

Australian Competition and Consumer Commission (ACCC)
Responses to Questions on Notice

Number	Name/Organisation	QoNs
25	ACCC	<p>How are AVC and CVC prices regulated on the NBN?</p> <p>The NBN Co Special Access Undertaking (SAU) is the key instrument through which AVC and CVC prices are currently regulated.</p> <p>The SAU sets out the maximum regulated prices for all NBN services (including prices for AVC and CVC services) that were being supplied (or in development) at the time of its acceptance.</p> <p>The SAU also sets out how the maximum regulated prices for AVC and CVC services may change over time. In particular, all prices are subject to a price control for the duration of the SAU (until 2040). NBN Co may not increase the price of a service by more than CPI minus 1.5 per cent within a 12 month period. The SAU only sets the maximum price and it is open to NBN Co to charge prices below that maximum.</p>
26	ACCC	<p>Can the ACCC please provide a high-level overview about the role it plays in price regulation on the NBN?</p> <p>Part XIC of the <i>Competition and Consumer Act 2010</i> enables the ACCC to set prices (and non-price terms) for access to a regulated service but also recognises the primacy of commercial negotiations. It does so by allowing the ACCC to make ‘access determinations’ for declared services, the terms of which will apply if the parties have not reached commercial arrangements or where an SAU is not in place. This hierarchy applies to NBN Co and other access providers of a declared service.</p> <p>Any conflicts between these different instruments are resolved by a hierarchy, which is set out in the legislation (section 152AY):</p> <ul style="list-style-type: none"> • An access agreement (commercially negotiated) prevails over a SAU; • An SAU prevails over a Binding Rule of Conduct (BROC); and • A BROC prevails over an access determination. <p>NBN Co’s overarching pricing framework is set out in the SAU, although prices are also set out in access agreements with retail service providers.</p> <p>The ACCC accepted the current SAU in December 2013. The SAU operates until 2040. This followed an extensive consultation with stakeholders and assessment process by the ACCC. As stated above, the SAU sets out the maximum regulated prices for all NBN services that were being supplied (or were in development) at the time the ACCC accepted the SAU. It also sets out the process for how maximum regulated prices may change over time.</p>

		<p>The ACCC proactively monitors NBN Co’s compliance with the SAU price controls, including verification that NBN Co’s prices do not exceed the maximum regulated prices specified under the SAU. It does this on an annual basis through a public process.</p> <p>The SAU allows some flexibility for prices to be reviewed. The review process can be triggered by either the ACCC or NBN Co where the price controls lead to unreasonable or unintended outcomes.</p> <p>Both the ACCC and NBN Co have the ability to initiate a price review at various times during the SAU. The price review process allows the ACCC to adjust any SAU price or group of prices. However, the price review process is subject to the constraint that any adjustment to prices must not adversely affect NBN Co’s ability to recover its efficient costs across the life of the SAU. In practice, this means that any adjustment must be revenue neutral.</p> <p>The ACCC may also set regulated prices for NBN Co’s services through access determinations or binding rules of conduct, to the extent they are not covered by the SAU. The ACCC is able to make access determinations and binding rules of conduct for new products or services introduced by NBN Co.</p> <p>In addition to its role in regulating prices for specific products, the ACCC is required by the SAU to make an annual long term revenue constraint methodology (LTRCM) determination.</p> <p>The LTRCM is based on a building block model, which is a methodology commonly used by the ACCC in infrastructure regulation. The purpose of the model is to provide an opportunity for the access providers, to recover prudent and efficient costs of supply (including an appropriate return on investment).</p> <p>The LTRCM determines NBN Co’s allowable revenue for each financial year. NBN Co’s actual revenue will be less than its allowed revenue during the rollout phase, but NBN Co will have the opportunity to recover this shortfall in later financial years after the rollout is completed. Once this shortfall has been fully recovered, NBN Co’s prices will then be subject to a revenue cap that will be determined by the ACCC.</p>
27	ACCC	<p>Does the ACCC monitor CVC provisioning at points of interconnect by provider?</p> <p>Yes. The ACCC receives a quarterly report from NBN Co regarding the CVC provisioned by each wholesale Access Seeker at all of the POIs. This report sets out for each CVC link acquired;</p> <ul style="list-style-type: none"> • the contracted CVC capacity (at the end of the quarter), • the average CVC capacity (over the entire quarter), and • the average CVC utilisation (peak and all day). <p>The report is confidential and is provided under the NBN Services in Operation Record Keeping Rules, which are set out here: https://www.accc.gov.au/regulated-infrastructure/communications/monitoring-reporting/nbn-services-in-operation-record-keeping-rules/rkr-2014</p>

		<p>The ACCC also requires NBN Co to provide a report for publication based on the data provided under the NBN Services in Operation Record Keeping Rules, known as the NBN Wholesale Market Indicators Report. This quarterly report includes (along with summary AVC data) information setting out the total contracted CVC capacity by state grouping (i.e. NSW/ACT, QLD, SA/NT, VIC/TAS and WA) and by traffic class (i.e. Traffic Class 1, 2 and 4). The NBN Wholesale Market Indicators reports are available here: https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-wholesale-market-indicators-report/reports</p>
28	ACCC	<p>Does the ACCC have to approve the prices set or proposed by NBN Co? Under what circumstances does it have to approve a proposed change in prices?</p> <p>The ACCC approved NBN Co's initial prices and price control arrangements (as discussed above) through its acceptance of the SAU in December 2013 and following a detailed and lengthy consultation with industry stakeholders. The ACCC also approved the parameters of the price and revenue caps that NBN Co is subject to.</p> <p>If NBN Co introduces a new product, it is able to set prices in the first instance so long as it has consulted with access seekers and notified the ACCC. If the ACCC considers that the price of a new product is unreasonable, it may make an access determination or binding rule of conduct that specifies a different price.</p> <p>The ACCC monitors the development of new products or services and can consult with industry members about any pricing concerns that may emerge.</p>
29	ACCC	<p>What are the general principles which guide what prices are set?</p> <p>In 2013, the ACCC assessed the proposed SAU (including the pricing framework) against the legislative criteria in Part XIC of the CCA. This requires that the ACCC be satisfied that the SAU promotes the long term interests of end-users (LTIE) and is reasonable. The LTIE test is a core part of the access framework.</p> <p>In considering the LTIE, the ACCC must have regard to whether the proposed pricing framework would promote competition, ensure any-to-any connectivity, and encourage efficient investment in and use of infrastructure. In considering whether the framework is reasonable, in addition to the LTIE, the ACCC must have regard to the legitimate business interests of NBN Co, the interests of access seekers, the direct costs of providing access, operational and technical requirements, and economic efficiency.</p> <p>A key consideration for the ACCC when assessing the SAU against these criteria in 2013 was that end-users should not be made worse off by virtue of their migration to the NBN from legacy copper and HFC networks. Specifically, it considered that prices for entry level NBN services should be broadly comparable to functionally equivalent legacy services.</p> <p>The ACCC also considers that NBN Co has incentives to price its</p>

		<p>products to encourage uptake of higher value services and increase revenue. End-users who value higher value services that cannot be provided by legacy infrastructure are likely to pay higher prices for those services.</p>
30	ACCC	<p>What are the technical considerations that underpin how the prices are set?</p> <p>Under the SAU pricing model, the maximum price that NBN Co may charge for a service is based on the attributes of the service, such as peak data rate and traffic class. These prices are consistent across all technology types including FTTP, fixed wireless and satellite. In its 2016 SAU variation proposal, NBN Co proposed that the existing pricing framework be extended to the multi-technology mix (MTM) technologies of FTTN, FTTB and HFC, which it is seeking to incorporate into the SAU.</p>
31	ACCC	<p>What elements make up the asset base which prices are set to recover?</p> <p>NBN Co's regulatory asset base includes all capital investment made in connection with the design, engineering, construction and maintenance of the national broadband network and other assets owned or controlled by NBN Co. Before capital expenditure is included in the regulatory asset base, the ACCC must be satisfied that NBN Co has met prudency requirements specified in the NBN Co special access undertaking (the SAU). The regulatory asset base forms part of the long term revenue constraint methodology (LTCRM), which is set out in the SAU.</p>
32	ACCC	<p>Does the ACCC have access to the long-term financial assumptions of NBN Co?</p> <p>If yes:</p> <ul style="list-style-type: none"> • Are these provided to the ACCC on a regular basis? • During what processes would this information ordinarily be provided to the ACCC? <p>When were these assumptions most recently updated with the ACCC?</p> <p>When assessing the original SAU in 2013, a key consideration for the ACCC was that NBN Co should have the opportunity, but not necessarily the guarantee, to recover the prudent and efficient costs of building, operating and maintaining the NBN. To assess whether the proposed SAU framework would provide this opportunity, the ACCC sought information from NBN Co regarding its long-term financial assumptions, including forecasts of expenditure and revenue.</p> <p>Information of this nature is not provided to the ACCC on a regular basis and is not required for the ongoing operation of the framework provided under the SAU. Rather, NBN Co is required to submit regulatory information to the ACCC on an annual basis. This information must be provided on an annual basis (by 31 October) and</p>

		includes NBN Co's expenditures and revenues during the preceding financial year. The ACCC assesses this information at part of the annual LTRCM process.
33	ACCC	<p>Until what year do the financial forecasts run? Is it 2040?</p> <p>See previous answer.</p>
34	ACCC	<p>How do assumptions about take-up, demand and average revenue per user feed into considerations about the appropriate price level?</p> <p>As noted above, the SAU sets out a framework around pricing that specifies the maximum regulated prices that NBN Co may charge (benchmarked against the prices of legacy services) and how those prices may change over time (the price controls).</p> <p>In assessing the SAU, the ACCC considered that the SAU pricing framework would provide NBN Co the opportunity to recover its efficient costs, but that cost recovery would not be guaranteed. The ACCC also considered that NBN Co's revenue sufficiency risk would create incentives for NBN Co to minimise costs, invest efficiently and price services in a manner that encourage uptake and increase revenue.</p> <p>The ACCC considered NBN Co's long-term financial assumptions (including demand and revenue forecasts) to assess whether the proposed pricing framework would allow NBN Co an opportunity to recover its efficient expenditure.</p>
35	ACCC	<p>What discount rate - or weighted average cost of capital (WACC) - does the ACCC use to assess an appropriate price level for services on the NBN?</p> <ul style="list-style-type: none"> • What is the WACC which applies to the NBN Service Access Undertaking (SAU)? <p>If the ACCC discount rate is higher than the NBN IRR (3 per cent):</p> <p>So if current prices are based on that discount rate, can you please explain why the NBN internal rate of return at around 3 per cent?</p> <p>For our clarity, why do the IRR and the WACC differ if the price level has been set to recover the asset base consistent with the WACC?</p> <p>The SAU specifies NBN Co's weighted average cost of capital (WACC) as the risk-free rate plus 350 basis points until 2023. After 2023, the WACC will be subject to periodic review. The WACC is used to determine the return on assets allowable to NBN Co and reflects benchmark efficient financing costs.</p> <p>The internal rate of return is a different concept to the WACC. The internal rate of return is the rate that gives a set of future cash flows over a specified period a net present value of zero. The internal rate of return is generally used to assess or rank specific investment projects and is not generally used for regulatory purposes.</p>

		<p>There are a number of reasons why the internal rate of return differs from the WACC. These include the timeframe over which the internal rate of return has been calculated, and the treatment of terminal values (which in this case is the regulatory asset base and initial cost recovery account). The ACCC does not have visibility over NBN Co's internal rate of return calculations.</p>
36	ACCC	<p>How do the non-commercial areas of the NBN footprint feed into the ACCC's consideration of prices for NBN services?</p> <p>Areas serviced by NBN Co's fixed wireless and satellite networks (mostly regional, rural and remote areas) are generally considered to be non-commercial as they are not expected to generate sufficient revenues to recover their cost.</p> <p>NBN Co developed its SAU price terms for NBN services with the intention of meeting an objective of uniform national wholesale pricing, consistent with government policy at the time. The SAU price terms are therefore predominantly access-technology neutral. The SAU provides NBN Co the opportunity to recover the long term costs of supplying as its commercial services become profitable over time.</p> <p>Prices for non-commercial services are subject to the same SAU price controls under the SAU as described above.</p>
37	ACCC	<p>Did the change of Government policy and the implementation of the Multi Technology Mix change the financial assumptions provided to the ACCC for the purposes of its price regulation role?</p> <p>If yes:</p> <p>How did those change impact on OPEX over the life of the project?</p> <p>How did it impact CAPEX over the life of the project?</p> <p>How did it impact assumptions about take-up and average revenue per user?</p> <p>The expected changes to NBN Co's financial forecasts as a result of the MTM was considered as part of the 2014 strategic review prepared by NBN Co for the shareholder ministers.</p> <p>Although the SAU was accepted in 2013, prior to the review, the SAU's pricing framework is technology neutral and unaffected by the shift in policy to the MTM. As such, the MTM has not significantly changed any of the underlying assumptions of the SAU.</p> <p>The ACCC considers that NBN Co continues to face uncertainty around long term cost recovery. Consistent with our assessment of SAU in 2013, we consider that this revenue sufficiency risk is likely to ensure NBN Co faces appropriate incentives to only incur efficient expenditure and to price services in a way that will encourage end-users to migrate to the NBN and choose higher value services over time.</p> <p>As noted above, NBN Co's allowed regulatory revenue is expected to significantly exceed its actual revenue during the rollout phase. Under</p>

		<p>the SAU, NBN Co has the opportunity to recover this initial shortfall in later financial years after the rollout is completed. Any changes to NBN Co's financial forecasts as a result of the implementation of the MTM will affect the timing of when this shortfall will be fully recovered. After revenue is fully recovered, NBN Co's prices will be subject to a revenue cap.</p>
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