



**Australian
Competition &
Consumer
Commission**

Assessment of FANOC's Special Access Undertaking in relation to the Broadband Access Service

Draft Decision

December 2007

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Abbreviations

ACCC	Australian Competition and Consumer Commission
BAS	broadband access service
Capex	capital expenditure
CSP	carriage service provider
FANOC	FANOC Pty Ltd
FTTN	fibre-to-the-node
FTTH	fibre-to-the-home
HFTP	hybrid fibre twisted pair
LTIE	long-term interests of end-users
Mbps	Megabits per second
Opex	operating expenditure
PSTN	public telephone switched network
SAOs	standard access obligations
SAU	special access undertaking
TPA	<i>Trade Practices Act 1974 (Cth)</i>
Tribunal	Australian Competition Tribunal
TSLRIC	total service long run incremental cost
ULLS	unconditioned local loop service
WACC	weighted average cost of capital

Executive Summary

On 30 May 2007, FANOC (a company created by the G9) lodged a 15 year special access undertaking (SAU) with the ACCC for third party access to a bitstream access service on a proposed ADSL2+ fibre-to-the-node (FTTN) network in the five mainland capital cities. The ACCC has published the SAU, FANOC's supporting submissions and submissions from interested parties on its website at www.accc.gov.au.

This report sets out the ACCC's draft decision on FANOC's SAU. In assessing the SAU, it is not the ACCC's role to express a preference for any particular type of next generation fixed access network or determine all the necessary measures to ensure 'open access' for third parties. This report does, however, set out the ACCC's draft general guidance on the elements of a bitstream access service that are likely to be appropriate for any FTTN upgrade. It is the ACCC's view that an appropriate access service would normally include the following:

- A **bitstream access service** over the bottleneck, at as low a layer within the network as feasible, so as to give the access seeker as much control as possible over its own customer traffic.
- **Access prices** that reflect efficient costs (whether actual or estimated) and give investors a return that reflects their investment risk.
- **Non-price terms and conditions of access** that meet minimum quality of service standards and do not discriminate anti-competitively.

A **smooth migration to the new services** for current access seekers and their customers would also be critical.

FANOC proposes to offer a 'Broadband Access Service' (BAS) to access seekers. Initially, it would offer five different BAS products including a stand-alone telephone access service and four bitstream services that may be used to provide voice *and* broadband services of varying theoretical peak speeds.

FANOC proposes a vertically separated model whereby the network owner (FANOC) will only provide access services to access seekers and will not itself participate in downstream retail markets. FANOC also proposes that access seekers would be represented collectively through a body (the 'BAS Manager'), which would have oversight of FANOC's decision-making in relation to budgets, network deployment, new service offerings and non-price terms and conditions of access.

The SAU contains initial access prices for the first three years for each BAS product and a price cap methodology for adjusting access prices over the remaining 12 years of the SAU, into which FANOC will enter key inputs such as its actual costs, depreciation profile and demand forecasts. FANOC adds an additional charge to these access prices that will be passed directly to Telstra for the use of Telstra's copper sub-loops between each customer premises and the node. FANOC assumes this charge will be in the range of \$5-15 per month. Putting the access price and the sub-loop pass-through charge

together, the total access price in the first year for the voice-only service would be up to \$25 per month. The initial prices for a bundle of voice and broadband services would range from up to \$29 – \$50 per month for broadband services with theoretical peak speeds ranging from 1.5 – 24 Mbps.

The ACCC is generally comfortable with FANOC's proposed long-term approach to pricing, which would provide a high degree of regulatory certainty for significant new investments, and notes the initial prices for the first three year access period may be in the appropriate range. The ACCC also considers that a vertically separated ownership model could reduce incentives for the access provider to discriminate between downstream users of the access service and, therefore, facilitate strong and effective competition between access seekers in retail markets. Where such an ownership model is in place, the ACCC considers the need for regulatory oversight of non-price terms and conditions of access, in particular, could be relatively low.

In relation to the BAS service specification, the ACCC's draft view is that FANOC has addressed many of the needs of a low level, bitstream access service over an FTTN network, although the ACCC has some concerns as to whether the proposed approach to voice services is appropriate, at least during the initial transition period.

However, the ACCC is concerned that the SAU gives FANOC too much discretion to determine access prices over the 15 year undertaking period without sufficient regulatory audit and review of the key inputs in the pricing methodology, including actual costs, demand forecasts and the depreciation profile. In addition, the ACCC is concerned that FANOC has too much unconstrained discretion in relation to determining non-price terms and conditions of access, including in relation to introducing or withdrawing BAS products, varying the service specification and setting notice periods for network changes over the life of the SAU.

While FANOC emphasises its discretion will be subject to effective oversight by access seekers through the BAS Manager and that it will not be vertically integrated, having assessed the proposed ownership and governance provisions the ACCC does not support this contention. The ACCC is of the view that the SAU expressly allows for a degree of vertical integration. Further, the ACCC is concerned that access seekers, via the BAS Manager, may not be able to provide sufficient and effective oversight of FANOC's decision-making on key access issues. Given this, the ACCC's draft view is that it is not satisfied that the proposed ownership and governance structure supports the significant discretion reserved to FANOC to determine price and non-price terms and conditions of access for 15 years.

Having examined the SAU, the ACCC's draft view is that the terms and conditions are consistent with the standard access obligations in s. 152AR of the *Trade Practices Act 1974* (TPA), however, the ACCC is not satisfied that the terms and conditions are reasonable, as required by subs. 152CBD(2)(b) of the TPA. Therefore, the ACCC's draft decision is to reject the SAU. The ACCC invites submissions from interested parties on this draft decision by 4 February 2008.

The ACCC notes it is open to FANOC to withdraw and refine its SAU for future consideration.

The ACCC invites submissions in relation to this draft decision. The closing date for submissions is 4 February 2008. Submissions should be directed to:

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Where submissions contain confidential information, this should be clearly indicated. Non-confidential and confidential versions of submissions should be provided to the ACCC at the time of making submissions.

1. Overview

1.1 Background

There have been several proposals in Australia for a fibre-to-the-node (FTTN) broadband access network. FANOC Pty Ltd is a company created by the G9 consortium that has put forward one such proposal. FANOC's proposal is for a high speed broadband FTTN network upgrade initially in the five mainland capital cities.

On 30 May 2007, FANOC lodged a special access undertaking (SAU) under the *Trade Practices Act 1974* (TPA) with the Australian Competition and Consumer Commission (ACCC). The SAU specifies the terms and conditions upon which FANOC undertakes to provide access to third parties over the FTTN network upgrade.

The Government has since said it intends to tender for an FTTN access network upgrade on an open access basis. FANOC itself may be a tenderer and could adjust its proposal. Accordingly, the SAU relates to just one of several possible means by which Australian broadband networks may be upgraded. However, all FTTN network upgrades would be likely to exhibit essentially the same bottleneck characteristics over the 'last mile' as Telstra's existing copper loop access network. Appropriate terms and conditions of third party access to the bottleneck will be critical for competition in downstream retail communications markets and to promote the long-term interests of end-users, including Australian households and businesses.

The terms of access should give network infrastructure investors the right incentives to invest and to recover their costs, with an appropriate return on risk, and also give access seekers the ability to invest in their own businesses, to compete and to innovate.

As many of the same third party access issues are likely to arise regardless of how an FTTN broadband access network is built, or by whom, the ACCC has provided guidance in this report on what would be expected of third party access to an FTTN broadband access network in order to promote the long-term interests of end-users. It assesses the FANOC SAU against the statutory criteria in light of this guidance.

In assessing the SAU, it is not the ACCC's role to express a preference for any particular type of next generation fixed access network or determine all the necessary measures to ensure 'open access' for third parties. Identifying whether any particular investment proposal would be better than any other is a choice for the market or, potentially, for government. In assessing an SAU, the ACCC is only assessing the terms and conditions of third party access if a network is built and services become 'active'.

1.2 The elements of third party access to any FTTN network upgrade

Since most of the same third party access issues arise regardless of how the FTTN broadband access network is built, or by whom, the ACCC provides guidance in this report on what would be expected of third party access on any FTTN broadband access network in order to promote the long-term interests of end-users.

At present, the core bottleneck in telecommunications services is the infrastructure (currently the metallic wire) for establishing a physical connection to customer premises.

The ACCC considers that the lower the 'layer' in the network at which access is granted and the closer it is to the basic physical infrastructure that makes up the bottleneck, the greater the ability of access seekers to control their own costs and supply chain, differentiate service offerings, innovate and improve service quality.¹ The ACCC considers that an approach to regulation that provides access seekers with greater control over their own business and products, to the extent that it is economically efficient, is likely to promote competition, innovation and investment in new services, and be in the long-term interests of Australian end-users.² Today, these requirements are met by access services such as the unconditioned local loop service (ULLS).

An FTTN access network upgrade is likely to make the current use of unbundled access to the copper loops via the ULLS more difficult, if not impossible.

The ACCC expresses no view here as to whether a ULLS service should continue to be available after an FTTN access network is deployed. That might well depend on the particular network upgrade. Decisions about access to the ULLS, including sub-loop unbundling, are the subject of separate consultation.

However, regardless of the future approach to the ULLS, it will be possible to offer an access service of some kind over the bottleneck. This could be some form of bitstream access service. The access service should be as close to unbundled access to copper as is feasible and give the access seeker as much control as possible over its own customer

¹ The functional inputs necessary to provide IP services and applications to end-users over the Internet are often categorised into various 'layers'. There are a number of different 'layering' schemas. In general terms, however, the lowest layer (Layer 1) is usually reserved for the signals using the physical transmission medium. For example, in the ULLS, Layer 1 equates to the use of the actual metallic pair. It could also refer to the use of other physical media, such as optical fibre or radio waves. The highest layer in each schema is generally the 'application layer'. It equates to the actual application itself, such as a voice, email or video application. Each layer sits on top of the preceding layers and assumes the lower layers perform the functionality required of each effectively and according to generally agreed protocols and standards.

² ACCC, *Fixed Services Review – a second position paper*, April 2007, p. 21.

traffic. The ACCC considers it would generally be feasible for the access provider to offer a ‘Layer 2’ bitstream access service.³

It is the ACCC’s view that an appropriate approach to a ULLS replacement access service over an FTTN access network would normally include the following:

- A **bitstream access service** over the bottleneck, at as low a layer within the network as feasible, so as to give the access seeker as much control as possible over its own customer traffic.
- **Access prices** that reflect efficient costs (whether actual or estimated) and give investors a return that reflects their investment risk.
- **Non-price terms and conditions of access** that meet minimum quality of service standards and do not discriminate anti-competitively.

A **smooth migration to the new services** for current access seekers and their customers would also be critical.

1.2.1 The bitstream access service

A future bitstream access service would need to be at a much lower level in the network than a wholesale xDSL service. If end-users are to reap the benefits of next generation broadband, access seekers need to be able to directly control their own customer traffic so they can innovate on services and applications and avoid simply reselling the access provider’s product. The user of a wholesale xDSL service has little control over the service and is often able to do little more than add its own marketing and call centre. By contrast, the proposed replacement for ULLS should be designed to give access seekers as much control as possible over their own customer traffic. The UK communications regulator, Ofcom, similarly describes a future broadband access product as needing to offer very high levels of flexibility and configurability, allowing competitive operators as much control as possible.

The ACCC notes that in terms of functionality, such a service lies between the ULLS and a wholesale xDSL service. While access seekers would not have as much control

³ The ACCC uses the term ‘Layer 2’ to refer to the basic functionality required to transmit a data stream across a physical (Layer 1) point-to-point link. A ‘Layer 2 bitstream access service’ would therefore require the access provider to provide an access service comprising both the physical layer (Layer 1), which in an FTTN network may equate to a hybrid fibre/copper link from the customer’s premises to a point of interconnection, as well as the Layer 2 protocols necessary to enable data to be carried over that link. There could be a number of Layer 2 protocols that are used, for example Ethernet. The access seeker would then be responsible for providing all of the higher layer protocols necessary to deliver IP services and applications to end-users.

A Layer 2 bitstream access service would provide access seekers with significant flexibility and control to adopt the protocols that best support the services and applications used by their customers. This is in contrast to a higher layer wholesale access service, where the access provider controls the higher layer protocols and, as a result, effectively limits the ability of access seekers to control these higher layers and offer differentiated services.

over the access service as they would using the ULLS, a bitstream access service such as FANOC's proposed BAS, may provide the greatest degree of functionality that is technically and commercially feasible in the circumstances.

Throughout this draft decision report, references to a bitstream access service are references to a replacement or alternative for the ULLS. They are not references to a wholesale ADSL2+ or wholesale VDSL2 product. Wholesale xDSL products are not currently declared or being considered for declaration in Australia.

Where the network owner is vertically integrated and has substantial market power in the retail market, a service which gives access seekers a lot of control over their traffic is also important to restrict the ability of the network owner to discriminate against access seekers. Therefore, the service specification of a bitstream access service is critical to promote competition and the long-term interests of end-users.

The ACCC's view is that a bitstream access service should normally meet the following criteria:

1. A Layer 2 bitstream access service, which may be offered at a variety of speeds but should include a product that is not throttled as well as a product that is symmetric to the extent the technology permits. Products (both consumer and business-grade) should be available to all access seekers on a non-discriminatory basis.
2. A service (whether the bitstream service or another service) that allows access seekers to provide a voice service.
3. Points of interconnection as close to customers as is appropriate and efficient, which in the first instance is likely to mean at or near existing local access switches and other points of interconnection for current ULLS and LSS products (it may have other points of interconnection as well).
4. Interconnection protocols based on well-accepted standards for broadband, voice and, if applicable, video, which are sufficiently well-described to allow access seekers to design and build their own interconnecting facilities.
5. Arrangements for access to buildings, shelters and facilities for interconnection.
6. Well-described and appropriate protocols for how packets are to be prioritised and handled.
7. Well-described and appropriate protocols for how congestion in shared network elements is to be handled.
8. Equivalent treatment of access seekers in relation to quality of service parameters such as jitter, delay and packet loss.
9. Interaction by access seekers with operations support systems, including:

- a. *visibility* of provisioning, fault reporting and rectification and service assurance; and
 - b. *control* of own customer configuration and use of the access seeker's allocated part of the capacity.
10. No barriers to multicasting and IPTV by access seekers.
 11. An appropriate process for amending service specifications in later periods as needed or desirable.

Initial bitstream access services should be sufficiently well specified in advance to allow for a smooth migration to the new services by access seekers.

Additional points of interconnection higher up in the network core may be needed where competitive backhaul does not yet exist to local access points of interconnect. They may also be needed on a longer term basis outside metropolitan areas if competitive backhaul would be inefficient.

The ACCC considers a bitstream access service with a service specification that addresses these minimum elements would be likely to provide access seekers with sufficient flexibility and control over the access service to allow any-to-any connectivity and enable access seekers to compete effectively and make appropriate decisions in relation to the efficient use of and investment in infrastructure. Therefore, the ACCC considers that such a service description would be likely to promote the long-term interests of end-users.

1.2.2 Access prices

Access prices should give network infrastructure investors the right incentives to invest and to recover their costs and an appropriate return on risk. If there is an increased degree of risk in an FTTN investment this should be appropriately reflected. At the same time, access prices should give access seekers the ability to invest in their own businesses, compete and innovate.

The TSLRIC+ pricing methodology has been commonly applied to date in telecommunications. The ACCC notes the Australian Competition Tribunal has endorsed TSLRIC+ in relation to historic, sunk networks. The ACCC expects this approach may remain appropriate for such networks. However, there is no reason to rule out proposals for different pricing approaches, especially for new networks where efficient and prudently incurred actual costs can be known.

Pricing issues are likely to become more complex if, as is likely, the builder of the network upgrade seeks regulatory certainty through a long-term access arrangement. FANOC for example has proposed an SAU that lasts for 15 years. This is in contrast to the maximum duration of ordinary access undertakings, which is three years under Part XIC (see subs. 152BV(2)(e) of the TPA).

Demand forecasts for high-speed broadband beyond about three years are likely to be more uncertain due to the rapid rate of change in the industry in terms of the underlying technology, available services and evolving consumer demand. This is apparent from both domestic and international analyses. Therefore, it is unlikely to be possible to set an accurate schedule of fixed prices for any firm for much more than three years.

Beyond this period, there is a risk that prices set in advance will be too low (increasing investment uncertainty) or too high (risking harm to downstream competitors, consumers, business end-users and the economy).

It may, however, be possible to set reasonable prices for the *initial period* and set a *methodology* for adjusting these prices over time. Such an approach is used in the gas industry, for example, where prices are set for the first year of an access arrangement period and prices for subsequent years within that period are adjusted according to the pricing methodology contained in the access arrangement. This approach would provide a high degree of regulatory certainty for access providers making significant new investments. This is because the pricing methodology would be set up-front, with the access provider only required to enter key inputs from time to time, such as its ongoing actual costs, depreciation and demand forecasts. With a fixed pricing methodology, the access provider has certainty as to how access pricing will be approached and the ACCC need only audit the key inputs for robustness, efficiency and prudence.

FANOC has proposed a similar approach. It proposes ‘initial prices’ for the first three years and a model to adjust prices for the remaining 12 years into which it will enter key inputs such as actual costs, depreciation and demand forecasts at regular intervals.

FANOC’s pricing methodology uses a building block approach of the kind used for long-term investments in gas, electricity and rail. In these industries, the regulatory asset base, forecast operating expenditure and forecast capital expenditure, given realistic expectations of demand, are set up-front. These levels are reset at the end of the regulatory period, which is usually five years. There may also be scope for the regulator to approve changes to these inputs based on pre-determined ‘trigger events’.

Further, FANOC’s pricing methodology uses an overall weighted average price cap approach. Such an approach gives an access provider flexibility in setting the prices for access services of different speeds as long as the weighted average of all prices is consistent with the overall cap. This allows the access provider to adjust its pricing for different services over time to reflect demand and so reduce the investment risks of uncertainty.

For new networks, where efficient and prudently incurred actual costs can be known, FANOC’s proposed pricing methodology could, theoretically, lead to efficient prices. Accordingly, the ACCC’s draft view is that this approach could be acceptable.

However, any methodology for setting access prices to essential bottleneck infrastructure would require effective, independent regulatory audit or review of the key inputs and parameters in the pricing methodology in instances where the undertaking period is very long, regardless of whether the access provider is vertically

integrated. For example, while it may be appropriate for the ACCC to accept an access undertaking for a period of 15 years that contains initial period prices and a pricing methodology for setting subsequent access prices, the ACCC would need to be confident that the access provider would exercise its discretion in applying the methodology in an efficient and prudent manner. This confidence could be achieved through providing the ACCC with a power to audit or review the key inputs in the pricing methodology (such as demand forecasts and forecast capital and operating expenditure) at appropriate intervals during the SAU period.

Currently, Part XIC of the TPA does not provide the necessary statutory source of power to allow an SAU to provide for the ACCC to perform functions or exercise powers in relation to an undertaking. Such functions or powers would be necessary to allow the ACCC to conduct an audit of the inputs in the pricing methodology while the SAU is on foot. For an SAU to provide for the ACCC to undertake new regulatory functions, an amendment to Part XIC would be required in terms similar to subs. 44ZZA(6A) of the TPA, which states:

If the undertaking provides for the Commission to perform functions or exercise powers in relation to the undertaking, the Commission may perform those functions or exercise those powers. If the Commission decides to do so, it must do so in accordance with the undertaking.

This subsection relates to Part IIIA access undertakings and was introduced in 2000 but not replicated in Part XIC.

1.2.3 Appropriate initial prices

The initial period access prices for a fibre rollout will depend on the specific network design, its costs, demand forecasts, cost of capital and the depreciation profile. The appropriateness of these prices will be related to the rigorousness of the assumptions in respect of these parameters.

If it is assumed that the cost of accessing Telstra's sub-loops is at the top of FANOC's estimated range of \$5-15 per line per month, FANOC's proposed initial access prices for broadband services will be between \$29 and \$50 per month, depending on the speed of the service. FANOC has proposed to set initial prices below the long-term average and have prices rise over time to build the market. The ACCC's draft view is that this approach may be appropriate. As a result, these prices may be in the appropriate range of initial prices for a network of this type.

1.2.4 Non-price terms and conditions

The ACCC would expect key non-price terms and conditions of access to cover:

1. The provision of appropriate and equivalent information to all access seekers and downstream users about service specification and proposed major and minor network changes.
2. Effective procedures for ordering and provisioning of equivalent quality for all parties.

3. Effective procedures for fault detection, handling and rectification of equivalent quality for all parties.
4. Equivalent treatment in respect of other operational and technical matters.

It would be sufficient for an SAU to set out the key non-price terms and conditions only. Normally the ongoing development of broad rules about service specifications would be a matter for commercial negotiation between the parties, the Communications Alliance or codes and standards under the *Telecommunications Act 1997*. Particular matters that are not resolved through these processes would be a matter for arbitration by the ACCC.

1.2.5 Smooth migration to the new services

The ACCC considers that a smooth migration to the new services is critical, rather than a new network builder necessarily continuing to offer all existing services. While the ACCC considers that existing services should be replicated under new networks where appropriate, there are some services that may need to be altered significantly or may not be replaced if an FTTN network is deployed. The ACCC considers that it would not be in the long-term interests of Australian consumers and business end-users to block network modernisation indefinitely to avoid any form of disruption to existing carriers and carriage service providers.

The ACCC notes the Australian Competition Tribunal in *Telstra Corporation Ltd (No.3)* [2007] ACompT 3 at [318] said:

We accept that access seekers do not have an unlimited right of access to Telstra's ULLS, or the right to prevent network modernisation ...

Carriers and carriage service providers investing in a dynamic industry would usually be expected to factor into their business plans the risk of technological obsolescence. In line with this, the ACCC notes its role is to protect the competitive process rather than specific competitors.

However, the ACCC considers it is appropriate for access seekers to expect reasonable notice and appropriate migration paths to ensure a smooth migration to the new services. If access seekers' investments are subject to sudden arbitrary stranding on unreasonable grounds, incentives for access seekers to compete, invest in facilities and create innovative new services for consumers and business users would likely be reduced. This would not be in the long-term interests of end-users. Similarly it is in the interests of Australian consumers and business end-users that the industry has sufficient time to develop solutions to migrate important services (such as payphones, EFTPOS and voice) to an FTTN access network.

Again, the Australian Competition Tribunal in *Telstra Corporation Ltd (No.3)* said (at [318]-[319]):

... but they [access seekers] ought not to be placed in a position where their substantial investments in infrastructure might be isolated and made redundant as a result of [the network owner's] timing and location of network upgrades.

Such a situation is not in the long-term interests of end-users of the services provided to them by access seekers using the ULLS. Nor is it in the interests of access seekers themselves. A consequence of an inadequate period of notice of network upgrades is that it will provide a disincentive to access seekers from engaging in facilities-based competition with [the network owner]. Such a situation would not be in the long-term interests of end-users.

However, it may not necessarily be appropriate to include the arrangements for a smooth migration in an SAU about terms and conditions of access. These arrangements may be better dealt with in another process. The ACCC's view, as previously stated in its 2006 Final Decision on the assessment of Telstra's ULLS monthly charge undertaking, is that issues surrounding network modernisation are inherently complex. The ACCC considers that such terms and conditions would more usually be determined by bilateral or multilateral commercial negotiation or by agreed operational procedures through self-regulatory mechanisms. It would be preferable that key network modernisation terms and conditions are not determined unilaterally by the access provider or solely through bilateral negotiations in circumstances where one negotiating party has little countervailing bargaining power. The ACCC may have a role where industry procedures prove insufficient.

1.3 FANOC's SAU

The ACCC has considered how FANOC's SAU compares to these general requirements.

FANOC proposes to build an FTTN upgrade to the fixed network initially in the five mainland state capital cities. This upgrade would make it possible to access the maximum ADSL2+ speeds from nearly all premises in the footprint. FANOC has indicated it would upgrade the network to VDSL2 when demand required.

FANOC proposes a vertically separated model whereby the network owner (FANOC) will only provide access services to access seekers and will not itself participate in downstream retail markets. FANOC also proposes that access seekers would be represented collectively through a body (the 'BAS Manager'), which would have oversight of FANOC's decision-making in relation to budgets, network deployment, new service offerings and non-price terms and conditions of access.

FANOC's SAU for third party terms and conditions of access to that network upgrade covers a bitstream access service called the Broadband Access Service (BAS). FANOC would offer access to several BAS products. Initially, these would be: (a) a Basic Telephone Access Service to support voice; (b) 1.5 Mbps; (c) 6 Mbps; (d) 12 Mbps; and (e) unlimited (in effect up to peak speeds of 24 Mbps or the maximum rate available on ADSL2+).

1.3.1 Approach to setting prices

The SAU sets maximum prices for the new fibre and electronics (the FANOC component charge) of the BAS services for the initial three year period. A 'pass-through' component that covers the cost of accessing Telstra's copper loop (which

FANOC estimates to be between \$5-15 per month) is then added to give the final access price. FANOC provides a methodology for setting the component charge of access prices for three successive four year access periods. The methodology is based on a weighted average price cap approach:

- The initial cost base for the component charge is related to FANOC's actual costs of building the new elements of the network.
- The methodology sets the target revenue required to recoup costs, which include a return on capital (at the regulated WACC), a return of capital (depreciation) and operating expenditures.
- On the basis of demand forecasts developed by FANOC, an overall price cap is determined which gives the percentage change in prices required across all products to ensure FANOC earns its target revenue provided it meets the demand forecasts.
- FANOC then has discretion as to how it sets prices for the different individual services, provided the weighted average change in these prices does not exceed the overall price cap.

The BAS Manager has an oversight role in assessing FANOC's proposed expenditure and deployments in each access period as well as its demand forecasts.

The SAU separately provides that the price of the Basic Telephone Access Service cannot increase by more than CPI.

1.3.2 Approach to determining non-price terms

The BAS service specification is set out in some detail in the SAU and in FANOC's response of 20 November 2007 to the ACCC's request for further information.

Otherwise, the SAU contains relatively few non-price terms and conditions of access. Instead, the SAU provides a role for the BAS Manager to submit 'reference' non-price terms and conditions for each BAS product to FANOC for approval. The SAU commits FANOC not to withhold its approval if, in FANOC's reasonable opinion, the terms are commercially prudent, the expenditure required is approved and the terms would not adversely affect the technical and operational quality of the network or the interests of access seekers.

1.3.3 Arbitration by the ACCC

It is not clear whether FANOC proposes, through the operation of the SAU, to effectively limit the ACCC's role as an arbiter of disputes between FANOC and access seekers to ensuring FANOC complies with the *processes* set out in the SAU for determining price and non-price terms and conditions of access or whether the ACCC's proposed role extends to arbitrating over the substance of those terms and conditions.

1.4 The ACCC's assessment

The TPA provides that the ACCC must, after considering an SAU, either accept or reject the SAU. The ACCC has no discretion to consider amendments or variations to an SAU once it is lodged for assessment.

The ACCC must not accept an SAU unless it is: (a) consistent with the standard access obligations in s. 152AR of the TPA; and (b) reasonable, according to the matters in s. 152AH of the TPA.

The ACCC has published the SAU and FANOC's supporting submissions on its website at www.accc.gov.au. On 21 June 2007, the ACCC published a discussion paper which set out the key terms of the SAU and invited submissions on the SAU. Submissions received from interested parties have also been published on the ACCC's website.

1.4.1 Draft Decision – Consistency with the standard access obligations

The ACCC's draft view is that it is satisfied that the SAU is consistent with the standard access obligations in s. 152AR of the TPA.

1.4.2 Draft Decision – Reasonableness of terms and conditions in the SAU

The ACCC's draft view is that it is not satisfied that the terms and conditions in the SAU are reasonable, having regard to the legislative matters in s. 152AH of the TPA, on the grounds that:

- (a) the initial prices for the first three year access period may be in the appropriate range; but
- (b) the terms and conditions of access give FANOC too much discretion, without sufficient regulatory oversight, to determine price and non-price terms and conditions for the 15 year SAU period.

In relation to the BAS service specification, the ACCC's draft view is that FANOC has addressed many of the needs of a low layer, bitstream access service. FANOC's proposed BAS offers access seekers a degree of control over their own customer traffic via a Virtual Local Area Network (VLAN) solution to give access seekers as much control as can be reasonably achieved on an FTTN upgrade. The ACCC notes that in terms of functionality, such a service lies between the ULLS and a wholesale xDSL service. While access seekers would not have as much control over the access service as they would using the ULLS, a bitstream access service such as FANOC's proposed BAS may provide the greatest degree of functionality technically and commercially feasible in the circumstances. However, questions about how congestion in the shared fibre backhaul will be managed have yet to be fully addressed by FANOC. In addition, the ACCC would also require further reassurances in relation to whether an appropriate approach to voice services has been proposed.

In relation to the price terms and conditions of access, the ACCC considers FANOC's proposed overall approach could be reasonable. In particular, FANOC's general proposal to use a building block approach of the kind used for long-term new investments in gas, electricity and rail appears appropriate and would provide a high degree of regulatory certainty for a significant new investment. The pricing methodology would be set up-front and would only require certain key inputs from the access provider to be entered from time to time, such as its ongoing actual costs, depreciation and demand forecasts. The ACCC is open to proposals for such pricing methodologies.

Given such a methodology for setting access prices to essential bottleneck infrastructure, all that would be required is effective, independent regulatory audit or review of the key inputs and parameters in the pricing methodology. Auditing the key inputs and parameters becomes particularly important in instances where the access undertaking period is very long. The ACCC notes that Part XIC of the TPA, in its current form, would not permit an access provider to assign powers and functions to the ACCC to allow it to undertake such an audit or review role in relation to an SAU.

In this case, the ACCC notes the SAU leaves FANOC with significant discretion in applying the pricing methodology over the 15 year period, particularly in relation to determining several of the key inputs, including the capital and operating expenditure that may be recouped through access prices, the proposed path of depreciation and the residual value of the assets at the end of the SAU.

FANOC also has significant discretion over setting the non-price terms and conditions of access according to the processes contained in the SAU, including in relation to introducing or withdrawing BAS products, varying their service specification and setting notice periods for network changes over the life of the SAU.

It is unclear whether the SAU effectively seeks to limit the ACCC's role in arbitrating access disputes between the access provider and access seekers to ensuring FANOC has complied with the methodologies for determining price and non-price terms and conditions of access.

In support of reserving to itself a significant level of discretion, FANOC emphasises that it will not be vertically integrated and its discretion will be subject to effective oversight by access seekers on the 'BAS Manager'. The ACCC considers that a vertically separated ownership model could, in principle, reduce incentives for the access provider to discriminate between downstream users of the access service and, therefore, facilitate strong and effective competition between access seekers in retail markets. Where such an ownership model is in place, the ACCC considers the need for regulatory oversight of non-price terms and conditions of access, in particular, could be reduced.

However, having assessed the proposed ownership and governance provisions in the SAU, the ACCC considers it cannot support FANOC's contention that these provisions support the reasonableness of its proposed approach. The ACCC's draft view is that:

- the SAU in fact allows a degree of vertical integration. While FANOC itself may not sell BAS products directly to retail end-users, the SAU expressly allows for (and FANOC envisages) access seekers having an ownership interest in FANOC. Although the SAU includes various ‘control restrictions’ on access seekers that purport to minimise the degree of vertical integration, the ACCC is not satisfied these provisions are sufficient to ensure FANOC will have no incentives to exercise its significant discretion to distort competition in downstream markets.
- the BAS Manager may not provide sufficient oversight of FANOC. The ACCC has concerns regarding the likely effectiveness of the BAS Manager’s oversight powers as well as the effectiveness of the internal operation of the BAS Manager.

Given this, the ACCC’s draft view is that it is not satisfied that the proposed ownership and governance structure justifies the significant discretion afforded to FANOC to determine price and non-price terms and conditions of access for 15 years without effective, independent oversight, such as audits of key parameters in the pricing methodology and the ability to arbitrate on the substance of non-price terms and conditions of access.⁴

Finally, FANOC has sought to confer powers and functions on the ACCC in relation to addressing non-compliance with the governance principles, assessing variations and arbitrating disputes. These functions and powers fall outside the ordinary legislative provisions under Part XIC. As the legislation currently stands, an SAU cannot confer these powers and functions on the ACCC. As a result, several terms and conditions in the SAU would appear to be inoperable.

The ACCC’s draft view is that it cannot currently be satisfied that the terms and conditions specified in the SAU are reasonable as required by subs. 152CBD(2)(b). Therefore, the ACCC’s draft decision is to reject the SAU as it stands.

The ACCC notes it is open to FANOC to withdraw and refine its SAU for future consideration.

⁴ The ACCC notes the greater the access provider’s interests are in downstream markets, the greater its incentives to discriminate between access seekers on an anti-competitive basis and the less effective a body such as the BAS Manager is likely to be in exercising the proposed oversight functions. While the proposed weighted average price cap methodology could be suitable even if the access provider was vertically integrated, a higher degree of regulatory audit might be required. For example, this could include effective powers for independent review and scrutiny of budgets (including expenditure proposals and demand forecasts) as is currently a feature of regulation in other industries. It could also include potential oversight of competition in downstream retail markets and stronger safeguards (for example, under an operational-separation regime) to prevent discrimination and cross-subsidisation, as is currently a feature of regulation in the telecommunications sector.

1.5 Making submissions

The ACCC invites submissions in relation to this draft decision. The closing date for submissions is 4 February 2008. Submissions should be directed to:

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GPO Box 520J
MELBOURNE VIC 3000

Email: anthony.wing@acc.gov.au

Fax: (03) 9663 3699

Any queries should be directed in the first instance to:

Jordana Hunter
Assistant Director, Convergence
Tel: (03) 9290 1872
Email: jordana.hunter@acc.gov.au.

Where submissions contain confidential information, this should be clearly indicated. Non-confidential and confidential versions of submissions should be provided to the ACCC at the time of making submissions.

1.6 Structure of this report

This report is structured as follows:

- **Chapter 2** provides background
- **Chapter 3** sets out the relevant legislative framework for assessing an SAU
- **Chapter 4** summarises the terms and conditions contained in the SAU
- **Chapter 5** assesses the *service specification* for the Broadband Access Service
- **Chapter 6** assesses the *price* terms and conditions of the SAU
- **Chapter 7** assesses the *non-price* terms and conditions of the SAU
- **Chapter 8** assesses the reasonableness of the terms and conditions in the SAU as a whole
- **Chapter 9** assesses the consistency of the terms and conditions in the SAU with the applicable SAOs
- **Chapter 10** contains the ACCC's draft decision on the SAU.

2. Background

2.1 The core competition issues

FANOC has proposed a hybrid fibre twisted pair (HFTP) access network – a form of FTTN network. It would effectively replace Telstra’s existing copper-based access network (the CAN) in the footprint proposed by FANOC, which initially covers around 4 million homes in five mainland capital cities. The ACCC considers that the HFTP network would exhibit essentially the same bottleneck characteristics over the ‘last-mile’ as the existing CAN. Therefore, the ACCC considers the rationale for requiring access to the CAN (through the declaration of the ULLS), would also be likely to apply to FANOC’s proposed HFTP network.

Telstra’s CAN is currently used to provide most fixed-line wholesale and retail telecommunications services.⁵ There are high barriers to facilities-based competition in fixed-line services due to high fixed costs and economies of scale associated with rolling out such networks. These barriers limit the ability of new entrants and existing players to deploy network infrastructure that is an effective substitute for the CAN.⁶ The ACCC notes it has yet to receive evidence that existing alternative customer access networks based on microwave, fixed wireless, optical fibre and satellite technologies constrain Telstra’s prices and behaviour in relation to the CAN.⁷

The ACCC noted these factors in its decision to re-declare the ULLS in July 2006. It is likely these factors would equally apply to a FANOC HFTP network, if such a network were to replace Telstra’s CAN, given the characteristics of the network, existing market conditions and the fact that FANOC has indicated it would only build a HFTP network if it received legislative protection from competitor overbuild for a period of time.

In light of this, the ACCC recognises that the terms and conditions of third party access to a HFTP network, should FANOC proceed with the proposal, will have a significant impact on competition in voice and broadband services.

2.2 Assessing future market conditions for broadband services

The ACCC notes that there is a relatively high degree of uncertainty regarding market conditions for broadband services in Australia. As a result, developing rigorous demand forecasts for broadband services is difficult, particularly over the medium to long-term. While it is widely anticipated that broadband demand will continue to grow, it is difficult to determine just how rapid this growth will be across the board and for services of different upstream and downstream speeds. The difficulties in developing

⁵ ACCC, *Declaration inquiry for the ULLS, PSTN OTA and CLLS, Final Determination*, July 2006, p. 14.

⁶ *ibid.*, p. 24.

⁷ *ibid.*, p. 15-16.

rigorous demand forecasts for broadband services are also recognised by regulators and industry groups overseas.⁸

Given the ongoing evolution of different technologies for delivering broadband services, there is also significant uncertainty in terms of the types of networks that are likely to be the most efficient in meeting future demand.

2.2.1 Demand uncertainty

One of the main sources of uncertainty in forecasting demand in the medium to long-term is forecasting future demand for existing and new services that will require broadband access and the necessary upstream and downstream speeds.

At present, 76 per cent of subscribers in Australia have broadband services with download speeds of less than 1.5 Mbps.⁹ Similarly, current use of broadband services in Australia is dominated by services for which 1.5 Mbps download speeds are sufficient (email, web browsing, online banking/bill payment and downloading music).¹⁰

However, recent trends suggest there may be growing end-user demand for higher speeds. According to the Australian Bureau of Statistics, the number of Australian internet subscribers on plans with connection speeds of 1.5 Mbps or greater increased by 68 per cent between June 2006 and March 2007. Similarly, research undertaken by the Internet Industry Association shows that average retail prices for high speed broadband packages are decreasing.¹¹

Significantly higher download speeds than 1.5 Mbps will be required to access newer applications, such as high quality video and gaming. Some of these applications also require higher upload speeds than those widely available.

For example, in relation to IPTV services, the amount of bandwidth required to access these services will depend significantly on the number of video services demanded simultaneously. This in turn is likely to depend on whether these services are a substitute for video content delivered by other means, such as traditional television broadcast services. The quality of services demanded will also be a significant factor. While viewing a single stream of standard definition content may only require a download connection speed of 2-3 Mbps, this may rise to 6-8 Mbps for each stream of high definition content.¹²

⁸ See, for example, Ofcom, *Future broadband: Policy approach to next generation access*, 26 September, 2007 p. 25. Available at:

http://www.ofcom.org.uk/consult/condocs/nga/future_broadband_nga.pdf

⁹ ABS 2007, *8153.0 Internet Activity Survey*, March 2007.

¹⁰ ACMA 2006, *Communications Services Availability in Australia 2005-06*, p. 45-46.

¹¹ Spectrum 2007, *Spectrum / IIA Price Index*, June 2007.

¹² It should be noted that the actual speeds delivered to end-users will ultimately depend on the 'end-to-end' speeds. This will in turn depend on the speed *within* the network, which would tend to be much slower than the 'last mile' customer connection due to constraints elsewhere in the system

Some industry observers forecast significant future demand for services such as remote diagnostics and telemedicine, which could require much higher speeds again as well as symmetrical connectivity.

There is also likely to be significant variation in end-user requirements. For example, in a report commissioned by the UK Broadband Stakeholder Group, Analysys Consulting indicated that the most bandwidth intensive households in the UK, which include young couples and households with children, will require 23 Mbps download and 14 Mbps upload speeds to satisfy household demand by 2012.¹³ However, Ovum's forecasts for the Australian market indicate that, despite stronger growth rates, high speed xDSL connections by the end of 2011 will still be outnumbered by services with connection speeds of between 0-10 Mbps. According to these forecasts, services with speeds of over 10 Mbps will comprise only 26 per cent of total xDSL services.¹⁴

2.2.2 Supply uncertainty

There are a range of technologies that may be used to deliver high speed broadband services. Within the family of xDSL technologies, which is the dominant service type in the OECD, there are a number of different technology options. These include ADSL with peak download speeds of up to 8 Mbps, ADSL2+ with peak download speeds of up to 24 Mbps and VDSL with peak download speeds of up to 50 Mbps, depending on a range of factors including the length of the copper loop between the customer's premises and the DSLAM. Reducing the copper loop length by upgrading the existing copper access network to FTTH would generally increase available speeds using xDSL technology. However, with technological developments, it is also possible that xDSL speeds for *given* copper loop lengths will improve over time.

Alternative forms of high speed access are also available. In Australia, Telstra has upgraded its Hybrid Fibre Coaxial (HFC) network to provide shared speeds of up to 30 Mbps in Sydney and Melbourne and is currently testing a 100 Mbps upgrade in Melbourne and a 75 Mbps upgrade in Sydney.¹⁵ Similarly, some HFC network operators in Europe and the United States are trialing 100 Mbps shared services.¹⁶

Fibre-to-the-home (FTTH) technology is also being deployed by incumbents and competitors overseas. While deployments have been strongest in the Asia Pacific region, particularly in Japan and South Korea, FTTH technology has also been rolled out in North America and Europe. In France, for example, Iliad and Neuf Cegetel have announced separate FTTH network rollouts to at least 4 million homes between them.¹⁷

(e.g. transmission congestion). At various times these constraints may increase download times dramatically.

¹³ Analysys 2006, *Green Paper – Predicting UK Future Residential Bandwidth Requirements*, May 2006, Prepared for the Broadband Stakeholder Group.

¹⁴ Ovum, *Detailed consumer DSL forecasts*, 3 October 2007.

¹⁵ Telstra, *Transcript of presentations at the Telstra Investor Day – Morning Session*, p. 18, 1 November 2007.

¹⁶ Ofcom, *Future broadband*, p. 19.

¹⁷ *ibid.*

FTTH networks can be configured to deliver symmetrical services of 100 Mbps or more.

Speeds available using other types of access networks, including wireless broadband technologies, are also increasing.

The type of upgrade to the existing copper access network that is adopted in Australia will impact on the ability and need to upgrade the network in future as new technology becomes available and demand conditions change.

2.3 Previous ACCC consideration of FTTN networks

There have been several proposals in Australia for an FTTN broadband access network. The ACCC held preliminary discussions with Telstra about a potential SAU for an FTTN network upgrade in 2006. Telstra withdrew from discussions in August that year and did not lodge an SAU.

2.4 Telstra's submission that FANOC's proposal should not be considered

Telstra argues the ACCC should dismiss FANOC's SAU without further consideration. It submits the SAU is 'out of bounds' and is an improper use of the SAU provisions.¹⁸ It argues the SAU is too 'highly conditional, incomplete and speculative', 'is riven with cascading uncertainties' that demonstrate the SAU is incapable of being reasonable and constitutes a request for an advisory opinion from the ACCC, contrary to 'both the ACCC's expressed policy across its whole range of functions, and to good regulatory practice'.¹⁹ Telstra further submits it is uncertain whether FANOC is entitled to lodge an SAU under s. 152CBA. Telstra argues it is unclear whether FANOC is a person who is, or expects to be, a carrier or carriage service provider supplying the relevant service, as required by that section.²⁰

The ACCC does not accept Telstra's proposition that the ACCC should refuse to consider FANOC's proposal.

An SAU sets out the terms and conditions of third party access to certain services, which the person submitting the SAU would be bound by if and when those services become available. To accept an SAU, the ACCC must be satisfied that these terms and conditions are consistent with the standard access obligations, as outlined in s. 152AR of the TPA, and are reasonable, as defined by s. 152AH of the TPA.

The ACCC notes the SAU provisions were added to the TPA to allow firms to seek regulatory certainty before committing to an investment. A decision to accept an SAU

¹⁸ Telstra, *Submission in response to the ACCC's Discussion Paper*, p. 13.

¹⁹ *ibid.*, p. 17-19.

²⁰ *ibid.*, p. 18.

does not bind a person to undertake the investment and offer the services contemplated in the SAU. Similarly, a decision to reject an SAU does not prevent a person from undertaking the investment and offering those services. Further, it is possible the ACCC could accept SAUs submitted by different persons that relate to similar investment proposals and services, even though it is likely that only one person will ultimately undertake the investment. The TPA does not require the ACCC to be satisfied that the services subject to the SAU *will be* provided by that person. Similarly, the ACCC is not required to be satisfied that the person has already made all necessary arrangements in order to be able to provide the services.

Any legislative amendments that may be necessary are a matter for government to consider and not the ACCC. Similarly, whether the person complies with all relevant legal and regulatory obligations, other than those under the TPA, is a matter for the relevant government bodies.

An SAU need not provide for *all* terms and conditions of access. The TPA contemplates that persons may lodge ordinary or special access undertakings that leave some terms and conditions of access to subsequent commercial negotiation or, failing agreement, arbitration by the ACCC. However, the onus is on the person lodging an SAU to provide sufficient information for the ACCC to be satisfied that the terms and conditions in the SAU are reasonable and consistent with the standard access obligations.²¹

²¹ *Telstra Corporation Limited* [2006] ACompT 4 at [20].

3. Legislation relevant to assessing special access undertakings

This chapter:

- discusses SAUs within the framework of Part XIC of the TPA
- sets out the criteria the ACCC must apply in assessing an SAU
- set outs the relevant procedural matters that apply to the ACCC's assessment of an SAU.

3.1 SAUs in the regulatory framework

3.1.1 Purpose

In 2002, the SAU mechanism was added to Part XIC of the TPA by way of the *Telecommunications (Competition) Bill 2002 (Cth)*. It is clear from the Explanatory Memorandum to this Bill that Parliament's intention was to give regulatory certainty to investors in telecommunications facilities as to the access obligations that would apply should they undertake their proposed investment.

The Explanatory Memorandum states:

This option would extend the existing provisions in Part XIC to enable the ACCC to grant exemptions and approve undertakings for services that are not yet declared or supplied. This would provide certainty for investors and thus encourage investment by allowing the ACCC to rule on whether a service should be exempt from declaration or whether the terms of a proposed undertaking are acceptable prior to the investment being made.²²

The Explanatory Memorandum notes in relation to SAUs:

Currently, potential investors in telecommunications services or infrastructure are unable to gain the certainty of an undertaking until the service that is proposed to be supplied becomes an active declared service. When the service becomes an active declared service, the standard access obligations apply to that service. This provides a disincentive for investment as it means potential access providers cannot obtain regulatory certainty as to the terms and conditions under which they would be required to provide access should the service be declared. In particular, where "risky investments" are subject to potential declaration, the investment may be rendered uneconomic as a result of this uncertainty.²³

²² *Telecommunications (Competition) Bill 2002 (Cth)* Explanatory Memorandum, p. 16.

²³ *ibid.*, p. 81.

The Explanatory Memorandum also notes:

The purpose of the proposed amendments is to provide certainty for potential investors in telecommunications infrastructure and services in relation to access to that infrastructure or service in the future by allowing the ACCC to rule on whether the terms of a proposed undertaking are acceptable prior to the investment being made.²⁴

In March 2007, the ACCC accepted Foxtel's Special Access Undertaking in relation to the Digital Set Top Unit Service. That decision is the first formal decision under the TPA on an SAU. It is available on the ACCC website (www.accc.gov.au).²⁵

3.2 Criteria for assessing an SAU

Under s. 152CBA of the TPA, an SAU can be lodged by a person who is, or expects to be, a carrier or a CSP, provided the service is not an active declared service.

A service supplied by a person who has given the ACCC an SAU, which the ACCC has accepted, is a declared service under subs. 152AL(7) of the TPA.²⁶ However, the ACCC may still declare a service under subs. 152AL(8) even if the service is to any extent covered by an SAU.

Section 152CBD of the TPA specifies that the ACCC must not accept the SAU unless:

- the ACCC is satisfied that the terms and conditions set out in the SAU would be consistent with the SAOs under s. 152AR, to the extent that those obligations would apply to the person in relation to the service if the service were treated as an active declared service
- the ACCC is satisfied that the terms and conditions set out in the SAU are reasonable
- the ACCC is satisfied that the SAU is consistent with any Ministerial pricing determination
- the ACCC has:
 - published the SAU and invited people to make submissions to the ACCC on the SAU
 - considered any submissions that were received within the time limit specified by the ACCC when it published the SAU.

²⁴ *ibid.*, p. 72.

²⁵ See also *Seven Network v ACCC* [2007] FCA 1929.

²⁶ Under Part XIC of the TPA, the ACCC may declare carriage services and related services to be declared services. Carriers and CSPs who provide declared services are required to comply with the SAOs in relation to those services. The SAOs facilitate the supply of declared services by access providers to access seekers, in order that access seekers can provide carriage services and/or content services.

The approach of the ACCC to assessing each of these matters is considered in turn below.

3.2.1 Consistency with SAOs

The SAOs are set out in s. 152AR of the TPA. Subject to any class or individual exemptions made by the ACCC, a carrier or CSP must comply with the SAOs in regard to declared services it supplies either to itself or to other persons.²⁷ In summary, if requested by a service provider, an access provider is required to:

- supply an active declared service to the service provider in order that the service provider can provide carriage and/or content services
- take all appropriate steps to ensure that the technical and operational quality of the service supplied to the service provider is equivalent to that which the access provider is supplying to itself
- take all appropriate steps to ensure that the service provider receives, in relation to the active declared service supplied to the service provider, fault detection, handling and rectification of a technical and operational quality and timing that is equivalent to that which the access provider provides to itself
- permit interconnection of its facilities with the facilities of the service provider for the purpose of enabling the service provider to be supplied with active declared services in order that the service provider can provide carriage and/or content services
- take all appropriate steps to ensure that the technical and operational quality and timing of the interconnection is equivalent to that which the access provider provides to itself
- if a standard is in force under s. 384 of the *Telecommunications Act 1997*, take all appropriate steps to ensure that the interconnection complies with the standard
- take all appropriate steps to ensure that the service provider receives fault detection, handling and rectification of a technical and operational quality and timing that is equivalent to that which the access provider provides to itself
- provide particular billing information to the service provider
- supply additional services in circumstances where a declared service is supplied by means of conditional-access customer equipment.

The assessment of whether the SAU is consistent with the applicable SAOs is considered in Chapter 8 of this report.

²⁷ Refer to ss. 152AS and 152AT of the TPA.

The ACCC will assess whether the terms and conditions in the SAU are consistent with the SAOs, as they would apply to FANOC if the BAS were an active declared service.

3.2.2 Terms and conditions are reasonable

An important part of the access regime is the terms and conditions of access (including the price or a method for ascertaining the price). Under Part XIC of the TPA, the ACCC cannot accept an SAU if it is not satisfied that the terms and conditions specified are reasonable. The ACCC does not determine reasonableness in a vacuum. The terms and conditions are always referable to the objectives of Part XIC set out in s. 152AB and the reasonableness criteria under s. 152AH.²⁸ In determining whether particular terms and conditions are reasonable, regard must be had to the following matters:

- Whether the terms and conditions promote the LTIE.
- The legitimate business interests of the carrier or CSP concerned, and the carrier's or CSP's investment in facilities used to supply the declared service concerned.
- The interests of persons who have rights to use the declared service concerned.
- The direct costs of providing access to the declared service concerned.
- The operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility.
- The economically efficient operation of a carriage service, a telecommunications network or a facility.²⁹

This does not, by implication, limit the matters to which regard may be had.³⁰

The ACCC considers that in order to have 'regard' to particular matters, it is required to take those matters into account and give weight to them as fundamental elements in making its determination.³¹

The ACCC notes that it is required to determine whether the terms and conditions are reasonable, not whether they are the best possible terms and conditions or whether they could be improved. This approach is supported by the Tribunal, which noted in its decision in respect of *Telstra Corporation Limited* [2006] ACompT 4 that:

²⁸ *Application by Optus Mobile Pty Ltd and Optus Networks Pty Ltd* [2006] ACompT 8 at [19].

²⁹ Section 152AH(1) of the TPA.

³⁰ Section 152AH(2) of the TPA.

³¹ In its decision in respect of *Telstra Corporation Limited* [2006] ACompT 4 at [68], the Tribunal stated 'when ss.152AH and 152AB require the Tribunal to have 'regard' to certain matters, the Tribunal is required, in the words of Mason J, to take those matters into account and to give weight to them as fundamental elements in making its determination: *The Queen v Hunt; Ex parte Sean Investments Pty Ltd* (1979) 180 CLR 322 at 329.' The ACCC considers these words are equally applicable to the ACCC's decision in the first instance.

In this analysis we are limiting ourselves to asking whether Telstra's charge term and its cost allocation method is reasonable having regard to the statutory matters. We are not concerned to enquire whether any other price term or cost allocation method is more reasonable.³²

The ACCC recognises that there is no one correct figure in determining reasonable costs as this will entail matters of judgement. The ACCC's task is to determine if the submitting party's method or approach to calculating its costs is reasonable having regard to the statutory criteria set out in s. 152AH and the objectives of s. 152AB.

However, in coming to a decision on whether or not a price term is reasonable, it is necessary for the ACCC to look at the means by which the price term was derived and to consider whether the method adopted was, in the circumstances, reasonable. That, in turn, requires evaluating the method adopted by reference to the same matters set out in ss. 152AH and 152AB.³³

Against that background, the ACCC believes that:

- it is the terms and conditions of the SAU as a whole that must be taken into account in assessing the reasonableness of the SAU
- any methodology or means used to establish or determine the terms and conditions must be considered against the matters set out in ss. 152AH and 152AB.

Further, reasonableness is not determined by reference to what would exist if the SAU was not accepted. In this sense, as has been confirmed by the Tribunal, it is not always necessary to apply a 'with and without' test in assessing the reasonableness of the SAU.³⁴ It may be useful to apply the 'with and without' test to individual criteria or in specific circumstances but, ultimately, the reasonableness test is applied as a stand-alone test.

This position was followed by the ACCC in relation to its assessment of Foxtel's SAU for its Digital Set Top Unit Service.³⁵ In that decision, the ACCC used the 'with and without' test to assist (as opposed to 'determine') its overall assessment of the reasonableness of the terms and conditions. It used the test to assist in assessing whether the SAU was likely to promote competition in markets for listed services. The ACCC found that the relevant counterfactual was the future without the SAU. It concluded:

as long as the Commission is satisfied that the proposed terms and conditions of supply embrace the SAOs and are reasonable, then the regulatory certainty of access afforded to access seekers

³² *Telstra Corporation Limited* [2006] ACompT 4 at [150]. See also *Seven Networks Limited (No 4)* (2005) ATPR ¶42-056 at [119].

³³ *Telstra Corporation Limited* [2006] ACompT 4 at [63-64].

³⁴ For example in *Application by Optus Mobile Pty Ltd and Optus Networks Pty Ltd* [2006] ACompT 8 and *Application by Vodafone Pty Ltd & Vodafone Australia Ltd* [2007] ACompT 1, the Australian Competition Tribunal did not undertake a 'with and without' analysis.

³⁵ ACCC, *Assessment of Foxtel's Special Access Undertaking in relation to the Digital Set Top Unit Service, Final Decision*, March 2007, p. 22.

by the SAU is an improvement on the uncertainty as to declared access they face without the SAU.³⁶

Set out below is a summary of the key phrases and words used in the reasonableness criteria. It should be noted that only some of the criteria have been judicially considered.

Long-term interests of end-users ('LTIE')

The phrase 'long-term interests of end-users' embodies three objectives, which are discussed below. In relation to the individual terms that make up the phrase, the Australian Competition Tribunal has stated:

Having regard to the legislation, as well as the guidance provided by the Explanatory Memorandum, it is necessary to take the following matters into account when applying the touchstone – the long-term interests of end-users:

End-users: "end-users" include the actual and potential [users of the service.]

Interests: the interests of end-users lie in obtaining lower prices (than would otherwise be the case), increased quality of service and increased diversity and scope of product offerings. This would include access to innovations [...] in a quicker timeframe that would otherwise be the case; and

Long-term: the long-term will be the period over which the full effects of the [...] decision will be felt. This means some years, being sufficient time for all players (being existing and potential competitors [...]) to adjust to the outcome, make investment decisions and implement growth – as well as entry and / or exit – strategies.³⁷

The ACCC has published a guideline explaining what it understands by the phrase 'long-term interests of end-users' in the context of its declaration responsibilities.³⁸ The ACCC considers that a similar interpretation is appropriate in the context of assessing an SAU.

In the ACCC's view, particular terms and conditions promote the interests of end-users if they are likely to contribute to the provision of goods and services at lower prices and higher quality or the provision of greater diversity of goods and services.³⁹

To consider the likely impact of particular terms and conditions, the TPA requires the ACCC to have regard to whether the terms and conditions are likely to result in the achievement of the following objectives:

- The objective of promoting competition in markets for carriage services and services supplied by means of carriage services.

³⁶ *ibid.*, p. 127.

³⁷ *Seven Network Limited (No 4)* [2004] ACompT 11 at [120].

³⁸ ACCC, *Telecommunications services — Declaration Provisions: A Guide to the Declaration Provisions of Part XIC of the Trade Practices Act*, July 1999.

³⁹ *ibid.*, p. 32-33.

- For carriage services involving communications between end-users, the objective of achieving any-to-any connectivity.
- The objective of encouraging the economically efficient use of, and economically efficient investment in:
 - the infrastructure by which listed carriage services are supplied
 - any other infrastructure by which listed services are, or are likely to become, capable of being supplied.⁴⁰

Promotion of competition

In considering whether competition will be promoted in markets for carriage services and services supplied by means of carriage services, subs. 152AB(4) and 152AB(5) of the TPA provide that:

(4) In determining the extent to which a particular thing is likely to result in the achievement of the objective referred to in paragraph (2)(c), regard must be had to the extent to which the thing will remove obstacles to end-users of listed services gaining access to listed services.

(5) Subsection (4) does not, by implication, limit the matters to which regard may be had.

The ACCC has previously expressed the view that the key issue in determining whether a regulatory decision will promote competition is whether the decision will assist in establishing conditions by which an improvement in competition will be likely to occur.⁴¹

The Tribunal has also adopted and refined this approach in the context of Part XIC, by adding the qualification that:

pursuant to s 152AB(2) we must have regard to “the extent to which” the term or condition is likely to result in the achievement of the objective of promoting competition in relevant markets. [...] When, for example, s 152AB(2)(c) directs the Commission (and the Tribunal on review) to have regard to the extent to which [a term or condition] is likely to result in the achievement of promoting competition [...], the Commission (and the Tribunal on review) must consider the extent of the competitive impact of [that term or condition] and the likelihood of that extent, not only the improvement of the environment for competition.⁴²

The ACCC considers it appropriate to adopt the Tribunal’s interpretation of the promotion of competition for the purpose of assessing the reasonableness of the SAU.

An important benchmark in assessing whether competition will be promoted is the consistency of the proposed terms of access with the principle of non-discriminatory access between downstream suppliers of a service.⁴³ Ultimately, a proposal for access

⁴⁰ Subsection 152AB(2) of the TPA.

⁴¹ ACCC, *Assessment of Foxtel SAU*, March 2007, p. 24.

⁴² *Telstra Corporation Ltd (No 3)* [2007] ACompT 3 at [96].

⁴³ The Tribunal has observed that the ‘promotion of competition’ is not satisfied merely by not inhibiting the ability of efficient competitors to compete: *Telstra Corporation Ltd (No 3)* [2007] ACompT 3 at [116].

must represent an opportunity for effective access by an access seeker to the particular service. An effective form of access should lead to the promotion of competition and contribute toward an efficient use of infrastructure.

Economically efficient use of, and economically efficient investment in, infrastructure

In the ACCC's view, the phrase 'economically efficient use of, and economically efficient investment in ... infrastructure' requires an understanding of the concept of economic efficiency. This concept consists of three components:

- *Productive efficiency* – this is achieved where individual firms produce the goods and services that they offer at least cost.
- *Allocative efficiency* – this is achieved where the prices of resources reflect their underlying costs so that resources are allocated to their highest valued uses (i.e. those that provided the greatest benefit relative to costs).
- *Dynamic efficiency* – this reflects the need for industries to make timely changes to technology and products in response to changes in consumer tastes and in productive opportunities.

The Tribunal has noted that:

The inclusion of the term "economically" in s.152AH(1)(f) suggests that the concepts of allocative, productive and dynamic efficiency should be considered. Allocative efficiency will be best promoted where the price of a service reflects the underlying marginal cost of providing the service.⁴⁴

Subsection 152AB(6) lists the matters the ACCC must have regard to in determining the extent to which the terms and conditions of an SAU are likely to result in the achievement of this objective. These matters are:

- Whether it is, or likely to become, technically feasible for the services to be supplied and charged for, having regard to:
 - the technology that is in use, available or likely to become available
 - whether the costs that would be involved in supplying, and charging for, the services are reasonable or likely to become reasonable
 - the effects, or likely effects, that supplying, and charging for, the services would have on the operation or performance of telecommunications networks.
- The legitimate commercial interests of the supplier or suppliers of the services, including the ability of the supplier or suppliers of the services, including the ability of the supplier or suppliers to exploit economies of scale and scope.

⁴⁴ *Telstra Corporation Limited* [2006] ACompT 4 at [94].

- The incentives for investment in:⁴⁵
 - the infrastructure by which the services are supplied
 - any other infrastructure by which the services are, or are likely to become, capable of being supplied.

According to the Explanatory Memorandum, the intention of the latter provision is to:

...ensure that the incentives for investment in new infrastructure by which services under consideration may be supplied, and the risk of making such an investment, is one of the matters to which regard should be had.⁴⁶

The ACCC will need to ensure that the access regime does not discourage investment in networks or network elements where such investment is efficient. The access regime also plays an important role in ensuring that existing infrastructure is used efficiently where it is inefficient to duplicate investment in existing networks or network elements.

In the past, the ACCC and the Tribunal have been satisfied that the factors impacting upon economic efficiency in the LTIE assessment (subs. 152AB(2)(e)) are also likely to impact upon economic efficiency in the reasonableness test (subs. 152AH(1)(f)).⁴⁷ In both contexts, the ACCC is required to assess the impact of the terms and conditions of access, as opposed to the proposed service, on economic efficiency.

The ACCC and the Tribunal have traditionally focussed on whether price encourages the economically efficient use of and investment in infrastructure. The Tribunal has been satisfied that the objective of encouraging efficient investment is met by access prices that allow the access provider to recover the costs of its efficient investment.⁴⁸

In assessing efficient costs, the ACCC has:

tended to take a 'scorched node' forward-looking approach using best-in-use technology. This amounts to a hybrid approach which combines the best technology currently available commercially with the existing network infrastructure.⁴⁹

However, in the Foxtel SAU decision the ACCC accepted a pricing methodology based on the actual costs incurred by Foxtel in rolling out digital services. The ACCC noted:

actual historic costs are costs that have been recently incurred. It is likely that these recently incurred costs closely approximate the replacement costs of modern equivalent assets.⁵⁰

⁴⁵ Note subs. 152AB(7A) requires that the ACCC, in determining incentives for investment, must have regard to the risks involved in making the investment.

⁴⁶ *Telecommunications Legislation Amendment (Competition and Consumer Issues) Bill 2005*, Explanatory Memorandum, p. 7.

⁴⁷ See *Telstra Corporation Ltd (No 3)* [2007] ACompT 3 at [279].

⁴⁸ *Telstra Corporation Limited* [2006] ACompT 4; *Telstra Corporation Ltd (No 3)* [2007] ACompT 3 at [159].

⁴⁹ ACCC, *Pricing of unconditioned local loop services (ULLS) Final Report*, March 2002, p. 16.

⁵⁰ ACCC, *Assessment of Foxtel SAU*, March 2007, p. 56-58.

The ACCC also accepted that the pricing methodology would lead to efficient access prices. While recognising the question of whether Foxtel's actual costs were efficient costs, the ACCC was of the view that the use of actual costs in Foxtel's pricing methodology was acceptable. In reaching this view, the ACCC noted, among other factors, that the commercial circumstances were such that:

Foxtel has no incentive to overspend on its network and has every incentive to minimise its costs.⁵¹

In its recent Mobile Terminating Access Service (MTAS) pricing principles determination report, the ACCC applied modelled efficient costs but noted it would consider any evidence put to it on the recently incurred actual costs and networks deployed by mobile network operators in Australia.⁵² It would be necessary to demonstrate that those actual costs were efficiently incurred. The ACCC noted the views of the Tribunal in *Application by Optus Mobile Pty Ltd and Optus Networks Pty Ltd* [2006] ACompT 8 that, in such a case:

Although there is merit in the proposition that a firm in a competitive market has an incentive to be efficient and to incur costs efficiently, there is still a need for the Commission (and, on review the Tribunal), to be satisfied, having regard to the matters set out in s.152AH and the objectives in s.152AB of the Act, that the firm's cost are efficiently incurred.⁵³

(i) *The technical feasibility of supplying and charging for particular services*

Generally, the onus will be on an access provider to demonstrate whether supply is technically feasible. The reasons for this could incorporate a number of elements including the technology that is in use or available, the costs of supplying and charging for the services and the effects on the operation of telecommunications networks.

In many cases, the technical feasibility of supplying and charging for particular services given the current state of technology may be clear, particularly where there is a history of providing access. The question will be more difficult where there is no prior access or where conditions have changed. Experience in other jurisdictions, taking account of relevant differences in technology or network configuration, will be helpful.

(ii) *The legitimate commercial interests of suppliers of the services, including the ability to exploit economies of scale and scope*

A supplier's legitimate commercial interests encompass its obligations to the owners of the firm, including the need to recover the cost of providing services and to earn a normal commercial return on the investment in infrastructure. The ACCC considers that allowing for a normal commercial return on investment will provide an appropriate

⁵¹ *ibid.*, p. 57.

⁵² ACCC, *Mobile Terminating Access Service (MTAS) pricing principles determination report*, November 2007, p. 1-2.

⁵³ *Application by Optus Mobile Pty Ltd and Optus Networks Pty Ltd* [2006] ACompT 8 at [118].

incentive for the access provider to maintain, improve and invest in the efficient provision of the service.

A significant issue relates to whether capacity should be made available to an access seeker. Where there is spare capacity within the network that is not assigned to current or planned services, allocative efficiency would be promoted by obliging the owner to release capacity for competitors.

Subsection 152AB(6)(b) also requires the ACCC to have regard to whether the access arrangement may affect the owner's ability to realise economies of scale or scope. Economies of scale arise from a production process in which the average (or per unit) cost of production decreases as the firm's output increases. Economies of scope arise from a production process in which it is less costly in total for one firm to produce two (or more) products than it is for separate firms to produce each of these products.

(iii) The impact on incentives for investment in infrastructure

Firms should have the incentive to invest efficiently in infrastructure. Various aspects of efficiency have been discussed already. It is also important to note that while access regulation may have the potential to diminish incentives for some businesses to invest in infrastructure, it also ensures that investment is efficient and reduces the barriers to entry or expansion for other competing businesses.

In considering the incentives for investment in infrastructure, the ACCC considers the impact the proposed terms and conditions will have on the investment decisions of the access provider as well as the build or buy choices of access seekers. This is the approach taken by the Tribunal in *Telstra Corporation Ltd (No 3)*, where it concluded that efficient investment by an access provider, and efficient build or buy choices by access seekers, are achieved where access charges are set to recover the efficient costs of investing in the infrastructure necessary to provide the declared service.⁵⁴

(iv) Other

The ACCC is not limited to these matters in its assessment of the extent to which the terms and conditions in an SAU are likely to achieve the objective of encouraging efficient use of infrastructure.⁵⁵

Legitimate business interests

The ACCC is of the view that the concept of legitimate business interests should be interpreted in a manner consistent with the phrase 'legitimate commercial interests' used elsewhere in Part XIC of the TPA. Accordingly, it would cover the carrier/CSP's interest in earning a normal commercial return on its investment.

This does not, however, extend to receiving compensation for the loss of any 'above-normal' economic profits due to increased competition.⁵⁶ In this regard, the Explanatory

⁵⁴ *Telstra Corporation Ltd (No 3)* [2007] ACompT 3 at [159-166].

⁵⁵ Subs. 152AB(7) of the TPA.

Memorandum for the *Trade Practices Amendment (Telecommunications) Bill 1996* states:

... the references here to the 'legitimate' business interests of the carrier or carriage service provider and to the 'direct' costs of providing access are intended to preclude arguments that the provider should be reimbursed by the third party seeking access for consequential costs which the provider may incur as a result of increased competition in an upstream or downstream market.⁵⁷

Further, in its decision in respect of *Telstra Corporation Limited* [2006] ACompT 4, the Tribunal noted:

We consider that a carrier's legitimate business interests is a reference to what is regarded as allowable and appropriate in commercial or business terms. ... When looked at through the prism of a charge term and condition of access and its relationship to a carrier's cost structure, it is a reference to the interest of a carrier in recovering the costs of its infrastructure and its operating costs and obtaining a normal return on its capital.⁵⁸

The ACCC also views this criterion as requiring an assessment of the broader commercial interests of the carrier/CSP in conducting its own business affairs. A carrier/CSP should not be unduly compromised in the conduct of its own legitimate business interests simply because it has an obligation to provide access to its service. For instance, a carrier/CSP must be able to make appropriate decisions about modifications and upgrades to its network or set appropriate requirements for billing and the payment of accounts. Generally, a carrier/CSP is entitled to have some legitimate control over its relationship with an access seeker to the extent reasonably required to protect its business concerns.

When considering the legitimate business interests of the carrier or CSP in question, the ACCC may consider what is necessary to maintain those interests. This can provide a basis for assessing whether particular terms and conditions in the SAU are necessary to maintain those interests.

Interests of persons who have rights to use the declared service

Persons who have rights to use a declared service will, in general, use that service as an input to supply carriage services, or a service supplied by means of carriage services, to end-users. In the ACCC's view, these persons have an interest in being able to compete for the custom of end-users on the basis of their relative merits. Terms and conditions that favour one or more service providers over others and thereby distort the competitive process may prevent this from occurring and consequently harm those interests.

⁵⁶ In its decision in respect of *Telstra Corporation Limited* [2006] ACompT 4, the Tribunal stated, at [136] 'We do not consider that Telstra's legitimate business interests extend to it achieving a higher than normal commercial return'.

⁵⁷ Explanatory Memorandum for the *Trade Practices Amendment (Telecommunications) Bill 1996*, p. 44.

⁵⁸ *Telstra Corporation Limited* [2006] ACompT 4 at [89]. This approach was also adopted in *Telstra Corporation Ltd (No 3)* [2007] ACompT 3.

Subsection 152AH(1)(c) of the TPA requires the ACCC to have regard to the interests of persons who already have rights to use the declared service in question. In assessing the SAU, the ACCC notes that there is no ‘declared service’ currently in existence and that SAUs in general apply to persons who are, or expect to be, supplying a service that is not an active declared service. The ACCC is of the view that under s. 152AH, it may consider the interests both of persons who currently have rights to use the service that is the subject of the SAU and the interests of persons who may wish to use the service in question in the event that the service is declared.

In respect of the interests of persons who may wish to use the service in question in the event that the service is declared, the ACCC’s focus is not on any one particular access seeker but all potential access seekers who may seek to use the service.

The ACCC’s approach is to recognise that simply because an access provider is the owner or controller of a facility and provider of the particular service, this does not mean that the provider can dictate the terms of access such that the form of proposed access does not represent a commercially feasible business model for the access seeker. This is about ensuring that the ability of an access seeker to compete in the supply of a service in a dependent market is based on the cost and quality of its service relative to its competitors, rather than about ensuring that an access seeker is able to conduct a profitable business. As noted above in relation to non-discriminatory treatment of downstream users, an access seeker should not be subject to overly onerous commercial terms simply because of its status as an access seeker.

On this basis, from a non-price perspective, the ACCC would, for example, expect an access seeker to have reasonable notification of proposed changes to a facility or service that affects its business interests or be consulted in relation to billing and credit matters, suspension of services and other facets of a business where its customer relationship may be impacted.

Direct costs

The ACCC’s Access Pricing Principles note that ‘direct costs’ are those costs *necessarily* incurred (or caused) by the provision of access. As stated in the Explanatory Memorandum:

... ‘direct’ costs of providing access are intended to preclude arguments that the provider should be reimbursed by the third party seeking access for consequential costs which the provider may incur as a result of increased competition in an upstream or downstream market.⁵⁹

The ACCC’s Access Pricing Principles also note that this requires that the access price should not be inflated to recover any profits the access provider (or any other party) may lose in a dependent market as a result of the provision of access.

Finally, the ACCC’s Access Pricing Principles note that this criterion also implies that, at a minimum, an access price should cover the direct incremental costs incurred in

⁵⁹ Explanatory Memorandum for the *Trade Practices Amendment (Telecommunications) Bill 1996*, p. 44.

providing access. It also implies that the access price should not exceed the ‘stand-alone costs of providing the service’, where this is defined to mean:

... costs an access provider will incur in producing a service assuming the access provider produced no other services.⁶⁰

Safe and reliable operation of a carriage service, a telecommunications network or a facility

Similar to the criterion relating to the legitimate business interests of the carrier or CSP above, this criterion requires the ACCC to take into account the need for the safe and reliable operation of a network or facility.

A carrier or CSP will generally seek to have in place operations and procedures designed to ensure the integrity of a network or facility is not harmed. Non-price terms and conditions such as these are considered necessary and essential to safeguard the business interests of both the carrier/CSP and access seekers, provided they are reasonable. In this regard, the ACCC would be concerned to ensure that any non-price terms and conditions, purportedly in relation to the safe operation of a network, are not used as a barrier to effective access.

In *Telstra Corporation Ltd (No 3)* the Tribunal concluded that:

[a] service provider will have a sufficient incentive to ensure the safe and reliable operation of carriage services, telecommunications networks or facilities so long as it receives sufficient revenue to cover the costs of ensuring safe and reliable operations.⁶¹

The Tribunal went on to equate ‘sufficient revenue’ with an access charge for the service that enables recovery of efficient costs inclusive of a normal return on investment.

Economically efficient operation of, and investment in, a carriage service

In the ACCC’s view, the phrase ‘economically efficient operation’ embodies the concept of economic efficiency set out above. It would not appear to be limited to the operation of carriage services, networks and facilities by the carrier or CSP supplying the declared service but would seem to include those operated by others (e.g. service providers using the declared service).

To consider this matter in the context of assessing an SAU, the ACCC may consider whether particular terms and conditions enable a carriage service, telecommunications network or facility to be operated in an efficient manner. This may involve, for example, examining whether they allow for the carrier or CSP supplying the declared service to recover the efficient costs of operating and maintaining the infrastructure used to supply the declared service under consideration.

⁶⁰ ACCC, *Access Pricing Principles – Telecommunications: A Guide*, July 1997, p. 10.

⁶¹ *Telstra Corporation Ltd (No 3)* [2007] ACompT 3 at [277].

In general, there is likely to be considerable overlap between the matters that the ACCC takes into account in considering the LTIE and its consideration of this matter.⁶²

3.2.3 Consistency with Ministerial pricing determination

Division 6 of Part XIC provides that the Minister can make a written determination setting out principles dealing with price or a method of ascertaining price relating to the SAOs. Subsection 152CI(1) of the TPA provides that if a provision of an access undertaking is inconsistent with any Ministerial pricing determination, the provision will have no effect to the extent of the inconsistency.

The Minister has not made a pricing determination in relation to the BAS.

3.2.4 Public process

Subsections 152CBD(2)(d)(i) and (ii) of the TPA require the ACCC to publish the SAU, invite submissions and consider any submissions received in response.

For the purposes of subs. 152CBC(6)(a) and 152CBD(2)(d), the SAU was published by the ACCC on 30 May 2007. The ACCC's Discussion Paper in relation to the SAU was released on 21 June 2007.

In response to the Discussion Paper, the ACCC received submissions from Mr Tony Antoniou, Pipe Networks and Telstra. These submissions were published on the ACCC's website on 6 September 2007.

FANOC provided further submissions in support of its SAU to the ACCC on 12 November and 20 November. These submissions were published on the ACCC's website.

The ACCC made one request for further information under s. 152CBB of the TPA on 26 September 2007. FANOC provided a response on 21 November 2007 which has been published on the website.

The ACCC has considered these submissions in reaching its draft decision on whether to accept the SAU.

Several issues were raised in the submissions to the ACCC that, while significant, are outside the scope of the matters to which the ACCC is required to have regard in reaching its draft decision on the reasonableness of the terms and conditions of access in this SAU. These issues include:

⁶² As noted above, in considering whether particular terms and conditions will promote the LTIE, the ACCC must have regard to their likely impact on the economically efficient use of, and the economically efficient investment in, the infrastructure by which listed carriage services are supplied and any other infrastructure by which listed services are, or are likely to become capable of being supplied.

- the lack of provisions to ensure a smooth transition from the current Telstra copper network to the proposed FANOC HFTP network.
- the lack of provisions dealing with services such as pay phones, emergency calls, security alarms and commercial services used by businesses.
- the implications of 100 per cent cutover of Telstra's copper tails to FANOC's proposed HFTP network.
- whether alternate networks to that proposed by FANOC would be more efficient and/or better promote the long-term interests of end-users.

While the ACCC is concerned to see a smooth transition to the new services, these issues are generally beyond the scope of the issues the ACCC is required to assess in considering the reasonableness of the terms and conditions of third party access contained in the SAU. The statutory criteria do not require the ACCC to assess the merits of the underlying network investment or apply a 'with and without' test to compare the proposed network and access arrangements against possible counterfactuals. Similarly, transition issues that could arise prior to BAS products becoming available are also likely to be beyond the scope of the ACCC's assessment of the SAU *per se*.

Indeed, the ACCC has previously said that issues surrounding network modernisation are inherently complex and that it considers that such terms and conditions would more usually be determined by bilateral or multilateral commercial negotiation or by agreed operational procedures through self-regulatory mechanisms.⁶³ The ACCC may have a role where industry procedures prove insufficient.

The ACCC acknowledges that these issues that are outside the scope of its consideration may be important considerations for government and other agencies to address through the relevant processes.

3.3 Procedural matters

3.3.1 Confidentiality

The ACCC recognises that the public consultation and its own decision-making process in relation to the SAU should be as transparent as possible. That said, the ACCC is aware of the need to protect certain elements of a provider's information where disclosure of such information may harm that provider's legitimate commercial interests.

The ACCC notes, however, that unless it can corroborate commercial-in-confidence information in some way, it is constrained in the weight that it can give to this

⁶³ ACCC, *Assessment of Telstra's ULLS monthly charge undertaking—final decision*, August 2006, p. 191.

information. To balance the possible harm to a provider from the disclosure of sensitive information and the harm that interested parties may suffer if they are unable to comment on matters affecting their interests, the ACCC considers a more limited form of disclosure of commercially sensitive information may be appropriate. In the public consultation for the current SAU this limited disclosure was facilitated through the use of confidentiality undertakings.

Confidentiality undertakings allowed interested parties access to FANOC's commercial-in-confidence material in FANOC's submissions on the proviso that this information was disclosed for the limited purposes of making submissions while preserving the general confidentiality of the information.

3.3.2 Statutory decision-making period

The ACCC has a six-month statutory timeframe in which to make a decision to accept or reject an SAU. If the ACCC does not make a decision within this timeframe, subs. 152CBC(5) of the TPA stipulates:

... the Commission is taken to have made, at the end of that 6-month period, a decision under subsection (2) to accept the undertaking.

For the purpose of calculating the six-month timeframe, certain periods of time are disregarded. Specifically, subs. 152CBC(6) of the TPA states the ACCC should disregard:

(a) if the Commission has published the undertaking under paragraph 152CBD(2)(d) – a day in the period:

(i) beginning on the date of publication; and

(ii) ending at the end of the time limit specified by the Commission when it published the SAU; and

(b) if the Commission has requested further information under section 152CBB of the Act in relation to the undertaking – a day during any part of which the request, or any part of the request, remains unfulfilled.⁶⁴

In addition, subs. 152CBC(7) of the TPA provides that:

The Commission may, by written notice given to the carrier or provider, extend or further extend the 6-month period referred to in subsection (5), so long as:

(a) the extension or further extension is for a period of not more than 3 months; and

⁶⁴ In relation to information requests about the SAU, subs. 152CBB(2) of the TPA states 'the Commission may request the carrier or provider to give the Commission further information about the undertaking', while subs. 152CBB(3) states 'the Commission may refuse to consider the undertaking until the carrier or provider gives the Commission the information'.

- (b) the notice includes a statement explaining why the Commission has been unable to make a decision on the undertaking within that 6-month period or that 6-month period as previously extended, as the case may be.

The decision-making period in relation to the SAU submitted by FANOC is discussed below.

3.3.3 Calculating the decision-making period for the SAU

The ACCC received the SAU from FANOC on 30 May 2007.

On 21 June 2007, the ACCC released a discussion paper and called for submissions on the SAU. The closing date for submissions was 7 August 2007 (this was extended to 31 August 2007 in recognition that the SAU raised many new and novel issues).

The discussion paper noted that if, prior to the expiry of this period, the ACCC makes a request of the access provider, under s. 152CBB, for further information about the SAU, the period would be extended by the time taken for the request to be fulfilled.

Since that date, the ACCC has made one request for further information under s. 152CBB of the TPA on 26 September 2007. FANOC responded on 20 November 2007.

In the ACCC's view, the SAU 'clock' was stopped during the consultation period (21 June – 7 August 2007) and while the request for further information was outstanding (26 September – 20 November 2007).

Accordingly, the six-month statutory timeframe in which to the ACCC must make a decision to either accept or reject the SAU expires on 12 March 2008.

3.3.4 Use and disclosure of confidential information in this report

The ACCC has relied on commercially sensitive information supplied by FANOC and interested parties in arriving at its draft decision. The ACCC has assessed this sensitive information having regard to its policy on the treatment of information⁶⁵ and, where applicable, determined that this information should not be reproduced in this report.

Accordingly, where information that is commercially sensitive has been relied on in reaching a conclusion, it has been aggregated to a level such that it is no longer commercially sensitive.

3.3.5 Documents examined by the ACCC

Under s. 152CGA of the TPA, where the ACCC:

- makes a decision under subs. 152CBC(2) accepting or rejecting an SAU and

⁶⁵ ACCC, *Collection and Use of Information*, 2000.

- the ACCC gives a person a written statement setting out the reasons for the decision

the ACCC must specify the documents it examined in the course of making the decision. The ACCC will include this list of documents in its final decision on FANOC's SAU.

In its assessment of the SAU, the ACCC has examined the supporting submissions provided by FANOC and submissions provided by interested parties.

4. Summary of FANOC's special access undertaking

This Chapter outlines the key terms of the SAU.

4.1 Structure of the SAU

In sub-clauses 3.1 (a) and (b) of the SAU, FANOC:

- agrees to be bound by the SAOs under s. 152AR of the TPA to the extent that those obligations would apply to FANOC if the BAS were treated as an active declared service, and
- undertakes to supply the BAS on the terms and conditions specified in the SAU.

The SAU includes three schedules:

- Schedule 1 provides a description of the network (the HFTP network).
- Schedule 2 comprises a description of the BAS, including specifying the initial BAS products to be offered.
- Schedule 3 comprises the pricing methodology by which, in conjunction with Clause 7, FANOC will calculate monthly access charges payable by access seekers.

The SAU also includes provisions relating to:

- commencement and duration (the SAU expires on the earlier of 15 years from the date the BAS is first supplied or 17 years after the SAU is accepted by the ACCC)
- third party access services, including prices, terms and conditions
- the management principles
- budgets
- record keeping and review
- equality of access to information
- appointment of an independent reviewer and matters submitted to the ACCC or an independent reviewer for a decision
- variation, replacement, withdrawal and extension of the SAU.

4.2 Governance structure

The SAU specifies the governance structure under which FANOC will supply BAS products to access seekers using the network. FANOC argues that the separation of the ownership and operation of the network will promote competition and efficient investment and remove any incentives for anti-competitive conduct inherent in vertically integrated control.⁶⁶

In FANOC's supporting submission, it states that FANOC will finance the acquisition and deployment of, and ultimately own, the network. FANOC will appoint an entity (known as the 'BAS Manager') to manage aspects of the operation of the network.

4.2.1 Ownership controls within the Management Principles

Clause 4 of the SAU contains 'Management Principles', which FANOC claims in its submission reflect two key elements of FANOC's structure and ownership, namely:

No vertical integration: FANOC will not provide downstream retail telecommunications services, so it will not be a vertically integrated wholesale provider. FANOC will therefore have straightforward incentives to maximise the utilisation of the network.

Diversity of ownership: By offering an attractive market based risk and return model, FANOC will attract a range of investors that will not have a strategic interest in the telecommunications sector, and can therefore operate independently of the interests of any single access seeker.⁶⁷

Clause 4.1 of the SAU gives effect to these elements. The following is a summary of clause 4.1:

- Clause 4.1(a) provides that FANOC will only provide carriage services to carriers or carriage service providers ('access seekers').
- Clause 4.1(b) provides that no access seeker (or group of access seekers acting in concert) can be in a position to control the material terms for BAS products set by FANOC.
- Clause 4.1(c) provides that FANOC may not discriminate against an access seeker on the basis of whether the access seeker is an investor in FANOC.
- Clause 4.1(d) provides that all access seekers (that are not a related body corporate of another BAS Manager member) will be entitled to be members of the BAS Manager.
- Clause 4.1(d) sets out the principles for voting rights for each BAS Manager member and limits the maximum percentage of the total voting rights of all

⁶⁶ FANOC, *Submission to the ACCC*, 30 May 2007, p. 20-22.

⁶⁷ *ibid.*, p. 16.

BAS Manager members such that no two BAS Manager members in aggregate hold more than 40 per cent of the aggregate voting rights.

- Clause 4.1(e) provides that no access seeker (or group of access seekers who are also investors in FANOC) can control the BAS Manager.
- Clause 4.1(f) provides that the BAS Manager board will include both representatives of access seekers and independent directors.

Clause 4.2 provides that the Management Principles will be reflected in a Management Agreement, entered into by FANOC and the BAS Manager.

4.2.2 Role of the BAS Manager

In appointing the BAS Manager to represent the interests of access seekers, FANOC submits that the primary purpose of the BAS Manager is:

- to facilitate a degree of separation between the funding and ownership of the HFTP network and its day to day operations
- to provide access seekers with a degree of oversight of the costs incurred by the access provider (since any inefficient costs would be borne by access seekers in the form of higher charges).⁶⁸

Specifically, the SAU outlines the role and functions of the BAS Manager:

- (i) Clause 5 provides that the BAS Manager will review, participate in the preparation of and consult on all budgets including the business plan for construction, ownership, operation and management of the network.
- (ii) Clause 6 provides that the BAS Manager will consult with FANOC regarding the introduction, variation or withdrawal of BAS products.
- (iii) Clause 6 also provides that the BAS Manager, in consultation with FANOC and access seekers, submit to FANOC for approval proposed reference non-price terms for each BAS product, including.
 - forecasting, ordering, provisioning, billing and associated procedures, and
 - technical and quality of service specifications.
- (iv) Clause 8.1 provides that the BAS Manager will be required, along with FANOC, to keep full and accurate records, supporting all costs and revenue included in the pricing model.

⁶⁸ *ibid.*, p. 18.

- (v) Clause 10.1 provides that the BAS Manager will consult with FANOC on the appointment of an independent reviewer.

Additionally, the BAS Manager is given a role in approving FANOC's proposed demand forecasts concerning BAS products. This role is provided for in the Pricing Model, as outlined in Schedule 3 of the SAU.

4.2.3 Compliance with the Management Principles

FANOC recognises the importance of ongoing compliance with the Management Principles.

Clause 4.3 of the SAU states:

FANOC agrees that following the Service Date:

- (a) the continued compliance with the Management Principles may have a material impact in relation to whether the terms of this Undertaking continue to be Reasonable.⁶⁹

Clauses 4.3 to 4.6 of the SAU outline a mechanism for ensuring that FANOC and the BAS Manager comply with the SAU's Management Principles.

These mechanisms include a process of variance and rectification notices, with the effect that if the Management Principles are contravened FANOC must:

- rectify its compliance,
- give additional SAUs to the ACCC to satisfy the ACCC of the continued reasonableness of the SAU, or
- withdraw the SAU.

FANOC must give 12 months notice before withdrawing the SAU. Clause 4.6 provides that FANOC must comply with any additional SAUs that the ACCC 'reasonably requires' to satisfy itself of the continued reasonableness of the SAU during the period once withdrawal has been notified.⁷⁰

4.3 Service description

The SAU may be without limitation or may be subject to such limitations as are specified in the SAU (subs. 152CBA(5) of the TPA). Under subs. 152AL(7) of the TPA, the service that is the subject of the SAU is deemed to be a declared service. If

⁶⁹ FANOC, *Special Access Undertaking to the Australian Competition and Consumer Commission Under Division 5 of Part XIC of the Trade Practices Act 1974 (Cth) in respect of the Broadband Access Service*, 30 May 2007, clause 4.3.

⁷⁰ *ibid.*, clause 4.6.

the SAU is subject to limitations, the service is a declared service only to the extent to which the service falls within the scope of the limitations.

4.3.1 Broadband Access Service to be provided as specific BAS products

The BAS is a generic term for broadband services offered over the network. In practice, a variety of specific services will be offered, for example, services at different speeds. These specific services are called the BAS products.

4.3.2 Initial BAS products

The initial BAS products that will be available to access seekers on the commencement of service are set out in Schedule 2 of the SAU. They are:

- (a) Basic Telephone Access Service (BTAS). Schedule 2 states this is an access service that will allow an access seeker to provide an internet protocol (IP) telephony based standard telephone service (or equivalent service) to a residential end-user.
- (b) Standard Broadband – 1.5 Mbps. Schedule 2 states this is a layer 2 point-to-point transmission service. It runs from the customer premises via copper to the node and then via fibre from the node to a point of interconnect. The Schedule states that the targeted maximum downstream line speed is 1.5 Mbps. The targeted minimum downstream line speed is 1.5 Mbps, which will be met in most cases.
- (c) Standard Broadband – 6 Mbps. The service will be provided as above but the targeted maximum downstream line speed is 6 Mbps. The targeted minimum downstream line speed is 1.5 Mbps, which will be met in most cases.
- (d) Standard Broadband – 12 Mbps. The service will be provided as above but the targeted maximum downstream line speed is 12 Mbps. The targeted minimum downstream line speed is 1.5 Mbps, which will be met in most cases.
- (e) Standard Broadband – Unlimited. The service will be provided as above but the targeted maximum downstream line speed is unlimited. The targeted minimum downstream line speed is 1.5 Mbps, which will be met in most cases.

4.3.3 Introduction, variation or withdrawal of BAS products

The BTAS may not be withdrawn or altered in a material respect during the term of the SAU unless the ACCC so approves (clause 6.4(a) of the SAU).

The other initial BAS products may not be withdrawn or altered in a material respect during the First Period of the SAU (until the end of three full financial years from the commencement of service) unless the ACCC so approves (clause 6.4(b) of the SAU).

FANOC may introduce new BAS products at any time but FANOC is first required to 'reasonably consult' with the BAS Manager.

Subject to the restrictions mentioned above on altering or withdrawing the initial BAS products, FANOC may also vary or withdraw a BAS product at any time. FANOC is first required to 'reasonably consult' with the BAS Manager.

The BAS Manager may request the provision of a new BAS product at any time (which would cover a varied version of an existing BAS product). In this case, FANOC must consult with the BAS Manager and 'reasonably consider' providing the requested BAS product.

Before introducing, varying or withdrawing a BAS product, FANOC must give access seekers 'reasonable notice'.

4.3.4 Technical and operational parameters of initial and new BAS products

The technical and operational parameters on which the initial BAS products will be offered are set out in Schedule 2. The ACCC also issued FANOC a request for further information under s. 152CBB of the TPA on 26 September 2007 on the technical and operational parameters of the initial BAS products. FANOC responded on 20 November 2007.

The specifications of new BAS products would provide certain technical and operational parameters.

FANOC will be required to comply with codes developed at Communications Alliance, or standards set by the ACMA, pursuant to the *Telecommunications Act 1997*.

4.4 Non-price terms and conditions of access

The SAU includes provisions relating to non-price terms and conditions under which FANOC will provide access to the BAS. These terms and conditions relate to:

- transitional arrangements and roll-out
- equality of access to information, and
- additional terms to be negotiated between FANOC and access seekers.

4.4.1 Transitional arrangements and roll-out

The SAU envisages that for each customer, or group of customers linked to a node, there will be a one-off transition from the old network to the upgraded network, although that one-off transition may occur node by node over a period of years during the rollout.

FANOC acknowledges the importance of transitional arrangements. The SAU does not make any specific provisions for these arrangements, however, in its submission FANOC states:

The Undertaking includes an acknowledgement that nothing in this SAU detracts from any power of the Commission in relation to determining appropriate processes and procedures to be followed to ensure that the roll-out of the HFTP Network occurs in an appropriate manner that balances the interests of FANOC and end users in an efficient deployment of the HFTP Network and the provision of BAS Products with the needs and interests of access seekers and their end users in minimising any disruption or inconvenience to their existing telecommunications networks and telecommunications services.⁷¹

4.4.2 Equality of access to information

FANOC will provide all access seekers with such information as, in FANOC's reasonable opinion, may be required in order for access seekers to make informed decisions in relation to the usage of BAS products, including equivalent information in relation to the technical and operational parameters of the Service Aggregation Network, the deployment schedule for that network, the BAS products that are being provided and the current maximum total charges for those products and any new BAS products that have been requested by an access seeker (clause 9 of the SAU). This is subject to exemptions surrounding commercial confidentiality.

FANOC states that these requirements contribute to ensuring that the management principles operate as they are intended – with all access seekers in a position to participate in the decisions of the BAS Manager on a fully informed basis.⁷²

4.4.3 Additional terms to be negotiated between FANOC and access seekers

Clause 3.2 notes the SAU does not specify all the terms and conditions on which FANOC will comply with the standard access obligations.

Other non-price terms and conditions for BAS products will be developed as follows. FANOC will request the BAS Manager to develop, in consultation with FANOC and access seekers, proposed reference non-price terms for each BAS product. These are to be submitted to FANOC for approval. FANOC will not withhold its approval to a proposed reference non-price term to the extent that, in FANOC's reasonable opinion, the non-price term is commercially prudent, the expenditure required is approved according to the Budget process described at clause 5 and it would not adversely affect

⁷¹ FANOC, *Submission to the ACCC*, 30 May 2007, p. 33.

⁷² *ibid.*

the technical and operational quality of the Service Aggregation Network and BAS products, nor the interests of access seekers in using BAS products (clause 6.6).

Should an access seeker object to any of these terms and conditions, it can seek a determination from the ACCC acting as arbitrator under Division 8 of Part XIC of the TPA. However, the ACCC is precluded (by subs. 152CQ(5)) from making an arbitration determination that is inconsistent with the SAU. Therefore, it is unclear whether the SAU, in effect, limits the ACCC's role in arbitrating a dispute relating to the terms and conditions agreed between FANOC and the BAS Manager to determining whether those terms and conditions were established in a manner consistent with the processes in the SAU.

4.5 Price terms and conditions of access

The SAU specifies the price terms and conditions under which FANOC will supply the BAS to access seekers. Schedule 3 of the SAU describes the pricing methodology by which FANOC will calculate access charges payable by access seekers.

The ACCC notes that FANOC has proposed a *methodology* for calculating annual access prices after the initial access period rather than a price list.

The total price that an access seeker will pay for access to the network will comprise two elements:

1. A **Pass-through Component** incorporating ULLS, or equivalent, access charges for access to the sub-loop; and
2. A **FANOC Component Charge** which is a charge for access to the FANOC Service Aggregation Network plus the node to pillar interconnect, calculated according to a specific pricing model. A single BAS product may include a number of FANOC component charges.

4.5.1 'Pass-through' component

The HFTP network requires access to the Telstra 'sub-loop' from the pillar to end-user premises in order to provide BAS products. Access from the pillar will require a charge be paid from FANOC to Telstra for the use of the sub-loop. Clause 7.1 in conjunction with clause 1.1 provides for these charges to be passed-through to access seekers at cost. The SAU does not discuss in any detail how the value of this 'pass-through' component will be determined. It is assumed however that it would be determined by commercial negotiation or, failing agreement, arbitration by the ACCC. It is important to note that the maximum FANOC component prices referred to in the SAU *do not* include this 'pass-through' component.

For the purpose of providing indicative all-inclusive prices for the first period, FANOC has assumed this component will fall between \$5 and \$15 per month.

4.5.2 FANOC component charge

The SAU sets initial maximum prices for the FANOC component charge of the BAS products for the initial three year period and provides a formula for re-setting those prices for successive four year access periods. The pricing methodology by which FANOC will calculate component charges payable by access seekers is described in detail in Clause 7 and Schedule 3 of the SAU. Additional information is provided in Schedule 4 in the NERA report.

FANOC explains its pricing model in two steps:

- **Target Revenue required to recoup costs.** At the beginning of each period, a calculation will be made of costs (capex and opex). Then the 'Target Revenue' required for FANOC to recoup its costs is calculated. The Target Revenue includes a return on capital (at the regulated WACC), a return of capital (depreciation), and operating and capital expenditures.
- **Resultant overall price cap on prices.** On the basis of demand forecasts that have been developed (and which will be approved by the BAS Manager, the ACCC or the Independent Reviewer), an overall price cap is then determined. The overall price cap is set at the level that provides the percentage change in prices needed across all products, so that FANOC will earn its 'Target Revenue' if it meets the forecasts.⁷³

After the initial three year period FANOC proposes a weighted average price cap approach to pricing. In general terms, under a weighted average price cap approach a firm is given the discretion to set individual prices for its regulated services, subject to the restriction that changes to regulated prices are, in combination, not greater than a change in a weighted average price. This weighted average price is set such that a firm can recover an amount which satisfies a predetermined specific revenue requirement. To ensure that this predetermined revenue requirement is met, the weighted average price can increase, or decrease, over time according to a CPI-X formula.

An important element of the weighted average price cap approach is that the revenue a firm earns depends on the individual prices it sets for different services and the volume of each service sold at those prices. This is seen to create important incentives for the development of efficient pricing structures.

Given the nature of the FANOC investment – which involves the development of a new network – the price cap involves a return on the actual costs of construction (rather than modelled costs). The rate of return (or WACC) uses the actual cost of debt and the actual cost of equity capital (rather than a modelled cost) arising from the initial investor bookbuild (capital auction), with an upper limit on the equity beta of 1.0.

⁷³ FANOC, *Submission to the ACCC*, 30 May 2007, p. 25.

The key elements of the proposed pricing methodology for the FANOC component charge are:

- (1) On the basis of long-term estimates of costs and demand, *maximum* prices for the FANOC component charge in the first access period will be set at:
 - \$10 for a basic telephone access service.
 - \$14.23 for a 1.5 Mbps broadband service (including basic telephone access for voice).
 - \$18.46 for a 6 Mbps broadband service (including basic telephone access for voice).
 - \$26.92 for a 12 Mbps broadband service (including basic telephone access for voice).
 - \$35.38 for an unlimited broadband service (including basic telephone access for voice).
- (2) In the second and subsequent access periods, the maximum prices for the FANOC component charge will be determined according to a weighted average price cap formula. The maximum prices for the FANOC component charge must not, in combination, result in a level of revenue which exceeds a predetermined revenue requirement. This predetermined revenue is calculated according to a CPI-X approach.
- (3) The value of 'X' in the pricing model will be determined in each access period such that the present value of forecast revenues in that access period equates to the present value of the 'target revenue requirements' over that access period.
- (4) The 'target revenue requirement' for each year of each access period will be determined in such a way so as to include a target level of expenditure, a target return on assets and a target return of capital. The terms 'target expenditure', 'target return of capital' and 'target return on assets' all have a specific technical meaning in the SAU.
- (5) The term 'target expenditure' includes target capital expenditure plus the forecast operating expenditure for that year based on the agreed budget.
- (6) The 'target return of capital' includes an amount for depreciation on the opening capital asset value. The SAU allows for the amount of depreciation to be set at FANOC's discretion provided that it be set such that the expected opening capital asset value at the beginning of the third and fourth access periods is not less than two-thirds and one-thirds, respectively, of the opening capital asset value at the beginning of the second access period.
- (7) The 'target return on assets' is determined by the opening capital asset value in an access period multiplied by the real post tax weighted average cost of

capital (WACC). The opening capital asset value in any access period refers to the amount of the capital asset value at the beginning of that access period.

- (8) In the initial access period, the opening capital asset value is equal to the initial capital asset value. The initial capital asset value is simply the difference between the capitalised actual expenditure *less* the capitalised actual revenue in the first access period.
- (9) In subsequent access periods, the opening capital asset value will be determined according to a formula which takes the opening capital asset value of the previous period and adds to it the actual expenditure in the previous period. It then deducts the target level of revenue in the previous period, as well as any revenue earned from capital disposals or from excluded products in the previous period. In addition, any difference between actual and estimated expenditure in the access period two periods before the current one is added to the opening capital asset value. Finally, any difference between actual and estimated revenue in the first access period is also added to the opening capital asset value.
- (10) It is proposed that the real post-tax WACC to be applied to the opening capital asset value be determined according to a methodology which provides for a return on debt and a return on equity.
- (11) A unique feature of the WACC methodology outlined in the SAU is that it proposes that in estimating the return on equity, the value of the equity beta be set *at the lower* of either 1.0 or a value derived through a capital raising auction.
- (12) In respect of a number of parameters in the pricing methodology – such as estimated quantities for existing and new products – the SAU outlines a process for determining their values. This involves an initial process of negotiation between FANOC and the BAS manager and, failing that, allows for either the ACCC or an Independent Reviewer to determine the values of these parameters in specific circumstances.

Initial period prices

Adding the FANOC estimated pass-through component charge of \$5 to \$15 to the FANOC component charge for first period, the estimated maximum all-inclusive prices in the first access period are:

- \$15 – 25 per month for a basic telephone access service.
- \$19.23 – 29.23 per month for a 1.5 Mbps broadband service (including basic telephone access for voice).
- \$23.46 – 33.46 per month for a 6 Mbps broadband service (including basic telephone access for voice).

- \$31.92 – 41.92 per month for a 12 Mbps broadband service (including basic telephone access for voice).
- \$40.38 – 50.38 per month for an unlimited broadband service (including basic telephone access for voice).

4.5.3 Addition/withdrawal of BAS products

The pricing methodology includes a provision which allows for the addition of new BAS products in an access period. At the beginning of each access period if a new product is likely to be introduced during that period, the allowed revenue will include the expected revenue from that product plus an adjustment that accounts for the impact of the introduction of the new BAS product on the demand for existing BAS services. In these circumstances, the BAS Manager will assess this volume sold of the new product – and the expected impact on existing products – on the basis of its understanding of what might have happened to volumes had the new product existed in the previous period. Should any disagreement arise between FANOC and the BAS Manager the issue will be put to the Independent Reviewer or the ACCC.

In addition, where BAS products are introduced or withdrawn during an access period this will impact on the assumed weighted average of forecast sales used in determining the appropriate ‘target revenue’ requirement for that access period. In such circumstances, the weighted average of forecast sales will need to be agreed by FANOC and the BAS Manager. Should a dispute arise it is proposed that this value be determined by an Independent Reviewer or the ACCC.

4.5.4 Prices for basic telephone services

The SAU notes that because certain basic telephony services are subject to social obligations (such as the retail price controls on basic line rental), the Basic Telephone Access Service will be required to be provided throughout the term of the SAU at the price specified for the first three years, subject only to CPI increases.

5. Assessment of service specification for the Broadband Access Service

The SAU provides for a Broadband Access Service over the network.

The BAS will be a Layer 2 bitstream service over the access network for the carriage of packets from customer premises to a point of interconnection. It is intended as the access service over an FTTN access network which replaces – or acts as an alternative to – the services used to access the unbundled physical copper loops today (i.e. the ULLS and the line sharing service (LSS)).

At present, the core bottleneck in telecommunications services is the infrastructure (currently the metallic wire) for establishing a physical connection to the customer premises.

The ACCC considers that the lower the layer in the network at which access is granted and the closer it is to the basic physical infrastructure that makes up the bottleneck, the greater the ability of access seekers to control their own costs and supply chain, differentiate service offerings, innovate and improve service quality. The ACCC considers that an approach to regulation that provides access seekers with greater control over their own business and products, to the extent that it is economically efficient, is likely to promote competition, innovation and investment in new services, and will be in the long-term interests of end-users.⁷⁴ Today, these requirements are met by access services such as the ULLS.

An FTTN access network upgrade is likely to make the current use of unbundled access to the copper loops via the ULLS more difficult, if not impossible.

The ACCC expresses no view here as to whether a ULLS service should continue to be available. That might well depend on the particular network upgrade. However, it will be possible to offer an access service of some kind over the bottleneck. This could be some form of bitstream access service. It will need to be as close to unbundled access to copper as is feasible and give the access seeker as much control as possible over its own customer traffic.

Unlike ULLS access to a copper line on the existing PSTN network, a bitstream access service on an FTTN network upgrade will carry signals over both the (non-shared)

⁷⁴ ACCC, *Fixed Services Review – a second position paper*, April 2007, p. 21. Ofcom (UK) has similarly made the point that: ‘Whereas competition between rival end-to-end infrastructures has proved to be effective and sustainable in the mobile market, this has not been the case in fixed telecoms. In fixed telecoms, we concluded that there were enduring economic bottlenecks – parts of the network where effective and sustainable competition was unlikely in the short to medium term. Therefore we adopted the principle that regulation should promote competition between competing infrastructures as deep in the network as such competition was likely to be effective and sustainable.’ Ofcom, *Final statements on the Strategic Review of Telecommunications, and SAUs in lieu of a reference under the Enterprise Act 2002, Executive Summary*, September 2005, p. 1.

copper from customer premises to the node and over the (shared) fibre, from the node to the point of interconnect. Thus, unlike the existing ability of an access seeker to add its own electronics to a passive copper loop, a person taking a bitstream access service over an FTTN network upgrade is taking a service that also includes use of the access provider's DSLAM at the node and control of traffic across the shared fibre by the access provider's electronics.⁷⁵

A future bitstream access service would need to be at a much lower level in the network than a wholesale xDSL service in order to promote competition and the long-term interests of end-users.⁷⁶ If end-users are to reap the benefits of next generation broadband, access seekers need to be able to directly control their own customer traffic so they can innovate on services and applications and avoid simply reselling the access provider's product. The user of a wholesale xDSL service has little control over the service and is often able to do little more than add its own marketing and call centre. By contrast, the proposed replacement for ULLS should be designed to give access seekers as much control as possible over their own customer traffic. The UK communications regulator, Ofcom, similarly describes a future broadband access product as needing to offer very high levels of flexibility and configurability, allowing competitive operators as much control as possible.⁷⁷

Where the network owner is vertically integrated and has substantial market power in the retail market, a service which gives access seekers a lot of control over their traffic is also important to restrict the ability of the network owner to discriminate against access seekers. Therefore, the service specification of a bitstream access service is critical to promoting competition and the long-term interests of end-users.

In addition, the ACCC considers that to promote competition it is important to ensure the proposed terms of access are consistent with the principle of non-discriminatory access between downstream suppliers of a service.

Accordingly, over the course of 2006 and 2007, the ACCC has made it clear to all parties proposing FTTN upgrades (or similar access network rollout) in Australia that a bitstream access service is required on a non-discriminatory basis at as low a layer as is reasonably possible, with points of interconnect close to customer premises (for example, at existing local access switches), which gives access seekers as much control over the shaping of their own customers' traffic as is reasonably possible.

This chapter sets out the ACCC's guidance as to the minimum elements of an FTTN access network that are likely to be necessary for the proposed access service to promote the long-term interests of end-users, particularly through promoting

⁷⁵ In the terms used by the UK regulator, Ofcom, it is an 'active' access service rather than a 'passive' access service. Ofcom, *Future broadband*, 26 September 2007, section 6.

⁷⁶ Existing wholesale bitstream services over current generation networks in other jurisdictions offer access seekers a variety of levels of control over their own customer traffic and are not necessarily comparable to the level of control described in this report for a bitstream access service over an FTTN network.

⁷⁷ Ofcom, *Future broadband*, 26 September 2007, section 6.

competition and the efficient use of and investment in infrastructure, as well as the interests of persons who have rights to use the service.

The chapter then provides the ACCC's detailed analysis of FANOC's Broadband Access Service, including the ACCC's consideration of the various submissions made by FANOC and interested parties, in light of these minimum elements and having regard to the matters set out in s. 152AH of the TPA.

5.1 The minimum elements of an FTTN access service

The ACCC is of the view that in relation to an FTTN network upgrade, or similar fibre access network rollout, any bitstream access service should include the following:

1. A Layer 2 bitstream access service, which may be offered at a variety of rates but should include a product that is not throttled as well as a product that is symmetric to the extent the technology permits. Products (both consumer and business-grade) should be equally available to all access seekers on a non-discriminatory basis.
2. A service (whether the bitstream service or another service) that allows access seekers to provide a voice service.
3. Points of interconnection as close to customers as is feasible and efficient, which in the first instance is likely to mean at or near existing local access switches and other points of interconnection for current ULLS and LSS products (it may have other points of interconnection as well).
4. Interconnection protocols based on well-accepted standards for broadband, voice and, if applicable, video, which are sufficiently well-described to allow access seekers to design and build their own interconnecting facilities.
5. Arrangements for access to buildings, shelters and facilities for interconnection.
6. Well-described and appropriate protocols for how packets are to be prioritised and handled.
7. Well-described and appropriate protocols for how congestion in shared network elements is to be handled.
8. Equivalent treatment of access seekers in relation to quality of service parameters such as jitter, delay and packet loss.
9. Interaction by access seekers with operations support systems, including:
 - a. *visibility* of provisioning, fault reporting and rectification and service assurance, and
 - b. *control* of own customer configuration and use of the access seeker's allocated part of the capacity.

10. No barriers to multicasting and IPTV by access seekers.

11. An appropriate process for amending service specifications in later periods as needed or desirable.

The ACCC considers a bitstream access service with a service specification that addresses these minimum elements would be likely to provide access seekers with sufficient flexibility and control over the access service to allow any-to-any connectivity and enable access seekers to compete effectively and make appropriate decisions in relation to the efficient use of and investment in infrastructure. Therefore, the ACCC considers that such a service description would be likely to promote the long-term interests of end-users.

The ACCC accepts that over the life of a 15-17 year SAU such as this one, there may be considerable technological and market developments. Accordingly, it may be justifiable that the access service is not set in stone for that entire period and an appropriate mechanism is provided to allow for changes to the technical and operational parameters and other non-price terms and conditions of the service over time.

However, the terms and conditions in an SAU must still provide for effective access by access seekers to the particular service for the ACCC to be satisfied that the terms and conditions are reasonable under s. 152AH. Therefore, access seekers will still need sufficient information about the initial form of the access service that is to be provided on the commencement of the service.

In relation to the level of detail required, the ACCC notes that SAUs do not have to provide for all possible terms and conditions of supply of the service and, indeed, it was envisaged by Parliament that they will not. The TPA provides that terms and conditions not included in an SAU are subject to commercial negotiation between the parties or, failing agreement, arbitration by the ACCC under Division 8 of Part XIC of the TPA. Further, many detailed technical and operational parameters may be provided for in Communications Alliance codes or ACMA standards.

Accordingly, firms providing SAUs have considerable leeway as to what terms and conditions they cover in the SAU and what they leave to future commercial negotiation or arbitration or development through codes or standards.

However, the Australian Competition Tribunal has observed that ‘the purpose of an undertaking is to specify enforceable rights and obligations between access providers and access seekers.’⁷⁸ The Tribunal in that case found that ‘the taking of [...] remedial action is no substitute for the provision of adequate and reasonable notice of network upgrades in the undertakings’.⁷⁹ While the reference is to specific terms and conditions (i.e. those relating to notification), it may be inferred that the Tribunal views some terms and conditions as so important, or inherent to reasonableness, that they must be

⁷⁸ *Telstra Corporation Ltd (No 3)* [2007] ACompT 3 at [316].

⁷⁹ *ibid.*

specified in an access undertaking. Which terms and conditions are of this character will likely vary on a case-by-case basis.

In this case, a proposal for a major network upgrade such as FTTN, which will replace the existing access services used by access seekers to serve their customers with a new access service, requires a smooth migration to the new service. The ACCC is of the view that a smooth migration requires greater certainty about the specification of the new access service than would be the case for the introduction of an additional access service.

This would certainly be the case if a vertically integrated carrier such as Telstra was to provide such an access service, since such an access provider can provide a service to its retail arm from day one whereas, absent sufficient up-front information, competing access seekers would face a lag while they design and build the facilities required to migrate existing customers or commence marketing to win new customers.

However, the ACCC considers that this will also be the case, at least some extent, for a provider such as FANOC, particularly given the SAU contemplates the possibility of at least some access seekers having a financial interest in FANOC.

Once that initial migration to new services has occurred, subsequent ongoing evolution of service details may be left more to commercial negotiation and arbitration or via existing *Telecommunications Act 1997* code and standard development processes as is the case today.

5.2 Overview of FANOC's service specification

FANOC's service specification is outlined in Chapter 4. In brief, FANOC's SAU is expressed to be in relation to the BAS which is defined in Schedule 2 to the SAU as follows:

The Broadband Access Service comprises any Carriage Service provided by a FANOC Ownership Entity:

- (a) over the HFTP Network
- (b) between the End User POI and an Access Seeker POI.

The BAS is to be provided in the form of specific BAS products. Initially five BAS products are to be provided and these are defined in Schedule 2 of the SAU as:

- (a) the Basic Telephone Access Service as described in Annexure A and
- (b) the Standard Broadband Services of the following bandwidths:
 - (i) Standard Broadband - 1.5 Mbps, as described in Annexure B of this Schedule 2.
 - (ii) Standard Broadband - 6 Mbps, as described in Annexure C of this Schedule 2.
 - (iii) Standard Broadband – 12 Mbps, as described in Annexure D of this Schedule 2.

(iv) Standard Broadband - Unlimited, as described in Annexure E of this Schedule 2.

5.3 Assessment of the service specification

In this section, the ACCC's assessment of the service specification for the BAS is discussed. The discussion also includes consideration of the various submissions made by FANOC and interested parties in relation to the reasonableness of specific non-price terms and conditions. The ACCC has analysed the service specification in light of the minimum elements set out in section 5.1 and has had regard to the matters listed in subs. 152AH(1).

5.3.1 A Layer 2 bitstream access service, which may be offered at a variety of rates but should include a product that is not throttled as well as a product that is symmetric to the extent the technology permits. Products (both consumer and business-grade) should be equally available to all access seekers on a non-discriminatory basis.

FANOC's submissions

FANOC's BAS is a Layer 2 bitstream access service.

The BAS products include a service which is not throttled at all (while it is sometimes described as a service up to 24 Mbps, it is not in fact capped at 24 Mbps). The products include asymmetric services whilst on ADSL2+, since that is what the technology permits. The products also include services that *are* throttled at various intermediate speeds. FANOC cannot withdraw the initial rate unlimited service for the first three years, after which FANOC must reasonably consult the BAS Manager and give access seekers reasonable notice before varying or withdrawing the service.⁸⁰

FANOC advises that it intends to develop other consumer and business-grade products in future.⁸¹ For example, it provides a draft of a 'Business Grade Broadband' service at Annexure F to its submission.

The ACCC repeats its views as set out in previous decisions on ordinary access undertakings that an important part of assessing whether competition will be promoted in the long-term interests of end-users is whether the principle of non-discrimination between downstream suppliers of the service is complied with.⁸²

FANOC will not offer retail services itself. Accordingly, the guarantees of equivalence in the standard access obligations may be of less use to ensure non-discrimination as between access seekers. However, FANOC of its own accord undertakes that it will supply any service it supplies to any other person to all access seekers upon request,

⁸⁰ FANOC, *Special Access Undertaking*, 30 May 2007, clause 6.3.

⁸¹ FANOC, *Submission to the ACCC*, 30 May 2007, p. 5.

⁸² ACCC, *Assessment of Telstra's PSTN and LCS SAU, Final Decision*, 29 November 2006, p. 26; ACCC, *Assessment of Telstra's ULLS monthly charge undertaking, Final Decision*, August 2006, p. 24.

with the maximum price as set out in the SAU, and that it will take all appropriate steps to ensure equivalence of technical and operational quality as between all access seekers.⁸³ Further, FANOC's SAU provides that it will not discriminate between access seekers in setting terms for the supply of BAS products on the basis of whether the access seeker is a shareholder in FANOC.⁸⁴ Finally, to ensure that access seekers know of the existence of a product so that they may request it, FANOC undertakes that it will reasonably provide equivalent information to access seekers who ask for it about the BAS products that are being provided and any new BAS products requested by an access seeker (subject to restrictions on the provision of commercial-in-confidence information).⁸⁵

Submissions

Submitters made no submissions directly relevant to this issue.

Telstra claimed that its proposed network upgrade would offer better consumer and business-grade services. The ACCC however takes no view on whose proposed network upgrade is better – that will be a matter for the market or the Government to decide. The ACCC is only assessing whether, if this network upgrade was built, the proposed terms and conditions of third party access would be reasonable.

The ACCC's draft view

The ACCC would prefer some guarantees that a non-throttled service will remain available. However, the ACCC notes that as FANOC is not intended to be a retail provider, it would likely have an incentive to provide such a service if there is demand for it.

The ACCC considers whether FANOC complies with the principle of non-discrimination in section 7.2. Subject to this matter, the ACCC's draft view is that the basic requirement to provide a Layer 2 bitstream service is met.

5.3.2 A service (whether the bitstream service or another service) that allows access seekers to provide a voice service.

FANOC's submissions

FANOC's BAS products include an access service designed to allow access seekers to provide a voice service.

The voice service will be an analogue service from customer premises to the node and then a bitstream service from the node to the point of interconnection at the LAP (or TAP). It is designed to support existing customer premises equipment such as handsets and fax machines (i.e. equipment conforming to AS/ACIF S002, S004 and AS/NZS

⁸³ FANOC, *Special Access Undertaking*, 30 May 2007, clause 3.1.

⁸⁴ *ibid.*, clause 4.1(c).

⁸⁵ *ibid.*, clause 9

60950-2000). The handoff is purely an Ethernet stream – access seekers must supply their own voice softswitch.⁸⁶

Telstra's submission

Telstra submits that:

G9 appears to anticipate that access seekers will introduce soft switches. However, no other country has replaced large parts of its PSTN with softswitches and the technology has not been deployed on any scale for voice services (although BT commenced such a migration in November 2006 in a process which is expected to take 2 to 3 years). Some new entrants are beginning to use such switches but are carefully managing the expansion of their voice services off a small base. An incumbent in Telstra's position would follow a more incremental pathway which kept the existing time division multiplex (TDM) switching architecture as a safety net.

The risks of the G9 telephony approach are higher still because there is little global experience with the application of VoIP technologies such as Session Initiation Protocol (SIP) to public telephony services supplied by multiple soft switches "sharing" a single access network. The required standards are immature, complicating the interconnection of multiple providers with different vendors to the FANOC network.⁸⁷

FANOC's submission in response

In response to Telstra's submission, FANOC further submitted that Telstra's concerns were invalid.

FANOC submitted that most access seekers now have softswitches and networks based on VoIP. The exception to this rule, it submitted, is where access seekers are required to interconnect with the Telstra network today, since Telstra forces access seekers to interconnect at the E1 level via media gateways that access seekers would no longer need to maintain for interconnection to the FANOC network.

FANOC further submitted that Telstra's comments are made redundant by its own well developed plans to fully deploy NGN technology, including the replacement of legacy switches with softswitches.⁸⁸

The ACCC's draft view

The ACCC does have concerns about whether the use of softswitches is sufficiently developed to *require* access seekers to use them to provide a voice service at this immediate point in time.

The ACCC does not object to *allowing* access seekers to use softswitches. The ACCC expects softswitches to be introduced widely across the network in Australia as part of the transition to a next generation IP core. It notes that Telstra appears to be well advanced on its own Next IP project.

⁸⁶ *ibid.* Annexure A. FANOC, *Submission to the ACCC*, 30 May 2007, p. 11.

⁸⁷ Telstra, *Submission in response to the ACCC's Discussion Paper*, p. 28. See also Annexure A, paras 1-10.

⁸⁸ FANOC, *Response to Telstra's submission on G9 SAU*, 20 November 2007, p. 5.

Accordingly, it may be only an interim difficulty and a matter of timing as to when the network upgrade would be rolled out and the first services would be migrated. Further, while FANOC did not propose this, it is possible that FANOC, as a single entity, could smoothly transit all services to FANOC softswitches and supply a voice service to access seekers. FANOC does observe that the collective capabilities of the G9 give it global expertise in network design and construction.⁸⁹ However, the ACCC notes that it may be asking a lot to expect all access seekers to both smoothly migrate their voice customers to the use of softswitches and to interwork with all other access seekers from day one.

The ACCC notes that in other countries where FTTH is being provided to residential customers, it appears the norm to retain the existing copper to run, among other things, voice services (the ACCC also notes Telstra's view that, ultimately, the copper will need to be retired and replaced by FTTH).⁹⁰

Given that the ACCC does not propose to accept this SAU for other reasons, it is not necessary to reach a view on this matter now. However, before accepting an SAU of this nature, the ACCC would seek further views on the matter.

5.3.3 Points of interconnection as close to customers as is feasible and efficient, which in the first instance is likely to mean at or near existing local access switches and other points of interconnection for current ULLS and LSS products (it may have other points of interconnection as well).

FANOC's submissions

FANOC's SAU contemplates two sets of points of interconnection – Local Access Points (LAP) and Transit Access Points (TAP).

Local Access Points will be the closest points to the customer at which access seekers will be able to interconnect. FANOC's SAU, submission and response to the s. 152CBB request states that the LAPs will be located in Telstra Exchange Building Access (TEBA) space at existing Telstra exchanges or similar locations.⁹¹

The TAPs are higher in the network, at points of greater aggregation. Access seekers interconnecting at such points would be buying a service that consisted of both the basic bitstream carriage between local access point and customer premises, and more aggregated and more shared backhaul over shared fibre back into the network. No information is given on where the TAPs might be located but each TAP would presumably service a larger number of LAPs and the customers connected via them. FANOC argues that the provision of a transit access point will remove the need for access seekers to have to provide backhaul to each exchange if this does not meet their

⁸⁹ *ibid.*, p. 2.

⁹⁰ Telstra, *Submission in response to the ACCC's Discussion Paper*, p. 40.

⁹¹ FANOC, *Special Access Undertaking*, 30 May 2007, Schedule 1; FANOC, *Submission to the ACCC*, 30 May 2007, p. 8; FANOC, letter to the ACCC, 20 November 2007, p. 1-2.

requirements.⁹² Due to the greater sharing with other carriers and service providers over the additional backhaul, interconnection at TAPs would be expected to give less control over the access seeker's own traffic but would also require less investment in interconnection equipment.

Pipe Networks' submission

Pipe Networks submits that interconnection close to the DSLAM (such as the local exchange) rather than close to the core is required to support innovative services such as local community closed user groups, multicasting and voice services over IP.⁹³

Telstra submission

Telstra submitted that the SAU did not contain any commitment to offer a point of interconnection at a TAP or did not define it. As a result, existing users of Telstra wholesale products would need to make additional investments in (unregulated) backhaul to transition their service to interconnect at local access points.⁹⁴

Access seekers would also, Telstra submitted, need to build media gateways to interface with both FANOC and Telstra. (Conversely, FANOC submitted, that where access seekers are required to interconnect with the Telstra network today, Telstra currently forces access seekers to interconnect at the E1 level via media gateways. FANOC submits that access seekers would no longer need to maintain such media gateways for interconnection to the FANOC network.⁹⁵)

The ACCC's draft view

The deeper/lower layer in the network an access service is, the greater access seekers can control the service they deliver to customers. As a result, they will have a greater ability to control their own costs and supply chain, differentiate service offerings, innovate and improve service quality. The ACCC considers that an approach to regulation that provides access seekers with this greater level of control over their own business and products is likely to promote the LTIE.⁹⁶

Accordingly, while it may not be efficient to provide access at individual nodes, the fact that access seekers using ULLS/LSS are currently able to interconnect efficiently at existing local exchanges suggests that they will be able to interconnect efficiently to a replacement bitstream access service at or near those exchanges. It does not appear justifiable to restrict interconnection to points higher in the network where greater aggregation of traffic has occurred.

Further, many access seekers have existing investments in DSLAMs and backhaul at those places. Having interconnection near existing investments will facilitate a smooth migration and is a relevant factor to be taken into account both in considering the

⁹² FANOC, letter to ACCC, 20 November 2007, p. 2

⁹³ Pipe Networks, *Response to the FANOC Special Access Undertaking Submission to the ACCC*, 7 August 2007, p. 4-5.

⁹⁴ Telstra, *Submission in response to the ACCC's Discussion Paper*, p. 29-30.

⁹⁵ FANOC, *Submission in response to Telstra's submission on G9 SAU*, 20 November 2007, p. 5.

⁹⁶ ACCC, *Fixed Services Review – a second position paper*, April 2007, p. 21.

promotion of competition and the interests of persons who have a right to use the service.

It is recognised that FANOC may not be able to provide interconnection within existing Telstra exchanges. The ACCC has not considered FANOC's rights to use such space. However, interconnection at similar locations nearby would then be a possible substitute.

FANOC's statements that LAPs will be at TEBA space in existing Telstra exchanges or similar locations therefore appear acceptable.

The ACCC would want to be reassured that confirmation of these points of interconnection would be in place well before migration. Otherwise, the ACCC considers this requirement has been met.

Telstra argues,⁹⁷ and the ACCC recognises, that as the network configuration develops, particularly if the rollout of VDSL2 or FTTH renders existing exchange buildings irrelevant to the network topology, there may be a need to revisit the situation.

Transit Access Points

In relation to TAPs, the ACCC agrees with Telstra that TAPs do not appear to be formally offered in the SAU. It is possible, but unclear, that TAPs may be needed in addition to LAPs on a permanent or interim basis where competitive backhaul has not been rolled out. However, the ACCC notes it could also be possible for other firms to offer a commercial wholesale backhaul service to access seekers.

Since the ACCC is unable to accept this SAU for other reasons, it is not necessary to resolve this point now.

Conversely, Pipe Networks has raised concerns about whether FANOC should be allowed to offer interconnection at TAPs, where FANOC will essentially be selling backhaul in a competitive market for metropolitan backhaul.

The ACCC notes an SAU is not a vehicle that can be used to prevent firms from selling particular services. If the SAU is restricted to services from customer premises to LAP, that will not prevent FANOC from selling that service plus backhaul to a TAP on a purely commercial basis. If such services were sold commercially at anti-competitive or predatory prices, then Parts IV and XIB of the TPA would be the relevant means of redress.

Media gateways

Finally, in relation to the conflicting claims of FANOC and Telstra as to whether the BAS removes or adds the need for media gateways, the ACCC is of the view that neither is correct. Media gateways would be necessary for interworking between the IP core network and the PSTN. As long as in future there are both IP and PSTN parts of

⁹⁷ Telstra, *Submission in response to the ACCC's Discussion Paper*, p. 38.

the network – and all the services outside the FTTN footprint will remain as PSTN services – then access seekers will need not only media gateways but also signalling and border network gateways to facilitate interworking and manage security. FANOC’s proposal neither adds this requirement nor removes it.

5.3.4 Interconnection protocols based on well-accepted standards for broadband, voice and, if applicable, video, which are sufficiently well-described to allow access seekers to design and build their own interconnecting facilities.

FANOC’s submissions

Broadband

Access seekers will have a physical Ethernet connection, with port bit rates of between 2 Mbps and 10 Gbps (or greater for business grade services).⁹⁸

FANOC provides that interconnection for broadband will be in accordance with DSL Forum TR-101 Reference Model and DSL Forum Technical Report TR-058 Multi-Service Architecture & Framework Requirements.⁹⁹

The ACCC accepts that these are well-accepted high level standards for broadband but notes that each incorporates multiple options which allow providers to accept their own protocols within those standards. Unless the particular protocols that will apply are specified clearly up front, it will be difficult for access seekers to design and purchase their own network and equipment to achieve a smooth transition. Accordingly, on 26 September 2007 the ACCC requested further information about interconnection protocols from FANOC.

FANOC advised on 20 November 2007 that its long-term approach would be to work cooperatively with the industry, through the Communications Alliance, to develop an agreed interconnection model similar to the ACIFG549 and ACIF G500 series of specifications for PSTN interconnection.¹⁰⁰

Voice

The voice service will be an analogue service from customer premises to node and then an Ethernet service from node to the point of interconnection at the LAP (or TAP). It is designed to support existing customer premises equipment such as handsets and fax machines (i.e. equipment conforming to AS/ACIF S002, S004 and AS/NZS 60950-2000). The handoff is purely an Ethernet stream – access seekers must supply their own voice softswitch.¹⁰¹

⁹⁸ FANOC, *Submission to the ACCC*, 30 May 2007, p. 10.

⁹⁹ FANOC, *Special Access Undertaking*, 30 May 2007, Annexures B, C, D, E.

¹⁰⁰ FANOC, letter to ACCC, 20 November 2007, p. 2.

¹⁰¹ FANOC, *Special Access Undertaking*, Annexure A; FANOC, *Submission to the ACCC*, 30 May 2007, p. 11.

As noted above, FANOC advised on 20 November 2007 that its long-term approach would be to work cooperatively with the industry, through the Communications Alliance, to develop an agreed interconnection model similar to the ACIFG549 and ACIF G500 series of specifications for PSTN interconnection.¹⁰²

Video

Video does not appear to be immediately applicable, other than to the extent that Web-based video is provided in the normal manner, or access seekers provide their own multicast IPTV services (with their own choice of protocols). The initial BAS products will not include a specialised multicast video product. FANOC has indicated its intention to develop such a product as demand arises.

Pipe Networks' Submission

Pipe Networks notes an absence of detail in the SAU as to how interconnection will work.¹⁰³

In relation to voice, Pipe Networks noted that there are various forms of voice interconnection in the non-SS7 world and therefore this part needs to state very clearly what it will support. Pipe Networks further went on to say that in relation to the Basic Telephone Access Service, the SAU refers to TR-058 and TR-101, but that this does not describe a method for interconnecting for the purposes of peering voice of any description.

More generally, Pipe Networks argued that the SAU did not exactly stipulate how interconnection will occur for the BAS.

Telstra's submission

Telstra expresses concern over access seekers' ability to provide a voice service over the HFTP network because FANOC's SAU is 'not detailed enough for an access seeker to understand the technical interconnection requirements for and costs of providing PSTN-like calls to end-users.'

It argues that

Among other things, the SAU fails to address:

- technical standards to be used for the VoIP service
- the node vendor's requirements for switch interfacing
- a mechanism by which voice traffic is presented separately from DSL traffic at the point of interconnection.¹⁰⁴

¹⁰² FANOC, letter to ACCC, 20 November 2007, p. 2.

¹⁰³ Pipe Networks, *Submission to the ACCC*, p. 7-8.

¹⁰⁴ Telstra, *Submission in response to the ACCC's Discussion Paper*, p. 27.

In a subsequent meeting of 24 October 2007, Telstra also suggested the ACCC ask FANOC more broadly to specify the technical standards, protocols and options within those protocols which are proposed to be used over the fibre link between the node and any point of interconnection.¹⁰⁵

The ACCC's draft view

The ACCC considers that the general approach to broadband and voice interconnection is appropriate but would want to be reassured that the process for developing non-price terms and conditions would provide reasonable advance notice of exact protocols.

5.3.5 Arrangements for access to buildings, shelters and facilities for interconnection.

FANOC's submissions

FANOC's SAU contemplates two sets of points of interconnection – Local Access Points (LAPs) and Transit Access Points (TAPs).

LAPs are the closest points to the customer at which access seekers can interconnect. FANOC's SAU and submission states that they will be located in Telstra Exchange Building Access (TEBA) space at existing Telstra exchanges or similar locations.¹⁰⁶

The TAPs are higher in the network, at points of greater aggregation. No information is given on where the TAPs might be located but each TAP would presumably service a larger number of LAPs and the customers connected via them.

The ACCC on 26 September 2007 requested further information about arrangements for access to buildings and facilities from FANOC.

FANOC advised on 20 November 2007 that these arrangements will be based on the existing standard terms and conditions for facilities access that are employed across industry today. They will be consistent with the obligations of the *Telecommunications Act 1997* and the Facilities Access Code.¹⁰⁷

Pipe Networks' submission

Pipe Networks submitted that the SAU might include points of interconnect at sites that FANOC does not control. It also sought a statement that where FANOC does control the facility, there should be an explanation about the process for access. Specifically it argued:

Interconnection in TEBA can be problematic with the operator of that space sometimes placing overtly onerous conditions, rules and other caveats onto the access seeker. Not to mention that TEBA agreements may prohibit this activity. If the LAP/TAP is in a facility the FANOC totally control then there needs to be a positive statement about the process for access under schedule 3

¹⁰⁵ Meeting with Telstra, 24 October 2007.

¹⁰⁶ FANOC, *Special Access Undertaking*, 30 May 2007, Schedule 1: FANOC, *Submission to the ACCC*, p. 8; FANOC, letter to the ACCC, 20 November 2007, p. 1-2.

¹⁰⁷ FANOC, letter to ACCC, 20 November 2007, p. 4.

section 17 (Low Impact, Inbuilding subscriber connection powers) of the [*Telecommunications Act 1997*] as well as Schedule 1 regarding interconnection. The [SAU] should not be used as an instrument to water down the full intent of these parts of the Act.¹⁰⁸

Telstra's submission

In a meeting of 24 October 2007, Telstra suggested the ACCC ask FANOC to describe how access to FANOC's points of interconnection will be managed if those points of interconnection are not housed in buildings owned or leased by FANOC.¹⁰⁹

The ACCC's draft view

The ACCC's view is that the general statement that arrangements will be based on the existing standard terms and conditions for facilities access that are employed across industry today and that they will be consistent with the obligations of the *Telecommunications Act 1997* and the Facilities Access Code is acceptable.

The ACCC would want to be reassured that the process for developing non-price terms and conditions would develop appropriate standard terms and conditions for buildings and facilities access well before migration.

5.3.6 Well-described and appropriate protocols for how packets are to be prioritised and handled.

The FTTN network will carry different types of traffic, including voice, data and video. These traffic types have different end-to-end requirements in terms of packet prioritisation and handling. For example, the quality of voice traffic deteriorates if there is excessive end-to-end delay or delay variation in the transport of packets. Conversely, email traffic is more tolerant of delay but it is preferable that email packets are not discarded by the network. Therefore, for the network to provide good quality of service it is necessary for packet prioritisation and handling to be treated differently for different traffic types. This may be achieved by assigning different 'Class of Service' (CoS) protocols for different traffic types on the network.

FANOC's submissions

FANOC provides that service classes (priorities) will be consistent with ITU protocols. For example, the standard broadband service has Transport Class 4 Layer 2 Ethernet Quality of Service (QoS).¹¹⁰ Support at the node will be in accordance with DSL Forum TR-059 DSL Evolution – Architecture Requirements for the Support of QoS-Enabled IP Services.¹¹¹ FANOC further provides an IP QoS table consistent with Communications Alliance guideline CA 632:2007 Quality of Service parameters for networks using the Internet Protocol guideline.

¹⁰⁸ Pipe Networks, *Submission to the ACCC*, p. 8

¹⁰⁹ Meeting with Telstra, 24 October 2007.

¹¹⁰ FANOC, *Submission to the ACCC*, 30 May 2007, p. 11.

¹¹¹ FANOC, *Special Access Undertaking*, 30 May 2007, Annexures A, B, C, D, E.

FANOC will further provide a menu of user profiles for access seekers to choose from that allow access seekers to select the options that best suit the needs of their customers.¹¹²

Telstra's submission

Telstra submits that managing packet flows using QoS maximises the efficiency of a customer's broadband connection, allows new services to be provided and keeps costs down. It submits that the SAU is not specific on the QoS issue.¹¹³

It also submits that Point to Point Protocol (PPP) and Layer 2 Tunnelling Protocol (L2TP) based architecture has limitations in supporting QoS.

The ACCC's draft view

Packet prioritisation and quality of service for a ULLS replacement service is a new concept and the ACCC's view is that a significant amount of detail is needed in the SAU. The ACCC's view is that the proposed approach of providing a VLAN solution is acceptable, with any remaining details to be resolved through self-regulatory processes.

¹¹² For example, FANOC proposes these options will include:

- best efforts at 1 Mbps, 5 Mbps, 12 Mbps
- best efforts at each of these speeds plus EF 512 kbps, 1 Mbps or 2 Mbps
- best efforts at each of these speeds plus AF 512 kbps, 1 Mbps or 2 Mbps

FANOC will also provide a variety of access contention options (for example, 1:1, 8:1 and 30:1), which will be discussed, prioritised and priced in conjunction with access seekers.

A queue-in-queue (QinQ) stacked VLAN plan is also proposed with the following options:

- Outer 'P' tag.
- Inner 'C' tag.

The Outer P tag on BNG-DSLAM links identifies the path to a specific DSLAM. The Inner C VLAN tags:

- Traffic VLAN per user customer site.
- Management VLAN(s) for managing the DSLAM.
- Management VLAN(s) for access seekers to manage their CPE.
- Multicast VLAN(s) for distribution of multicast data to allow for future products.
- FANOC will finalise these protocols once the Communications Alliance finalises the guideline CA 632:2007 Quality of Service parameters for networks using the Internet Protocol guideline.

See FANOC, letter to ACCC, 20 November 2007, p. 4-5, for further information.

¹¹³ Telstra, *Submission in response to the ACCC's Discussion Paper*, Annex 1, p. 81.

5.3.7 Well-described and appropriate protocols for how congestion in shared network elements is to be handled.

FANOC's submissions

FANOC will manage congestion in its network based on service level agreements set out in BAS product specifications. More generally, congestion will be managed by the application of standard network engineering practices and with regard to any applicable Communications Alliance codes such as ACIF C519:2004 End-to-end network performance for the standard telephone service code.

Specifically in relation to service classes (priorities), FANOC provides that these will be consistent with ITU protocols. For example, the standard broadband service has Transport Class 4 Layer 2 Ethernet QoS.¹¹⁴ Support at the node will be in accordance with DSL Forum TR-059 DSL Evolution – Architecture Requirements for the Support of QoS-Enabled IP Services.¹¹⁵ Points of interconnection will support bandwidth/QoS policy enforcement.¹¹⁶

In the access network using DSLAMs a packet transfer mode would be used on the link between the customer premises equipment (CPE) modem and the IP DSLAM. FANOC will provide Ethernet with no asynchronous transfer mode (ATM) permanent virtual circuits (PVCs) unless the IP DSLAM falls back to an ATM mode.

Where packet transfer mode is used, the upstream traffic is classified at the DSLAM based on certain criteria. CoS flow policing is available to ensure traffic does not exceed configured limits.¹¹⁷

The ACCC's draft view

Congestion for a ULLS replacement service is a new concept and the ACCC's view is that a significant amount of detail is needed in the SAU. The ACCC's view is that most elements of this requirement are met by the SAU but it is necessary to describe further how the backhaul capacity will be allocated between users (i.e. what share each access seeker will get and what happens to any spare capacity).

¹¹⁴ FANOC, *Submission to the ACCC*, 30 May 2007, p.11.

¹¹⁵ FANOC, *Special Access Undertaking*, Annexures A, B, C, D, E.

¹¹⁶ *ibid.*, Schedule 1.

¹¹⁷ FANOC has stated that the downstream traffic is mapped by the IP DSLAM according to VID and p-bit into queues (8 per line, 4 per latency path) via CoS flow policing towards a traffic scheduler. Each queue is emptied by the scheduler according to one of the following algorithms (selectable):

- Strict priority
- Deficit round robin (DRR)
- Modified deficit round robin (MDRR)

The p-bit is used in the access and transport networks to manage QoS and a consistent network wide policy implemented to ensure all packets with the same classification are treated equally.

See FANOC, letter to ACCC, 20 November 2007, p. 5-6, for further details.

5.3.8 Equivalent treatment of access seekers in relation to quality of service parameters such as jitter, delay and packet loss.

FANOC's submissions

FANOC guarantees access seekers equivalence of treatment for any BAS product at a statistical level over a population sample of interest.¹¹⁸

The ACCC's draft view

The ACCC understands that these are well understood requirements in the industry. The ACCC's draft view is therefore that the requirements are met.

5.3.9 Interaction by access seekers with operations support systems, including: (a) *visibility* of provisioning, fault reporting and rectification and service assurance; and (b) *control* of own customer configuration and use of the access seeker's allocated part of the capacity.

FANOC states that access seekers will have network management access to all elements of the FTTN network (including the DSLAM and backhaul network) for provisioning, capacity management, service assurance, etc.¹¹⁹

This will be via a mediation device that accepts inputs/requests from the access seeker's network management system.

As described above, it will also have control via management systems of a VLAN path.¹²⁰

Telstra's submission

Telstra submitted that access seekers would be required to develop new IT systems and processes, including billing interfaces, fault reporting and CRM, and that this would be a significant barrier to small ISPs.¹²¹

In a meeting of 24 October 2007, Telstra submitted that operations support systems have required a great deal of effort to set up on existing networks and are likely to require an equal level of effort on new networks.¹²²

The ACCC's draft view

The ACCC considers that effective operations support system interfaces have been critical to competition on existing networks and will be equally so for a bitstream access service for an FTTN access network upgrade. Further, bitstream access networks also raise completely new issues, such as setting of customer packet priorities.

¹¹⁸ FANOC, letter to ACCC, 20 November 2007, p. 6.

¹¹⁹ FANOC, *Submission to the ACCC*, p. 10.

¹²⁰ FANOC, letter to ACCC, 20 November 2007, p. 5-6.

¹²¹ Telstra, *Submission in response to the ACCC's Discussion Paper*, p. 31.

¹²² Meeting with Telstra, 24 October 2007.

In particular, the ACCC considers that access seekers should have:

- *visibility* of provisioning, fault reporting and rectification, service assurance and own customer configuration
- *control* of own customer configuration and use of the access seeker's allocated part of the capacity.

The ACCC is not satisfied that the SAU currently makes sufficient provision for appropriate and effective operations support systems to be in place well before migration.

5.3.10 No barriers to multicasting and IPTV by access seekers.

FANOC's submissions

FANOC indicates the network will be able to support multicast capability.¹²³ The points of interconnection will provide multicast control and potential for a separate multicast content injection point.¹²⁴ The Inner C VLAN tags will identify multicast VLAN(s) for distribution of multicast data to allow for future products.¹²⁵

Points of interconnection will include Local Access Points. FANOC's SAU and submission state that they may be located in Telstra Exchange Building Access (TEBA) space at existing Telstra exchanges or similar locations.¹²⁶

Pipe Networks' submission

Pipe Networks submits that interconnection close to the DSLAM (such as the local exchange) rather than close to the core is required to support multicasting.¹²⁷

Telstra's submission

Telstra submits that point-to-point protocols are less efficient at supporting multicast video than its own Ethernet protocols.¹²⁸

The ACCC's draft view

The ACCC takes no view on whose proposed network upgrade is better – that will be a matter for the market or government to decide. The ACCC is only assessing whether, if this network upgrade is built, the terms and conditions of third party access offered over it would be reasonable.

¹²³ FANOC, *Special Access Undertaking*, 30 May 2007, Schedule 1, Clause.7.

¹²⁴ *ibid.*, clause 8.

¹²⁵ FANOC, letter to ACCC, 20 November 2007, p. 5.

¹²⁶ FANOC, *Special Access Undertaking*, 30 May 2007, Schedule 1; FANOC, *Submission to the ACCC*, 30 May 2007, p. 8.

¹²⁷ PIPE Networks, *Submission to the ACCC*, p. 4-5.

¹²⁸ Telstra, *Submission in response to the ACCC's Discussion Paper*, p. 34-35; See also Annexure 1, p. 80-81.

Should an access seeker wish to provide multicast video, it will need broadband access from FANOC at local access points, its own content injection site (a playout centre) and backhaul from local access points to its playout centre. There do not appear to be any barriers in this SAU to acquiring the inputs to deploy such a product. Alternatively, existing backhaul operators or content providers may build such products to wholesale to others. FANOC has also indicated its intention to develop a multicast video product for access seekers as demand arises. Such a product could, in principle, go beyond not raising barriers to multicast and IPTV to actively supporting it.

The ACCC notes that barriers to the delivery of multicasting and IPTV could arise outside this SAU if one party controlled the gateway for delivery of content to the home via control of the majority of IPTV customer premises devices in Australia. This might for example arise in circumstances where one party has substantial market power in content and hence the majority of customers use their device and are unwilling to pay for a second device – similar to the situation in respect of Pay TV digital set top units addressed by Foxtel’s SAU. However, such a situation would be dealt with directly through Part XIC. The important aspect here is that this SAU does not prevent it from doing so.

Therefore, the ACCC’s draft view is that the SAU does not impose barriers to multicasting or IPTV by access seekers.

5.3.11 An appropriate process for amending service specifications in later periods as needed or desirable.

FANOC’s submissions

FANOC’s SAU contains processes for amending service specifications over time. These processes are discussed in Chapter 7.

ACCC’s draft views

Normally the ongoing development of broad rules about service specifications would be a matter for commercial negotiation between firms or for the Communications Alliance and codes and standards under the *Telecommunications Act 1997*.

Particular matters that could not be resolved through that process would be a matter for commercial negotiation between the parties or, failing agreement, arbitration by the ACCC.

Normally the ACCC would be happy with that approach as long as there is sufficient detail up-front to allow access seekers to plan a smooth migration. However, in this case, the ACCC has some concerns about the breadth of discretion given to FANOC in developing non-price terms and conditions, including ongoing service specification. This is discussed further in Chapter 7.

5.4 Summary of the ACCC's assessment of the service specification

The ACCC considers a bitstream access service with a service specification that addresses the minimum elements set out in section 5.1 would be likely to provide access seekers with sufficient flexibility and control over the access service to allow any-to-any connectivity and enable access seekers to compete effectively and make appropriate decisions in relation to the efficient use of and investment in infrastructure. Therefore, the ACCC considers that such a service description would be likely to promote the long-term interests of end-users as well as the interests of persons who have rights to use the service.

In relation to the service specification proposed in FANOC's SAU, the ACCC considers that FANOC has addressed many of these minimum elements in specifying a low layer, bitstream access service to serve as a replacement where necessary for the ULLS.

Access seekers should ideally have as much control over their own customer traffic as is reasonably feasible. FANOC's service offers access seekers a degree of control over their own customer traffic via a VLAN solution which gives access seekers as much control as can be reasonably achieved over an FTTN upgrade, although questions about how congestion in the shared fibre backhaul will be managed have yet to be fully addressed. There will also need to be ongoing development of interconnection protocols to ensure these are finalised and published well in advance of migration.

The ACCC would require further assurances in relation to whether an appropriate approach to voice services has been proposed, particularly in the short to medium term. FANOC proposes to provide a Basic Telephone Access Service which requires access seekers to provide their own softswitches to manage a VoIP-based service. While the ACCC considers softswitches are likely to be widely adopted in the future, even large carriers are currently proceeding slowly with the transition. The SAU, however, requires numerous small access seekers to adopt this new technology and interwork with each other effectively from day one. This concern may be only a temporary one, as global telecommunications networks progressively move to softswitches and IP cores. However, the ACCC considers that, as at December 2007, it may raise significant risks to the ability of access seekers to provide reliable voice services to consumers and business customers, which is not in the long-term interests of end-users. This also raises some concerns in relation to any-to-any connectivity as well as to the operational and technical requirements necessary for the safe and reliable operation of a carriage service.

6. Assessment of price-related terms and conditions

The ACCC is required to assess the reasonableness of the terms and conditions of the SAU. The ACCC has, for the purposes of its analysis, divided the SAU into price terms and conditions and non-price terms and conditions. This chapter contains the ACCC's consideration of the price terms and conditions set out in FANOC's SAU having regard to the matters set out in s. 152AH of the TPA. Chapter 7 contains the ACCC's consideration of the non-price terms and conditions set out in the SAU.

This chapter presents an overview of the price terms and conditions specified in the SAU. It also presents the ACCC's views on the information provided by FANOC and other interested third parties with regard to the price terms and conditions.

6.1 Overview of the price terms and conditions

The SAU specifies the price terms and conditions under which FANOC will supply BAS products to access seekers. Schedule 3 of the SAU describes in detail the methodology by which FANOC proposes to calculate the monthly access charges during each access period.

FANOC refers to a paper by NERA in support of its submission of 30 May 2007 which describes and explains FANOC's proposed pricing methodology in detail.¹²⁹ This paper is available on the ACCC's website.

A summary of FANOC's pricing methodology is contained in Chapter 4.

6.2 Assessment of the price terms and conditions

This section discusses the ACCC's analysis of the price terms and conditions set out in the SAU.

The assessment of the price terms and conditions of the SAU is made having regard to the relevant legislative matters in subs. 152AH(1) of the TPA. The discussion includes consideration of the submissions made by FANOC and other interested parties in relation to particular price terms and conditions as part of the assessment of the SAU.

The ACCC has considered all of the price terms and conditions of FANOC's SAU. It considers the following matters as the key issues in its assessment of the SAU's price terms and conditions:

¹²⁹ NERA Economic Consulting, *Economic Properties of the FANOC SAU dated 30 May 2007*.

1. The general approach to pricing.
2. The level of initial prices.
3. The estimated range for the pass through component and its impact on final demand.
4. The incentives to incur costs efficiently.
5. The proposed path of depreciation and price volatility.
6. The weighted average cost of capital (WACC).

These issues are discussed below.

6.2.1 General pricing approach

FANOC's submission

The SAU specifies a set of prices for the BAS products for the initial three year period. However, after this initial pricing period the SAU does not set out specific prices for the BAS products, rather prices in these periods will be determined according to a pricing model. This pricing model will be based on three access periods each of four year duration (i.e. a further 12 years).

In its supporting submission to the SAU, FANOC notes that the prices for the BAS products in the second, and subsequent, access periods will be set on the basis of a weighted average price cap methodology.

FANOC outlines the pricing model (methodology) in the second, and subsequent, access periods as comprising two stages:

- First, at the beginning of each access period, a calculation will be made of costs which will determine the 'Target Revenue' required for FANOC to recoup its costs. The Target Revenue includes a return on capital (at the regulated WACC), a return of capital (depreciation), and operating and capital expenditures.
- Second, on the basis of demand forecasts that have been developed (and which will be approved by the BAS manager, the ACCC or the independent reviewer), a price cap is then applied to provide a percentage change in prices needed across all products, so that FANOC will earn its 'Target Revenue' if it meets the forecasts.¹³⁰

A distinguishing feature of the proposed pricing model is that it gives FANOC the discretion to set and vary individual prices, provided that in combination the weighted average price does not change by more than a specified percentage (i.e. an X factor).

¹³⁰ FANOC, *Submission to the ACCC*, 30 May 2007, p. 25.

According to the proposed methodology, the prices of individual BAS products will be calculated annually and are dependent on a number of factors including forecast demand and previously incurred expenditures. The NERA report which supports the SAU submits that such discretion in setting prices creates the appropriate incentives for FANOC to price the BAS products efficiently in response to changes in market demand.

In determining the parameters of the pricing model the SAU specifies that FANOC must provide the BAS Manager with a level of oversight in regard to some of the parameters to be used in the pricing model and when determining any replacement benchmarks.¹³¹ In addition, the SAU requires FANOC to keep full and accurate records to support all cost and revenue estimates included in the pricing model.

The SAU specifies that at least six months prior to the commencement of each access period, FANOC must provide the ACCC with an estimation of the Target Revenue for each year of the access period, including the opening Capital Asset Value. In addition, FANOC must provide the ACCC with a copy of an Independent Report. This report should confirm that FANOC's component prices in the previous period were consistent with the pricing model and that the variables used in the calculation of the component prices in the following period are supported by appropriate records.

Views of interested parties

Telstra submits the proposed pricing mechanism is not a price cap but rather is a revenue cap. In addition, Telstra claims that the SAU provides no certainty regarding the level and structure of prices beyond the first period and that the proposed pricing model is sensitive to forecast demand and initial cost estimates.¹³²

Telstra submits that there does not appear to be any commitment to non-discriminatory price terms and conditions in the SAU, noting that FANOC states that it may set different charges for different access seekers.¹³³

Telstra submits that one of its main concerns with FANOC's proposal is the inconsistency between the price terms and conditions set out in the SAU and the principles that the ACCC has used in the past to assess cost-based access prices. Telstra notes that the ACCC, in assessing Telstra's undertakings in the past, has applied the 'forward looking' principle to its assessment of cost-based access prices and placed substantial weight on the importance of optimal network design and efficient costs. Telstra notes that while it does not necessarily agree with the approach the ACCC has taken in the past, it is important that regulatory decisions are made on a consistent basis across different access providers and that any deviation from the past principles be fully justified.¹³⁴

¹³¹ FANOC, *Special Access Undertaking*, 30 May 2007, Schedule 3, Clause 6 and 7.

¹³² Telstra, *Submission in response to the ACCC's Discussion Paper*, Annex 3 Pricing Issues, p. 95.

¹³³ *ibid.*, p. 85.

¹³⁴ *ibid.*, p. 86.

The ACCC's draft view

At a general level, FANOC's proposed pricing methodology raises two high-level issues considered below.

(i) Pricing flexibility

FANOC's proposed pricing approach is, in general terms, consistent with a weighted average price cap approach to pricing. In simple terms, this approach to setting prices typically works in the following way. First, a predetermined or 'target' revenue requirement for the regulated firm is set. Then, using forecast demand levels, the maximum rate of change in the overall price level (the 'X factor') over the access period is determined. Using a series of weights for expected demand for each service, which is typically based on the previous period's consumption levels, an overall price cap is determined. The regulated firm is allowed to adjust its prices subject to the requirement that the weighted average of the regulated prices does not change by more than the rate of inflation and the X factor. Under this approach, the overall price cap is set at a level that allows FANOC to earn its Target Revenue if it meets its demand forecasts.

Once the target revenue – and therefore the overall limit on the weighted average basket of prices – is set, the regulated firm has discretion to set individual prices for the different services it supplies. If the regulated firm sells a greater volume of services than forecast and as a result achieves above its target revenue within a regulated period then it is allowed to keep any excess revenue. Conversely, should its target revenue requirement not be met it will suffer a potential loss. It is this exposure to demand or market risk under the weighted average price cap approach which, it is argued, encourages regulated firms to price their different services in an efficient manner. In particular, it gives rise to the incentive to increase prices on inelastic services while lowering prices on the most elastic services towards marginal cost.

It is widely acknowledged that allowing regulated firms the flexibility to price different services according to the relative demand for those services can, in principle, result in movements toward efficient price structures. Therefore, in principle, FANOC's proposed pricing methodology could promote the long-term interests of end-users by leading to access prices that promote competition in downstream markets and efficient use of and investment in infrastructure. However, the extent to which regulated firms have *in practice* exercised this flexibility to set efficient price structures is less clear.

There are a number of factors that can impact the efficacy of this type of pricing approach when applied in practice. First, as noted above, the movement to efficient price structures will depend on the willingness of the regulated firm to actually set prices in a way that reflects market conditions and not on the basis of other factors. In particular, an important factor is the extent to which access prices are passed through to final retail prices. If retail prices are largely insulated from movements in access prices (at least over some range), the weighted average price cap mechanism described above will no longer give rise to incentives to set the access prices efficiently.

Second, while this approach ensures that overall prices are set such that the regulated firm only recovers its efficient costs over the lifetime of the SAU, it does not specify or

constrain the price path for individual services at specific points *during* the SAU. As such, the magnitude of price changes for individual services during or between regulatory periods may – depending on the level of initial prices, the accuracy of the forecasts of demand for those services and the firm’s costs at the beginning of each regulatory period – be substantial. In particular, in settings where costs or demand are highly uncertain, large variations in the X factor, and therefore prices, may be required between access periods in order to satisfy the overall revenue requirement over the entire duration of the SAU. The X factor, and hence the price path, is also highly sensitive to the firm’s depreciation schedule – if the firm is permitted to increase significantly the return of capital it may recover in any one period, this could lead to a substantial increase in the X factor for that period.

Third, competition issues can potentially arise when using this approach where a regulated firm is vertically integrated so that it provides both access services and also has substantial market power in a downstream retail market. Put simply, allowing the regulated firm the flexibility to set access prices may, in some settings, result in a potential price squeeze whereby the access service is priced substantially above cost in order to exclude competitors from retail markets. While the proposed general approach to pricing access services could still be appropriate if the access provider was vertically integrated, additional regulatory oversight of access price setting and, potentially, competition in downstream markets than is envisaged in the SAU may be required for the pricing approach to be in the long-term interests of end-users.

Finally, while this type of pricing approach has been used in other regulated sectors – notably energy – this would be the first time it is applied to telecommunications access services. There are obviously significant differences between the market conditions in the energy and telecommunications sectors. While these differences do not automatically negate the appropriateness of applying this pricing approach to telecommunications services, it does mean that the outcomes may differ from those observed in other sectors. For example, market conditions – such as cost and demand conditions – relevant to pricing access for gas and electricity assets are (to a large degree) reasonably well understood both by the regulator and market participants. In addition, most weighted average price caps in the energy sector allow for the regulator to periodically review and re-set the key parameters. Using a weighted average price cap in these circumstances is likely therefore to result in more stable and predictable adjustments to prices over time. This differs from the case of broadband services, where both the costs involved and the demand for the services are less certain, and may require substantial price variations over time to allow prices to adjust to evolving market conditions.

In the ACCC’s assessment the proposed pricing approach of FANOC may, in certain circumstances, result in movements toward efficient price structures and, to the extent this occurs, promote the long-term interests of end-users by promoting competition and efficient use of, and investment in, infrastructure. However, as noted above, the likelihood and extent of such movements toward efficient price structures will depend on a number of important market and contextual factors, such as: the level of initial prices; the accuracy of demand forecasts for each access period; the incentives for FANOC to set prices which reflect relative demand for the different BAS products;

FANOC's depreciation profile; the composition of, and relationship between, FANOC and the BAS Manager (particularly to the extent that it relates to the proposed governance structure); and the nature of competition in the retail market.

Ultimately the commitments provided in the SAU are insufficient for the ACCC to be satisfied that the pricing discretion afforded to FANOC will likely lead to movements toward efficient price structures. Moreover, the uncertainty regarding the proposed structure of FANOC – including its relationship with the BAS Manager and other access seekers – makes it difficult for the ACCC to be confident that sufficient safeguards exist to ensure FANOC uses the flexibility afforded to it to price access for BAS services in an efficient manner. As a result, the ACCC has concerns that the application of the pricing methodology in this SAU may result in access prices that are not in the long-term interests of end-users. Access prices that are not efficient are also unlikely to be in the interests of persons who have rights to use BAS services or promote the economically efficient operation of, and investment in, carriage services.

(ii) Consistency with past approach to access pricing

The ACCC's approach to access pricing is governed by the legislative criteria outlined in s. 152AH of the TPA. In addition, the ACCC's approach has to date been guided by the principles contained in the 1997 publication: *Access Pricing Principles – Telecommunications: a guide* (the APP guide) and other relevant guidance from the Tribunal.

The APP guide sets out four broad pricing principles to guide access providers and access seekers when considering access prices:

1. Access prices should be cost-based.
2. Access prices should not discriminate in a way which reduces efficient competition.
3. Access prices should not be inflated to reduce competition in dependent markets.
4. Access prices should not be predatory.

The specific cost-based pricing approach suggested by the ACCC in the APP guide is based on the total service long-run incremental cost (TSLRIC) of providing the service. Accordingly, in practice, the ACCC has in the past generally adopted a TSLRIC plus indirect costs (TSLRIC+) approach to price declared telecommunications services, such as the domestic PSTN originating and terminating access services and the ULLS. For such services, the ACCC considered TSLRIC+ appropriate because an access price based on TSLRIC would usually best promote the long-term interests of end-users. The ACCC notes that the Australian Competition Tribunal has endorsed TSLRIC+ in relation to historic sunk networks.¹³⁵

¹³⁵ *Seven Network Limited (No 4)* [2004] ACompT 11 at [137].

In the ACCC's view, the appropriateness of TSLRIC+ as a cost-based pricing methodology depends on a combination of factors, including: public policy objectives such as the promotion of infrastructure-based competition; the continuing relevance of the underlying assumptions of the TSLRIC+ pricing methodology (for example, in relation to the potential for rapid and substantial changes, which can impact both costs and demand in the telecommunications sector); and other features of the specific setting in which it is being applied. However, there is no reason to rule out proposals for different pricing approaches, especially for new networks where efficient and prudently incurred actual costs can be known.

The APP guide recognises in the introduction that the pricing principles, pricing guides and specific cost-based methodology is not static and that access pricing in telecommunications services is a developing issue. Further, the special access undertaking provisions of the TPA allow potential investors to propose other approaches. The ACCC is required to assess whether the terms and conditions proposed are reasonable not whether they are optimal or the 'most reasonable' terms and conditions.¹³⁶ Nor could the ACCC refuse to accept an SAU which had reasonable terms and conditions on the grounds that it preferred some other access arrangement.¹³⁷

For example, in the Foxtel SAU Decision, the ACCC accepted a pricing methodology based on the actual costs incurred by Foxtel in rolling out digital services. The ACCC noted:

actual historic costs are costs that have been recently incurred. It is likely that these recently incurred costs closely approximate the replacement costs of modern equivalent assets.¹³⁸

The ACCC also accepted that the pricing methodology would lead to efficient access prices. While recognising the question of whether Foxtel's actual costs were efficient costs, the ACCC was of the view that the use of actual costs in Foxtel's pricing methodology was acceptable. In reaching this view, the ACCC noted, among other factors, that the commercial circumstances were such that:

Foxtel has no incentive to overspend on its network and has every incentive to minimise its costs.¹³⁹

In its recent Mobile Terminating Access Service (MTAS) pricing principles determination report, the ACCC applied TSLRIC+ but noted that it would consider any evidence put to it on the recently incurred actual costs and networks deployed by mobile network operators in Australia.¹⁴⁰ It would be necessary to demonstrate that those actual costs were efficiently incurred. The ACCC noted the views of the Tribunal in *Application by Optus Mobile Pty Ltd and Optus Networks Pty Ltd* [2006] ACompT 8 that, in such a case:

¹³⁶ *Telstra Line Sharing Service* [2006] ACompT 4 at [150] and *Seven Networks Limited (No 4)* (2005) ATPR 42-056 at [119].

¹³⁷ Cf. *ACCC v Australian Competition Tribunal* [2006] FCAFC 83 at [165].

¹³⁸ ACCC, *Assessment of Foxtel SAU*, March 2007, p. 56-58.

¹³⁹ *ibid.*, p. 57.

¹⁴⁰ ACCC, *Mobile Terminating Access Service (MTAS) pricing principles determination report*, November 2007, p. 1-2.

Although there is merit in the proposition that a firm in a competitive market has an incentive to be efficient and to incur costs efficiently, there is still a need for the Commission (and, on review the Tribunal), to be satisfied, having regard to the matters set out in s.152AH and the objectives in s.152AB of the Act that the firm's cost are efficiently incurred.¹⁴¹

Therefore, it could be argued – as FANOC does – that the existing TSLRIC+ costing methodology is not an appropriate cost-based methodology for estimating the costs associated with the HFTP assets, on the basis that:

- the HFTP assets are yet to be built. This means that the actual costs of the development of these assets can be measured with some precision.
- there is no need to value any historic assets, and the value of the HFTP assets going forward will be based on the actual expenditure on these assets.
- costs are by definition forward looking and this eliminates the need to engage in hypothetical modelling to estimate forward looking costs of a constructed network.
- to the extent to which the HFTP assets are governed by legislative protection from competitive overbuild (a stated condition of FANOC's proposal), the access price will no longer continue to act as a signal of the relevant 'build/buy' decision for potential entrants.

Given the broader issues raised in relation to the SAU discussed in this chapter the ACCC does not see a need to be definitive at this stage on whether this type of argument is supported. However, it is the ACCC's assessment that its use of a TSLRIC+ based approach to access pricing in the past does not bind it to such an approach in perpetuity and it is open to access providers to propose alternatives as appropriate, for example to reflect changing conditions in telecommunications markets or the differences inherent to setting access prices for new, as opposed to legacy, networks. The ACCC considers this conclusion to be fully consistent with the statements made in the Access Pricing Principles guide.

6.2.2 Initial prices

FANOC's submission

The SAU sets out the maximum FANOC component prices that will be applied to BAS products in the first three year period of the SAU (the initial period). The initial period prices are determined by an 'initial pricing model' which is described by FANOC as a bottom up costing of the HFTP network.

FANOC notes that sales in the first period will be more uncertain than in subsequent periods as broadband penetration rates will be dependent on the rollout and coverage of the HFTP network. As a way to overcome this uncertainty, FANOC has based prices in

¹⁴¹ *Application by Optus Mobile Pty Ltd and Optus Networks Pty Ltd* [2006] ACompT 8 at [118].

this first period on long-term forecasts of expenditures and service demand on the HFTP network. These forecasts include long-term forecasts of broadband penetration on various network platforms and forecast demand for the BTAS and standard broadband services ranging in speed from 1.5 Mbps to 24 Mbps. FANOC submits that the application of the pricing model in the initial period could lead to inappropriate results if based on early unstable demand estimates.

Views of interested parties

Telstra submits that prices in the first period are based on estimates of costs and demand which FANOC does not commit to in the SAU. As a result of this lack of commitment, Telstra claims that first period access charges are nothing more than arbitrary prices, with 100 per cent of the risk associated with any errors in the estimation of costs or demand forecasting borne by access seekers and ultimately consumers.¹⁴²

The ACCC's draft view

The ACCC has considered two particular issues when assessing the appropriateness of the initial maximum prices proposed by FANOC in its SAU.

The first issue related to the accuracy and rigour of the underlying data which has informed these initial price estimates. As FANOC acknowledges, the initial prices are based on forward looking estimates of factors such as expected broadband penetration, projected demand for different services and future expenditure on the development of the HFTP network. A second issue is whether FANOC's proposed pricing mechanism allows for any misspecification of initial prices to be corrected in the second, and subsequent, access periods. This goes to the relevance of the initial prices when considered in the context of FANOC's overall pricing approach.

Arguably, the level of initial maximum prices proposed by FANOC should be irrelevant under FANOC's proposed pricing approach. This is because any misspecification of initial prices for different services can, in principle, be adjusted in subsequent periods to ensure that over the duration of the SAU FANOC recovers only its efficient expenditure.

However, the level of maximum initial prices is a matter of practical interest for two reasons. First, if the initial prices are based on highly inaccurate forecasts of demand and expenditure over the duration of the SAU, this may result in FANOC setting prices in such a way which never allows them to fully recover the actual costs associated with the development of the network. As noted above, the ACCC accepts that it would be very difficult to set accurate demand forecasts for a 15 year period. However, the ACCC considers that realistic expectations of future demand should be factored into the level of initial prices.

¹⁴² Telstra, *Submission in response to the ACCC's Discussion Paper*, Annex 3 Pricing Issues, p. 84.

A second, and related point, is that the maximum initial prices set for the different BAS services may be important insofar as they can be determinative of how much the prices for the different BAS services can be rebalanced over the lifetime of the SAU. Put another way, how prices are set in first period may, in practical terms, affect the magnitude by which relative prices for the different BAS services can be increased/decreased over time.

The maximum initial prices submitted by FANOC in the SAU for the first access period may be in the appropriate range. However, in the ACCC's view, the supporting information provided by FANOC in respect of how it has determined the maximum initial prices is insufficient to give the required level of assurance that these prices are appropriate. This is not to say that these prices for proposed BAS services are inaccurate but that the ACCC does not have before it sufficient evidence by which to make such an assessment. As such, the ACCC cannot be confident that the maximum initial prices proposed by FANOC are appropriate.

The ACCC considers that in order to make an assessment as to the appropriateness of the initial prices proposed in the SAU, it would need to have before it rigorous estimates of the expected penetration of the network, projected demand for different services, expected future efficient costs associated with the development of the network and the proposed depreciation profile, including constraints on the minimum capital asset value at the end of the SAU. Appropriate approaches to costs and depreciation are discussed further below.

6.2.3 The pass-through component

FANOC submission

The access seekers of FANOC's HFTP network will also have to use Telstra's 'sub loop' from the node to the end-user premises in order to provide broadband services. The SAU provides that the amount Telstra charges for access to the sub loop will be 'passed through' to access seekers at cost.

This means that the final price that access seekers will face will be the sum of the pass-through component and the FANOC component. There are two standard options to determine the value of the pass-through component: commercial negotiation with Telstra or, if the ULLS sub-loop is a declared service under Part XIC, ACCC determination following an access dispute.

FANOC's estimate of the cost of the ULLS sub-loop is based on industry cost modelling and previous regulatory decision-making. FANOC outlines that it is seeking access to the last half mile of the copper in Band 2 areas, noting the ACCC has set interim determinations for monthly charges for the entire ULLS in this Band at \$17.70. This charge is made up of two components: a specific cost component (which FANOC

states is not relevant to its model) and a network cost component¹⁴³ which is of relevance to FANOC's pass-through component. FANOC cites Telstra's claim that its PIE II model estimates network costs of \$14.89 for the current ULL service description and the ACCC view that the upper bound of these network costs is \$12. Based on these figures, FANOC argues that since it is only seeking access to the last half mile of copper, its regulatory costing of this network component is slightly less than \$5.¹⁴⁴

For the purpose of providing indicative all-inclusive prices for the first period, FANOC has assumed that the price for access to the sub-loop will lie within a range of \$5 and \$15 per month. FANOC does, however, state that it considers \$5 to be the reasonable charge for the pass-through component.¹⁴⁵

Views of interested parties

Telstra notes that FANOC has proposed an amendment to s. 152EB of the TPA which would have the effect of access seekers, rather than the Commonwealth, being required to pay 'just terms' compensation for acquisitions of property arising under Part XIC of the TPA. Telstra submits the definition of the pass-through component is drafted so widely so as to catch any liability of FANOC arising under the amended s. 152EB in respect of sub-loop unbundling. Telstra submits the potential liability under the amended s. 152EB is uncertain and that it could not be in the long-term interests of end-users for the ACCC to accept the SAU in circumstances where such a significant component of the FANOC pricing model is at large.¹⁴⁶

The ACCC's draft view

In the ACCC's view, the estimated range of prices for the pass-through component is inextricably linked to the appropriateness of the pricing of the services provided by FANOC over the HFTP network. This is because the final demand for broadband services will depend on the final price, including the pass-through component, for those services. Put another way, it is the relative level of *both* the FANOC component *and* the pass-through component which will ultimately determine the demand for different broadband services at different points during the life of the SAU. It follows that it is this demand for the different broadband services at the prevailing final prices which will feed back through into FANOC's proposed pricing model, and impact the future prices for each of the BAS products.

The ACCC does not need to decide on a precise methodology to price the pass-through component in assessing the reasonableness of this SAU as this will be determined through other processes. However, because of the link between final demand and the prices for BAS products noted above, the ACCC does need to be satisfied that FANOC's proposed pass-through component charge results in prices that lie within an appropriate range.

¹⁴³ The 'specific' costs of the ULLS are those costs incurred by Telstra to allow for supply of the declared service. The 'network' costs are the costs of the copper line which constitutes the declared ULLS.

¹⁴⁴ FANOC, *Submission to the ACCC*, 30 May 2007, Schedule 3, Clause 6 and 7, p. 8.

¹⁴⁵ FANOC, *Submission to the ACCC*, 30 May 2007, p. 6.

¹⁴⁶ Telstra, *Submission in response to the ACCC's Discussion Paper*, Annex 3 Pricing Issues, p. 98-99.

It is the ACCC's preliminary assessment that the network component of the Band 2 ULL access price appears to be an appropriate upper bound for the expected level of the pass-through component that FANOC may be charged for access to the sub-loop. This assessment is, however, preliminary and conditional on information provided by FANOC as to its proposed coverage of the HFTP network, the timing of its roll-out and other assumptions. As such, this preliminary assessment does not bind the ACCC in any future assessment of the efficient price for access to the sub-loop.

6.2.4 The incentives to incur efficient costs

FANOC's submission

FANOC states that as the HFTP network is not yet built and actual costs are therefore not yet known, it is not possible to compare actual costs with estimates of 'efficient costs'. Moreover, as the network is to be constructed in the future using the latest technology, FANOC considers that there is no need to consider replacement costs. Instead, it argues, it is necessary to consider whether the correct incentives and controls are in place to ensure that, when they are incurred, actual costs are efficient.¹⁴⁷

In the initial pricing period long-term forecasts of expenditures are used to determine prices. In the initial period pricing model, total capital expenditure is based on vendor pricing for each modelled network element within categories Nodes (DSLAM, Street cabinets and power systems); Installations; and Fibre Installation (ducts and trenching). Capital asset lives are provided for each category. Operating expenditures are based on a network build program that involves a three year build.¹⁴⁸

FANOC argues the SAU creates the appropriate incentives to ensure that costs are efficiently incurred. FANOC notes that the ability of the BAS Manager to oversee its annual budgets will ensure that FANOC does not incur material expenditure that is not 'commercially prudent'. Specifically, should FANOC exceed its approved expenditure in a financial year by more than 5 per cent in the first period, or 7.5 per cent in subsequent periods, it must submit a budget variation to the BAS Manager. If the BAS Manager does not consider this expenditure to be commercially prudent then according the SAU the decision to approve the expenditure will be referred to an independent reviewer or to the ACCC.

Further, FANOC notes that because its rate of return on that expenditure is not excessive it does not have the incentive to advocate excessive expenditure in the budget setting process.

¹⁴⁷ FANOC, *Submission to the ACCC*, 30 May 2007, p. 30.

¹⁴⁸ *ibid.*, Schedule 3.

Views of interested parties

Telstra submits that the SAU will result in costs higher than efficient costs because of high initial implementation costs, continuing inefficiencies associated with vertical separation and the ‘uniquely convoluted’ governance model.¹⁴⁹

Telstra argues that over time, as technology advances, the gap between the costs associated with FANOC’s network and the most efficient means of supply will continue to grow. Telstra submits that the SAU proposes a very different approach to the recovery of costs than has been applied by the ACCC to Telstra’s network in the past. Telstra submits that the SAU allows FANOC to recover its actual network costs over the full 15 years of the SAU, regardless of the efficiency of that network during that time. Further to this, any costs incurred in optimising the network over time would be passed straight through to access seekers. Telstra believes that it would be inappropriate for FANOC’s costs to be treated this way while it continues to bear the full costs associated with the continual re-optimisation applied to its PSTN.¹⁵⁰

In relation to cost recovery over time and the roll forward of losses, Telstra submits that the approach put forward by FANOC is inconsistent with the position that the ACCC has previously taken where it has allocated costs to specific periods and where the access provider is exposed to any shortfall if costs are not recovered. In contrast, Telstra argues that the SAU includes a mechanism for rolling forward losses incurred in each period and to be capitalised in the Capital Asset Value (CAV).¹⁵¹

Telstra submits that FANOC’s SAU envisages a complete role reversal in terms of assessing the allocation of common costs. Telstra notes that it is not aware of any decision made by the ACCC that has allowed the use of an alternative methodology of allocating common costs, such as Ramsey pricing. Telstra specifically points to the ACCC’s rejection of the application of Ramsey pricing in the context of mobile terminating access services due to the uncertainty associated with demand elasticities.¹⁵² On this basis, Telstra requests the ACCC test whether the \$10 per month allocated to the Basic Telephone Access Service exceeds the stand alone efficient cost of providing the service, and, therefore, is an example of FANOC cross- subsidising the cost of providing broadband services.

The ACCC’s draft view

FANOC’s proposal for the HFTP network differs from existing telecommunications network infrastructure in that the assets have not yet been built. This means that unlike the ACCC’s previous decisions in respect of other telecommunications assets, it is potentially able to observe the actual costs of building the network. However, the fact that the actual costs associated with the development of the HFTP assets will be observed does not necessarily mean that these costs will be incurred efficiently. As noted in Chapter 3, the ACCC recognises that there is no one correct figure for

¹⁴⁹ Telstra, *Submission in response to the ACCC’s Discussion Paper*, p. 41.

¹⁵⁰ *ibid.*, Annex 3 Pricing Issues, p. 88-89.

¹⁵¹ *ibid.*, p. 89.

¹⁵² *ibid.*, p. 93.

‘reasonable costs’ as this will entail matters of judgement. The ACCC’s task is to determine if FANOC’s approach to calculating its costs is reasonable, having regard to the statutory criteria set out in s. 152 AH and the objectives of s. 152AB.

In the SAU and supporting materials, FANOC places a heavy reliance on the proposed arms-length relationship between FANOC and the BAS Manager as being the principal mechanism to ensure that the costs incurred in the development of the network will be efficient.

However, in the ACCC’s assessment the lack of clarity regarding the proposed relationship between FANOC and the BAS Manager raises concerns that sufficient safeguards may not exist to ensure that costs will be efficiently incurred by FANOC. Moreover, while the SAU envisages a role for an independent reviewer or for the ACCC in the event of a disagreement between FANOC and the BAS manager it is not clear from the SAU how this might actually operate in practice. In particular, it is not clear who the independent reviewer might be or how the ACCC might derive the authority to act as an ongoing arbiter in these types of disputes (see Chapter 7).

The ACCC notes that in assessing the reasonableness of the terms and conditions under s. 152AH, the ACCC is required to take into account the direct costs of providing access. The direct costs are those costs necessarily incurred by the provision of access. Under s. 152AH, the ACCC is also required to take into account the economically efficient operation of, and investment in, a carriage service. In considering this matter, the ACCC has indicated it may examine whether the terms and conditions in an SAU allow for the carrier supplying the declared service to recover the efficient costs of operating and maintaining the infrastructure used to supply the service under consideration. In principle, the ACCC accepts that FANOC should be allowed to recover actual costs which are efficient and necessary expenditures associated with building the HFTP network, in order to recover its direct costs of providing the access service as well as allow for the efficient operation of, and investment in, the HFTP network.

For the reasons set out above, the ACCC is not satisfied that the SAU provides sufficient incentives and safeguards to ensure that FANOC’s actual costs will be incurred in an efficient manner. If actual costs are not incurred efficiently and are passed on to access seekers through inefficient access prices, this may have a negative impact on competition in downstream markets and may also distort the build/buy signals that would otherwise drive the efficient use of and investment in infrastructure. Such an outcome would not be in the long-term interests of end-users.

6.2.5 Return of Capital

FANOC’s submission

The SAU states the Target Return of Capital may be set by FANOC at its discretion, within a number of constraints. Specifically, the Target Return of Capital must be set such that the expected CAV at the beginning of the third and fourth access periods is not less than two-thirds and one-third respectively of the opening CAV at the beginning of the second access period unless otherwise approved by the BAS Manager, an

Independent Reviewer or the ACCC. The SAU also allows for the Target Return of Capital to be negative.¹⁵³

The NERA report submitted in support of the SAU notes that the CAV will not be allowed to become negative, and that the Target Return of Capital cannot – without the prior approval of the ACCC – be expected to push the CAV below the level associated with straight line depreciation of the CAV over the last 12 years of the SAU.¹⁵⁴

Views of interested parties

Telstra acknowledges the constraints on the level of depreciation in the second and third access periods. However, it notes that the SAU does not appear to offer any such constraint as to the amount of depreciation that can be recovered in the fourth access period. In addition, Telstra submits that no commitment is made as to the level of the CAV at the end of the SAU and therefore there is nothing preventing FANOC from setting depreciation in the fourth access period to a level that exceeded full cost recovery.¹⁵⁵

Telstra submits that since 2000 the ACCC has adopted a tilted annuity to reflect the profile of cost recovery in a competitive market. For assets that are at risk of technological obsolescence, a tilted annuity front-loads the profile of cost recovery over time, recovering more in the early years and less in the later years of the asset's life. In contrast, Telstra argues that FANOC's approach to depreciation involves back-loading cost recovery and therefore deviates from the approach adopted by the ACCC in the past.¹⁵⁶

The ACCC's draft view

At a general level, the depreciation profile adopted will impact the timing of when capital invested in the HFTP assets is returned to the investors in FANOC. This is because FANOC's decision as to when it recovers its investment in the network is reflected through the depreciation charge. In addition, the path of depreciation also impacts the relative adjustments to price for the different BAS products over the lifetime of the HFTP assets.

Depending on the degree of volatility in BAS prices this could potentially impact the viability and behaviour of access seekers at different points over the life of the SAU. For example, where the profile of depreciation is such that there is a substantial rebalancing of prices for BAS services between access periods this may require substantial changes to the operations of various access seekers. Depending on the nature and extent of changes to the operations of access seekers this may have a significant negative effect on access seekers and, potentially, reduce competition and deter efficient investment more generally, which would be to the detriment of the long-term interests of end-users.

¹⁵³ FANOC, *Special Access Undertaking*, 30 May 2007, p. 35.

¹⁵⁴ NERA Economic Consulting, *Economic properties of the FANOC SAU*, 30 May 2007, p. 8.

¹⁵⁵ Telstra, *Submission in response to the ACCC's Discussion Paper*, Annex 3 Pricing Issues, p. 85.

¹⁵⁶ *ibid.*, p. 91.

In the ACCC's assessment, the constraints on depreciation set out in the SAU provide some guidance as to FANOC's proposed approach to depreciation. However, in the ACCC's view these constraints are insufficient to ensure that access seekers may not be adversely impacted by substantial variations in price for BAS services between access periods. This is especially the case given the uncertainty regarding the expenditure on the development of the HFTP assets as well as the limited information and binding constraints on the residual value, if any, of the assets at the end of the SAU.

It is therefore difficult for the ACCC to be satisfied that the pricing methodology is appropriate in the absence of sufficient information and constraints on the depreciation profile, given its impact on the path of access prices over the duration of the SAU. This is particularly the case given the SAU has a duration of 15 years and there will be no opportunity for the ACCC to review the parameters periodically.

6.2.6 Weighted average cost of capital

The weighted average cost of capital (WACC) is a commonly used measure for determining an appropriate return on asset base and has been consistently used by regulators in Australia and elsewhere. The WACC for a firm is the weighted average of returns on its equity and debt financing.

The ACCC has historically adopted a WACC which is a weighted average of the nominal post-tax cost of equity and the nominal pre-tax cost of debt. This WACC does not include the impact of business income tax. The ACCC generally includes the tax liabilities of the firm in the firm's cash flow model and adjusts the cash flow amount to account for the utilisation of imputation credits.

FANOC's submission

As the HFTP network has not yet been built, FANOC submits that there exists a possibility to observe, rather than estimate, the risk adjusted cost of capital. Accordingly, the SAU proposes that the WACC be set as the lesser of:

- the maximum WACC that arises from a predetermined formula
- the actual WACC as derived using the actual equity beta as determined by a competitive capital raising process.

(i) Maximum WACC

FANOC states that the maximum return it will make on its investment is consistent with the standard assumptions used by regulators for natural monopoly assets in the energy sector. In its supporting submissions, FANOC states that based on market interest rates at the time of submitting the SAU, the maximum WACC methodology would result in a nominal post-tax WACC of approximately 9.0 per cent. In support of the reasonableness of this maximum WACC figure, FANOC cites a Telstra presentation to analysts in August 2006 where Telstra stated that it had negotiated a return on investment with the ACCC of 10.34 per cent.

FANOC specify in its SAU that the real post-tax WACC will be determined by the following formula:

$$\text{Real post tax WACC}_n = R_e (E/V) + R_d (D/V)$$

where R_d is the real cost of debt. FANOC states that the real cost of debt will be an estimate of the yield on nominal Australian dollar denominated debt for corporate entities with an A-AA credit rating and a number of years to maturity matching the n th access period less expected inflation derived from indexed and nominal bond yields using the Fisher equation.

R_e is the real post-tax return required by equity holders and is determined by the following formula:

$$R_e = r_f + \beta_e(r_m - r_f)$$

where r_f or the risk free rate is equal to the mean yield on nominal Commonwealth Government Securities with a maturity matching the length of the n th access period. FANOC submits this is equivalent to those published by the Reserve Bank of Australia as at 30 May 2007 as 'Indicative Mid Rates of Selected Commonwealth Government Securities'. The SAU also allows for an adjustment to be made for expected inflation.

FANOC submits that the equity beta (β_e) will be set equal to the lower of the 'actual equity beta' (discussed below) or 1.0. FANOC also submits that the Market Risk Premium ($r_m - r_f$) is deemed to be 6 per cent. The proportion of debt in the capital structure of FANOC ownership entities in the SAU is deemed to be 60 per cent while the proportion of equity is deemed to be 40 per cent.

(ii) Actual WACC

The actual WACC would be derived using the actual equity beta as determined by a competitive capital raising process. FANOC proposes that the 'actual equity beta' be revealed through a transparent equity raising process. FANOC anticipates that this process will take the form of an auction whereby equity in FANOC will be offered to the market at a particular equity beta. The equity beta will initially be set low and gradually be raised until the market is prepared to meet FANOC's required level of funding.

FANOC likens the auction to being similar to a standard book build process used to raise equity capital in initial public offerings. However, in this case the amount of equity required will be predetermined and the equity beta will be increased until the required capital funds are raised.

FANOC claims that the competitive auction process will eliminate any expectations for monopoly returns and ensure that the cost of capital is the absolute minimum market determined cost of capital required to finance the HFTP network.¹⁵⁷

Views of interested parties

Telstra submits that in considering the SAU, the ACCC would need to be satisfied that the proposed WACC is indeed sufficient to fully fund the proposed deployment, and, in the event of the capital raising auction failing, FANOC is committed and capable of making good any deficiency.¹⁵⁸

The CRA report, attached to Telstra's submission, notes that FANOC provides little justification, if any, for its proposed WACC parameters. In addition, it notes that the SAU provides little detail on the proposed capital raising auction including the format of the auction to assess the transparency of the process and the claimed efficiency benefits.¹⁵⁹ CRA submits that the literature it examined suggests that it is extremely unlikely that any auction process or book build process will result in an opening value for the asset that closely mirrors the value that the market subsequently places on the asset, even without additional information being revealed about the company.¹⁶⁰

The ACCC's draft view

In assessing the reasonableness of the terms and conditions of access in the SAU under s. 152AH, the ACCC must have regard to the legitimate business interests of the access provider as well as its investment in facilities used to provide the access service. As noted in Chapter 3, the ACCC considers it appropriate that access prices permit the access provider to earn a normal commercial return on its investment. Further, the ACCC considers that allowing a normal commercial return will provide an appropriate incentive for the access provider to maintain, improve and invest in the efficient provision of the service, which is likely to be in the long-term interests of end-users.

FANOC's proposed approach to the estimation of the maximum WACC in the SAU is, in general terms, broadly consistent with the approach adopted by the ACCC in previous decisions. Similarly, the proposed methods for estimating the various parameters as part of the WACC calculation – such as the risk free rate, market risk premium and return on debt – are in principle consistent with the ACCC's approach in the past.

One area where the proposed approach represents a significant departure from the ACCC's past practice is in the proposal that the WACC be set *either* as a 'maximum WACC' based on a predetermined equity beta of 1.0, or in the alternative, as an 'actual WACC' based on an 'actual equity beta' revealed through a capital raising process.

¹⁵⁷ FANOC, *Submission to the ACCC*, 30 May 2007, p. 29.

¹⁵⁸ Telstra, *Submission in response to the ACCC's Discussion Paper*, p. 44.

¹⁵⁹ CRA International, *WACC under the FANOC SAU*, Henry Ergas and Jeremy Hornby, 6 August 2007, p. 4.

¹⁶⁰ *ibid.*, p. 5.

This 'either-or' approach to the estimation of the WACC has not previously been considered by the ACCC. While this does not automatically rule-out the possibility of such an approach being considered appropriate, it does require that the ACCC be satisfied that such a departure from past practice is warranted, and, moreover is likely to be in the long-term interests of end-users of telecommunications services.

The ACCC is open to considering new approaches such as this. At present, in the ACCC's assessment, there are insufficient commitments in the SAU to justify such a departure from past practice. Specifically, the ACCC is unable to be satisfied that the proposed method for estimating the 'actual WACC' – on the basis of the return revealed through a capital raising process – will operate in the long-term interests of end-users on the basis of the information provided. The reasons for this are as follows. First, capital raising auctions take many forms in practice and the way in which they are structured can greatly impact the outcomes. The SAU does not provide sufficiently detailed information about the specifications and rules which would govern such a capital raising process, for example, information such as: who may participate in such a bid, whether bids will be sequential or simultaneous, whether bids would be sealed or open, and finally, whether bidders may submit multiple bids.

A second concern the ACCC has with the proposed methodology for estimating the 'actual WACC' relates to the limited possibility in the SAU for the equity beta to be adjusted over the lifetime of the HFTP assets. Unlike other areas of regulatory activity where the possibility exists for the equity beta to be periodically adjusted – such as at the time of a re-set to reflect changing market conditions – the FANOC proposal effectively 'locks-in' the actual equity beta for the life of the SAU. In the ACCC's view, there may be drawbacks in not having the flexibility to adapt the equity beta over time to reflect changes in market conditions. For example, a situation might arise over the 15 year SAU period where, as a result of the emergence of new technologies, the relative riskiness of FANOC's assets compared to the market portfolio increases. Should this occur this may impact on the ability of FANOC to maintain sufficient capital investment to remain financially viable. However, it could be argued that if a party is prepared to invest in FANOC on the basis of this SAU, then if the financial viability of FANOC changes in the future equity holders will bear any downside or are able to sell or re-finance their investment.

In conclusion, it is the ACCC's assessment that the limited information surrounding the proposed capital raising auction, coupled with the limited possibility for any actual WACC determined through that process to be adapted over time, means that it cannot be sufficiently assured that the proposed approach to the estimation of the WACC in the SAU will be in the long-term interests of end-users. However, the ACCC welcomes further comments from industry on the appropriateness of FANOC's proposed approach.

6.3 Summary of the ACCC's assessment of the price terms and conditions

The ACCC has assessed the price terms and conditions in the SAU in accordance with the legislative criteria set out in Part XIC of the TPA. The ACCC has also had regard to the ACCC's 1997 APP guide and other relevant guidance from the Tribunal.

The ACCC notes the FANOC SAU differs from those considered in the past in relation to telecommunications services. FANOC proposes to build a new telecommunications network in a market with growing but uncertain future demand. In addition, the SAU proposes a new approach to governance and management of the network and to pricing for access to telecommunications services. Finally, unlike similar pricing approaches in other industries, the SAU provides no opportunity for periodic review by the regulator but rather relies on the proposed governance and structural arrangements to create the appropriate incentives over the term of the SAU.

The ACCC is open to considering alternative approaches to pricing in telecommunications, especially for new network investments. At a general level, the ACCC considers FANOC's proposed pricing approach may, in certain circumstances, result in movements toward efficient price structures and, to the extent this occurs, promote the long-term interests of end-users by promoting competition and efficient use of, and investment in, infrastructure. Efficient price structures would also be in the interests of persons who have rights to use BAS services and would promote the economically efficient operation of carriage services.

However, while the novel features of the SAU do not automatically mean it will not operate in the long-term interests of end-users, it does create a greater level of uncertainty around a number of key elements to which the ACCC must have regard in its assessment. Consequently, for the ACCC to be satisfied that the terms and conditions in the SAU are reasonable and will operate in the long-term interests of end-users, it is necessary for it to be able to rely on detailed and well-grounded information, such as: realistic estimates of likely future demand to support the level of initial prices; verifiable estimates and forecasts of cost conditions; plans relating to the proposed future composition and governance structure of FANOC, the operation and role of the BAS Manager; and other information relating to the future operations of FANOC such as its proposed approach to depreciation.

The ACCC's overall conclusion is that the price terms and conditions in the SAU are not sufficiently supported by the commitments within the SAU and the required evidence for it to be satisfied that the SAU is reasonable, according to the criteria in s. 152AH, and that it will operate in the long-term interests of end-users of telecommunications services. More specifically, the ACCC cannot be assured that the discretion afforded FANOC in respect of pricing for BAS services under its proposed pricing model is sufficiently constrained by the appropriate incentives and safeguards to ensure efficient outcomes. Therefore, the ACCC cannot be satisfied that the SAU will result in access prices that promote competition or efficient use of and investment in infrastructure.

Notwithstanding this conclusion, the ACCC's decision should not be interpreted as suggesting that all of the price terms and conditions proposed in the SAU are unreasonable at a conceptual level. The ACCC is of the view that a number of the elements proposed in the SAU have merit *in principle* and could – depending on how they are implemented – operate in the long-term interest of end-users.

For new networks, where efficient and prudently incurred actual costs can be known, FANOC's proposed pricing methodology could, theoretically, lead to efficient prices. However, any methodology for setting access prices would require effective regulatory audit or review of key inputs and parameters in the methodology (such as demand forecasts and forecast or actual capital and operating expenditure) at appropriate intervals if the undertaking period is very long. This would be necessary for the ACCC to be confident that the access provider will exercise its discretion in applying the pricing methodology in an efficient manner. The ACCC notes that currently under Part XIC of the TPA it cannot carry out any power or functions under an SAU that would be necessary to allow for such an audit or review function while the SAU is on foot.

The ACCC's primary concern with the price terms and conditions outlined in FANOC's SAU is generally not one of principle but rather that it cannot be sufficiently confident, given the commitments made by FANOC, that such outcomes are likely to occur in practice. As the discussion above has noted, the ACCC has the following specific concerns in relation to the SAU:

- While the ACCC acknowledges that the proposed approach to pricing may, in principle, result in movements toward efficient price structures, the commitments in the SAU are insufficient for it to assess the likelihood and extent of such movements.
- The limited information before it in relation to expected future costs and demand does not allow the ACCC to be confident that the proposed level of initial prices in the SAU mitigates the likelihood of unreasonable future price volatility in the second, and subsequent, access periods.
- The limited information and commitments regarding the proposed path of depreciation and proposed residual value of the assets at the end of the SAU again raises the possibility of high levels of price volatility between access periods. Should this occur this may adversely impact the viability and operations of access seekers and ultimately the outcomes for consumers.
- The lack of clarity regarding the proposed relationship between FANOC and the BAS manager in the SAU raises concerns that costs relating to the development and operation of the HFTP assets may not be efficiently incurred.
- The information regarding the proposed 'either-or' approach to the estimation of the WACC in the SAU is insufficiently detailed for the ACCC to justify a departure from past practice.

Taking all of the above into account, it is the ACCC's draft conclusion is that it cannot be satisfied that the price terms and conditions in the SAU will operate in the long-term interests of end-users of telecommunications services and will be reasonable under s. 152AH.

7. Assessment of the non-price terms and conditions

Non-price terms and conditions are important for promoting competition, efficient use of infrastructure and incentives to invest. In particular, the ACCC would expect:

1. the provision of appropriate and equivalent information to all access seekers and downstream users about service specification and proposed major and minor network changes
2. effective procedures for ordering and provisioning, of equivalent quality for all parties
3. effective procedures for fault detection, handling and rectification, of equivalent quality for all parties
4. equivalent treatment in respect of other operational and technical matters

However, these matters are often not set out in an SAU but rather left to self-regulatory mechanisms or to commercial negotiation between firms and, failing that, arbitration by the ACCC.

This chapter sets out the ACCC's analysis of the non-price terms and conditions that have been included in FANOC's SAU, including the ACCC's consideration of the various submissions made by FANOC and interested parties, having regard to the matters set out in s. 152AH of the TPA. While the ACCC examined all the non-price terms and conditions in the SAU, the discussion below focuses on those of most significance to the ACCC's assessment under s. 152AH.

7.1 Duration of the SAU

The SAU is expressed to expire on the earlier of 15 years from the first provision of a BAS in Australia or 17 years from the date on which the SAU is accepted by the ACCC, unless the SAU is otherwise terminated, withdrawn or replaced in accordance with the TPA.¹⁶¹

¹⁶¹ FANOC, *Special Access Undertaking*, 30 May 2007, clause 2.2.

FANOC's submission

FANOC submits the term of the SAU is reasonable because of the risks FANOC faces and the need for regulatory certainty. FANOC claims the proposed HFTP network requires infrastructure investment of significant scale and faces additional structural risks from the requirement that FANOC not be vertically integrated. Therefore FANOC will be more sensitive to the impact of regulation and has a greater need for certainty via a longer term SAU.¹⁶²

Telstra's submission

Telstra raises concerns that the term of the SAU:

would lock Australia into an ADSL2+ service for 15 years with no commitment to upgrade and an incentive structure, that is likely to lead to deadlock over decisions about upgrading.¹⁶³

In addition, the 15 year term

lock[s] out the Commission from review of key elements of the decisions made by FANOC which determine the price paid by access seekers and end-users.¹⁶⁴

The ACCC's draft view

The ACCC notes the purpose of the TPA provisions to allow SAUs was specifically to encourage investment in telecommunications infrastructure and services by providing regulatory certainty for potential investors in relation to the access obligations that will apply to new infrastructure.¹⁶⁵ The ACCC considers that allowing SAUs with a longer term than that generally allowed for ordinary access undertakings (three years) is consistent with the objective of providing greater regulatory certainty for investors in new services.

In assessing the appropriateness of the duration of the SAU under s. 152AH, the ACCC considers that a duration of longer than three years may encourage efficient investment in infrastructure and may be in FANOC's legitimate business interests as a carrier. The ACCC notes, for example, in its decision to accept Foxtel's SAU it considered that an SAU of eight years duration was appropriate.

The ACCC does, however, have concerns as to whether it can be satisfied that the specific terms and conditions of access in FANOC's SAU, if applied over 15 years, will continue to promote competition and remain in the interests of access seekers. The ACCC has considered the proposed duration of the SAU in assessing the reasonableness of FANOC's terms and conditions of access in this draft decision.

¹⁶² FANOC, *Submission to the ACCC*, 30 May 2007, p. 32.

¹⁶³ Telstra, *Submission in response to the ACCC's Discussion Paper*, p. 33, 132.

¹⁶⁴ *ibid.*, p. 132.

¹⁶⁵ *Telecommunications (Competition) Bill 2002 (Cth) Explanatory Memorandum*, p. 82.

7.2 Non-discrimination

FANOC undertakes not to discriminate between access seekers regarding the supply of the BAS and to provide access seekers with equivalent information.

In clause 3.1(c), FANOC undertakes to supply BAS products to all access seekers and to ensure:

The technical and operational quality of the BAS Product supplied to each Access Seeker is equivalent to that which FANOC provides to other Access Seekers generally in respect of that BAS Product.

Clause 4.1(c) prevents FANOC from discriminating against an access seeker on the basis of whether it is an investor in FANOC. However, FANOC does acknowledge the potential for price discrimination on other bases in clause 7.6 of the SAU:

FANOC may set the charges for BAS Products for each Access Seeker at lower charges than those set out in the Reference Price List and at different charges for different Access Seekers

In relation to fault handling, FANOC states in its initial BAS product specifications that it will comply with ACIF C513:2004 Customer and Network Fault Management Industry Code.¹⁶⁶ Accordingly there is an existing industry code that access seekers may look to in planning their initial transition – a situation which differs to that for other matters, such as interconnection protocols. The ACCC expects that the manner in which this is carried out in relation to fault management would be subject to Communications Alliance and for codes and standards under the *Telecommunications Act 1997* that are in place from time to time.

In relation to equivalence of information, Clause 9.1 provides:

FANOC will provide all Access Seekers with such information as, in FANOC's reasonable opinion, may be required in order for Access Seekers to make informed decisions in relation to the usage of BAS Products. FANOC will provide all Access Seekers that seek such information with equivalent information in relation to:

- (a) The Technical and operational parameters of the Service Aggregation Network;
- (b) The Deployment schedule for the Service Aggregation Network;
- (c) The BAS Products that are being provided and the current maximum Total Charges for each of those BAS Products; and
- (d) Any new BAS Products that have been requested by an Access Seeker.

FANOC's submission

FANOC argues it is bound not to discriminate between access seekers on the basis of ownership interest in FANOC and, in any case, it has no incentive to discriminate between access seekers.

¹⁶⁶ FANOC, *Special Access Undertaking*, 30 May 2007, Annexures A, B, C, D, E.

FANOC further submits:

the Undertaking is designed to ensure non-discriminatory access. Clause 4.1 of the Undertaking obliges FANOC to make services available to all access seekers at the same price and quality of service, and to make information available to all access seekers on an equal basis. It ensures that FANOC may not discriminate in making pricing and operational decisions on the basis of which access seeker is using the service.¹⁶⁷

With respect to equivalence of information, FANOC submits that these provisions generally support the appropriateness of the SAU by allowing access seekers to compete and make their own investment and business on the basis of equivalent information. FANOC further submits:

these requirements also contribute to ensuring that the management principles operate as they are intended – with all access seekers in a position to participate in the decisions of the BAS Manager on a fully informed basis.¹⁶⁸

Telstra's submission

Telstra submits there does not appear to be any commitment to non-discriminatory price terms and conditions in the SAU.¹⁶⁹ Further, Telstra notes clause 7.6 explicitly states FANOC may set different charges for different access seekers. Telstra also submits there is the potential for discrimination in the non-price terms of supply of the BAS because the non-discrimination provision in clause 3.1(c)(i) is qualified as it only commits FANOC to provide equivalent quality to that which it *generally* provides to other access seekers.¹⁷⁰

In relation to fault handling, Telstra submits this would become more complex and difficult under the FANOC network.¹⁷¹

In a meeting of 24 October 2007, Telstra also suggested the ACCC ask FANOC how all access seekers will be guaranteed equivalent service levels in respect of ordering, provisioning and faults and how this will be assessed and monitored.¹⁷²

The ACCC's draft view

An important benchmark in assessing whether the terms and conditions of access in an SAU will promote competition is the consistency of the proposed terms and conditions with the principle of non-discriminatory access between downstream suppliers of a service. In addition, in assessing the interests of person who have rights to use the declared service under s. 152AH, the ACCC's view is that these person have an interest in being able to compete for the custom of end-users on the basis of the cost and quality of their service relative to their competitors. Terms and conditions that favour one or

¹⁶⁷ FANOC, *Submission to the ACCC*, 30 May 2007, p. 39.

¹⁶⁸ *ibid.*, p. 33

¹⁶⁹ Telstra, *Submission in response to the ACCC's Discussion Paper*, p. 55, p. 85.

¹⁷⁰ *ibid.*, p. 129.

¹⁷¹ *ibid.*, p. 31-33.

¹⁷² Meeting with Telstra, 24 October 2007.

more access seekers over others have the potential to distort the competitive process and harm the interests of access seekers.

The SAU appears to leave some potential for FANOC to discriminate among access seekers, although this ability is constrained by clause 4.1(c), which prevents FANOC from discriminating on the basis of upstream ownership interests. FANOC relies on this clause to justify the appropriateness of other terms and conditions in the SAU.

The ACCC notes clause 4.1(c) forms part of the management principles, which FANOC suggests are not enforceable in the usual manner.¹⁷³ The ACCC does not agree with FANOC's suggestion that certain clauses in the SAU are not enforceable in the usual manner or would be excluded from the usual SAU enforcement mechanisms. However, given FANOC's comments in this regard, the ACCC has some concerns regarding the weight it may place on clause 4.1(c) to constrain FANOC's behaviour. The ACCC notes that discrimination between access seekers on the basis of membership of FANOC would likely have a negative effect on competition and therefore be to the detriment of the long-term interests of end-users. Further, it will not be in the interests of access seekers that do not have ownership interests in FANOC.

In relation to equivalence of information, clause 9.1 appears to require FANOC to provide such information that, *in FANOC's reasonable opinion only*, may be required for access seekers to make informed decisions. This raises potential enforcement concerns, particularly in relation to determining the 'reasonableness' of FANOC's opinion.

There is also the potential for deliberate or inadvertent discrimination between access seekers in terms of the *timing* of the provision of information. That is, access seekers with an ownership interest in FANOC may be privy to FANOC's decisions in relation to deployment and proposed changes to BAS products before other access seekers. To the extent that this occurs, this may also have a negative impact on competition and on the interests of access seekers. The ACCC has noted previously that equivalence of access to information is an important consideration for access seekers.¹⁷⁴ The ACCC's model non-price terms for core declared services reflect this view, requiring access providers to give equivalent notice in relation to network upgrades.¹⁷⁵ Similarly, the Tribunal has discussed the importance of equivalence of information between access seekers and access providers.¹⁷⁶

The ACCC notes that in certain circumstances there may be legitimate commercial reasons for offering different terms and conditions of access to different access seekers (for example, offering discounts based on volume) that may not amount to anti-competitive discrimination. The ACCC also notes FANOC's ability to discriminate between access seekers continues to be constrained by the equivalence provisions in the

¹⁷³ FANOC, *FANOC Special Access Undertaking: Further Submission to the Australian Competition and Consumer Commission*, 12 November 2007, p. 2.

¹⁷⁴ ACCC, *Assessment of Telstra's ULLS monthly charge undertaking—final decision*, August 2006, p. 174-9.

¹⁷⁵ ACCC, *Final determination—model non-price terms and conditions*, October 2003, p. 71.

¹⁷⁶ Australian Competition Tribunal, *Telstra Corporation Ltd (No 3)* [2007] ACompT 3 at [320].

standard access obligations in s. 152AR of the TPA as well as the competition rule in Part XIB of the TPA, particularly where such discrimination would lead to a substantial lessening of competition.

Normally the ongoing development of broad rules about service specifications would be a matter for commercial negotiation between the parties, the Communications Alliance or codes and standards under the *Telecommunications Act 1997*. Particular matters that are not resolved through these processes would be a matter for arbitration by the ACCC.

In this case, however, FANOC is given a significant degree of discretion in relation to developing the non-price terms and conditions, according to the methodology contained in the SAU. As noted above, the ACCC has concerns regarding the enforceability of key provisions in the SAU that FANOC uses to justify the appropriateness of this discretion. It appears further that FANOC may effectively seek to limit the role for the ACCC to arbitrate disputes between FANOC and access seekers to arbitrating on whether the *process* in the SAU for developing non-price terms and conditions has been followed, rather than the substance of any such terms and conditions. Whether the methodology in the SAU for determining non-price terms and conditions is likely to result in reasonable terms and conditions is discussed further in section 7.4.

7.3 Reasonable notification periods

FANOC envisages that the following principles are likely to govern any proposed notice periods:

- The notice periods will be consistent with the ACCC's current model terms and conditions in that they will reflect the principles of non-discrimination and of equivalent notice being provided to access seekers.
- There will be consultation between FANOC and access seekers in respect of any changes, with disputes to be resolved as per a dispute resolution process.
- Notice periods will reflect the nature of the specific change and the impact that this is likely to have on users of the network.

FANOC expects to draw a distinction between 'major upgrades' and 'minor upgrades', reflecting the size or nature of works that the access seeker would need to undertake. For example, a minor upgrade would include changes that:

- do not have the potential to adversely affect any customers of the access seeker other than a minor temporary disruption
- do not require any action or expenditure from the access seeker or
- require some action or expenditure, but:
 - materials or equipment required are commonly available.

- any labour or administrative activity required (including notification of affected customers) could be undertaken within 10 business days.
- no regulatory approvals need be obtained.
- the cost to the access seeker would be less than \$10,000.

By contrast, major upgrades would have a significant impact on the provision of service to access seekers. Major upgrades would require a notice period of at least 12 months.¹⁷⁷

Telstra's submission

In a meeting of 24 October 2007, Telstra noted the ACCC had previously observed the transition to an FTTN upgrade would require not only notice periods for individual services but also a detailed rollout schedule to allow access seekers to undertake workforce planning in relation to their own customer migration.¹⁷⁸

The ACCC's draft view

In assessing the reasonableness of the terms and conditions of the SAU under s. 152AH, the ACCC is required to have regard to the legitimate business interests of the access provider and its investment in facilities used to supply the access service. The ACCC is of the view that this matter requires it to consider the broader commercial interests of the access provider in conducting its own business affairs. The access provider should not be unduly compromised in the conduct of its legitimate business interests simply because it has an obligation to provide access to its service. For example, the access provider should be able to make appropriate decisions about modifications and upgrades to its network. At the same time, however, the ACCC is also required by s. 152AH to have regard to the interests of persons with rights to use the access service. Such persons clearly have a strong interest in having reasonable notification of proposed changes to a facility or an access service that affects its business interests.

The ACCC has previously discussed reasonable notice periods for network modernisation at length in its decision on Telstra's ULLS monthly charge undertaking.¹⁷⁹

This matter was then considered by the Australian Competition Tribunal in *Telstra Corporation Ltd (No.3)* [2007] ACompT 3, where it said of notice periods of major upgrades by the owner of the underlying infrastructure, in this case Telstra:

We accept that access seekers do not have an unlimited right of access to Telstra's ULLS, or the right to prevent network modernisation, but they ought not to be placed in a position where their substantial investments in infrastructure might be

¹⁷⁷ FANOC, letter to ACCC, 20 November 2007, p. 7-8.

¹⁷⁸ Meeting with Telstra, 24 October 2007.

¹⁷⁹ ACCC, *Assessment of Telstra's ULLS monthly charge undertaking*, Final Decision, August 2006, Appendix G.

isolated and made redundant as a result of Telstra's timing and location of network upgrades.

Such a situation is not in the long-term interests of end-users of the services provided to them by access seekers using the ULLS. Nor is it in the interests of access seekers themselves. A consequence of an inadequate period of notice of network upgrades is that it will provide a disincentive to access seekers from engaging in facilities-based competition with Telstra. Such a situation would not be in the long-term interests of end-users.

There are two aspects to the objection to the Network Modernisation Provisions. ... The [second] aspect is the period of notice which will apply to major network upgrades which will involve the removal, rearrangement, replacement or decommissioning of the continuous metallic pair used for the supply of the ULLS to access seekers. Such upgrades will result in a substantial interference with, and interruption of, the service supplied by access seekers to end-users. It is not possible to anticipate all the particular circumstances which will confront an access seeker when notified of such a major network upgrade by Telstra. Nevertheless it is apparent that some major network upgrades would involve Optus and other access seekers having to adopt courses of conduct that would mean the cessation of their current network configuration and that they would have to rely on unregulated services provided by Telstra or other access providers. Telstra posited a number of alternatives which might be open to Optus and other access seekers to maintain continuity of their service, but the terms of such alternatives, their technical and financial feasibility, and their cost, were not provided to us.

What is missing from the undertakings, and what is required having regard to the breadth of the activities covered by the definition of "Network Upgrades" in the undertakings, is a provision which either tailors particular periods of notice to particular types of network upgrades or the provision of an arbitration or dispute resolution procedure if an access seeker wants to contend that the period of notice of a particular network upgrade by Telstra is unreasonable and inadequate, having regard to the nature of the particular network upgrade.¹⁸⁰

In this case, the Tribunal was of the view that a notice period of 15 weeks was inadequate for major network upgrades such as FTTN. The ACCC notes that in New Zealand, two years notice is required to be given before network modernisation of this scale.¹⁸¹ The Tribunal also noted the importance of the equivalence of notice for network upgrades between access seekers and access provider.¹⁸²

The broad philosophy envisaged by FANOC for notice of upgrades may be appropriate. However, the ACCC notes there is no guarantee, in terms of obligations arising directly

¹⁸⁰ *Telstra Corporation Ltd (No.3)* [2007] ACompT 3, paras 318-321.

¹⁸¹ New Zealand Commerce Commission, *Standard terms determination for the designated service Telecom's unbundled copper local loop network - Decision 609*, November 2007, p. 84-85. See also Appendix A to Decision 609, *Standard terms determination for Telecom's unbundled copper local loop network service - UCLL General Terms*, November 2007, Section 38.

¹⁸² Australian Competition tribunal, *Telstra Corporation Ltd (No 3)* [2007] ACompT 3 at [320].

from the SAU, that actual notice periods will be consistent with the approach 'envisaged'.

The ACCC would also, as Telstra noted, expect detailed rollout schedules to allow access seekers to manage workforce planning for their own customer migration.

These matters would not necessarily be dealt with in an undertaking. The ACCC has previously said that issues surrounding network modernisation are inherently complex and that it considers that such terms and conditions would more usually be determined by bilateral commercial negotiation or by agreed operational procedures through self-regulatory mechanisms.¹⁸³ It would be preferable that key network modernisation terms and conditions are not determined unilaterally by the access provider or solely through bilateral negotiations in circumstances where one negotiating party has little countervailing bargaining power. The ACCC may have a role where industry procedures prove insufficient. The ACCC may have a role where industry procedures prove insufficient.

In this case, however, FANOC is given a significant degree of discretion in relation to developing non-price terms and conditions according to the methodology contained in the SAU. Further, it is unclear whether the SAU would limit the ACCC's scope to arbitrate disputes to the issue of whether the methodology for developing non-price terms and conditions has been followed, rather than the substance of any such terms and conditions. The appropriateness of FANOC's significant discretion is discussed later in this chapter. At this stage, however, the ACCC notes it is not satisfied that the SAU would allow individual access seekers to contest, through dispute resolution or an arbitration process, the reasonableness of a notice period.

7.4 Governance structure

FANOC has proposed a governance structure which it states justifies the significant discretion the SAU reserves to FANOC to set terms and conditions. It states that its proposed 'management and ownership structure materially support the reasonableness of the terms and conditions of the Undertaking'.¹⁸⁴ That structure is considered here.

7.4.1 The core competition concerns

FANOC acknowledges the HFTP network is likely to constitute a bottleneck in the delivery of fixed telecommunication services for the term of the SAU.¹⁸⁵ However, FANOC submits the structure and governance arrangements enshrined in the SAU, including the Management Principles, result in the correct incentives for FANOC to deliver high quality and cost effective access services to maximise its own returns.

¹⁸³ ACCC, *Assessment of Telstra's ULLS monthly charge undertaking*, p. 191.

¹⁸⁴ FANOC, *Submission to the ACCC*, 30 May 2007, p. 16.

¹⁸⁵ *ibid.*, p. 13.

FANOC argues these incentives will ensure open competition and that consumers will receive the lowest price and greatest quality services.¹⁸⁶

The key elements of FANOC's proposed structure and governance arrangements are:

- provisions that seek to prevent FANOC from being vertically integrated to minimise any incentives for it to discriminate anti-competitively between access seekers
- provisions that create a body (the 'BAS Manager') that represents the interests of access seekers and has oversight of FANOC's key decision-making in relation to price and non-price issues and new investment.

The SAU reserves significant discretion to FANOC to determine the price and non-price terms and conditions of access for the 15 year duration of the SAU. As discussed in the preceding chapter, this is particularly the case in relation to setting access prices. Prices for different BAS products over the life of the SAU, other than the three year 'initial pricing period', are to be determined according to the pricing methodology. The methodology gives FANOC considerable discretion to set and vary individual prices within the overall constraint imposed by the price cap. The pricing methodology allows FANOC to recoup its actual capital and operating costs, within certain constraints on depreciation. In addition, it builds in an incentive for FANOC to maximise utilisation of the HFTP network by exceeding the demand forecasts it sets for itself each period by allowing it to keep as profit any revenues it earns in excess of its target revenue.

Should FANOC proceed with the network, it is likely to have significant market power by virtue of the fact that it would be the sole provider of BAS products to parties competing in downstream markets. Absent regulation, FANOC may therefore have incentives to restrict the supply of BAS services and increase prices to extract monopoly rents. If there are no effective by-pass possibilities, FANOC may also have weak incentives to maintain quality of service or to innovate.

The standard approach to addressing these efficiency concerns and the resultant harm to end-users has been to ensure sufficient oversight of the price and non-price terms of third party access to the essential bottleneck infrastructure. In the communications sector, this has been achieved through the declaration of services under Part XIC, the acceptance of ordinary access undertakings of three years maximum duration (thereby providing for regular review), the arbitration of access disputes or *ex post* competition regulation under Part IV and Part XIB.

In its SAU, FANOC proposes a different approach by creating the BAS Manager body, which is designed to represent the interests of access seekers and provide the oversight role otherwise exercised by the ACCC, particularly in relation to the setting of access prices and determining non-price terms and conditions of access for the 15 year SAU period. FANOC argues this approach is appropriate as the BAS Manager will have strong incentives to ensure FANOC minimises its costs, sets efficient access prices,

¹⁸⁶ *ibid.*, p. 5.

maintains appropriate quality of service standards and makes efficient investment decisions to enable access seekers to innovate and meet end-user demand. FANOC also suggests BAS Manager oversight will correct any adverse incentives that could arise as a result of the pricing methodology, such as the incentive for FANOC to under-forecast demand for each period or to overstate its actual costs.

FANOC recognises in its submissions that the ACCC's assessment of the reasonableness of the SAU, including the significant discretion reserved to FANOC in relation to access prices and the long duration of the SAU, depends on the nature of the relationship between FANOC and the BAS Manager.¹⁸⁷

FANOC also recognises that the reasonableness of the SAU, in its current form, depends in large part on the degree to which FANOC is actually structurally separated. If FANOC does in fact have an interest in downstream markets, for example due to a degree of access seeker ownership of FANOC, FANOC may have an incentive to use its monopoly power over the provision of BAS products to discriminate in favour of these access seekers on price or non-price terms in order to stifle competition in downstream markets.

The ACCC notes that anti-competitive discrimination between access seekers could also arise even if FANOC is completely structurally separated – for example, if one or more access seeker effectively controls the BAS Manager and can thereby influence the price and non-price terms of access in their favour.

Finally, while FANOC submits that providing a role for access seekers in the oversight of FANOC is pro-competitive and will enhance efficiency, it is arguable that the existence of the BAS Manager could in fact have negative consequences. For example, Telstra argues that the BAS Manager may make it easier for access seekers to collude or for individual access seekers to use their voting rights strategically to discriminate against competitors. Telstra also argues that the BAS Manager may itself face weak incentives to drive cost savings or to support efficient investment or innovation due to free-rider problems, which would weaken its incentive to ensure FANOC acts efficiently. The ACCC recognises it is also possible, however, that the BAS Manager could provide effective countervailing buyer power against a monopoly provider by organising otherwise widely distributed and heterogeneous access seekers.

The ACCC considers, therefore, that an examination of FANOC's proposed structure and governance arrangements is necessary to assess whether FANOC is likely to exercise its discretion to set price and non-price terms and conditions of access that promote the long-term interests of end-users. To be satisfied that the SAU is reasonable in its current form, the ACCC would need to be satisfied that:

1. provisions that seek to prevent FANOC from being vertically integrated, to minimise any incentives for it to discriminate anti-competitively between access seekers, are sufficient

¹⁸⁷ FANOC, *Further Submission*, 12 November 2007, p. 2.

2. the BAS Manager has the incentive and ability to provide effective oversight of FANOC decision-making in relation to price and non-price terms and conditions of access.

7.4.2 Extent of structural separation

FANOC's submission

In its supporting submission, FANOC states its proposed 'management and ownership structure materially support the reasonableness of the terms and conditions of the Undertaking'.¹⁸⁸ FANOC submits:

The structure of FANOC and the BAS Manager and arrangements between them [...] will establish an environment in which the relevant economic incentives encourage an attractive regulatory dynamic that will promote competition and efficient investment in infrastructure.¹⁸⁹

FANOC states it will not be vertically integrated as a result of the governance and ownership structure set out in the Management Principles in the SAU. FANOC submits it will be prohibited from providing any BAS services to parties other than access seekers (clause 4.1(a)). In addition, access seekers will not be permitted to control FANOC (clause 4.1(b)) and FANOC will be prohibited from discriminating against an access seeker on the basis of whether it is an investor in FANOC (clause 4.1(c)). FANOC argues this will ensure FANOC operates 'independent of the objectives of any individual telecommunications carrier or group of carriers'.¹⁹⁰ No single access seeker or a group of access seekers with a financial interest in FANOC will be permitted to control the BAS Manager (clause 4.1(e)).

According to FANOC, these ownership and control restrictions remove any incentive FANOC may have to discriminate between access seekers and restrict FANOC's economic incentives 'to making an appropriate return on the investment in the HFTP Network, as a standalone investment, by maximising the utilisation of the network'.¹⁹¹ In turn, FANOC argues this will 'create the economic incentives that will promote vigorous competition in the retail supply of broadband services in Australia'.¹⁹²

As competition will be based on the relative merits of access seekers, FANOC argues the SAU is in the interests of access seekers as a whole. In particular, FANOC contends that technical and operational barriers to competition are likely to be significantly lower in downstream markets where management decisions at the wholesale level are not heavily influenced by the interests of a particular carrier (or group of carriers).¹⁹³

¹⁸⁸ FANOC, *Submission to the ACCC*, 30 May 2007, p. 16.

¹⁸⁹ *ibid.*, p. 20.

¹⁹⁰ *ibid.*, p. 21.

¹⁹¹ *ibid.*, p. 17.

¹⁹² *ibid.*, p. 4.

¹⁹³ *ibid.*, p. 21.

FANOC also submits that ‘the ownership controls in the Undertaking provide a competitive framework with in-built incentives for innovation that go beyond the requirements of SAOs on any vertically integrated provider.’¹⁹⁴

Views of interested parties

Telstra submits the SAU does not actually prevent FANOC from offering retail services as the definition of access seeker does not exclude FANOC itself.¹⁹⁵

Telstra rejects FANOC’s argument that FANOC’s proposed structure ensures all access seekers face the same wholesale prices whereas in the *status quo*, Telstra faces only the marginal cost of access, which is lower than the wholesale input cost faced by access seekers. Telstra argues it in fact faces the same input costs as access seekers because it faces the marginal cost as well as the foregone contribution from the sale of access services. However, Telstra argues that even if FANOC is correct in stating that the retail arm of a vertically integrated access provider faces lower wholesale input costs, this competitive advantage would also arise under FANOC’s model and would accrue to access seekers with a financial interest in FANOC.¹⁹⁶

Telstra argues the Australian Competition Tribunal has found the mere fact of vertical separation does not preclude conduct that is so discriminatory as to materially harm downstream competition.¹⁹⁷ Telstra further notes there are effective regulatory safeguards imposed on it in relation to the equivalence of price and quality to ensure there is not discrimination against access seekers in the *status quo*.¹⁹⁸

Telstra also submits FANOC’s proposed structurally separated ownership model is inefficient.¹⁹⁹ These inefficiencies are outlined in an annexed report prepared by CRA on ‘vertical externalities’ associated with the separation of ownership from participation in downstream retail sectors. The externalities include weaker incentives to innovate and improve service quality and the potential for a higher aggregate mark-up over marginal cost by all firms in the vertical chain compared to the mark-up of a profit-maximising vertically integrated firm (‘double marginalisation’). CRA suggests FANOC’s proposal is therefore inefficient as it fails to address these externalities. CRA also suggests the experience of vertical separation in telecommunications and other markets has been largely negative.²⁰⁰

FANOC’s further submission

FANOC rebuts a number of Telstra’s arguments in its further submission. FANOC rejects Telstra’s argument that the SAU does not preclude FANOC from selling BAS products directly to end-users. FANOC states that while the SAU could allow FANOC

¹⁹⁴ *ibid.*, p. 15.

¹⁹⁵ Telstra, *Submission in response to the ACCC’s Discussion Paper*, p. 130.

¹⁹⁶ *ibid.*, p. 58-9.

¹⁹⁷ *ibid.*, p. 59.

¹⁹⁸ *ibid.*, p. 59.

¹⁹⁹ *ibid.*, p. 6.

²⁰⁰ Telstra submission, Annex 2, CRA International, *Efficiency Consequences of the G9 SAU*, Henry Ergas, p. 36.

to sell BAS products to itself, clause 4.1(a) requires FANOC to sell BAS products only to access seekers, which precludes FANOC from selling services directly to retail customers.²⁰¹

FANOC also rebuts Telstra's arguments relating to vertical inefficiencies arising from structural separation. In particular, FANOC suggests Telstra's submission 'fails to take into account the inefficiencies experienced by third party access seekers seeking to utilise part of a vertically integrated infrastructure.'²⁰²

In addition, FANOC provides further information on the intended operation of the Management Principles, including the ownership and control restrictions. FANOC suggests that a failure to comply with the Management Principles would not constitute a breach of the SAU. Instead, it would give the ACCC a right to require the SAU to be withdrawn. FANOC suggests this flexibility is required 'to ensure that any necessary future adjustments to the management and ownership arrangements can be made without breaching an enforceable undertaking'.²⁰³

In relation to ownership, FANOC suggests that in addition to the control rules contained in clause 4.1(b) of the SAU, the interests of third party equity financiers will also serve to ensure FANOC is not controlled by access seekers.²⁰⁴

The ACCC's draft view

The ACCC considers that many of the issues raised by FANOC and Telstra regarding the relative merits of the *status quo* arrangements compared to FANOC's proposed ownership model are generally beyond the scope of the issues the ACCC is required to assess in considering the reasonableness of the terms and conditions contained in the SAU.

The ACCC acknowledges FANOC has proposed to establish a governance structure with a degree of structural separation and with minimal or no incentives for the network owner to discriminate between access seekers on price or non-price terms and conditions of access.

Clause 4.1(a) of the SAU provides that no FANOC Ownership Entity or subsidiary of any FANOC Ownership Entity will provide any carriage service to any person that is not an access seeker. Therefore, FANOC is undertaking not to provide any carriage services, which would include BAS products, directly to retail end-users. However, the ACCC notes the SAU nonetheless permits a degree of vertical integration by allowing access seekers to have a financial stake in FANOC. Further, FANOC's submissions clearly anticipate that at least some access seekers will have a financial interest in FANOC. Given this, it is necessary for the ACCC to assess whether the terms of the SAU effectively provide for sufficient separation to support FANOC's claims that its governance model delivers the competitive benefits associated with this.

²⁰¹ FANOC, *Further Submission*, 12 November 2007, p. 7.

²⁰² *ibid.*, p. 8.

²⁰³ *ibid.*, p. 2.

²⁰⁴ *ibid.*, p. 5.

It is not possible for the ACCC to determine the exact degree of vertical integration that will arise under FANOC's model. The composition of FANOC will not be apparent until after the capital raising process, which would not occur until after the SAU is accepted. In addition, ownership interests may change over time.

The SAU contains a number of 'control' restrictions that purport to limit the amount of direct or indirect influence access seekers may have over FANOC. The SAU provides that no single access seeker may control FANOC. Similarly, no single access seeker may control the BAS Manager. In both instances 'control' is defined according to s. 50AA of the *Corporations Act 2001* ('Corporations Act'). The concept of control under the Corporations Act involves ascertaining whether an entity has the capacity to determine the outcome of decisions about another entity's financial and operating policies. This is determined by considering the practical influence that can be exerted, rather than the rights that can be enforced, and taking into account any practice or pattern of behaviour affecting the financial or operating policies. Therefore, this concept of control includes de facto control, not just legal control (for example, through voting rights).

While the ACCC does not object, in principle, to restrictions based on the concept of control under the Corporations Act, it is of the view that there will likely be substantial difficulties in monitoring, gathering sufficient information and determining compliance with the control restrictions under the SAU. As noted above, ownership interests may change over time. The ACCC is not satisfied that the SAU sets out adequate monitoring and compliance reporting mechanisms in order to ensure continued adherence to the Management Principles.

The difficulties associated with identifying breaches of the control restrictions will be even more pronounced in relation to the restrictions applying to two or more access seekers. Clause 4.1(b)(ii) provides that two or more access seekers together are prohibited from controlling FANOC if such control:

1. would enable those access seekers to control the determination of *material terms* for BAS products set by FANOC and
2. is *reasonably likely* to result in those material terms being determined in *favour* of the interests of those access seekers and *contrary* to the interests of access seekers generally.²⁰⁵

Similarly, clause 4.1(e)(ii) provides that the restriction on control of the BAS Manager by two or more access seekers *with a financial interest in FANOC* is prohibited if control is *reasonably likely* to result in the decisions of the BAS Manager being made *in the interests of FANOC*.

FANOC recognises the potential for access seekers acting in concert to control FANOC. However, the additional provisions that must be met set a much higher threshold than the control restrictions on individual access seekers and raise significant

²⁰⁵ Italics added.

hurdles for the identification of non-compliance. For example, there may be practical and evidentiary difficulties in identifying whether control of FANOC by two or more access seekers is ‘reasonably likely’ to result in terms for BAS products being determined in favour of their interests, and even identifying the ‘interests’ of particular parties. There may be similar difficulties in identifying whether control of the BAS Manager by two or more access seekers is ‘reasonably likely’ to result in decisions being made in the interests of a FANOC Ownership Entity.

FANOC states it does not intend for the ACCC to enforce the control restrictions. In fact, FANOC submits that a failure to comply with the Management Principles, including the control restrictions, would not constitute a breach of the SAU. Instead, clauses 4.3-4.6 of the SAU contain a process whereby FANOC must report any ‘material’ non-compliance with the principles to the ACCC and the ACCC must then assess the ongoing reasonableness of the SAU in light of this.

The appropriateness of deeming certain terms to be unenforceable in the usual manner is discussed further in section 7.7. At this point, however, the ACCC notes the complexity of the control restrictions is likely to create significant difficulties for the ACCC in identifying non-compliance with the restrictions themselves as well as with the obligation on FANOC to report non-compliance.

Given this, it is difficult for the ACCC to be satisfied that FANOC will have only minimal interest in downstream markets, due to access seeker control of FANOC or, alternatively, that FANOC will not act in the interests of certain access seekers due to access seeker control of the BAS Manager.

As a result, the ACCC is not satisfied that the SAU provides a rigorous and unambiguous framework for sufficient separation between the ownership of the HFTP network and the downstream retail sector for the ACCC to accept FANOC’s claim that its governance model prevents *effective* vertical integration.

Clearly, the most straightforward approach to ensuring separation would be to prohibit parties with ownership interests in FANOC from participating in downstream markets. Once some degree of vertical integration is permitted, the ACCC acknowledges it is difficult to determine appropriate thresholds for identifying when the degree of integration is likely to raise competition concerns.

The greater FANOC’s interests are in downstream markets, the more likely FANOC is to discriminate between access seekers on an anti-competitive basis and the less effective the BAS Manager is likely to be in exercising its oversight functions. While the proposed weighted average price cap methodology could be appropriate in such circumstances, a high degree of regulatory oversight would be required, such as: effective powers to review and scrutinise budgets (including expenditure proposals and demand forecasts), potential oversight of pricing in downstream retail markets and much stronger safeguards (for example, under an operational-separation regime) to prevent discrimination and cross-subsidisation.

Given the SAU expressly provides for some level of integration by not prohibiting access seekers from having any financial interest in FANOC, the SAU could have

provided greater safeguards to tighten ownership and control restrictions. For example, the SAU could have included provisions:

- setting out stricter control restrictions using specific triggers based on ownership or voting thresholds applying both to individual and groups of access seekers so that non-compliance can be identified easily. Given the difficulties in identifying maximum ‘safe’ ownership thresholds, the ACCC would tend to take a cautious approach to determining these thresholds
- ensuring strict separation of directors, managers and employees of FANOC and the BAS Manager as well as business and IT systems
- requiring ongoing reporting on compliance with the Management Principles, including ownership interests and voting rights.

7.4.3 Effective oversight

The ACCC must also consider whether the BAS Manager has sufficient and effective oversight of FANOC’s decision-making in relation to price and non-price terms and conditions of access. There are two separate issues to be addressed:

- Whether the BAS Manager has sufficient oversight to ensure FANOC exercises its discretion in the long-term interests of end-users.
- Whether the BAS Manager has the right incentives and ability to exercise its oversight role.

7.4.4 BAS Manager oversight of FANOC’s decisions

FANOC’s submission

According to FANOC, the governance structure supports the interests of access seekers by providing the BAS Manager with direct influence over the management of the network and budget expenditure, including network deployments and setting non-price terms and conditions of access. FANOC contends this will ensure access charges reflect efficient expenditure and ensure FANOC provides the right services and quality standards to allow access seekers to meet the demands of end-users.²⁰⁶ FANOC argues this will directly promote an open and competitive environment.²⁰⁷

In its initial supporting submission, FANOC suggests the BAS Manager will be responsible for the day-to-day operational management of the HFTP network. The SAU states the exact allocation of responsibilities between the BAS Manager and FANOC will be set out in a Management Agreement, which must be consistent with the Management Principles. The Principles specify the BAS Manager will have two

²⁰⁶ FANOC, *Submission to the ACCC*, 30 May 2007, p. 22.

²⁰⁷ *ibid.*, p. 18.

primary functions: (1) oversight of FANOC budgets and network deployment and (2) development of non-price terms and conditions for BAS products (clause 4.1(g)).

Budget oversight, network deployment and introduction of new services

Clause 5 of the SAU requires FANOC to submit draft budgets to the BAS Manager for approval. Approval must also be sought for the demand forecasts for individual BAS products for each pricing period and for other parameters in the pricing model as well as any proposals to exceed budgeted expenditure or agreed deployments by a certain amount. The BAS Manager may dispute expenditure or proposed deployments where it considers these are not ‘commercially prudent’. If the disagreement cannot be resolved, FANOC may refer the dispute to arbitration. The BAS Manager may also request FANOC provide new access services. While final approval rests with FANOC, clause 6.7 places some limits on its discretion to withhold approval.

FANOC acknowledges its incentives to minimise costs may be blunted as it is the only provider of BAS services.²⁰⁸

Expenditure incurred by FANOC will flow through to access seekers in the form of higher chargers for the Broadband Access Service. Therefore FANOC’s yield is largely protected, provided the quantity of services is consistent with forecasts. Therefore, it is arguable that FANOC may not have a sufficient incentive to ensure expenditure is efficient.

FANOC submits that BAS Manager oversight of budgets will create the necessary incentives to minimise costs and ensure expenditure is commercially prudent.²⁰⁹ In addition, oversight will ensure there is appropriate expenditure to maintain quality of service and support innovation where efficient.²¹⁰ This oversight role will help ensure access prices set using the pricing methodology are efficient. The NERA report submitted by FANOC also contends that mandating access seeker input into FANOC budgets will ensure that the new network ‘makes the maximum use of existing infrastructure owned by all access seekers’, as opposed to budget priorities ‘being determined primarily to suit the vertically integrated arm of the infrastructure owner’.²¹¹

Establishing non-price terms

Clause 6 of the SAU requires FANOC to request the BAS Manager to develop and submit for approval proposed reference non-price terms and conditions for each BAS product. While final approval rests with FANOC, clause 6.6 places some limits on its discretion to withhold approval. FANOC contends that providing this role for access seeker will promote an open competitive environment, including by lowering the technical and operational barriers to competition.²¹²

²⁰⁸ *ibid.*, p. 7.

²⁰⁹ *ibid.*

²¹⁰ NERA Economic Consulting, *Economic properties of the FANOC SAU*, 30 May 2007, p. 13.

²¹¹ *ibid.*, p. 193.

²¹² FANOC, *Submission to the ACCC*, 30 May 2007, p. 21.

FANOC's further submission

In its further submission, FANOC states that the BAS Manager is likely to have operational and management responsibilities in addition to those specified in the SAU. However, only those matters which may impact upon the ACCC's assessment of reasonableness are specifically provided for at this stage.²¹³

Views of interested parties

Budget oversight, network deployment and introduction of new services

Telstra states the BAS Manager's budget oversight role is insufficient as it is limited to reviewing expenditure and deployments and does not permit review of FANOC's Component Charge for individual BAS products.²¹⁴ Telstra also notes FANOC has final say over the introduction or variation of new BAS products with no automatic escalation of disagreements to the ACCC or independent reviewer.²¹⁵

Establishing non-price terms

Telstra argues the BAS Manager has limited oversight over non-price terms and conditions. Telstra notes FANOC has the final say over terms and the BAS Manager has no express right of escalation of disputes to the ACCC or the BAS Manager.²¹⁶ Telstra acknowledges clause 6.6 seeks to limit FANOC's discretion to reject the BAS Manager's proposed reference non-price terms if FANOC, in its reasonable opinion, considers that the terms are not 'commercially prudent'. However, Telstra argues that commercial prudence 'is a very broad and ill defined concept'.²¹⁷

The ACCC's draft views

Budget oversight, network deployment and introduction of new services

The SAU appears to provide some ability for the BAS Manager to oversee FANOC's budgets once services commence over the HFTP network. While the power to refer disputes over expenditure and deployment to an independent reviewer would appear to rest solely with FANOC, the ACCC notes clause 5.3 provides that FANOC is unable to recoup disputed expenditure through the pricing model. This penalty is likely to be sufficient in most instances to ensure FANOC seeks BAS Manager approval of budgets.

The ACCC is concerned, however, that there is considerable uncertainty regarding the degree of oversight that the BAS Manager will have over FANOC's budget for the initial rollout of the HFTP network. Clause 5.2(a)(i) requires FANOC to provide the draft budget for the construction of the network and operation in the first access period to the BAS Manager at least three months prior to the commencement of construction. However, clauses 4.1-2 suggest the Management Principles, including provisions relating to the governance and functions of the BAS Manager and FANOC's obligation

²¹³ FANOC, *Further Submission*, 12 November 2007, p. 8.

²¹⁴ Telstra, *Submission in response to the ACCC's Discussion Paper*, p. 131.

²¹⁵ *ibid.*, p. 132.

²¹⁶ *ibid.*, p. 122.

²¹⁷ *ibid.*, p. 112.

to report non-compliance, do not apply until the date on which FANOC first supplies a BAS – presumably after the network is built. To be satisfied the BAS Manager has an effective oversight role of FANOC in relation to ensuring initial network costs are efficient, the ACCC would need the SAU to include an obligation that the Management Principles come into effect at an appropriate stage *prior* to the commencement of construction.

There is also a need for further clarity in the SAU regarding the extent of FANOC's discretion to refer disputes with the BAS Manager on the value of parameters, such as demand forecasts, used in the pricing methodology to arbitration (clause 7.1 of Schedule 3 of the SAU sets out a process for determining parameters but clause 7.1(d) provides that, in the event of a dispute, FANOC 'may' refer the parameter to the ACCC or an Independent Reviewer). It is not clear the extent to which failure to agree on parameter values would mean that deployments and expenditure under the budget is 'disputed'. Given FANOC may have incentives to underestimate demand forecasts, in particular, and this may have a material effect on whether FANOC's significant discretion under the pricing methodology is appropriate, the ACCC would need further reassurance on this matter prior to accepting the SAU.

The ACCC also notes that for the BAS Manager to exercise effective oversight of FANOC's budget process, it will require sufficient information on cost and demand data and a sufficient amount of time to conduct its assessment. It is not clear that the SAU, in its current form, provides for this.

The ACCC also notes FANOC is only required to 'reasonably consider' introducing new BAS products requested by the BAS Manager (clause 6.7). The SAU does not provide for dispute resolution in the event that the BAS Manager disagrees with FANOC's decision. This would appear to confer significant discretion on FANOC and means the BAS Manager's purported oversight role in relation to ensuring FANOC introduces new products is potentially limited.

Establishing non-price terms

The ACCC notes there is some ambiguity in relation to the effectiveness of the BAS Manager's oversight role in developing non-price terms and conditions for BAS products. While FANOC's discretion to reject the BAS Manager's proposed reference non-price terms is limited by clause 6.6, these limitations leave considerable scope for FANOC to act in its own business interests as opposed to the interests of the BAS Manager or access seekers. For example, FANOC could withhold approval to a non-price term if, in its own 'reasonable opinion', the non-price term is not 'commercially prudent' (clause 6.6). The SAU does not provide for dispute resolution in the event that the BAS Manager disagrees with FANOC's decision. Again, this clause would appear to confer significant discretion on FANOC and means the BAS Manager's purported oversight role in relation to setting non-price terms is potentially limited.

b. BAS Manager’s incentives and ability to exercise its oversight role

FANOC’s submission

Effective operation of the BAS Manager governance structure

FANOC states the corporate governance structure supports the reasonableness of the SAU. All access seekers may be members of the BAS Manager but the BAS Manager may not be controlled by any single member. Voting rights will be weighted by reference to the volume of BAS products acquired in the previous financial year (or an estimate) but with voting rights capped so that no two members hold more the 40 per cent in aggregate. According to FANOC, the cap will ensure the BAS Manager reflects a ‘balance of the interests’ of all access seekers.²¹⁸ This will prevent decisions being made in the interests of individual access seekers where this ‘could potentially create technical and operational barriers or otherwise impact upon competition in downstream markets’.²¹⁹

Views of interested parties

Telstra submits the SAU lacks sufficient detail on how the BAS Manager will actually operate. For example, Telstra submits the SAU does not clearly allocate responsibilities for specific obligations (such as reviewing budgets) to the BAS Manager board, its executives or members.²²⁰

In addition, Telstra argues FANOC has a large degree of discretion in implementing the cap on voting rights. It states:

‘Consider, for example, the case where Telstra’s past market share would entitle it to 36% of the votes and two other Speedreach members each with 12% of the votes, and four other parties each with 10% of the votes. At one extreme, FANOC could ensure compliance with Clause 4.1 by granting Telstra 28% of the votes; at another, it could reduce the voting share of all other parties except Telstra to 4%. An infinite number of options lie between these extremes’.²²¹

Telstra suggests that FANOC’s discretion could allow it to punish large access seekers that are too diligent, for example, in assessing FANOC’s costs and quality controls.²²²

Telstra is also concerned that granting smaller access seekers disproportionately large voting rights increases the possibility of inefficient decision-making ‘as it weakens the participants with the greatest and most direct interest in seeing timely and efficient

²¹⁸ FANOC, *Submission to the ACCC*, 30 May 2007, p. 18.

²¹⁹ *ibid.*

²²⁰ Telstra, *Submission in response to the ACCC’s Discussion Paper*, p. 111.

²²¹ Telstra submission, Annex 2, CRA International, *Efficiency Consequences of the G9 SAU*, Henry Ergas, p. 30.

²²² *ibid.*, p. 30.

decisions taken'.²²³ Telstra argues the varying sizes and business focus of access seekers on the BAS Manager:

'provides each downstream competitor with the incentive and the ability to block or retard the initiatives of others, especially those most competitively threatening to their own business, while gaming to ensure that their preferred improvements are agreed.'²²⁴

Telstra draws a parallel between the BAS Manager and the Telecommunications Access Forum, which Telstra argues was characterised by inefficient decision-making and which 'failed to agree on a single product to recommend for declaration'.²²⁵ Telstra suggests the large number of access seekers on the BAS Manager, coupled with their lack of common interest, would make effective decision-making similarly elusive.

Overall, Telstra submits, the BAS Manager structure is characterised by a 'misalignment of incentives'. This would result in a structure that will not ensure sufficient investment and innovation.²²⁶

Telstra also considers that the BAS Manager structure raises significant scope for collusion between downstream competitors. Telstra suggests the BAS Manager effectively amounts to a joint venture between competitors.²²⁷ Telstra argues the governance model 'provides downstream competitors with greater opportunity than otherwise to gather information or consider collusion with their retail rivals.'²²⁸ Telstra argues that the smaller downstream competitors 'will generally have more to gain by colluding', with the aim of blocking the development and delivery of new services.²²⁹

FANOC's further submission

In its further submission, FANOC provides additional detail on the operation of the BAS Manager and responds to a number of Telstra's criticisms.

FANOC confirms that access seekers will not be required to be members of the BAS Manager.

In relation to the governance model, the SAU provides for a BAS Manager Board of Directors, comprising independent directors and directors nominated by access seekers. In its further submission, FANOC suggests the board will consist of at least five directors, with a majority required to be independent of any particular access seeker.²³⁰ FANOC also suggests the BAS Manager board will appoint a management team with certain responsibilities as specified in

²²³ Telstra, *Submission in response to the ACCC's Discussion Paper*, p. 49.

²²⁴ *ibid.*, p. 130.

²²⁵ *ibid.*, p. 6.

²²⁶ Telstra submission, Annex 2, CRA International, *Efficiency Consequences of the G9 SAU*, Henry Ergas, p. 55.

²²⁷ Telstra, *Submission in response to the ACCC's Discussion Paper*, p. 59-60.

²²⁸ *ibid.*, p. 130.

²²⁹ *ibid.*, p. 60.

²³⁰ FANOC, *FANOC Special Access Undertaking: Further Submission*, 12 November 2007, p. 9.

the BAS Manager constitution.²³¹ On the voting mechanism, FANOC notes that certain BAS Manager decisions, such as approval of FANOC's budget and the appointment of directors, may require a special majority.²³²

In response to Telstra's criticisms that the BAS Manager structure is 'tortured and dysfunctional', FANOC notes the Management Principles provide the BAS Manager with discrete responsibility and clear timeframes

which will not create any delay or impediment to timely and appropriate decision making in respect of the HFTP network. Further, the BAS Manager board and management team would be able to establish appropriate systems to obtain feedback from members and pass it on to FANOC.²³³

FANOC submits the BAS Manager will not be structured in a manner that would result in blockaded or inefficient decision-making.²³⁴

FANOC further argues Telstra's submissions on the potential for collusion inherent within the proposed governance structure 'are without merit and should be disregarded'.²³⁵ FANOC submits the role of the BAS Manager does not give rise to any exclusionary conduct or price fixing between access seekers and, in any event, arrangements made by either the BAS Manager or FANOC members will be subject to Part IV of the TPA. FANOC also states it will manage any risk of collusion by 'putting in place proper protocols and safeguards concerning the sharing of sensitive commercial information'. FANOC notes the 40 per cent cap on the aggregate votes of any two access seekers will likely make it too difficult for any form of coalition to form.²³⁶

FANOC acknowledges it retains significant discretion to establish the governance arrangements. However, it argues that it is not necessary for all the details of the arrangements, including the constitutions of the respective bodies and the Management Agreement, to be provided for the ACCC to be satisfied that the SAU is reasonable.²³⁷

The ACCC's draft views

The ACCC notes FANOC and Telstra's submissions on the potential for collusion between downstream competitors within the BAS Manager. The ACCC notes that, on the information currently available, it is not clear whether the operation of the BAS Manager as described in the SAU and FANOC's supporting submissions would, prima facie, amount to or give rise to collusive behaviour, although the ACCC notes Telstra's view that the proposed structure raises 'scope for collusion'. Further, if it was considered likely that the operation of the BAS Manager would breach Part IV, FANOC could seek authorisation of the BAS Manager structure under subs. 88(1) of

²³¹ *ibid.*, p. 10.

²³² *ibid.*, p. 9.

²³³ *ibid.*, p. 10.

²³⁴ *ibid.*

²³⁵ *ibid.*, p. 11.

²³⁶ *ibid.*

²³⁷ *ibid.*, p. 3.

the TPA. This provision allows the ACCC, in certain circumstances, to grant immunity from legal action for conduct that might otherwise raise concerns under the competition provisions in the TPA, where the public benefits of the conduct outweighs any public detriment. The ACCC has not formed a view on whether the proposed arrangements would breach Part IV and/or satisfy the net public benefit test under Part VII. Assessment of the latter would be based on the merits of any application for authorisation received.

FANOC argues the BAS Manager's oversight role supports the reasonableness of the SAU. To fully assess this argument, the ACCC must consider whether the BAS Manager will have the incentive and ability to exercise its oversight role. If there is a significant risk that the BAS Manager structure will not operate effectively, the ACCC cannot be satisfied that the BAS Manager will, in fact, be able to provide effective oversight of FANOC.

The ACCC considers the SAU lacks sufficient detail for the ACCC to be satisfied that the BAS Manager structure will operate effectively. In particular, the ACCC notes there is a lack of clarity regarding the constitution and roles of the various BAS Manager bodies anticipated in the SAU and FANOC's submissions as well as the application of the cap on voting rights.

While the ACCC notes FANOC's statement that it will establish effective governance procedures in due course, the ACCC considers the SAU leaves considerable discretion to FANOC to define the procedures as it sees fit. It is possible FANOC may have incentives to determine these procedures in a way that limits the BAS Manager's ability to provide effective oversight. Given the potential for a degree of vertical integration of FANOC, it is also possible FANOC could exercise its discretion, particularly in relation to applying the voting cap, to reward or penalise certain access seekers.

FANOC's contention that the Management Principles are not enforceable in the usual manner also raises uncertainty regarding whether there would be any recourse available to the ACCC in the event that it was concerned the governance arrangements did not conform to the Management Principles but FANOC refused to submit a Variance Notice under clause 4.3(b)(i).

A number of arguments were raised by the parties in relation to the potential impact of specific elements of the proposed ownership and governance structure on incentives for efficient investment. FANOC suggests that the pricing methodology creates strong incentives for FANOC to invest efficiently in the network in order to maximise utilisation.²³⁸ In addition, FANOC argues that access seekers will have strong incentives to direct FANOC, via the BAS Manager, to undertake efficient investment so that access seekers can provide the services required by end-users.²³⁹

However, Telstra disputes FANOC's claim that the governance and ownership structure will promote efficient investment. In particular, Telstra suggests the proposed

²³⁸ FANOC, *Submission to the ACCC*, 30 May 2007, p. 17.

²³⁹ *ibid.*, p. 18.

structural separation of FANOC will create vertical externalities that will reduce FANOC's own incentives to invest in its network.²⁴⁰ In addition, Telstra argues that the committee nature of the BAS Manager will reduce the incentive or ability of individual access seekers to pursue efficient investment.²⁴¹

In assessing these arguments, the ACCC finds it useful to distinguish between two broad categories of investments: (1) investment in the underlying HFTP network used to deliver BAS (for example, an upgrade from ADSL2+ FTTN to VDSL FTTN to FTTH) and (2) investment in higher layer services and applications.

In relation to the first category of investment, the ACCC considers that the SAU would appear to create mixed incentives. On the one hand, as a potential monopoly infrastructure owner, FANOC itself may have weak incentives to invest in network infrastructure. However, the proposed pricing methodology may counteract this in a number of ways. First, the pricing methodology allows FANOC to recoup actual capital expenditure through access prices (subject to certain constraints in the SAU). Therefore, there appears to be little incentive *not* to carry out capital expenditure. Second, by permitting FANOC to keep additional revenue earned in any access period that exceeds its target revenue, the proposed pricing methodology would appear to create an incentive for FANOC to invest in the network where this is likely to increase network utilisation. However, the ACCC notes that if FANOC significantly exceeds its target revenue in one access period, the BAS Manager may have a strong incentive to ensure FANOC sets a higher (potentially more realistic) target revenue in the next access period as this would generally flow through into lower access prices in that period. This consideration may mitigate the strength of FANOC's incentive to maximise utilisation.

The incentives of the BAS Manager to promote investment in the HFTP network are also somewhat mixed. The ACCC notes CRA's argument that while the incentives of certain individual access seekers to encourage investment may be strong, sufficient support would be required across the BAS Manager for it to vote to direct FANOC to invest. For a range of reasons, including concerns about free-riding, it may take longer for support for network investment to reach the necessary level across the BAS Manager. The ACCC also notes that the incentives of access seekers to bring forward, via the BAS Manager, proposals for new investment in the HFTP network may be weaker as this could mean access seekers lose any first mover advantage.

However, in assessing the impact of the governance and ownership arrangements on incentives for investment in the underlying HFTP network, the ACCC notes that many of these general concerns are likely to apply to upgrading all forms of fixed line bottleneck access networks. Upgrading an ADSL2+ FTTN network to a VDSL FTTN or FTTH network would likely involve significant capital expenditure. This type of investment is unlikely to be undertaken by industry unless it is supported by either a strong business case based on demand, efficiency or competition drivers or by

²⁴⁰ Telstra submission, Annex 2, CRA International, *Efficiency Consequences of the G9 SAU*, Henry Ergas, p. 20.

²⁴¹ *ibid.*, p. 19.

government (as has occurred in some overseas jurisdictions). In addition, given the likelihood of continued regulated access in some form to an upgraded access network, where it remains an essential bottleneck, any party making such an investment would have a realistic expectation of being required, under the TPA, to provide access to access seekers.

In relation to the second category of investment (investment in higher layer services and applications), the ACCC considers that the pricing, ownership and governance principles in the SAU could, in theory, promote efficient investment. It is not clear to the ACCC that access seekers would have reduced incentives to undertake this type of investment as a result of the BAS Manager structure. Provided the SAU ensures access seekers have effective access to the BAS products at the lowest feasible network layer, access seekers should have sufficient flexibility and control over the access service to invest efficiently to provide new services and applications that meet the needs of end-users and compete among themselves for customers.

On balance, the ACCC considers FANOC's proposed pricing methodology, ownership and governance structure could, in principle, promote efficient use of and investment in carriage services. However, this view must be read in conjunction with the ACCC's overriding concerns as to whether the specific terms and conditions in the SAU will in fact lead to reasonable price and non-price terms and conditions of access. The ACCC acknowledges that as technology relating to both access networks and end-user services and applications evolves, these issues are likely to require further consideration.

Across all issues raised, the lack of certainty regarding the governance arrangements in the SAU and the significant discretion reserved to FANOC in this regard means the ACCC cannot be satisfied that the BAS Manager will exercise its oversight role effectively.

7.4.5 Summary of the assessment of governance structure

The SAU reserves significant discretion for FANOC to determine the price and non-price terms and conditions of access for the 15 year duration of the SAU. FANOC argues the proposed governance and ownership structure supports the reasonableness of the SAU. FANOC contends it will not be vertically integrated and therefore will have no incentives to discriminate between access seekers.²⁴² Further, there will be effective oversight of FANOC's decision-making by access seekers via the BAS Manager. FANOC argues this will ensure FANOC uses its discretion to set reasonable price and non-price terms and conditions of access.

However, having assessed the proposed governance and ownership provisions in the SAU, the ACCC considers the SAU in fact envisages FANOC would have a degree of vertical integration. Further, the ACCC has significant concerns regarding the application of the control restrictions, including their status in the SAU. The possibility of vertical integration raises concerns for the ACCC about FANOC's potential incentives to exercise its significant discretion anti-competitively to favour certain

²⁴² FANOC, *Submission to the ACCC*, 30 May 2007, p. 17.

downstream entities. The ACCC is also not satisfied that the SAU provides for effective oversight of FANOC by the BAS Manager, both in terms of the oversight provisions relating to FANOC's decisions on budgets, network deployment, new services and non-price terms and conditions or in terms of the effectiveness of the internal operation and decision-making of the BAS Manager. Concerns in relation to the potential effectiveness of the BAS Manager also become more pronounced the greater the potential degree of FANOC's vertical integration.

Given these concerns, the ACCC cannot be satisfied that FANOC's proposed ownership and governance structure will ensure that the wide discretion reserved to FANOC to set the price and non-price terms in accordance with the methodologies contained in the SAU will result in reasonable terms and conditions of access under s. 152AH. The ACCC cannot be satisfied that the terms and conditions of access developed under these methodologies will promote the long-term interests of end-users. In particular, it is possible that FANOC could exercise its discretion to harm competition and, through setting inefficient access prices, may send signals that lead to the inefficient use of and investment in infrastructure. Such outcomes will not be in the interests of persons who have a right to use the services subject to the SAU.

7.5 ACCC's power to arbitrate disputes between FANOC and access seekers

The SAU does not specify all the terms and conditions on which FANOC will comply with its obligations to supply the BAS products. Clauses 3.2-3.3 explicitly confirm the power of the ACCC to determine disputes between FANOC and an access seeker, including in relation to unspecified terms and conditions. However, under subs. 152CQ(5) of the TPA, the ACCC is precluded from making an arbitral determination that is inconsistent with the SAU.

FANOC's submission

FANOC appears to take the view that the SAU is non-exhaustive in providing for all the non-price terms and conditions of supply of the BAS products. Clause 3.2 explicitly states:

This Undertaking does not specify all the terms and conditions on which FANOC will comply with the obligations referred to in section 152AR of the TPA...

FANOC's submission further states:

Clause 3.2 of the Undertaking emphasises that the Undertaking does not specify all the terms and conditions on which FANOC will comply with the standard access obligations. This leaves a number of other terms to be either negotiated and agreed between FANOC (or the BAS Manager) and individual access seekers, or failing agreement, determined under Division 8 of Part XIC of the TPA.²⁴³

²⁴³ FANOC, *Submission to the ACCC*, 30 May 2007, p. 33.

Pipe Network's submission

Pipe Networks acknowledge in their submission that the SAU contains 'some attempt to construct an environment that allows for the setting of non-price terms'.²⁴⁴

The ACCC's draft view

The ACCC takes the view that clause 6 of the SAU reserves substantial discretion to FANOC and the BAS Manager to determine non-price terms and conditions of access.

The ACCC notes that clause 3.2 of the SAU states the SAU does not specify all of the terms and conditions on which FANOC will comply with its obligations and that, where FANOC and an access seeker fail to agree on additional terms and conditions, they will be determined in accordance with Division 8 of Part XIC of the TPA.

However, given the significant discretion provided in clause 6 for FANOC and the BAS Manager to determine non-price terms and conditions, there is uncertainty regarding how the process set out in the SAU is intended to operate in relation to subsequent negotiations with access seekers.

There is also potential uncertainty regarding the operation of these processes vis-à-vis the ACCC's statutory arbitration function under Part XIC. The SAU cannot prevent the ACCC from arbitrating access disputes in relation to the relevant service. However, the ACCC is precluded from making any arbitral determination that is inconsistent with an SAU in operation. Therefore, to the extent that the SAU sets out non-price terms and conditions, the ACCC would not be able to make an arbitral determination that is inconsistent with those terms and conditions. In the present case, it is not clear whether FANOC is suggesting that the ACCC's arbitral role under Part XIC would be limited to determining whether the processes for developing non-price terms and conditions set out in the SAU have been followed. To the extent that this is what FANOC is proposing, the ACCC would not be satisfied that this would be appropriate.

The ACCC notes that the SAU contains relatively few non-price terms and conditions of access. Although, as has been noted above, the ACCC does not consider it necessary for an SAU to set out all the terms and conditions of access, the ACCC does need to be satisfied that the terms and conditions will promote the long-term interests of end-users. The SAU appear to reserve significant discretion to FANOC to determine non-price terms and conditions in accordance with the process in clause 6.

7.6 Arbitration of disputes between FANOC and the BAS Manager

Clauses 5.2(f), 10.2, and 7.1 of Schedule 3 of the SAU purport to confer power on the ACCC to resolve disputes between FANOC and the BAS Manager. Under Part XIC, the ACCC has a statutory function to arbitrate disputes between access seekers and access providers.

²⁴⁴ Pipe Networks, *Submission to the ACCC*, p. 12.

FANOC's submission

FANOC submits:

There is provision for independent review or determination by the Commission in the event of dispute between the BAS Manager and FANOC over whether expenditure over budget is necessary. This process ensures that any expenditure over budget would nevertheless be efficient.²⁴⁵

Telstra's submission

Telstra submits that the dispute resolution powers FANOC purports to confer on the ACCC through the SAU are beyond the statutory powers of the ACCC. Telstra states:

The Commission's role in the governance structure is troubling and inconsistent with its powers as a creature of statute. If the BAS Manager and FANOC cannot agree on capital investment, operational and other key issues, the Commission is to stand in their shoes and make those commercial decisions. The Commission, as a regulator, is ill equipped to make fundamentally commercial decisions. Vesting the Commission with such broad powers under the SAU also fly in the face of the plain statutory intent of Part XIC that the Commission be empowered merely to accept or reject an undertaking and not to create an entirely new regulatory regime: eg s.152CBC(2).

The further problem with the creating of these non-statutory powers is that they exist outside the framework of principles, procedures, and review mechanisms of Part XIC within which the Commission must exercise its powers.²⁴⁶

Telstra also questions the appropriateness and ability of the ACCC assuming the proposed dispute resolution role within the vaguely defined parameters set by the SAU. Specifically Telstra submits:

The SAU requires the Commission to assume a role which is inappropriate from a legal and policy perspective. The Commission becomes the ultimate arbiter of network design, deployment and upgrades and the capital expenditure required to be made by FANOC. This reaches substantially beyond the Commission's legal powers to approve or reject SAUs and its role as an arbitrator of the terms of access under Part XIC.²⁴⁷

And:

It is not part of the capabilities or responsibilities of the Commission to take complex operating and investment decisions on behalf of the industry; moreover, the Commission would not be financially accountable for those decisions, were it to take them.²⁴⁸

Finally, Telstra submits that the ACCC has no role in arbitrating disputes between FANOC and the BAS Manager over non-price terms and service description.²⁴⁹

²⁴⁵ FANOC, *Submission to the ACCC*, 30 May 2007, p. 31.

²⁴⁶ Telstra, *Submission in response to the ACCC's Discussion Paper*, p. 130.

²⁴⁷ *ibid.*, p. 132.

²⁴⁸ *ibid.*, p. 50.

²⁴⁹ *ibid.*, (in footnote), p. 17.

FANOC's further submission

In response to Telstra's objection to the involvement of the ACCC in arbitrating disputes between FANOC and the BAS Manager regarding operating and investment decisions, FANOC submits:

the ACCC regularly makes decisions which directly or indirectly determine operating expenditure and investment decisions in regulated industries, either by way of arbitration of disputes between particular parties or by way of regulatory decisions.²⁵⁰

Further, FANOC submits:

In any event, if the ACCC is not appropriate, the Undertaking makes provision for an independent expert decision-maker.²⁵¹

The ACCC's draft view

The ACCC considers that the proposed dispute resolution function in clauses 5.2(f), 10.2, and 7.1 of Schedule 3 relate to disputes between FANOC and the BAS Manager and, therefore, appears to fall outside the ACCC's statutory arbitration functions. The ACCC is of the view that FANOC does not have the power, without reference to statutory authority, to confer functions and powers on the ACCC in an SAU. Therefore the ACCC is not empowered, under Part XIC, to arbitrate disputes between FANOC and the BAS Manager.

Even if the ACCC could arbitrate disputes between FANOC and the BAS Manager, the ACCC is not satisfied that the SAU provisions that purport to govern these arbitrations are appropriate. The ACCC shares Telstra's concerns about the appropriateness of the ACCC interpreting and applying the proposed 'Commercial Prudence'²⁵² test in arbitrating commercial decisions. The ACCC's role in assessing 'commercial prudence' as envisioned by the SAU would appear to be significantly less well defined than the assessments of prudence and efficiency undertaken by the ACCC in other industries. This is particularly concerning given that market conditions in the telecommunications sector are generally less stable.

7.7 Conferral of additional powers on the ACCC

In addition to arbitrating disputes between FANOC and the BAS Manager, the SAU purports to confer several additional powers and functions on the ACCC.

²⁵⁰ FANOC, *FANOC Special Access Undertaking: Further Submission*, 12 November 2007, p. 12.

²⁵¹ *ibid.*, p. 13.

²⁵² FANOC, *Special Access Undertaking*, 30 May 2007, 'Commercial Prudence' is defined in clause 1.1 of the Undertaking.

Clause	Power/ function
4.3(b)	Discretion to issue a Rectification Notice for non-compliance with the Management Principles
4.4	Acknowledgment that matters in a Variance Notice do not affect the reasonableness of the SAU
4.5(b) & 4.6	Accept additional SAUs to ensure reasonableness of SAU together with additional SAUs
6.4	Approve withdrawal or material alteration of the Basic Telephone Access Service or the Initial BAS during the First Period
7.7	In the event of an Unanticipated Event, approve: (a) variation of parameters of the Pricing Model; or (b) alter the pricing method and timeframe
7.9	Approve designation of a BAS Product as an Excluded Product
8.3	Ability to request records and other information from FANOC to be satisfied of FANOC's compliance with the Pricing Model
10.1	(c) Objecting to a proposed Independent Reviewer (e) Approving a proposed Independent Reviewer

FANOC's submission

FANOC generally contends these provisions are appropriate. FANOC does not address the issue of whether these provisions are potentially beyond the ACCC's statutory powers and functions.

Telstra's submission

Telstra raises a number of concerns with the purported conferral of powers upon the ACCC. Telstra submits, in reference to clause 4:

A provision of this sort is unlawful because:

(a) it purports to confer powers and functions on the Commission which have no statutory foundation: e.g. clauses 4.3(b)(ii), 4.4, 4.5, 4.6;

(b) it purports to set up some kind of "statutory estoppel" against the Commission (clause 4.4); and

(c) it is ultimately unenforceable in any event because, as clauses 4.5 and 4.6 tacitly acknowledge, the Commission has no power to withdraw approval of the undertaking and all that clauses 4.5 - 4.6 provide for is for FANOC itself to decide voluntarily to withdraw the SAU in certain circumstances.

Accordingly, while clause 4.3 and following comprise an acknowledgment that, as the SAU is framed, its operation may cease to be “reasonable”, the SAU provides no effective mechanism to address that eventuality. Thus, it follows, as a matter of logic and law that the Commission simply cannot be satisfied under section 152CBD(2) that the undertaking will be reasonable in its operation.²⁵³

The ACCC’s draft view

The ACCC does not consider that FANOC’s purported conferral of power through the SAU is valid. The ACCC can only exercise a power or function if it is authorised by statute, expressly or impliedly, to do so. A private person (including a corporation) does not have the power, without reference to statutory authority, to confer functions and powers on the ACCC. The ACCC notes that while Part IIIA of the TPA provides for an undertaking to confer powers and functions on the ACCC (see subs. 44ZZA(6A)), Part XIC does not contain an equivalent provision.

The clauses set out above appear to intend to confer powers and functions on the ACCC. If the ACCC were to carry out these functions, the ACCC considers there would be a risk any such action may be challenged as beyond power. The ACCC considers it is not reasonable to accept an SAU that contains clauses which are instrumental to the operation of the SAU where their effectiveness and operability are in doubt.

Even if the ACCC were able to accept these powers or functions the ACCC has concerns about the appropriateness of the specific clauses.

Clauses 4.3(b) and 4.4 appear to establish an alternative process for varying an SAU. The statutory process, in s. 152CBG, requires the ACCC to undertake a public consultation process and allows six months for the ACCC to reach a decision. In contrast, the process outlined in clauses 4.3(b) and 4.4 of the SAU provides the ACCC with 20 business days to make a decision on the reasonableness of the SAU where FANOC intends to vary the Management Principles and makes no provision for public consultation or even consultation with affected users via the BAS Manager. If the ACCC does not reach a decision within the timeframe, it is deemed to have accepted the variation of the Management Principles. The ACCC is not satisfied that the timeframe is sufficient for it to meet its statutory obligation to consult publicly on a variation of the SAU or to assess the reasonableness of the proposed variation.

Clauses 4.5(b) and 4.6 appear to be intended to operate outside of the statutory process for consideration and acceptance of a variation of an SAU. The ACCC is concerned about the potential inconsistency between these provisions and the statutory processes and therefore whether these provisions would be operable. Any person whose interests are affected may seek enforcement of the SAU if they consider FANOC has breached the SAU. Therefore, even if the ACCC was satisfied that additional SAUs were reasonable, unless these additional SAUs were incorporated into the original SAU via the statutory variation process, a court may find FANOC in breach of the terms of the original SAU.

²⁵³ Telstra, *Submission in response to the ACCC’s Discussion Paper*, p. 133.

Clauses 6.4 and 7.7 relate to proposed variations of the SAU. It is unclear whether FANOC envisages that the ACCC's approval under clauses 6.4 and 7.7 would be conditional on the statutory process for a variation (s. 152CBG of the TPA). The ACCC would be unable to accept a variation unless its decision was made in accordance with those statutory requirements.

Clause 7.9 appears to envisage an on-going role for the ACCC in relation to the approval of a BAS product as an Excluded Product, with the subsequent exclusion of that BAS product from the pricing model. It is unclear whether this clause envisages variation of the SAU. In any event, the ACCC's role is to accept or reject the SAU and accept or reject any proposed variation. The ACCC does not have an ongoing role in relation to informally approving variations or making decisions that would affect the operation of the pricing model.

Clause 8.3 appears to confirm powers and functions the ACCC already has under the TPA to request information in relation to compliance with the SAU.

The ACCC does not consider it can be satisfied that the terms and conditions of the SAU are reasonable under s. 152AH while uncertainty remains as to whether the ACCC can act in the manner envisioned by the SAU. In particular, the ACCC does not consider that it is in the interests of persons with rights to use the services subject to the SAU under subs. 152AH(1)(c) for there to be such a significant degree of uncertainty regarding the operation of the SAU. In addition, the ACCC is not satisfied that the powers and functions FANOC seeks to confer on the ACCC are appropriate, particularly in relation to the very short timeframes the SAU seeks to impose on the ACCC to undertake certain functions.

7.8 Summary of the ACCC's assessment of the non-price terms and conditions

FANOC has a wide discretion to set the price and non-price terms and conditions of access in accordance with the methodologies contained in the SAU. It justifies this discretion on the basis that it will not be vertically integrated and the BAS Manager will have effective oversight of FANOC's decision-making.

However, having assessed the proposed ownership and governance provisions in the SAU, the ACCC considers:

- the SAU allows for a degree of vertical integration. Although the SAU includes various 'control restrictions' that purport to minimise the degree of vertical integration, the ACCC is not satisfied these provisions are strong enough to ensure FANOC has no incentive to distort competition in downstream markets
- the BAS Manager may not provide sufficient oversight of FANOC. The ACCC has concerns regarding the likely effectiveness of the BAS Manager's oversight powers as well as the effectiveness of the internal operation of the BAS Manager.

Given these concerns, the ACCC cannot be satisfied that FANOC's proposed ownership and governance structure will ensure that the wide discretion reserved to FANOC to set the price and non-price terms in accordance with the methodologies contained in the SAU will result in reasonable terms and conditions of access under s. 152AH. The ACCC cannot be satisfied that the terms and conditions of access developed under these methodologies will promote the long-term interests of end-users. In particular, it is possible that FANOC could exercise its discretion to harm competition and, through setting inefficient access prices, may send signals that lead to the inefficient use of and investment in infrastructure. Such outcomes will not be in the interest of persons who have a right to use the services subject to the SAU or be in the long-term interests of end-users.

The ACCC notes the SAU makes undertakings about equivalence in relation to matters such as fault handling, ordering and provisioning and provision of information. It also makes statements about notice periods. That these are not fully detailed in this SAU would generally not be an overriding concern. Normally the ongoing development of broad rules about service specifications would be a matter for the Communications Alliance and for codes and standards under the *Telecommunications Act 1997*. Matters could also be resolved through commercial negotiation between the parties or, failing agreement, arbitration by the ACCC.

Indeed, the ACCC has previously said that issues surrounding network modernisation in particular are inherently complex and that it considers that such terms and conditions would more usually be determined by bilateral commercial negotiation or by agreed operational procedures through self-regulatory mechanisms. The ACCC may have a role where industry procedures prove insufficient.

In this case, however, FANOC is given a significant degree of discretion in relation to developing the non-price terms and conditions. In addition, it is unclear whether the SAU effectively limits the ACCC's arbitral role to determining whether the process for developing these terms and conditions has been followed, rather than determining the substance of the terms and conditions.

Finally, FANOC has also sought to confer powers and functions on the ACCC in relation to addressing non-compliance with the governance principles, assessing variations and arbitrating disputes. The functions and powers fall outside the ordinary legislative provisions under Part XIC. FANOC does not have authority to confer these powers and functions on the ACCC. As a result, several terms and conditions in the SAU would appear to be inoperable. The ACCC does not consider it can be satisfied that the terms and conditions of the SAU are reasonable under s. 152AH while uncertainty remains as to whether the ACCC can act in the manner envisioned by the SAU.

8. Is the ACCC satisfied that the terms and conditions are reasonable?

8.1 Introduction

The ACCC must not accept the SAU unless it is satisfied that the terms and conditions are reasonable. This chapter contains the ACCC's assessment of whether it is satisfied that the terms and conditions specified in the SAU are reasonable.

In Chapters 5, 6 and 7, the ACCC set out its views on a number of the specific terms and conditions. In this chapter, the ACCC has assessed whether it is satisfied that the terms and conditions, as a whole, are reasonable taking into account not only the effect of individual terms and conditions but also the way in which the terms and conditions interact with each other and the effect they would have or are likely to have on relevant interests and matters.

Section 152AH of the TPA specifies that in determining whether particular terms and conditions are reasonable, the ACCC must at least have regard to the following matters:

- whether the terms and conditions promote the LTIE
- the legitimate business interests of the service provider and its investment in the facilities used to supply the service
- the interests of persons who have rights to use the service
- the direct costs of providing access to the service
- the operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility and
- the economically efficient operation of a carriage service, a telecommunications network or a facility.

8.2 Consideration of each of the matters relevant to reasonableness

8.2.1 Whether the terms and conditions promote the LTIE

In determining whether the SAU promotes the LTIE of either carriage services or services supplied by means of carriage services ('listed services'), s. 152AB of the TPA requires the ACCC to have regard to the extent to which the SAU is likely to result in achieving the following objectives:

- the objective of promoting competition in markets for listed services
- for carriage services involving communications between end-users, the objective of achieving any-to-any connectivity and
- the objective of encouraging the economically efficient use of, and economically efficient investment in:
 - the infrastructure by which listed services are supplied and
 - any other infrastructure by which listed services are, or are likely to become, capable of being supplied.²⁵⁴

The above list limits the matters to which the ACCC may have regard in determining whether the SAU promotes the LTIE.²⁵⁵

The ACCC has made its assessment of whether the SAU promotes the LTIE by having regard to these three objectives. The ACCC's view in relation to each of the objectives is set out below.

The objective of promoting competition in markets for listed services

As required by subs. 152AB(4), in determining the extent to which a particular thing is likely to result in the achievement of the objective of promoting competition in markets for listed services, the ACCC has regard to the extent to which that thing will remove obstacles to end-users of listed services gaining access to listed services.

The ACCC has considered the likely effect of accepting the SAU in various markets for listed carriage services. The ACCC does not consider it necessary, for this purpose, to set out any view as to the exact boundaries of the relevant market(s).

Under the SAU, access seekers would have two main avenues to gain access to FANOC's BAS. First, access seekers could gain access to the BAS through commercial negotiation. Second, access seekers could gain access to the BAS under the terms of the SAU for 15 years from the commencement date.

²⁵⁴ Subs. 152AB(2) of the TPA.

²⁵⁵ Subs. 152AB(3) of the TPA.

The ACCC has assessed the proposed service description, price and non-price terms and conditions of access in the SAU in Chapters 5-7 of this report.

Service description

In order to promote competition, an SAU should provide for effective, non-discriminatory access by access seekers to the particular carriage services. The ACCC is of the view that effective access to an FTTN network would require the specification of a bitstream access service over the bottleneck portion of the network, at as low a layer within the network as feasible, so as to give access seekers as much control as possible over their own customer traffic. That is, the extent to which the service description is likely to promote competition depends on the extent to which it enables access seekers to control their own costs and supply chain, differentiate service offerings, innovate and improve service quality, where this is economically efficient.

The ACCC accepts that over the life of the SAU, there may be considerable technological and market development. Accordingly, it may be justifiable that the access service is not set in stone and an appropriate mechanism is provided to allow for changes to the technical and operational parameters and other non-price terms and conditions of the service over time. However, the terms and conditions in an SAU must still provide for effective access by access seekers to the particular service for the ACCC to be satisfied that the terms and conditions are reasonable under s. 152AH. Therefore, access seekers will still need sufficient information about the initial form of the access service that is to be provided on the commencement of the service.

The ACCC considers the proposed service description addresses many of the needs of a low layer, bitstream access service. FANOC's proposed service offers access seekers a degree of control over customer traffic via a VLAN solution to give access seekers as much control as can be reasonably achieved on an FTTN upgrade. The ACCC notes FANOC's proposed approach to managing congestion in the shared fibre backhaul is yet to be fully detailed. On balance, the ACCC considers the proposed service description will likely promote competition in relation to broadband services, although this view is subject to the ACCC's views on the reasonableness of the non-price terms and conditions, set out below.

In relation to voice services, however, the ACCC requires additional assurances as to whether FANOC's proposed approach will promote competition. FANOC's proposed approach requires access seekers to provide their own soft-switches to manage a VoIP-based service. Given this technology is still nascent, the ACCC is concerned that this requirement could raise significant obstacles to certain access seekers competing effectively in the provision of voice services.

Price terms and conditions

The SAU specifies a set of prices for BAS products for the initial three year period and a pricing methodology, based on a weighted average price cap, for determining prices in subsequent access periods.

At a general level, the ACCC considers FANOC's proposed pricing approach may, in certain circumstances, result in movements toward efficient price structures and, to the

extent this occurs, promote the long-term interests of end-users by promoting competition as well as efficient use of, and investment in, infrastructure.

The ACCC considers the combination of specific initial prices for the first three years and a pricing methodology to determine subsequent prices is an appropriate means to provide regulatory certainty to both the access provider as well as access seekers regarding pricing issues over the lengthy period covered by the SAU. Regulatory certainty will generally be in the interests of the access provider as well as access seekers and is also likely to support conditions that promote competition. In this regard, the ACCC notes it is very unlikely it could be satisfied that setting specific access prices for much longer than three years would promote competition, due to significant difficulties in identifying appropriate access prices in the future, particularly given the degree of uncertainty as to long-term future demand in communications markets.

The ACCC considers that access prices or a pricing methodology will be likely to promote competition if the prices are cost-based, do not discriminate in a way that reduces efficient competition, are not inflated to reduce competition in dependent markets and are not predatory.

The ACCC accepts that FANOC's general approach to pricing could meet these objectives and, in theory, result in efficient price structures for BAS products and could promote competition. In relation to new networks, where the actual costs of rollout are known and are likely to be efficient, the ACCC considers that pricing approaches other than TSLRIC+ may result in access prices that promote competition. However, in the particular circumstances before it, the ACCC cannot be satisfied that the proposed initial prices and pricing methodology will result in access prices that promote competition.

The maximum initial prices in FANOC's SAU may be within an appropriate range. However, further evidence as to expected costs and demand and commitments to the proposed depreciation profile would be needed for the ACCC to be satisfied. While in principle any misspecification of initial prices may be adjusted in subsequent periods under the pricing methodology, the resulting price path may lead to substantial price shocks over the life of SAU, which may have a negative effect on the interests of access seekers and on competition in downstream markets. In particular, the ACCC notes the pricing methodology is very sensitive to changes in factors such as the underlying capex and opex estimates and the proposed depreciation profile, including constraints on the residual value of the assets at the end of the SAU.

FANOC has not provided the ACCC with sufficiently robust information in relation to cost estimates or the proposed depreciation profile for it to form a view on the appropriateness of the initial prices. In particular, in relation to the depreciation profile, the ACCC notes that constraints referred to in FANOC's supporting submission on the capital asset value at the end of the 15 year period are not in fact included in the SAU and, therefore, are not binding on FANOC.

The pricing methodology is also sensitive to changes in demand. However, the ACCC considers it is appropriate for access prices to be responsive to such changes given the difficulty in forecasting demand over such a long period, provided the demand

forecasts used in the pricing methodology for each access period (including to set initial prices) are robust and subject to effective scrutiny.

Whether the methodology is likely to lead to access prices that promote competition will also depend on whether FANOC will exercise its pricing discretion to set efficient and non-discriminatory pricing structures over the life of the SAU. FANOC argues the proposed ownership and governance structure will ensure this occurs. However, as discussed in Chapter 7, the ACCC is not satisfied that this is the case. In particular, the ACCC is not satisfied:

- that the provisions in the SAU that purport to minimise FANOC's degree of vertical integration are sufficient to ensure FANOC has no incentive to set access prices in such a way that distorts competition in downstream markets, or
- that the BAS Manager will provide sufficient and effective oversight of FANOC's decisions in relation to access prices.

In light of this, the ACCC is not satisfied that FANOC will exercise its wide discretion to set appropriate access prices. Therefore, while the ACCC considers the pricing approach could be appropriate, there is currently insufficient evidence for the ACCC to be satisfied that the price terms and conditions in the SAU will promote competition.

Non-price terms and conditions

The SAU contains undertakings about equivalence in relation to matters such as fault handling, ordering and provisioning and the provision of information. It also includes references to notice periods.

That the non-price terms and conditions are not fully detailed in the SAU would not necessarily be an overriding concern. Often, the ongoing development of broad rules about service specifications would be a matter for the Communications Alliance and for codes and standards under the *Telecommunications Act 1997*. Matters could also be resolved through commercial negotiation between the parties or, failing agreement, arbitration by the ACCC.

Indeed, the ACCC has previously said that issues surrounding network modernisation in particular are inherently complex and that it considers that such terms and conditions would more usually be determined through bilateral commercial negotiation or by agreed operational procedures through self-regulatory mechanisms. However, it would be preferable that key network modernisation terms and conditions are not determined unilaterally by the access provider or solely through bilateral negotiations in circumstances where one negotiating party has little countervailing bargaining power.

In this case, the SAU provides a role for the BAS Manager to submit 'reference' non-price terms and conditions for each BAS product to FANOC for approval. The ACCC considers that this methodology creates significant discretion for FANOC in setting non-price terms and conditions. In addition, it is unclear whether the methodology in effect limits the ACCC's ability to arbitrate on non-price terms and conditions to ensuring the methodology has been complied with. Whether this methodology is likely

to result in non-price terms and conditions that promote competition will largely depend on a sufficient separation of FANOC's interests in upstream and downstream markets and the effectiveness of BAS Manager oversight. As already stated, the ACCC is not satisfied on either count. Therefore, the ACCC is not satisfied that the proposed methodology in the SAU for determining non-price terms and conditions of access will promote competition.

Finally, FANOC has sought to confer powers and functions on the ACCC in relation to addressing non-compliance with the governance principles, assessing variations and arbitrating disputes. These functions and powers fall outside the ordinary legislative provisions under Part XIC. FANOC does not have authority to confer these powers and functions on the ACCC. As a result, several terms and conditions in the SAU would appear to be inoperable. The ACCC does not consider it can be satisfied that the terms and conditions of the SAU will promote competition or be reasonable under s. 152AH while uncertainty remains as to whether the ACCC can act in the manner envisioned by the SAU.

The objective of achieving any-to-any connectivity

In relation to broadband services, the ACCC is satisfied that the terms and conditions promote the object of any-to-any connectivity. However, in relation to voice services, the ACCC is concerned that the SAU may impose unreasonable technical obstacles to any-to-any connectivity as a result of the requirement that access seekers provide their own soft-switches to manage a VoIP-based voice service. While such a requirement may be appropriate in the future, the ACCC notes the technology is still new and even large carriers are proceeding slowly with this transition.

The objective of encouraging the economically efficient use of, and economically efficient investment in the infrastructure by which listed services are supplied or any other infrastructure by which listed services are, or are likely to become, capable of being supplied

As noted in Chapter 3, in considering this objective, the ACCC will need to ensure that the access regime does not discourage investment in networks or network elements where such investment is efficient. The access regime also plays an important role in ensuring that existing infrastructure is used efficiently where it is inefficient to duplicate investment in existing networks or network elements. The ACCC considers this consideration is particularly important in the context of a bitstream access service provided over an FTTN network as it utilises a portion of the existing copper loop access network bottleneck and, therefore, is likely to perpetuate the bottleneck features of the existing network.

The ACCC is required to assess the impact of the terms and conditions of access on economic efficiency as opposed to the broader efficiency of the underlying network or carriage service. In considering these issues, the ACCC and Tribunal have traditionally focussed on the efficiency of the proposed access prices. In Chapter 6, the ACCC considered the reasonableness of the price terms and conditions in the SAU. As noted, the ACCC is satisfied that FANOC's proposed approach to pricing may, in certain circumstances, result in movements towards efficient price structures. Therefore, the ACCC considers that the proposed conceptual approach to pricing could result in

access prices that send the appropriate build/buy signals to access seekers and potential investors.

However, as explained above, the ACCC is not satisfied that there are sufficient safeguards in this SAU for the ACCC to be satisfied that, in this instance, efficient prices will be set over the life of the SAU.

Conclusion

For the reasons set out above, the ACCC is not satisfied that the SAU in its current form promotes the LTIE.

8.2.2 The legitimate business interests of the service provider and its investment in the facilities used to supply the service

The ACCC does not consider that the terms and conditions in the SAU would be likely to lead to the access provider recovering less than required to meet its legitimate business interests, including a normal return on capital. However, the ACCC does not consider that this criterion justifies the significant discretion reserved to FANOC in the SAU in relation to the setting of price or non-price terms and conditions of access, in the absence of effective regulatory audit or oversight.

8.2.3 The interests of persons who have rights to use the declared service

The ACCC is not satisfied that the terms and conditions in the SAU provide for an effective form of access. In particular, the ACCC is concerned that, for the reasons outlined in section 8.2.1, the terms and conditions may not lead to appropriate and efficient access prices or appropriate non-price terms and conditions. Therefore, the ACCC is not satisfied that the terms and conditions of access in the SAU are in the interests of persons who would have rights to use the BAS service.

8.2.4 The direct costs of providing access to the service

The ACCC considers that the price terms and conditions in the SAU provide sufficient compensation to FANOC to cover the direct costs necessarily incurred by the provision of access.

8.2.5 The operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility

The ACCC does not consider that the terms and conditions in the SAU raise any issues of concern under this criterion in relation to BAS products. However, as noted above, the ACCC has some concerns in relation to the reliable operation of voice services.

8.2.6 The economically efficient operation of a carriage service, a telecommunications network or a facility

The ACCC considers that similar factors to those considered in section 8.2.1 in relation to efficient investment should be considered in assessing this criterion. On balance, the ACCC considers FANOC's proposed pricing methodology, ownership and governance structure could, in principle, promote efficient operation of a carriage service. However, this view must be read in conjunction with the ACCC's overriding concerns as to whether the specific terms and conditions in the SAU will lead to reasonable price and non-price terms and conditions of access.

8.2.7 Other relevant factors

In assessing the reasonableness of the SAU, subs. 152AH(2) confirms that the ACCC may consider other factors that it considers to be relevant. In Chapter 7, the ACCC considered specific terms and conditions in the SAU that purport to confer certain powers and functions on the ACCC. The ACCC does not consider such a conferral of powers or functions is valid or appropriate. The ACCC considers it is not reasonable to accept an SAU that contains clauses that are instrumental to the operation of the SAU where their effectiveness and operability are in doubt. Further, even if the ACCC were able to accept these powers or functions, the ACCC has concerns about the appropriateness of the specific clauses, particularly in relation to the very short timeframes the SAU seeks to impose on the ACCC to undertake certain functions.

8.3 Conclusion

The ACCC has reached the draft view that accepting the terms and conditions in the SAU would not promote the LTIE. Further, the ACCC has concerns about the terms and conditions in relation to several other criteria set out in s. 152AH. Therefore, the ACCC's draft view is that it is not satisfied that the terms and conditions in the SAU are reasonable.

The ACCC has not used a 'with and without' analysis to assist it to assess the reasonableness of the terms and conditions in the SAU. In Chapter 3, the ACCC noted it may use this analysis where it is likely to be helpful but is not required to apply it where it is not helpful to do so. In assessing this SAU, the ACCC does not consider the 'with and without' analysis to be helpful. As the ACCC's draft view is that it is not satisfied that the terms and conditions in the SAU are reasonable, the ACCC must make the draft decision to reject the SAU (as required by subs. 152CBD(2)).

9. Consistency with the standard access obligations

Under subs. 152CBD(2)(a) of the TPA, the ACCC must not accept the SAU unless it is satisfied that the terms and conditions specified in the SAU would be consistent with the SAOs, to the extent that those obligations would apply to FANOC if the service was treated as an active declared service.

The SAOs are set out in s. 152AR and are referred to in Chapter 3 above. Part of the purpose of this provision is to ensure that an access undertaking at least meets the basic level of access obligations that would apply to the provider if the service was treated as a declared service.

9.1 Approach to assessing consistency with the SAOs

Subsection 152CBD(2)(a) provides that the ACCC must not accept an SAU unless:

the Commission is satisfied that the terms and conditions referred to in paragraph 152CBA(3)(b) would be consistent with the obligations referred to in paragraph 152CBA(3)(a).

Subsection 152CBA(3) provides that the SAU must state that, in the event that the person supplies the service (whether to itself or to other persons), the person:

- (a) agrees to be bound by the obligations referred to in section 152AR, to the extent that those obligations would apply to the person in relation to the service if the service were treated as an active declared service; and
- (b) undertakes to comply with the terms and conditions specified in the undertaking in relation to the obligations referred to in paragraph (a).

Clause 3.1 of the SAU provides that:

FANOC undertakes to the Commission that from the Service Date until the expiry of this Undertaking it will:

- (a) be bound by the obligations referred to in section 152AR of the TPA to the extent that those obligations would apply to FANOC in relation to the Broadband Access Service if the Broadband Access Service were treated as an active declared service;
- (b) comply with the terms and conditions specified in this Undertaking in relation to the obligations referred to in clause 3.1(a); and
- (c) in respect of each BAS Product it supplies to itself or to any other person, supply that BAS Product:
 - (i) to all Access Seekers that request that BAS Product at charges determined in accordance with this Undertaking; and

- (ii) take all reasonable steps to ensure that the technical and operational quality of the BAS Product supplied to each Access Seeker is equivalent to that which FANOC provides to other Access Seekers generally in respect of that BAS Product.

Therefore, the SAU complies with subs. 152CBA(3).

This leaves the question of whether the terms and conditions would be consistent with the SAOs. The TPA does not specify a particular approach for assessing whether the terms and conditions are consistent with the applicable SAOs. The ACCC finds it useful to adopt the following approach:

- Identify those SAOs that would be applicable to a particular access provider.
- Assess whether the proposed SAU would be consistent with the applicable SAOs. This assessment may involve consideration of whether the terms and conditions raise any inconsistencies with the applicable SAOs.

It is the ACCC's view that it is not necessary for an SAU to exhaustively address all matters that could relate to the applicable SAOs. Any relevant matters that are not addressed in the SAU could be determined through a process defined in the SAU or settled by commercial negotiation between FANOC and access seekers. Accordingly, the ACCC considers that the absence of terms and conditions about certain matters does not, of itself, make an SAU inconsistent with the SAOs. However, it is open to the ACCC to take the absence into account in conducting its assessment under subs. 152CBD(2)(a).

The issue of consistency with the SAOs is especially relevant with respect to the non-price terms and conditions in the SAU. The price terms and conditions are considered to be consistent with the SAOs (that is, it is consistent with the SAOs to specify prices or a methodology for determining prices at which access will be provided). The key issue in relation to price terms and conditions is whether these terms are reasonable (this was considered in Chapters 6 and 8).

9.2 Argument that the SAU is fundamentally inconsistent with the SAOs

Telstra argues that, as a preliminary threshold issue, FANOC's proposal to build the network relies on proposed legislative amendments to subs. 152AR(4) of the TPA to allow FANOC to access *all* of Telstra's copper sub-loops. Telstra argues that absent these amendments, FANOC's proposed network design (rather than the terms and conditions of the BAS) is fundamentally inconsistent with the SAOs.²⁵⁶

²⁵⁶ Telstra, *Submission in response to the ACCC's Discussion Paper*, p. 64.

As noted in Chapter 2, the ACCC does not agree with Telstra's view that the ACCC should not consider FANOC's SAU on the basis that FANOC would require legislative amendments in order to build the network and offer the proposed access services.

9.3 The applicable SAOs

FANOC contends it will be a wholesale provider of BAS products only and will not itself provide retail telecommunications services.²⁵⁷ This may suggest that the SAOs relating to the equivalence of services provided to access seekers and those provided to the access provider are not directly applicable to FANOC's SAU. Both FANOC and Telstra assume this is the case.²⁵⁸

However, as discussed in Chapter 7, the SAU expressly allows FANOC to provide BAS products to itself.²⁵⁹ Therefore, the ACCC has assessed the SAU against all obligations contained in subs. 152AR(3) and (5)-(7). Subsection 152AR(8) relates to conditional-access customer equipment and is not applicable.

9.4 Consistency with the applicable SAOs

FANOC submits that the SAU is consistent with the applicable SAOs.²⁶⁰ As noted above, clause 3.1(a) of the SAU explicitly provides that FANOC will be bound by the relevant SAOs.

In relation to the SAOs, Telstra argues that the terms and conditions of the SAU would not promote efficiency or competition.²⁶¹ As this argument relates to the reasonableness of the terms and conditions, rather than consistency with the SAOs, Telstra's arguments have been discussed in Chapters 5 – 8.

Subsection 152AR(3): Supply, quality and fault handling

FANOC commits in clause 3.1(a) of the SAU to comply with the SAOs.

Clause 3.1(c) requires FANOC to provide BAS products to all access seekers that request these products and take all reasonable steps to ensure equivalent technical and operational quality between access seekers. Certain details of the BAS products are set out in Schedule 2 of the SAU. Clause 6 also contains a process whereby FANOC and the BAS Manager may determine non-price terms and conditions of access for BAS products, which may include terms relating to quality and fault handling.

²⁵⁷ FANOC, *Submission to the ACCC*, 30 May 2007, p. 4.

²⁵⁸ *ibid.*, p.14; Telstra, *Submission in response to the ACCC's Discussion Paper*, p. 64.

²⁵⁹ For example, clause 3.1(c) of the SAU, FANOC, *Special Access Undertaking*, 30 May 2007.

²⁶⁰ FANOC, *Submission to the ACCC*, 30 May 2007, p. 34.

²⁶¹ Telstra, *Submission in response to the ACCC's Discussion Paper*, p. 64-65.

The SAU does not contain explicit obligations binding FANOC to provide equivalent technical and operational quality for BAS products between itself and access seekers or obligations in relation to fault detection, handling and rectification. However, while FANOC could technically supply the service to itself, it would obtain supply as an access seeker hence clause 3.1(c) would apply.

Therefore, the ACCC's draft view is that the SAU is consistent with the SAOs in relation to the supply and quality of BAS products and related fault handling obligations.

Subsection 152AR(5): Interconnection of facilities

The BAS products will be supplied by FANOC at points of interconnect and pursuant to terms and conditions, including interface standards, as set out in the BAS Specification for each BAS product or as agreed with the access seeker.²⁶²

As noted in Chapter 5, the SAU permits interconnection by access seekers to the BAS at two sets of interconnection points – Local Access Points and Transit Access Points. Schedule 2 of the SAU and FANOC's letter of 20 November 2007 in response to the ACCC's request for further information provide some detail on the standards for interconnection for each initial BAS product. The process outlined in clause 6 of the SAU for determining non-price terms and conditions of access for BAS products would also encompass further terms relating to interconnection. Alternatively, these terms could be determined through commercial negotiation between FANOC and access seekers. In determining terms relating to billing information, FANOC is bound by clause 3.1(a) of the SAU to comply with the SAOs.

The ACCC notes that, for the purposes of subs. 152AR(5)(d)(ii), there is no applicable standard in force under s. 384 of the *Telecommunications Act 1997*.

The ACCC's draft view is that the SAU is consistent with the SAOs in relation to interconnection facilities.

Sections 152AR(6) and (7): Provision, timing and content of billing information

The SAU does not contain terms and conditions on the provision, timing and content of billing information.

The ACCC does not consider that the absence of terms and conditions necessarily means the SAU is inconsistent with the SAOs. These terms and conditions may be determined according to the process in clause 6 of the SAU or via direct negotiation between FANOC and access seekers. In determining terms relating to billing information, FANOC is bound by clause 3.1(a) of the SAU to comply with these SAOs.

²⁶² For initial BAS products, the BAS Specifications are set out in Annexures A to E to Schedule 2 of the SAU. In respect of new BAS products, the BAS Specifications form part of the non-price terms to be developed via consultation between FANOC, the BAS Manager and access seekers (clauses 6.5 and 6.6 of the SAU), FANOC, *Special Access Undertaking*, 30 May 2007.

The ACCC's draft view is that the SAU is consistent with the SAOs in relation to billing information.

9.5 Conclusion

The ACCC's draft view is that the terms and conditions in the SAU are consistent with the applicable SAOs to the extent that those obligations would apply to FANOC if the BAS was a declared service.

10. Draft Decision on FANOC's Special Access Undertaking

In relation to this particular set of terms and conditions of third party access put forward by FANOC to its proposed FTTN network, and following from the analysis provided in the preceding chapters, the ACCC's draft findings are as follows:

- the ACCC's draft view is that it is satisfied that the terms and conditions specified in the SAU are consistent with the applicable SAOs to the extent that those obligations would apply to FANOC if the relevant service was treated as a declared service, as required by subs. 152CBD(2)(a).
- the ACCC's draft view is that it is not satisfied that the terms and conditions specified in the SAU are reasonable, as required by subs. 152CBD(2)(b).

Pursuant to subs. 152CBD(2), the ACCC must not accept an SAU unless it is satisfied of both of the matters that are set out in subs. 152CBD(2)(a) and subs. 152CBD(2)(b). In the present case, the ACCC's draft view is that it is not satisfied of the second of these matters. As a result, the ACCC's draft decision is to reject the SAU.