www.accan.org.au
info@accan.org.au
02 9288 4000

Submission

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Proposed variation to the NBN Co Special Access Undertaking

Submission by the Australian Communications Consumer Action Network (ACCAN) to the Australian Competition and Consumer Commission

About ACCAN

The Australian Communications Consumer Action Network (ACCAN) is the peak body that represents all consumers on communications issues including telecommunications, broadband and emerging new services. ACCAN provides a strong unified voice to industry and government as consumers work towards communications services that are trusted, inclusive and available for all.

Consumers need ACCAN to promote better consumer protection outcomes ensuring speedy responses to complaints and issues. ACCAN aims to empower consumers so that they are well informed and can make good choices about products and services. As a peak body, ACCAN will represent the views of its broad and diverse membership base to policy makers, government and industry to get better outcomes for all communications consumers.

Contact

PO Box A1158
Sydney South NSW 1235
Email: info@accan.org.au
Phone: (02) 9288 4000
Fax: (02) 9288 4019
Contact us through the National Relay Service

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Executive Summary

In this response, ACCAN outlines the three key requirements which any variation to NBN's Special Access Undertaking must address:

Steady and affordable prices to allow all consumers to access and utilise the network

There is a need for a guarantee within NBN's proposed framework to allow for consumers to access and use the network at an affordable price over the duration of the SAU. Whilst we support repositioning 25/5 Mbps as the entry-level service, certainty is needed around the price of this service and assurances that the entry level service will remain a viable option for those that need it are required. Prices need to be set so consumers have a genuine choice of service speed over the long term. In addition, there must be a long term commitment to specifically assist low income households in gaining access to the network.

NBN services must be able to meet appropriate minimum performance and service standards

Consumers expect that the NBN will work all the time, with quick connections and fast rectifications when issues occur. There needs to be a quality of service framework which ensures consumers receive appropriate minimum levels of performance and service from the network. This framework should be supported by robust transparency requirements so that the network is held accountable.

NBN faces a revenue constraint which is fit for purpose

There must be greater recognition of the significant wider social and economic benefits that NBN has delivered. Increasing use of high speed internet has positive externalities on the wider economy which need to be accounted for. As such, the framework should acknowledge the public service obligations NBN faces. Furthermore, NBN's revenue constraint needs to provide certainty that the prices of NBN's services are linked to the efficient cost of providing them. This would ensure that the SAU promotes the long term interest of end users through encouraging the economically efficient use of the NBN.

Introduction

NBN's Special Access Undertaking (SAU) sets out the rules by which NBN provides wholesale access to retail service providers (RSPs). The details within the SAU can have an impact on the price and quality of voice and broadband services delivered over the NBN. The SAU will expire in 2040, so the implications of any change will be felt by consumers over the long term.

Since NBN's Special Access Undertaking (SAU) was originally accepted in 2013, there have been significant changes within the sector as well as to consumer behaviour and expectations. Some key developments include the introduction of the Multi-Technology Mix, the increased retailing of unlimited data plans, and the heightened consumer dependence on high speed internet access, making broadband an essential service. The essentiality of broadband services has meant that consumer expectations have changed significantly since the original SAU. Therefore, it is apt that the SAU is varied to modernise NBN's regulatory framework to better meet consumer expectations. The lifespan of the SAU requires this modernisation to also account for the future needs of consumers.

ACCAN's response focuses on price, service quality and revenue constraint aspects of the SAU. Whilst there are some elements of the SAU variation which will benefit consumers, based on our consideration of these three key areas, the long term implications for consumers in NBN's approach, and the SAU variation as a whole, ACCAN recommends the ACCC reject the SAU variation in its current form due to the following concerns:

- A lack of price certainty for the entry-level service over the lifetime of the SAU.
- Prices for different service speeds which converge over the duration of the SAU, limiting consumer choice.
- A lack of a long term commitment to establishing a service targeted at helping low income households use the network.
- A lack of a service quality framework to protect against poor reliability, including appropriate timeframes for faults and repairs, new connections and appointment keeping as well as a sufficient utilisation management commitment.
- Insufficient transparency requirements regarding network quality issues.
- The lack of acknowledgment of the significant economic and social benefits that the NBN has delivered.
- Uncertainty regarding the Initial Cost Recovery Account at the end of the SAU, as well as the extent to which the 'unders and overs' account will protect future users from price rises.
- The appropriateness of mechanisms which could increase NBN's allowed revenue such as the financeability test, Expenditure Objectives, Expenditure Factors and cost-pass through applications.
- The need for more oversight of cost allocation between competitive and non-competitive services.

In forming our response to the ACCC's consultation paper, we have had regard to the questions posed in the paper.

Price controls

ACCAN supports some of NBN's pricing proposals, namely removing the variable charge (CVC) on the higher speed tiers, repositioning 25 Mbps as the entry-level service, switching to utilisation-based billing where the CVC charge is retained,[1] and reducing the cost of the voice-only product. We consider that these developments will have a significant benefit to consumers. Below ACCAN examines the pricing proposals in regard to their construct, levels and controls as well as the treatment of discounts and how low income consumers can be assisted in gaining access to the network.

Price constructs

High speed services (100 Mbps+): ACCAN supports removing the variable charge on higher speed tiers as this will benefit consumers through improving price certainty for retailers, meaning retailers no longer need to account for the risk caused by unexpected price shocks. Indeed, to the extent that retailers are currently overprovisioning CVC in order to avoid price shocks, this comes at a cost to end-users. Removing CVC on higher speed tiers will also remove the disconnect that currently exists between the wholesale product and the retail product, by aligning the wholesale product closer to the product that end-users are purchasing and will continue to expect, that is, high speed unlimited data plans. ACCAN hopes that aligning the wholesale product closer to the retail product will take unnecessary cost out of the system, reducing overall consumer prices.

50 Mbps service: ACCAN has previously questioned the logic behind retaining the variable charge on the 50 Mbps service.[2] Given it appears that the majority of 50 Mbps services currently advertised are sold with unlimited data, we do not consider there is a need to retain the variable charge on this service in order to allow retailers to continue offering limited data allowances. As this service is currently the most popular service, it is important that the price construct is fit for purpose and is not solely designed to encourage consumers to purchase higher speed tiers where they might not require them. ACCAN understands that this service is widely used by small businesses, adding to the importance of ensuring that the price of this service remains reasonable. If the cost of this service became prohibitively expensive for small businesses, this would hamper their ability to operate online.

Entry level service (25 Mbps): NBN has proposed retaining the CVC charge for the 25 Mbps service in order for retailers to offer limited data allowances at a cheaper price to consumers who do not require unlimited services. Whilst we support giving consumers who do not require large amounts of data opportunity to access the network at a lower price, this proposal comes at the expense of creating price certainty for the entry-level product. Where the 25 Mbps service is sold as an unlimited data plan, the wholesale cost, and therefore retail price, will increase with growth in data demand. A sudden unexpected shift in total data demand, such as that experienced during the COVID-19 pandemic,[3] could result in the end-users of these services experiencing price increases due to retailers

[1] Where retailers are only charged for the capacity which is used.

[2] ACCAN, 2021, *Submission to RMID1064 – nbn Special Access Undertaking Variation 2021 – Discussion Paper* https://accan.org.au/files/Submissions/2021/ACCAN%20submission%20to%20NBN%20PDF%20SAU%20discussion%20paper.pdf

[3] Such as the 35%+ increase in traffic experienced during COVID-19 lockdowns in 2020 and 2021. NBN Co, 2022, *nbn Special Access Undertaking Variation 2022 – Supporting Submission Public Version.*

having to purchase more CVC. Alternatively, to contain costs, retailers may not purchase enough CVC to keep track of demand, and consumers may experience congestion.

ACCAN's position is that the SAU should allow for retail variation to allow retailers to offer both limited and unlimited data plans, whilst at the same time creating price certainty. Therefore, ACCAN considers this could be achieved through selling the 25 Mbps service via both pricing constructs, that is, an AVC only price for retailers (and end-users) who value price certainty and unlimited data plans, and an AVC + CVC bundle to allow for the retail of cheaper, data capped plans. This will ensure that those on legacy, data-capped plans are able to keep purchasing the service if that is what they require. Alternatively, if the CVC charge were to be removed entirely from this speed tier, it should be done in such a way that it does not result in price increases for those consumers who are currently purchasing limited data plans.

On principles of equity, the entry-level service needs to be priced at a level which means that the majority of households are able to purchase the service that allows them to reasonably engage with the digital economy. ACCAN has long advocated for the 25 Mbps service to be regarded as the entry-level service, to align with Statutory Infrastructure Provider (SIP) obligations.[4] Given the lifetime of the SAU, there will come a time when the 25 Mbps service no longer meets the minimum needs of consumers, and the SAU should allow for review and repositioning of the entry-level service as time goes on to ensure it remains responsive to the needs of end-users.

Price levels

ACCAN supports NBN's proposal to make the voice-only service substantially cheaper over the lifetime of the SAU. Whilst demand for fixed voice services has significantly fallen, this service remains essential to households who live in regional and remote areas, in bushfire prone areas, in areas with no or limited mobile coverage and for older people or people with life threatening medical conditions. Therefore, it is of the utmost importance that consumers in these circumstances have the choice of a fixed voice service at an affordable price point. We consider that NBN's latest proposal regarding voice-only services will achieve this.

ACCAN is concerned that NBN's SAU variation will see lower speed tiers becoming significantly less affordable over the duration of the SAU, and is therefore concerned that the proposals are not in the long-term interest of end-users. While NBN has proposed to reduce the bundled price for the 25 Mbps to $26 per month, which will allow consumers to get on the network at a lower access price, the retention of an $8 CVC charge will mean that eventually the effective charge for this service will increase to the point of converging with the 100 Mbps over the duration of the SAU.

NBN have also proposed to increase the bundled price for the 50 Mbps service by $5 per month. Similarly the retention of CVC charges on 50 Mbps services means that as growth in data demand increases, the cost of this service also increases to a point where it will cost the same to purchase a 100 Mbps service. The price convergence of these services will not benefit consumers, as this reduces choice, forcing users onto higher speeds. This is particularly inequitable where consumers are forced

[4] The services supplied by SIPs should enable retailers to provide broadband service speeds that achieve a peak of at least 25 Mbps for downloads and 5 Mbps for uploads. https://www.acma.gov.au/sip-obligations

to purchase slower speeds due to their connection being unable to support higher speed tiers, such as certain end-users on FTTN/C access technologies. In this instance, the price of the services would not incentivise NBN to improve the line condition.

Assessing the ACCC's model of NBN's SAU projected access costs, the overall price for the lower speed services is largely dependent on CVC utilisation at the beginning of the SAU, and the growth in utilisation over time. We have serious concerns about the extent to which it is possible to accurately predict these inputs, as the greater the uncertainty around CVC utilisation, the greater the price uncertainty. As mentioned above, ACCAN considers that there are equitable grounds for securing price certainty for the entry-level service at a minimum, given access and use of the network should be available at a predictable price.

Prohibitively expensive wholesale costs will have the effect of pushing more people off the network in favour of more affordable, but less suitable alternatives. Boosting take up of the NBN via appropriately priced services should be prioritised as this will work to improve dynamic efficiency in the economy through new and innovative goods and services brought about through the use of high speed broadband.

Low income consumers

ACCAN frequently hears from our members and directly from consumers who are currently unable to afford access to the network.

A nationally representative survey carried out by ACCAN in April 2022 of nearly 1000 respondents found that 27% of people considered their phone and internet costs to be unaffordable. The percentage of people who found their phone and internet costs unaffordable increased with lower levels of gross household income.[5] In another recent survey carried out by ACCAN, out of 924 respondents, 14% went without other essentials such as food or medicine to pay a phone and internet bill or debt.[6] While internet costs are only one component of the overall costs of telecommunications to consumers, feedback from ACCAN members and consumers on low incomes alike indicates that the cost of the NBN, an essential service provided by a monopoly government-owned provider, contributes to the financial hardships some households face.

NBN has proposed to meet to discuss affordability once a year for the first two years of the SAU. In addition to the lack of cost certainty for the entry-level service, we do not consider that this commitment goes nearly far enough to address the issue of affordability. ACCAN recommends that:

1. There be a broad obligation within the SAU variation for NBN to introduce targeted services which improve the affordability of its services for low income consumers.
2. The services NBN introduces should be approved by a low income committee, made up of consumer representatives and representatives of organisations working directly with low

[5] ACCAN, 2022, Forthcoming, *Omnibus research*.
[6] ACCAN and PIAC, 2022, Forthcoming, *Paying to pay.*

income households, similar to Telstra's legacy obligations.[7] The low income committee should regularly review the appropriateness of the offer and approve the service.

While we believe that the targeted service should be a 50 Mbps unlimited package that allows for a retail price of $30 per month,[8] the requirements for low income households may change in the future. Additionally, it would be beneficial if the NBN enabled a service which can be retailed on a prepaid basis to assist with households' budgets. As such, we see merit in not embedding one specific low income service in the revised SAU, but instead propose including the obligation of having a committee review and approve measures which work towards improving the affordability of broadband, to allow for flexibility.

We recognise that the provision of a low income service comes at a cost to NBN, and for that reason our position calls for there to be a co-contribution from Federal Government in order to achieve the policy objective of home broadband for all.

Price controls

NBN has proposed that for the higher speed services, it is allowed to increase prices at a rate of CPI + 3% for the first two years of the SAU, followed by the higher of CPI or 3% in the subsequent regulatory periods. It is unclear to ACCAN what justification there is for a 3% increase above the CPI, and indeed the extent to which CPI reflects NBN's costs is also questionable. Consumers who are purchasing the same service year-on-year will be frustrated with a real price rise that is not associated to any improvements in speed or quality.

Whilst NBN has proposed that the monthly price of access for lower speed tiers grows with the rate of inflation, and the price of CVC remain constant in real terms over the period of the SAU, the variable component of CVC reduces the price certainty and weakens price controls for these services. These proposals are a significant step backwards from the current SAU which requires prices to change by CPI – 1.5% each year on a 'use it or lose it' basis. At a minimum, the price controls for all speeds should be retained from the current SAU to incentivise NBN to achieve efficiency savings. NBN should aim to recover costs by increasing take up of services and moving consumers who value higher speed tiers, onto higher speeds, rather than increasing prices.

Treatment of discounts

To reduce the uncertainty brought about by significant discounting, NBN has proposed a new discounting rule to prevent material gaps between the Maximum Regulated Prices (those listed in the SAU) and the prices NBN charges. Under the rule, NBN must reduce the Maximum Regulated Prices when the total value of discounts to its residential services exceeds 5% of total residential revenues in a financial year. Where the limit is exceeded, NBN will 'ratchet down' the maximum regulated prices

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[7] Telecommunications (Carrier Licence Conditions – Telstra Corporation Limited) Declaration 2019 – Section 13 Low-income measures

[8] See ACCAN, No Australian Left Offline proposal– developed in consultation and endorsed by organisations who work with low income households. https://accan.org.au/accans-work/no-australian-left-offline

to reduce the difference. NBN will determine which Maximum Regulated Prices will decrease following the threshold limit being reached.

Whilst it is important that the Maximum Regulated prices and the prices NBN charges retailers are not significantly different as this creates price certainty, ACCAN questions what impact this discounting rule will have on NBN's incentives to offer discounts in the future, which are also important and valued by consumers. We would want to avoid a situation where NBN would only be willing to offer a discount so long as it does not exceed the 5% threshold. Furthermore, not only might the discounting rule change NBN's incentives to offer discounts, but it might not have the intended effect of creating price certainty as there is no guarantee that the service which received the discount would be adjusted, as it is up to NBN which prices they 'ratchet down'. Ideally, the Maximum Regulated Prices should be set at an efficient reasonable level so that large scale discounting is not needed, to avoid the situation which has arisen under the current SAU.

ACCAN's concerns regarding the affordability of broadband for low income households are shared amongst other organisations. This section on price has been endorsed by:

Australian Digital Inclusion Alliance

TasCOSS

Infoxchange

ACTCOSS

Australian Seniors Computer Clubs Association

Service quality and other regulatory matters

General regulatory structure and replacement module assessment process

Replacement module process

Any changes to the replacement module process should be consistent with the Competition and Consumer Act. Additionally, the ACCC should be given sufficient time to allow for proper consultation and consideration. These are non-negotiable issues which ensure the ACCC can carry out its functions appropriately.

Maximum term of commercial agreement

NBN is proposing to change the maximum duration of standard form of access agreements to broadly align with the length of the replacement modules. ACCAN is opposed to the proposal which could potentially lock in terms of commercial agreements for a maximum of 5 years. The Wholesale Broadband Agreement (WBA) negotiation process ensures that the terms and conditions for which NBN provides its services are regularly reviewed and updated. It is important to consumers that the terms and conditions of access are regularly updated to keep in line with consumer expectations which can change in a period shorter than 5 years. As the NBN moves out of the build phase and focuses on operations, we would assume that the negotiation process would become more streamlined. Therefore, we recommend retaining the current length of the commercial agreements at 2 years.

Service quality

There is consensus today that NBN's services are essential. Because of this, consumers need the utmost reliability of service. Service quality issues are one of the key problems consumers raise with ACCAN. Furthermore, poor reliability is a key concern for many small businesses where dropouts and outages can have significant negative consequences on a small business' ability to operate. Currently there is no regulatory requirement for the NBN to provide an appropriate independently determined level of service standard and performance. ACCAN considers that consumers would benefit from a comprehensive service quality framework being established within the SAU. Whilst we would also hope to see the Minister create Statutory Infrastructure Provider (SIP) Standards to cover all networks, there is opportunity for the SAU to provide NBN-specific appropriate service standards. Indeed, the proposed SIP Standards do not preclude NBN from offering higher quality service standards within the SAU.

Service quality measures determined via the Wholesale Broadband Agreement (WBA) have to date fallen short of consumer expectations. The WBA involves retailers engaging in commercial negotiation with a monopoly provider, however individually, they possess little bargaining power in this context. The extent to which retailers advocate in the best interests of consumers is also questionable, and consumers have no direct input into the WBA. This current approach contributes to issues of reliability that have been a long-standing problem for consumers, as shown by the proportion of complaints received by the TIO that relate to reliability issues.[9] Therefore we are opposed to NBN's proposals that service standards continue to be set solely by commercial negotiation. Consumers would benefit from a comprehensive service quality framework being established within the SAU.

We recognise the importance and need for there to be a defined link between price and quality, yet the proposal by NBN to create this link via a cost pass-through application for improvements to its service standards is not reasonable, as there is no alternative mechanism for instances where the service standards have decreased. ACCAN considers that a safety net of wholesale obligations to deliver minimum standards regarding timeframes for faults and repairs, new connections and appointment keeping is needed and should be set out within the SAU. This includes setting appropriate definitions for faults, modernising mass service disruptions definitions and establishing requirements for timeframes which should allow for retailers to match and meet their requirements under the Customer Service Guarantee.[10]

Utilisation management commitment

The proposed transition to AVC-only pricing means there will no longer be a link between usage payments and network capacity provisioning. Therefore NBN has proposed a utilisation management commitment to ensure that shared network resources will continue to be provisioned with sufficient capacity to support the bandwidth needs of end-users. The proposed utilisation management commitment requires NBN to take corrective measures where utilisation of its shared network resource in the transit backhaul network exceeds 95% for 15 minutes or more on 3 separate days in a 30 day period, subject to certain exceptions. Where the threshold is met, NBN must within 15 business days take measures to return the shared network resource to below the utilisation threshold.

ACCAN is concerned that allowing for 3 days prior to the utilisation threshold being passed would create dissatisfaction amongst consumers. Furthermore, we note that the utilisation threshold as defined in the WBA 4 is lower, at 70%, and we question why it is proposed at 95% in the SAU variation. We question whether this will allow retailers to deliver on their market speed claims and thus consumers to receive the speeds they are expecting. Furthermore, 15 business days allows for too long a period for NBN to undertake corrective measures. We urge the ACCC to examine this threshold carefully, as embedding an inappropriate service standard into the SAU would not be in the interests of consumers.

Retailer regulatory requirements

As the ACCC's consultation paper highlights, there is no commitment under the SAU variation to improve service quality to enable retailers to efficiently meet their regulatory requirements. Should the ACMA require retailers to adhere to certain service level commitments, it is unclear how a retailer

[9] In 2020-21, 16.7% of complaints made to the TIO about internet services were in relation to no phone or internet service, 16.5% for intermittent service or dropouts, 13.6% for slow data speed and 6.6% for missed appointments - https://www.tio.com.au/sites/default/files/2021-09/TIO_AR_Accessible_LR.pdf

[10] Noting that the Customer Service Guarantee only covers voice services, hence the need to establish similar protections regarding broadband services.

would meet these requirements should the service quality determination be above that which is set out in the WBAs. Whilst the recent WBA allows for the relevant access terms to be modified where necessary to comply with law or legally binding regulation, the regulatory events clause may be removed from future WBAs. To allow retailers to meet their regulatory requirements over the duration of the SAU, ACCAN considers that there would be benefit in including a similar regulatory events clause in the SAU.

Service description

It is important that the SAU covers all of NBN's services in operation. As such, ACCAN supports changes to include MTM technologies into the SAU. However, the extent to which incorporating the MTM technologies into the SAU is in the LTIE will depend on the service descriptions, as well as the extent to which the SAU promotes the LTIE more generally. It is important that the definitions and service descriptions are sufficiently clear so that NBN's obligations are well defined and understood.

Generally the network boundary points defined in the SAU variation are reasonable. For "Non-Multi Dwelling units" such as a single dwelling premise, the FTTC boundary point puts NBN's equipment (the network connection device) outside of NBN's network boundary. It is feasible that there will be cabling between a power socket and the network connection device within an end-user's premises. Whilst the cabling would be the responsibility of the end-user, NBN should still retain the responsibility for the network connection device. ACCAN expects that the SAU should clearly define this responsibility, yet it is unclear if this is the case, given the network boundary points defined in the variation.

Service level reporting

Currently there is limited transparency in relation to network reliability. Therefore, a transparency regime of network reliability reporting needs to be established. NBN has proposed to report on network capability to achieve certain speeds, network congestion, outages, service faults and performance incidents, recurring faults, right first-time installations and network availability. Some of the reporting will be done directly to retailers, whilst in other cases it will be to the ACCC. It is unclear to ACCAN to what extent this information will be made public.

Whilst this is a step in the right direction, we consider that it would benefit consumers if performance reporting provided greater detail and was timelier than proposed by NBN. It is ACCAN's preference that performance reporting be made public, that it be provided on a monthly basis, and is geographic specific, as national averages can conceal localised poor performance. This will ensure timely accountability and visibility over the quality of services NBN is delivering.

A record keeping rule prescribed by the ACCC would satisfy ACCAN's concerns regarding the transparency of network reliability, with the added benefit of being more flexible, in that the ACCC could change the rules if needed. Indeed, we would support a reporting framework prescribed through a record keeping rule, that addresses the concerns mentioned above.

Revenue constraint

The purpose of NBN's revenue constraint is to allow NBN the opportunity to recover the prudent and efficient cost of supplying the service, this includes an appropriate return on its investment. The revenue constraint is built up of 'building blocks' which include operating expenditure, capital expenditure, depreciation of capital and tax. Costs which feed into NBN's revenue constraint must be prudently and efficiently incurred, as ultimately consumers will have to pay for them.

Widespread high speed internet adoption has positive externalities for the wider economy, such as cost savings in governments' service delivery, growth in service industries, new and innovative applications and services, e-commerce, reduction of excess inventories and optimisation of supply chains. Additionally, through increasing social inclusion, the internet can reduce societal costs. Network externalities - where the benefit to each individual using the network increases with the number of other users on the network - also exist in broadband markets. ACCAN urges the ACCC to consider how these benefits can be acknowledged and reflected in NBN's regulatory framework. At a minimum, there needs to be quantification of the extent to which the Government benefits from the NBN through lowering the cost of government service delivery, which could offset the Government's return on investment as an equity owner.

Building block model – general approach

ACCAN is concerned about the impact of the current lack of revenue constraint due to the size of the Initial Cost Recovery Account (ICRA). The ICRA is made up of the gap between nbn's actual revenue and the revenue it is allowed to earn. These accumulated, unrecovered costs incurred in the NBN build are significant and are unlikely to be recovered over the lifetime of the SAU, resulting in no meaningful revenue constraint as NBN can exceed its revenue requirement so long as the ICRA is positive. This also results in no contemporaneous link between revenue requirement and prices and increases the risk that future end-users could be disproportionality burdened by NBN's ability to increase prices. The current framework does not necessarily mean that efficient costs, and thus allowed revenues, are linked to prices.

NBN Co's proposed additional fixed principles

NBN has proposed to include four new fixed principle terms and conditions within the building block model. A key aspect of one of NBN's fixed principles is the establishment of a binding revenue cap, which includes a nominal annual drawdown of ICRA. NBN has proposed that the Real Core Services ICRA will be apportioned over a 27 year timeframe, which is currently longer than the SAU expiry date. Whilst ACCAN supports lengthening the timeframe in which NBN can recover the ICRA, as this will mean that annual revenue is more tightly constrained, it is not clear to ACCAN why a 27 year timeframe has been chosen, noting that a longer timeframe would mean that revenue is further constrained. It is also not clear what will happen to the remaining ICRA after the lifetime of the SAU.

The financeability test

The financial sustainability of the NBN is essential to its ability to continue providing services for consumers. NBN has proposed to introduce a financeability test where a number of financial indicators would be calculated using NBN's revenue requirement and other benchmark values for debt and interest expense. The financial indicators are then used to calculate an overall credit rating, if the rating is less than the benchmark credit rating (Baa2), then the revenue requirement would be adjusted upwards to ensure the benchmark credit rating is met. An upward adjustment to the revenue requirement would allow NBN to charge consumers more for its services. Whilst the financeability test is useful in determining the internal consistency of a determination by the ACCC, ACCAN shares the concern raised by the ACCC that the test could result in an automatic upward adjustment to revenue.

ACCAN considers that NBN's financeability test should operate similarly to the NSW IPART's financeability test. This involves IPART liaising with the regulated entity to confirm the validity of the data, and then identifying the source of a financeability concern, such as setting the revenue allowance too low, the business taking imprudent or inefficient decisions, or the timings of cash flows. This is achieved through conducting the test on the benchmark business as well as the actual business. IPART then determines the appropriate remedy based on the source identified, noting that this process still relies upon a degree of regulatory judgment.[11] Indeed, IPART's test only considers a pricing adjustment where there is a temporary cash flow problem, and if the adjustment is considered appropriate, it is limited in its application. Thus, ACCAN is opposed to the financeability test operating in the way proposed by NBN, as the test should be used to trigger a review of the determination before it is made, to ensure that there are no errors and check that debt funding and rate of return on equity are at appropriate levels, rather than triggering a guaranteed upward adjustment of the revenue requirement.

Recovery of accumulated losses

The proposal for NBN to forgo growing the ICRA by the regulated cost of capital growth as well as the introduction of the annual ICRA drawdown provides greater certainty about the recovery of accumulated losses compared to the current SAU. However, ACCAN is concerned that this is negated somewhat by the 'unders-overs account'. This mechanism works to carry forward 50% of the revenue shortfall or the over-recovery of revenue compared to the regulated revenue requirement into the following regulatory cycle, shifting part of the revenue risk to retailers and ultimately consumers. The Weighted Average Cost of Capital will also be applied to the unders-overs accounts when carried forward.

To the extent that NBN will not reach its revenue cap for some time, the accumulated losses within the unders-overs balance would introduce price uncertainty similar to the current ICRA, albeit this will be less severe given the size of the losses will be reduced each regulatory cycle. As such, we are not confident that NBN's SAU variation, including the unders and overs account, paired with the pricing proposal, would protect against the possibility of unexpected price rises, increasing the risk of disproportionately burdening future end-users with recouping past losses.

Cost allocation

NBN has proposed to establish separate cost bases for 'core' and 'non-core' services using cost allocation. Competitive services (initially made up of enterprise ethernet, business satellite and satellite mobility services) would be categorised as non-core services with all other services categorised as core. Following this, a separate cost base for core and non-core services will be determined in accordance with the cost allocation framework. Categorisation would occur before the

[11] IPART, 2018, *Final Report – Review of our financeability test.* https://www.ipart.nsw.gov.au/sites/default/files/documents/final-report-review-of-our-financeability-test-november-2018.pdf

start of each regulatory cycle (every 3-5 years) through the replacement module process. Cost allocation is an important aspect in the regulatory framework to prevent NBN from cross subsidising from the non-competitive (residential) services to the competitive services, which would be at the detriment to residential consumers.

ACCAN's view is that the cost allocation principles do not necessarily provide the basis for effective separation of the competitive services from the regulated services as they do not detail what a core regulated/competitive service is, rather they detail how to separate the costs between them. While the separation of competitive services from regulated services seems appropriate, ACCAN considers more guidance within the SAU is needed regarding how new services will be defined in the future. ACCAN considers that ACCC oversight in this area is vital and therefore we recommend that the SAU variation include principles by which services are to be defined core or non-core, an annual review of the categorisation of services and cost allocation, and for the ACCC to have the power to approve and review the cost allocation manual. This will work towards ensuring that the appropriate separation of services and the cost allocation between them occurs over the lifetime of the SAU.

Cost drivers

NBN has proposed that shared capital costs between competitive services and core regulated services are allocated via cost drivers which include premises passed, premises connected and provisioned bandwidth. Additionally, NBN has proposed that operational costs are to be allocated between core regulated services and competitive services proportionally based on the shares of revenue, and then operational costs are allocated to core regulated services based on the number of connected premises.

ACCAN considers revenue is not the most appropriate cost allocator for the operational costs of core and competitive services. NBN's Cost Allocation Manual states that revenue is considered the most accurate allocator available because it best reflects the higher average value of competitive services. Given NBN is a monopoly with the ability to cross-subsidise between its competitive and non-competitive segments, we cannot be confident that pricing (and therefore revenue) which is reflective of willingness to pay reflects the cost of providing different services. We encourage the ACCC to consider whether there is a more appropriate cost allocator regarding operational costs.

Expenditure criteria

Scrutiny of NBN's future operating and capital expenditure is needed to ensure that NBN's revenue requirement, and therefore prices, are reflective of NBN's efficient costs. Indeed, ACCAN supports the ACCC's opportunity to review NBN's forecast expenditures as well as NBN's actual capital expenditure before it feeds into the Regulatory Asset Base, ultimately impacting prices consumers pay. However, NBN has proposed constraints to this review, requiring the ACCC to have regard to the Expenditure Objectives and Expenditure Factors, discussed below.

Expenditure Objectives

NBN has proposed that its forecast operating expenditure and capital expenditure needs to reasonably reflect the expenditure that a prudent and efficient operator in NBN's position, acting in accordance with good industry practice, would incur in achieving a set of objectives referred to as the 'Expenditure Objectives'. The Expenditure Objectives include meeting or managing expected demand, satisfying applicable regulatory requirements, implementing projects directed by the Commonwealth government, maintaining the quality, reliability, safety, security and integrity of services and maintaining a national network offering ubiquitous access to all Australians.

ACCAN's view is that as the Expenditure Objectives appear to be quite broad, it is unclear to what extent and how the ACCC is supposed to take the objectives into account when assessing expenditure. Given the ACCC must have regard to the Expenditure Objectives in determining whether to accept or reject a replacement module application, it is vital that they are appropriately defined otherwise they may constrain the ACCC's ability to scrutinise the efficiency of certain expenditures.

Expenditure Factors

For determining whether forecast expenditure reflects that of a prudent and efficient operator in meeting the Expenditure Objectives, there would need to be regard to 'Expenditure Factors' which include items such as historical trends, robustness of models used, and the promotion in competition in telecommunications markets, along with a number of other factors.

ACCAN is concerned that the expenditure factors will require NBN to provide the ACCC with a significant amount of information to provide evidence that forecast expenditure is reflective of expenditure that a prudent and efficient operator in NBN's position would incur, having both regard to the Expenditure Objectives and the Expenditure Factors. This process could be unnecessarily burdensome for both the ACCC and NBN. Furthermore ACCAN questions the appropriateness of some of the factors and their open-ended-ness. Given how extensive the Expenditure Factors are, ACCAN urges the ACCC to consider to what extent they will constrain the assessment process.

Cost pass-through applications

NBN proposed to introduce an ability for the revenue cap to be re-opened (and Maximum Regulated Prices adjusted) during a Regulatory Cycle in circumstances where NBN incurs a material change in costs as the result of a particular unexpected event, or as the result of a service standard improvement agreed with RSPs. NBN has proposed to introduce a cost pass-through arrangement when NBN incurs or expects to incur costs due to tax changes, regulatory changes, force majeure events or service standard improvements included in commercial negotiations. Regulatory changes can include any legal, regulatory or administrative obligations or requirements, any policy or direction to NBN issued or maintained by any government agency, or a Government Policy Project Notice. The ACCC will have oversight of whether the costs passed through are reasonable, to ensure they are only efficiently and prudently incurred, however they must have regard to the Expenditure Factors mentioned above.

Whilst the 'unders-overs' account works to limit NBN's risk between regulatory cycles, the cost-pass through application works to reduce NBN's risk within regulatory cycles. The impact of this is that it can undermine the certainty which the revenue cap and Maximum Regulated Prices are supposed to create. It is for this reason that ACCAN considers only unforeseen events, such as force majeure events and tax changes are appropriate reasons for triggering a cost pass-through. ACCAN considers that policy direction from Government and service standard improvements are not entirely unforeseen events and therefore do not need to be included.

In regard to the cost pass through for service standard improvements, NBN proposed that it would be required to provide the ACCC with details of previous service standards and identify the nature of the change. ACCAN does not consider this appropriate as NBN can recover costs incurred through changes to service standard improvements, unlike those caused by force majeure events. Indeed, changes to service standards are better reflected in a service-level framework discussed above. As previously mentioned, NBN has not proposed to decrease costs should the service quality decrease. Lastly, it is ACCAN's understanding that NBN has proposed to align the commercial negotiations with the Regulatory Cycle, so under that proposal there would not be a need to pass through costs from service level improvements mid-regulatory cycle.

Government directed projects

NBN has proposed limitations on the ACCC's assessment of expenditure forecasts for the purpose of its replacement module determinations, reviews of previous capital expenditure and assessment of cost pass-throughs. These limitations will apply when the ACCC examines the prudency of expenditure on Government-directed projects and related cost pass-throughs. NBN's expenditure on these projects is to be deemed prudent, that is the expenditure reflects a reasonable choice amongst alternatives available at the time NBN made the decision.

ACCAN considers that all NBN costs, regardless of whether they are a result of a government directive, should undergo an appropriate assessment before being included in the Building Block Model. When it comes to Government-directed projects, a more circumscribed regulatory assessment is needed, which takes into consideration the wider societal implications of certain decisions. This should lead to more transparency around how Government-directed projects feed into NBN's pricing.

Weighted average cost of capital

NBN has proposed to prescribe a Weighted Average Cost of Capital (WACC) methodology for the entirety of the SAU. We consider that the current arrangement, whereby the ACCC has discretion in calculating the WACC, is more appropriate. Indeed, over the lifetime of the SAU, reviews of the WACC are likely to be necessary, as is done in other regulated industries, [12] and the SAU variation should allow for this flexibility.

NBN has proposed to apply a nominal vanilla WACC to determine the allowed rate of return on capital. It is important that the cost of capital is accurate to NBN's cost of capital, otherwise there is a risk that consumers will be required to pay more than necessary for the NBN to deliver services should the rate be set above NBN's true cost of capital. Despite the importance of accuracy in this area, choosing a WACC involves a high degree of estimation. It is for this reason that there needs to be flexibility within the SAU to review the WACC in order to avoid embedding any mistakes.

ACCAN urges the ACCC to carefully consider whether NBN should be allowed to earn a commercial rate of return. Whilst on one hand, without having to earn a commercial rate of return, NBN may undercut private sector competition, however we have concerns that the objective of competitive neutrality comes at a cost to consumers when NBN's WACC is not reflective of its true cost of capital.

[12] Such as the Australian Energy Regulatory review of the rate of return used in determinations every 4 years. https://www.aer.gov.au/publications/guidelines-schemes-models/rate-of-return-instrument-2022

Indeed, whilst competitive neutrality is important, the extent that NBN faces competition needs to be considered.

There is potential for NBN to benefit from below-market rates for debt financing due to its government ownership and consequent implicit guarantee. ACCAN notes that in 2021 it was reported that NBN Co took out a private loan with an interest rate of 1%.[13] We note that NBN has begun paying down the $19.5 billion government loan using a mix of privately-sourced debt funding; the repayment has decreased NBN Co's weighted average cost of drawn debt from 3.96% to 3.17%, and NBN expects this to continue to reduce as it refinances more of the government loan.[14] The ACCC should consider if NBN is able to borrow commercially at below rates for comparable private enterprises and whether being allowed to earn a commercial rate of return is in the long term interest of end-users. We are aware that the Productivity Commission's current consideration of NBN's compliance with the competitive neutrality policy creates further uncertainty.[15] In addition to this, the possibility for the NBN to be privatised over the lifetime of the SAU furthers the need for flexibility in how the WACC is set.

The Australian Communications Consumer Action Network (ACCAN) is Australia's peak communication consumer organisation. The operation of ACCAN is made possible by funding provided by the Commonwealth of Australia under section 593 of the Telecommunications Act 1997. This funding is recovered from charges on telecommunications carriers.

[13] Chris Duckett, 2021, "Budget 2021: NBN has repaid AU$5.5 billion of its AU$19.5 billion government loan", https://www.zdnet.com/article/budget-2021-nbn-has-repaid-au5-5-billion-of-its-au19-5-billion-government-loan/

[14] Ry Crozier, 2021, "NBN Co pays $3 billion of its $19.5 billion government loan" https://www.itnews.com.au/news/nbn-co-pays-3-billion-of-its-195-billion-government-loan-560876

[15] Australian Government Competitive Neutrality Complaints Office, 2022, *Competitive Neutrality Complaints*, https://www.pc.gov.au/competitive-neutrality