

# NBN Co submission to the ACCC's Domestic Transmission Capacity Service Final Access Determination Discussion Paper – Primary Prices

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# 1 Introduction and overview

NBN Co welcomes the opportunity to comment on the ACCC's discussion paper on the Domestic Transmission Capacity Service Final Access Determination – Primary Prices (the Discussion Paper).

The DTCS FAD is relevant to NBN Co in terms of its effects on:

- the cost of NBN Co's interim transit arrangements – NBN Co currently purchases managed transmission services on a large number of routes that variously link greenfield and brownfield sites with relevant interim and permanent POIs. Many of these routes are covered by the current DTCS declaration and are therefore covered by the regulated pricing in the current DTCS FAD. Although currently extensive, NBN Co's use of managed transmission services is temporary, and will phase down as the POI rollout and transit network build is completed and the interim POIs are migrated to the relevant permanent POIs; and
- the cost of Access Seekers' backhaul from NBN Co's 121 (permanent) POIs – only a small number of Access Seekers will own their own fibre backhaul networks from all of NBN Co's POIs, so all other Access Seekers will need to buy backhaul services directly (as wholesale transmission) or indirectly (as part of a wholesale aggregation service). Many of the relevant backhaul routes are covered by the current DTCS declaration (and therefore the DTCS FAD).

The key aspects of NBN Co's submission are as follows.

- NBN Co supports the continued use of a domestic benchmarking approach for the 2015 FAD (section 2.1).
- However, the underlying principles of this approach should be fully explained and its implementation consulted upon and made transparent at each stage (including to explain what changes needed to be made in moving from a principled to a practical approach that accounts for any data or analytical limitations) (section 2.1).
- Given that prices are expected to vary over time, NBN Co considers that a key challenge for the 2015 FAD is to develop a suitable approach for empirically testing price trends and incorporating any detected trends into a pre-determined FAD price path (section 2.2).
- The 2015 FAD should expressly state that it applies to all non-specified variants of the DTCS that fall within the specified conditions (for example, speed, capacity, protection, etc.) addressed in the FAD (section 2.3).
- The ACCC should collect benchmarking data for at least the same set of variables as was collected for the 2012 FAD (i.e. provider, route category, distance, redundancy, data speed (i.e. capacity), network interface, contract term, connection charge and annual charge). Additional data should be collected in regard to contract term (section 2.4)
- All stakeholders (including both transmission customers and transmission providers) should be consulted on the specification for the ACCC's data request (section 2.5).
- In the transition to the NBN, it would be useful if the FAD were to account for speeds above 1Gps and also for the concentration of traffic that is likely to occur on NBN POI routes (sections 2.4.2 and 2.4.3).
- The most appropriate time period for the FAD will depend on the findings from the regression analysis (in particular, whether it is possible to estimate a price trend) and how these findings are incorporated into the final pricing model.

## 2 Issues for consultation

### 2.1 Pricing methodology and rationale

The Discussion Paper states the ACCC's preliminary view that a domestic benchmarking approach continues to be an appropriate model for determining regulated prices for the DTCS FAD.<sup>1</sup>

NBN Co broadly supports the continued use of a domestic benchmarking methodology for the 2015 DTCS FAD. In particular, NBN Co agrees that alternative pricing approaches, such as cost-based approaches, are likely to be much more complex and resource intensive, without necessarily leading to more appropriate outcomes.

Having said this, NBN Co considers that the principles and assumptions underpinning a domestic benchmarking approach should be fully explained as part of the 2015 FAD consultation process.

At a high level, the Discussion Paper notes that "prices on the competitive routes would provide a good baseline of what would be expected on non-competitive (regulated) routes given the number of competitive routes and areas in the DTCS market."<sup>2</sup> However, it does not provide further detail on the principles or assumptions underlying the approach and this raises a number of questions. For example, does the benchmarking approach assume that prices on competitive routes reflect (or are converging towards) the efficient costs of providing transmission services on those routes and, when these prices are applied via the benchmarking approach to regulated routes, would a DTCS provider be expected to earn a normal return on investment over the asset lifecycle?

The underlying principles and assumptions of the benchmarking approach should be used to guide the analysis and considerations that feed into the final pricing model. For example, to the extent that prices on deregulated routes are assumed to reflect (or be converging towards) efficient costs as a result of competition, it is important that the ACCC considers the degree of competition on the routes for which data is being collected. In addition, there may be a question as to whether pricing data should also be collected for those routes newly identified by the ACCC as competitive in the 2014 DTCS Declaration but that are yet to be deregulated (due to the 9 month transitional period, ending 31 December 2014).<sup>3</sup>

NBN Co would also emphasise the importance of the ACCC making clear, throughout the 2015 FAD consultation process, the analysis and considerations that feed into the final specification of the FAD pricing model. For example, stakeholders should have visibility over: the variables on which data is collected; which variables are accounted for in the final pricing model; and how and why other variables have not been taken into account in the final pricing model. NBN Co considers that greater understanding amongst industry about the analysis and considerations that guide the ACCC's decision making will enable a more informed and effective FAD consultation process.

### 2.2 Accounting for price trends over time

NBN Co understands that prices on competitive routes have been decreasing over time on a like-for-like basis and expects that this will continue into the future. NBN Co considers it is important to account for these price trends over time in order to avoid a bias in the pricing output from the FAD model, whereby regulated prices are systematically higher than prices for equivalent services on competitive routes. The effects of any such a bias may be magnified if the 2015 FAD were to be based on benchmarking data from

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<sup>1</sup> ACCC, *DTCS FAD Discussion Paper – Primary Prices*, July 2014, p. 14.

<sup>2</sup> ACCC, *DTCS FAD Discussion Paper – Primary Prices*, July 2014, p. 14.

<sup>3</sup> Due to the 9 month transitional period for the 2014 DTCS Declaration, newly deregulated routes will remain regulated under the existing FAD until 31 December 2014.

2014 and yet have an approximately four year term (expiring 31 March 2019) as contemplated in the Discussion Paper<sup>4</sup> – in that case, the 2019 regulated prices would be based on benchmarking data that was over four years old.

The ACCC acknowledged in its decision on the 2012 DTCS FAD the existence of a time lag between benchmarking data and final prices. Although the ACCC also noted that the effect of this time lag will be “somewhat mitigated in the pricing model as the data also contains pricing for forward years where contracts have been negotiated for terms beyond 2011”<sup>5</sup>, NBN Co considers that the nature and extent of price trends over time should be empirically tested.

Separate, but related to this, NBN Co considers that it would be better for both access seekers and access providers if the 2015 FAD specified ‘upfront’ the pricing (factoring in any relevant price trends) to apply in each year of the FAD (which may involve a downward price path). As compared to an option that may involve a ‘mid term’ review, a pre-determined price path would provide price certainty over the term of the FAD, which should promote efficient investment in infrastructure (in both upstream and downstream markets). Further, as the ACCC has noted previously,<sup>6</sup> such certainty may encourage parties to commercially negotiate longer term contracts, promote more economically efficient use of infrastructure, and encourage efficient market entry. A pre-determined price path will also avoid the time and resource intensive process involved in a ‘mid term’ review.

For the current FAD, a key challenge is therefore to develop and then empirically test a suitable approach to incorporating price trends into a pre-determined FAD price path.

NBN Co considers that the ACCC should have regard to two possible approaches:

- a historical time series approach, based around a comparison between the 2011 data collected for the 2012 FAD and the 2014 data that will be collected for the 2015 FAD; and
- a more forward looking approach, based around analysis of how prices vary according to contract term and how many years (or months) are remaining on a contract.

Until the relevant data is collected and analysed it is not possible to say whether either approach (or perhaps some combination of the two) would provide an appropriate basis for the 2015 FAD.

## 2.2.1 Historical time series approach

The Discussion Paper notes that the ACCC expects to have a time series of DTCS pricing data, which may be useful in considering any trends in DTCS pricing over time.<sup>7</sup> This dataset will include data gathered in 2011 for the 2012 DTCS FAD, as well as data gathered in 2014 for the 2015 FAD.<sup>8</sup> NBN Co strongly supports the ACCC using this data to detect any trends in DTCS pricing over time and, if appropriate, accounting for these trends in the 2015 FAD.

NBN Co understands that there may be challenges in using the time series data to identify trends in prices due to some shifts in how DTCS services are offered (for example, Telstra’s Managed Lease Line service as compared to its Data Carriage Service<sup>9</sup>). Nonetheless, NBN Co encourages the ACCC to explore options for how to make appropriate like-for-like comparisons across time.

NBN Co notes that the issue of how to account for price trends was explored in the course of the 2012 FAD process. For example, in an expert report for Telstra,<sup>10</sup> Professor Trever Breusch makes a number of

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<sup>4</sup> ACCC, *DTCS FAD Discussion Paper – Primary Prices*, July 2014, p. 23.

<sup>5</sup> ACCC, *Final Access Determination for the DTCS - Explanatory Statement*, June 2012, p. 5.

<sup>6</sup> ACCC, *Final Access Determination for the DTCS - Explanatory Statement*, June 2012, pp. 67-8.

<sup>7</sup> ACCC, *DTCS FAD Discussion Paper – Primary Prices*, July 2014, p. 17.

<sup>8</sup> ACCC, *DTCS FAD Discussion Paper – Primary Prices*, July 2014, p. 17.

<sup>9</sup> ACCC, *DTCS FAD Discussion Paper – Primary Prices*, July 2014, p. 12.

<sup>10</sup> Breusch, *Review of proposal for a price updating mechanism in the DTCS*, April 2012, pp. 2-5.

suggestions regarding how to combine two waves of data in one model in order to undertake benchmarking when prices vary over time.

As part of looking at historical price trends, NBN Co suggests that the ACCC also tests the predictive accuracy of the pricing in the 2012 FAD against the data gathered in the 2015 FAD. This will highlight the extent of price movements in the period between 2011 and 2014, and may help to identify aspects of the benchmarking approach that could be improved.

### 2.2.2 The relationship between expected prices and contract term

NBN Co's understands that there is an inverse relationship between length of contract term and price for DTCS services (for both connection and recurring charges). In addition, NBN Co understands that providers often offer discounts for contract renewals.

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A number of submissions to the 2012 FAD argued that discounts for contract terms longer than 12 months should be taken into account in the FAD.<sup>11</sup> In particular, Optus noted that contract length has a significant influence on commercial DTCS pricing.<sup>12</sup>

The Discussion Paper notes that discounts on connection charges for longer term contracts are likely to reflect the incremental costs of continuing to provide a service.<sup>13</sup> NBN Co considers there may be other important factors driving the inverse relationship between contract term and recurring charges.

Firstly, discounts for longer term contracts and/or contract renewals may reflect an expectation about future prices. That is, if service providers offer discounts for longer term contracts, it may reflect an expectation that prices in the market will decrease over the term of the contract, and therefore the contracted price is set to reflect an average of the expected price for each year of the contract. Secondly, lower prices for longer term contracts may also reflect some sharing between the parties of the perceived benefits in terms of greater certainty and/or avoided transaction costs.

NBN Co suggests that the ACCC investigate the empirical relationship between price, contract term and contract starting date, as part a broader domestic benchmarking approach, to further inform how price trends over time can be incorporated in the 2015 FAD.

## 2.3 Specification of DTCS service

The DTCS service description to which the 2012 FAD applies is specified relatively broadly and provides limited detail on technological variations between the different services it covers. NBN Co considers that, if a service offered by an access provider fits within the service description of the DTCS (e.g. it is within the range of bandwidths specified in the declaration), it is important to ensure that the service is covered by the terms of the FAD, including price terms.

Section 152BC(3)(a) of the CCA specifies that a FAD may specify "any or all" of the terms and conditions on which a carrier/CSP is to supply the declared service. Although NBN Co considers it is impractical for the FAD to describe every possible technical variation (and hence every term and condition applicable to the DTCS) which an access provider might offer, it is important that access providers cannot argue that a particular variant of the DTCS is outside the scope of the FAD due to that matter.

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<sup>11</sup> AAPT, *Submission to ACCC Draft FAD for the DTCS*, December 2011, pp. 9-10; Optus, *Submission in response to ACCC Draft FAD for the DTCS*, February 2012, paragraphs 4.36-4.39.

<sup>12</sup> Optus, *Submission in response to ACCC Draft FAD for the DTCS*, February 2012, paragraph 4.36.

<sup>13</sup> ACCC, *DTCS FAD Discussion Paper – Primary Prices*, July 2014, p. 20.

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Therefore, NBN Co considers that the FAD should expressly state that the FAD applies to all non-specified variants of the DTCS which fall within the specified conditions (for example, speed, capacity, protection, etc.). That is, if the technical details of a service supplied or capable of being supplied by an access provider fit the technical details set out in the FAD, the service is subject to all the terms and conditions of the FAD, regardless of whether the service also includes additional technical details which are not addressed in FAD.

## 2.4 Service provider data request and regression variables

As a general principle, NBN Co considers that the specification of the service provider data request and regression variables should be based on the underlying principles and assumptions of the domestic benchmarking approach (e.g. to use pricing data from competitive routes to provide a forward-looking estimate of efficient prices for equivalent services on regulated routes). NBN Co understands that there are a number of potential challenges and limitations arising from the data available to the ACCC from access providers. These limitations may impose practical constraints on the analysis that is able to be undertaken in the FAD process. However, any deviations from a principled approach to the data collection and regression analysis should only be made as practically required.

Accordingly, NBN Co considers the ACCC should collect data on a wide range of variables, which it can test for significance and include in the regression model as appropriate. Specifically, data should be collected for at least the same set of variables as was collected for the 2012 FAD (i.e. provider, route category, distance, redundancy, data speed (i.e. capacity), network interface, contract term, connection charge and annual charge).<sup>14</sup> The following sections outline NBN Co's specific comments on the pricing data request and regression variables.

### 2.4.1 Contract term

NBN Co suggests that the ACCC collects additional information to support analysis of the relationship between contract term and prices, and to account for the forward looking nature of longer term contracts. Such information should include: contract start and end dates; and how pricing varies over the contract term (if at all).

### 2.4.2 Capacity

The 2012 FAD set prices for services with data rates ranging from 2Mbps to 1Gbps. In its Explanatory Statement to the 2012 FAD, the ACCC noted that there was not sufficient pricing information available for the regression model to robustly predict prices of services with data rates higher than 1Gbps.<sup>15</sup>

NBN Co understands that the regression model can only provide robust estimates of prices for services with capacities for which sufficient data is available. However, during the transition to the NBN, demand for and availability of higher capacity services is likely to increase and 1Gbps may not be adequate to accommodate the increasing bandwidth requirements.

Given that the availability of data for higher capacity services is likely to have increased since 2012, NBN Co submits that the ACCC should collect data on all capacities for which data is available. Tests can then be run

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<sup>14</sup> DAA, *DTCS Price Benchmarking – Data Review and Exploratory Analysis*, June 2011, p. 2.

<sup>15</sup> ACCC, *Final Access Determination for the DTCS - Explanatory Statement*, June 2012, p. 38.

to determine whether this data is sufficient to allow the regression model to robustly estimate prices for higher capacity services.

### 2.4.3 NBN POI Routes

As NBN Co has noted previously,<sup>16</sup> backhaul from NBN Co POIs to access seekers' Points of Presence (POPs), usually located in capital cities, is an essential input to achieve connectivity with the NBN. Of the 121 POIs, only 46 are in ESAs that will remain regulated under the DTCS declaration from 1 January 2015, and of these 17 are in regional areas (not including Hobart and Darwin).

All NBN access seekers will need to self-supply or directly or indirectly purchase transmission on these routes which, as a consequence, will exhibit an increasingly higher concentration of DTCS traffic. In particular, regional POI routes may begin to exhibit similar characteristics to intercapital or significant capital to regional routes, such as Melbourne-Bendigo or Sydney-Wollongong.

Accordingly, NBN Co considers that the ACCC should account for the concentration of traffic on NBN POI routes in the 2015 FAD. NBN Co notes that accounting for POI routes in the 2015 FAD would not necessarily require collecting more data from transmission providers. Rather, existing information about NBN permanent POIs could be used to incorporate an NBN POI route explanatory variable into the regression model and test for significance. At this stage of the NBN rollout, a POI route variable may not yet show up as significant in the regression analysis; however, NBN Co considers this variable should be tested for significance and accounted for in the FAD pricing model if appropriate.

In addition, NBN Co suggests the ACCC considers reviewing the impact of NBN POI routes on DTCS prices during the term of the 2015 FAD. If the FAD is set for an approximately four year term (as contemplated in the Discussion Paper), the impact of NBN POI routes on DTCS pricing may increase significantly over that time. To the extent that a higher concentration of traffic on POI routes drives down prices on those routes, the FAD should be updated to reflect such trends.

## 2.5 Consultation on service provider data request

NBN Co encourages the ACCC to provide all stakeholders with the opportunity to review and provide comment on the service provider data request before it is finalised and issued to access providers. The specification of the data request is critical to ensuring the right data is collected for analysis and, if appropriate, included in the regression model.

## 2.6 FAD term

In determining an appropriate time period for the FAD, an appropriate balance needs to be achieved between providing pricing certainty for access seekers and access providers, and providing sufficient flexibility to respond to changing market conditions and circumstances over time.

NBN Co considers that the findings of the FAD regression analysis, and how the ACCC incorporates these findings into the pricing model, will be a key factor in determining what FAD term most effectively achieves this balance. For example, setting the 2015 FAD for a period of almost four years (as contemplated in the Discussion Paper) is only likely to be appropriate if the FAD takes into account expected price trends over the FAD period.

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<sup>16</sup> NBN Co, *Submission on ACCC Discussion Paper reviewing the Declaration for the DTCS*, August 2013, p. 7.