



Submission to the ACCC – Superfast broadband class exemption and deemed functional separation undertaking - Consultation paper

17 July 2020



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1 Executive Summary

- 1.1 **nbn** welcomes the ACCC's Consultation Paper on 'Superfast broadband network class exemption and deemed functional undertaking' (**Superfast Broadband Consultation**). While **nbn** understands that the superfast broadband network class exemption and deemed functional separation undertaking will not apply to us, the class exemption in particular has the potential to undermine competition and reduce investment incentives, and we have concerns about that as further described in this submission.
- 1.2 **nbn** strongly supports measures that will promote competition and incentivise investment in superfast broadband infrastructure. Conversely, **nbn** cannot support regulatory measures that are not likely to promote the long-term interests of end users (**LTIE**).
- 1.3 **nbn** does not support the need for a class exemption. As **nbn** has submitted in the past, **nbn** submits that the principle of regulatory symmetry is essential. **nbn** is concerned about the creation of small vertically integrated monopolies which are exempt from the requirement to comply with the wholesale-only obligations or functional separation requirements. There is a high degree of uncertainty about whether entry by these small vertically integration monopolies will promote competition or efficient investment, whether in the manner suggested by the ACCC in the Superfast Broadband Consultation or otherwise. For the reasons described in this submission, **nbn** does not support the granting of the class exemption.
- 1.4 Alternatively, if the ACCC does proceed with the class exemption, **nbn** submits that it should be issued only in respect of the narrowest class of services and number of services (i.e. no more than 2,000 residential customers), as currently drafted. The class exemption should not be expanded unless and until the ACCC has conducted a review of whether the expansion to additional services or residential customers would promote the LTIE. This review can only be conducted at a later time if and when a regulation is made by the Minister to expand the number of customers beyond 2,000. Therefore, no automatic expansion of the class exemption should be built in.

2 Promotion of LTIE

- 2.1 **nbn** supports a detailed and considered analysis of the promotion of the LTIE when the ACCC is considering whether to grant a class exemption under section 143A of the Telecommunications Act.



- 2.2 It is important to note that the ACCC does not need to grant any such class exemption. Only if the ACCC is affirmatively satisfied that the class exemption would promote the LTIE should the ACCC proceed to do so.
- 2.3 **nbn** submits that granting the class exemption will neither promote competition nor will it encourage the economically efficient use of, and economically efficient investment in, infrastructure.

With and without test

- 2.4 A fundamental analytical tool that the ACCC uses when considering whether a particular regulatory action will promote the LTIE is the ‘with and without test’. As the ACCC’s states in its Declaration Guide:

“The ACCC considers it helpful to apply the future with and without test as one way to determine whether the LTIE will be promoted by declaration. The test compares the likely future situation with declaration, and the likely future situation without the declaration before deciding which situation will promote the LTIE.

If there is direct reliable material which can be used to determine the likely future situation that clearly demonstrates the LTIE is promoted, then this makes it easier for the ACCC to form such a conclusion. However, if there is only indirect or circumstantial material, simple modelling, or modelling that is contested, the ACCC’s task to make such a conclusion is more difficult because a number of conclusions may be open. In such circumstances, the ACCC will take particular care and also carefully consider the risks before reaching the required conclusion that declaration will promote the LTIE.”¹

- 2.5 **nbn** submits that the ‘with and without’ analytical tool should also be applied by the ACCC when considering whether to grant a class exemption under section 143A. When applying the ‘with and without’ test, the ACCC should have close regard to the above statement in its Declaration Guide.
- 2.6 In particular, **nbn** submits that there is no directly reliable material on which the likely future situation ‘with’ the class exemption can be assessed.

¹ ACCC, A guideline to the declaration provisions for telecommunications services under Part XIC of the Competition and Consumer Act 2010, August 2016 at page 30. Available at: <https://www.accc.gov.au/system/files/MEA-Final%20-%20Part%20XIC%20Declaration%20Guidelines%20August%202016%20-%20Published.pdf>



Promotion of competition

- 2.7 **nbn** submits that granting a class exemption to facilitate entry by small vertically integrated monopolies will not promote competition. In particular, the potential for small vertically integrated monopolies to reduce downstream competition is likely to outweigh the benefits of their entry.
- 2.8 The ACCC will be well aware of the concerns associated with vertical integration and these concerns remain notwithstanding the legislated conditions and limitations in the draft class exemption.
- 2.9 When applying the ‘with and without’ test and the ACCC’s Declaration Guideline, there is no directly reliable material that clearly demonstrates that the granting of the class exemption will promote competition. At best, the benefits of entry by small vertically integrated monopolies are very likely to be outweighed by the detriment to competition long associated with vertical integration. At worst, the legislated condition and limitations will be ineffective and competition will be damaged in the long term by the entry of these small vertically integrated monopolies.
- 2.10 The ACCC also raises the question whether the exemption threshold should be allowed to automatically rise to 12,000 should the number of services be increased by the Minister through regulation. Again applying the ACC’s Declaration Guideline, where there is only indirect or circumstantial material or material relating to the LTIE (or an element of it) is contested, the ACCC’s task to make such a conclusion about the LTIE is more difficult. **nbn** does not support the grant of a class exemption without clear definable evidence. Given that we cannot know whether the Minister will exercise this right under regulation and when this might occur, it is impossible to perform a ‘with and without’ test at this time given the uncertainty of assessing the impact on competition.

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

- 2.11 **nbn** submits that granting a class exemption to small vertically integrated monopolies will not promote efficient use of, or economically investment in, infrastructure.
- 2.12 The ACCC’s brief analysis on ‘efficiency’ in the Consultation Paper focuses solely on the efficiency gains for networks up to the maximum threshold of 2,000 services due to avoiding the costs of structural or functional separation.
- 2.13 **nbn** wishes to make two points about this analysis:



- (a) For the same reasons described above when applying the ACCC's Declaration Guideline and the 'with and without test', **nbn** submits that there is no directly reliable evidence of the efficiency gains described by the ACCC. There is no estimation of the "disproportionate" costs of separation nor is there a close analysis of the level of investment that "should" be promoted by the granting of the class exemption. In the absence of any directly reliable evidence of these matters, **nbn** submits that the ACCC should be reluctant to grant the class exemption for the reasons described in the ACCC's Declaration Guideline.
- (b) Further and as stated above, the ACCC's analysis on 'efficiency gains' is solely focused on networks up to the maximum 2,000 services threshold. However, the requirement in the LTIE is to consider any impact on efficiency and investment. Critically, this analysis must not be limited to the efficiency impact on the networks the subject of the draft class exemption, but must also include a consideration of the efficiency impact on networks not the subject of the class exemption.

2.14 **nbn** submits that a regulatory system which creates a three-tiered system of investment runs the risk of significantly undermining efficiency. In this three-tiered system of investment:

- one set of investors can invest in small vertically integrated monopolies (with the inherent competitive advantaged described above);
- another set of investors can invest in larger networks subject to functional separation but not subject to the wholesale-only obligation; and
- another set of investors who have and can invest in larger networks, including the investment in the **nbn** network, are subject to structural separation. These larger separated networks will have disincentives to invest when disadvantaged by an uneven playing field due to competition from small vertically integrated monopolies. This is especially the case in areas servicing high value customers. This disadvantage is compounded by the advantage that those large network operators who are only subject to functional separation will benefit from because they are not subject to the wholesale only requirement.

2.15 Such a three-tiered system of investment in superfast broadband networks has the potential to create a high degree of inefficient investment. In this regard, **nbn** notes in another context, the following



statement made in the Vertigan report when considering the option of extending or ‘improving’ the old network extension rules:

*“There are no credible low cost options for improving the network extension rules. Thus, were it desirable to redesign the statutory exemption to significantly restrict entry such as that proposed by TPG, the likely effect of possible rule changes would be to impose onerous restrictions on legitimate maintenance and development activities by existing network infrastructure operators. The 1 kilometre exemption has an artificial character, and **any workable alternative will be similarly artificial, creating the risk of unexpected market entry as well as of unintended consequences in adversely affecting the ongoing functioning of existing networks.**” (emphasis added)²*

2.16 **nbn** submits that the creation of different incentives to invest by small and large network operators may have the same artificial effect that the Vertigan review warned about in relation to the old network extension rules. There is a high risk of unexpected entry by small vertically integrated monopolies and larger network operators who are only subject to functional separation and not the rigours of the wholesale only obligation.

2.17 As also warned by Vertigan in that other context, this differential system of investment also raises the risk of unintended consequences in adversely affecting the **ongoing functioning of existing networks**. The ACCC should proceed with a high degree of caution given these prescient warnings.

3 Scope of class exemption and responses to questions

3.1 Should the ACCC proceed with the class exemption, as a general principle and for the reasons described in section 2, **nbn** submits that the class exemption should be drafted based on the narrowest class of exemption available to the ACCC. Any broader exemption will even further and more significantly undermine competition and infrastructure investment, when compared with not granting the class exemption.

² NBN Market and Regulation Report at p.78. Available at: https://www.communications.gov.au/sites/default/files/NBN-Market-and-Regulatory-Report.pdf?acsf_files_redirect



3.2 In this section, we respond to the ACCC's questions including those questions relevant to the scope of the class exemption should the ACCC decide to proceed notwithstanding the material provided by **nbn** in section 2 above. We have not responded to each and every question and hence some questions are omitted below.

Q1. Should the ACCC specify a class of persons other than for the maximum number of residential customers being supplied with fixed line services?

3.3 **nbn response:** For the reasons described in section 2 above, **nbn** submits that the ACCC should not proceed with the class exemption because to do so will not promote the LTIE. If it does so, **nbn** submits that the class of persons to be subject to the class exemption should be defined by the narrowest scope available. This scope would be for a class of persons serving a maximum threshold of 2,000 residential superfast broadband connections.

Q2. Would you favour an exemption instrument that allowed for an automatic extension of the 2,000 services to any maximum threshold of fixed line carriage services subsequently determined by the Minister under regulation?

3.4 **nbn response:** **nbn** does not agree with any automatic extension from the 2,000 services, up to any maximum threshold of fixed line carriage services subsequently determined by the Minister under regulation. It is simply impossible to perform an LTIE analysis or a with and without analysis on a future Ministerial regulation that may or may not occur and the timing of which is completely uncertain.

3.5 There is little or no evidence for the basis of the grant of the exemption for up to 2,000 services. There is even less evidence or justification to allow for the automatic increase in this exemption. It is impossible to conduct an analysis of the effect on competition or investment when it is uncertain whether and when the Minister may increase the threshold and to what level. **nbn** would strongly oppose any automatic extension for these reasons.

Q3. For the purposes of the above, do you consider that the LTIE would be promoted by a class exemption at the maximum threshold of 12,000 residential fixed line carriage services that can be specified by regulation?

3.6 **nbn response:** No. See reasons given in response to Question 2 above.



Q5. Should the ACCC specify a designated carriage service (other than a Layer 2 Bitstream Service) for the ongoing conditions and limitations of the exemption? If yes, would the services covered by the LBAS and/or SBAS declarations make a suitable designated carriage service?

3.7 **nbn response:** For the reasons described in section 2 above, **nbn** submits that the ACCC should not proceed with the class exemption because to do so will not promote the LTIE. If it does so, **nbn** has no objection to the services covered by the LBAS and or SBAS declaration as a suitable designated carriage service.

Q7. Would competition in the markets for the supply of wholesale and retail superfast broadband services to residential customers be promoted by the draft class exemption instrument?

3.8 **nbn response:** No, **nbn** does not think that competition will be promoted by the draft class exemption, for the reasons described in sections 2.7 to 2.10.

Q10. Would competition continue to be promoted if the exemption threshold were allowed to rise to 12,000 services in line with any subsequent regulation made by the Minister?

3.9 **nbn response:** No. **nbn** does not believe that any credible analysis or conclusion can be performed in relation to the likely impact on competition in relation to an event that may or may not happen and in respect of which the timing is completely uncertain. For the reasons described above, **nbn** strongly submits that competition will not be promoted if the exemption threshold were allowed to automatically rise to 12,000 services.

Q.12 Will the draft class exemption instrument promote the economically efficient use of, and economically efficient investment in, infrastructure?

3.10 **nbn response:** No. **nbn** does not agree that the class exemption will promote the economically efficient use of, and economically efficient investment in, infrastructure. In particular, the ACCC's analysis needs to be expanded beyond the efficiency gains obtained by small vertically integrated monopolies from the class exemption and also needs to consider the broader impact on efficiency and investment in respect of larger networks.



Q13. Would this continue to be the case if the exemption threshold were allowed to rise to 12,000 services in line with any subsequent regulation made by the Minister?

- 3.11 **nbn response:** For the same reasons described in response to question 2, **nbn** does not believe there can be any credible basis on which a ‘with and without’ test can be performed in relation to a discretion (i.e. the Minister making a regulation to expand the number of services up to 12,000) when we don’t know whether the Minister will exercise that discretion and when that might occur. It is impossible to know the state of, or impact on, competition or investment at an unknown future time.
- 3.12 For the reasons described above, **nbn** strongly submits that economically efficient use of, and economically efficient investment in, infrastructure will not be promoted if the exemption threshold were allowed to automatically rise to 12,000 services.