁶ The effects of the length of regulatory cycles on NBN Co’s efficiency incentives are discussed in more detail on page 26 of the Response to Submissions.

⁵⁷ NBN Co July 2013 Submission, p. 5.

⁵⁸ Ibid.

ACCC to concurrently engage in the process of assessing a replacement module application *and* the process of making a replacement module determination.⁵⁹ Since replacement module applications are assessed as variations to the SAU under section 152CBG of the CCA, the ACCC would be undertaking public consultation on NBN Co's proposals. The information obtained during this consultation process would be relevant to the making of a replacement module determination if the ACCC ultimately does not accept NBN Co's proposed replacement module application.

Therefore, in the Notice to Vary, the ACCC has only included NBN Co's proposed variations in relation to the length of the regulatory cycle and some aspects of the content of replacement module applications.

⁵⁹ ACCC Response to Submissions, p. 25.

3. Services to which the SAU relates

The variations that are discussed in this section relate to the issues discussed in chapter 3 of the Draft Decision, section 2.2 of the Consultation Paper, section 2.2 of the Response to Submissions and Schedules 1A and 2A of the Notice to Vary.

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

In the draft Notice to Vary, the ACCC proposed to include the following variations to the SAU:

- an acknowledgement that the ACCC may declare services;
- an acknowledgement that the SAU does not affect NBN Co's obligations under the Standard Access Obligations (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 is, products, product components, product features, Ancillary Services or types of Facilities Access Service) that NBN Co is required to supply under the SAU; and
- the amendment of clauses referring to the fulfilment of obligations under the SAU and the SAOs that might otherwise be inconsistent with the above.⁶⁰

These variations are intended to remove uncertainty as to how the SAU will interact with the powers conferred on the ACCC by the CCA to declare services and set terms and conditions for those services via regulatory determinations in circumstances where NBN Co may not face incentives to respond to evolving end-user demand.

In its submission to the draft Notice to Vary, NBN Co submits that the third proposal is unnecessary. NBN Co argues that this commitment (that is, clauses 1A.7.2 and 2A.2 of the draft Notice to Vary) "attempts to exclude any Regulatory Determination in relation to a service (that falls within the scope of the NBN Access Service but is not an Offer) from being inconsistent with the SAU",⁶¹ and that it "does not agree that the SAU should attempt to define what matters may or may not be inconsistent with it when dealt with in future Regulatory Determinations, as this is a matter to be determined on a case by case basis pursuant to Part XIC."⁶² NBN Co instead proposes drafting amendments that "clarifies that the SAU does not affect NBN Co's obligations to supply, whether that obligation arises under section 152AXB or under terms and conditions of supply as imposed on NBN Co by the ACCC."⁶³ In contrast, access seeker submissions support an approach where regulatory determinations about ACCC-declared services are not rendered inconsistent with the SAU.⁶⁴

⁶⁰ Ibid, p. 36.

⁶¹ NBN Co July 2013 Submission, p. 7.

⁶² Ibid.

⁶³ Ibid, p. 8.

⁶⁴ AAPT Submission, p. 5; CCC Submission, p. 2; Macquarie Telecom Submission, pp. 4-5; Telstra Submission, p. 17.

The inclusion of the proposed clauses 1A.7.2 and 2A.2 was intended to clarify that the SAU is not intended to render regulatory determinations inconsistent with the SAU (that is, regulatory determinations *will* have effect) in the following particular circumstances:

- where the ACCC declares a service that falls within the scope of the SAU service descriptions, but is not an Offer that NBN Co is required to supply under the SAU, and the ACCC sets price and non-price terms and conditions for that ACCC-declared service in regulatory determinations; or
- where the ACCC makes a regulatory determination requiring NBN Co to supply a product that falls within the scope of the SAU service descriptions, but is not an Offer that NBN Co is required to supply under the SAU, and that regulatory determination sets price and non-price terms for the supply of that service.

These proposed variations were *not* aimed at changing the operation of the Part XIC legislative hierarchy.

Following further consideration, the ACCC is of the view that the inclusion of this commitment in the SAU is unnecessary. The ACCC notes that these drafting amendments are complex and their effect could be uncertain. At this time, the ACCC considers that if it is necessary to do so, it is able to rely on the Part XIC powers and processes, specifically, its declaration power, to require NBN Co to supply specific services that are not Offers that NBN Co is required to supply under the SAU. In accordance with the normal operation of Part XIC, the terms and conditions in any regulatory determinations in relation to that ACCC-declared service will apply to the extent that they are not inconsistent with the SAU.

Therefore, the ACCC has deleted these proposed commitments (that is, clauses 1A.7.2 and 2A.2 of the draft Notice to Vary), and is not adopting NBN Co's suggested drafting amendments in the Notice to Vary.

3.2. Product component bundling

In its submission to the draft Notice to Vary, NBN Co argues that the ACCC's proposed variations to clauses 1A.3.2 and 2A.3 of the draft Notice to Vary (clauses 1A.4.2 and 2A.3 in the Notice to Vary), which allow NBN Co to require access seekers to purchase the four product components (UNI, AVC, CVC and NNI) where technically necessary for the supply of the NBN Access Service, does not address a number of implementation issues. For example, NBN Co submits that the following issues would not be covered:

- technical or operational issues associated with the supply of a CVC or an NNI in conjunction with an AVC (NBN Co provides some examples of this — including that a CVC of the same traffic class as the AVC is required to supply a service, and a new NNI Group must be purchased beyond 4000 CVCs); and
- technical reasons where the supply of an AVC of one traffic class requires that it be purchased in conjunction with an AVC of a different traffic class (NBN Co provides one example of this — that the supply of a Multicast AVC requires an underlying traffic class 4 AVC to provide a backchannel data path).⁶⁵

The ACCC acknowledges the implementation issues raised by NBN Co. However, the ACCC considers that NBN Co's proposed drafting amendments (including a broad exception for "reasons of technical compatibility, network operations, capacity or scale associated with the supply of the CVC or NNI"),⁶⁶ may give NBN Co discretion to require access seekers to

⁶⁵ NBN Co July 2013 Submission, pp. 8-9.

⁶⁶ *Ibid*, p. 39.

purchase extra product components beyond those necessary from a technical perspective for the supply of the NBN Access Service.

To address these issues, the ACCC has instead refined the drafting of clauses 1A.4.2 and 2A.3 in the Notice to Vary to provide that NBN Co may require access seekers to acquire a UNI, a CVC and a NNI, or an AVC of a different traffic class in conjunction with the AVC, if it would otherwise not be possible to supply the NBN Access Service. This is intended to clarify that the SAU only permits NBN Co to require access seekers to purchase further product components where it is technically necessary for the supply of an end-to-end access service by NBN Co.

4. Product development, product withdrawal and reference offers

The variations that are discussed in this section relate to the issues discussed in chapter 4 of the Draft Decision, section 2.3 of the Consultation Paper, section 2.3 of the Response to Submissions and Schedules 1I and 2D of the Notice to Vary.

4.1. Product development and variation

4.1.1. Term of operation of the PDF Processes and interaction with network design change provisions

The 18 December 2012 SAU requires NBN Co to establish a Product Development Forum (PDF).⁶⁷ Module 1 of the 18 December 2012 SAU establishes 'PDF Processes' that specify terms and conditions about how NBN Co will consult with its customers via the PDF about whether to develop a new product or vary an existing product.⁶⁸

Module 1 of the 18 December 2012 SAU also includes provisions which establish a customer engagement process that NBN Co must follow to make certain types of network design changes.⁶⁹ This customer engagement process uses the PDF and the PDF Processes to consult with access seekers about these network changes.⁷⁰ Module 1 also contains provisions which address circumstances in which the development of a new product, or the variation of an existing product, will require a network design change.⁷¹ Module 2 contains provisions which address the interaction between making minor product variations and network design changes.⁷²

The draft Notice to Vary proposed to:

- reduce the term of the provisions for making network changes in Module 1 to five years;
- reduce the term of the PDF Processes in Module 1 to five years;
- replace the provisions in Module 1 which address the interactions between product development and network changes with a single clause which states that "Notwithstanding any provisions in this Schedule 1J, NBN Co must comply with any applicable requirements in relation to the identification, selection, consultation and endorsement of any Network Change including, during the period in which they have effect, clauses 1E.8 to 1E.12"; and
- replace the provisions in Module 2 which address the interactions between minor product variations and network changes with a single new clause in Module 2 which states that "Notwithstanding any provisions in this Schedule 2E, NBN Co must comply

⁶⁷ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1I, clause 1I.3.1; Schedule 2E, clause 2E.4.1. (NBN Co 18 December 2012 SAU)

⁶⁸ Ibid, Schedule 1I, Annexure 1.

⁶⁹ Ibid, Schedule 1E, clauses 1E.6.7 to 1E.6.11.

⁷⁰ Ibid, Schedule 1E, clauses 1E.7.4 and 1E.8.2(b).

⁷¹ Ibid, Schedule 1I, clauses 1I.3.4 and 1I.4(b).

⁷² Ibid, Schedule 2E, clause 2E.5.2(b).

with any applicable requirements in relation to the identification, selection, consultation and endorsement of any network change.”

In NBN Co’s submission:

- NBN Co considers that there needs to be a workable approach to network changes once the current PDF Processes expire after five years in the event that a replacement set of PDF Processes are not in place (NBN Co’s proposed approach is discussed in section 6.2.3.3 below).⁷³
- NBN Co submits that the ACCC should reinstate the former clause 11.3.4(b) in the Notice to Vary. It argues that prior customer endorsement of a network change is important because without it NBN Co would not be able to include this capital expenditure in the RAB for recovery over time.⁷⁴
- NBN Co notes that in clause 2E.1.1(b) of the draft Notice to Vary the ACCC has retained a requirement in relation to NBN Co’s compliance with network changes in Module 2. It argues that this drafting is redundant as the network change process no longer has a role to play in Module 2.⁷⁵ It also argues that any requirements concerning the process for network changes and expenditure on network changes in Module 2 are not yet known, and that NBN Co cannot commit to compliance with unknown and uncertain requirements.⁷⁶

The ACCC’s position on the approach to network changes after the initial five years of the SAU is discussed in section 6.2.3.3. In summary, the Notice to Vary includes provisions that will allow the ACCC to approve a network design change proposed by NBN Co after the initial five years, including via a network change endorsement process contained in an Access Determination. The ACCC considers that these changes will provide a workable approach to network changes once the current PDF Processes expire, as desired by NBN Co.

As a consequence of these proposed changes, the Notice to Vary reinstates clause 11.3.4(b) as a new clause 11.3.7, as requested by NBN Co, with some further amendments to reflect the changes made to the network design endorsement processes. The ACCC considers that this clause should provide certainty to NBN Co that any prudent and efficient capital expenditure associated with new product idea that requires a network design change will be recognised in the RAB, and should therefore ensure that NBN Co is not discouraged from making otherwise prudent and efficient investments.

In relation to clause 2D.2.1(a), the ACCC recognises NBN Co’s concerns that it is difficult for it to commit to complying with network change provisions that have not yet been established, in particular given that the ACCC proposes to remove the existing network change provisions from Module 2. The ACCC therefore has not included the proposed clause 2E.1.1(b) in the Notice to Vary.

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

The draft Notice to Vary proposed to allow Consumer Advocacy Groups to participate in the PDF, under the following definition:

Consumer Advocacy Group means a body or association that represents the interests of consumers.

⁷³ NBN Co July 2013 Submission, p. 11.

⁷⁴ Ibid, p. 15.

⁷⁵ Ibid, p. 16.

⁷⁶ Ibid.

NBN Co's submission states that the ACCC's proposed definition covers any type of group representing any form of consumer interests.⁷⁷ NBN Co proposes that the definition of Consumer Advocacy Group should include reference to the fact that the group should be one that deals with telecommunications interests of end-users.⁷⁸ In light of this, NBN Co proposes the following definition of Consumer Advocacy Group (NBN Co's additions are underlined):

Consumer Advocacy Group means a body or association that represents the interests of consumers in relation to telecommunications services and issues in Australia.

Optus' submission argues that references to Consumer Advocacy Groups should be removed.⁷⁹ Optus reiterates views it provided in its previous submission to the SAU Draft Decision which states that it is not clear what benefits arise from having a formal role for Consumer Advocacy Groups in the PDF, particularly in the context of wholesale decision making.⁸⁰

The ACCC has not adopted Optus' proposal to remove the concept of Consumer Advocacy Groups and participation of these groups in the PDF. The ACCC's reasons for including a role for Consumer Advocacy Groups are outlined in its Response to Submissions for the draft Notice to Vary.⁸¹ The ACCC does not consider that it has received new or updated information that would warrant a different approach in the Notice to Vary.

In relation to NBN Co's submission, the ACCC recognises that the definition in the draft Notice to Vary could allow any group that represents the interests of consumers to participate in the PDF. This could, in some circumstances, lead to discussions in the PDF about consumer-related issues which are not related proposing and developing new products supplied over the NBN (or the variation of existing products), and the prices, technical specifications and service levels of these products.

As one of the primary objectives of the PDF is to facilitate open and consultative dialogue with access seekers and Consumer Advocacy Groups about the development of new product ideas and the enhancement or variation of existing products,⁸² the ACCC considers that it is reasonable to limit participation to Consumer Advocacy Groups that at minimum represent consumers of telecommunications services. However, the ACCC does not consider that participation by Consumer Advocacy Groups in the PDF should not be limited to those groups that only represent consumers in relation to the delivery of telecommunications services. This might otherwise prevent the participation of more diverse groups that represent broader consumer interests (such as small business representatives and generalist consumer representatives) but who also represent the interests of consumers in the delivery of telecommunications services.

In light of these views, the Notice to Vary adopts an amended version of NBN Co's proposed definition. The amendments are intended to reduce any uncertainty or ambiguity about whether a group whose functions include (but are not limited to) representing consumers in relation to the delivery of telecommunications services may participate in the PDF. This definition is as follows (with the additions from the draft Notice to Vary underlined):

Consumer Advocacy Group means a body or association whose functions include representing the interests of consumers of telecommunications services in Australia.

⁷⁷ Ibid, p. 11.

⁷⁸ Ibid.

⁷⁹ Optus Submission, pp. 28-29.

⁸⁰ Ibid, p. 29.

⁸¹ ACCC Response to Submissions, pp. 43-47.

⁸² NBN Co 18 December 2012 SAU, 18 December 2012, Schedule 11, clause 11.3.1(c)(iii).

4.1.3. Confidential Information and Intellectual Property terms

The PDF Processes include clauses which establish rights and obligations for NBN Co and its customers about the treatment of confidential information and intellectual property associated with new product ideas.⁸³

The draft Notice to Vary proposed to remove these provisions from the 18 December 2012 SAU, and insert new clauses in Module 1 and Module 2 which:

- state that NBN Co may require access seekers and Consumer Advocacy Groups to enter into arrangements regarding the treatment of confidential information and intellectual property rights prior to participating in the PDF; and
- confer a power on the ACCC to determine the terms of any such arrangements in the event of disagreement between the parties.

Submissions provide the following views:

- NBN Co proposes some minor refinements to the drafting in relation to the ACCC's conferred power to address what it considers are some practical issues of implementation.⁸⁴
- In Telstra's submission:
 - Telstra expresses concern that the proposed conferral of power which allows the ACCC to determine the confidentiality and intellectual property arrangements between NBN Co and other parties may impact on an RSP's willingness to engage in these processes. It argues that the value of an RSP's pre-existing intellectual property or commercially valuable information may be materially devalued (or destroyed) if it is passed to NBN Co or other participants without adequate consideration to these matters.⁸⁵
 - Telstra also considers that the ACCC's proposal fails to acknowledge that there are two very different roles that participants play in the PDF: (1) the role of the participant who submits a Product Idea, and (2) the role of the participant who is simply an interested party in the consultation processes.⁸⁶
 - Telstra proposes that, when a party submits a Product Idea to NBN Co, the confidentiality and intellectual property terms with that idea should only be subject to agreement between the parties, and does not believe that these terms can, or should, be settled through the intervention of the ACCC.⁸⁷
 - Telstra proposes that participation by other interested parties should not be conditional upon that party reaching agreement with NBN Co on confidentiality and intellectual property provisions associated with Product Ideas.⁸⁸ However, Telstra notes that confidentiality provisions may need to be agreed prior to participation to ensure that information that is shared with participants is appropriately protected.⁸⁹

⁸³ Ibid, Schedule 11, Annexure 1, clauses 5 and 6.

⁸⁴ NBN Co July 2013 Submission, p. 12.

⁸⁵ Telstra Submission, p. 19.

⁸⁶ Ibid.

⁸⁷ Ibid, pp. 19-20.

⁸⁸ Ibid, p. 20.

⁸⁹ Ibid.

- Optus proposes an additional clause stating that nothing in the clauses has the effect of preventing parties or multiple parties requesting additional non-disclosure agreements to be signed to gain access to particular proposals that have intellectual property attached.⁹⁰

The ACCC recognises that there are differing views between parties as to how intellectual property and confidential information should be protected during the product development process, and how agreements between parties on the treatment of intellectual property and confidential information should be established or determined. These differing views mean that it is difficult to establish a framework in the SAU that is both flexible enough to adequately protect the confidential information and intellectual property rights of parties in all circumstances, while also maximising participation in the product development processes.

In light of this, the Notice to Vary does not include the conferral on the ACCC to determine the terms of any confidentiality and intellectual property arrangements that were proposed in the draft Notice to Vary. However, the Notice to Vary includes a clause which clarifies the extent to which the ACCC can specify terms and conditions regarding the treatment of confidential information and intellectual property, including in an Access Determination.

This will mean that any confidentiality and intellectual property arrangement between NBN Co and another party will be subject primarily to commercial negotiation between the parties. This will allow the parties to agree to the types of confidentiality and intellectual property protections necessary to participate in the PDF, including those that are tailored to different circumstances (for example, the submission of a product idea, or general participation in consultation) and to different parties. In the event of disagreement between the parties, the ACCC may consider further how it may exercise its other powers under Part XIC to address these matters.

The Notice to Vary retains the provision that allows NBN Co to require access seekers and Consumer Advocacy Groups to enter into confidentiality and intellectual property agreements in relation to their participation in the PDF. The ACCC considers that this provision is appropriate because the Notice to Vary also requires NBN Co to make the PDF open to participation by all access seekers and Consumer Advocacy Groups (irrespective of whether these parties have agreed to confidentiality and intellectual property arrangements). Without a provision in the SAU that allows NBN Co to require parties to enter into confidentiality and intellectual property arrangements, NBN Co would be required to allow parties to participate in the PDF without any agreements in place about the use and disclosure of confidential information and intellectual property. This would likely discourage the submission and development of product ideas.

4.1.4. List of Initial Products exempt from product development and the PDF Processes

The 18 December 2012 SAU establishes that the product development provisions in the SAU (including the PDF Processes) do not apply to products, product components and product that are covered by, or contemplated within, NBN Co's Initial Product Roadmap.⁹¹

The draft Notice to Vary proposed to remove the exclusion of products that are covered by, or contemplated within, NBN Co's Initial Product Roadmap. However, it proposed a list of Initial Products (contained in Attachment D to the Main Body of the SAU) that would be excluded from the product development provisions. The draft Notice to Vary also added provisions that made it clear that the product development provisions apply to all Ancillary Services and types of Facilities Access Service.

In NBN Co's submissions, it proposes that the following additional products should be added to the list of Initial Products:

⁹⁰ Optus Submission, p. 30.

⁹¹ NBN Co 18 December 2012 SAU, Schedule 11, clause 11.1.3(b)(i); Schedule 2E, clause 2E.1.3(b)(i).

- CVC TC-1 (50, 100, 150, 200, 250, 300, 400 and 500 Mbps).⁹²
- CVC TC-4 (150, 250, 2,000, 3,000, 4,000, 5,000, 6,000, 7,000, 8,000, 9,000 and 10,000 Mbps).⁹³
- AVC TC-MC 60 Mbps.⁹⁴
- Ancillary Services — the Platform Interfacing Service and the Sandpit.⁹⁵
- Facilities Access Service — Cross-Connect, NBN Co Co-Location, NBN Co ODF Termination Point and “other Facilities supplied by NBN Co that are necessary to facilitate entry to buildings, such as cable trays or building duct access.”⁹⁶

In addition to its submissions, NBN Co has also requested the inclusion of the following products to the list of Initial Products (as well as NBN Offers in Schedule 1C, as discussed in section 5.2.1.1):

- NBN Co Building Entry Service (as a type of Facilities Access Service).
- CVC TC-4 (1100, 1200, 1300, 1400, 1500, 1600, 1700, 1800 and 1900 Mbps).

In relation to the additional AVC and CVC product features, NBN Co submits that these products have already been announced by NBN Co in either its Product and Pricing Overview documents or in its Product Roadmap, and have already been consulted on.⁹⁷ In relation to the addition of Ancillary Services and types of Facilities Access Services, NBN Co submits that Facilities Access Services and Ancillary Services have now been brought into the scope of the PDF and should be included within the scope of what is covered by Initial Products.⁹⁸

In Telstra’s submission, it proposes the following amendments to the list of Initial Products:

- Removal of CVC TC-4 (700, 800, 900 and 1000 Mbps) product features — Telstra argues that further customer engagement is required in respect of speeds greater than 600 Mbps.⁹⁹
- Removal of CVC TC-2 (all data-rates) and TC-3 (all data-rates) product features — Telstra argues that the industry is yet to see detailed products technical specifications on any TC-2 or TC-3 and as such they should not be included in the list of Initial Products.¹⁰⁰
- Removal of ‘Additional Enhanced Service Levels’ product feature — Telstra argues that further customer consultation is required in respect of Additional Enhanced Service Levels because NBN Co has not produced a paper detailing what will be introduced, the product roadmap does not have any planned implementation dates and it is not known what the exact timeframes or prices will be in respect of this product feature.¹⁰¹
- Removal of ‘Business Grade NTD’ product feature — Telstra argues that the business Grade NTD should not be included in the list of Initial Products because NBN Co has

⁹² NBN Co, *Drafting refinements proposed by NBN Co*, 6 September 2013, p. 47. (NBN Co September 2013 Submission – drafting refinements)

⁹³ NBN Co July 2013 Submission, p. 50.

⁹⁴ Ibid.

⁹⁵ NBN Co September 2013 Submission – drafting refinements, p. 49.

⁹⁶ Ibid.

⁹⁷ NBN Co July 2013 Submission, p. 12.

⁹⁸ NBN Co September 2013 Submission – cover letter, p. 1.

⁹⁹ Telstra Submission, Annexure 6.

¹⁰⁰ Ibid, p. 19.

¹⁰¹ Ibid.

not provided any discussion papers or consulted with industry in respect of this product feature.¹⁰²

- Addition of CVC TC-1 (50, 100, 150, 200, 250, 300, 400 and 500 Mbps) product features — Telstra notes that these product features are set out in Schedule 1C of the SAU and should be reflected in the Initial Products list for consistency.¹⁰³

In Optus' submission, it proposes that the list of exempt Initial Products should be refined to take into account only the products that have already been delivered to market.¹⁰⁴ It also proposes that, in the absence of this refinement (or even in addition to this), the ACCC should be granted a conferral of power to allow the operation of the PDF to include any discussion on products listed within the suite of Initial Products (similar to the ACCC 'disallowance' power proposed for product withdrawal matters).¹⁰⁵ Optus proposes a list of criteria that could warrant the ACCC excluding a product from the list of Initial Products.¹⁰⁶

In light of these views, the Notice to Vary proposes the following variations to the list of Initial Products that were contained in the draft Notice to Vary:

- Addition of the CVC TC-1 (50, 100, 150, 200, 250, 300, 400 and 500 Mbps) product features.
- Addition of the CVC TC-4 (1100, 1200, 1300, 1400, 1500, 1600, 1700, 1800, 1900 and 2000 Mbps) product features (discussed below).
- Addition of the AVC TC-MC 60 Mbps product feature.
- Addition of Ancillary Services (Platform Interfacing Service and the Sandpit) — the ACCC is satisfied that NBN Co has sufficiently consulted with industry on these products, including on technical specifications and prices.¹⁰⁷
- Addition of Facilities Access Service (Cross-Connect, NBN Co Co-Location and NBN Co ODF Termination Point) — the ACCC is satisfied that NBN Co has sufficiently consulted with industry on these products, including on technical specifications and prices.¹⁰⁸
- Removal of the 'Business Grade NTD' product feature — upon further consideration, the ACCC considers that it has not received evidence in order to be satisfied that there has been sufficient consultation on this product feature for it to be included on the list of Initial Products.

The Notice to Vary only includes a number of minor refinements to the headings and drafting of Attachment D, as proposed by NBN Co.¹⁰⁹

In relation to the additional CVC TC-4 product features up to 2000 Mbps, as discussed further in section 5.2.1.1, the ACCC understands that NBN Co intends to release these products by the end of 2013. The ACCC considers that requiring these product features to go through the PDF Processes will likely delay (potentially significantly) the commercial release of these products.

¹⁰² Ibid.

¹⁰³ Ibid.

¹⁰⁴ Optus Submission, p. 32.

¹⁰⁵ Ibid.

¹⁰⁶ Ibid.

¹⁰⁷ For example, see NBN Co, NBN Co Wholesale Access Service Product and Pricing Overview for Service Providers, December 2011, Attachment F.

¹⁰⁸ Ibid, Attachment E.

¹⁰⁹ NBN Co September 2013 Submission – drafting refinements, p. 47.

The Notice to Vary does not include the CVC TC-4 product features between 2,000 and 10,000 Mbps, as proposed by NBN Co. While these product features have recently been added to NBN Co's Initial Product Roadmap, these product features are intended to be release until 2015 and beyond. The ACCC considers that it is appropriate to subject these additional CVC tiers to the product development process, as it will give access seekers and Consumer Advocacy Groups an opportunity to provide feedback to NBN Co on the development and introduction of these additional tiers (including on service levels and price) in the context of the market environment.

The Notice to Vary also does not include "other Facilities supplied by NBN Co that are necessary to facilitate entry to buildings, such as cable trays or building duct access", as proposed by NBN Co.¹¹⁰ This is because, in contrast to the other product components, product features and types of Facilities Access Service contained on the list of Initial Products, this type of Facilities Access Service is broadly defined and may cover types of Facilities Access Service that have not yet been developed or undergone sufficient consultation to date. This will mean that, if NBN Co wishes to introduce a type of services that is necessary to facilitate entry to buildings such as cable trays or building duct access, it must do so in accordance with the product development provisions.

Finally, the Notice to Vary retains the CVC TC-2, CVC TC-3 and Additional Enhanced Service Levels product features, rather than removing these product features as proposed by Telstra.¹¹¹ In relation to the CVC product features, the ACCC is satisfied that these products have been subject to sufficient consultation to be included on the list of Initial Products. Furthermore, NBN Co has recently released technical specifications for these product features, which should address Telstra's concerns. In relation to Additional Enhanced Service Levels, while NBN Co has only consulted on the pricing for the 12 and 8 hour offerings,¹¹² the ACCC is satisfied that this product construct has been subject to sufficient consultation to be included on the list of Initial Products.

4.1.5. Additional variations proposed by Telstra

In its submission to the Draft Decision and Consultation Paper on the Notice to Vary, Telstra proposed a number of additional variations to the product development provisions in the 18 December 2012 SAU. The ACCC sought further views on Telstra's proposals in its Response to Submissions.

Submissions provide the following views:

- NBN Co agreed to adopt the additional variations proposed by Telstra and proposed SAU drafting to implement the proposals.¹¹³
- Telstra proposed SAU drafting to implement its proposals.¹¹⁴
- Optus,¹¹⁵ CCC,¹¹⁶ AAPT¹¹⁷ and Herbert Geer¹¹⁸ supported the additional variations proposed by Telstra.

¹¹⁰ NBN Co September 2013 Submission – drafting refinements, p. 49.

¹¹¹ Telstra Submission, p. 19.

¹¹² For example, NBN Co, NBN Co Industry Consultation Paper: Proposed Business and Enterprise Fibre Services, 23 December 2011, p. 41.

¹¹³ NBN Co July 2013 Submission, pp. 13-14.

¹¹⁴ Telstra Submission, Annexure 4.

¹¹⁵ Optus Submission, p. 34.

¹¹⁶ CCC Submission, p. 3.

¹¹⁷ AAPT Submission, p. 8.

¹¹⁸ iiNet Submission, pp. 7-8.

The Notice to Vary proposes drafting to implement the following of the variations proposed by Telstra:

- That NBN Co be required to include on the Product Ideas register additional information and updates about the status of product ideas under consideration and development.
- That NBN Co be required to consult with the PDF on its initial assessment on whether to develop a product idea.
- That a 'Product Construct Paper' should contain NBN Co's proposed price-related terms.
- That NBN Co be required to consult on the technical attributes for each product idea.
- That NBN Co be required to publish and maintain an 'Integrated Product Roadmap' that outlines how IT support and operational support are being developed for the new products under development.

The drafting to implement these proposals in the Notice to Vary seeks to balance the legitimate business interests of NBN Co and the interests of access seekers. To develop this drafting, the ACCC has adopted drafting from both NBN Co and Telstra's submissions where it considers it appropriate.

4.2. Product withdrawal and reference offers

4.2.1. Product withdrawal disallowance

The draft Notice to Vary proposed a conferral of a power on the ACCC to disallow the withdrawal of a currently supplied product, product component, product feature, Ancillary Service and types of Facilities Access Service by NBN Co. Under this conferral of power, NBN Co would be prevented from withdrawing a product for the time period specified by the ACCC, which must not be more than five years.

In NBN Co's submission, it argues that five years is too long a period to disallow a product withdrawal, and that a shorter period of two years should be applied.¹¹⁹ It argues that the ACCC will still have an objection power in relation that subsequent product withdrawal after an initial two years. This means that ACCC would be able to ensure that the withdrawal of products that would not promote the long-term interests of end-users would not occur.¹²⁰

The Notice to Vary has retained the proposal that the ACCC may disallow the withdrawal of a product for up to five years. This will allow the ACCC to determine the timeframe in which NBN Co cannot withdraw a product based on the individual circumstances of the withdrawal. The ACCC considers that this is both reasonable and necessary because:

- there may be circumstances where it will promote the long-term interests of end-users for a product to not be withdrawn for up to five years (for example, it may promote the long-term interests of end-users to ensure the on-going supply of certain products);
- allowing the ACCC to disallow the withdrawal of this product for the full five years will reduce the regulatory and administrative burden of repeating the process of notification and disallowance every two years; and

¹¹⁹ NBN Co July 2013 Submission, p. 16.

¹²⁰ Ibid.

- for those circumstances in which there is persuasive evidence that disallowing a product withdrawal for less than five years will promote the long-term interests of end-users (including when there is a likelihood that circumstances may change), the drafting of the Notice to Vary will give the ACCC the flexibility to disallow the product withdrawal for a shorter period.

4.2.2. Removal of distinction between reference and non-reference offers

In the Response to Submissions for the draft Notice to Vary, the ACCC provided its preliminary view is that removing the concepts of Reference Offers and Non-Reference Offers, in favour of reliance on the proposed product withdrawal conferral of power, could vastly simplify the operation of the SAU. The ACCC sought interested parties' views on this proposal.

Submissions provide the following views:

- NBN Co supports removing the concepts of Reference Offers and Non-Reference Offers, and proposes drafting to implement these changes which NBN Co states replicate the commitment to keep fixed in nominal terms until 30 June 2017 the Maximum Regulated Prices of what would otherwise have been Reference Offers.¹²¹
- CCC supports the proposal, so long as the areas where the distinction makes a material difference remains.¹²²
- iiNet submits that while in principle it could support the removal of the concepts of Reference Offers and Non Reference Offers in order to simplify the SAU, it could not do so if this would result in the removal of the commitment not to increase prices for Reference Offers before 1 July 2017 or the removal of any other commitment made in respect of Reference Offers.¹²³
- AAPT supports the removal of the concepts of Reference Offers and Non-Reference Offers to the extent that it removes ambiguity and complexity around whether products can or cannot be withdrawn; however it does not support their removal altogether until a review of the SAU has been undertaken to ensure that such a distinction is not material and necessary for the proper operation of other provisions.¹²⁴
- In Optus' submission:
 - Optus states that the issues with the product withdrawal provisions have been addressed to some extent with the conferral of power on the ACCC to disallow a product withdrawal, provided that this power remains unconstrained.¹²⁵
 - Optus states that it is not opposed to the requirement for NBN Co to specify a suite of Reference Offers, in order to set suitable price 'anchors' for the introduction of future prices. However, it notes that there is a risk that a Non-Reference Offer may be subject to product withdrawal during the relevant regulatory term.¹²⁶
 - Optus considers that it is important that the composition of the Reference Offers in Module 1 (and any subsequent replacement modules) be designed to represent

¹²¹ Ibid.

¹²² CCC Submission, p. 3.

¹²³ iiNet Submission, p. 8.

¹²⁴ AAPT Submission, pp. 8-9.

¹²⁵ Optus Submission, p. 37.

¹²⁶ Ibid.

the products required by Access Seekers to provide entry-level residential and business grade services to end-users.¹²⁷

The ACCC has considered the views from submissions and has decided to implement the proposal to remove the concepts of Reference Offers and Non-Reference Offers in the Notice to Vary. To implement these changes, the Notice to Vary adopts the drafting proposed by NBN Co in its submission with some minor amendments.

The implications of these proposed changes to the SAU are as follows:

- NBN Co will be required to supply 'NBN Offers'.
- The initial suite of NBN Offers is listed in the SAU and includes the same Products, Product Components, Product Features, Ancillary Services and types of Facilities Access Services (or combinations thereof) that were previously specified as Reference Offers and Non-Reference Offers. NBN Co may develop new NBN Offers in accordance with the product development provisions set out in Schedule 1I and 2D.
- NBN Co may withdraw any NBN Offer throughout the SAU term (including the NBN Offers that were previously specified as Reference Offers) in accordance with the product withdrawal provisions set out in Schedule 1I and 2D, with the following conditions:
 - NBN Co must provide notice that it intends to withdraw the Products, Product Components, Product Features, Ancillary Services and types of Facilities Access Services contained within the NBN Offer; and
 - the ACCC may object to and disallow the withdrawal of the relevant Products, Product Components, Product Features, Ancillary Services and types of Facilities Access Services, having regard to the long-term interests of end-users and certain factors listed in the SAU.
- The Maximum Regulated Prices that applied to Reference Offers and Non-Reference Offers in the 18 December 2012 SAU will continue to apply to the NBN Offers. This means that the maximum prices of NBN Offers that were previously specified as Reference Offers will be fixed in nominal terms until 30 June 2017, and the maximum prices of all other NBN Offers will not be greater than the individual price control limit.

The ACCC considers that the drafting adopted in the Notice to Vary to remove the concept of Reference Offers and Non-Reference Offers, combined with the operation of the product withdrawal disallowance power, will simplify the drafting and operation of the SAU.

The ACCC also considers that the drafting adopted in the Notice to Vary will address concerns raised by submissions about removing the concept of Reference Offers and Non-Reference Offers, namely that:

- the pricing commitments that apply to Reference Offers and Non-Reference Offers will apply to NBN Offers; and
- the ACCC can ensure the ongoing supply of any NBN Offer over the SAU term, if it is in the long-term interests of end-users to do so, including entry-level residential and business grade services.

¹²⁷ Ibid, p. 36.

4.2.3. Product variations

As well as the development of new products and the withdrawal of existing products, Schedules 1I and 2E of the 18 December 2012 SAU also applies to variations made by NBN Co to its existing products.¹²⁸ The draft Notice to Vary did not propose any changes to these clauses in the SAU.

Upon further consideration, the ACCC considers that NBN Co's ability to make material variations to its products could allow NBN Co to bypass the intention and operation of the product withdrawal disallowance power. This may lead to circumstances where the SAU does not promote the long-term interests of end-users.

For example, if NBN Co were to reduce the service quality or functionality of lower-functionality and lower-value products, this could mean that the SAU would 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 (this is because NBN Co could reduce the service quality or functionality of lower-functionality products to artificially promote take-up of higher-functionality products rather than through pricing its higher-value services efficiently); and
- current consumers of services provided over copper and HFC networks are not 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.

As noted in the Draft Decision, the ACCC considers that if these outcomes were to be delivered by the SAU, economically efficient use of and investment in the NBN would more likely be encouraged.¹²⁹

In light of these views, the Notice to Vary proposes a new clause in Schedule 1I and 2D which states that:

- NBN Co will not vary any Product in a manner that changes the functionality, performance or features of that Product to such an extent that results in the Product no longer being reasonably capable of delivering at least the same functionality, performance or features previously associated with the Product.
- If NBN Co wishes to vary the Product to such an extent that results in the Product is no longer reasonably capable of delivering at least the same functionality, performance or features, NBN Co will seek to withdraw the Product and introduce a new Product in accordance with Schedule 1I or 2D.

4.2.4. Additional variations proposed by Telstra

In its submission to the Draft Decision and Consultation Paper on the draft Notice to Vary, Telstra proposed a number of additional variations to the product withdrawal provisions in the 18 December 2012 SAU in relation to the transitional arrangements that NBN Co will put in place when it withdraws a product.

Submissions provide the following views:

¹²⁸ NBN Co 18 December 2012 SAU, Schedule 1I, clause 1I.1.3(a); Schedule 2E, clause 2E.1.3(a).

¹²⁹ ACCC, Draft Decision on the Special Access Undertaking lodged by NBN Co on 18 December 2012, April 2013, p. 90. (ACCC Draft Decision)

- NBN Co agreed to adopt the additional variations proposed by Telstra and proposed drafting to implement the proposals.¹³⁰
- Telstra proposed SAU drafting to implement its proposals.¹³¹
- AAPT supports the additional variations proposed by Telstra.¹³²
- Optus submits that Telstra's proposal should to some extent be adopted.¹³³ (Optus do not elaborate on what aspects of Telstra's proposal should or should not be adopted.)

The Notice to Vary proposes drafting to implement Telstra's proposal that NBN Co should be required to provide the following minimum information to the ACCC, access seekers and Consumer Advocacy Groups in respect of a product that it intends to withdraw:

- NBN Co's assessment of the factors that it is required to have regard to when considering withdrawing a product; and
- the following information about NBN Co's proposed transitional arrangements for migration to an alternative product:
 - the proposed alternative product;
 - the proposed timeframes for migration to that alternative product;
 - the proposed testing arrangements for the alternative product;
 - the details of any trials or transition processes for the alternative product; and
 - if NBN Co will not offer an alternative product, NBN Co's reasons for not doing so.

The ACCC has largely adopted the drafting proposed by NBN Co in its submission to implement Telstra's proposals.

¹³⁰ NBN Co July 2013 Submission, pp. 17-18.

¹³¹ Telstra Submission, Annexure 4.

¹³² AAPT Submission, p. 8.

¹³³ Optus Submission, p. 39.

5. Maximum Regulated Prices

The variations that are discussed in this section relate to the issues discussed in section 5.4 of the Draft Decision, section 2.4.1 of the Consultation Paper, section 2.4.1 of the Response to Submissions, and Schedules 1C, 1G, 2B and 2E of the Notice to Vary.

An important aspect of the Notice to Vary is the role of 'Maximum Regulated Prices'. Maximum Regulated Prices set the maximum Price that NBN Co may charge — were NBN Co to charge a Price higher than the Maximum Regulated Price, it may be in breach of the SAU (subject to that higher Price not having been agreed between NBN Co and an access seeker(s)).

A number of initial Maximum Regulated Prices are set out in the Notice to Vary.¹³⁴ Further, the Notice to Vary permits the ACCC to determine initial Maximum Regulated Prices (subject to certain conditions) for NBN Offers and Other Charges:

- where the Maximum Regulated Price currently specified in the Notice to Vary is zero; or
- where there is currently no Maximum Regulated Price specified in the SAU.¹³⁵

The Notice to Vary also establishes how initial Maximum Regulated Prices, once set, are able to change over time via the CPI-1.5 per cent price control, a revenue neutral rebalance or in response to a tax change event.¹³⁶ Also of relevance, once the Building Block Revenue Period commences, NBN Co must determine its Prices such that the revenues that it expects to earn do not exceed the forecast Annual Building Block Revenue Requirement (ABBRR).

This section of the document discusses the variations in the Notice to Vary relating to these matters and is structured as follows:

- Section 5.1 discusses some overarching issues with respect to the pricing provisions in the SAU — firstly the interaction between Maximum Regulated Prices, Prices and the Long Term Revenue Constraint Methodology and secondly, the re-opening mid regulatory cycle of the ABBRR in response to particular Maximum Regulated Price change events.
- Section 5.2 discusses variations relating to the initial Maximum Regulated Prices set out in the SAU, and those relating to setting initial Maximum Regulated Prices for new NBN Offers and Other Charges and to introducing a Maximum Regulated Price for previously zero-priced NBN Offers and Other Charges.
- Section 5.3 discusses the variations relating to how the Maximum Regulated Prices in the SAU will change over time — in particular, the periodic revenue neutral review of Maximum Regulated Prices and how Maximum Regulated Prices may change in response to Tax Change Events.

¹³⁴ ACCC, *Notice to Vary NBN Co SAU*, October 2013, Schedule 1C (ACCC Notice to Vary). The ACCC noted in the Response to Submissions that one aspect of the 18 December 2012 SAU that made the pricing commitments particularly complex was the Reference Offer – Non-Reference Offer distinction. As noted in section 4.2.2 of this Explanatory Statement, the Notice to Vary removes the Reference Offer – Non-Reference Offer distinction. In addition, the Notice to Vary ensures that the pricing commitments which were to attach to the Reference Offers are maintained — for example, the commitment to fix Maximum Regulated Prices in nominal terms for the NBN Offers that were previously Reference Offers up until 30 June 2017.

¹³⁵ *Ibid*, Schedule 1C, clause 1C.5.1; Schedule 2B, clause 2B.2.2.

¹³⁶ *Ibid*, Schedule 1C, clause 1C.5; Schedule 1G; Schedule 2B, clause 2B.2; Schedule 2E.

5.1. Overarching issues

This section discusses three overarching issues with respect to the Maximum Regulated Price provisions in the SAU. Two of these issues arise due to the combined operation of the approach to regulating Maximum Regulated Prices and the Long Term Revenue Constraint Methodology.

It is intended by NBN Co — and the ACCC accepts this proposed operation — that:

- Whilst NBN Co is in the Initial Cost Recovery Account phase of the Long Term Revenue Constraint Methodology, even if setting Prices up to the maximum allowed by the CPI-1.5 per cent price control 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 Maximum Regulated Prices allowed for by the CPI-1.5 per cent price control, subject to the effect of any price review arrangement or regulatory determination. Similarly, during the Building Block Revenue Period of the Long Term Revenue Constraint Methodology, it is intended that NBN Co is not permitted to increase Prices above the Maximum Regulated Prices allowed for by the CPI-1.5 per cent price control in order to expect to be able to earn revenues calculated in accordance with the forecast ABBRR.
- Whilst NBN Co is in the Building Block Revenue Period phase of the Long Term Revenue Constraint Methodology, its Prices will be set to only allow it to recover its forecast Annual Building Block Revenue Requirement — so, if setting Prices up to the maximum level allowed by the CPI-1.5 per cent price control were to allow NBN Co to earn more than its forecast Annual Building Block Revenue Requirement, NBN Co would be required to set Prices below those allowed for by the price control in order to reduce its revenues and comply with the forecast ABBRR.

The operation of the CPI-1.5 per cent price control differs from the operation of price caps in certain other regulatory regimes. In particular, the price control is fixed for the duration of the SAU. In comparison, in certain other regulatory regimes price caps remain fixed only over the regulatory period and are set so as to recover the revenue requirement, determined in accordance with a building block methodology.

The operation of the CPI-1.5 per cent price control, fixed for the duration of the SAU, is intended to complement other aspects of the SAU and NBN Co's operating environment to provide incentives for NBN Co to invest in infrastructure and incur expenditure in an efficient manner. The combination of the large initial capital outlay by NBN Co, initial under-recovery and uncertainty about future demand and revenue, with the price controls which limit NBN Co's ability to increase prices, means that NBN Co is likely to face strong incentives to be efficient.

However, the operation of the CPI-1.5 per cent price control, in combination with the Long Term Revenue Constraint Methodology, also creates some unique issues. Section 5.1.1 discusses issues with the clauses in the Notice to Vary that specifically describe and establish how Maximum Regulated Prices, Prices and the Long Term Revenue Constraint Methodology operate together. Section 5.1.2 discusses NBN Co's proposals to re-open the ABBRR in particular circumstances.

Thirdly, the ACCC has made amendments to clause 1C.1.2 to clarify that NBN Co must supply the NBN Offers referred to in clause 1C.3 from the SAU Commencement Date. In the absence of this clause, the ACCC is concerned that there would be no commitment by NBN Co to supply those NBN Offers referred to in clause 1C.3. However, the ACCC has exempted some CVC tiers from this requirement because NBN Co has indicated that it will not be in a position to provide those CVC tiers from the SAU Commencement Date.

5.1.1. Interaction between Maximum Regulated Price, Prices and the LTRCM

In the drafting that NBN Co provides with its submission, NBN Co has made variations which provide that NBN Co may set prices up to or equal to the Maximum Regulated Price.¹³⁷ The ACCC considers that this creates some uncertainty as to whether, during the Building Block Revenue Period, the *right* established by these clauses to set prices up to or equal to the Maximum Regulated Price takes precedence over the *obligation* on NBN Co to determine Prices in such a manner that its forecast revenue equals the forecast Annual Building Block Revenue Requirement. In such a case, NBN Co might be able to earn total revenues greater than the sum of those allowed for by the Annual Building Block Revenue Requirements, by over-recovering revenues in each year until the final regulatory cycle of the SAU term.

As noted in the Response to Submissions, the ACCC considers that it is necessary for the SAU to be absolutely clear about this matter. This is because it is essential to:

- the incentives created by the CPI-1.5 per cent price control for NBN Co to invest, operate and price efficiently — if NBN Co expected that it would be able to increase Prices above the Maximum Regulated Prices allowed for by the CPI-1.5 per cent price control, this would dull the positive incentive properties created by the price control; and
- the efficacy of the constraint on revenues established by the Annual Building Block Revenue Requirements and the Long Term Revenue Constraint Methodology — if the CPI-1.5 per cent price control allowed NBN Co to earn revenues in excess of those allowed for by the ABBRR, the Long Term Revenue Constraint Methodology would not operate to ensure that the net present value of NBN Co's cash inflows and outflows over the life of the SAU came to zero.

In the Notice to Vary, the ACCC has therefore included the following amendments to address its concerns about this matter:

- clarifying that NBN Co must set prices subject to both Maximum Regulated Prices and the revenue constraint by amending the drafting in clauses 1C.1.4, 1E.2.4(c), 2B.1.4 and 2C.6.2 of the Notice to Vary.
- including a new clause (clause 2C.6.2 of the Notice to Vary) to ensure that, over a regulatory cycle within the Building Block Revenue Period (or that part of a regulatory cycle that is within the Building Block Revenue Period), prices are set so that NBN Co's forecast revenue does not exceed its allowed revenues.

5.1.2. Re-opening the LTRCM in response to Maximum Regulated Price change events

As noted above, the operation of the CPI-1.5 per cent price control differs from price cap mechanisms in certain other regulatory regimes. This is because the price control is fixed for the duration of the SAU and the price caps that result from the operation of the price control are not varied for the purpose of allowing the access provider to expect to earn revenues during the forthcoming regulatory period that are determined in accordance with a building block methodology.

¹³⁷ NBN Co, *Submission on ACCC draft Notice to Vary – SAU Variation*, 26 July 2013; Schedule 1C, clauses 1C.1.3 and 1C.1.5; Schedule 1E, clauses 1E.1.4 and 1E.2.4; Schedule 2B, clause 2B.1.4; Schedule 2C, clause 2C.1.2. (NBN Co July 2013 Submission – SAU Variation)

In the draft Notice to Vary, and as discussed further below, the ACCC proposed that Maximum Regulated Prices may be able to be changed *during* a regulatory cycle in response to:

- a periodic revenue neutral review (that is, a 'Price Review Arrangement' coming into effect);
- a Tax Change Event; and/or
- the ACCC determining a Maximum Regulated Price for a new Offer or Other charge, or a previously zero-priced Offer or Other Charge.¹³⁸

In its submission, NBN Co proposes to include a new provision in the SAU which relates to the operation of the Long Term Revenue Constraint Methodology in Module 2. The new provision would allow for the Forecast Nominal ABBRR, Forecast Real Annual Building Block Revenue Requirement and Annual Forecast Revenue for a regulatory cycle to be adjusted to account for the incremental effects of a Price Review Arrangement or a Regulatory Determination of a new Maximum Regulated Price on those forecast amounts. According to NBN Co's proposal, any necessary adjustments would be specified in the relevant Regulatory Determination or relevant Price Review Arrangement.¹³⁹

NBN Co notes that the above mentioned forecasts are relevant to the calculation of the Initial Cost Recovery Account at the end of each year.¹⁴⁰

The ACCC considers that it is difficult to ascertain now the extent to which costs and revenues may be expected to change over the relevant regulatory cycle in response to a price review arrangement or a regulatory determination of a new maximum regulated price. A price review arrangement or a regulatory determination of a new maximum regulated price in Module 2 may involve no changes in expected costs or revenues. However, there may be cases where a price review arrangement or a regulatory determination of a new maximum regulated price would be expected to have a material impact on costs and revenues over the relevant regulatory cycle.

NBN Co's forecast nominal ABBRRs (which represent NBN Co's annualised costs) will be set up-front before each regulatory cycle. Forecast revenue will also be set up-front if forecast revenues are used to determine unrecovered cost and the roll-forward the ICRA (this is discussed further in section 6.3.2). If a price review arrangement or a regulatory determination of a new maximum regulated price is expected to materially change NBN Co's expected revenues and costs, continuing to use the forecasts of costs and revenues determined through the replacement module process may result in NBN Co being under or over compensated. The ACCC therefore considers that a mechanism that allows for the re-opening of forecasts is appropriate.

The ACCC considers that NBN Co's proposed re-opening mechanism is appropriate and has adopted it in the Notice to Vary, subject to two minor drafting amendments. The first amendment is to require that adjustments made under these provisions will be made 'to the extent the ACCC considers necessary', rather than 'to the extent necessary'. The second amendment is to require that the adjustments made under the provisions account for 'any effects' on the forecast amounts, rather than 'the incremental effects'.¹⁴¹

¹³⁸ ACCC, *Draft Notice to Vary NBN Co SAU*, 4 July 2013, Schedule 1D; Schedule 1H; Schedule 2C; Schedule 2F. (ACCC Draft Notice to Vary)

¹³⁹ NBN Co July 2013 Submission, pp. 21-22.

¹⁴⁰ *Ibid.*, p. 20.

¹⁴¹ ACCC Notice to Vary, Schedule 2C, clause 2C.4.

5.2. Initial Maximum Regulated Price setting

This section of the document discusses the views expressed in submissions about the initial Maximum Regulated Prices set out in the draft Notice to Vary.

It also discusses the variations in the Notice to Vary that relate to the approach to setting initial Maximum Regulated Prices for new NBN Offers and Other Charges, and those that relate to introducing a Maximum Regulated Price for previously zero-priced NBN Offers and Other Charges.

5.2.1. Initial Maximum Regulated Prices currently set out in the SAU

Submissions raised a limited number of issues with respect to the Maximum Regulated Prices currently specified in the SAU.¹⁴²

John de Ridder reiterates the concerns about CVC pricing that he raised in his submission to the Consultation Paper on the Notice to Vary. That is:

- that CVC pricing discriminates against small access seekers;
- that CVC pricing has the same effect as volume discounting;
- that there would be no discrimination if CVC pricing was per GB (not sold in blocks);
- that transitory CVC credits do not remove the barrier to entry for small access seekers; and
- that the difference in the cost of CVC capacity is not in the long-term interests of end-users.¹⁴³

These concerns were addressed by the ACCC in section 2.4.1.1 of its Response to Submissions.¹⁴⁴ John de Ridder's submission has not provided any additional information that has not already been considered by the ACCC. The ACCC has therefore not proposed any changes in the Notice to Vary in relation to John De Ridder's most recent submission.

iiNet submits that the Multicast AVC Offer and the Multicast Domain Offer should be removed from the SAU, because this would allow access seekers and NBN Co further time to negotiate multicast prices and, if agreement cannot be reached, for access seekers to seek an Access Determination from the ACCC.¹⁴⁵

In contrast, in the Draft Decision on the 18 December 2012 SAU, the ACCC noted that the initial Maximum Regulated Prices for multicast services were likely to be efficient due to a number of factors that were likely to constrain or 'anchor' NBN Co's multicast pricing.¹⁴⁶ The ACCC concluded that in the absence of additional information about why the initial Maximum Regulated Prices for multicast functionality were not reasonable, its preliminary view was that multicast initial Maximum Regulated Prices were reasonable.¹⁴⁷ In the draft Notice to Vary, the

¹⁴² The issues discussed in this section relate to those discussed in section 5.4.1 of the Draft Decision, section 2.4.1.1 of the Response to Submissions, Schedules 1C and 1D of the draft Notice to Vary and Schedule 1C of the Notice to Vary.

¹⁴³ John de Ridder, *A final word on CVC pricing*, July 2013, p. 1.

¹⁴⁴ ACCC Response to Submissions, pp. 68-69.

¹⁴⁵ iiNet Submission, p. 5.

¹⁴⁶ ACCC Draft Decision, p. 13.

¹⁴⁷ Ibid.

ACCC did not propose any variations to the initial Maximum Regulated Prices for multicast, as submissions to the Draft Decision did not provide any additional information that had not already been considered in making the Draft Decision.¹⁴⁸

The ACCC notes that, in order to demonstrate its concerns about Maximum Regulated Prices for multicast services, iiNet provides confidential cost modelling comparing the additional costs it faces to deliver Fetch services to its customers with the additional costs that would apply to deliver the service if NBN Co's multicast services were used.¹⁴⁹ The ACCC considers that this information shows that it would cost more to deliver Fetch services using NBN Co's multicast services than it costs to deliver via On Net DSL.

However, the ACCC notes that there are alternative products to multicast that are supplied by NBN Co that can be used to supply content services to end-users. In addition, access seekers may be able to negotiate different multicast prices with NBN Co.

iiNet also submits that if NBN Co's multicast prices are accepted by the ACCC for inclusion in the SAU, NBN Co may seek to use this as a justification not to lower the prices in the future even if a compelling case is made for them to be lowered.¹⁵⁰

The ACCC noted in the Draft Decision that NBN Co could, at a future time, reduce multicast prices to encourage take-up if it so chose.¹⁵¹ The ACCC acknowledges that NBN Co may not always face incentives to respond to market developments in this way — if this were the case, the ACCC could review the Maximum Regulated Prices for multicast via the Price Review Mechanism (see section 5.3.1 below).

The content services that NBN Co's multicast product is designed around are still in a relatively nascent state. If over time market conditions and the evolution of content services are such that the Maximum Regulated Prices for multicast services are no longer reasonable, the ACCC will be able to review them via the Price Review Mechanism (see section 5.3.1 below).

Optus states that it still has concerns over the appropriateness of the starting prices of many of the NBN product components, and the suitability of the components to be used by retail service providers to supply a retail service that replicates existing service levels at existing price points.¹⁵² Optus submits that the ACCC should place greater weight on the views of RSPs, rather than NBN Co when assessing whether the prices in the SAU are likely to enable retail prices that promote the long-term interests of end-users.¹⁵³

The ACCC notes that, when assessing the reasonableness of NBN Co's maximum regulated prices, it must balance the legitimate business interests of NBN Co and access seekers. Optus' latest submission has not specified which prices it is concerned about in the SAU, and has not provided the ACCC with evidence to support its submissions. Further, Optus has not responded to the ACCC's analysis in its Response to Submissions or NBN Co's analysis in its submission to the Consultation Paper on the Notice to Vary. In the absence of this information, the ACCC has not proposed any changes to NBN Co's initial maximum regulated prices in the Notice to Vary in response to Optus' submission.

5.2.1.1. Additional NBN Offers and Maximum Regulated Prices

The Notice to Vary includes the following additional products, product components, product features, Ancillary Services or types of Facilities Access Service in Schedule 1C as an 'NBN Offer':

¹⁴⁸ Response to Submissions, p. 69.

¹⁴⁹ iiNet Submission, pp. 4-5.

¹⁵⁰ Ibid, p. 5.

¹⁵¹ ACCC Draft Decision, p. 13.

¹⁵² Optus Submission, p. 10.

¹⁵³ Ibid.

- NBN Co Building Entry Service.
- CVC TC-4: 1100, 1200, 1300, 1400, 1500, 1600, 1700, 1800, 1900 Mbps and 2 Gbps.

These products have been included at the request of NBN Co.

Additional information about these products, and the reasons for including them as NBN Offers in the Notice to Vary, are discussed below.

NBN Co Building Entry Service

The NBN Co Building Entry Service is a type of Facilities Access Service. This service allows an access seeker to connect fibre optic cables from a physical location outside an NBN Co site or facility to an ODF Termination Point or another agreed location within an NBN Co facility. This service is defined in clause 1A.7 of the Notice to Vary as:

NBN Co building entry service, which enables an Access Seeker to install, house, operate, test, maintain and remove lead-in or backhaul transmission cables at a POI Site that is located within a Type 1 Facility (**NBN Co Building Entry Service**).

The price for the NBN Co Building Entry Service is set out in clause 1C.3(g) of the Notice to Vary, and is \$190 per month per fibre cable.

The ACCC understands that this \$190 per month price for the NBN Co Building Entry Service is based on NBN Co's understanding of the market rates for similar product elements that would provide access seekers with the same capability as this service, as well as based upon the cost associated with building this service. The ACCC has not received evidence from NBN Co in support of these market rates or the relevant costs.

The NBN Co Building Entry Service has been included in NBN Co's Wholesale Broadband Agreement (WBA) since February 2013 and is currently being supplied by NBN Co.

The ACCC has included the NBN Co Building Entry Service in the Notice to Vary because specifying this product as an NBN Offer will ensure that the Maximum Regulated Price of this product will be determined in accordance with the provisions in Schedule 1C and 2B of the Notice to Vary.

As discussed in section 4.1.4, the NBN Co Building Entry Services has also been included in Attachment D (Initial Products), which means that this product will be exempt from further consultation through the PDF Processes.

CVC TC-4

The 18 December 2012 SAU includes CVC TC-4 up to 1 Gbps at individual tiers of between 50 Mbps and 100 Mbps.¹⁵⁴ The price for CVC TC-4 is \$20 per Mbps per month (which means that the total cost is calculated by multiplying \$20 times the amount of Mbps of CVC purchased).

The additional CVC TC-4 tiers requested by NBN Co extend these tiers up to 2 Gbps with individual increments of 100 Mbps. The price for these additional tiers remains at \$20 per Mbps per month.

The ACCC understands that NBN Co intends to release these additional CVC tiers commercially by the end of 2013. NBN Co has also stated that a reason for releasing these additional CVC tiers is to support the release of additional AVC tiers, such as 1 Gbps.

The ACCC has included these additional CVC TC-4 tiers in the Notice to Vary because:

¹⁵⁴ NBN Co 18 December 2012 SAU, Schedule 1C, clause 1C.2.5.

- the initial price of these tiers are likely to be reasonable because they are the same as the existing CVC tiers in the SAU (\$20 per Mbps per month); and
- specifying these products as NBN Co Offers will ensure that the price of this product will be subject to the individual price control limit and the price review mechanism in the SAU immediately upon its release.

As discussed in section 4.1.4, these additional CVC TC-4 tiers have also been included in Attachment D (Initial Products), which means that these specific product features will be exempt from further consultation through the PDF Processes.

5.2.1.2. Minor variations to Schedules 1C and 2B submitted by NBN Co

In its submission, NBN Co proposed a number of minor variations to Schedules 1C (NBN Offers and Other Charges) and 2B (Pricing Commitments).

The ACCC considers that most of these minor variations have no impact on the ACCC's consideration of whether the SAU satisfies the statutory criteria for acceptance of an SAU under Part XIC, and has therefore adopted most of the variations in the Notice to Vary.

However, the ACCC notes the following in relation to the effects of removing the Standard Business Offer and the maximum regulated price for a Subsequent Installation.

Firstly, as discussed in section 4.2.1, the concept of 'reference offers' has been removed in the Notice to Vary. As a consequence of this variation, NBN Co has proposed to no longer supply (as a bundle) the reference offer that was defined as the Standard Business Offer (SBO). The maximum regulated price for the SBO was \$53, and the SBO included:

- a 25/10Mbps AVC PIR (TC-4), including:
 - access to, and use of, one available UNI-D; and
 - the option to use one available UNI-V; and
- a symmetric access capacity 500kbps CIR (TC-1) AVC.¹⁵⁵

Under the drafting provided in NBN Co's submission, access seekers would still be able to purchase the above product features; however, they would be required to purchase product features (i) and (ii) separately. The maximum regulated prices for these product features in the drafting provided in NBN Co's submission are \$30 and \$33, respectively. That is, the effective Maximum Regulated Price appears to be \$10 higher than under the draft Notice to Vary.

However, NBN Co's WBA Price List sets out a mechanism through which access seekers who purchase a symmetric access capacity AVC (TC-1) in conjunction with an asymmetric AVC (TC-4) will receive a credit equivalent to the recurring charge for 0.15 Mbps TC-1 (CIR) data transfer rate.¹⁵⁶ The WBA Price List specifies a charge for this service of \$10 per month.¹⁵⁷ Therefore, based on the WBA Price List, if an access seeker was to purchase services (i) and (ii) above, the total cost to the access seeker would be \$53 (\$30+\$33-\$10) per month.

In its 6 September 2013 submission, NBN Co proposed drafting to include this pricing credit mechanism in the SAU.¹⁵⁸ However, the ACCC is not satisfied that this pricing credit alone will ensure that access seekers will be able to purchase what was previously defined as the SBO for \$53. This is because the value of the pricing credit is directly linked to the actual Price for a

¹⁵⁵ ACCC Draft Notice to Vary, Schedule 1C, clause 1C.2.4.

¹⁵⁶ NBN Co, *Price List – release 2.6*, August 2013, clause 2.1.

¹⁵⁷ *Ibid.*

¹⁵⁸ NBN Co September 2013 Submission – drafting refinements, Schedule 1C, clauses 1C.3(b) and 1C.4(e)(i).

0.15Mbps AVC (TC-1), rather than the Maximum Regulated Price for this service. This means that if NBN Co sets the Price for the 0.15Mbps AVC (TC-1) below the Maximum Regulated Price (currently \$10), the value of the pricing credit provided to access seekers will fall, leading to an effective Price for the previous SBO bundle that is greater than \$53.

It is not clear why removing the concept of reference offers requires NBN Co to no longer supply the SBO. To ensure that the effective Maximum Regulated Price for the previous SBO bundle reflects that which was consulted on via the original consultation on the SAU and the draft Notice to Vary, in the Notice to Vary the ACCC has re-introduced the SBO as an NBN Offer, described as:

- an Asymmetric AVC Offer with the following Data Transfer Rates:
 - 25 Mbps PIR (TC-4) downlink; and
 - 10 Mbps PIR (TC-4) uplink; and
- a Symmetric Access Capacity Offer with a symmetrical Data Transfer Rate of 0.5 Mbps CIR (TC-1).¹⁵⁹

The maximum regulated price for the SBO will be \$53 per SIO, per month until 30 June 2017.¹⁶⁰ After this date, consistent with other NBN Offers, the maximum regulated price will be determined in accordance with clauses 1C.5 and 2B.2.

Regarding the 0.15Mbps AVC (TC-1) pricing credit mechanism, the ACCC considers that including this mechanism in the SAU will promote efficient use of the network because it will encourage access seekers to take up Symmetric Access Capacity Offers (TC-1), where the value they place on these offers outweighs the associated cost. Further, including the pricing credit mechanism in the SAU will provide access seekers with certainty over the continuation of the pricing credit mechanism for the duration of Module 1.

However, NBN Co's proposed drafting of the pricing credit mechanism is ambiguous in terms of when the credit will apply and what the value of the credit will be. Therefore, the Notice to Vary includes amended drafting in a new clause 1C.4.4 to give effect to NBN Co's proposed pricing credit mechanism.

Secondly, clause 1C.4.2(a) of NBN Co's revised drafting specifies the maximum regulated price for a 'subsequent installation'. A subsequent installation is defined as a standard or non-standard installation that is not the first installation performed by NBN Co (or an installer) in respect of a premise.¹⁶¹ In the drafting provided as part of its submission, NBN Co has varied the charge description for a subsequent installation — the charge is specified as "\$270 plus Hourly Labour Rate plus cost of materials, charged for a minimum amount equivalent to 3.67 hours", whereas it was previously defined as "\$270 plus Hourly Labour Rate plus cost of materials".¹⁶²

NBN Co submits that the rationale for this variation is that a subsequent installation was previously subject to a minimum charge of \$270, which translates to 3.67 hours at the current Hourly Labour Rate of \$75 per hour.¹⁶³ That is, it appears that NBN Co's intention was to clarify that the minimum charge of \$270 was simply equivalent to 3.67 hours of labour.

The ACCC understands the intent of NBN Co's proposed variation but considers that its proposed drafting is unclear and could be interpreted to mean that access seekers will be

¹⁵⁹ ACCC Notice to Vary, Schedule 1C, clause 1C.2.15.

¹⁶⁰ Ibid, Schedule 1C, clause 1C.3(h).

¹⁶¹ Ibid, Attachment C (Dictionary).

¹⁶² NBN Co July 2013 Submission – SAU Variation, Schedule 1C, clause 1C.4.2; ACCC Draft Notice to Vary, Schedule 1D, clause 1D.3.2.

¹⁶³ NBN Co July 2013 Submission – SAU Variation, p. 35.

charged \$270 plus the Hourly Labour Rate (for a minimum of 3.67 hours) plus the cost of materials.

Therefore, the Notice to Vary sets out that the charge for a subsequent installation is defined as “the Hourly Labour Rate charged for a minimum amount equivalent to 3.67 hours, plus cost of materials.”¹⁶⁴

5.2.2. Setting initial Maximum Regulated Prices for new and previously zero-priced offers and other charges

This section commences by explaining broadly the intended operation of the provisions in the draft Notice to Vary and the Notice to Vary relating to the ACCC’s ability to determine initial Maximum Regulated Prices for new Offers and Other Charges, and previously zero-priced Offers and Other Charges.¹⁶⁵ It then addresses how the views expressed in submissions to the draft Notice to Vary in relation to these provisions have been taken into account in finalising the Notice to Vary.

By way of background, the ACCC notes that its ability to determine initial Maximum Regulated Prices that are not commercially agreed or specified in the SAU arises due to the normal operation of Part XIC. The variations in the Notice to Vary are aimed at clarifying the ACCC’s oversight role under Part XIC for initial Maximum Regulated 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 Maximum Regulated Prices for any new product or ‘other charge’, or currently zero-priced offer or ‘other charge’, despite the fact that these initial Maximum Regulated Prices may not be able to be agreed or may otherwise be set by NBN Co at levels that are not reasonable.

The ACCC reiterates that — while the ACCC recognises the potential for NBN Co to face positive incentives at certain stages during the proposed SAU term — the ACCC should have the ability to reset the Maximum Regulated Prices if the initial prices set by NBN Co are not reasonable.

Having said this, if NBN Co’s observed behaviour indicates the desired impact of the aforementioned positive incentives, the ACCC expects that it would not be necessary for it to determine initial Maximum Regulated Prices. That is, modifying the SAU so that the ACCC is not prevented from doing so does not necessarily mean that the ACCC should or must intervene in relation to initial Maximum Regulated Prices, even if not commercially agreed.

The ACCC also reiterates that, in the event that it did need to address this issue through its existing Part XIC powers, the ACCC would be required to have regard to NBN Co’s legitimate business interests.

5.2.2.1. Intended operation of the provisions

According to the Notice to Vary, it is intended that NBN Co and access seekers will, in the first instance, negotiate over the initial Price of new Offers and Other Charges, and previously zero-priced Offers and Other Charges. If NBN Co and access seekers agree to an initial Price, that Price becomes the initial Maximum Regulated Price. This is set out in clauses 1C.5.1 and 2B.2.2, which (broadly) state that, in a given Financial Year, if the ACCC has not made a regulatory determination in relation to the Maximum Regulated Price of a new Offer/Other Charge, or a previously zero-priced Offer/Other Charge, the Maximum Regulated Price will be the Price introduced by NBN Co. In addition, clauses 1C.5.4(b)(i) and 2B.3(b)(i) permit NBN Co to introduce a Price for a zero-priced Offer/Other charge by providing no less than 6 months’

¹⁶⁴ ACCC Notice to Vary, Schedule 1C, clause 1C.4.2.

¹⁶⁵ The issues discussed in this section relate to those discussed in section 5.4.2 of the Draft Decision, section 2.4.1.1 of the Consultation Paper, section 2.4.1.2 of the Response to Submissions, Schedules 1D and 2C of the draft Notice to Vary and Schedules 1C and 2B of the Notice to Vary.

notice to access seekers and the ACCC of its intention to introduce a Price for the Offer/Other Charge.

However, it is intended that — in the event that agreement cannot be reached on the Price that NBN Co wishes to introduce — the ACCC will be able to determine the Maximum Regulated Price in a Binding Rule of Conduct and/or Access Determination.

As set out in clauses 1C.5.1 and 2B.2.2, it is intended that the Binding Rule of Conduct or Access Determination must have particular characteristics in order for it to ‘set’ the Maximum Regulated Price.

Firstly, the Binding Rule of Conduct or Access Determination must be made within 24 months of NBN Co commencing supply of the new Offer or Other Charge, or introducing a Price for the zero-priced Offer or Other Charge.¹⁶⁶ This constraint is intended to provide NBN Co with certainty that the ACCC may not intervene in respect of new prices following this 24 month time period. Further, after the 24 month period, any issues about the pricing of such a product are likely to be more appropriately addressed through a revenue neutral price review.

Secondly, where the regulatory determination in question is an Access Determination, and it is made in relation to the Maximum Regulated Price of a new Offer or Other Charge, the ACCC must have taken into account the characteristics and costs of, and impacts on demand for and revenues earned from, other existing NBN Offers and Other Charges.¹⁶⁷ 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. The ACCC does not need to take into account these matters if the regulatory determination in question is a Binding Rule of Conduct, and it considers that due to the urgent need to make the Rules, it is not practicable to do so. It also does not need to take into account these matters in determining the initial Maximum Regulated Price of a previously zero-priced Offer or Other Charge.

Once the initial Maximum Regulated Price is set (either by agreement between NBN Co and access seekers, or ACCC regulatory determination) the CPI-1.5 per cent price control will govern how the Maximum Regulated Price can change over time (subject to any later Price Review or Tax Change Event, and the forecast Annual Building Block Revenue Requirement during the Building Block Revenue Period).¹⁶⁸

5.2.2.2. Submissions relevant to initial Maximum Regulated Prices for both newly introduced and previously zero-priced Offers and Other Charges

NBN Co’s submission notes the following points which are relevant to the setting of initial Maximum Regulated Prices for both newly introduced and previously zero-priced Offers and Other Charges:

- The SAU should clarify that the initial Maximum Regulated Prices set in a Regulatory Determination have effect from the date the ACCC made that Regulatory Determination until the end of the financial year in which the Regulatory Determination was made (or earlier if the ACCC makes a subsequent Regulatory Determination).¹⁶⁹
- The SAU should clarify that it is NBN Co, rather than the ACCC, who determines Prices for NBN Offers and Other Charges, including new Prices. This is to clarify that,

¹⁶⁶ ACCC Notice to Vary, Schedule 1C, clause 1C.5.1; Schedule 2B, clause 2B.2.2.

¹⁶⁷ Ibid.

¹⁶⁸ Ibid.

¹⁶⁹ NBN Co July 2013 Submission, p. 20.

while the ACCC may set the applicable Maximum Regulated Prices, it is NBN Co that sets the actual Prices (up to or equal to the applicable Maximum Regulated Price).¹⁷⁰

- The Initial Pricing Principles should be retained in the SAU to provide access seekers with transparency about how NBN Co sets the initial prices for new and previously zero-priced Offers and Other Charges.¹⁷¹

In relation to the first point, NBN Co has provided limited explanation of its proposed changes. The ACCC's understanding is that NBN Co is seeking to preclude the ACCC from firstly, 'backdating' Maximum Regulated Prices in Regulatory Determinations, and secondly, specifying multiple Maximum Regulated Prices for an Offer or Other Charge across multiple financial years (that is, a Maximum Regulated Price for year 1, a Maximum Regulated Price for year 2).

The ACCC does not see strong reasons for or against NBN Co's proposed variations.

On the one hand, it does not seem necessary to address particular ways that the ACCC may choose to exercise its statutory powers. The ACCC would already 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.

On the other hand, the ACCC understands that NBN Co is seeking certainty over the scope of the effect of an ACCC determination.

In this regard, the intended operation of clauses 1C.5.1(b), 1C.5.1(d), 2B.2.2(b) and 2B.2.2(d) in the Notice to Vary is that an ACCC determination 'resets' on a 'once-off' basis the level of a Maximum Regulated Price during the 24 month window — to the extent that the ACCC does not do so during this window, the CPI-1.5 per cent otherwise applies.

Further, it may be acceptable in the current context to accept a restriction on the ACCC's ability to backdate Maximum Regulated Prices, because the ACCC is able to rapidly specify a Maximum Regulated Price using Binding Rules of Conduct.

Due to this ability to rapidly specify Maximum Regulated Prices in a Binding Rule of Conduct or an Interim Access Determination, the ACCC accepts that it is also necessary for clauses 1C.5.1(b), 1C.5.1(d), 2B.2.2(b) and 2B.2.2(d) to contemplate that multiple regulatory determinations for a new Offer or Other Charge may be made during the 24 month window. In particular, an Access Determination may *follow* Binding Rules of Conduct and/or an Interim Access Determination. For example, if the ACCC urgently issued Binding Rules of Conduct, it must commence an Access Determination inquiry, and may wish to adjust the Maximum Regulated Price in light of further information and analysis.

The ACCC therefore accepts the objectives that NBN Co is seeking to achieve via its proposed variations. However, the ACCC has not adopted NBN Co's proposed drafting in the Notice to Vary — rather it has included clauses 1C.5.1(b), 1C.5.1(d), 2B.2.2(b) and 2B.2.2(d), which each state that if the ACCC has made a Resetting Regulatory Determination in respect of that NBN Offer or Other Charge:

“...the Price specified in that Resetting Regulatory Determination (which may be a Price of \$0.00), with effect on and from the date on which that Resetting Regulatory Determination is made until the earlier of the end of that Financial Year and the date on which another Resetting Regulatory Determination is made in that Financial Year...”

In relation to the second point submitted by NBN Co, in the draft Notice to Vary, because the ACCC proposed variations which were designed to permit the ACCC to determine Maximum

¹⁷⁰ Ibid.

¹⁷¹ Ibid.

Regulated Prices in certain circumstances, the ACCC also proposed consequential variations to the SAU to remove references to 'NBN Co determining' initial prices and to remove clauses that purported to allow NBN Co to apply 'Other Charges' at its discretion.

However, the ACCC understands the distinction that NBN Co has raised between the ACCC determining 'Maximum Regulated Prices' and NBN Co determining 'Prices'. That is, the Maximum Regulated Price sets the price level that NBN Co must not determine a Price above; but it is ultimately NBN Co that determines the precise level of that Price (subject to it not being higher than the Maximum Regulated Price and it not leading to forecast revenues above the forecast ABBRR during the Building Block Revenue Period).

The ACCC has therefore re-instated clauses which clarify that NBN Co determines Prices. However, for the reasons outlined in section 5.1.1, it has not adopted NBN Co's proposed drafting with respect to allowing NBN Co to determine Prices 'up to and including' the Maximum Regulated Price. Rather, the relevant clauses are described as NBN Co determining Prices subject to both Maximum Regulated Price and Building Block Revenue Requirement constraints.

In relation to the third point submitted by NBN Co, in the draft Notice to Vary, the ACCC proposed the removal of the Initial Pricing Principles from the SAU.¹⁷² In light of the ACCC's role in being able to determine initial Maximum Regulated Prices, the ACCC does not consider these principles to be necessary in order for the SAU to satisfy the statutory criteria. Further, some of the principles do not necessarily align well with the matters that the ACCC must take into account in making a regulatory determination under Part XIC, and could in turn cause some confusion as to the matters that are relevant to the determination of initial Maximum Regulated Prices under Part XIC. This is particularly the case in the context of the legislative hierarchy, whereby an Access Determination or Binding Rule of Conduct only has effect to the extent that it is consistent with the SAU. Lastly, the ACCC considers that the principles would be difficult, if not impossible, to effectively enforce in any event. Whilst the ACCC appreciates NBN Co's desire to provide transparency, the ACCC does not consider that including unenforceable commitments in the SAU is the appropriate avenue for doing so. Should NBN Co wish to provide transparency as to the matters it will take into account in setting initial Maximum Regulated Prices, it could publish a statement on its website.

5.2.2.3. Submissions about initial Maximum Regulated Prices for newly introduced Offers and Other Charges

NBN Co submits that, when making a regulatory determination about the initial Maximum Regulated Price for a new Offer or Other Charge, the SAU should require the ACCC to be satisfied that the specified price for the Offer or Other Charge will not result in financial detriment to NBN Co compared to a situation in which NBN Co did not introduce the Offer or Other Charge. It states that, without this requirement, every time NBN Co introduces a new Offer or Other Charge there would be a risk that it could be made worse off (through ACCC intervention) than if it had not introduced the new NBN Offer or Other Charge. As a consequence, NBN Co may have mixed incentives to engage in ongoing product development.¹⁷³

To give effect to this submission, NBN Co proposes the following clause be included in clauses 1C.5.1(d) and 2B.2.2(d) of the Notice to Vary:

“...the ACCC has made a Regulatory Determination...for the purposes of which, the ACCC is satisfied that the price for that NBN Offer or Other Charge will not result in financial detriment to NBN Co compared to a situation in which NBN Co did not introduce the NBN Offer or Other Charge...”

Parties other than NBN Co did not submit in relation to the ACCC's ability to determine initial Maximum Regulated Prices for new Offers and Other Charges.

¹⁷² ACCC Response to Submissions, p. 75.

¹⁷³ NBN Co July 2013 Submission, p. 19.

Whilst the ACCC understands the point that NBN Co makes in relation to this matter, the ACCC has not adopted NBN Co's proposed additional characteristic that a regulatory determination must have in order for that determination to set an initial Maximum Regulated Price.

The ACCC has concerns that locking in the particular characteristic proposed by NBN Co for the 27 year term of the SAU could lead to unintended or unforeseen consequences, which, at worst, could unduly preclude the ACCC's ability to effectively exercise its powers to determine initial Maximum Regulated Prices. In particular, the meaning of 'financial detriment' could be interpreted very broadly. If such circumstances arose, it would not be open to the ACCC or other parties to seek to amend the clause, even if it were leading to outcomes that were demonstrably not reasonable.

The ACCC reiterates that, in making an Access Determination under Part XIC, the ACCC must take into account (amongst other things):

- whether the determination will promote the long-term interests of end-users — which would require that the ACCC has regard to the extent to which the determination would result in the achievement of the objective of encouraging economically efficient use of and investment in the NBN; and
- NBN Co's legitimate business interests and its investment in the NBN.

Further, as proposed in the draft Notice to Vary, a determination made by the ACCC will only 'set' the Maximum Regulated Price if, in making the determination, the ACCC has taken into account the characteristics and costs of other NBN offers, and the demand for and revenues earned from, these other Offers.¹⁷⁴ The requirement to take into account these matters is intended to provide NBN Co with certainty that, in determining an initial Maximum Regulated Price for a new Offer or Other Charge, the ACCC will consider the effects of that new Maximum Regulated Price on the revenues earned from its existing product set.¹⁷⁵ This is in order to address NBN Co's concerns that the ACCC might set a new initial Maximum Regulated Price in such a way as to undermine its current and expected future revenue streams.¹⁷⁶

It is therefore open to NBN Co at the time that the ACCC conducts an inquiry into making an Access Determination to make arguments and provide evidence about:

- the impacts of particular initial Maximum Regulated Prices for new Offers or Other Charges on its expected revenue streams;
- how particular initial Maximum Regulated Prices for new Offers or Other Charges impact upon its financial position, and how this is inconsistent with its legitimate business interests; and
- how particular initial Maximum Regulated Prices for new Offers or Other Charges would dissuade it from introducing the Offers or Other Charges, and how this would not promote efficient investment in and use of the NBN.

The ACCC would then consider these arguments and this evidence on its merits at the time of the Access Determination inquiry. Were a particular initial Maximum Regulated Price to result in outcomes that were contrary to NBN Co's legitimate business interests, and/or which did not encourage efficient investment in and use of the NBN, it is highly unlikely that the ACCC would determine such a Maximum Regulated Price.

¹⁷⁴ ACCC Draft Notice to Vary, Schedule 1H, clause 1H.3.8(b).

¹⁷⁵ ACCC Response to Submissions, p. 73.

¹⁷⁶ NBN Co May 2013 Submission, p. 75. The ACCC has made some minor changes to clarify that it is the impact of the ACCC's decision on demand and revenues for and from other Offers that will be taken into account in making its decision, rather than just existing demand and revenues for and from those other Offers.

For these reasons, the ACCC has not adopted NBN Co's proposed 'financial detriment' clause in the Notice to Vary.

5.2.2.4. Submissions about initial Maximum Regulated Prices for zero-priced offers and other charges

In the draft Notice to Vary, the ACCC proposed that the SAU be varied to incorporate a 'New Price Disallowance Power', which would allow the ACCC to object to the introduction by NBN Co of a non-zero Maximum Regulated Price for Offers and Charges that are currently specified in the SAU as having a zero Maximum Regulated Price. This objection would have been able to take place after NBN Co had provided notice (of no less than 6 months) of its intention to introduce a non-zero Price. It was proposed that this power would extend to all Offers (that is, to both Non-Reference Offers and Reference Offers) and to all Other Charges (that is, including those associated with both Reference offers and Non-Reference Offers).¹⁷⁷

In addition, the ACCC proposed variations that would allow it to determine the initial Maximum Regulated Price in respect of a previously zero-priced Offer or Other Charge, in the event that commercial agreement could not be reached on the Price. This meant that, if NBN Co were permitted by the ACCC to introduce a Price for a previously zero-priced offer or other charge, the actual Maximum Regulated Price would be established separately — primarily as agreed between NBN Co and access seekers, and failing agreement, determined by the ACCC.¹⁷⁸

The ACCC also noted in the Response to Submissions that, whilst the ACCC considered the New Price Disallowance Power to be unobjectionable, there were questions as to its necessity in light of the variations that the ACCC was proposing to allow it to determine Maximum Regulated Prices for previously zero-priced Offers and Other Charges.¹⁷⁹

In its submission, NBN Co states that:

- It shares the ACCC's views as to the necessity of the New Price Disallowance Power, and therefore proposes amendments to remove it from the SAU.¹⁸⁰
- The preconditions and 6 month notice period for the introduction of a new price for a currently zero-priced offer or other charge should be retained, in order to provide access seekers with greater certainty about future pricing of currently zero-priced Offers or Other Charges.¹⁸¹

The proposed drafting submitted by NBN Co also re-introduces the clause which the ACCC had removed in the draft Notice to Vary which states that "nothing in [clause 1C.5.4 of NBN Co's submission] restricts NBN Co from introducing a non-Price term or condition in respect of an Other Charge to address the behaviours or circumstances described in clause 1C.5.4(b)(ii)".¹⁸² These behaviours and circumstances are: that one or more Access Seekers' use of the Offer or activity associated with the Other Charge results in additional costs to NBN Co or degraded service outcomes for other Access Seekers; and any other circumstance which makes it uneconomic for NBN Co to maintain the zero-price. NBN Co does not provide any arguments in support of the retention of this clause.

Given that the Notice to Vary allows the ACCC to determine the initial Maximum Regulated Price of a previously zero-priced Offer or Other Charge (in the event that agreement cannot be reached over the Maximum Regulated Price between NBN Co and access seekers), the ACCC has not included the New Price Disallowance Power in the Notice to Vary. The ACCC has

¹⁷⁷ ACCC Response to Submissions, p. 74.

¹⁷⁸ Ibid.

¹⁷⁹ Ibid.

¹⁸⁰ NBN Co July 2013 Submission, p. 20.

¹⁸¹ Ibid.

¹⁸² NBN Co July 2013 Submission – SAU Variation, Schedule 1C, clause 1C.5.4(d); Schedule 2B, clause 2B.3(d).

however, in line with NBN Co's submission, retained the clauses which require NBN Co to provide no less than 6 months' notice to access seekers and the ACCC of its intention to introduce a Price for a zero-priced Offer or Other Charge.

On the other hand, in contrast to NBN Co's proposed drafting, the ACCC has not retained the clauses which list factors that NBN Co must be satisfied of in order to introduce a non-zero Price or Maximum Regulated Price. In line with the ACCC's views outlined above in relation to the Initial Pricing Principles, the ACCC considers that these clauses would be difficult if not impossible to enforce. Whilst NBN Co considers that these clauses provide greater certainty to access seekers in regard to future pricing of currently zero-priced Offers and Other Charges, the ACCC does not consider that including unenforceable commitments in the SAU is the appropriate avenue for doing so. Should NBN Co wish to provide certainty to access seekers as to the matters it will take into account in deciding whether to introduce a non-zero Price, it could publish a statement on its website.

Further, the ACCC has not re-introduced the clause which states that "nothing in [clause 1C.5.4 of NBN Co's submission] restricts NBN Co from introducing a non-Price term or condition in respect of an Other Charge to address the behaviours or circumstances described in clause 1C.5.4(b)(ii)". The ACCC notes that this clause refers to a clause which, as outlined in the previous paragraph, the ACCC has now removed. The ACCC does not consider that the remaining clauses would preclude NBN Co from negotiating with access seekers to include non-price terms in Access Agreements to address the behaviours or circumstances described.

iiNet submits that the ACCC's power to issue a New Price Disallowance Determination should be retained and broadened to include a power to specify an alternative price to the one proposed by NBN Co.¹⁸³ However, the ACCC considers that its ability to determine initial Maximum Regulated Prices under clauses 1C.5.1(b) and 2B.2.2(b) will allow it to determine a price which is different to that notified to access seekers and the ACCC by NBN Co. The ACCC has also included variations in the Notice to Vary to clarify that this determined Maximum Regulated Price can be zero.

iiNet also submits that, given the complex issues that may need to be considered and the need for consultation with stakeholders, the ACCC should have discretion to extend the six month period in which to make a New Price Disallowance Determination when reasonably required.¹⁸⁴ However, the ACCC notes that, under clauses 1C.5.1(b) and 2B.2.2(b), the ACCC has 24 months from the time the Offer or Other Charge ceases to be Zero-priced to make a determination which specifies a different Maximum Regulated Price to that notified by NBN Co. The ACCC considers that this will provide sufficient time to consider issues that arise, and to consult with stakeholders.

Telstra submits that NBN Co should be required to commence consultation on the proposed prices for zero-priced items at the same time as it gives notice of its intention to introduce new prices.¹⁸⁵ The ACCC considers that such a commitment is in line with the approach taken for consultation over the initial Prices for new offers (that is, that consultation must take place via the Product Development Forum) and is consistent with the ACCC's desire for commercial negotiation to take place prior to any regulatory intervention. The ACCC has hence included clauses 1C.5.4(b) and 2B.3(b) in the Notice to Vary, which require NBN Co to provide at least 6 months' notice to access seekers and the ACCC of its intention that (and reasons why) an NBN Offer or Other Charge cease to be zero-priced, and to consult with access seekers in relation to the proposal.

The ACCC has also made minor amendments to clarify that the ACCC may make a Resetting Regulatory Determination in relation to a new price introduced by NBN Co for a previously zero-priced offer referred to in clause 1C.3 prior to 30 June 2017. In addition, the ACCC has made amendments to clarify what happens in a situation where a Maximum Regulated Price

¹⁸³ iiNet Submission, p. 4.

¹⁸⁴ Ibid.

¹⁸⁵ Telstra Submission, p. 16.

set out in clause 1C.3 was changed (prior to 30 June 2017) in the previous financial year as a result of NBN Co introducing a price for a zero-priced offer, the ACCC resetting the Price of a previously zero-priced offer or a tax change event. In these circumstances, the Maximum Regulated Price for the previous financial will continue to apply. That is, if a Maximum Regulated Price set out in clause 1C.3 is changed via one of the circumstances noted above, the new Maximum Regulated Price for that NBN Offer may not be increased via the Individual Price Increase Limit prior to 30 June 2017.¹⁸⁶

5.3. Changes to Maximum Regulated Prices over time

The 18 December 2012 SAU states that Maximum Regulated 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 Maximum Regulated 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).¹⁸⁷

In the draft Notice to Vary, the ACCC largely maintained this approach, but:

- consulted on whether removing the distinction between Reference Offers and Non-Reference Offers from the SAU would simplify the operation of the SAU;¹⁸⁸
- proposed that Maximum Regulated Prices be able to be changed during a Revenue Neutral Price Review by the making of a 'Price Review Arrangement';¹⁸⁹ and
- proposed that Maximum Regulated Prices be able to be changed if changes to taxes occur, according to processes set out in the SAU.¹⁹⁰

According to the draft Notice to Vary, in a given financial year, the Maximum Regulated Price of the Offer is — if a Price Review Arrangement is in operation — as per that Price Review Arrangement.¹⁹¹ If no Price Review Arrangement is in operation, then the Maximum Regulated Price is determined in accordance with the CPI-1.5 per cent price control.¹⁹² The Maximum Regulated Prices established under the Price Review Arrangement and via the CPI-1.5 per cent price control may also be changed in accordance with the proposed Tax Change Events process during Module 1, and any subsequent process put in place during Module 2 for addressing tax change events.¹⁹³

In the Notice to Vary, the ACCC has largely maintained this broad framework and drafting, but has made some further changes to address issues raised in submissions. The issues raised in submissions and changes made to the draft Notice to Vary are discussed below.

¹⁸⁶ ACCC Notice to Vary, Schedule 1C, clause 1C.5.1(f).

¹⁸⁷ NBN Co 18 December 2012 SAU, 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 an "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).

¹⁸⁸ ACCC Response to Submissions, p. 59.

¹⁸⁹ ACCC Draft Notice to Vary, Schedule 1H, clause 1H.3.4; Schedule 2F, clause 2F.2.4.

¹⁹⁰ Ibid, Main Body, clause 4.7; Schedule 1H, clause 1H.2.

¹⁹¹ Ibid, Schedule 1D, clause 1D.4.1(a); Schedule 2C, clause 2C.2.2(a).

¹⁹² Ibid, Schedule 1D, clause 1D.4.1(f); Schedule 2C, clause 2C.2.2(f).

¹⁹³ Ibid, Schedule 1H, clause 1H.2.5.

5.3.1. Periodic revenue neutral review of Maximum Regulated Prices

The periodic review of prices in the draft Notice to Vary was intended to operate as follows.

Firstly, NBN Co or the ACCC may issue a notice to the other stating that they wish to commence a review of Maximum Regulated Prices, which Maximum Regulated Prices they consider should be reviewed and the reasons why.¹⁹⁴

NBN Co would then have 120 days after the notice is issued to provide the ACCC with a proposal about how the particular Maximum Regulated Prices should be changed. The proposal would need to include a proposed 'Price Review Arrangement' developed in accordance with the 'Price Review Criteria' (and an explanation of how the proposed Price Review Arrangement is consistent with the criteria), as well as the forecasts (and underlying assumptions relating to those forecasts) used by NBN Co to apply the Price Review Criteria to the proposed Price Review Arrangement.¹⁹⁵

The ACCC may then:

- accept the proposed Price Review Arrangement; or
- reject it and issue its own Price Review Arrangement; or
- discontinue the price review without making any decision on the proposed Price Review Arrangement.¹⁹⁶

The ACCC is also able to issue a notice to NBN Co setting out variations to the Price Review Arrangement proposal which, if made, would allow NBN Co to re-submit a revised Price Review Arrangement proposal.¹⁹⁷ (This is intended to be a similar power to the ACCC's 'Notice to Vary' power under Part XIC.)

The ACCC must not accept a proposed Price Review Arrangement or issue an ACCC determined Arrangement unless it is satisfied that:

- the Maximum Regulated Prices in the Arrangement are reasonable (having regard to the matters specified in section 152AH of the CCA and any other matter the ACCC considered relevant); and
- there is no material difference between the expected *total* net revenues (that is, not just those relating to the particular Maximum Regulated Prices being reviewed) over the remaining term of the SAU with and without the Price Review Arrangement in operation.¹⁹⁸

These two criteria are known as the 'Price Review Criteria'. These criteria are intended to require that any changes to the Maximum Regulated Prices in question lead to 'reasonable' Maximum Regulated Prices (having regard to the established criteria set out in section 152AH of the CCA) and that the changes do not leave NBN Co materially better or worse off in terms of their expected net revenues over the remaining term of the SAU.¹⁹⁹

¹⁹⁴ Ibid, Schedule 1H, clause 1H.2.5.

¹⁹⁵ Ibid, Schedule 1H, clause 1H.3.2; Schedule 2F, clause 2F.2.2.

¹⁹⁶ Ibid, Schedule 1H, clause 1H.3.3; Schedule 2F, clause 2F.2.3.

¹⁹⁷ Ibid, Schedule 1H, clause 1H.3.4; Schedule 2F, clause 2F.2.4.

¹⁹⁸ Ibid, Schedule 1H, clause 1H.3.8(a); Schedule 2F, clause 2F.2.8(a).

¹⁹⁹ ACCC Response to Submissions, p. 80.

In addition, under the draft Notice to Vary, in deciding whether to accept or issue a Price Review Arrangement, the ACCC would have to take into account the characteristics and costs of other NBN offers *not* the subject of the review, and the demand for and revenues earned from, these other Offers.²⁰⁰ The requirement to take into account these matters is intended to provide NBN Co with certainty that, in deciding whether or not the Price Review Arrangement should come into effect, the ACCC will consider the effects of the arrangement on the revenues earned from its existing product set.²⁰¹ This is in order to address NBN Co's concerns that the ACCC might change Maximum Regulated Prices in such a way as to undermine its current and future revenue streams.²⁰² The ACCC could also take into account any other factor it considered relevant.

If accepted, the proposed Price Review Arrangement would come into effect — that is, the prices set out in the Price Review Arrangement would become the Maximum Regulated Prices; if rejected and the ACCC issued its own Price Review Arrangement, that arrangement would come into effect.²⁰³

A Price Review Arrangement would need to specify its commencement date (which cannot be a date in which an existing Price Review Arrangement is in effect) and an expiry date. It also must specify the Offers to which the Price Review Arrangement applies and the associated Maximum Regulated Prices for one or more financial years within the period of the Price Review Arrangement. (The Maximum Regulated Prices may be different for each financial year of the Price Review Arrangement, for example, to establish a 'glide path' of Maximum Regulated Prices.)²⁰⁴

According to the draft Notice to Vary, during Module 1, only one notification could be given by either NBN Co or the ACCC, and this could not be given before 1 July 2016. The associated Price Review Arrangement could not be made before 1 July 2018. During Module 2, notifications could be given at any time an existing Price Review Arrangement was not in operation, and Price Review Arrangements could have terms of between three to five years.

5.3.1.1. Frequency of review during Module 1

As noted, the draft Notice to Vary set out that only one notification could be given by either NBN Co or the ACCC during Module 1, and that this could not be given before 1 July 2016. The associated Price Review Arrangement could not come into effect before 1 July 2018.²⁰⁵

In contrast, access seekers submit that the ACCC should not be prevented from implementing a price review arrangement prior to 1 July 2018; and that the ACCC should not be restricted to undertaking only one price review during the initial regulatory period.²⁰⁶ Access seekers argue that this is because:

- the prices specified in the SAU are largely untested;²⁰⁷
- the telecommunications sector is dynamic in nature;²⁰⁸
- NBN Co's activities are significant in scale and new and unique;²⁰⁹

²⁰⁰ ACCC Draft Notice to Vary, Schedule 1H, clause 1H.3.8(b); Schedule 2F, clause 2F.2.8(b).

²⁰¹ ACCC Response to Submissions, p. 80.

²⁰² NBN Co May 2013 Submission, p. 75.

²⁰³ ACCC Draft Notice to Vary, Schedule 1H, clauses 1H.3.5 and 1H.3.6; Schedule 2F, clauses 2F.2.5 and 2F.2.6.

²⁰⁴ *Ibid*, Schedule 1H, clause 1H.3.7.

²⁰⁵ *Ibid*, Schedule 1H, clause 1H.3.

²⁰⁶ AAPT Submission, pp. 7-8; iiNet Submission, pp. 2-3; Macquarie Telecom Submission, p. 4; Optus Submission, pp. 22-23; Telstra Submission, pp. 14-16.

²⁰⁷ iiNet Submission, p. 3.

²⁰⁸ Macquarie Telecom Submission, p. 4.

²⁰⁹ *Ibid*.

- three-year price reviews are consistent with Australian and international regulatory frameworks;²¹⁰
- the risks to the long-term interests of end-users arising from incorrect CVC pricing are likely to arise in the near term — without a review of CVC prices, the risks facing access seekers will adversely impact their decisions to invest in NBN-based services; and
- access seekers will be required to either increase end-user prices or reduce service quality.²¹¹

Access seekers variously propose that:

- The ACCC should actively consider whether to conduct a price review every three years for the term of Module 1, with the consideration of the first review taking place in the period between the commencement of the SAU and 1 July 2016.²¹²
- The ACCC could have the discretion to initiate a review on a date not prior to 1 July 2015, and there should be the discretion for the ACCC to initiate subsequent reviews at least three years following the commencement of the initial review.²¹³
- A review should be able to be requested (either by access seekers, the ACCC or NBN Co) in circumstances which meet prescribed threshold criteria.²¹⁴

Access seekers argue that these changes would:

- provide access seekers with some regulatory certainty during Module 1, particularly around CVC pricing;²¹⁵ and
- allow for the appropriate allocation of risk between NBN Co and access seekers.²¹⁶

Specifically in relation to CVC pricing, submissions note the following.

Telstra submits that:

- The assumptions underpinning NBN Co's current CVC pricing are out-of-date and not reflective of the current experience on high bandwidth networks. Further, the current disparity between actual CVC requirements per end-user and NBN Co's current assumptions will increase significantly over the near term.²¹⁷
- If NBN Co does not reduce CVC prices in response to demand growth, RSPs will be required to either increase end-user prices or reduce service quality. Further, without a reduction in CVC prices, the likely outcome will be a reduction in NBN-based investment by RSPs.²¹⁸
- The risks to the long-term interests of end-users arising from the incorrect pricing of CVC are likely to arise in the near term.²¹⁹

²¹⁰ Telstra Submission, pp. 15-16.

²¹¹ Ibid, p. 14.

²¹² Ibid

²¹³ AAPT Submission, p. 8; CCC Submission, p. 2; Macquarie Telecom Submission, p. 4; Optus Submission, p. 23.

²¹⁴ AAPT Submission, p. 7.

²¹⁵ Telstra Submission, p. 16.

²¹⁶ Ibid

²¹⁷ Ibid, pp. 12-13.

²¹⁸ Ibid, p. 14.

²¹⁹ Ibid, p. 12.

- These concerns could be mitigated by providing for earlier and more regular price reviews over the life of the NBN Co SAU (including in Module 1).²²⁰

Optus submits that CVC is the product component that has the most direct impact on the consumer experience.²²¹ It further submits that NBN Co's commitment in the SAU to lower CVC pricing over time is ambiguous and should be replaced with a specific link between CVC price declines and actual throughput levels. It provides an example that the CVC price could be specified for different average traffic levels, such as 150kbps and 300kbps.²²²

The CCC submits that it would provide greater comfort to access seekers if there were provisions that allowed the ACCC to have a formal role in reviewing CVC pricing.²²³

Macquarie submits that current CVC pricing will result in access seekers making a trade-off between high end-user prices and inferior service quality and that the SAU should contain more specific commitments for the ACCC to review the CVC price on or before 1 July 2016.²²⁴

AAPT submits that, as exponential growth in data traffic continues, CVC charges will quickly make up an increasingly greater proportion of the costs of providing services to end-users. It submits that, to provide greater comfort to access seekers about future CVC pricing, the ACCC should have a formal role in reviewing CVC pricing over time.²²⁵

In its submission to the draft Notice to Vary, NBN Co did not provide any further views on the frequency of price reviews during Module 1. However, in its submission to the Consultation Paper on the Notice to Vary, NBN Co submitted that the ACCC should not review prices at all 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 1.²²⁶

The decision as to 'how soon' and 'how frequently' a price review should be able to occur during Module 1 is a finely balanced one.

On the one hand including an earlier price review mechanism in Module 1 could potentially introduce additional pricing uncertainty for NBN Co in a period in which it already faces a high degree of demand uncertainty. Further, during the rollout period, NBN Co may have incentives to price its services in such a way as to encourage end-users to increase their use of the NBN because it is likely to face a high degree of revenue sufficiency risk.

On the other hand, the longer the period of time before initial prices are subject to review, the more pricing risk access seekers will face. As noted above, access seekers submit that this may adversely affect their NBN-based investment decisions. In particular, given the uncertainty about CVC demand growth, there may be merit in the ACCC having the option to review CVC prices earlier during Module 1.

On balance of these considerations, the ACCC has decided to:

- Provide it and NBN Co with the opportunity to commence a price review (by issuing a notice) from 1 July 2014 onwards.

²²⁰ Ibid, p. 14.

²²¹ Optus Submission, pp. 10-11.

²²² Ibid, p. 11.

²²³ CCC Submission, p. 3.

²²⁴ Macquarie Telecom Submission, p. 5.

²²⁵ AAPT Submission, pp. 5-6.

²²⁶ NBN Co May 2013 Submission, pp. 72-73.

- Allow for the outcomes of such a review (that is, for changes to Maximum Regulated Prices accepted or determined in a Price Review Arrangement) to have effect from 1 July 2016 onwards.²²⁷

Importantly, this does not mean that the ACCC must or will commence a review by issuing a notice to NBN Co in July 2014. Rather, it provides the ACCC with the *opportunity* to do so if it considers that there are Maximum Regulated Prices that should be reviewed. It also does not mean that Maximum Regulated Price must or will be changed on 1 July 2016; rather, it simply provides the opportunity for this to take place.

In addition, the ACCC has decided to:

- Allow for more than one price review to take place, and for more than one Price Review Arrangement to have effect, during Module 1 — but no more than two.²²⁸
- Allow for the Price Review Arrangement to have effect from one to five years, as accepted or determined by the ACCC.²²⁹
- Only allow a subsequent Price Review Arrangement to come into effect after the expiry of a previous arrangement.²³⁰

Combined, this means that Maximum Regulated Prices can only be changed twice by means of a review during Module 1; and that the ACCC has discretion when making the first review arrangement to determine how soon after a subsequent review should be able to occur. For example, the ACCC may decide that it does not consider that another should take place until five years after the first review, in which case it would specify a term for the Price Review Arrangement of five years. Or, it may decide that a further review should take place three years after the first review, in which case it would set a term of three years for the Price Review Arrangement.

The ACCC has provided itself with the option of making a Price Review Arrangement with a one or two year term because it has also (in response to NBN Co's submission)²³¹ now adopted this approach in Module 2 — the ACCC considers the review process should be as consistent as possible across Modules 1 and 2.

When a Price Review Arrangement is not in operation, either the 'fixed prices' of Offers that were previously Reference Offers will apply (up until 30 June 2017), or the CPI-1.5 per cent price control will apply.

Importantly, the ACCC recognises the potential for NBN Co to face positive incentives during Module 1. Whilst limiting the review to only being able to take place in the second half of Module 1 would have given NBN Co certainty that the prices set out in the SAU would apply for a substantial period of time, 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. Having said this, if NBN Co's observed behaviour during Module 1 indicates the desired impact of these incentives, the ACCC expects that it would be unlikely to be necessary for it to commence a review process as early as 1 July 2014 or make a Price Review Arrangement as soon as 1 July 2016, or to undertake more than one review during Module 1.

²²⁷ ACCC Notice to Vary, Schedule 1G, clauses 1G.3.1 and 1G.3.7.

²²⁸ Ibid, Schedule 1G, clause 1G.3.1.

²²⁹ Ibid, Schedule 1G, clause 1G.3.7.

²³⁰ Ibid, Schedule 1G, clause 1G.3.7.

²³¹ In its July 2013 submission, NBN Co proposes an amendment to the draft Notice to Vary that a Price Review Arrangement in Module 2 must be between one and five years long. NBN Co submits that the ACCC did not explain in the Response to Submissions why a Price Review Arrangement in Module 2 should be between three and five years long, while in Module 1 the length could be as short as one year.

Further, whilst limiting the review to only being able to take place in the second half of Module 1 would have ensured that all parties have the benefit of experience and data before a review occurs, if the amount of experience with and data about NBN Co's pricing is insufficient at the time of a review, the ACCC expects that it would be unlikely to make a Price Review Arrangement.

5.3.1.2. Price Review Criteria and matters the ACCC must take into account in assessing a Price Review Arrangement

As noted, in the draft Notice to Vary, in order for the ACCC to accept or make a Price Review Arrangement, it has to be satisfied that:

- the Maximum Regulated Price of each Reviewed Offer for each Financial Year to which the Price Review Arrangement applies is reasonable, having regard to the matters specified in section 152AH of the CCA and any other matter the ACCC considers relevant; and
- there is no material difference between:
 - the present value of the difference between the expected Revenue and the 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
 - the present value of the difference between the expected Revenue and the 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.²³²

Further, in making its decision about a Price Review Arrangement, it must take into account:

- the characteristics of the Reference Offers, Non-Reference Offers and Other Charges other than the Reviewed Offers (Other Offers);
- the costs associated with Other Offers;
- the Revenue associated with Other Offers; and
- demand for Other Offers.²³³

NBN Co expressed a number of concerns in its submission about the Price Review Criteria and the matters that the ACCC must take into account in making its decision. Each of these concerns are addressed below.

Impact on medium term cash flows

NBN Co states that the matters that the ACCC must take into account in making a Price Review Arrangement that were specified in the draft Notice to Vary, as well as the requirement that the ACCC must have regard to NBN Co's legitimate businesses interests under the reasonableness criteria in section 152AH, do not recognise "the importance of medium term cash flow stability for NBN Co's ability to efficiently (and cost effectively) finance its ongoing operations". It goes on to state that, "it is foreseeable that the risk of NBN Co's medium term cash flows being significantly lowered as a result of a price re-balancing may have a

²³² ACCC Draft Notice to Vary, Schedule 1H, clause 1H.3.8(a); Schedule 2F, clause 2F.2.8(a).

²³³ Ibid, Schedule 1H, clause 1H.3.8(b); Schedule 2F, clause 2F.2.8(b).

detrimental impact on NBN Co's future debt raising" and that "this would be contrary to NBN Co's legitimate business interests and the LTIE".²³⁴

Clause 1G.3.8(a) of the draft Notice to Vary already requires that the ACCC must not accept or issue a Price Review Arrangement unless it is satisfied that it is reasonable, having regard to the matters specified in section 152AH of the CCA. This includes having regard to NBN Co's legitimate business interests and the long-term interests of end-users. The ACCC considers that it would be likely to take into account NBN Co's ability to raise debt within the context of these criteria.

The ACCC has not adopted NBN Co's proposed drafting,²³⁵ because it has concerns about the potential difficulty for it to assess the likely impact of a Price Review Arrangement on NBN Co's ability to raise funds, including debt. In particular, it could lead to a forensic assessment of NBN Co's financing practices which might not be appropriate. Further, the ACCC considers NBN Co's proposed drafting is overly prescriptive given the 27 year term that the objective would be 'locked in' for.

Nonetheless, the ACCC has made a change to the draft Notice to Vary to address NBN Co's concern. The Notice to Vary now specifies that, in making its decision on a Price Review Arrangement, the ACCC will take into account the legitimate business interests of NBN Co.²³⁶ This will allow NBN Co, at the time of the price review, to make arguments as to how a particular Price Review Arrangement would affect its ability its legitimate business interests, including its ability to raise and service funds (whether this be in the short, medium or long term) and for the ACCC to consider those arguments at that time.

The ACCC has also made some minor changes to clarify that it is the *impact* of the ACCC's decision on demand and revenues for and from other Offers that will be taken into account in making its decision, rather than just existing demand and revenues for and from those other Offers.²³⁷

Defining 'material difference'

NBN Co states the following:

- It is concerned that the term 'material difference' could be open to a wide range of possible interpretations.
- A Price Review Arrangement sets a Maximum Regulated Price or Maximum Regulated Prices that flow through to forecast net revenue via assumptions about the relationship between prices and demand for all NBN offers and charges — Maximum Regulated Prices could thus be set so as to achieve exact net revenue neutrality on a forecast basis. A concept of materiality is therefore not needed at all.
- However, such Maximum Regulated Prices may need to be specified to an unworkably large number of decimal places. It is therefore more practical to include a well-defined materiality concept that would allow some flexibility to set Maximum Regulated Prices to a "commercially relevant" number of decimal places.²³⁸

The well-defined materiality concept that NBN Co proposes is that a material difference be defined as an amount plus or minus \$1 million at the SAU commencement date, and then indexed to the CPI over time. NBN Co argues that this definition "represents an amount that ... would provide sufficient flexibility on the first occasion that a Price Review Arrangement could

²³⁴ NBN Co July 2013 Submission, p. 22.

²³⁵ Ibid. NBN Co proposes that the ACCC "must have regard to the objective of minimising the difference in NBN Co's net revenues over the five year period from when the Price Review Arrangement commences..."

²³⁶ ACCC Notice to Vary, Schedule 1G, clause 1G.3.8(d); Schedule 2E, clause 2E.2.8(d).

²³⁷ Ibid, Schedule 1G, clause 1G.3.8(d); Schedule 2E, clause 2E.2.8(d).

²³⁸ NBN Co July 2013 Submission, p. 22.

come into effect ... and provides flexibility later in the SAU term, as the number of forecast years of Net Revenue between the date of the PRA and the end of the SAU term diminish".²³⁹

The implications of NBN Co's proposal are that, in order for the ACCC to be able to accept or make a Price Review Arrangement which changes Maximum Regulated Prices, that change must have a less than \$1 million impact on NBN Co's expected net revenues over the remaining term of the SAU.

The ACCC appreciates that NBN Co wishes to have greater certainty over the extent to which a re-balancing of Maximum Regulated Prices will be able to impact upon its expected net revenues.

However, whilst NBN Co states that the \$1 million figure provides "sufficient flexibility", it has not provided information or modelling to demonstrate why this is the case.

The ACCC therefore cannot be satisfied that the proposed approach will not lead to unintended consequences in terms of unduly constraining its ability to re-balance Maximum Regulated Prices over the term of the SAU.

This uncertainty is exacerbated by the fact that the definition would be 'locked in' for the 27 year term of the SAU. Were the definition to lead to unintended consequences, it would not be open to the ACCC or other parties to seek to amend the definition.

Given the untested nature of this aspect of the Price Review Criteria, the ACCC wishes to be able to garner the benefit of experience in assessing and making Price Review Arrangements prior to locking in definitions such as those proposed by NBN Co. It will be open at the time that NBN Co lodges its first Price Review Arrangement proposal to expand upon its arguments about why only a \$1 million difference in expected net revenues is an appropriate benchmark to adopt in determining whether a Price Review Arrangement should or should not be accepted or made.

Costs to be netted off revenues in determining whether there is a material difference in net revenues

The ACCC accepts NBN Co's argument that the meaning of the term 'the expected costs that would be inputs to the ABBRR' generates ambiguity.²⁴⁰ The ambiguity is that it is not clear whether it is intended that:

- the sum of expected Capital Expenditure over the remaining term of the SAU; or
- the sum of the expected return of and return on that Capital Expenditure over the remaining term of the SAU, be included in the calculation of the difference between revenues and 'costs'.

The ACCC has not adopted NBN Co's proposed approach to addressing this ambiguity, whereby it would be the sum of expected Capital Expenditure over the remaining term of the SAU that would be taken into account. The ACCC notes that NBN Co has not provided any arguments in support of why this particular approach should be adopted.

NBN Co's proposed drafting would mean that (at the time of the review) the ACCC would subtract from total expected revenues the total sum of expected capital expenditure over the remaining term of the SAU.

²³⁹ Ibid.

²⁴⁰ Ibid, p. 23.

The ACCC would then compare the resulting 'net revenues' in the scenario where the Price Review Arrangement is in operation to those in the scenario where the Price Review Arrangement is not in operation.

If the change in Maximum Regulated Prices does not result in a change in demand which subsequently affects capital expenditure, it is in effect simply the difference between the expected revenues earned over the remaining term of the SAU under each scenario that needs to be compared.

On the other hand, it is possible that a change in Maximum Regulated Prices could generate an increase in demand which leads to an increase in capital expenditure over the remaining term of the SAU (for example, due to a need to upgrade capacity). Under NBN Co's proposed drafting, the *total value* of that additional capital expenditure would be subtracted from the revenues that are expected to be earned over the remaining term of the SAU.

In effect, there could therefore only be 'no material difference' between the net revenues earned 'with and without' the Price Review Arrangement if expected revenues increased such that they allowed NBN Co to recover the *total value* of the additional capital expenditure *during the remainder of the SAU term*.

This is despite the fact that a reasonable depreciation profile may suggest that part of the additional capital expenditure should be recovered after the expiry of the SAU.

That is, as is generally the case for any entity regulated under a Building Block Model, NBN Co should not be entitled to recover the full value of an amount of capital expenditure within the year it is incurred, or a period that is less than the life of the relevant asset to which the capital expenditure relates. Rather, the recovery of that capital expenditure should be spread over time (typically over the life of the relevant assets in question), in accordance with an established depreciation profile. Capital expenditure that is not recovered in the regulatory period remains in the RAB, to be recovered in future regulatory periods.

The implications of only being able to make a Price Review Arrangement which changes Maximum Regulated Prices in such a way that the total value of the additional capital expenditure is recovered during the remainder of the SAU term are as follows:

Firstly, it would lead to inconsistency between revenues generated by prices under a Price Review Arrangement made in this way and the amount of revenue that NBN Co is entitled to recover when the building block revenue period is in operation. Under the Price Review Arrangement, NBN Co would be able to recover all additional capital expenditure in the SAU period resulting from the rebalanced prices (in cases where the rebalanced prices result in an increase in capital expenditure). In contrast, NBN Co would only be able to recover the portion of additional capital expenditure that is depreciated during the SAU period when the building block revenue period is in operation, with any undepreciated amounts to be recoverable beyond the SAU period.

Secondly, Maximum Regulated Prices would be higher than they would have been had only the part of the capital expenditure that is depreciated before the end of the SAU been included in the 'netting off' calculations. In turn, the current relationship that is established by the CPI-1.5 per cent price control between expected revenues and expected annualised costs over the term of the SAU would change. A key reason for the ACCC proposing that any price review be 'revenue neutral' is that doing so should maintain the positive incentives created by the CPI-1.5 per cent price control for NBN Co to invest and operate efficiently. The incentives to behave efficiently with respect to investment and operations derive from the prospect that NBN Co may not be able to recover its expected annualised costs over the term of the SAU — incentives are in turn created for it 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 expected annualised costs over the term of the SAU is enhanced by virtue of an increase in Maximum Regulated Prices reflecting more than the increase in those costs, these incentives may be dulled. For these reasons, in assessing what change in Maximum Regulated Prices would satisfy the

requirement that the change does not lead to a material difference in net revenues, the ACCC considers that the resulting change in revenues allows NBN Co to recover the proportion of the additional capital expenditure that it is entitled to earn a return of and on for the remaining term of the SAU (as opposed to the *total value* of the capital expenditure). The proportion of the additional capital expenditure that NBN Co has not yet recovered at the expiry of the SAU term would remain in the RAB for future recovery.

To implement this approach, the ACCC has adopted the following drafting. In order to accept a Price Review Arrangement, the ACCC must be satisfied that there is no material difference between:

the present value of the difference between the expected Revenue and the sum of expected ABBRR for each Financial Year, between the commencement of the Price Review Arrangement and the SAU Expiry Date, if the Price Review Arrangement were in operation; and

the present value of the difference between the expected Revenue and the sum of expected ABBRR for each Financial Year, between the commencement of the Price Review Arrangement and the SAU Expiry Date, if the Price Review Arrangement were not in operation.²⁴¹

Importantly, the same assumptions must be made about asset lives, the same depreciation method must be used and the same rate of return must be applied (for the purposes of both estimating the return on capital and for establishing present values) in undertaking this comparison across the two scenarios.

Constraints in relation to Uniform National Wholesale Pricing and the legislative hierarchy in Part XIC

NBN Co submits that:

- the ACCC's decision making in regard to price review arrangements should be subject to the same conditions in regard to uniform national pricing as apply to ACCC decisions on Access Determinations and SAUs;²⁴² and
- the SAU should specify that price review arrangements have no effect to the extent of any inconsistency with the SAU.²⁴³

The ACCC accepts NBN Co's first submission and has included drafting to address this issue in the Notice to Vary.²⁴⁴

However, regarding the second submission, the ACCC considers that it could not make a decision under a power conferred by the SAU that was inconsistent with another part of the SAU regardless of whether or not NBN Co's proposed drafting is adopted (not least because to do so would lead to an internally inconsistent regulatory arrangement — this would create ambiguity and a lack of regulatory certainty). The ACCC has therefore not included NBN Co's proposed drafting in the Notice to Vary.

²⁴¹ ACCC Notice to Vary, Schedule 1G, clause 1G.3.8(a); Schedule 2E, clause 2E.2.8(a).

²⁴² NBN Co July 2013 Submission, p. 23.

²⁴³ Ibid.

²⁴⁴ ACCC Notice to Vary, Schedule 1G, clauses 1G.3.8(b) and 1G.3.8(c); Schedule 2E, clauses 2E.2.8(b) and 2E.2.8(c).

5.3.2. Changes to Maximum Regulated Prices in response to tax change events

As noted in the Response to Submissions, there are certain changes to taxes that qualify as 'tax change events' that the ACCC considers should be able to be passed through into Maximum Regulated Prices.²⁴⁵ As Maximum Regulated Prices are established by the SAU, the SAU must therefore provide for Maximum Regulated Prices to change as a result of these 'tax change events'.

The draft Notice to Vary therefore proposed a process which would allow these changes to take place. It is intended that the proposed process for changing Maximum Regulated Prices in response to tax change events would operate as follows.

Under the draft Notice to Vary, during Module 1, NBN Co and access seekers would in the first instance negotiate and agree upon the changes to Maximum Regulated Prices that occur as a result of tax change events. To give effect to this, according to clause 1G.2.2(a), NBN Co has 60 business days to identify that a tax change event has occurred and to publish a statement on its website that sets out proposed changes to Maximum Regulated Prices. If no access seeker objects to the changes to the Maximum Regulated Prices within a relatively short period of time, these changes take effect. If any access seeker objects, the changes do not take effect. NBN Co may include multiple tax change events in a single proposal and propose changes to the maximum regulated prices to reflect the collective effect of those tax change events.

However, the ACCC also recognises that, in the case of increases to Maximum Regulated Prices as a result of an increase in taxes, NBN Co may have incentives to seek to increase Maximum Regulated Prices by more than should be permitted — that is, by more than is required to recover the increased costs associated with the increase in taxes. Further, in the case where there is a decrease in taxes, NBN Co may seek to decrease Maximum Regulated Prices by less than is reflective of the decrease in costs associated with the tax reduction, or to delay or avoid any decrease in Maximum Regulated Prices at all.

Consequently, while the SAU provides for Maximum Regulated Prices to change as a result of tax change events through agreement between NBN Co and access seekers, the ACCC considers that it is necessary for the SAU to also provide for the ACCC to determine this if it cannot be agreed.

In order to address a situation where NBN Co may not have incentives to decrease Maximum Regulated Prices in response to a negative tax change event, under clause 1G.2.5 the ACCC may issue a notice to NBN Co in relation to a negative tax change event if:

- NBN Co and access seekers cannot agree on the decrease in prices and NBN Co does not apply to the ACCC in relation to the event; or
- if NBN Co does not publish a statement about a negative tax change event within the 60 business days of the tax change event occurring.

This is aimed at creating incentives for NBN Co to negotiate with access seekers in relation to negative tax change events by enlivening a power for the ACCC to determine changes to Maximum Regulated Prices if NBN Co does not do so.

If an access seeker objects to NBN Co's proposed changes to Maximum Regulated Prices (and these changes therefore do not take effect) NBN Co may apply to the ACCC to change Maximum Regulated Prices in relation to a tax change event or tax change events, and the ACCC may determine the change to Maximum Regulated Prices (which may or may not be the

²⁴⁵ ACCC Response to Submissions, p. 82.

same as that proposed by NBN Co). The ACCC may also determine the change to Maximum Regulated Prices if it has issued a negative tax change events proposal. 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 change to Maximum Regulated Prices must be reasonable, taking into account a number of matters. The ACCC considers it should have discretion to refuse to change Maximum Regulated Prices (that is, make a decision of no change) if the change in NBN Co's costs is not material, or to consider a tax change in context (for example, that there have been a number of small tax changes, or offsetting tax changes, etc.).

During Module 2, the ACCC considers that there may be a need to revisit how tax change events are treated. Consequently, the ACCC has proposed that the replacement module process is utilised to do this. That is, the specific manner in which Maximum Regulated Prices may be changed in response to a tax change event is to be determined through the replacement module process. The draft Notice to Vary therefore recognised in the price controls in Module 2 that these are subject to this aspect of a replacement module. It is intended that there is scope to address how changes in taxes are treated for the purposes of both the revenue constraints (ABBRR/ICRA) and price controls (Maximum Regulated Prices) through replacement modules, including the kinds of taxes and changes to these taxes that would constitute a tax change event during Module 2, as well as processes for changing relevant values.²⁴⁶

Only limited submissions were received to the draft Notice to Vary in relation to the proposed approach to addressing tax change events.

NBN Co submitted that:

- The timeframe within which NBN Co must publish a statement in relation to a tax change event in Module 1 should be changed from 60 business days to 12 months. This is because it may take an extended period of time to determine the effects of some tax change events.²⁴⁷
- In the definition of 'relevant tax', the word 'means' should be changed to 'includes'. This would have the effect of defining the taxes that may be passed through to customers in a non-exhaustive way. As a result, any other taxes not listed in the 'relevant tax' definition could be passed through to customers either by commercial agreement between NBN Co and access seekers, or as determined by the ACCC.²⁴⁸

The ACCC accepts that there may be circumstances in which 60 days may be too short a timeframe to consider the effects of a particular tax change event. However, the ACCC considers that addressing this problem by increasing the timeframe for notification of a change to Maximum Regulated Prices to 12 months could allow NBN Co to delay proposing changes to Maximum Regulated Prices in response to negative tax change events, whilst not doing so in response to positive tax change events. This could allow NBN Co to 'keep' the gains from Maximum Regulated Prices not reflecting a decrease in costs for a longer period of time that it 'wears' any increase in costs resulting from positive tax change events. As noted in the Response to Submissions, the ACCC considers that it is important for there to be symmetry in how positive and negative tax change events are treated, in order to maintain the positive incentive properties of the CPI-1.5 per cent price control.

To address NBN Co's concern that 60 business days may be too short a timeframe to consider the effects of a particular tax change event, in the Notice to Vary, the ACCC has included

²⁴⁶ See clause 4.6(d) of the ACCC Notice to Vary.

²⁴⁷ NBN Co July 2013 Submission, p. 24.

²⁴⁸ Ibid.

clauses which allow NBN Co to apply to the ACCC to extend the timeframe for publishing a statement, and for the ACCC to approve or reject this extension application.

The ACCC has not adopted NBN Co's suggested change to the definition of 'Relevant Tax', because the ACCC *intends* for the types of events listed in the definition to be an exhaustive list. The last two limbs of the definition of 'Relevant Tax' proposed by NBN Co in the 18 December SAU referred to changes to taxes imposed on third parties.²⁴⁹ Changes to taxes imposed on third parties do not normally constitute tax changes for regulatory purposes, and the ACCC therefore removed these two limbs from the definitions in the Notice to Vary. The ACCC does not accept NBN Co's submission that the definition of 'Relevant Tax' should be defined in a non-exhaustive way in order to allow the pass-through of such taxes to access seekers by agreement or Regulatory Determination. However, the ACCC notes that the exhaustive nature of the drafting does not prevent NBN Co and access seekers from commercially agreeing to such a pass-through in an Access Agreement, which would override the SAU to the extent of any inconsistency under the legislative hierarchy.

The ACCC has also clarified the circumstances in which the ACCC may notify NBN Co of the occurrence of a negative tax change event and proceed to make a determination on whether and how Maximum Regulated Prices may be changed in response to the negative tax change event. The drafting changes makes it clear that the ACCC may notify the tax change event if NBN Co does not issue a tax change events proposal in response to a negative tax change.²⁵⁰ The ACCC may also notify the tax change event where NBN Co has issued a tax change event proposal in relation to a negative tax change event and an access seeker has objected to the proposal, but NBN Co has not requested that the ACCC make a determination on the negative tax change event.²⁵¹

²⁴⁹ NBN Co 18 December 2012 SAU, Main Body, Attachment C, clause 1, definition of 'Relevant Tax', paragraphs (a)(iii) and (iv).

²⁵⁰ ACCC Notice to Vary, Schedule 1G, clause 1G.2.5(a).

²⁵¹ *Ibid*, Schedule 1G, clause 1G.2.5(b).

6. Long-term revenue constraint

The variations that are discussed in this section relate to the issues discussed in section 5.5 of the Draft Decision, section 2.4.2 of the Consultation Paper, section 2.4.2 of the Response to Submissions and Schedules 1D, 1E, 1F and 2C of the Notice to Vary.

The key variations that the ACCC proposed to the long-term revenue constraint methodology in the draft Notice to Vary were as follows:

- In Module 1, the RAB, ICRA and annual revenue requirements would continue to be determined on an ex-post basis by applying the methodologies set out in the SAU. However, the draft Notice to Vary proposed that the ACCC would determine these values, rather than NBN Co, including the values of capital and operating expenditure. The draft Notice to Vary also included 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 would continue to be determined based on forecasts approved by the ACCC. However, the draft Notice to Vary proposed that most of the detailed methodologies for calculating the forecasts of the individual components should be removed. The draft Notice to Vary also proposed 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 actual costs for the term of the SAU.
- The long-term revenue constraint methodology would be amended so that all cash flows would be recognised on a consistent end-of-year basis for the duration of the SAU term. This change would be implemented through the removal of the half-WACC adjustment to capital expenditure when it is rolled into the RAB, and equivalent changes to the annual construction in progress allowance.

The ACCC also sought views on whether variations were required to address issues arising in relation to 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.

The following matters were raised in submissions in response to the draft Notice to Vary:

- Access seekers generally supported the approach adopted by the ACCC in the draft Notice to Vary.
- Access seekers supported the ACCC's intention to further clarify in the SAU when the price controls binds and when the long-term revenue constraint binds.
- Optus indicated its preference for greater discretion for the ACCC in relation to the long-term revenue constraint.
- NBN Co proposed further amendments on the following matters:
 - Timing of cash flows — NBN Co has proposed that the long-term revenue constraint methodology recognise cash flows on a mid-year basis;
 - Criteria for allowing capital expenditure to be rolled into the RAB in Module 1;
 - RAB roll-forward arrangements in Module 2; and

- The basis for calculating the ICRA in Module 2.

The rest of this section sets out the ACCC's considerations of these submissions, and explains the variations adopted in the Notice to Vary:

- Section 6.1 sets out some overarching issues with the long-term revenue constraint methodology (in particular, the mechanics of the ACCC's assessment of LTRCM components and the assumptions made with respect to the timing of cash-flows).
- Section 6.2 sets out the variations to the long-term revenue constraint methodology in Module 1.
- Section 6.3 sets out the variations to the long-term revenue constraint methodology in Module 2.

6.1. Overarching issues with the long-term revenue constraint methodology

This section sets out the variations that the ACCC is proposing in relation to the overarching issues with the long-term revenue constraint methodology, in particular:

- the mechanics of ACCC assessment of LTRCM components and transitional issues;
- cash flow timing assumptions; and
- long-term revenue constraint definitions.

6.1.1. Mechanics of ACCC assessment of LTRCM components and transitional issues

In the Response to Submissions, the ACCC indicated that it had identified some practical issues regarding the mechanics of the ACCC's assessment of the LTRCM and transitional issues between Module 1 and Module 2 and between regulatory cycles in the building block revenue period in Module 2.²⁵²

Regarding the transition from Module 1 to Module 2, the ACCC noted that the opening RAB and opening ICRA balance in Module 2 would not be finalised until after the ACCC had completed its LTRCM assessment for the final year of Module 1, which would only be completed in the first year of Module 2. As the ACCC determines forecast nominal ABBRRs on an ex-ante basis in Module 2, the ACCC noted that explicit provisions that allow for the estimation of the RAB and ICRA would be required. It also indicated that it would give further consideration to how any differences between estimated and actual values for these items would be treated.

Regarding the transition between regulatory cycles in the building block revenue period in Module 2, the amount of revenue NBN Co will be able to recover over a regulatory cycle would be based on forecast nominal ABBRR (which will be determined by the ACCC before the start of the regulatory cycle through the replacement module process) and an amount carried forward from either Module 1 or the previous regulatory cycle. This amount will not be known until after the regulatory cycle begins. The ACCC indicated that it would consider whether a provision that allows for the ACCC to estimate the amount carried forward as part of the replacement module process would be required, and if so, whether any explicit mechanism is

²⁵² ACCC Response to Submissions, pp. 88-89.

required to address any deviation between the estimated and the actual values of these amounts.

In its submission to the draft Notice to Vary, NBN Co made the following points:

- The RAB and the ICRA should be treated as regulatory accounting concepts, and based on actual values (or, where relevant, ACCC determined values based on actual values), and that there is no apparent benefit from, and some risk involved in, using estimates instead of actuals in this context.
- There is already provision in the draft Notice to Vary for forecasting the RAB for the purpose of calculating the Forecast Nominal ABBRR in Module 2, and NBN Co proposes an amendment so that the relevant clause also covers forecasting the opening value of the RAB in the first Financial Year in a Regulatory Cycle.
- In regard to the ICRA, there is no calculation in the SAU that explicitly includes reference to a forecast value of the ICRA. NBN Co will be implicitly required to forecast the ICRA in regard to likely methodology change event notices, but that forecast will be based on the actual value of the ICRA up to whatever is the current point in time.
- In regard to the building block revenue period in Module 2, the SAU provides for the automatic carry forward of amounts and there is no need for estimates of any carried forward amounts to be made as part of a Replacement Module. The SAU is deliberately silent in regard to whose role it is to calculate the relevant amounts of such carry forward or what reporting will be provided to the ACCC in regard to compliance with these aspects of the LTRCM. This leaves open the possibility of (and the flexibility for) the ACCC using its RKR and other powers under the CCA to address these matters as appropriate over time.²⁵³

No other submissions commented on the mechanics and transitional issues identified in the Response to Submissions.

The ACCC has considered these matters further and proposes further amendments in the Notice to Vary in relation to the RAB and ICRA in Module 2 and the operation of the building block revenue period in Module 2. These are discussed in the following sections.

6.1.1.1. RAB and ICRA in Module 2

The ACCC has given further consideration to the need to estimate an opening RAB value at the start of Module 2 and each regulatory cycle, as well as the arguments made by NBN Co in its submission to the draft Notice to Vary.

The ACCC considers that it is necessary to estimate the RAB, to the extent that the relevant actual information or values are not known at the time of the replacement module assessment process, for the purposes of calculating the return on assets component of the forecast nominal ABBRR for each year of the regulatory cycle. A value for the opening RAB in each year of an upcoming regulatory cycle is needed for this calculation. However, as noted above, given that the forecast nominal ABBRR is determined before the start of each regulatory cycle, the actual values of capital expenditure and disposals for the final year (or years) of the current regulatory cycle — which are necessary inputs into this calculation — will not yet be known.

In the Notice to Vary, the ACCC has adopted NBN Co's proposal to expand the provisions regarding the calculation of the forecast RAB to clarify that an estimate of the RAB at the start of a regulatory cycle may be made to the extent that actual values of the inputs are

²⁵³ NBN Co July 2013 Submission, pp. 24-35.

unavailable.²⁵⁴ The ACCC has made minor drafting amendments to those provided by NBN Co in its submission to provide further clarity regarding how the estimate is to be made.

Further, the ACCC has given consideration to how any differences between estimated and actual values of the RAB should be treated once they are known. The ACCC has considered this issue because the return on assets component of the forecast nominal ABBRR in each year of a regulatory cycle would be based on a forecast value of the RAB. This forecast RAB would depend on the opening value of the RAB for the regulatory cycle which, as mentioned above, would be estimated to the extent that the required information is not available. If the estimated opening RAB for the regulatory cycle is greater than the value of the opening RAB which is rolled forward at the end of that regulatory cycle, then NBN Co would receive a greater return on assets than what would be allowed by the actual value of the RAB. Conversely, if the estimated opening RAB for the regulatory cycle is less than the value of the opening RAB which is rolled forward at the end of that regulatory cycle, then NBN Co would receive a lower return on assets than what would be allowed by the actual value of the RAB.

NBN Co has not expressed a view in its submission on how differences between estimated and actual RAB values should be treated.

The ACCC considers that a mechanism is required to account for any such differences. This is to ensure that NBN Co would earn an appropriate return on its assets, and that any effect associated with deviations between actual and estimated values would be removed. The new clause 2C.7.7(a)(ii)(B) achieves this.

Finally, the ACCC has considered the need for provisions that allow for the estimation of the ICRA. The ACCC agrees with NBN Co's argument that because the ICRA is not used in the calculation of any other elements of the long-term revenue constraint methodology, there is no need to estimate it. Further, the ACCC recognises that NBN Co will need to estimate the ICRA in anticipation of a methodology change event. Therefore, the ACCC considers that a provision for this purpose is not required.

6.1.1.2. Building Block Revenue Period in Module 2

The ACCC has given further consideration to the operation of the building block revenue period in Module 2.

Clause 2D.5 of the 18 December 2012 SAU provides for the following:

- over a regulatory cycle, NBN Co will be entitled to recover the sum of the total forecast nominal ABBRR over that regulatory cycle;
- for the purpose of determining the amount of revenue NBN Co is entitled to recover over a regulatory cycle, forecast nominal ABBRR and revenues are evaluated in present value terms and adjusted for changes in CPI;
- any relevant tax effects, including those related to tax change events will be taken into account; and
- any amount carried forward from Module 1 or the previous regulatory cycle (either as a revenue variation during the building block revenue period or as a carry forward revenue adjustment if the ICRA period ends in the final year of Module 1 or the previous regulatory cycle), is to be added or subtracted from the amount of revenue that NBN Co is entitled to recover.

²⁵⁴ ACCC Notice to Vary, Schedule 2C, clause 2C.7.7(a).

During Module 2, the forecast nominal ABBRR for each year of a regulatory cycle will be approved or determined by the ACCC before the regulatory cycle starts through the replacement module process.

However, there is no explicit role for the ACCC in relation to other parts of the process for determining the amount of revenue NBN Co is entitled to recover over a regulatory cycle. That is, the ACCC has no explicit role in approving or determining how adjustments for the time value of money and CPI are made, or the amount to be carried forward (as either a revenue variation or carry-forward revenue adjustment) from Module 1 or between regulatory cycles.

The ACCC considers that flexibility in the operation of the building block revenue period in Module 2, which is provided for by the principles in clause 2D.5 of the 18 December 2012 SAU, is appropriate. However, the ACCC is concerned that the flexibility of these provisions, and the absence of an explicit ACCC role in determining or approving amounts calculated under these provisions, could lead to disagreements between NBN Co, the ACCC and other parties in relation to the amounts of revenue to be carried forward between regulatory cycles. As amounts carried forward from previous regulatory cycles will determine the amount of revenue that NBN Co is entitled to recover over a regulatory cycle, the ACCC considers that the SAU should include an explicit role for it in approving or determining these amounts.

The ACCC notes NBN Co's comments that the SAU is deliberately silent on whose role it is to calculate the relevant amounts carried forward from previous regulatory cycles or from Module 1. Although these matters may be able to be addressed in Module 2 through the making of an Access Determination or a Binding Rule of Conduct, it is unclear how these instruments could be used to resolve disagreements about the amount carried forward between regulatory cycles, and how they would interact with the SAU. The ACCC therefore considers that an explicit mechanism should be included in the SAU to address this issue.

The ACCC has therefore included provisions in the Notice to Vary that provide for NBN Co to propose an estimate of the amount to be carried forward from either Module 1 or the previous regulatory cycle as part of a replacement module application, and for this amount to be assessed by the ACCC. The estimate of the amount carried forward would then be reflected as adjustments to the forecast nominal ABBRRs for the relevant regulatory cycle.²⁵⁵

Under this approach, both elements of the revenue that NBN Co will be entitled to recover over a regulatory cycle (forecast nominal ABBRRs and the amount carried forward) will be assessed as part of the replacement module process and will ensure that any amounts carried forward are subject to explicit ACCC review.

The ACCC considers that this approach will provide sufficient oversight of the operation of the building block revenue period in Module 2 and is more consistent with the overall structure of the SAU compared to other potential options (such as an annual tariff or revenue approval process).

6.1.2. Cash flow timing assumptions

In section 2.4.2.1 of the Response to Submissions, the ACCC stated it is not satisfied that assuming that capital expenditure is incurred in the middle of the year (on average) while assuming that operating expenditure and revenues occur at the end of the year will lead to NBN Co being compensated for only its efficient costs (including a normal commercial return). The ACCC proposed 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, and therefore that the half-WACC adjustment to capital expenditure be removed from the SAU. This is because:

²⁵⁵ Ibid, Schedule 2C, clause 2C.6.1(d); clause 4.6(b).

- whereas in the context of energy and Telstra's fixed-line services, cash flow timing assumptions can be reviewed periodically by the AER and ACCC, accepting the SAU in its current form would 'lock in' inconsistent cash flow timing assumptions for the full SAU term,²⁵⁶
- NBN Co has not provided any economic justification in support of why the inconsistency in its cash flow timing assumptions is reasonable,²⁵⁷ and
- the ACCC does not consider that there is appropriate provision to accommodate for consistent cash flow timing assumptions in Module 2, as argued by NBN Co, and in any case the ACCC considers that cash flow timing assumptions should be consistent between Module 1 and Module 2.²⁵⁸

Whilst the ACCC stated in its Response to Submissions that it would consider it reasonable to consistently assume that cash flows occur in the middle of the year on average, the ACCC proposed, because of the complexity involved in implementing this approach, that end-of-year assumptions be made.²⁵⁹

In its submission to the draft Notice to Vary, NBN Co proposes that:

- cash flows be consistently assumed to occur mid-year in Module 1, as this assumption would be more realistic than an end-of-year assumption; and
- in Module 2, cash flow timing assumptions to apply for a particular Regulatory Cycle should be addressed as part of the relevant Replacement Module Application.²⁶⁰

Further, NBN Co submits that its mid-year approach for Module 1 is consistent with an Allen Consulting Group report to the ACCC in 2002 on the subject of working capital.²⁶¹ In this report, a methodology for recognising mid-year cash flows is derived.²⁶²

NBN Co has provided drafting in its submission that gives effect to these proposals.

Optus submits that it supports the ACCC's proposed variations to the LTRCM in the draft Notice to Vary, including the removal of the half-WACC adjustment.²⁶³ No other submissions provided views on this issue.

The ACCC has considered NBN Co's submission and analysed NBN Co's proposed mid-year approach. However, the ACCC is not satisfied that NBN Co's proposed amendments represent an appropriate method for recognising mid-year cash flows, nor does it consider that it is reasonable to depart from the proposal in the draft Notice to Vary to treat cash flows in a consistent end-of-year manner. This is for the following reasons:

- Firstly, NBN Co's mid-year proposal treats operating expenditure as a capital cost by applying a half-WACC adjustment to the full value of operating expenditure in any given year, when operating expenditure should be capitalised only to the extent that it is

²⁵⁶ ACCC Response to Submissions, p. 91.

²⁵⁷ Ibid, p. 92.

²⁵⁸ Ibid.

²⁵⁹ Ibid, p. 93.

²⁶⁰ NBN Co July 2013 Submission, pp. 25-26.

²⁶¹ Ibid, p. 25.

²⁶² Allen Consulting Group, *Working Capital – Relevance for the Assessment of Reference Tariffs*, March 2002, p. 26. (Allen Consulting Group report)

²⁶³ Optus Submission, p. 13.

unrecovered (and only during the initial cost recovery period). This is already done with the initial cost recovery account.

- Secondly, the proposal does not account for the mid-year timing of capital-related revenue, and instead assumes that it is received at the end of the year. As a result of the capitalised operating expenditure building block and end-of-year assumption with regard to capital-related revenue, on an intra-year basis, NBN Co's mid-year model would generate excess returns via a greater return on cash flow timing than in the Allen Consulting Group model.
- Thirdly, the variable approach to cash flow timing in Module 2 in NBN Co's proposal raises the possibility of such outcomes as artificially inflating the amount of capitalised unrecovered cost that NBN Co is entitled to recover.

These reasons are discussed in more detail in the sections below.

Treatment of operating expenditure as capital

NBN Co's proposed amendment to the ABBRR formula applies a half-WACC adjustment to operating expenditure, thereby increasing NBN Co's revenue requirement in any given year. The ACCC considers that this is inappropriate.

In other regulatory models, such as the AER's Post Tax Revenue Model and the ACCC's Fixed Line Services Model, revenues and operating expenditure are assumed to be approximately synchronised, and as a result there is no adjustment made to operating expenditure in building block calculations. This assumption is also reflected in the mid-year approach specified in the Allen Consulting Group report cited by NBN Co in its submission.²⁶⁴ In the current context, the ACCC considers that it is reasonable to make the same assumption about the relative timing of NBN Co's operating expenditure and revenues — and this is an assumption that is reflected in the 18 December 2012 SAU. Therefore, the ACCC considers that the operating expenditure building block should not be increased by a half-WACC.

The ACCC acknowledges that during such time as NBN Co's revenues are insufficient to recover its operating expenses, this shortfall should be capitalised. NBN Co's proposed ABBRR applies a half-WACC adjustment to the full value of operating expenditure in any given year. However, the ACCC considers that operating expenditure should only be capitalised to the extent that it is unrecovered in a particular year — so as to be recovered in a later year — and in any case this is achieved through the initial cost recovery account. Therefore, the ACCC considers that an adjustment to the operating expenditure component of the revenue requirement should not be made for this purpose, in either the initial cost recovery period or the building block revenue period.

Non-recognition of mid-year timing of capital-related revenue

NBN Co's proposed amendments do not account for an approximated mid-year timing of cash inflows relating to the return on and of capital. Given that the capital-related components of NBN Co's revenues would be assumed to be received evenly throughout the year, and given that there is no mid-year adjustment made to these building blocks in NBN Co's proposed mid-year ABBRR, NBN Co would earn a return on the timing difference between when it actually receives capital-related revenue (throughout the year) and when the LTRCM assumes it receives capital-related revenue (at the end of the year).²⁶⁵ Therefore, the ACCC considers that an appropriately specified revenue requirement recognising mid-year cash flows should

²⁶⁴ Allen Consulting Group report, pp. 26-27.

²⁶⁵ In NBN Co's proposed mid-year model, over time, the mid-year adjustment effectively occurs only at the *end* of every year. As a result, there is scope for NBN Co to earn excess return (via the larger capital building blocks) *throughout* the year.

discount the return on and of capital building blocks by a half-WACC. This is also reflected in the mid-year approach specified in the Allen Consulting Group report cited by NBN Co.²⁶⁶

Potential for excess returns under NBN Co's mid-year proposal

Despite treating operating expenditure as capital and not recognising the mid-year timing of capital related revenue, NBN Co argues in its submission, as noted above, that its proposed mid-year model is consistent with the mid-year approach specified in the Allen Consulting Group report. This consistency is intended to be achieved through the adjustment of the unrecovered cost formula. However, the ACCC's analysis has indicated that this adjustment will result in excess returns accruing to NBN Co throughout the SAU term.

Throughout any given year (that is, on an intra-year basis), the revenue requirement under NBN Co's mid-year approach would be greater than the revenue requirement calculated under the Allen Consulting Group approach. This is because, firstly, operating expenditure is increased by a half-WACC, and secondly, the mid-year timing of capital-related revenue is not recognised. While the Allen model is a mid-year model on an intra-year basis (with capital-related revenue discounted by a half-WACC), NBN Co's mid-year proposal is an end-of-year model on an intra-year basis, allowing a full year's return on cash flow timing. In the years when NBN Co earns revenue in excess of the ABBRR in order to reduce the size of the ICRA, NBN Co will realise this extra return on cash flow timing in two forms: firstly, by recovering larger than efficient unrecovered costs accrued in the loss-accumulation phase, and secondly, the higher return on cash flow timing in the current year. Since these excess returns are not accounted for by NBN Co's mid-year approach, the model results in a net present value of zero. However, if the excess returns were appropriately recognised as cash inflows, it would produce a positive net present value result.

Potential consequences of different cash flow timing assumptions between modules

NBN Co's proposal for cash flow timing assumptions to be unspecified in Module 2 raises the possibility of inconsistent assumptions being made between Module 1 and Module 2. The ACCC considers that this approach may result in unintended consequences in the future. If, for example, NBN Co's mid-year approach were adopted for Module 1, this would result in a certain level of the ICRA being reached through the capitalisation of previously unrecovered cost (calculated each year in accordance with NBN Co's proposed mid-year unrecovered cost formula). If these mid-year assumptions were not maintained, and there were a switch to end-of-year cash flow timing assumptions in Module 2, then from the start of Module 2 onwards unrecovered cost would be higher in each year than it would have been if mid-year assumptions had been maintained. Subsequent capitalisation of these higher unrecovered costs would then result in a higher level of the ICRA. Put simply, switching to end-of-year assumptions in Module 2 could potentially lead to a significantly larger amount of capitalised unrecovered cost that NBN Co would be entitled to recover. Therefore, in order to avoid this possibility, as well as any other unintended consequences of switching between different cash flow timing assumptions throughout Module 2, the ACCC considers that cash flow timing assumptions should be consistent throughout the SAU term — regardless of whether a mid-year or an end-of-year approach is adopted.

The ACCC acknowledges that issues relating to cash flow timing could arise over the course of Module 2 that may need to be addressed. For example, it may come to be that at some point during the SAU term, the timing of NBN Co's revenues and operating expenditure is no longer aligned. However, due to the possibility of such outcomes as artificially inflating the level of the ICRA during Module 2, as mentioned above, the ACCC considers that there should be no changes to the fundamental assumptions of cash flow timing throughout the SAU term. Rather, the ACCC considers that cash flow timing assumptions should be maintained throughout the SAU term and that any issues arising from changes in NBN Co's actual cash flow timing can be

²⁶⁶ Allen Consulting Group report, pp. 26-27.

addressed by other means, for example by including an adjustment to the forecast revenue requirement in a replacement module application.

6.1.3. Variations to LTRCM definitions

The Notice to Vary includes variations to a number of LTRCM definitions. These variations are included both in response to NBN Co's submissions and the ACCC's further consideration of these matters. The key variations, and the reasons for including them, are as follows.

Related Body Corporate of NBN Co

In the 18 December 2012 SAU, the definitions of Operating Expenditure and Relevant Assets (as well as a number of assets and equipment) include 'related body corporate of NBN Co'. However, the definition of Revenue refers only to revenue earned by NBN Co, and the definition of Capital Expenditure does not specify whom it is incurred by. This creates some uncertainty about whether the sources of revenue in the SAU will under or over-compensate NBN Co for the sources of its expenditure.

The Notice to Vary clarifies that the definition of Revenue includes revenue received by a 'related body corporate of NBN Co', and the definition of Capital Expenditure includes capital expenditure incurred by a 'related body corporate of NBN Co'. The definitions of a number of asset and equipment related matters have also been similarly amended.

These changes to Revenue and Capital Expenditure in the Notice to Vary are proposed to provide consistency between the sources of revenue and expenditure under the SAU. This will ensure that NBN Co is not under or over-compensated in the SAU.

Capital Expenditure and Third Party Funded Network Changes

The 18 December 2012 SAU includes a number of mechanisms to address assets funded by third parties. For example, clause 1E.2.1(b) of Schedule 1E precludes NBN Co from including in the RAB any capital contributions of network assets. However, capital expenditure related to third party funded network changes is deemed prudent and may be included in the RAB. The ACCC understands that NBN Co's intention is that any funds received from a third party in relation to the network change will also be specified as revenue.

NBN Co proposes a number of changes to these provisions, and associated definitions, in its September submission, to address confusion.²⁶⁷

In response to NBN Co's submission, the Notice to Vary adopts the following variations:

- the definition of Revenue now states that this includes monies received by NBN Co from a third party in relation to a 'third party funded network change';
- the definition of Third Party Funded Network Change now states that the funding arrangement with the third party must have a zero or positive net present value;
- the definition of Capital Expenditure now states that this only includes capital expenditure incurred by NBN Co or a 'related body corporate of NBN Co' (as opposed to a capital contribution from a third party); and
- the phrase "excludes any capital contributions of network assets" has been removed from clause 1D.2.1(b) in Schedule 1D.

²⁶⁷ NBN Co September 2013 Submission – cover letter, p. 2.

These changes clarify how NBN Co intends the SAU to operate in relation to third party funded network changes, and also reduce confusion about which types of capital expenditure may be included in the RAB. These changes also ensure that NBN Co will not be under or over-compensated in the SAU.

Under the Notice to Vary, capital expenditure from third parties will operate as follows:

- If a third party incurs capital expenditure for an asset and this asset is subsequently given to NBN Co after it is constructed, this expenditure will not be included in NBN Co's RAB.
- If NBN Co (or a related body corporate) incurs capital expenditure in response to a third party request and this expenditure is fully or partially funded by a third party (for example, if a local council pays for a local extension of the NBN fibre network), this expenditure may be included in the RAB and the third party funds will be recognised as revenues under the SAU.

Operating Expenditure

The Notice to Vary amends the definition of Operating Expenditure to clarify that any amounts relating to capital gains tax will not be included in operating expenditure. As proposed by NBN Co in its submission to the Draft Decision (and adopted by the ACCC in the draft Notice to Vary), capital gains will be reflected in NBN Co's taxable profits. NBN Co will receive an allowance for capital gains tax through the net tax allowance and will therefore not need to be compensated for this through operating expenditure.

6.2. Long-term revenue constraint methodology in Module 1

Module 1 of the 18 December 2012 SAU includes methodologies for calculating the Regulatory Asset Base (RAB), initial cost recovery account and the building block components that make up annual revenue requirements.²⁶⁸ These methodologies would be applied annually by NBN Co.

The draft Notice to Vary provided the ACCC with a role calculating these values by applying the methodologies in the SAU on ex-post basis. Under this proposal, the values of the LTRCM will be published in an annual 'LTRCM Determination' by the ACCC.

This section sets out the variations the ACCC is proposing to the overall administration of the long-term revenue constraint methodology and particular variations to the capital expenditure and operating expenditure provisions, in response to submissions.

6.2.1. General comments on the long-term revenue constraint methodology in Module 1

In Optus' submission, Optus raises a number of concerns with the overall approach to the long-term revenue constraint methodology in the draft Notice to Vary. In particular:

- Optus submits that the approach adopted should ensure that the ACCC does not unnecessarily restrict its ability to adjust the RAB or other LTRCM values between periods, where such variation would promote the long-term interests of end-users. It

²⁶⁸ NBN Co 18 December 2012 SAU, Schedules 1E and 1F.

considers that this would be consistent with the ACCC's powers under Part XIC of the CCA.²⁶⁹

- Optus reiterated its views put forward in its previous submissions that the ACCC should have the ability to use both ex-post and ex-ante review powers to ensure efficient expenditure, and be able to use all information before it to assess the efficiency of capital and operating expenditure proposals.²⁷⁰
- Optus reiterates its preference for consistent powers between all ACCC regulatory determinations/undertakings in the telecommunications markets. It submits that the SAU should be varied to include provisions similar to that in the Wholesale ADSL Final Access Determination which enables the ACCC to assess the prudence of capital expenditure with regard to Telstra's fixed line network, and proposed two approaches to implement these variations. Optus argues that it would be a perverse outcome if the effect of the SAU were to provide the ACCC with less ability to review efficiency of new fixed-line monopolies than was provided over the old fixed-line monopolies.²⁷¹

The Notice to Vary retains the same overall approach for determining the values of the LTRCM in Module 1 as proposed in the draft Notice to Vary. This includes the ex-post approach to determining the values of the RAB and other LTRCM values and the ex-post approach to capital and operating expenditure and the methodologies for determining prudent capital and operating expenditure.

The reasons for adopting this approach are outlined in both the ACCC's Draft Decision on the 18 December 2012 SAU and the Response to Submissions for the draft Notice to Vary, which take into account the views put forward by Optus in previous submissions.²⁷² The ACCC has received any further information that would warrant adopting a different conceptual approach to determining the values of LTRCM.

The ACCC has however made a number of amendments to the process for calculating the LTRCM values and particular aspects of the methodologies for determining prudent capital and operating expenditure, in response to submissions. These are set out through the remainder of this section.

6.2.2. Administration of long-term revenue constraint methodology in Module 1

The draft Notice to Vary imposes a number of administrative requirements on the ACCC in assessing and issuing an LTRCM Determination. This includes requirements to consult with and inform NBN Co and interested parties, to issue a draft determination and to issue a final determination within twelve months.

6.2.2.1. Requirements for consulting on and issuing an LTRCM Determination

In NBN Co's submission:

- NBN Co considers that the timeframe for the ACCC to make an LTRCM Determination should be nine months rather than twelve months. It argues that a twelve month timeframe could result in NBN Co not receiving the ACCC's LTRCM Determination in respect of one year until the same day that it lodges its reports to the SAU in respect of the subsequent year. It considers that this is problematic given the cumulative nature of many of the calculations in the LTRCM, and the possibility that there may be some

²⁶⁹ Optus Submission, p. 15.

²⁷⁰ Ibid.

²⁷¹ Ibid, p. 19.

²⁷² ACCC Draft Decision, pp. 135-136 and pp. 141-149; ACCC Response to Submissions, pp. 93-101.

relevant guidance in an LTRCM Determination in regard to how NBN Co should report on certain matters in subsequent year.²⁷³

- NBN Co considers that, in addition to the existing requirements in the draft Notice to Vary that the ACCC must publish a draft LTRCM Determination, the mechanism should also include a requirement to consult on the draft LTRCM Determination and consider any submissions received. It argues that this will provide for appropriate consultation with interested parties on the draft LTRCM Determination.²⁷⁴

In response to NBN Co's submission, the Notice to Vary now includes a requirement that the ACCC must consult on a draft LTRCM determination and consider any submissions it receives. This will provide NBN Co and other interested parties with an opportunity to consider and provide submissions on the ACCC's proposed values for the LTRCM prior to it being finalised. The ACCC considers that this will have appropriate regard to NBN Co's legitimate business interests, as well as having regard to the interests of persons who have rights to use NBN Co's declared services.

The ACCC has retained the twelve month timeframe for making an LTRCM Determination, rather than adopt the nine months as proposed by NBN Co.

In relation to NBN Co's argument in support of nine months, the only information NBN Co is required to provide the ACCC within the twelve month timeframe are forecasts of expenditure for the following financial year on 30 June. NBN Co is not required to provide the ACCC with any calculations for its LTRCM inputs (for example, opening RAB and ICRA) for the following financial year until 31 October — that is, four months after the latest date the ACCC may issue its LTRCM Determination for the previous financial year. The ACCC considers that four months is sufficient time for NBN Co to take into account how the values determined by the ACCC in the LTRCM Determination will affect NBN Co's proposed LTRCM values for the next financial year.

6.2.2.2. Disclosure of confidential information in an LTRCM Determination

In NBN Co's submission, it expresses concern that the mechanism in the draft Notice to Vary has no explicit recognition of the need to protect NBN Co's confidential information in an LTRCM Determination. It considers that, as part of making an LTRCM Determination, the ACCC may be provided with a range of confidential information by NBN Co and this must be subject to appropriate protections.²⁷⁵

To address these concerns, NBN Co proposes that the SAU include two clauses that state that:

- in issuing an LTRCM Determination, any information contained in the determination that is confidential to NBN Co or another person must only be disclosed in accordance with the ACCC's confidentiality procedures; and
- in issuing an LTRCM Determination, the ACCC must not permit the disclosure of the confidential information of NBN Co to a third party, except pursuant to confidentiality arrangements between NBN Co and that third party.²⁷⁶

The CCA and the general law already impose obligations in relation to how the ACCC should deal with confidential information received from NBN Co or other parties. The ACCC considers that these obligations adequately address NBN Co's concerns in respect of confidential information.

²⁷³ NBN Co July 2013 Submission, p. 26.

²⁷⁴ Ibid.

²⁷⁵ Ibid.

²⁷⁶ NBN Co July 2013 Submission – SAU variation, p. 128.

That said, for the purposes of clarification, the ACCC has included in the Notice to Vary the clauses proposed by NBN Co, with one amendment. The amendment will mean that the ACCC would be permitted by the SAU to disclose confidential information to a third party when it is permitted or required by law. This is to ensure that the clause would not be at odds with circumstances that may arise under which the ACCC is required or permitted to disclose the information by law.

6.2.3. Capital expenditure

Under Module 1 of the 18 December 2012 SAU, NBN Co may include in its RAB all actual 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, a permitted variation to these rules or an endorsed network change;²⁷⁷
- satisfies the Prudent Cost Condition — capital expenditure incurred using a competitive tendering and procurement process that comply with the NBN Co Procurement Rules, or comply with a number of other means of procurement or circumstances;²⁷⁸ or
- is deemed to have been prudently incurred.²⁷⁹

As noted above in section 6.2.1, the draft Notice to Vary provided the ACCC with a role to determine whether NBN Co's capital and operating expenditures satisfy the prudence requirements set out in the SAU and to calculate the value of the capital expenditure to be included in the RAB. The draft Notice to Vary also proposed variations to the Prudent Cost Condition, the permitted variations provisions and the network change endorsement provisions.

This section sets out the variations the ACCC has adopted in the Notice to Vary (including changes and additions to the draft Notice to Vary in response to submissions) to the prudence provisions that apply to capital expenditure, including to the Prudent Cost Condition, the benchmarking of previously incurred expenditure and the network change endorsement provisions.

The process for determining prudent capital expenditure in the Notice to Vary, incorporating the changes as outlined in this section, is described in Attachment B.

6.2.3.1. Prudent cost condition

The variations to the Prudent Cost Condition as contained in the draft Notice to Vary are described in detail in the Response to Submissions.²⁸⁰

In NBN Co's submission:

- NBN Co proposes that capital expenditure incurred on 'arm's length terms' and in 'commodities market' should not be limited to factors that the ACCC will have regard to when considering the extent to which competitive process has been engaged in. It states that the intention of including the 'arm's length' transactions category is to ensure that transactions that involve arm's length parties negotiating appropriate terms and conditions are recognised as a legitimate and efficient method of procuring capital

²⁷⁷ NBN Co 18 December 2012 SAU, Schedule 1E, clause 1E.5.

²⁷⁸ Ibid, Schedule 1E, clause 1E.4.

²⁷⁹ Ibid, Schedule 1E, clause 1E.3.2.

²⁸⁰ ACCC Response to Submissions, pp. 97-100.

expenditure. Similarly, it argues that capital expenditure on goods and services purchased in commodities markets are also efficiently incurred.²⁸¹

- NBN Co proposes that the ‘exceptional circumstances’ clause should also recognise a legal or regulatory requirement imposed on NBN Co regarding a particular procurement. It submits that, if NBN Co is required to procure a good or service in accordance with such a requirement, this is a relevant factor the ACCC should take into account when assessing compliance with the Prudent Cost Condition.²⁸² NBN Co proposed SAU drafting to reflect this intent.

In Optus’ submission, it expresses concern about the reliance on compliance with Procurement Rules to assess prudence because these Rules are not yet drafted. Optus provides an example in which NBN Co may include a catch-all condition in the Rules that permits the CEO to sign-off compliance. Optus submits that the assessment of prudence be made against the powers under Part XIC of the CCA.²⁸³

As noted previously, the Notice to Vary does not propose to change the overall approach to determining the prudence of capital expenditure, including the methodologies. However, in response to the views in submissions, and further consideration of the approach to determining prudent capital expenditure, the ACCC proposes some specific variations to the Prudent Cost Condition to that contained in the draft Notice to Vary, as follows.

Competitive tendering and other means of procurement

In the draft Notice to Vary, the Prudent Cost Condition would be met if the ACCC is satisfied that NBN Co incurred capital expenditure pursuant to a contract entered into in accordance with a competitive tendering and procurement process and which includes a process for the management of the design, engineering and construction of the relevant asset through a process of 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 a process.

In considering whether it is satisfied of this condition, the ACCC would have regard to:

- whether the contract was entered into in accordance with NBN Co’s procurement process, 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’s considers relevant.

The ACCC accepts NBN Co’s argument that incurring capital expenditure in an open and competitive market, or on arm’s length terms, reflect efficient means of procuring capital expenditure. As such, in the Notice to Vary, any capital expenditure that the ACCC is satisfied

²⁸¹ NBN Co July 2013 Submission, p. 27.

²⁸² Ibid.

²⁸³ Optus Submission, p. 18.

was incurred by these means will be considered prudent and included in the RAB (subject to also satisfying the Prudent Design Condition).

As a consequence of this change, the Notice to Vary also extends the requirements that NBN Co's contracts includes a process for the management of the design, engineering and construction of the relevant asset through a process of contract variations to those contracts entered into on arm's length terms; when there is only one potential supplier; or where there are exceptional circumstances.

In relation to Optus' concern about the reliance on compliance with Procurement Rules to assess prudence, the ACCC notes that the Procurement Rules are only a factor that the ACCC must have regard to when assessing whether capital expenditure was incurred subject to a competitive tendering and procurement process. The ACCC can also have regard to any other factors it considers relevant. This means that the ACCC does not necessarily have to be satisfied that the capital expenditure is prudent simply because it was incurred in accordance with NBN Co's Procurement Rules.

The efficiency of contracts under material changes in circumstances

As previously noted, in the draft Notice to Vary, capital expenditure may be included in the RAB if the ACCC is satisfied that it has been incurred pursuant to a contract that has been procured through an efficient means of procurement (for example, competitive tendering) and complies with a prudent network design (as set out in the SAU).

In the absence of a broader ex-post efficiency test, the ACCC is satisfied that incurring capital expenditure through an efficient means of procurement will mean that the associated capital expenditure should broadly reflect efficient capital expenditure. However, the ACCC recognises that NBN Co will likely enter into long-term contracts for the design, engineering and construction of the Relevant Assets, including for the entirety of Module 1. This means that an item of capital expenditure incurred in the final year of Module 1 could be incurred pursuant to a contract entered into at the beginning of Module 1. This raises a potential question of whether a procurement process that results in efficient expenditure in year one will still lead to efficient expenditure by the end of Module 1, in particular when there are material changes to the design, engineering and construction of the Relevant Assets.

As a commercial reality, the ACCC recognises that for minor changes to the design, engineering and construction of the Relevant Assets, it may be most efficient for NBN Co to make variations to its existing contracts (and in many cases these circumstances would be recognised in the contracts themselves). In these circumstances, the associated capital expenditure is still likely to be efficient. However, for significant and material changes to the design, engineering and construction of the Relevant Assets, a question arises as to whether any capital expenditure for these changes which are incurred pursuant to a long-term contract can still be considered to represent an efficient outcome, and whether it is prudent for NBN Co to retender for its services or find another potential supplier in incurring the capital expenditure

In light of this, the Notice to Vary includes a new provision which provides that, if there is a material changes in circumstances, the ACCC must also be satisfied that NBN Co has considered whether to incur capital expenditure through making variations to its existing contracts, or whether to incur the capital expenditure through a new contract that has been procured efficiently (for example, through a new competitive tender process). If the ACCC is satisfied that NBN Co has reasonably considered these options, the corresponding capital expenditure will be included in the RAB.

To provide certainty to NBN Co as whether a material change in circumstance has occurred, the Notice to Vary defines a material change in circumstance as the following:

A material change in circumstances occurs if there is a variation, change or enhancement to the design, engineering and construction of the Relevant Assets and the estimated capital expenditure associated with the implementation of that variation,

change or enhancement of the Relevant Assets exceeds or is expected to exceed the Minor Expenditure Limit.

In the Notice to Vary, the Minor Expenditure Limit is defined as \$50 million at the SAU Commencement Date, and thereafter increased annually by CPI.

Expenditure associated with legal, policy, regulatory or administrative requirements

The 18 December 2012 SAU provides for NBN Co to recover capital expenditure associated with a Shareholder Minister, legal, policy, regulatory or administrative requirement. For example, under the Prudent Design Condition, NBN Co is permitted to make variations to the design, engineering and construction of the Relevant Assets in order to comply with a legal, policy, regulatory or administrative requirement.²⁸⁴ This means NBN Co may recover capital expenditure associated with these requirements if NBN Co also incurs the relevant capital expenditure through an efficient means of procurement (for example, competitive tendering).

However, the ACCC recognises that the draft Notice to Vary did not address circumstances where NBN Co is required to procure capital expenditure in a particular way as specified by a legal, policy, regulatory or administrative requirement (for example, requiring NBN Co to procure capital expenditure in a particular period of time or with a particular supplier). In these circumstances, it may be unclear whether the associated capital expenditure would satisfy the Prudent Cost Condition and be included in the RAB.

To address this concern in the Notice to Vary, capital expenditure that was procured in a manner required or rendered desirable by legal, policy, regulatory or administrative requirement, or a requirement of the Shareholder Ministers is something the ACCC can now have regard to when determining whether exceptional circumstances exist. This will mean that if NBN Co is required by law, policy or regulation to procure capital expenditure in a particular way which means it is not desirable or practicable to procure the expenditure through a competitive tender, for example, the expenditure may still be included in the RAB.

Internal capital expenditure

The capital expenditure provisions in the draft Notice to Vary relate primarily to the contracts that NBN Co enters into with third parties in relation to designing, engineering and constructing the Relevant Assets.

Upon further consideration, the ACCC considers that it is unclear from these provisions how the ACCC would be satisfied of the prudence of capital expenditure that is not in relation to a third party contract (or otherwise referred to as 'internal capital expenditure'). This may include expenditure incurred by NBN Co on the design of a Relevant Asset and expenditure associated with managing third party contracts for the construction of Relevant Assets.

Consequently, the Notice to Vary makes it explicit how the ACCC will assess the prudence of this expenditure. The approach adopted in the Notice to Vary is that an item of internal capital expenditure may be included in NBN Co's RAB if the ACCC is satisfied that the operating expenditure was incurred in a manner that seeks to achieve value for money and the lowest total cost of ownership. This test is consistent with the approach to internal operating expenditure in the 18 December 2012 SAU, and is discussed further in section 6.2.4 about operating expenditure.²⁸⁵

6.2.3.2. ACCC substitute value of capital expenditure

In the draft Notice to Vary, the ACCC would be able to determine a substitute amount of capital expenditure to include in the RAB, in the event that the ACCC is not satisfied that NBN Co's capital expenditure was incurred in accordance with the capital expenditure methodologies in

²⁸⁴ NBN Co 18 December 2012 SAU, Schedule 1E, clause 1E.6.2(vi).

²⁸⁵ Ibid, Schedule 1F, clause 1F.7.1(c)(i).

the SAU. This substitute amount is primarily based on prior capital expenditure that has been included in the RAB (or otherwise known as 'historical benchmarking'). The reasons for adopting this approach are set out in the Response to Submissions.²⁸⁶

In NBN Co's submission, it proposes that the 'historical benchmarking' clause should not be limited to failures to meet the Prudent Cost Condition, and should apply to the extent that the ACCC is not satisfied that capital expenditure meets either or both of the Prudent Design Condition or the Prudent Cost Condition (or the 'deemed' categories of expenditure). It argues that capital expenditure may, in some circumstances, fall outside the scope of the Network Design Rules or Permitted Variations (and have not been through the Network Change process). In these circumstances, NBN Co considers that access seekers may still obtain a benefit from the capital expenditure and accordingly the ACCC should be able to determine a level of capital expenditure that should be included in the RAB.²⁸⁷

In Optus' submission, it disagrees that prudence of capital expenditure should be assessed with reference to consistency with previous years. It argues that, depending on its implementation, this will enable NBN Co to entrench cost inefficiencies in an industry that exhibits declining capital expenditure cost trends, noting that NBN Co has committed to declining capital expenditure over time in its Corporate Plan for 2012-15. Optus submits that this could be addressed by removing references to 'consistent with capital expenditure that has been included in the RAB in respect of a prior financial year and replace with 'consistent with capital expenditure that has been included in Corporate Plan forecasts and other data provided to Parliament'.²⁸⁸

As noted by the ACCC previously, the ACCC considers that efficient investment would be enhanced if the ACCC were to determine the values that roll into the RAB in accordance with the SAU methodologies. This includes determining the values of capital expenditure that is materially consistent with or within the scope of the Network Design Rules and permitted variations. Under NBN Co's proposal in its submission, if the ACCC was not satisfied that capital expenditure was incurred in accordance with the Prudent Design Condition, NBN Co would nevertheless be given an amount of capital expenditure in the RAB as determined by the ACCC.

The ACCC does not consider that it is necessary that capital expenditure that does not satisfy the Prudent Design Condition be included in the RAB. This is because the Network Design Rules and the permitted variations provisions in the Prudent Design Condition provide NBN Co with considerable flexibility to design, engineer and construct its networks as it sees fit to implement the Government's objectives for the NBN. Furthermore, in circumstances where NBN Co wishes to vary the network design and it considers that access seekers will obtain a benefit from the capital expenditure, NBN Co will be able to seek ex-ante endorsement for these network design changes from access seekers or the ACCC (as discussed in section 6.2.3.3).

Consequently, in the Notice to Vary, the ACCC has not adopted NBN Co's proposal. However, the ACCC has amended the relevant clauses to address circumstances in which capital expenditure is associated with an asset that is partially within the scope of the Network Design Rules, a permitted variation or an endorsed network change. This will mean that NBN Co will not be prevented from recovering capital expenditure associated with this partially prudent asset.

In relation to the ACCC's ability to determine a substitute value of capital expenditure based on capital expenditure previously included in the RAB, the ACCC notes that the use of prior capital expenditure is a pragmatic solution given that the lack of appropriate benchmarks for NBN Co's capital expenditure. However, the ACCC recognises Optus' concern that relying on previous capital expenditure that has been included in the RAB may in some circumstances enable NBN

²⁸⁶ ACCC Response to Submissions, p. 100.

²⁸⁷ NBN Co July 2013 Submission, p. 27.

²⁸⁸ Optus Submission, pp. 17-18.

Co to entrench cost inefficiencies. To address this issue, the Notice to Vary allows the ACCC to have regard to the NBN Co Corporate Plan that was applicable at the time the capital expenditure was incurred when determining a substitute value of capital expenditure. This will mean that the ACCC can have regard to cost savings that were projected in the relevant Corporate Plan for the construction of particular assets. This will ensure that any substitute value does not reflect prior capital expenditure that is no longer considered to be efficient, including by NBN Co's own projections as set out in the relevant Corporate Plan.

The approach to determining whether capital expenditure will be included in the RAB in the Notice to Vary will operate as follows:

- The ACCC will first determine whether NBN Co's capital expenditure satisfies the Prudent Design Condition, the Prudent Cost Condition or was incurred in connection with a number of 'deemed prudent' categories. If the ACCC is satisfied of these matters, the capital expenditure will be included in the RAB.
- If the ACCC is not satisfied that the capital expenditure was incurred in connection with a 'deemed prudent' category, the ACCC would then consider whether the capital expenditure satisfies the Prudent Design Condition and Prudent Cost Condition.
- If the ACCC is not satisfied that the capital expenditure satisfies the Prudent Design Condition, then that capital expenditure will not be included in the RAB. In practice, this will apply to two types of capital expenditure:
 - Capital expenditure associated with an asset that as a whole does not satisfy the Prudent Design Condition (for example, a new satellite that is not contemplated by the Network Design Rules). In this circumstance, the entire amount of capital expenditure will not be included in the RAB.
 - Capital expenditure associated with an asset that partially satisfies the Prudent Design Condition (for example, a cable or piece of active equipment that included more capacity than required under the Network Design Rules). In this circumstance, the ACCC would determine the proportion of capital expenditure associated with this asset that it considered was consistent with the Network Design Rules and only include this expenditure in the RAB.
- If the ACCC is not satisfied that the capital expenditure satisfies the Prudent Cost Condition (but otherwise satisfies the Prudent Design Condition), then that capital expenditure will not be included in the RAB and the ACCC would determine a substitute amount of capital expenditure.
- The ACCC's substitute amount of capital expenditure must be consistent with capital expenditure that has been included in the RAB in respect of any prior financial year of the SAU term, having regard to:
 - the relative amounts of the Capital Expenditure incurred in those Financial Years;
 - the relative cost of relevant goods or services in those Financial Years;
 - any relevant differences in the scale and scope of the Relevant Assets in connection with which the Capital Expenditure was incurred in those Financial Years;
 - the NBN Co Corporate Plan applicable at the time the Capital Expenditure was incurred; and
 - any other matter the ACCC considers relevant.

6.2.3.3. Customer engagement process for endorsing network changes

Module 1 of the 18 December 2012 SAU contains a process for NBN Co to seek customer endorsement of proposed network changes.²⁸⁹ The process makes use of the PDF (and the associated PDF Processes) to engage and consult with customers on a proposed network change. If a network change is endorsed by customers, then the capital expenditure associated with that network change may be included in the RAB.

The draft Notice to Vary proposed to reduce the term of the customer engagement provisions to five years, rather than the full term of Module 1. As discussed in section 4.1.1, the draft Notice to Vary also proposed to reduce the term of the PDF Processes to five years.

In NBN Co's submission:

- NBN Co considers that there needs to be a workable approach to network changes after five years in the event that a replacement set of PDF Processes are not in place.²⁹⁰
- NBN Co proposes minor variation to clause 1D.6 (Product Design Condition for capital expenditure) to allow the ACCC to approve a network change if there is no active customer engagement process in place. It argues that this ensures that there is no 'gap' in the SAU which would prevent an otherwise prudent network change from being able to be adopted and any associated capital expenditure included in the RAB.²⁹¹
- NBN Co proposes that the definition of 'network change' should continue to operate for the full period of Module 1, rather than expire after five years, to support the change made to clause 1D.6.

The ACCC acknowledges that, in the absence of a process in the SAU for endorsing changes to the network design after the initial five year period, the SAU may prevent otherwise prudent capital expenditure from being included in the RAB during this period. In the Response to Submissions, the ACCC stated that this concern can be overcome with NBN Co proposing an SAU variation that includes an extension and/or revision of the current customer engagement provisions. However, the ACCC recognises that this does not ensure that there will be a set of customer engagement processes in place after five years and therefore may not provide certainty to NBN Co that it will be able to recover the capital expenditure associated with prudent network changes.

The ACCC has adopted NBN Co's proposal to allow the ACCC to approve a network change if there is not active customer engagement process in place. The ACCC has amended the drafting to ensure that any approval by the ACCC can be made via a Regulatory Determination made by the ACCC, which may include a replacement set of customer engagement processes.

The ACCC considers that these changes will address the concerns raised by NBN Co in relation to whether NBN Co may adopt a prudent network change and include the associated capital expenditure in the RAB, while also ensuring that the customer engagement provisions may be revisited after five years in light of operational experience. The ACCC considers that these changes will promote the encouragement of efficient investment by NBN Co.

The ACCC has also amended clause 1D.7.4 (d) of the Notice to Vary to clarify how the Prudent Design Condition is to be satisfied when there are changes to the Network Design Rules. The amended clause provides that if there is a change to the Network Design Rules, in the first instance the revised version of the Network Design Rules will apply to any new capital expenditure, while the previous version will apply to construction that is in progress at the time

²⁸⁹ This process also allows the ACCC to endorse a network change in the event of a dispute between NBN Co and a customer about a proposed network change.

²⁹⁰ NBN Co July 2013 Submission, p. 28.

²⁹¹ Ibid.

the Network Design Rules are changes. The revised clause also allows for NBN Co to propose an alternative approach for determining which version of the Network Design Rules is to apply to capital expenditure and for this proposal to be reviewed by the ACCC.

6.2.4. Operating expenditure

In the draft Notice to Vary, the ACCC proposed an approach to determining the prudence of operating expenditure that was largely identical to the approach proposed for capital expenditure. This approach is described in the Response to Submissions.²⁹²

In NBN Co's submission:

- NBN Co submits that the amendments it proposes to the capital expenditure provisions (for example, in relation to arm's length transactions and commodities markets and regulatory requirements imposed on NBN Co) should also be applied to the operating expenditure provisions.²⁹³
- NBN Co proposes a number of other minor amendments to the provisions.²⁹⁴

In Optus' submission:

- Optus states that, while the conditions in clause 1F.8.2 and 1F.8.3 refer to third party operating expenditure, no reference is made to the internal opex of NBN Co (for example, staff costs, building rent, etc.). Optus has previously noted that such expenditure should be able to be benchmarked across the industry (for example, staff costs) or market (for example, rent costs).²⁹⁵
- Optus recommends that the SAU be varied to state that prudence be assessed against NBN Co forecast statements and documents, such as Corporate plans and other public documents.²⁹⁶ It submits that this could be addressed by replacing references in clause 1F.8.2(c) with 'consistent with capex that has been included in Corporate Plan forecasts and other data provided to Parliament'.²⁹⁷
- Optus submits that the ACCC should be able to assess opex as not being prudent where there is sufficient evidence supporting such a conclusion, notwithstanding compliance with the yet to be written Procurement Rules.²⁹⁸

In the Notice to Vary, the provisions relating to operating expenditure mirror the provisions relating to capital expenditure, including the proposed changes to the means of procuring operating expenditure and material changes in circumstances. The reasons for making these changes are set out in section 6.2.3.1 about capital expenditure.

In relation to the internal operating expenditure of NBN Co (for example, staff costs, building rent and other overheads), the ACCC accepts that it is unclear in the draft Notice to Vary how the ACCC would be satisfied of the prudence of NBN Co's internal operating expenditure. This is because the provisions in the draft Notice to Vary deal primarily with operating expenditure that has been incurred pursuant to a contract with third parties.

²⁹² ACCC Response to Submissions, pp. 103-106.

²⁹³ NBN Co July 2013 Submission, p. 29.

²⁹⁴ Ibid; NBN Co July 2013 Submission – SAU Variation, pp. 136-139.

²⁹⁵ Optus Submission, p. 20.

²⁹⁶ Ibid.

²⁹⁷ Ibid.

²⁹⁸ Ibid.

Consequently, the Notice to Vary makes it explicit how the ACCC will assess the prudence of this expenditure. The approach adopted in the Notice to Vary is that an item of internal operating expenditure may be included in NBN Co's annual revenue requirements if the ACCC is satisfied that the operation expenditure was incurred in a manner that seeks to achieve value for money and the lowest total cost of ownership. This test is consistent with the approach to internal operating expenditure in the SAU.²⁹⁹

The process for determining prudent operating expenditure in the Notice to Vary, incorporating the changes as outlined, is described in Attachment C.

6.3. 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:

- the approach to rolling forward the RAB;
- the use of actual versus forecast revenue in the calculation of the initial cost recovery account; and
- the criteria for determining the rate of return.

6.3.1. 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.³⁰⁰ 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* capital expenditure, depreciation and asset disposals.³⁰¹

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.

²⁹⁹ NBN Co 18 December 2012 SAU, Schedule 1F, clause 1F.7.1(c)(i).

³⁰⁰ ACCC Draft Decision, p. 168.

³⁰¹ ACCC, Consultation Paper – variation of NBN Co SAU, 4 April 2013, pp. 33-34.

In response, NBN Co proposed that instead of locking in a method of rolling forward the RAB for the duration of Module 2, that the RAB should be rolled forward in accordance with 'RAB roll-forward arrangements' which would be determined before each regulatory cycle through the replacement module process. The ACCC considered that the concept of RAB roll-forward arrangements was appropriate and adopted them in the draft Notice to Vary. However, the ACCC did not adopt all aspects of the drafting proposed by NBN Co that would give effect to these arrangements. The key differences between NBN Co's proposal and the draft Notice to Vary were:

- Including additional options for how capital expenditure and regulatory depreciation will be treated in rolling-forward the RAB. These additional options would allow other methods adopted in any other regime for the economic regulation of infrastructure services to be adopted in the RAB roll-forward arrangements. These options would provide flexibility for NBN Co and the ACCC to adopt a wider range of methods for rolling forward the RAB than the specific methods proposed by NBN Co, in the event that the ACCC considered these methods to no longer be reasonable at the time of assessing a replacement module.
- The removal detailed criteria proposed by NBN Co by which the ACCC would be required to undertake its ex-post assessment of capital expenditure. Not specifying criteria in Module 2 would ensure that any criteria put in place (through the replacement module process) would be adaptable in response to changing circumstances and would encourage efficient investment across a range of possible future scenarios.
- Drafting amendments to align the structure of the RAB roll-forward provisions with other aspects of the LTRCM provisions in Module 2 and to clarify that the return on assets is to be calculated using a forecast of the rolled-forward RAB value.

6.3.1.1. Submissions to draft Notice to Vary

In response to the draft Notice to Vary, NBN Co raised the following concerns:³⁰²

- The RAB roll-forward equation in the draft Notice to Vary is expressed on a regulatory cycle basis rather than an annual basis. This creates ambiguity as to how to apply any option for the RAB roll-forward that relies on knowing in which year within a regulatory cycle capital expenditure was rolled into the RAB. For example, a method that relies on this information is calculating depreciation based on the value of capital expenditure rolled into the RAB. To address this, NBN Co proposes amendments to revert to an annual basis for the RAB roll-forward equation.
- There is not a clear sequence of options for either the method for determining the amount of capital expenditure to be included in the RAB, or the method for determining depreciation. NBN Co considers that specifying such a sequence (with a clear role for the ACCC in assessing the reasonableness of options in the order of the sequence), would provide an appropriate measure of stability and predictability for NBN Co, access seekers and their end-users in regard to future RAB roll-forward arrangements. NBN Co has proposed amendments that provide for options for the treatment of capital expenditure and depreciation in the RAB roll-forward to be assessed in order of sequence:
 - For capital expenditure, NBN Co proposes that the first option is to roll in actual capital expenditure, and this option is to be used if the ACCC is satisfied that the method is reasonable. If this is not the case, then NBN Co proposes that the second option, again to be used if the ACCC is satisfied that the method is reasonable, is to allow the amount of capital expenditure rolled-in to the RAB to be related to the forecast capital expenditure as used to calculate the Nominal Forecast ABBRR for that regulatory cycle.

³⁰² NBN Co July 2013 Submission, pp. 31-33.

- For depreciation, NBN Co proposes that the first option is real straight line depreciation, and this option is to be used if the ACCC is satisfied that the method is reasonable. In applying the depreciation method in respect of capital expenditure, the relevant amount of depreciation will be based on either the value of capital expenditure rolled-in to the RAB for that Financial Year, or the value of the forecast capital expenditure for that Financial Year as used to set the Forecast Nominal ABBRR, if the ACCC is satisfied that either method is reasonable.
- For each of capital expenditure and depreciation, NBN Co proposes that the final option, should the ACCC consider other options to not be reasonable, should be 'consistent with NBN Co achieving a reasonable likelihood of long term recovery of prudently incurred costs'. This contrasts with the alternative approach adopted in the draft Notice to Vary, which is based around methods used in other regimes. NBN Co's proposed alternative provides flexibility to both adopt and to innovate, as circumstances demand, but subject to the method being relevant to NBN Co's context.

In response to the draft Notice to Vary, Optus noted the following:³⁰³

- Optus supports the roll-in of capital expenditure that is consistent with previously approved forecasts, and where capital expenditure is greater than the approved forecast it can be reviewed by the ACCC.
- Optus does not see the need for the restriction on the ability of ACCC to assess whether the capital expenditure above the approved forecast is consistent with Part XIC of the CCA. The ability of the ACCC to exercise its powers under Part XIC should not be restricted by conditions agreed in previous regulatory cycles (which could be a period up to five years earlier).
- Optus strongly recommends that the SAU contain no additional obligations/restrictions on the ACCC above that imposed by Part XIC of the CCA. All assessments of the reasonableness of NBN Co proposals should be consistent with the CCA.

No other submissions commented on RAB roll-forward arrangements.

6.3.1.2. ACCC position on RAB roll-forward arrangements

The ACCC has given further consideration to the RAB roll-forward arrangements in light of submissions to the draft Notice to Vary. The ACCC has made further changes to the RAB roll-forward provisions in the Notice to Vary. These include some, but not all, of the variations proposed by NBN Co in its submission to the draft Notice to Vary. These issues are discussed in the following section.

Specification of the RAB roll-forward equation

The ACCC agrees with NBN Co's comments regarding the specification of the RAB roll-forward equation and that the equation should be specified on an annual rather than a cyclical basis. The ACCC has therefore adopted in the Notice to Vary the equation proposed by NBN Co in its submission to the draft Notice to Vary. The ACCC has also made a range of consequential amendments to other clauses within the RAB roll-forward provisions to accommodate this change.

Sequencing of RAB roll-forward options

³⁰³ Optus Submission, pp. 18-19.

The ACCC notes that the RAB roll-forward approach in the draft Notice to Vary provides NBN Co with certainty at the commencement of a regulatory cycle about how the RAB will be rolled forward at the end of that cycle.

The ACCC considers that NBN Co's proposed approach seeks to provide NBN Co with a greater degree of certainty now about the likely RAB roll-forward approach that will be adopted for future regulatory cycles during Module 2. Under NBN Co's proposed approach, in making its own replacement module determination, the ACCC would be constrained by the order of the options for rolling in capital expenditure and accounting for depreciation, and could not adopt an option which the ACCC may consider to be more appropriate unless the ACCC first finds that the options higher in the order are not reasonable.

The ACCC considers that the sequencing of RAB roll-forward options as proposed by NBN Co could have adverse implications regarding replacement module application process and the ACCC's replacement module determinations. In particular, the ACCC considers that NBN Co's proposed approach would:

- appear to limit the ACCC's ability to consider the interaction between capital expenditure and depreciation methods in making a replacement module determination in the event that the ACCC rejects NBN Co's replacement module application. NBN Co's proposal does not appear to contemplate that the reasonableness of the various options for capital expenditure and depreciation need to be considered together. NBN Co's proposed approach could compromise the ACCC's ability to adopt appropriate combinations of capital expenditure and depreciation methods in replacement module determinations;
- reduce clarity around how the replacement module application process would operate due to the complexity of the default sequencing. In particular, it is not clear under NBN Co's proposed approach how NBN Co is constrained by the order of options for rolling in capital expenditure and accounting for depreciation; and
- confine the ACCC to adopting the first default option for each matter even though the ACCC may consider a later option to be more appropriate.

The ACCC considers that on balance, these implications are likely to outweigh the potential benefits of providing further certainty to NBN Co regarding future RAB roll-forward arrangements. The ACCC has therefore not adopted NBN Co proposal to sequence RAB roll-forward options and has retained the general approach adopted in the draft Notice to Vary.

Further, in arriving at this position, the ACCC has reconsidered whether it is reasonable for there to be an explicit option that specifies the roll-in of all actual capital expenditure (regardless of the approved forecast) in the SAU. Such an option is not consistent with the recent rule changes to the National Electricity Rules made by the AEMC.³⁰⁴ The ACCC notes that rolling forward the RAB using all actual capital expenditure (regardless of the approved forecast) was used in energy under the National Electricity Rules. In the AEMC's review of the National Electricity Rules, the method of rolling forward the RAB using all actual capital expenditure was found to create incentives for overinvestment and be a key driver of electricity price increases.³⁰⁵ In the Notice to Vary, the ACCC has removed all actual capital expenditure as an explicit option for rolling forward the RAB from the Notice to Vary.

The ACCC has retained as an explicit option that capital expenditure up to the approved forecast will be automatically rolled in, with any capital expenditure above the forecast to be subject to ACCC review. In the event that actual capital expenditure exceeds the forecast, the forecast amount would be rolled in and the ACCC assesses the additional amount above the forecast amount. This would allow for actual capital expenditure to be rolled into the RAB if the

³⁰⁴ AEMC, Rule Determination – National Electricity Amendment (Economic Regulation of Network Service Providers) Rule 2012, 29 November 2012.

³⁰⁵ Ibid.

ACCC considered the amount above the forecast level to be prudent and efficient. The ACCC has retained this as an explicit option because it represents a method that the ACCC consider could be a reasonable option for a regulatory cycle in Module 2. Whether this option is fact reasonable for a particular regulatory cycle will be assessed at the time when a replacement module application is assessed or when the ACCC makes its own replacement module determination. This is the method now in place in the National Electricity Rules following the AEMC's review. The ACCC also notes that this approach has been endorsed by Optus.

The ACCC has adopted NBN Co's proposal that real straight line depreciation be specified in the SAU as an explicit option that may be adopted, in addition to specifying that the RAB may be rolled forward by using either forecast depreciation or depreciation on capital expenditure that is rolled into the RAB over a particular regulatory cycle.

'Fall-back' options for RAB roll-forward

The ACCC has adopted, with some further amendments, NBN Co's proposed 'fall-back' option for the treatment of capital expenditure and depreciation in the RAB. Under NBN Co's proposal, this option would require that the method for including capital expenditure into and removing depreciation from the RAB must result in reasonable likelihood of long term recovery of prudently incurred costs. The ACCC considers that NBN Co's proposed 'fall-back' would allow a range of options to be adopted for rolling forward the RAB, which is consistent with the original intention of including such an option, and is sufficiently broad to allow methods used in other regulated industries (particular those regulated by the ACCC and AER) to be adopted.

The ACCC has made two further amendments to NBN Co's proposal in the Notice to Vary. First, the drafting has been amended to refer to 'prudently and efficiently incurred costs' as opposed to 'prudently incurred costs'. The ACCC considers that this amendment is required for consistency with other aspects of the LTRCM in Module 2, which does not confine the ACCC's assessment of LTRCM to the concept of prudence. Second, the drafting has been amended to require the promotion of the long-term interests of end-users. The ACCC considers that this amendment is required to make it clear that the ACCC may consider a range of matters that are relevant to the long-term interests of end-users and at the same time give NBN Co the certainty that the roll-forward method will be consistent with NBN Co achieving reasonable likelihood of long term recovery of its prudent and efficient costs.

6.3.2. Use of actual versus forecast revenue in the calculation of the initial cost recovery account

In Schedule 2D of the 18 December 2012 SAU, it is specified that the ICRA will be rolled forward during Module 2 using forecasts of annual revenue.³⁰⁶ This differs from the method of rolling forward the ICRA during Module 1, which is done using revenues that are actually earned by NBN Co.³⁰⁷

In its Supporting Submission to the 18 December 2012 SAU, NBN Co stated that the use of forecast revenue in the ICRA roll-forward in Module 2 will strengthen the financial incentive it faces to price in such a way as to increase the likelihood of recovering its long-term costs,³⁰⁸ and it will enhance the incentive to improve the efficiency of expenditure.³⁰⁹

The ACCC has not previously proposed, in the Draft Decision or draft Notice to Vary, any amendments to the methodology for rolling forward the ICRA in Module 1 or Module 2.

³⁰⁶ NBN Co 18 December 2012 SAU, Schedule 2D, clause 2D.4.3(a).

³⁰⁷ Ibid, Schedule 1F, clause 1F.4.1(a).

³⁰⁸ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p. 113.

³⁰⁹ Ibid, p. 132.

In its submission to the draft Notice to Vary, NBN Co states that due to other changes proposed in the draft Notice to Vary, the use of forecast revenue in the ICRA roll-forward in Module 2 is no longer necessary.³¹⁰ NBN Co submits that issues may arise in the event that the ACCC chooses to intervene in regard to new product pricing or price rebalancing — such as forecasts becoming invalid³¹¹ — and that such issues would be reduced if actual revenue was used.³¹² Therefore, NBN Co proposes in its submission that the method of rolling forward the ICRA in Module 2 (that is, whether forecast or actual revenue is used) be determined during the replacement module process.³¹³ In practice, this would mean that NBN Co would propose the use of forecast or actual revenue in a replacement module application, which would then be subject to ACCC assessment.

NBN Co has provided drafting in its submission that gives effect to this proposal.

Optus submits that the calculation of the ICRA in Module 2 should be based on actual revenue rather than forecast revenue, as the use of forecast revenue would create an incentive for NBN Co to understate forecast revenue.³¹⁴ No other submissions provided views on this issue.

The ACCC considers that using forecast revenue to roll-forward the ICRA can supplement existing incentives facing NBN Co (for example, price controls) to set prices in an efficient manner, and encourage the take-up and development of new products. The ACCC acknowledges that its role in relation to new prices and price rebalancing will also create incentives to set prices efficiently.

The ACCC considers that the incentives NBN Co faces in relation to the setting of individual prices will change over time. The ACCC cannot be certain at this stage about whether the additional incentive created by the use of forecast revenue to roll-forward the ICRA in Module 2 will be necessary. Therefore, the ACCC considers that it is reasonable to determine periodically, via the replacement module process, whether forecast or actual revenue should be used to roll-forward the ICRA during Module 2. As such, the ACCC has incorporated NBN Co's proposed amendments into the Notice to Vary.

The ACCC considers that this amendment would be consistent with other aspects of the replacement module process. For example, each replacement module application must include a RAB Roll-Forward Proposal which specifies a method for the roll-in of capital expenditure into the RAB and a method for accounting for depreciation in rolling forward the RAB. They must also include an LTRCM Proposal which includes, among other things, forecast revenue requirements and forecasts of the inputs into the revenue requirement. Under NBN Co's proposed drafting, the LTRCM Proposal would also include a proposal as to whether the ICRA will be rolled forward using forecast or actual revenue.

6.3.3. Criteria for determining the rate of return

In the draft Notice to Vary, the ACCC proposed that, during Module 2, the “rate of return will be determined by estimating a nominal vanilla WACC having regard to the risks involved in making the investment”.³¹⁵ The ACCC noted that it did not consider it was 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 considered the fact that it is required, under subsection 152AB(7A) of the CCA, to have regard to “the risks involved in making the investment”. However, the ACCC noted that it was not satisfied that it is reasonable to specify that a benchmarking approach will

³¹⁰ NBN Co July 2013 Submission, p. 33.

³¹¹ NBN Co has proposed new provisions which deal with reviewing forecasts if a price rebalancing occurs (this is discussed in section 5.1.2 of this Explanatory Statement).

³¹² NBN Co July 2013 Submission, p. 33.

³¹³ Ibid.

³¹⁴ Optus Submission, p. 18.

³¹⁵ ACCC Draft Notice to Vary, Schedule 1D, clause 1D.2.1(c).

always be adopted to determine NBN Co's financing costs, because a benchmarking approach to determining NBN Co's WACC parameters may not always be best regulatory practice.³¹⁶

In its submission, NBN Co proposes that the clause that defines the rate of return to be a nominal vanilla WACC should refer to having regard to the risks in making the investment "in the Relevant Assets". NBN submits that, without these words, the relevant context for the investment is not appropriately "anchored" to NBN Co's context.³¹⁷

Parties other than NBN Co did not submit on the criteria for determining NBN Co's rate of return during Module 2.

The ACCC understands NBN Co's concerns about the criteria for determining the rate of return being quite open in the absence of the words 'in the relevant assets'. However, the ACCC is concerned that these words may suggest that the WACC could take on different values, based on the assets being invested in. The ACCC has also recognised the need for rate of return clause in Module 2 to refer to "efficient financing practices", to ensure that the rate of return only compensates NBN Co for the risk it would face if it were financing its investment efficiently.

Therefore, clause 2C.2.1(d) of the Notice to Vary states that "the rate of return will be determined by estimating a nominal vanilla WACC for Financial Year t having regard to efficient financing practices and the risks involved in providing the NBN Access Service, Ancillary Services and the Facilities Access Service".

³¹⁶ ACCC Response to Submissions, p. 118.

³¹⁷ NBN Co July 2013 Submission, p. 31.

7. Non-price terms and conditions

The variations that are discussed in this section relate to the issues discussed in chapter 6 of the Draft Decision, section 2.5 of the Consultation Paper, section 2.5 of the Response to Submissions and Schedules 1A and 1H of the Notice to Vary.

7.1. Dispute management

In the draft Notice to Vary, the ACCC proposed to retain an amended version of the dispute management provisions.³¹⁸

In its submission to the draft Notice to Vary, Telstra notes that significant progress has been made to address the potential for perceived and actual bias in decision-makers in the dispute resolution processes.³¹⁹ However, Telstra suggests further detailed variations to the dispute management provisions to:

- provide that NBN Co's role in the appointment, management and termination of decision-makers is administrative only, and to increase the role of RSPs and the ACCC; and
- include standardised terms for the appointment of resolution advisors in the SAU.³²⁰

In relation to the first proposal, the ACCC does not consider that it is necessary to implement the majority of Telstra's detailed drafting amendments, because the dispute management provisions in the draft Notice to Vary incorporate sufficient safeguards to ensure that decision-makers will be independent and free from bias. As noted in the Response to Submissions, NBN Co is required to consult with customers and access seekers in nominating decision-makers, and the ACCC has the power to approve the appointment and termination of decision-makers and approve guidelines for the resolution of disputes.³²¹

However, the ACCC has adopted Telstra's proposal to remove the provision relating to the termination of Panel Members (that is, clause 5.3 of Annexure 1 to Schedule 11 of the draft Notice to Vary).³²² Telstra notes that this can be effected in accordance with the processes under the *Commercial Arbitration Act 2010* (NSW) (CAA),³²³ and the ACCC understands that the dispute management terms in current SFAA-based Access Agreements provide that panel arbitration will be governed under the CAA.³²⁴ To reflect this approach, the ACCC has adopted Telstra's proposed amendment, and has proposed drafting amendments to clause 1H.5 of the Notice to Vary to clarify that NBN Co must provide in SFAAs that the conduct of panel arbitrations includes a procedure for challenging panel members.

The ACCC has also proposed to generally remove references to the CAA, to avoid any potential inconsistencies in the application of the dispute management provisions in the SAU and the provisions in the CAA. NBN Co and access seekers would nevertheless be able to agree to the application of the legislation that will govern arbitration processes (which could be the CAA) in their Access Agreements.

³¹⁸ ACCC Response to Submissions, pp. 124-125.

³¹⁹ Telstra Submission, p. 20.

³²⁰ Ibid.

³²¹ ACCC Response to Submissions, p. 124.

³²² Telstra Submission, p. 85.

³²³ Ibid. See, for example, sections 12 and 13 of the *Commercial Arbitration Act 2010* (NSW).

³²⁴ See, for example, NBN Co, *Wholesale Broadband Agreement*, 9 July 2013, Module G, clause G5.

In relation to the second proposal, the ACCC notes that Telstra considers that the inclusion of standard terms would avoid further consultation or decision-making about these terms during the dispute resolution process, and that Telstra has proposed detailed drafting for such terms.³²⁵ The ACCC considers that it is preferable for parties to commercially negotiate and agree to terms to the extent possible. Therefore, the ACCC has not included these detailed terms in the Notice to Vary.

The ACCC also notes that NBN Co has proposed minor timing and wording adjustments to the dispute management provisions.³²⁶ The ACCC has included these minor variations in the Notice to Vary.

7.2. POI-related matters

In the draft Notice to Vary, the ACCC proposed a number of variations to the POI-related provisions.³²⁷

In its submission to the draft Notice to Vary, NBN Co proposes that the following clauses should be deleted:

- clause 11.4.5, which provides that any ACCC regulatory determinations requiring NBN Co to provide additional information regarding the location of POIs would not be inconsistent with the SAU; and
- clause 1A.3.5, which provides that NBN Co will specify the POI for each CSA and may also utilise temporary POIs for providing interconnection to the NBN.³²⁸

In relation to clause 11.4.5 of the draft Notice to Vary, the ACCC stated in the Response to Submissions that it included this commitment in light of Telstra's submission to the Draft Decision, which proposed that NBN Co be required to provide additional information about POI migration processes and timeframes.³²⁹ The ACCC acknowledges NBN Co's argument that this clause could cause uncertainty about the intended role for regulatory determinations for other POI-related matters and in other areas of the SAU where such an explicit clarification is not made.³³⁰ Therefore, as the ACCC now considers that the inclusion of this commitment is unnecessary, the ACCC has deleted this clause from the Notice to Vary.

In relation to clause 1A.3.5 of the draft Notice to Vary, the ACCC stated in the Response to Submissions that a number of variations were required to be made to this clause to ensure that interconnection is offered at locations which promote the long-term interests of end-users.³³¹ Alternatively, the ACCC proposed that this clause be deleted, with the effect that the locations for interconnection with CSAs would be determined via commercial negotiations, or regulatory determinations where agreement cannot be reached.³³² NBN Co submits that deletion is preferable, and notes that this would ensure that there can be no future potential inconsistency between the ACCC's exercise of its existing powers under the CCA and the operation of this clause.³³³ Therefore, the ACCC is adopting its second proposed option, and has deleted this clause from the Notice to Vary.

³²⁵ Telstra Submission, p. 20.

³²⁶ NBN Co July 2013 Submission, pp. 36-37.

³²⁷ ACCC Response to Submissions, pp. 126-129.

³²⁸ NBN Co July 2013 Submission, pp. 38-39.

³²⁹ ACCC Response to Submissions, p. 127.

³³⁰ NBN Co July 2013 Submission, p. 38.

³³¹ ACCC Response to Submissions, pp. 127-129.

³³² Ibid, p. 129.

³³³ NBN Co July 2013 Submission, p. 39.

Removing these commitments would mean that NBN Co and access seekers could commercially negotiate and agree to terms and conditions for these matters, or if unable to be agreed, the ACCC would be able to address these terms through regulatory determinations.

7.3. Retail-level regulatory requirements

In its submission to the draft Notice to Vary, Telstra notes that it would welcome the inclusion of a general commitment to support retail-level regulatory requirements.³³⁴ Telstra submits that since NBN Co will indirectly set the terms and conditions of downstream supply through its SFAAs, the ability of RSPs to meet its regulatory commitments will be directly affected by the extent to which NBN Co enables this compliance.³³⁵

The ACCC has not adopted Telstra's proposal. These proposed commitments are intended to support access seekers in complying with retail-level regulatory requirements that apply in downstream markets in respect of non-price terms and conditions (in particular, service level standards such as the Customer Service Guarantee and Priority Assistance arrangements). As the ACCC has taken the approach of removing most of the non-price terms and conditions from the SAU in their entirety (including the service level commitments), the ACCC considers that it is unnecessary to include commitments to support retail-level regulatory requirements in the SAU.

The ACCC notes that it is open to NBN Co and access seekers to set the terms for this matter through commercial negotiations, or if unable to be agreed, the ACCC would be able to address these terms through regulatory determinations.

³³⁴ Telstra Submission, p. 20.

³³⁵ Ibid.

8. Fixed Principles

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.³³⁶

In the draft Notice to Vary, the ACCC proposed to vary clause 5 of the Main Body of the SAU to specify that only the following terms and conditions included in Module 2 are fixed principles terms and conditions:

- 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.³³⁷

In its submission to the draft Notice to Vary, NBN Co maintains the view that all of the terms and conditions in Modules 0 and 2 should be specified as a fixed principle, or at the least, the following terms and conditions should also be a fixed principle (in addition to the three matters identified by the ACCC):

- in Module 0 — the expiry date of the SAU (clause 3.2); the fixed principles terms and conditions (clause 5.3); and
- in Module 2 — the roll-forward of the ICRA (clause 2C.5.4); the maximum regulated prices for NBN Offers (clause 2B.2).³³⁸

NBN Co also submits that in the absence of the SAU specifying all of the terms and conditions in Modules 0 and 2 as a fixed principles term and condition, the SAU should include a series of 'acknowledgements' to provide NBN Co with certainty that the accepted terms and conditions in Modules 0 and 2 will remain unaffected by the ACCC's assessment of SAU variations during the replacement module process.³³⁹

The ACCC has not adopted the majority of NBN Co's proposals. 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,³⁴⁰ which are intended "to provide greater regulatory certainty in certain circumstances."³⁴¹ The terms and conditions that are specified as fixed principles will apply to subsequent undertakings, thereby providing certainty that those terms and conditions will continue under future access arrangements. Specifically, under Part XIC, the implication of specifying a term or condition as a fixed principles term and condition is that:

- once the SAU is accepted, if NBN Co wanted to submit a new SAU in relation to the same service or a variation to the SAU during the term of the SAU that contained the

³³⁶ CCA, s. 152CBD(4).

³³⁷ ACCC Response to Submissions, p. 136.

³³⁸ NBN Co July 2013 Submission, pp. 41-42.

³³⁹ Ibid, p. 42.

³⁴⁰ EM to the CACS Bill, p. 205.

³⁴¹ Ibid, p. 182.

same fixed principles term and condition, it must include that term or condition in the new or varied SAU; and

- the ACCC would therefore not be able to reject the new SAU or the proposed variation to the SAU “for a reason that concerns” that term or condition (unless the specified qualifying circumstances exist).³⁴²

In effect, this means that in the ACCC’s future assessment of a new SAU or a variation to the SAU, the fixed principles are not subject to the statutory criteria. Therefore, the ACCC is concerned to ensure that it is not constrained in a way that prevents it from ensuring that the SAU only contains terms and conditions which promote the long-term interests of end-users and are reasonable over the term of the SAU.

As noted in the Response to Submissions, acceptance of 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.³⁴³ The ACCC considers that this can deliver NBN Co’s desire for certainty over its ability to recover its costs over the term of the SAU, because the terms and conditions in Modules 0 and 2 will be in place for the SAU term. Therefore, the ACCC maintains the view that it is not necessary to make all of the terms and conditions in Modules 0 and 2 a fixed principle to deliver this certainty.

For the reasons set out in the Response to Submissions, the ACCC is of the view that in the current context, the only matters in the SAU that should be specified as a fixed principle are those:

- relating to long-term cost recovery in Module 2 and the content of replacement modules,³⁴⁴ and
- where there is limited scope for multiple interpretations such that the term or condition could be implemented or operationalised in a future SAU variation in a manner which does not meet the statutory criteria.³⁴⁵

NBN Co submits that the additional matters that it has identified meet the conditions specified by the ACCC, that is, they are linked to long-term cost recovery and will not have the future operational and implementation issues discussed in the Response to Submissions.³⁴⁶ The ACCC does not propose to specify the provisions relating to the expiry date of the SAU, the fixed principles terms and conditions and the maximum regulated price for NBN Offers as fixed principles, because doing so will not provide greater regulatory certainty about NBN Co’s future access arrangements in the context of the modular structure and length of the SAU term. Further, specifying these additional matters as fixed principles could lead to uncertainty as to the ACCC’s ability to ensure that those terms and conditions will promote the long-term interests of end-users and will be reasonable over the term in which they are proposed to be fixed principles. For instance, in the context of assessing a proposed variation to the SAU, if the variation proposes to change the existing terms in Modules 0 and 2 in such a way that, by virtue of the interaction between the terms in Modules 0 and 2 and the fixed principles, the fixed principles would no longer satisfy the statutory criteria after the variation, the ACCC may not be able to reject the variation. This is because such a rejection could be “for a reason that concerns” the fixed principle. As a result, the ACCC would not be able to ensure that these proposed fixed principles will always promote the long-term interests of end-users and be reasonable in light of NBN Co’s future variations to the SAU.

Following further consideration, the ACCC is of the view that the provision in Module 2 specifying how the ICRA is to be rolled-forward may be specified as a fixed principle, subject to

³⁴² CCA, ss. 152CBAA(5) and 152CBAA(6).

³⁴³ ACCC Response to Submissions, p. 136.

³⁴⁴ Ibid, p. 135.

³⁴⁵ Ibid, p. 136.

³⁴⁶ NBN Co July 2013 Submission, pp. 41-42.

minor drafting amendments. The ICRA roll-forward is a key part of the long-term cost recovery provisions in the SAU, and plays a similar role to the RAB roll-forward equation (which is proposed to be specified as a fixed principle) in that both represent amounts of revenue that NBN Co is yet to recover. Further, the ACCC considers that the ICRA roll-forward equation will still be reasonable in the context of a future assessment of a new SAU or proposed variation to the SAU. Therefore, the ACCC has amended the relevant clause in the Notice to Vary (clause 2C.5.4) and adopted it as a fixed principle. Specifically, the ACCC has split this clause into two parts, so that the term 'Unrecovered Cost' is not included in the fixed principle. This is because the detailed methodology for rolling forward the ICRA, including the calculation of 'Unrecovered Cost', involves judgement and discretion which creates scope for multiple interpretations. Only the first part of the clause, which specifies that the ICRA for a financial year will be rolled forward from the ICRA for the previous financial year, without specifying how the revenue shortfall for each financial year is determined, is a fixed principle.

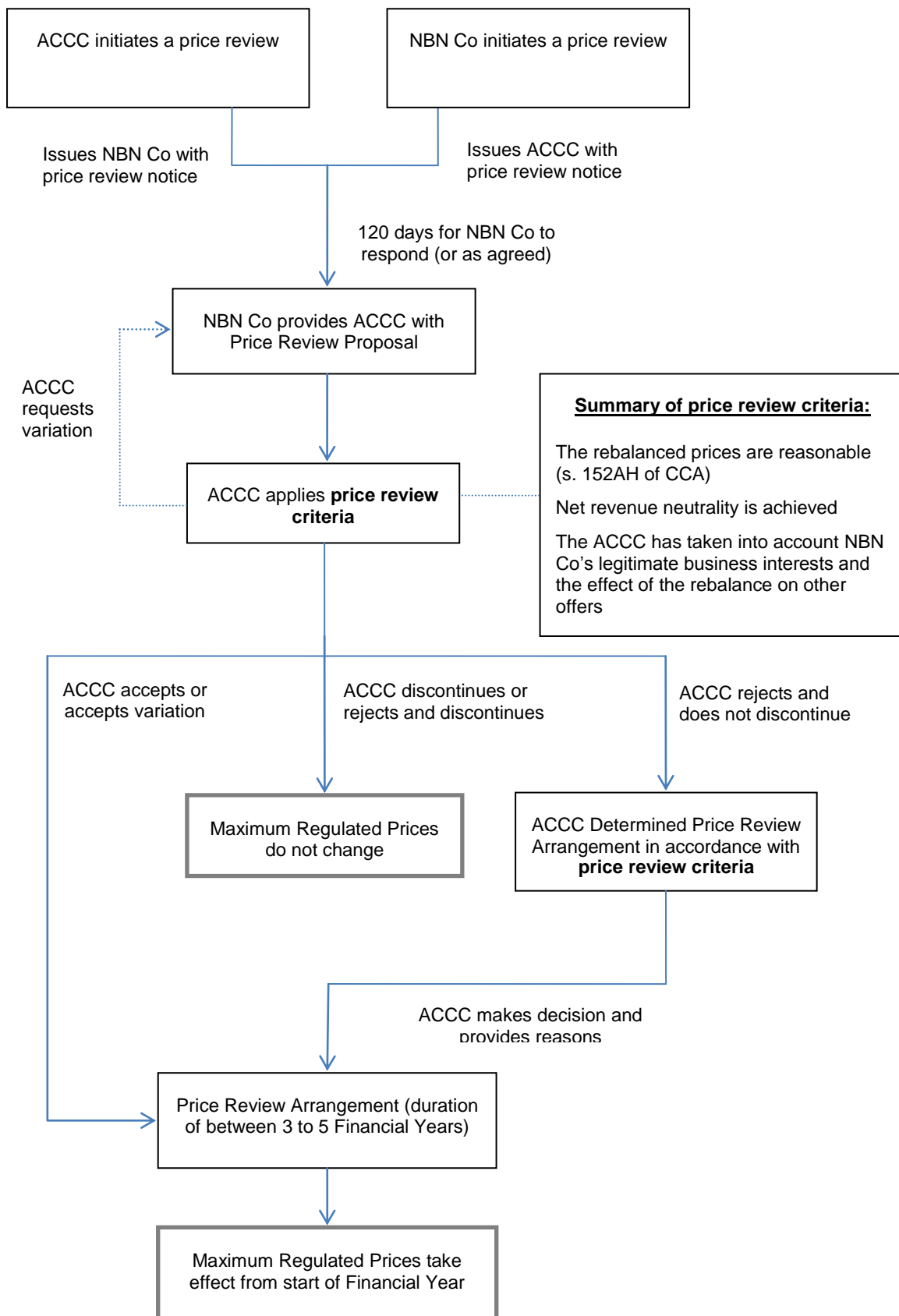
In relation to NBN Co's proposed drafting to set out 'acknowledgements' about the ACCC's role in assessing SAU variations during the replacement module process, the ACCC considers that this would add an additional layer of interpretation in its future decision-making. The ACCC reiterates its view, also recognised by NBN Co,³⁴⁷ that it is only able to assess (and make a decision to accept or reject) the variation proposed by NBN Co, and not the existing terms and conditions in Modules 0 and 2 that have been accepted by the ACCC in its initial assessment of the undertaking. That is, whilst the ACCC could decide that an SAU variation does not meet the statutory criteria by virtue of its interaction with a term or condition in Module 0 or 2 (and therefore that the variation should be rejected), the ACCC is unable to reject or amend the terms or conditions in Modules 0 or 2 that have been accepted at the outset, which will be in place for the term of the SAU. Therefore, the ACCC does not consider that it is necessary to adopt NBN Co's suggested drafting amendments.

Therefore, in the Notice to Vary, the ACCC has specified the following terms and conditions in Module 2 as a fixed principle term and condition:

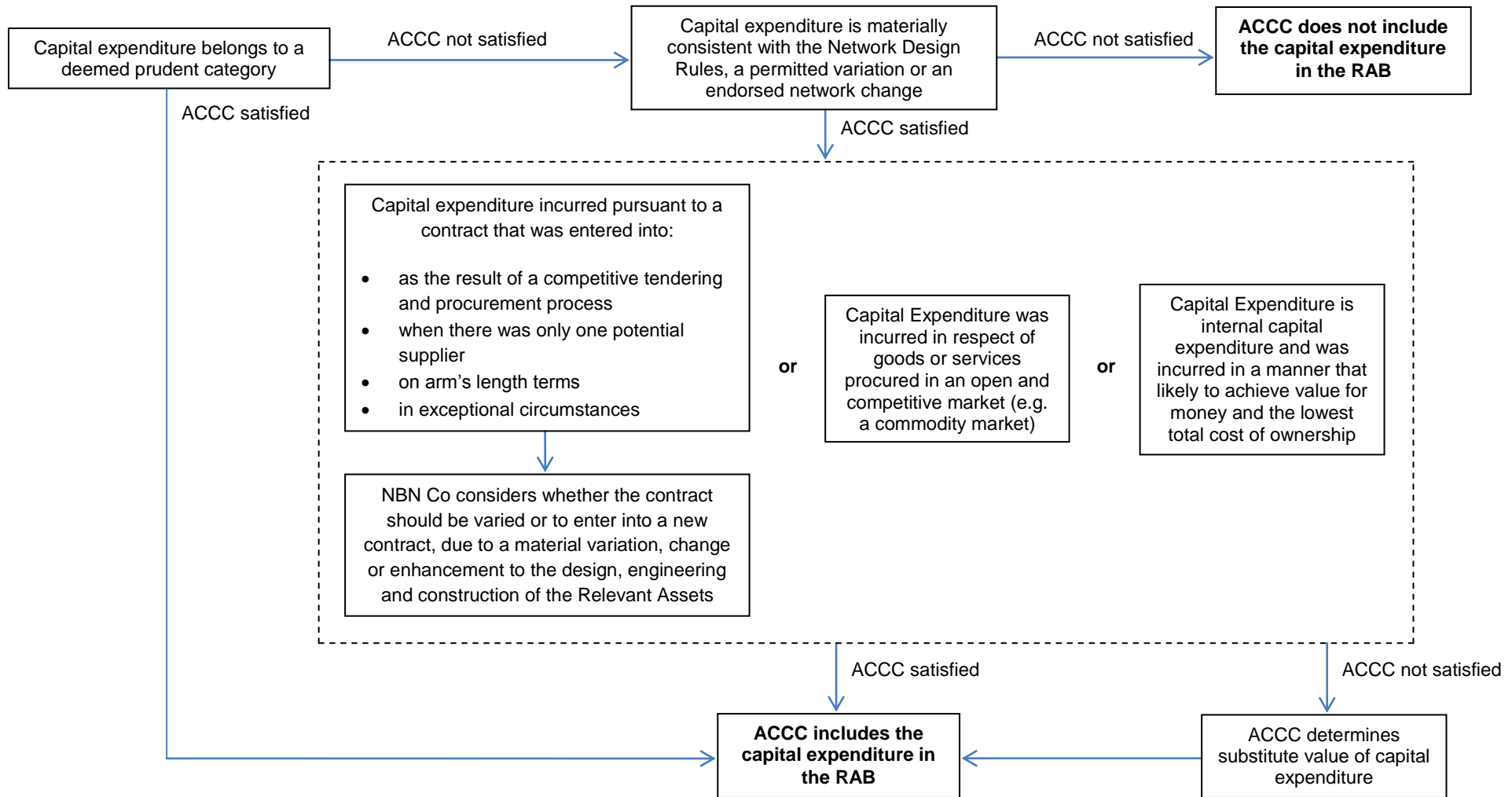
- the Regulatory Asset Base roll-forward equation;
- the Initial Cost Recovery Account roll-forward equation;
- the fact that the annual revenue requirements will be calculated using the following building block components — a return on capital, depreciation, operating expenditure and tax allowance; and
- the deemed prudent expenditure categories relating to the Telstra and Optus arrangements.

³⁴⁷ Ibid, p. 42.

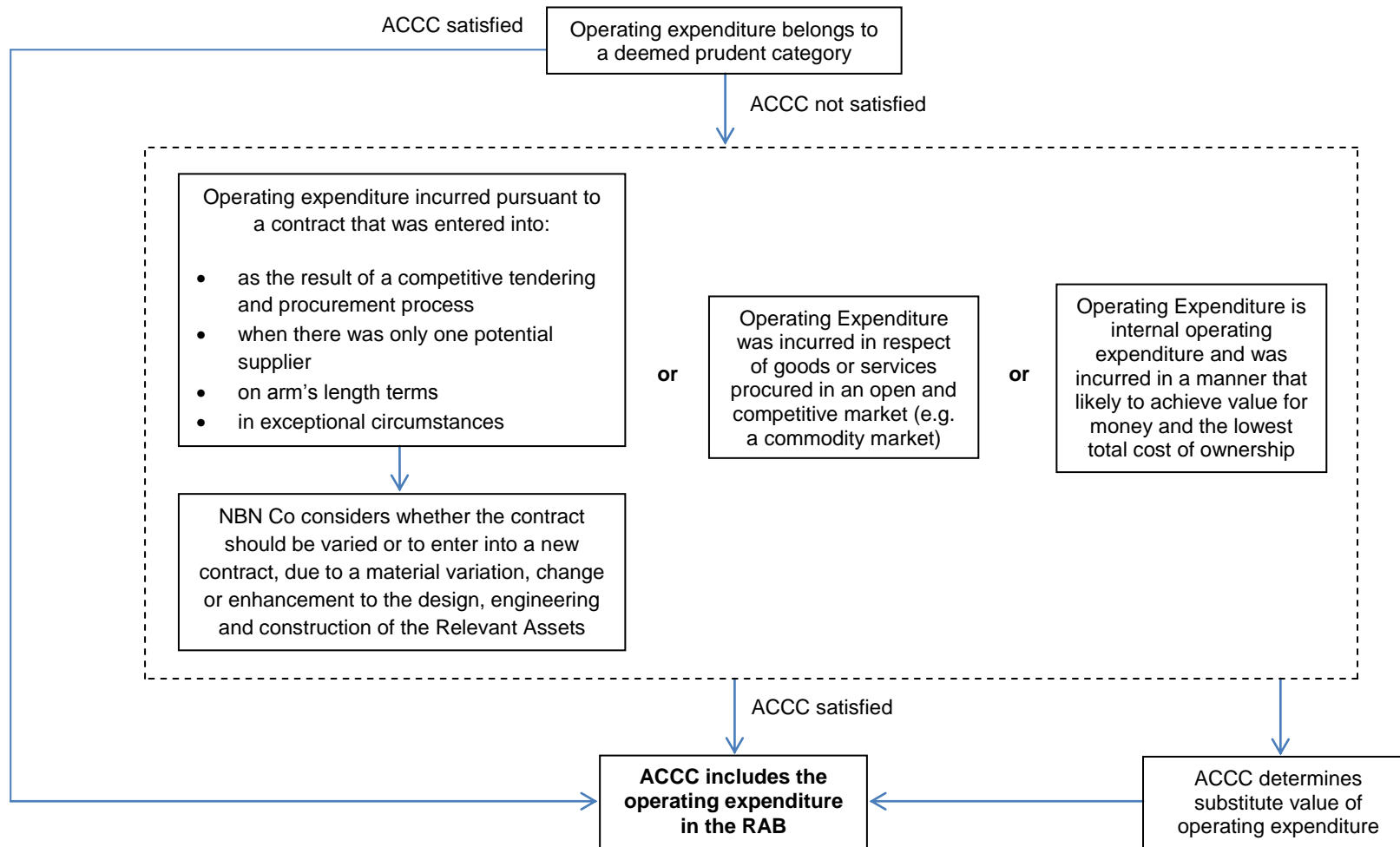
Attachment A: Price re-balancing process



Attachment B: ACCC assessment of capital expenditure in Module 1



Attachment C: ACCC assessment of operating expenditure in Module 1



Attachment D: NBN Co proposed minor variations

In Attachment A of the Response to Submissions, the ACCC listed a set of minor variations suggested by NBN Co in its May submission to the Draft Decision, on which the ACCC was seeking views on whether to adopt in the Notice to Vary.³⁴⁸ The ACCC has included these minor variations in the Notice to Vary.

In its July and September submissions, NBN Co proposed a set of further minor variations and drafting refinements “to provide increased clarity as to the intended operation of the SAU”,³⁴⁹ and “to ensure that the clauses operate as intended, and as effectively as possible.”³⁵⁰ The ACCC has adopted most of these variations in the Notice to Vary (the more material variations are discussed in the relevant sections of this Explanatory Statement), including those relating to:

- refinements to various definitions in the Dictionary (section 1 of Attachment C to the Main Body), including for WBA alignment;³⁵¹
- changes to terminology in Schedule 1A (Implementation of NBN Access Service, Ancillary Services and the Facilities Access Service) and Schedule 2A (Implementation) for WBA alignment;³⁵²
- refinements to Schedule 1C (NBN Offers and Other Charges) to more explicitly define the NBN Offers and for WBA alignment;³⁵³
- refinements to the type of information NBN Co is required to provide the ACCC per annum in Schedule 1F (Regulatory Information), in particular in relation to the risk free rate and the nominal rate of return, accounting and tax asset lifetimes, capital expenditure in an Expenditure Compliance Report and the first financial year;³⁵⁴
- refinements to the Expenditure Compliance Report in Schedule 1F (Regulatory Information), so that NBN Co’s Chief Executive Officer is required to provide their opinion of whether capital and operating expenditure has been prudently incurred, rather than to certify that it has been prudently incurred;³⁵⁵ and
- refinements to the definition of ‘Third Party Funded Network Changes’ and ‘capital contributions’, as described in section 6.3.1.³⁵⁶

³⁴⁸ ACCC Response to Submissions, p. 137.

³⁴⁹ NBN Co July 2013 Submission, p. 34.

³⁵⁰ NBN Co September 2013 Submission – cover letter, p. 1.

³⁵¹ NBN Co July 2013 Submission, p. 1; NBN Co September 2013 Submission – cover letter, p. 3.

³⁵² NBN Co July 2013 Submission, p. 1.

³⁵³ Ibid, pp. 34-55; NBN Co September 2013 Submission – cover letter, p. 1.

³⁵⁴ NBN Co July 2013 Submission, p. 40.

³⁵⁵ NBN Co September 2013 Submission – cover letter, p. 2.

³⁵⁶ Ibid.

³⁵⁷ NBN Co July 2013 Submission, p. 40.

³⁵⁸ Ibid.

³⁵⁹ NBN Co September 2013 Submission – cover letter, p. 2.

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