Submission in response to the revised proposed variation to the NBN Co Special Access Undertaking

17 February 2023

1 Introduction

1.1 Commpete—an industry alliance for greater competition in telecoms markets—welcomes the opportunity to contribute to the Australian Competition and Consumer Commission's (**ACCC**) consideration of the proposed variation dated 29 November 2022 to the NBN Co's special access undertaking (**the proposed SAU variation**).

1.2 Our responses to some of the ACCC's consultation questions are set out below.

In short, Commpete believes the proposed SAU variation is a substantial improvement on NBN Co's March 2022 proposal, in particular the revised treatment of the ICRA and the inclusion of accounting separation and service standards frameworks.

We welcome these long overdue reforms which Commpete has strongly advocated and we see this change is a crucial milestone for NBN. As a strategic piece of national infrastructure, ensuring it plays an important role in serving the needs of broadband nationwide is essential.

However, Commpete does not support the requirement in the post-2032 regulatory period that ACCC's decision making should be constrained by NBN Co's desire to achieve or maintain any particular credit rating.

Simply put, the future regulation of the NBN monopoly is in the public interest and cannot be made contingent on the irrelevant considerations of credit rating agencies. We advise against the ACCC accepting any such constraint on its regulatory decision-making and believe these specific conditions need be corrected, and until this occurs, that the proposed SAU variation unfortunately should be rejected despite its improvement in other areas. It would be disappointing if the SAU proposal reaches a stalemate and results in delays to its implementation to benefit industry and end users for conditions which in principle arguably should not be embedded within its scope in the first place.

2 General regulatory framework and modular structure

> Question 2: The ACCC seeks comments from stakeholders on whether NBN Co's proposed changes to the replacement module process are reasonable and in the LTIE. In particular, the ACCC seeks comments on:
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> - the suitability and completeness of the proposed regulatory module processes, including the new pre-lodgement consultation requirement and the proposed timeframes;
> - the appropriateness of the change in control provisions to terminate the SAU then in operation.

2.1 Commpete supports the proposed changes to the replacement module process only in respect of the 'subsequent regulatory period' that will end on 30 June 2032.

3 Post-2032 arrangements

> Question 3: The ACCC seeks comments from stakeholders on whether the post-2032 arrangements are reasonable and in the LTIE. In particular, the ACCC seeks comments on the following issues:
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> - whether the proposed arrangements achieve an appropriate balance between providing regulatory certainty to both NBN Co and retailers about how matters are to be determined through the replacement module process, and flexibility to determine arrangements that better respond to conditions and regulatory best practice at the time
> - whether the proposed Module 3 principles are likely to provide appropriate incentives on NBN Co to operate in a prudent and efficient manner and safeguard against price shocks while allowing it a reasonable opportunity to achieve a stand-alone credit rating before the end of the SAU term. If not, what changes to the principles would you propose?
> - whether the proposed arrangements are likely to result in any undue complexity or whether there are gaps in the regulatory framework that could lead to any unintended consequences
> - whether the proposed arrangements appropriately mitigate the risk of price shocks that could result from NBN Co pricing its services to achieve a stand-alone credit rating for the duration of each regulatory cycle in the post 2032 period.

3.1 Commpete does not support the proposal to tie the making of RMA/RMDs in the 'post-2032 regulatory period' to NBN Co's achievement or maintenance of any particular credit rating. We agree with the ACCC's preliminary observations (at pages 29-30) to the effect that any such requirement would not satisfy the efficient use and investment limb of the LTIE test and, further, would unduly restrict the ACCC's ability to administer the NBN regulatory regime post-2032.

3.2 As Commpete noted in July 2022 when a similar requirement formed part of the 'financeability test' in NBN Co's March 2022 proposal, it is not the ACCC's role to ensure that its decisions do not negatively impact the credit rating of a regulated entity. If the ACCC were to take on such a role, it would in effect be transferring the same obligation onto the industry through the restraint or adjustments that the obligation would entail. This is inappropriate and we advise against the ACCC taking on such a responsibility via acceptance of the proposed SAU variation.

3.3 It is the role of management to operate a business to achieve the outcomes that its owners require, including any maintenance of a credit rating at a certain level. If the ACCC were inclined to make decisions in fulfilment of the criteria laid down in legislation or in instruments such as the SAU, and those decisions negatively impacted NBN Co's business and credit ratings, then it would be a matter for the Board and management of NBN Co to take further action to address the consequences. It should not be for the ACCC to take action to adjust for its own decisions.

4 Pricing and product constructs

Question 4: The ACCC would welcome stakeholder views on the possible implications that they see of the proposed wholesale pricing model. In addition, we seek views on the following specific matters:

- are stakeholders supportive of the proposed approach to encourage uptake of wholesale services at higher speed tiers, including migrating 12 Mbps broadband access towards a 25 Mbps speed tier, and more-intensively used 50/20 Mbps services to the 100/20 Mbps tier? Do retailers have the capability to manage individual AVCs onto the wholesale speed tier that would optimise their costs under the proposed pricing model? If not, what assistance might they need to achieve this? What would be the cost outcomes for a retailer that could not optimise in this manner?
- the gap in minimum access costs between the 50 Mbps and 100 Mbps services is relatively small, and narrows further once the cost of CVC overage is factored in. Do stakeholders consider that the proposed wholesale pricing model is suitably calibrated so that both the 50 Mbps and 100 Mbps wholesale speed tiers remain viable inputs that will support retail product and price differentiation?
- the effectiveness of low-income measures could depend on a high level of engagement from low-income representatives, and NBN Co having a strong incentive to respond efficiently to their recommendations. Does the current proposal make these things likely? What other commitments if any could be needed so that low income and other disadvantaged consumers can receive a reasonable level of support?
- does the SAU provide sufficient support for low use customers, particularly those that require maximum speeds of 12 Mbps or 25 Mbps beyond the first regulatory period?
- in relation to the ability to bypass regulatory consideration of product withdrawals, are there sufficient protections against NBN Co pushing wholesale services to higher yielding tiers in future by withdrawing or placing limitations on access to lower yielding tiers?

4.1 Commpete can see no justification for the retention of the CVC pricing construct for any speed tier. Now that the initial rollout and take-up of service is complete, NBN Co's prices and revenues must be a function of its efficiently incurred costs and not indexed to matters—such as capacity—that are not drivers of those costs.

4.2 Retaining a CVC component for speed tiers <100 Mbps, while removing it for those tiers ≥100 Mbps, is unlikely to promote the efficient use limb of the LTIE test as it will tend to force end-users to move up speed tiers and potentially well beyond their actual usage requirements. It is also likely to encourage greater mobile substitution than otherwise would occur, which would ultimately result in higher unit costs.

4.3 Additionally, NBN Co. charges that restrict the completive nature of the market into organically and inorganically acquiring new customers between RSP's should also be removed to support a healthy market operation in the LTIE. The charges that should be removed include the "Service Transfer" and "Non-Infrastructure Transfer" Fees that NBN Co. levies on each AVC transfer between RSP's. These charges are unjustified taxes relating to purely electronic/zero cost transactions for the movement of active services between RSP's either as 'Business As Usual' daily 'churns' or bulk service transfers in the case of merger and & acquisition activities.

4.4 Regarding the "sufficient support for low use customers", we support the change in the pricing construct for the 25/5 and 25/10 speed tier, this will provide a more suitable entry level service for low use and budget constrained customers. However, we do not support the change to the pricing of the "Voice Only" 12/1 <100kbps CVC inclusion offer which will see the effective cost for this service fall by 44%. This represents an extreme and unwarranted value transfer to the incumbent provider of PSTN Voice Services at the expense of the broader NBN RSP market. NBN should re-purpose this "value transfer" to rebalance the effective cost of all other NBN AVC speed tiers to support increased competition, enhanced market viability and ultimately and directly benefit the LTIE for the entire market and not just the incumbent's near monopoly of PSTN Voice Services.

5 Recovery of accumulated losses

Question 7: The ACCC seeks comments from stakeholders on whether NBN Co's proposed treatment of accumulated losses is reasonable and in the LTIE. In particular, the ACCC seeks stakeholder views on:

- whether the proposed methodologies NBN Co has used in developing its proposed opening ICRA balance of $12.5 billion represents an appropriate approach to achieving and maintaining a standalone investment grade credit rating.
- whether the proposed arrangements would likely promote efficient investment in and use of the NBN
- whether the commitments to extinguish residual ICRA balances at the end of the subsequent regulatory period and the post-2032 regulatory period would resolve concerns around future price and regulatory uncertainty beyond 2040
- whether the proposal to determine ICRA drawdown amounts ahead of each regulatory cycle, subject to the condition that the total amounts specified in the SAU can be recovered, provides a suitable safeguard against price shocks or prices that are higher than needed given the more fundamental limitation proposed on the ACCC's power to make a determination in the post-2032 regulatory period

5.1 Commpete has long called for reform of the ICRA and the proposed SAU variation has—at long last—substantially addressed those concerns. Commpete supports the proposed treatment of the ICRA balance (subject to our comments above about the inappropriateness of subjecting the making of RMA/RMDs in the post-2032 regulatory period to NBN Co's achievement of any particular credit rating). We do not have a view on the appropriateness of the approach used to determine the opening ICRA balance but do note that it is not based on strict arguments of economic efficiency or the actual recovery of loses and instead focuses on the loss recovery needed to meet other owner objectives.

6 Cost allocation and accounting separation

> Question 9: The ACCC seeks comments from stakeholders on whether NBN Co's proposed cost allocation framework, and proposed accounting separation and transparency framework for the subsequent regulatory period are likely to promote the LTIE and are reasonable. In particular, the ACCC seeks stakeholder views on the following:
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> - would the proposed cost allocation principles and framework for the subsequent regulatory period provide for effective accounting separation of NBN Co's competitive services from its monopoly services?
> - is the initial cost allocation manual submitted by NBN Co fit for purpose and clear in its approach to cost allocation between NBN Co's core and non-core services?
> - are the proposed cost allocation principles for the subsequent regulatory period, and cost allocation manual, likely to reflect relevant cost drivers and appropriately allocate costs between NBN Co's core and non-core services?
> - are the processes for periodically reviewing cost allocations for the subsequent regulatory period through the replacement module process, and for considering cost allocations for new services in the subsequent regulatory period, appropriate and adaptable to changing market and other conditions?
> - do the proposed cost allocation framework and accounting separation procedures achieve the right balance between appropriate flexibility on implementation and effective ACCC oversight, regulatory control, and recourse where necessary?

6.1 The principles as stated are standard for an effective cost allocation system. However, they are insufficient in themselves to ensure effective accounting separation of NBN Co's competitive and monopoly services.

6.2 The principles provide the following:

(a) costs that are directly attributable to a Core Regulated Service will be allocated to that Core Regulated Service;
(b) costs that are directly attributable to a Competitive Service will be allocated to that Competitive Service;
(c) shared costs (i.e., costs that are not directly attributable to a Core Regulated Service or Competitive Service) will be allocated to reflect causal relationships between supplying services and incurring costs, unless establishing a causal relationship would require undue cost or effort in which case an alternative suitable allocator will be used;
(d) all costs will be allocated; and
(e) no cost should be allocated more than once to any service.

6.3 There are only two categories of service that are recognised—Core Regulated and Competitive—and it would appear to be NBN Co's intention that all relevant costs should be allocated to one or other of these categories. There is no room in these principles for relevant costs to be unallocated; they are to be allocated directly or shared.

6.4 Neither the principles nor the Cost Allocation Manual (CAM) address the issue of whether there are any costs that are or may be incurred by NBN Co that are not relevant to the allocation process. Typically, these would be costs that are associated with other, completely separate businesses that NBN Co might be authorised to conduct. They would not necessarily be Competitive Services of the kind listed in the dictionary section of the proposed SAU.

6.5 Commpete therefore suggests that the ACCC require NBN Co to insert further principles providing that costs associated with any other separate business, quite apart from the Core Regulated and Competitive Services, should be declared by NBN Co as Other Business Services. Where those costs may be directly allocated to Other Business Services then they should be so allocated, and where they are included in shared costs then they should be allocated on a reasonable cost causation basis.

6.6 The principles and CAM should also guard against inappropriate allocation of costs to NBN Co's regulated monopoly services. Commpete suggest that the ACCC require NBN Co to amend the principles and CAM to reflect a presumption that if a cost or cost-share is in any way uncertain, then it shall be presumed to be 'competitive' or 'other' and excluded from the regulated cost base.

Cost allocation manual

6.7 Commpete is not satisfied that the initial cost allocation manual submitted by NBN Co is fit for purpose.[1] The problems with the initial CAM include:

(i) the issues already discussed above (i.e. the omission of coverage of irrelevant costs for Other Businesses in the principles and the omission in the principles of a presumption against including ambiguous or uncertain costs in the regulated service category);

(ii) the limited number of cost allocators envisaged in the CAM; and

(iii) the use of revenues to allocate shared costs.

[1] It is not clear whether NBN Co is asserting that it is fit for purpose in its present form given NBN Co proposes to submit a proposed cost allocation manual within 30 days of the Second SAU Variation Date. However, in all likelihood, if the ACCC indicates acceptance of the present initial CAM, the proposed CAM in 30 days is likely to be the same or very similar.

6.8 Commpete appreciates that NBN Co wishes to use cost allocators that can be readily assembled from available operating data, and clearly Provisioned Bandwidth, Premises Passed and Premises Connected serve this purpose. It is accepted that expediency and convenience may be important considerations in designing a low-cost, readily implementable cost allocation within an accounting separation regime. However, these measures may not be the only ones that should be considered as allocators now and into the future. Commpete suggests that the ACCC explicitly reserves a power to substitute different and more appropriate cost allocators in the future should they emerge. There is no reason why the ACCC or industry should be limited to the allocators included in the initial CAM, even if they are accepted by the ACCC to be reasonable for the time being.

6.9 We also consider it inappropriate for NBN Co to allocate shared costs based on the revenues that they generate. Allocation by revenues—especially given that some of the pricing involved is driven by the market and demand factors—is not allocation by cost causation. Allocation by revenue share therefore does not comply with Principle (c) enunciated by NBN Co. Indeed, the use of revenue as an allocator can lead to a circular form of argument, where regulated prices and revenues are to be based on costs reasonably and efficiently incurred, and the costs in turn are assessed based on past revenues. Commpete suggests that the ACCC should require NBN Co to propose alternatives to revenue-based allocation, particularly in the area of OPEX where it is especially proposed. It may well be that the ACCC might need to require NBN Co to undertake some activity-based costing (ABC) sampling to better allocate shared costs than the methods proposed in the initial CAM.

7 Service quality

Question 12: The ACCC seeks views on whether the service quality framework and benchmark service standards for the subsequent regulatory period by NBN Co in the SAU variation are reasonable and promote the LTIE. In particular, the ACCC seeks views on:

- whether the proposed regulatory oversight is sufficient to promote the adoption of benchmark service standards that reflect more closely end-user service requirements and willingness to pay
- whether clause 5.10(b)(iv) and (d) (Main Body of the SAU variation) would permit the ACCC to establish a mid-cycle regulatory review mechanism and/or introduce a service performance incentive scheme for a regulatory cycle of the post-2032 regulatory period
- whether proposed regulatory safeguards provide sufficient flexibility during a regulatory cycle to respond to unforeseen events, and
- whether the proposed benchmark service standards for the first regulatory period address current issues that could be impacting NBN consumers and, are reasonable. In addition, whether there is sufficient clarity and certainty with regards to service quality in the proposed benchmark service standards

7.1 Commpete supports the proposed inclusion of service standards but does not believe it is appropriate for the standards for the subsequent regulatory period to be so closely based on those in WB4. It is reasonable to expect that there would be meaningful and substantial improvements in NBN Co’s service standards over a period of six years (2020-26).

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