



Submission to NBN Co Special Access Undertaking Consultation

March 2012

Introduction

The Competitive Carriers' Coalition welcomes the opportunity to comment on the NBN Co Special Access Undertaking.

The CCC has been a long-standing advocate of pro-competition structural reform of the telecommunications industry. In many ways, the fundamental design of the policies that have created the NBN Co represent an attempt by the Government to create the competitive ideal, and a future-proofed universal underlying network architecture that would otherwise be many years away, if in fact ever achievable without dramatic Government intervention.

The challenge now is to translate those policy and regulatory principles into the business case of NBN Co itself.

The CCC believes that the regulatory regime that oversees the communications industry built on the NBN must be as future-proof as the technology being installed. The CCC agrees that the arrangements cannot be overly prescriptive because there is too much that is unforeseeable.

However, the CCC believes that the best means by which flexibility and certainty can be balanced, is to create a regulatory framework that allows for on-going and effective regulatory oversight through the types of well-established public processes that the Commission has developed over the past 15 years. These processes need not be overly intrusive into NBN Co's business decision-making, nor should they create uncertainty. The threshold for the Commission to take action in disputes has proven to be high in the past, and public processes allow the market to follow and understand the reasoning that the Commission will bring to bear when disputes are brought before it.

The CCC does not believe that the SAU as it stands meets these requirements. The need for regulatory oversight arrangements in which all parties can have confidence is a threshold issue that needs to be resolved before other elements of the SAU can be fully considered. The CCC therefore does not purport to be in a position to comprehensively comment on the SAU, but presents in this submission what it regards as the first order issues of concern, starting with the regulatory oversight arrangements.

Regulatory Oversight and ACCC Powers

The NBN is explicitly intended by the Government to be a monopoly provider of wholesale fixed line access services for most Australian households. It necessarily follows, therefore, that negotiations over terms of supply between NBN Co and its retail service provider customers will be conducted in an environment of asymmetrical market power.

When the regulatory arrangements pertaining to the NBN were being legislated between 2010 and 2011, it was the understanding of the competitive industry that the relationship between different elements would follow the precedents of past regulatory arrangements, with enhancements to address areas where the previous regime had proved deficient.

That is, it was expected that the NBN would be acknowledged as a monopoly provider of bottleneck services, and subject to the oversight of an independent regulator.

The primary means of regulation of its market power and commercial conduct is through the Commission's power to determine the terms of access to its network.

Alternatively, it is open to NBN Co to submit an undertaking to the ACCC that would represent as comprehensive a coverage as possible of the price, terms and conditions of access under which NBN Co would sell services to all customers. It was expected that this would be the course of action that NBN Co would pursue.

Matters outside the undertaking would be subject to full ACCC oversight, including the ability of the ACCC to determine access terms.

If no undertaking acceptable to the ACCC was presented, the terms of access would be established through determinations. Both the undertaking and determinations processes would be fully transparent and would seek submissions from any interested party.

In the past, this has been the standard approach to preparing and assessing undertakings, and to the level of detail assumed necessary by access providers in preparing and proposing undertakings for the supply of regulated services.

That is, once an undertaking was accepted, access seekers would be able to rely on the terms set out in that undertaking to acquire bottleneck services. Any matters not specified in the undertaking would be subject to the normal regulatory oversight powers of the ACCC, were a dispute to arise.

It is important to note that the rationale for making undertakings available as a regulatory instrument is that it provides for greater certainty for both access providers and access seekers. It is not intended as a mechanism by which access providers can avoid regulatory oversight of activities that would otherwise be subject to regulation.

In the view of the CCC, the approach being taken by NBN Co in developing the regime under which access seekers will acquire services, does not reflect these precedents and is, in fact, novel in the Australia regulatory experience. It does not meet the expectations of access seekers as to the nature of appropriate regulation of a bottleneck natural monopoly access provider.

The SAU does not - and cannot - stand alone because access seekers are required to enter into a Wholesale Broadband Access (WBA) agreement with NBN Co for the supply of services, even if an undertaking is accepted by the Commission. The SAU contains limited detail about the services to be offered, the pricing of these services, or the basis for the pricing of these individual services. These details largely reside in the WBA or in some cases are yet to be released.

It is not clear to the CCC whether the SAU is intended to be subservient to the WBA where inconsistencies arise. Further, the SAU, once accepted, would appear to limit the ability of the ACCC to exercise its other regulatory oversight instruments.

That is, access seekers unhappy with the prices, terms and conditions of supply proposed by NBN Co in a WBA and contract of supply do not appear to have the alternative of seeking to have the ACCC determine matters, even when they are outside the terms of an accepted SAU. Rather, dispute resolution processes are defined which constrain the access to and power of the ACCC.

The CCC does not believe that this is the approach that was envisaged when the regulatory regime was being legislated. The policy environment created to encompass the NBN suggests that the Parliament had formed the view that the new monopoly access network being created should have

less commercial discretion than had been allowed in the past, under the arrangements by which Telstra supplied services. This attitude by the Parliament was reflected, for example, in the non-discrimination provisions with which NBN Co must comply.

The CCC believes that the Commission's powers in relation to the binding rules of conduct and access determinations must be preserved, and that access seekers must have access to these rights enshrined in the SAU such that they are accessible even where a WBA has been entered into.

These powers are fundamental to the Commission's ability to ensure compliance with the SAU, and to its ability to deal with conduct by NBN Co that might not be foreseen in the WBA, or in situations where disputes arise about the interaction between the SAU and the WBA, or interpretation of the WBA.

The SAU seeks, in effect, to contract the Commission as a dispute resolution arbitrator into negotiations between parties, rather than having the Commission sit apart from these negotiations as an independent regulator that can exercise its legislated powers in the event of disputes or an unforeseen issue arising.

The principle that regulatory oversight arrangements and processes should be contracted is problematic in itself. In the SAU, NBN Co has proposed roles for the Commission that are too narrow in scope and too constrained in terms of the periods when the Commission can be petitioned by access seekers to become involved in contract terms.

The SAU seeks to define the role of the Commission and constrains the role of the Commission, in terms of, *inter alia* :

- When it can become involved in disputes;
- The timeframe within which parties can respond to the Commission; and
- The discretion (or lack of) for the Commission to determine appropriate resolutions.

The CCC submits that these arrangements are inadequate to provide access seekers with the comfort they need in dealing with what will be a monopolist provider of fixed line services, and do not represent good regulatory practice.

Further, the CCC submits that the proposed arrangements for regulatory oversight are not in the interests of either NBN Co or access seekers. For example, the regulatory recourse mechanism proposed for matters not covered by the SAU is confined to the period before the execution of an access agreement. It provides for a tightly constrained process whereby NBN Co and its prospective retail customer present their preferred options to the Commission, which must choose between the options presented with only non-material variations available to the Commission.

The CCC submits that NBN Co is creating a situation where it removes the ability of the Commission to bring to bear its expertise and experience in order to develop what might be sensible, reasonable and acceptable alternative solutions to disputes.

This proposal is unsatisfactory, in the view of the CCC. It appears motivated by an unfounded nervousness about the role and capability of the Commission. Access seekers are willing to submit themselves to the judgment of the Commission as an expert independent umpire and see no reason why NBN Co should not do likewise. This would give great comfort to access seekers regarding NBN Co's attitude to regulation.

The ability for NBN Co to be regulated, according to the reasonable expectations of the industry that will be reliant on its services, is a threshold issue for this process. If the SAU cannot provide a mechanism that allows for the Commission's powers to oversee and regulate NBN Co's on going conduct, it must be open to question whether an undertaking is the appropriate form of regulation, or whether direct regulation by the Commission using its determinations powers is a preferable approach.

Again, the CCC submits that the resolution of this oversight issue must be the primary issue at this stage of the consideration of the SAU.

Proposed 30 year Term is Too Long

NBN Co appears to be arguing that the proposed 30 year undertaking provides the regulatory certainty that underpins its ability to roll forward losses from the capital-spending intensive roll out years. This smooths prices such that access prices in early years are not prohibitively high.

However, on its face, 30 years seems an unreasonably long term given the nature of the communications industries. For example, 30 years ago, in 1982, the Internet was in its infancy and the World Wide Web was almost a decade away. Ten years ago, in 2002, ADSL based broadband was still new in Australia and the unbundled local loop services had not begun to have an impact on competition. Mobile communications in Australia began in the 1980s and the evolution from simple mobile voice to mobile data only began in earnest only in the past 10 years. The revenue and charging model for almost all communications services today is almost unrecognisable from what it was 20 years ago.

While the basic network architecture for the dominant fixed line network has changed little, these changes in services and technological capabilities have had profound impacts on the uses of - and revenues derived from - the underlying infrastructure of the telecommunications network. Consumer welfare has undoubtedly benefited from these innovations.

This is the environment of rapid and unpredictable change in which all communications companies are required to operate and invest. Most of the changes have been at the layer 3 applications level and will increasingly be so as next generation networks are rolled out. This means retailers have been and will continue to be both subject to the greatest uncertainty and to be required to be most flexible in their product offerings.

Investments in layer 1 fixed line infrastructure have proven able to continue to generate revenues throughout these changes albeit however, from forms of traffic that were unimaginable to most people when the investment was initially made.

It is impossible to anticipate what services and charging models will look like in 2042. Indeed, this is a point that has been repeatedly made by the Government in describing its rationale for investing public money in the NBN. It is intended to be a catalyst for innovation and the creation of consumer and business services that are not conceivable on the present infrastructure.

Yet the SAU seeks to provide some certainty for NBN Co by ensuring a return on investment for the entire useful life of the basic assets being installed. This in turn means the SAU is necessarily is light on the detail that access seekers need about the pricing of specific services.

The CCC submits that NBN Co's desire for certainty for its business needs comes at the expense of certainty for competitive access seekers, and that this imbalance must be rectified for the SAU to be

capable of being accepted in the long term interest of end users. For example, the longer the term, the less specific the SAU can be in elements such as pricing.

Central to whether a 30 year term is capable of being acceptable is the scope for the SAU to be revised by NBN Co, the Commission or other stakeholders in the light of evidence of market changes. The CCC submits that it is unlikely that a set of review processes sufficiently comprehensive in scope could be developed to allow for a 30 year undertaking. That is, the review parameters would need to be so broad that they would be barely distinguishable from a new undertaking process.

The CCC submits that the review processes proposed by NBN Co offer inadequate provision for the review and change of the SAU over time. NBN Co has too much control and discretion about the elements of the SAU that would be reviewed under the arrangements proposed by NBN Co.

Certainly, the proposed arrangements for review do not provide for the degree of flexibility to “reset” the terms of the SAU that would be necessary for the Commission to be satisfied that the SAU is reasonable.

The CCC believes a more reasonable term would be no more than 10 years or until the build phase is over, whichever comes first. This would incorporate the entire build period for the NBN. It would also be consistent with the regulation of the NBN Co points of interconnect arrangements.

Further, the successful operation of a 10 year undertaking would provide a framework for the next period of regulation, and should give NBN Co and its stakeholders comfort about on-going stable, regulatory arrangements.

Pricing Models and Pricing Details

NBN Co’s proposed pricing models are important not only because of the level of prices but also because their design will shape the development of downstream markets.

NBN Co’s proposed pricing models must be considered in the context of the downstream business models that exist now, and those that might be inadvertently advantaged or disadvantaged by the proposed pricing models. That is, consideration must also be given to business models that do not exist today but would be expected to develop if thriving competitive conditions prevailed at the retail and wholesale level.

NBN Co’s proposed two part pricing approach combines a fixed cost access element with a usage based charge for the CVC component. While the usage component is forecast to be initially modest in both absolute terms and on a per subscriber basis, it rises rapidly over the term of the proposed SAU as end users are projected to migrate to faster services and average usage increases.

It is not clear to the CCC that a usage based wholesale pricing component is consistent with the Government’s stated intention to promote the greatest possible take up of broadband among the greatest possible proportion of the population, nor that usage-based pricing is the best means of meeting the long term interest of end users.

NBN Co, in its Corporate Plan, acknowledges that usage growth should be encouraged.

The balance between AVC and CVC pricing has been designed to enable NBN Co to drive – and benefit from - substantial increased usage in the future. This has been achieved by keeping the AVC as low as possible in order to encourage consumers up the speed tiers, and relying on CVC revenues to drive ARPU growth.ⁱ

The Corporate Plan also indicates that the CVC charge is expected to reduce from \$20 per mbps to \$8.75 as average usage increases, although it is not clear when this is expected to occur. It is also not clear where or how this commitment is reflected in the SAU.

The CCC submits that NBN Co should clarify this issue and how it is reflected in the SAU. If the commitment is not in the SAU, it should explain how this commitment will be enforceable.

A further issue is that the CVC pricing model – which proposes a minimum purchase of 100mbps – would favour large and broad scale downstream service providers. The NBN Co has offered interim pricing relief until 30,000 homes are passed in a CSA: however, this too represents an assumption about the business model of retail service providers. It would, for example, suggest that the scope of entrepreneurial retail models focusing on niche markets would be disadvantaged. The CCC believes it is incumbent on NBN Co to at least discuss how it believes alternative business models could be facilitated. It is not clear, however, that NBN Co envisages that there will be such a market.

The CCC submits that alternative pricing models should be considered and NBN Co should explain why they are not preferable to the approach it has proposed. The CCC is not necessarily rejecting the pricing approach proposed by NBN Co but submits that NBN Co must draw out its expectations of what the downstream competitive markets can - and should - look like in order to explain why its choice of pricing model is in the Long Term Interest of End Users.

With regard to prices to access circuit service, the CCC is concerned that NBN Co has again adopted a novel approach in the way in which it has incorporated pricing commitments into its undertaking. In the past, undertakings have included specific pricing commitments for all regulated services that were subject to the undertaking.

It was the expectation of the competitive industry when the regulatory arrangements were put in place and NBN Co first discussed submitting an SAU, that a full “rate card” would be presented for the Commission’s consideration.

In the event, NBN Co has not included the individual prices for the full range of its proposed access services, instead reserving the details of the pricing of most services in the WBA processes. In the SAU, it has specified only the price for its Basic Access Offer service in what it calls its Price Controlled Offer.

The other mechanisms by which the prices for Access services proposed by NBN Co will be constrained do not appear adequate. However, the CCC submits that before the Commission considers how those constraints might be made more robust, it must satisfy itself on a matter of basic principle – is it sufficient for an access service monopolist to submit an undertaking without detailed prices for all of its proposed services?

The CCC submits that this degree of pricing flexibility is unprecedented for regulated monopoly services. However, this may again be a consequence of the very long term of the proposed SAU. NBN Co might be able to provide more specific price commitments if it revises and shortens the term of the undertaking.

Prudency of Expenditures

The cost of network investments by NBN Co is recovered through access prices, so it is crucial that any such investment is efficient.

The CCC is concerned that the proposed prudency regime provides too much discretion to NBN Co, and too little direct regulatory oversight. The CCC does not accept that NBN Co's other reporting obligations to the Government and to the Parliament are relevant to whether the Commission can be satisfied that NBN Co will incur efficient costs, or that the Commission will be able to rectify a situation where NBN Co has incurred inefficient investment.

This is not to suggest that the CCC believes that NBN Co is incurring inefficient costs, or that it is not seeking to be prudent. Rather, the CCC submits that a high standard of oversight is needed simply because this must be a matter of core principle in regulating a monopolist.

Under NBN Co's proposed arrangements as understood by the CCC, NBN Co itself determines whether its proposed expenditure satisfies its prudent design and prudent costs conditions, and it reports to the Commission only on whether it has acted consistently with its own rules.

The Commission cannot independently verify whether the Network Design rules with which NBN Co must comply are themselves prudent.

The Commission cannot determine whether expenditure based on these design rules is prudent, as NBN Co itself determines if the expenditure meets its own assessment criteria.

The CCC cannot see how this affords the Commission with the opportunity to independently verify whether the investment plans and expenditure by NBN Co are prudent.

Inconsistencies with WBA

In circumstances where there is an inconsistency between the terms of the SAU and the WBA, it would appear to be the case that NBN Co intends that the terms of the WBA would prevail. This is a situation that the CCC considers to be wholly unacceptable.

There are examples in the SAU and the WBA where inconsistencies do appear to arise. One of these is in the sensitive and contentious areas of points of interconnect (PoI), which serves to illustrate the point about the extent and importance of these areas of uncertainty.

The number and location of points of interconnect will have a fundamental bearing on the shape of competitive backhaul market, and on the business case for downstream retailers who choose to locate their own equipment in PoIs to interconnect directly with NBN Co.

Under the SAU, PoI locations will be reviewed in five years in consultation with access seekers. NBN Co will only close or relocate a PoI consistent with the results of that review, and once it obtains ACCC approval.

However, under the WBA, NBN Co will close or relocate a PoI only after it has provided customers with 12 months' notice of the closure, and has provided a relocation or closure plan. Customers are not able to delay the closure of a PoI by raising a dispute about NBN Co's proposal.

It is not clear whether the requirement on NBN Co to receive ACCC approval is consistent with the WBA provision that NBN Co is entitled to close or relocate any PoI, as long as it has met its obligations to provide customers with notice.

NBN Co proposes a mechanism to align clauses of its WBA with clauses of any accepted SAU. However, it would appear to the CCC that NBN Co has discretion about how it would do this. It is not clear that the “alignment” must be the precise form of words of the SAU or whether NBN Co will offer its interpretation of the effect of the SAU clause.

Other Issues Related to the Scope of the SAU

The CCC is concerned that there are too many matters that are either not within the scope of the SAU, or are unclear with respect to how the SAU will deal with these issues.

For example, the proposed pricing and supply arrangements for NBN Co’s Multicast service are currently outside the scope of explicit pricing/product commitments in the SAU, yet are potentially matters relevant to the development of competition and investment in a range of related downstream markets within which content and broadband services are supplied. The competition implications of the relative pricing of content services delivered over Internet services, including multicast technologies, and content services delivered over other high speed data services on the NBN must be considered by the Commission.

This is potentially a good example of where more effective ongoing regulatory oversight by the ACCC of NBN Co’s activities, including issues that emerge as markets develop, will enable the ACCC to monitor the development of competition and deal with unanticipated issues.

These areas of uncertainty again point to the need for NBN Co to publish its view of what a competitive downstream market would look like, and how the various services it proposes to offer would interact to support the most competitive possible retail market activity.

ⁱ NBNco Corporate Plan pg 103