



Submission by AAPT Limited (18 January 2013)

to

**Australian Competition and Consumer Commission -
Consultation on the NBN Co Limited (NBN Co) 2012 Special
Access Undertaking (SAU), dated 18 December 2012**



Introduction

1. AAPT Limited (**AAPT**) welcomes the opportunity to contribute to the Australian Competition and Consumer Commission (**ACCC**) consultation on the NBN Co Limited (**NBN Co**) 2012 Special Access Undertaking (**SAU**) dated 18 December 2012.
2. AAPT acknowledges NBN Co's efforts in progressing the earlier version of its SAU dated 5 December 2011 to the much improved SAU that is currently before the ACCC. Unfortunately, despite the improvements, AAPT considers the current SAU is still overly complex and is not in a form that can be considered reasonable for acceptance by the ACCC.
3. In stark contrast to the labyrinthine nature of the SAU, the concept that if an entity is a monopoly, it must be regulated is a simple one. That is, NBN Co must be regulated to ensure it does not engage in behaviour that abuses its market position to the detriment of the long term interests of end-users (**LTIE**). While the achievement of 'structural separation' under the Telstra Structural Separation Undertaking and the inception of NBN Co as a wholesale-only access provider are significant steps towards the development of effective and sustainable competition in the relevant markets, they do not negate the need to ensure that the LTIE does not suffer through NBN Co's future behaviour.
4. Although the SAU is a right step towards ensuring that NBN Co is sufficiently constrained from abusing its market position (by the terms of the SAU), AAPT considers that there are a number of fundamental principles and changes, which need to be addressed and/or incorporated into the SAU, before it can be considered reasonable .
5. This submission provides comments on the following fundamental principles and changes, which AAPT considers need to be addressed and/or incorporated into the SAU:

- the principle that NBN Co and access seekers' incentives are not aligned; and
- changes relating to:
 - i. the structure of the SAU (to clearly identify which terms should be locked in over the 30 year term);
 - ii. more appropriate timing and form of independent review;
 - iii. more reasonable form of regulatory oversight; and
 - iv. the price regulation provisions.

2. NBN Co and access seekers' incentives are not aligned

6. AAPT considers that the SAU needs to expressly include the promotion of competition as one of its objectives to address the potential for NBN Co's interests and incentives (and therefore its conduct) to conflict with the achievement of the LTIE.
7. NBN Co has often made representations that because it is not vertically integrated, it does not compete with wholesalers and therefore it will behave differently to the way vertically integrated incumbents have in the past. Rather, NBN Co has stated that, like wholesalers, its incentive is to maximise downstream activity. In addition, NBN Co will be subject to non-discrimination obligations that provide a further important constraint on its conduct.
8. While AAPT make take some comfort in the above, history has shown there is still potential for the incentives of infrastructure monopolies (even wholesale only operators) to not always align with the best long term outcome for competition in every case. For example:

- During the roll out and transition phase of the NBN and beyond, NBN Co's strongest incentive will be to maximise the use of the NBN, encourage the migration of end users to it as quickly as possible and maximise sale of its wholesale services. Accordingly, there is inherent risk for NBN Co to favour (in both the short term and long term) its customers who will best help to achieve these outcomes. Such circumstances are likely to arise at the expense of competition.
 - As noted at the ACCC Stakeholder Forum held in December 2012 (**SAU Forum**), the interests and incentives of access seekers will often diverge. Accordingly, there is a real risk that in considering and balancing the differing interests of access seekers, NBN Co will settle on positions which it considers are most appropriate. It is not difficult to imagine that customers with the largest customer base will fare best in these cases.
 - In areas where there exists competitive infrastructure to the NBN, there is potential for NBN Co to be incentivised to discourage competition in wholesale markets.
9. In addition, the Government has clear intention to privatise NBN Co in the future, and such arrangements could well be commenced, if not concluded, during the operation of the SAU. In such circumstances, where there is likely to be a dramatic shift in incentives, there should be no room in the SAU for the incentives of a privatised NBN Co to be preferred to the detriment the LITE.
10. **Non-discrimination obligation** – AAPT has stated in previous submissions that the SAU should contain an explicit commitment by NBN Co to comply with non-discrimination obligations. AAPT still holds this view but notes that even with such commitment, there is still a need for regulatory recourse. Given the ACCC's guidance on its interpretation of the non-discrimination obligations (some parts of which AAPT has fundamental issues with), it would be unnecessarily uncertain to rely on non-discrimination provisions which are

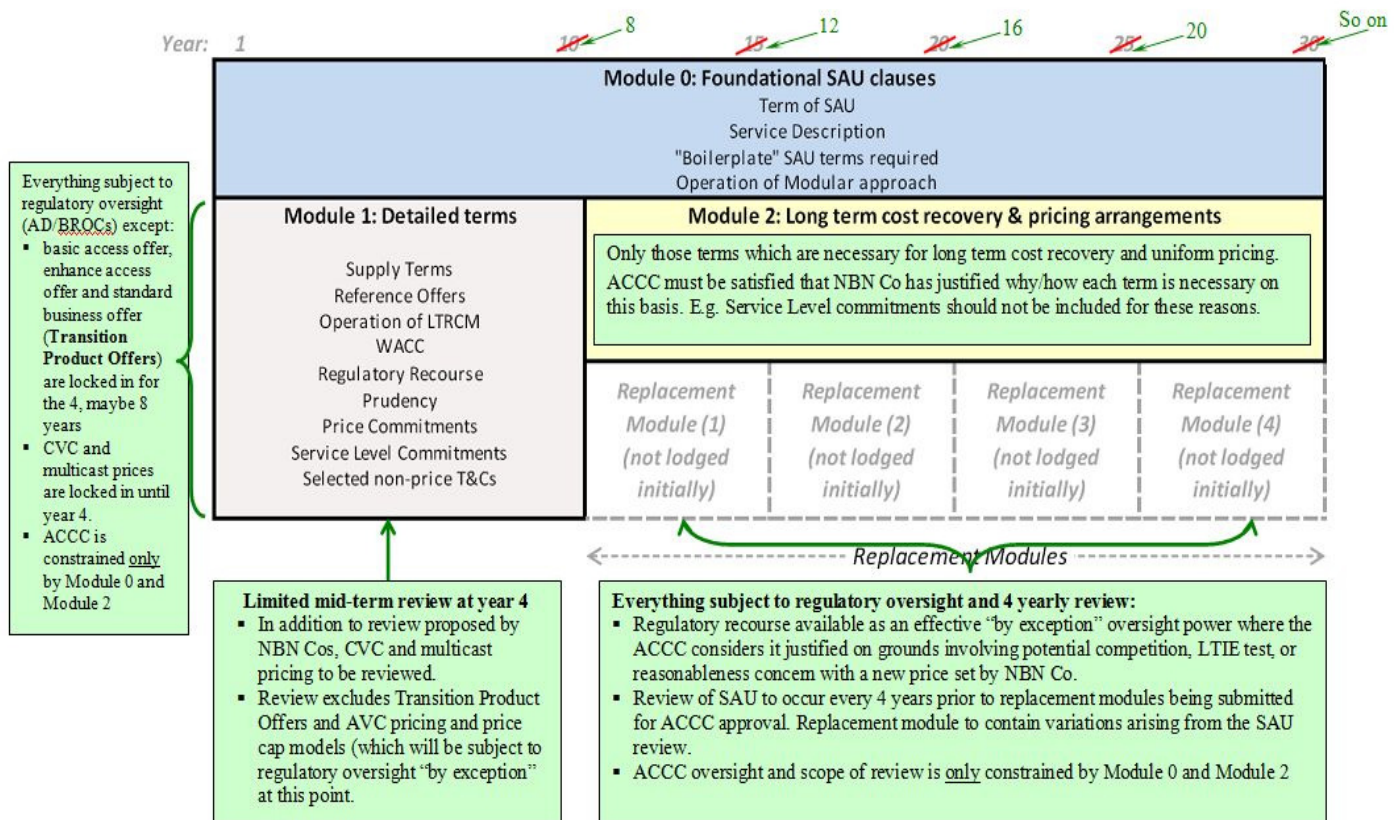
untested to resolve the incentives issues. It would be more practical to allow for recourse to the ACCC instead of access seekers having to go before the Federal Court, thereby creating a dynamic more likely to lead to commercially negotiated outcomes. AAPT sets out what it considers is the appropriate of regulatory recourse mechanism at paragraphs 24 to 29.

3. Structure of the SAU

3(a) Modular Structure

11. In principle, AAPT supports the modular based approach proposed by NBN Co for the current SAU and considers it has the potential to be an effective method for striking the balance between NBN Co having long term certainty for efficient cost recovery (**Cost Recovery Certainty**) and giving industry players an acceptable level of regulatory comfort in a novel monopolistic environment.
12. However AAPT considers some changes to the modular based structure are needed before the ACCC can be satisfied that it is reasonable. These changes relate to:
 - Clearly identifying which terms should be locked in over the 30 year term.
 - Where applicable, the timing and form of independent review.
 - Implementing a more appropriate form of regulatory recourse.
13. In the figure below, AAPT has attempted to summarise the changes it proposes by way of mark-up (in green) of the structure diagram provided by NBN Co in its submission in support of the SAU.

The structure of the revised SAU can be illustrated as follows:



3(b) 30 year term and locked-in provisions

14. A 30 year term for an access undertaking is an extremely long time by any industry standard, but even more so for the communications market, which is well known for its ever changing landscape.
15. AAPT acknowledges that, in this SAU, it may acceptable to lock some terms for a 20 or 30 year term to meet NBN Co's requirement for Cost Recovery Certainty, provided that:
 - only those terms that can be justified as necessary for NBN Co to meet its Cost Recovery Certainty related objectives is 'locked in' in Module 0 and Module 2, as fixed principles; and

- any remaining terms (including non-price terms, pricing terms and pricing structure provisions) are subject to appropriate independent review and regulatory oversight (refer to paragraphs 24 to 29).
16. In determining whether a provision is to be locked in for 30 years (i.e. be included in Module 0) or for the last 20 years of the SAU (i.e. be included in Module 2), the ACCC must be satisfied that NBN Co has justified why and/or how that provision is necessary to be locked in for 30 or 20 year term (as applicable) to achieve Cost Recovery Certainty and uniform national wholesale pricing.
17. **Most pricing should not be locked-in** - AAPT does not believe that terms such as the commitment to reduce prices by CPI -1.5% (which is a very specific pricing pathway) will be sufficiently great a reduction over the SAU term. At this point, no modelling or financial data has been provided that could assist access seekers in assessing the efficiency of the long-term revenue constraint methodology and that future charges do not represent over-recovery of costs.¹ For these reasons, it should not be locked in. Price regulation under the SAU is discussed in further detail at paragraphs 30 to 35
18. **Service Description** – In Attachment A to Module 0 of the SAU, NBN Co defines the NBN Access Service in extremely broad terms so that it effectively covers any layer 2 service that is, or might be, provided over the NBN. This very broad definitional approach contrasts with the more narrowly defined service descriptions that have traditionally been used by the ACCC in relation to declared services. The impact of this approach is to greatly limit the ability of the ACCC to exercise its powers to determine the services that NBN Co is required to provide. Pursuant to s.152AL(8F) of the Competition and Consumer Act 2010 (CCA), the ACCC retains the power to declare new services, even where such services are covered to some extent by a special access undertaking.

¹ This is despite a request from Optus to NBN Co for such data for those purposes. See: Optus seeks NBN Co's confidential financials, ZDNET Australia, 5 December 2012. < <http://www.zdnet.com/au/optus-seeks-nbn-cos-confidential-financials-7000008317/>>

However, if a new service declared by the ACCC falls within the bounds of the broadly defined NBN Access Service, in accordance with s.152AY(b)(ii) of the CCA, NBN Co's standard access obligations in relation to any such service will be as set out in the SAU. In addition, the SAU provides that the variation of existing services and the creation of new services is ultimately within the sole discretion of NBN Co (see for example 2E.4.3). As set out in s.152CBIA of the CCA, to the extent that any access determination is inconsistent with this approach, and sought to overrule NBN Co's discretion in relation to defining products or product features, such an access determination would be of no effect.

19. Accordingly, it can be seen that the SAU has the effect of drastically curtailing, or possibly totally excluding the power of the ACCC to intervene in the process for varying existing products or creating new products for the entire duration of the SAU. Experience has shown that market requirements for telecommunications products shift rapidly. It has consistently been the case over recent decades that products move from being mainstream staple products to being totally superseded within a timeframe of 5 years or less. Changes in service requirements have been a consistent source of dispute between suppliers and acquires under the existing telecommunications regime. In this environment it is not appropriate to allow NBN Co, a monopoly provider facing no competitive tension, to have sole discretion to determine the specifications of the services to supply to wholesale customers. It is not realistic to assume that such an approach will produce the most efficient outcomes and be in the long term interests of end users. It is virtually inevitable that tensions and disputes will arise between the interests of NBN Co and access seekers in relation to the specifications of the services supplied over the NBN, and it is appropriate that the ACCC has the ability to intervene to resolve such disputes when required.

3(c) 8 year term with a limited mid point review for Module 1

20. For any matters not locked into Module 0 or Module 2, they will necessarily be included in Module 1. While the proposed term of 10 years for Module 1 is

relatively shorter than the terms of the Module 0 or Module 2, it is still too long a time to lock in certain SAU terms by precluding regulatory oversight or excluding them from the scope of the proposed mid point review.

21. For example, the non-price provisions and service levels provision have not been properly settled with the industry and it would be inappropriate to lock them in without some flexibility for development and refinement. As set out in the figure above, AAPT considers it would have more comfort if the term of Module 1 was reduced from 10 years to 8 years, with a limited mid point review at year 4.
22. As stated above, AAPT acknowledges there is a need to lock in certain provisions for a period of time to give NBN Co some operational certainty and flexibility. In this regard, AAPT supports the following structure (which is summarised in the figure at paragraph 13 above):
 - Lock in the following the following initial reference offer products so they are exempt from regulatory oversight for 4 years (though 8 years would be acceptable if all recommendations in this submission were sufficiently addressed):
 - (i) Basic Access Offers (12/1Mbps);
 - (ii) Enhanced Access Offer (25/5 Mbps) – fibre only; and
 - (iii) Standard Business Offer (25/10 Mbps bundled with 500 kbps (TC-1) of Symmetric Access Capacity)) – fibre only.
 - Lock in CVC pricing and methodology for 4 years.
 - At year 4 of the module 1 term, a limited mid-point review will occur as NBN Co proposes. However, AAPT considers that this should also include a pricing review, including a review of CVC and multicast prices at this stage. AAPT would not be against excluding from a review of AVC



pricing and the price cap model provided they are subject to the effective regulatory oversight.

- All other terms of Module 1, including non-price terms and products, the product development process, services, pricing of new products and so on are all subject to effective regulatory oversight during the term of Module 1 (refer to paragraphs 24 to 29 for further discussion of what AAPT regards as effective regulatory oversight).

3(d) Subsequent 4-yearly review and replacement modules

23. AAPT considers the replacement module mechanism is appropriate subject to the following changes:

- each replacement module should have a term of 4 years or less;
- a mandatory review of the SAU be undertaken in a timely manner prior to lodgement of each replacement module, involving industry consultation to determinate scope of the review and subsequently the variations to be included in each replacement module;
- ACCC approval of each replacement module should be mandatory before they take effect;
- it be completely open for the ACCC to suggest variations to address any 'unacceptable' aspects of the proposed replacement module in order to allow it to become acceptable (subject only to Module 0 and Module 2); and
- the ACCC should be given effective regulatory oversight, including the right to make a BROC or AD at any time, with such ability to only be constrained by the content of Module 0 and Module 2.

4 Regulatory Oversight

24. AAPT believes that in circumstances where NBN Co clearly benefits from unequal bargaining power, and where those relying on it for access to consumers have no alternative source of supply, the ability to seek regulatory recourse in the case of disputes is unquestionably necessary. AAPT does not consider that an argument against regulatory oversight on the basis of uncertainty due to the possibility of the myriad of actions likely to be taken by access seekers is a valid one. On the contrary, in many cases, the availability of effective regulatory oversight is likely lead to quicker and effective commercially negotiated outcomes.
25. As set above at paragraphs 7 and 10, the different interests and incentives of access seekers and NBN Co means regulatory oversight cannot be dispensed with, even in circumstances where NBN Co is not a vertically integrated access provider and there are non-discrimination obligations.
26. Like most parties to negotiations, access seeker would prefer to reach a commercial outcome, rather than one that was only obtained via regulatory means. However, without an effective form of regulatory oversight, most access seekers are unlikely to be in a position to negotiate with a monopoly provider like NBN Co and be able to reach a position that is acceptable. The implementation of a regulatory oversight mechanism, which acts to control the behaviour of the NBN Co before and during negotiation, will facilitate reaching commercial outcomes since access seekers will have the comfort of a regulatory backstop, which may never be required.
27. In AAPT's view, an effective regulatory oversight power should at the very least comprise the following features:
 - the scope of matters that are subject to regulatory recourse should not be narrowed except as set out at paragraph 13 and sections 2(a) and 2(b) above; and



- the way the ACCC exercises its effective oversight powers should not be constrained, except by the content of Module 0 and 2 of the SAU.

4(a) Timing and availability of a regulatory outcome

28. Any regulatory recourse mechanism formulated for the SAU should only be acceptable where wholesale customers are able to obtain the benefit of an access determination (AD) or binding rule of conduct (BROC) in an effective manner.

29. AAPT considers the following changes should made to the regulatory recourse mechanism (which contemplates implementation of ADs and BROCs via the SFAA) in order to ensure its effectiveness:

- it should be mandatory, not at NBN Co's discretion (as is currently the case), to consult and properly engage with industry in relation to all proposed changes considered necessary for the implementation of regulatory decisions;
- Where the ACCC makes an AD or BROC, the ACCC should have the ability to direct which parts of a determination are mandatory and which NBN Co must amend all access agreements to include, rather than giving access seekers the option to not have those determinations reflected in their subsequent access agreements. Without this, an AD or BROC could be rendered redundant, which could not have been the legislative policy intent.
- BROCs are intended to be a short-term regulatory tool (12 months) that enables the ACCC to urgently respond to identifying conduct that it regards as anti-competitive or against the interests of consumers. Unlike ADs, it would be completely inappropriate to wait two years to implement a BROC.
- the benefit of an AD or BROC should be available to all access seekers without conditions. For example they should not have to:
 - sign up to the new SFAA; or

- to accept other changes that NBN Co may unilaterally decide to include in an updated SFAA,

in order to avail themselves of an AD or BROCC.

- Timely application of AD or BROCC must be implemented, with backdating employed where appropriate, to ensure access seekers don't 'miss out'.

5. Price regulation

30. AAPT considers that given the potential for the cost of CVC to increase exponentially in line with the exponential growth of data usage, it is crucial that NBN Co include in the SAU more specific commitments in relation to CVC price reductions. This should take the form of a commitment to a minimum reduction pathway if certain demand and usage forecasts are met. This is important as it could adversely impact investment and business model decisions of wholesalers.
31. **Long Term Revenue Constraint** - NBN Co's letter to Optus of 14 January 2013 makes clear that NBN Co's own projections show that the Long Term Revenue Constraint will not come into effect during the term of the SAU. NBN Co asserts that this should provide comfort to access seekers as it implies that access seekers have been able to purchase NBN Co's services at prices that have not yet enabled NBN Co to recover its prudently incurred costs of supply (inclusive of an appropriate return on capital). However, this also makes clear that the LTRC will in fact impose no realistic constraint or limitation on NBN Co's pricing of services during the term of the SAU or at least for many years. In addition, it provides absolutely no assurance that the price of individual services offered by NBN Co are efficient, appropriate or in the LTIE. It would be perfectly possible for NBN Co to be within the LTRC, and yet for individual services or service components to be priced uneconomic levels.

32. While the locked in prices for already available services provides some context and may create some anchor constraint on prices, in AAPT's view, the Reference Offers are unlikely to provide an effective means of constraining the pricing of new products during the term of module 1.
33. Further, considering whether existing prices provide constraints on the level of prices for new services is not a simple matter of considering whether existing prices create a "ceiling". Services can be priced too low, or the terms and conditions of access can be such that a particular service is offered in a manner that discriminates in favour of a particular access seeker or discriminates against others, whether by design or otherwise. In addition, given the time it can take for new products to come to market, what was once a premium product could change to a basic level entry product.
34. These factors demonstrate how critical it is for there to be available independent review of new product price, terms and conditions by the ACCC, where appropriate.
35. In AAPT's view, ACCC review would be appropriate where it has grounds to believe that there is a potential competition, LTIE test, or reasonableness concern with a new price set by NBN Co – that is, the ACCC is given a "by exception" oversight power through its usual statutory processes, including making ADs or BROCs to remedy any problems it identified and only constrained by Module 0 and Module 2. As set out above, this means that new prices (including pricing of zero priced Reference Offers) should be subject to a regulatory recourse mechanism.



6. Conclusion

36. AAPT considers that the SAU in its current form, cannot be accepted by the ACCC. However, it is a step in the right direction and if the principles and changes set out this submission and others are addressed and/or incorporated into a revised SAU, it could potentially be considered reasonable.