Independent cost-benefit analysis of broadband and review of regulation

Statutory review under section 152EOA of the *Competition and Consumer Act 2010*

June 2014

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The Hon Malcolm Turnbull MP
Minister for Communications
Parliament House
CANBERRA ACT 2600

30 June 2014

Dear Minister

Statutory review under section 152EOA of the *Competition and Consumer Act 2010*

Together with my panel colleagues Ms Alison Deans, Professor Henry Ergas and Mr Tony Shaw, I am pleased to submit to you the report of the statutory review under s.152EOA of the *Competition and Consumer Act 2010* of the telecommunications industry access arrangements and of specific elements of the *National Broadband Network Companies Act 2011*.

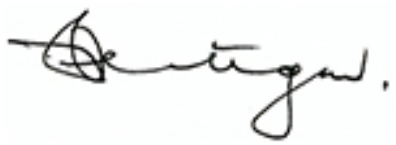
This report addresses one part of the terms of reference (item 2a) of the panel conducting the cost-benefit analysis and review of regulatory arrangements for the National Broadband Network. The panel will report to you separately on the other aspects of its terms of reference.

The panel consulted broadly and sought submissions from across the telecommunications industry sector. We appreciate the time given by individuals and organisations and the quality and content of the submissions received.

Overall, the review found a high level of satisfaction among stakeholders with the 2010-11 changes to the legislative framework and its operation. The report recommends the broad framework should be retained for the time being but with some important modifications.

The panel has been assisted by a secretariat and other staff within the Department of Communications. We record our appreciation for their professional efforts in helping us prepare this report.

Yours sincerely



Dr Michael Vertigan AC
Chair
Cost-Benefit Analysis and Review of Regulation

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1. Executive summary and recommendations

1.1 Executive summary

During 2010-11 significant changes were made to the telecommunications access regime in Part XIC of the *Competition and Consumer Act 2010* (CCA) (formerly the *Trade Practices Act 1974*) in the context of the structural changes associated with the establishment of NBN Co Limited (NBN Co) and the structural separation of Telstra.

The Parliament also legislated to provide a framework for the operation of NBN Co through the *Telecommunications Legislation Amendment (National Broadband Network Measures – Access Arrangements) Act 2011*, which amended the *Telecommunications Act 1997* (Telecommunications Act), the CCA, and the *National Broadband Network Companies Act 2011* (NBN Companies Act).

In light of the significance of these changes, the Parliament required that Part XIC and certain provisions of the NBN Companies Act be reviewed before 30 June 2014. Specifically, s.152EOA of the CCA requires the Minister to cause to be conducted a review of the operation of:

- Part XIC of the CCA;
- the remaining provisions of the CCA so far as they relate to Part XIC;
- Division 2 of Part 2 of the NBN Companies Act; and
- the remaining provisions of the NBN Companies Act so far as they relate to Division 2 of Part 2 of the NBN Companies Act.

Overall, this review has found a high level of satisfaction among stakeholders with the 2010-11 changes to the legislative framework and its operation. This accords with the panel's own assessment.

As such, the broad framework should be retained largely unchanged for the time being but with some important modifications. The recommended modifications deal mostly with NBN Co's non-discrimination obligations, regulatory recourse to the Australian Competition and Consumer Commission (ACCC) in relation to an NBN Co access agreement and oversight of regulatory decision-making.

Relative stability in these elements of the regulatory arrangements will be of benefit given other significant changes taking place in the industry with the rollout of the National Broadband Network (NBN).

1.2 Summary of recommendations

Recommendations are only made where the panel suggests a change to the current arrangements. Issues where no change is proposed are discussed in the report and the panel's view is made clear. The full context for, and details of, the panel's recommendations for changes outlined below can be found in the relevant sections of the report.

Part XIC

Recommendation 1: The Government should consider more clearly specifying the Australian Competition and Consumer Commission's (ACCC's) powers in relation to directly regulating access to facilities under Part XIC of the *Competition and Consumer Act 2010* (section 3.2).

Recommendation 2: The telecommunications-specific anti-competitive conduct regime in Part XIB of the *Competition and Consumer Act 2010* should be reviewed to assess the continued utility and effectiveness of its provisions (section 3.3).

Recommendation 3: The Government should continue to monitor the issue of carrier access to in-building cabling to ensure carriers are readily able to supply services to end-users (section 3.4).

Recommendation 4: The Department of Communications should continue to provide information to interested parties and the public on the arrangements pertaining to the provision of vectored VDSL and similar services in multi-unit buildings (section 3.4).

Recommendation 5: Part XIC of the *Competition and Consumer Act 2010* should be amended so that provision of access to in-building cabling controlled by a carrier or service provider for use in conjunction with a declared service is included in the standard access obligations (section 3.4).

Recommendation 6: The ACCC should commence a public inquiry with a view to declaring vectored VDSL services for the purposes of Part XIC of the *Competition and Consumer Act 2010* and making wholesale bitstream services available to access seekers (section 3.4).

Recommendation 7: Building on the submission of the Communications Alliance, the ACCC should also consider any necessary amendments to existing declarations that may be required by the deployment of vectored VDSL (section 3.4).

Recommendation 8: Should the ACCC identify legislative impediments to declaring vectored VDSL services, then the Government should consider amending the legislation to facilitate future declaration (section 3.4).

Recommendation 9: Interference between competing vectored VDSL systems should at this stage be dealt with through industry processes managed by the Communications Alliance and the regulators. However, if suitable arrangements cannot be put in place via these mechanisms, then the Government should take further necessary action (section 3.4).

Recommendation 10: Consistent with best regulatory practice, the ACCC should, as part of any declaration decision, specifically address why it believes the benefits of a declaration exceed its costs (section 3.5.1).

Recommendation 11: Arrangements should be put in place to enable carriers and service providers to have effective recourse to the ACCC for a specified period on the terms and conditions of an access agreement they are entering into with NBN Co and which they consider are unreasonable (section 3.6).

Recommendation 12: Standard access obligations should be amended as follows (section 3.7.2):

a) where an access provider (whether NBN Co or another) is supplying to others a service that it supplies to itself – so there are equivalence benchmarks that can be set by the provider supplying the service to itself – the service should be offered for supply at a technical and operational quality equivalent to that at which it is supplied to itself and with associated ancillary services (effectively the current requirement under the Category A standard access obligations);

b) where an access provider (whether NBN Co or another) is supplying to others a service declared by the ACCC that it does not supply to itself – so there are no equivalence benchmarks set by the provider supplying the service to itself – the ACCC should set minimum equivalence standards as part of its access declaration. The ACCC should be required to take account of the costs the benchmark imposes on the access provider and will need to be satisfied that the current and likely costs are consistent with the access provider's legitimate interests and that those costs are outweighed by benefits;

c) where NBN Co is supplying to others a service that it does not supply to itself – so there are no equivalence benchmarks set by the provider supplying the service to itself – NBN Co should specify minimum equivalence standards in its standard form of access agreement (or special access undertaking), with these being approved by the ACCC. Alternatively, the ACCC should set its own standards where NBN Co fails to set acceptable standards, with the general non-discrimination provisions modified as proposed in section 3.8 otherwise applying to NBN Co; and

d) the parties should be able to negotiate away from these standards.

Recommendation 13: Sections 152AXC and 152AXD of the *Competition and Consumer Act 2010*, which apply to NBN Co alone, should be replaced by provisions that allow discrimination by NBN Co where it aids efficiency or is otherwise authorised by the ACCC (section 3.8).

Recommendation 14: NBN Co should be required to publish and lodge with the ACCC a statement of difference where a proposed agreement differs from its standard form of access agreement in anything other than an insubstantial way, subjecting the agreement to ACCC scrutiny.

Affected parties should have the opportunity to object to the ACCC about an agreement.

Parties to the agreement should also be able to seek prior clearance from the ACCC.

The ACCC should be able to reject the agreement on the basis it has reason to believe the discrimination is not based on demonstrable efficiency benefits or is otherwise contrary to the long-term interest of end-users (section 3.8).

Recommendation 15: In the longer term, if NBN Co faces effective competition, the non-discrimination provisions should be removed altogether on the basis that competitive tensions will be sufficient to prevent NBN Co from disadvantaging certain customers (section 3.8).

Recommendation 16: In relation to the matters that the ACCC must take into account when making access determinations, once the review of Part IIIA of the *Competition and Consumer Act 2010* is completed, the Government should consider the scope to align, to the degree practicable, the access pricing criteria in Part XIC with those in Part IIIA (section 3.9.2).

Recommendation 17: In setting access charges through an access determination for infrastructure providers other than NBN Co, the ACCC should be required, along with other factors, to take account of the manner in which it set charges for NBN Co (section 3.9.2).

Recommendation 18: When the ACCC makes decisions of enduring impact, these should be subject to regulatory oversight. Specifically, decisions in relation to access determinations, anticipatory exemptions and special access undertakings should be subject to full and effective merits review, subject only to the limitations in scope and application required to prevent clearly unnecessary delays to regulatory decisions (section 3.9.5).

Recommendation 19: Were the Government not to proceed with reintroducing full and effective merits review as proposed in Recommendation 18, then it should (section 3.9.5):

a) introduce pricing principles into Part XIC of the *Competition and Consumer Act 2010*, including a general requirement to adopt a 'building block' approach to price determination;

b) reintroduce ordinary exemptions and ordinary access undertakings, thus allowing access providers to secure certainty over the terms and conditions of access; and

c) introduce a legislative requirement for the ACCC's discharge of its responsibilities to be subject to review, no less often than every five years, by the Productivity Commission.

Recommendation 20: Part XIC of the *Competition and Consumer Act 2010* should be amended so that the ACCC must make reasonable efforts to consult with affected parties, including in relation to interim access determinations and binding rules of conduct but the mere fact it fails to do so should not invalidate the decision by the ACCC (section 3.9.6).

Recommendation 21: The role of binding rules of conduct should be reconsidered in the context of reviewing Part XIB of the *Competition and Consumer Act 2010* (see Recommendation 2) (section 3.10.1).

Recommendation 22: A notice to vary a special access undertaking should be confined to matters that are, as a matter of fact, essential for the ACCC to be satisfied that the special access undertaking will pass the relevant thresholds for acceptance, recognising that this involves a degree of judgement by the regulator (section 3.11.3).

Recommendation 23: Part XIC of the *Competition and Consumer Act 2010* should be amended to give the person providing a special access undertaking flexibility in responding to a notice to vary, noting that the ACCC will still need to assess the special access undertaking using the statutory tests it must take into consideration. (section 3.11.3).

Recommendation 24: The Government should amend the statutory criteria for the assessment of 'conduct' and 'terms and conditions' to simplify and accelerate the special access undertakings assessment process (section 3.11.3).

Recommendation 25: In relation to fixed principles (section 3.11.4):

a) s.152CBAA of the *Competition and Consumer Act 2010* should be amended so that the ACCC cannot reject a variation to a special access undertaking on the basis that it includes a fixed principle the ACCC has already accepted, or on the basis of either the application of a fixed principle that has been accepted or a consequence of a fixed principle that has been accepted;

b) an equivalent approach should be applied in relation to the use of fixed principles in access determinations as provided for in s.152BCD; and

c) the ACCC should be required to have regard to relevant fixed principles already approved in a special access undertaking in assessing a special access undertaking put forward by another carrier or where the ACCC proposes to include fixed principles in an access determination, with a view to maximising consistency of approach.

Rules about the operation of NBN corporations

Recommendation 26: In relation to NBN Co's wholesale-only obligations, the Government should be prepared to investigate the operation of the retail market should a situation eventuate where large corporate customers seek to by-pass retail service providers as a matter of course and acquire services directly from NBN Co for their own internal use (section 4.1).

Recommendation 27: In relation to NBN Co dealing with end-users, the Government should continue to monitor NBN Co's activities and, if concerns arise, then it should consider providing either itself or the ACCC with the power to set appropriate rules of conduct relating to any NBN Co dealings with end-users (section 4.3).

Recommendation 28: In relation to NBN Co being legally limited to Layer 2, the Government should monitor NBN Co's behaviour and stand ready to adopt suitable measures where NBN Co is found to be operating in higher than necessary layers of the Open Systems Interconnection model (section 4.4).

Recommendation 29: In relation to line of business restrictions on NBN Co, the NBN Companies Act should be amended to enable NBN Co's field of operation to be expanded through regulations, noting that regulations are subject to rigorous development processes and disallowance by either House of Parliament (section 4.5).

Recommendation 30: NBN Co should be able to offer a generic service to enable network providers to interface with retail service providers to assist access seekers to gain access to wholesale services from non-NBN networks (section 4.5).

Recommendation 31: In relation to eligible services, NBN Co should prioritise the development of white papers associated with services required to support the 'Special Services' identified in Schedule 4 of Telstra's Migration Plan and that this task should be substantially completed by the end of 2015 (section 4.6).

Recommendation 32: If the Government accepts the panel's recommendations to relax NBN Co's non-discrimination obligations, in the event that NBN Co proposes to invest in a retail service provider, even on a transitional basis, the Government should impose additional measures to ensure that NBN Co does not favour that retail service provider over others (section 4.7).

Recommendation 33: In relation to investment activities, if NBN Co participates in a joint venture, then the joint venture should operate subject to the rules generally applying to NBN Co (section 4.7).

Recommendation 34: In relation to NBN migration arrangements, including in a future multi-technology mix environment, appropriate multi-stakeholder processes should be developed with a view to improved migration processes being put in place (section 4.8.3).

2. Background

2.1 Panel's terms of reference

On 12 December 2013 the Minister for Communications announced a panel to conduct an independent cost-benefit analysis of broadband policy and review the regulatory arrangements for the National Broadband Network (NBN).

The panel's terms of reference are provided at Attachment A.

2.2 Review under section 152EOA of the Competition and Consumer Act

Under its terms of reference (part 2a), the cost-benefit analysis and regulatory review was required to undertake the review of the telecommunications industry access arrangements and other provisions that is required under s.152EOA of the CCA.

The review requirements are:

> ***Review of operation of this Part etc.***
>
> *(1) Before 30 June 2014, the Minister must cause to be conducted a review of the operation of:*
>
> *(a) this Part [i.e. Part XIC]; and*
>
> *(b) the remaining provisions of this Act so far as they relate to this Part; and*
>
> *(c) Division 2 of Part 2 of the National Broadband Network Companies Act 2011; and*
>
> *(d) the remaining provisions of the National Broadband Network Companies Act 2011 so far as they relate to Division 2 of Part 2 of that Act.*
>
> *(1A) Without limiting subsection (1), a review under that subsection must consider the following matters:*
>
> *(a) the supply by NBN corporations of eligible services covered by section 10, 11, 12, 13, 14, 15 or 16 of the National Broadband Network Companies Act 2011;*
>
> *(b) the types of eligible services that have been, are being, or are proposed to be, supplied by NBN corporations.*
>
> *(1B) For the purposes of subsection (1A), eligible service has the same meaning as in section 152AL.*

(2) A review under subsection (1) must make provision for public consultation.

(3) The Minister must cause to be prepared a report of a review under subsection (1).

(4) The Minister must cause copies of the report to be tabled in each House of the Parliament within 15 sitting days of that House after the completion of the preparation of the report.

Part XIB of the CCA contains telecommunications-specific provisions relating to anti-competitive conduct and record-keeping rules. This is not covered by the panel's terms of reference.

This report (the review under s.152EOA of the CCA) also forms part of the post implementation review of the National Broadband Networks Companies Bill 2010 and the Telecommunications Legislation Amendment (National Broadband Network Measures – Access Arrangements) Bill 2011.[1]

2.3 Guidance for readers

This report first examines the operation of Part XIC and then turns to the provisions in the NBN Companies Act that are required to be reviewed.

In general, the report explains the relevant provisions for review, explores possible issues, reports on submissions to the review and presents the panel's conclusions and recommendations.

The matters that need to be reviewed under s.152EOA, while important in themselves, are nonetheless part of the broader regulatory framework for broadband and telecommunications generally. The outputs of this statutory review form part of the panel's full report under its complete terms of reference.

A key concept in the telecommunications regulatory regime - and Part XIC in particular – is that of the 'long-term interests of end-users' (LTIE). The concept is discussed in a number of instances in the report, for example, in relation to the declaration of services and the approval of special access undertakings (SAUs). Section 152AB of the CCA sets out the objectives to which regard must be had in determining whether something is in the LTIE. In summary, these are the objectives of promoting competition; of achieving any-to-any connectivity; of encouraging the economically efficient use of, and economically efficient investment in, infrastructure. These concepts are expanded on in s.152AB.

1 See page 5 of Office of Best Practice Regulation list of required Post-Implementation Reviews at https://ris.govspace.gov.au/files/2012/04/PIR_table_required.pdf

The report and its recommendations relate to both the industry arrangements in the transitional period prior to the full rollout of the NBN and the period once the NBN's rollout is completed.

Part XIC of the CCA includes a number of provisions that support the operation of Part 7 of the Telecommunications Act. As the panel is considering the future operation of Part 7 as part of its wider review, it has not addressed these aspects of Part XIC in this document. It may be, however, that the panel's other work, once complete, will be relevant to the provisions.

2.4 Consultation and industry submissions

On 24 March 2014, the panel released a discussion paper on the telecommunications industry access and other relevant arrangements and invited stakeholders to make submissions providing their views. While the paper identified a range of specific issues for comment, it also invited stakeholders to raise other issues as they considered relevant. That is, stakeholders were actively encouraged to take a broad perspective, raise their concerns and make proposals.

The panel received 15 submissions[2] from:

- the Australian Competition and Consumer Commission (ACCC);
- Mr RV Barbero;
- Broadband Today Alliance;
- Competitive Carriers' Coalition (CCC);
- iiNet;
- Macquarie Telecom;
- NBN Co;
- Nextgen Group;
- O3b Networks;
- Optus (including a supplementary submission);
- Telstra;
- Telecommunications Industry Ombudsman (TIO);
- TPG; and
- Vodafone Hutchison Australia (VHA)

2 Submissions are available on the Department of Communications' website at www.communications.gov.au/broadband/national_broadband_network/costbenefit_analysis_and_review_of_regulation/telecommunication_regulatory_arrangements_submissions_received_by_the_panel

On 13 February 2014 the panel also released a broader Regulatory Framing Paper that focussed more on structural issues. To the extent that issues relevant to the review under s.152EOA were raised in submissions to that paper, they have been taken into account. These submissions are also available on the Department of Communications' website. The panel has also taken into account relevant points raised in its discussions with stakeholders.

3. Part XIC of the Competition and Consumer Act

The CCA contains telecommunications-specific parts dealing with anti-competitive conduct and record-keeping rules (Part XIB) and regulated access (Part XIC).

Part XIC sets out a telecommunications industry-specific access regime which is administered by the ACCC. It applies to listed carriage services or to services that facilitate the supply of a listed carriage service.

All industry submitters agreed that Part XIC as a telecommunications-specific access regime should be retained. Even though most submitters thought there were issues with the current regime, they considered these were not fundamental to the design of the regime and could be addressed through amendments to the regime rather than by replacing it. Optus was an exception in this respect, proposing that the regime be reoriented towards a direct focus on substantial market power. Submitters' suggestions for amending the regime are covered in the relevant sections below.

The view generally expressed in submissions was that Part XIC was serving to promote access to telecommunications services on a reasonable basis and that the 2010 amendments to Part XIC had generally served to improve the effectiveness and efficiency of Australia's telecommunication access regime. The panel has concluded that a fundamental restructure of Part XIC is not required, but recommends significant changes in a number of areas. The recommended modifications deal mostly with NBN Co's non-discrimination obligations, regulatory recourse to the ACCC in relation to an NBN Co access agreement and oversight of regulatory decision-making. They are outlined in the relevant sections below.

3.1 Functional focus of Part XIC

The panel considered whether Part XIC should give greater emphasis to access to lower level service functionality or whether the status quo, in which this is left to the discretion of the regulator, should remain. The panel questioned whether Part XIC encouraged the use of resale services to the detriment of innovation in the supply of services or whether it had struck the right balance between resale and quasi-infrastructure services, such as the unconditioned local loop service (ULLS).

Submissions

Telstra took the view that a 'menu approach' of "simultaneously regulating at higher and lower levels of the network …is not in the long term interests of end-users (LTIE) because it

undermines the superior outcomes in innovation and price competition which competition based on unbundled network elements is capable of delivering end-users." Telstra went on to argue that "technology costs have fallen so far that there are not significant barriers of investment or scale to use of unbundled access services, even by smaller operators, other than potentially in rural and remote areas" (p.11).

This view was not shared by other submitters. iiNet noted that it was "unlikely that competition based on network access services … would have developed without the existence of declared resale services which allowed access seekers to build sufficient scale in order to make the necessary infrastructure investments in order to compete using the declared network services". iiNet also argued that, for a number of reasons, "network access based competition on Telstra's copper network is not feasible in all locations" (p.6).

NBN Co suggested that "the current regime has already struck the right balance between resale and quasi-infrastructure [competition]" (p.19). Nextgen likewise argued for retention of the status quo, whereby the ACCC has discretion about the reach of Part XIC, "this approach can enable access to lower level service functionality where this promotes the LTIE" (p.4).

Panel's view

The panel notes Telstra's comments about the effects of simultaneously regulating services at higher and lower levels of the network and the risk that this approach could undermine the benefits associated with the competitive use of unbundled network elements. Past experience has highlighted these risks as well as the costs that can be imposed by the regulation of what may be close substitutes (such as access at adjacent network layers).

However, it is not prudent to conclude, as Telstra suggested, that there are no longer significant barriers to investment in unbundled services. While the panel does not endorse that decision specifically, concerns about such barriers were a factor in the ACCC's decision in April 2014 to extend the declaration of fixed line resale services on the basis that it would enable access seekers to compete effectively on a national basis during the transition to the NBN. The ACCC's view was that the NBN rollout will increasingly reduce the viability of further investment in unbundled services. It would therefore be desirable for Part XIC to retain the flexibility to regulate services at different layers of the network.

On balance, the current Part XIC framework allows the ACCC the appropriate flexibility to declare access to services at a range of functional levels and no change is required in this area.

Other changes the panel proposes in this report, notably the move to merits review of ACCC decisions in section 3.9.5, are intended to provide more effective discipline over the ACCC's use of its powers and, hence, are an element in the recommendation that the powers be

retained. In particular, should the ACCC set access charges for closely substitutable services in ways that are inconsistent, or otherwise create opportunities for inefficient arbitrage, merits review would provide an opportunity to challenge the relevant decisions. The scope for such challenge to occur is an important factor in the panel's decision not to recommend changes to this aspect of the regime.

3.2 Regulation of access to facilities

The panel considered whether Part XIC should more clearly specify the ACCC's powers in relation to directly regulating access to facilities and how such access can be made available in a timely manner. Direct access to certain facilities is provided for in Schedule 1 to the Telecommunications Act. The facilities access regime in the Telecommunications Act provides an *ex ante* right of access to certain types of facilities and retains a 'negotiate-arbitrate' mechanism to settle terms and conditions. By contrast, Part XIC, which may apply to services that are supplied over facilities, applies only to declared services and uses an 'access determination' mechanism to set regulated terms and conditions.

Submissions

Some submissions called for the facilities access regime in Schedule 1 to be replaced by Part XIC.

Macquarie Telecom argued that, "the shortcomings of this regime drive the need for facilities access services to be properly and appropriately regulated by the ACCC through the Part XIC declaration process" (p.2). VHA said "Part XIC should be extended to allow declaration of access to underlying physical infrastructure. The current inter-carrier facilities access regime … can then be repealed" (p.13).

TPG observed that while access determinations had generally been effective "in constraining Telstra's ability to extract monopoly rents for declared services … none of the existing regimes provide for upfront pricing or access terms with respect to non-declared Telstra facilities like TEBA [Telstra Exchange Building Access] and Duct access" (p.2). TPG argued therefore that "the functional focus of Part XIC should not be limited to just access to services provided over telecommunications networks" (p.2).

A number of parties, including the ACCC, noted that there was an overlap between the provisions in Schedule 1 and Part XIC. The ACCC noted that it could declare a service that facilitates the supply of a listed carriage service, "which would appear to include some ancillary obligations that may require a service provider to also grant access to relevant facilities". Alternatively, the ACCC observed that it can set terms in access determinations "for access to facilities that are ancillary to the use of declared services" (p.20).

However, the ACCC also considered that "it would provide more certainty if the ACCC's powers in relation to directly regulating access to facilities were specified more clearly in Part XIC" (p.21). This call for certainty was echoed by Nextgen and TPG.

Telstra argued "that any additional regulation of facilities access through Part XIC is unwarranted because facilities access – including Telstra Exchange Building Access (TEBA) and duct access – is already regulated through long established and well understood mechanisms" (p.12).

Panel's view

The facilities access regime in the Telecommunications Act effectively gives *ex ante* rights of access to certain facilities without those facilities needing to be declared. This can enhance the efficiency and effectiveness of the access regime. It would not be appropriate to align the facilities access regime with Part XIC by providing the ACCC with a new explicit access determination power for the purposes of these provisions of the Telecommunications Act. This is because the types of facilities covered by the Schedule 1 regime tend to have specific characteristics and cost profiles and it is not clear that generic determinations could readily be developed. By contrast, the case-by-case approach provided for under Schedule 1 enables outcomes tailored to the individual circumstances.

However, the existence of facilities access provisions in Schedule 1 should not preclude the use of Part XIC to regulate access to particular categories of facilities where this is warranted, either as a service that facilitates the supply of a carriage service or as an ancillary element to the supply of a declared service. To the extent that the ACCC declares access to facilities for the purposes of Part XIC, it can make access determinations in relation to that access. This would provide *ex ante* terms and conditions of access as proposed by some submitters. Noting the comment of the ACCC, the Government should also look at more clearly specifying the ACCC's powers in relation to directly regulating access to facilities under Part XIC. Should it become apparent with the course of time that Part XIC can effectively supersede the Schedule 1 regime, the Government could consider repealing Schedule 1 as a deregulatory measure.

Recommendation 1: The Government should consider more clearly specifying the ACCC's powers in relation to directly regulating access to facilities under Part XIC of the *Competition and Consumer Act 2010*.

3.3 Part XIC and the concept of 'significant market power'

The panel considered whether Part XIC should focus on parties with significant (or a substantial degree of) market power (SMP) rather than be of general application as it is at present.

Restricting access obligations to providers with SMP could promote investment by smaller providers and new entrants who would not be required to provide access to declared services on their networks.

On the other hand, restricting the access regime to providers with SMP could be argued to discriminate against these providers by imposing costs upon them that were not borne by other providers. More importantly, asymmetric regulation creates inherent risks, as it may weaken the industry's incentives to effectively monitor the quality of the regulation being imposed (since its costs would only fall on the major player or players) and may be used to improperly prevent the largest (and potentially most efficient) firms from competing on their merits. In addition, asymmetric regulation could inhibit the achievement of any-to-any connectivity.

Submissions

The majority of submissions did not support the inclusion of SMP provisions in Part XIC for a variety of reasons.

Telstra noted that the use of SMP provisions would mean that "smaller competitors will potentially be able to invest in products and services without the same regulatory rules applying" (p.14).

NBN Co argued that SMP provisions "would increase the level of regulatory uncertainty associated with Part XIC" (p.18).

TPG observed that SMP provisions would take away the ACCC's flexibility in how it defines markets (p.2).

iiNet argued that "limiting Part XIC to access providers who have SMP is likely to reduce the ability of Part XIC to deliver outcomes that maximize benefits for end users in circumstances where what have been referred to as 'mini monopolies' develop" (p.9).

In a similar vein, Nextgen said "altering Part XIC to focus on parties with SMP would result in numerous disadvantages, including the possibility of parties without SMP but still in possession of 'sway' creating their own monopolies by locking others out of certain market segments, eroding the 'any-to-any' aspect of the current declaration criteria and reducing choice for end users" (p.4).

In contrast, VHA argued that including an SMP threshold in the declaration assessment process may deliver a more flexible regime (p.13). Optus argued for *ex ante* regulation of carriers with SMP "a clearer obligation on the ACCC to apply regulation only on operators with SMP would reduce the regulatory burden on industry" (p.18). Optus, in both its first and supplementary submissions, also argued that SMP tests should be used in conjunction with a new overall approach to telecommunications regulation, based on that employed in the European Union, and which gave the ACCC much greater regulatory flexibility. Optus argued there is a "need to: future proof the communications competition regime by introducing a more flexible regime than currently provided under Part XIC" (p.3, supplementary submission).

Panel's view

Any benefits that may arise from the introduction of a threshold SMP test for declaration would likely be outweighed by the added complexity of implementing such a test and the risk of uncertainty caused by challenges to the ACCC's decisions. However, the ACCC can have regard to the degree of market power held by an access provider in relation to a declared service when considering whether to exempt that provider from the terms of an access determination made in respect of that service. Given that gauging SMP is inherently complex and contentious, it is preferable to address those complexities when that is specifically required, rather than making the assessment of SMP a central component in the regime's operation.

On balance, given the ACCC can consider SMP issues in making declarations and exemptions from them, the current framework is appropriate and no change is required in this area.

The panel would also like to respond further to the proposal by Optus that Australia introduce a more extensive and flexible regulatory regime for telecommunications, drawing on that employed in the European Union. The panel appreciates Optus thinking broadly and innovatively about competition issues in the telecommunications market. There are a range of sources for anti-competitive conduct in telecommunications markets and the Part XIC regime can deal with some but not all of them. As Optus identifies, new competition challenges may arise through the conduct of parties at the retail level, including the bundling of content.

The panel does not believe that any Australian Government since 1997, when Part XIC was introduced, assumed that Part XIC was able to deal with all telecommunications competition issues. Part XIC is clearly designed to deal with access to underlying services and infrastructure and this is what it is has been doing. When Part XIC was enacted it was seen as part of a broader framework for dealing with competition issues. The bedrock of the framework was the general competition provisions of the Trade Practices Act (now the Competition and Consumer Act), particularly Part IV. This was supplemented by Part XIB, to

deal specifically with anti-competitive conduct in the telecommunications sector, as well as Part XIC. Part XIB supplemented general competition law, for example, by including an effects test, not simply a purpose test, and mechanisms to respond to anti-competitive conduct issues swiftly. In 2010, Part XIB was amended to clarify that it can deal with issues that may arise in relation to the supply of content or related services.

Part XIB also includes a range of record-keeping rule powers that can be used to implement many of the remedies suggested by Optus, for example, in relation to transparency, accounting separation and equivalence rules. In addition, the Telecommunications Act gives the Minister for Communications wide ranging powers to make licence conditions. Far from relying solely on Part XIC, the regulatory model envisaged in 1997 was one in which industry-specific regulation would, in time, give way to generic competition regulation.

In reality, the European Union framework has many similarities with Australia's and it would be wrong to think that it offers that much more than is available in Australia. Even when there are significant differences in the apparent structure of the regimes, their operation in practice is not all that dissimilar. For instance, candidate markets under the European Union approach tend to be defined in functional, rather than product, terms, aligning them relatively closely with the scope of access declarations under Part XIC. Furthermore, the use in the European Union of the concept of joint or collective dominance means remedies may apply to carriers that would not meet traditional, single-firm, thresholds of SMP. Jurisdictions within the European Union have also defined what amount to single-firm markets so as to deal with situations in which even a relatively small entity controls a single access line to a customer. Arguably, this is more sensibly dealt with in Part XIC, including through the reference in the LTIE test to any-to-any connectivity.

Many of the other remedies applied in the European Union can be applied under general competition law or Part XIB. That said, the panel's understanding is that it is up to national regulators in Europe to apply the remedies provided for in European Union directives; they are not all necessarily applied in practice. As a matter of principle, however, it is questionable whether *ex ante* remedies should be applied in the absence of demonstrable problems, as opposed to *ex post* in the light of actual experience. Some of the European Union remedies may not sit well with broader Australian law. For example, structural separation or divestment requirements may raise issues of acquisition of property. That said, the panel is not aware of any European jurisdiction that has seriously grappled with the structural separation of its incumbent as Australia has.

There are superficial attractions in giving a regulator a broad range of tools to deal with a range of potential, but uncertain, problems. However, it is not clear that the approach proposed offers that much more than is in place already and it is far from clear that it would warrant the significant disruption to well understood and accepted regulatory practices at this time when Australia is already undertaking an unprecedented change in its

telecommunications landscape. The panel is also cautious, as a matter of principle, about the powers and discretion conferred on regulators, as is demonstrated by its recommendations on merits review and procedural fairness.

While the panel accepts that there may be issues of competition at the retail level, it remains committed to the broad approach that underpinned the Hilmer reforms: notably, that access regulation should control those features of the network that have natural monopoly elements, thereby creating scope for efficient competition at the retail layer. It is not, and should not be, the task of the regulator to determine outcomes in retail markets. Rather, the regulator's role is to create the conditions for market forces to determine those outcomes. Of course, that does not mean that even with appropriate access arrangements in place, competition issues cannot arise at the retail layer, as they do in many other industries. However, to the extent to which they do arise, they should primarily be dealt with using the general instruments of competition policy, supplemented, if needs be, by those provided under Part XIB.

Of course, the Part XIB powers have more recently been supplemented by the scope for the ACCC to issue binding rules of conduct under Part XIC. Additionally, the current competition policy review may recommend changes to the CCA which have a bearing on the continued application of Part XIB. Further, some of the recommendations in this report may affect the role and relevance of Part XIB, as will the wider changes underway in the industry. As a result, and given the time since Part XIB was last reviewed, the panel considers that there would be benefit in undertaking a review of Part XIB to assess the continued utility and effectiveness of its provisions.

Recommendation 2: The telecommunications-specific anti-competitive conduct regime in Part XIB of the *Competition and Consumer Act 2010* should be reviewed to assess the continued utility and effectiveness of its provisions.

3.4 Part XIC and vectored VDSL

Vectored VDSL is a technology that allows carriers to install infrastructure that increases the data throughput that a copper connection can deliver. Vectoring is capable of providing combined download/upload speeds of up to 160 Mbps[3]. However, at least as the technology now stands, maximising technical performance is dependent on there being only a single vectored VDSL provider in a locality. This gives rise to the concern that if vectored VDSL equipment is installed in multi-dwelling buildings by firms that do not provide open access, it will result in a multitude of small scale monopolies, where access seekers have difficulty

3 Communications Alliance, Submission to Regulatory Framing Paper, page 7.

gaining access to services. These issues are all the more acute where a supplier of vectored services seeks, as part of agreeing to provide those services, an agreement from the owners or managers of the relevant premises to have exclusive rights to use in-building cabling to supply those services.

The panel sought views on the use of exclusive agreements for the use of in-building cabling and on regulated access to vectored VDSL. Related issues considered by the panel were access to in-building customer cabling not owned by a vectored VDSL provider and ongoing use of such cabling by competing service providers.

Submissions

In its submission to the panel's Regulatory Framing Paper, the Communications Alliance raised significant issues about the use of vectored VDSL and in-building cabling. In particular, the Communications Alliance noted that there could only be one vectored VDSL operator in a cable sheath if performance was to be optimised. For this reason and others, it argued that there should be a single design authority to co-ordinate and optimise performance, that legacy building copper cabling may need to be regulated and that transitional arrangements may be required (pp.3-4).

TPG indicated that it and other carriers had made use of exclusivity agreements with building owners to be the sole provider of vectored VDSL services within multi-dwelling units. TPG noted that it is no longer engaging in this practice and advocated that legislation be amended to prevent such agreements being made in the future.

VHA pointed out that "Part XIC applies to carriers and carriage service providers, so only applies in relation to infrastructure that comprises a 'network unit' under the *Telecommunications Act 1997* (Cth). Customer cabling is not normally a network unit, so is not currently subject to regulation under Part XIC". VHA advised that the matter has been addressed in overseas regimes: for example, in-building cabling must be open access in Hong Kong, and tenants there have non-discriminatory access to the telecommunications provider of their choice (p.13). VHA argued that in-building cabling should be regulated under the Telecommunications Act rather than Part XIC (pp. 13-14).

Some submissions broadly supported regulating access to vectored VDSL networks. iiNet stated that "an effective way to deal with the issue is to have specific statutory arrangements that make such networks wholesale only and open access" (p.10). Macquarie Telecom argued that "the benefits of competition and choice are paramount and [it] supports a regime under which access seekers have rights of access to such services on terms set by the ACCC via an access determination" (p.3).

Further, some submitters argued that NBN Co should be the sole provider. Macquarie Telecom stated that "NBN Co ought to be the ubiquitous access network operator and the only effective provider of VDSL2 services" (p.4). Optus agreed, saying that this issue "has the potential to undermine the key principles on which the NBN project is based. Instead of having one national NBN (be it supplied by one or more network operators), there would be a patchwork system of NBN and non-NBN superfast networks and a patchwork of regulatory obligations" (p.21). Telstra agreed with Optus that there should be a uniform approach, "…whatever policy approach is adopted, a level playing field should apply between all third party network builders" (p.15).

TPG, a company building a vectored VDSL network, argued that this network "will bring speedy and positive outcomes for end users and should not be regulated unless there is evidence of an anti-competitive effect. It is in these types of circumstances, where it is important to consider the balance between promoting economic efficiency through access regulation and encouraging infrastructure investment" (p.3).

The ACCC noted that "while declaration of a service under Part XIC can require an access provider to provide access to a service upon request where it provides the service to itself or others ('open access') it cannot mandate a network be 'wholesale-only' " (p.22).

Panel's view

In relation to the issues surrounding in-building cabling and vectored VDSL, there is a risk that end-users in multi-premises buildings serviced by a single provider will not have retail competition and choice unless service providers have some form of access to wholesale services. It would be preferable for service providers to have access to Layer 2 services such as those that are being provided by NBN Co. In principle, end-users should not be prevented from having a choice of service provider and should not be forced to change service provider (other than in circumstances where a service provider is no longer willing to provide services). Where exclusivity is efficient at the network layer, this should be facilitated so long as end-users retain the ability to choose their service provider.

Access to in-building cabling controlled by building owners

The panel understands that while carriers have some legislated powers to enter buildings to install and maintain facilities to help them provide services, they cannot use these powers to access in-building cabling owned by the building owner. If a carrier requires access to in-building cabling to provide services, it needs to obtain the cabling owner's agreement, whether formally or tacitly. Such agreements are a private matter that is currently beyond the scope of the telecommunications regulatory regime.

There is a theoretical risk that an owner of in-building cabling could refuse to provide access. This might be addressed by developing an access regime in relation to such cabling. This would be challenging and complex, not least because it would first be necessary to bring the owner within the scope of the telecommunications access arrangements. However, access is generally provided by agreement, as building owners have real incentives to facilitate the supply of services to their occupants. On balance, therefore, such a scheme should not be developed at this time, but the Government should continue to monitor the issue.

Recommendation 3: The Government should continue to monitor the issue of carrier access to in-building cabling to ensure carriers are readily able to supply services to end-users.

Given the Government's interest in providing access to fast and affordable telecommunications services to all Australians, it has a role in ensuring information is available to building owners on the risks associated with entering into agreements that provide exclusive access to in-building cabling, particularly on a perpetual basis.

The Department of Communications has contacted the relevant peak bodies to provide information on the risks associated with entering into agreements providing exclusive use of in-building cabling and also made that information available on its website[4]. The panel supports these actions and believes they should continue.

Recommendation 4: The Department of Communications should continue to provide information to interested parties and the public on the arrangements pertaining to the provision of vectored VDSL and similar services in multi-unit buildings.

Access to in-building cabling for exchange-based services

Where one carrier or service provider obtains access to in-building cabling to deliver services (for example, telephony or vectored VDSL), the carrier will effectively control that bottleneck access to the customer. There are two scenarios that need to be considered: where end-user services are supplied directly from the Telstra exchange and where vectored VDSL services are supplied using equipment located within the premises.

Where services are exchange-based, competing access seekers need to have effective access to the in-building cabling for them to also be able to provide services. It is not clear that this matter is easily dealt with under Part XIC as it stands because such in-building cabling is not

4 See: http://www.communications.gov.au/broadband/broadband_initiatives/broadband_networks_in_apartment_buildings

ordinarily owned or controlled by carriers or carriage service providers (being the persons who would be bound by the Part XIC regime). However, to the extent the cabling is within the legal and operational control of a carrier or service provider, there may be an argument that the regime has some application.

There are three possible solutions to this situation.

First, Part XIC could be amended to make it clear that where a carrier or service provider controls customer cabling (whether its own or another party's), access to that cabling is able to be declared under Part XIC.

Second, carriers or service providers could be prohibited from impeding or hindering use by another service provider of in-building cabling that it controls.

Third, the provision of access to in-building cabling controlled by a carrier or service provider for use in conjunction with a declared service could be included in the standard access obligations (SAOs)[5]. In the event that such a SAO was not met, the ACCC could issue binding rules of conduct (BROCs)[6] or take other enforcement action.

The third option would fit best with the existing framework but the first option may also need to be utilised to provide clarity that access to such cabling is covered.

Recommendation 5: Part XIC of the *Competition and Consumer Act 2010* should be amended so that provision of access to in-building cabling controlled by a carrier or service provider for use in conjunction with a declared service is included in the standard access obligations.

Access to monopoly vectored VDSL services

Multiple vectored VDSL networks operating within a building have the potential to degrade services for end-users but this has to be balanced against the benefits associated with infrastructure competition. Ultimately it will be a matter for building owners to decide if their building is serviced by a particular vectored VDSL provider on an exclusive basis. In doing so, they would trade off the benefits of competition 'for the market' (that is, the right to provide exclusive access to their premises for a period of time) against those of on-going competition 'in the market' (that is, residents' access to a range of network providers).

5 Standard access obligations are discussed in section 3.7.

6 Binding rules of conduct are discussed in section 3.10.

From a policy perspective, so long as that is an informed choice, the balancing between these is best undertaken by those who have the most at stake, that is, building owners and/or building residents. To that extent, and given the technical benefits of the VDSL network at a multi-unit building being provided by a single entity, the fact that only one entity would be in a position to provide Layer 2 (network layer) service is not in itself a matter of policy concern.

However, competing retail providers should be able to access bitstream products (preferably at Layer 2) on a reasonable basis.

The ACCC should commence a public inquiry with a view to declaring vectored VDSL services for the purposes of Part XIC and making wholesale bitstream services available to access seekers. The infrastructure provider's own retail business should not receive an undue advantage over its competitors through the manner in which this service is provided. Building on the submission of the Communications Alliance, the ACCC should also consider any necessary amendments to existing declarations that may be required by the deployment of vectored VDSL. However, this approach needs to be balanced against the desirability of ensuring there are incentives for undertaking, in a timely and efficient way, the investments required to provide these services. The stronger the competitive incentive to do so, the more likely it is that consumer interests will be protected and the more light-handed should be the regulatory approach.

Ensuring the balance between the incentives for timely investment and the benefits of retail competition is struck correctly is a matter for the ACCC, subject to the requirements of Part XIC. On the other hand, should the ACCC identify legislative impediments to declaring vectored VDSL services (which it has not done in its submissions to this review), the Government should consider amending the legislation to facilitate their declaration in the future.

Recommendation 6: The ACCC should commence a public inquiry with a view to declaring vectored VDSL services for the purposes of Part XIC of the *Competition and Consumer Act 2010* and making wholesale bitstream services available to access seekers.

Recommendation 7: Building on the submission of the Communications Alliance, the ACCC should also consider any necessary amendments to existing declarations that may be required by the deployment of vectored VDSL.

Recommendation 8: Should the ACCC identify legislative impediments to declaring vectored VDSL services, then the Government should consider amending the legislation to facilitate future declaration.

As indicated above, the Communications Alliance noted the scope for interference between competing vectored VDSL systems and made a number of proposals for their co-ordination. At this stage, the panel considers these matters can be addressed through industry processes

managed by the Communications Alliance and the regulators. However, if suitable arrangements cannot be put in place via these industry-led mechanisms, the Government should take further necessary action. If action needs to be taken urgently, a general carrier licence condition and/or service provider rule may be suitable vehicles.

Recommendation 9: Interference between competing vectored VDSL systems should at this stage be dealt with through industry processes managed by the Communications Alliance and the regulators. However, if suitable arrangements cannot be put in place via these mechanisms, then the Government should take further necessary action.

3.5 Declaration

Before access-seekers can gain regulated access to a service, it must first be declared. There are four methods by which a service can be declared.

The most common means by which a service is declared is following a public inquiry by the ACCC to determine whether declaration would promote the LTIE.

The ACCC can accept an SAU from an access provider, which has the effect of declaring the service to which the SAU relates but only in relation to that access provider and only for services that the ACCC has not declared and made an access determination in relation to.

Where a service is being supplied, or is capable of being supplied, by NBN Co and it publishes a standard form of access agreement (SFAA)[7] for that service on its website, the NBN Co service to which the SFAA relates is declared.

The ACCC may be required to declare a specified service in accordance with the CCA. In 2011, the CCA was amended to require the ACCC to declare a Layer 2 bitstream service for the purposes of Part 7 of the Telecommunications Act.

3.5.1 The long-term interest of end-users test

The criteria for the LTIE test are that declaration of a service would:

- promote competition in relevant markets;
- promote the achievement of any-to-any connectivity (where relevant); and

7 A standard form of agreement or SFAA is effectively a document setting out NBN Co's standard offer of supply.

- encourage the economically efficient use of, and investment in, infrastructure.

The panel considered whether the LTIE test needs to be revised and, if so, to what end. Should greater emphasis be given to the promotion of investment and, if so, how? Should different categories of investment be given greater weight, for example, investment in networks, infrastructure required to interconnect with networks (for example DSLAMs) or services? Is any-to-any connectivity still relevant? Is guidance required on the definition of a market? Should the LTIE criteria be brought closer in content and operation to those set out under the National Access Regime and, if so, how? The panel was also interested in views about the application of the LTIE test throughout Part XIC.

Submissions

With the exception of VHA, industry submissions generally supported retaining the LTIE test unchanged. VHA argued that the "concept of 'any-to-any connectivity' is superfluous and should be removed. The concept has rarely been given any weight by the ACCC in declaration decisions or otherwise" (p.14). In contrast, Nextgen argued that "any-to-any connectivity remains a relevant — indeed fundamental — consideration …. based upon the clear complementarity between upstream and downstream infrastructure in the context of providing telecommunication services to end users" (p.4).

Telstra argued that explicit deregulation criteria should be included in Part XIC, noting that this would be consistent with the Government's deregulation agenda (p.3).

Panel's view

There was general support from submitters for retaining the LTIE test in its current form. As noted by the ACCC, it is appropriate that the access regime focuses on the interests of end-users and it should have the flexibility to deal with a range of circumstances. The LTIE test is well-understood by market participants and changing it would bring about unnecessary uncertainty.

The panel agrees with Telstra's comments on the importance of applying regulation only where there is a net benefit to doing so. However, the 'efficiency' component of the LTIE test already encompasses a consideration of the costs and benefits of regulation and the ACCC has already adopted this principle, including in its recent review of the declaration of fixed line services. As such, Telstra's proposed changes to the LTIE test would not materially affect the ACCC's existing approach to the test. That said, consistent with best regulatory practice, the ACCC should, as part of any declaration decision, specifically address why it believes the benefits of a declaration exceed its costs.

Recommendation 10: Consistent with best regulatory practice, the ACCC should, as part of any declaration decision, specifically address why it believes the benefits of a declaration exceed its costs.

Other than this change, in the absence of any clear or compelling argument for change, the LTIE test should not be altered and no changes are required in this area.

3.5.2 Duration of declaration

In general, a declaration made by the ACCC must have a duration of between three and five years, unless there are good reasons for the duration to be made for a longer or shorter period. The panel sought views on whether there are services which should be declared on an enduring basis.

Submissions

The majority of submissions argued against declarations on an enduring basis. For example, TPG argued that "declaration on an enduring basis generally is not appropriate or desirable in technological and competitive environments that are evolving" (p.3).

In contrast, VHA argued for longer declaration periods, proposing that after an initial three year declaration "subsequent declarations should be permitted for up to 15 years (noting that this would only occur in compelling circumstances)" (p.14).

The ACCC argued that "such changes are not necessary; the ACCC already has sufficient discretion, due to the 2011 amendments, to make declarations over long time frames where this is appropriate. The ACCC also concurs with the panel's view [as expressed in its consultation paper] that the dynamic nature of the industry may limit the circumstances where open-ended (or very long time frame) declarations are warranted" (p.12).

Panel's view

Services should not be declared on an enduring basis. The current duration of access determinations of five years, with flexibility for the ACCC to set different periods as appropriate, provides a reasonable basis upon which to set the terms of access for telecommunications services**.** As such, no change is recommended in this area.

3.6 Standard forms of access agreements

The panel considered whether SFAA processes work effectively and, if not, how they could be improved.

Under Part XIC, NBN Co can publish an SFAA setting out the terms and conditions on which it will provide services. The SFAA ensures access seekers, and the public more generally, have ready access to this information. The SFAA also provides a mechanism by which NBN Co could put products into the marketplace in advance of the ACCC considering an SAU. As noted in section 3.5, products specified in an SFAA are declared services. This is intended to ensure that those services are subject to ACCC regulation under Part XIC. It is also open to access seekers to negotiate on the terms of access set out in an SFAA, subject to constraints on NBN Co under its obligation not to discriminate between access seekers (s.152AXC) and its approved SAU.

An SFAA itself has no place in the regulatory hierarchy (discussed later in this section and in section 3.13). However, once an access seeker signs an SFAA, it becomes an access agreement in relation to which the ACCC cannot intervene under Part XIC with respect to matters covered by the agreement, until the agreement expires, unless this is provided for in the terms of the agreement. The ACCC cannot intervene because access agreements sit at the top of the regulatory hierarchy: in others words, in the event of any difference between its terms and those in other instruments, the terms in an access agreement are determinative. The SFAA therefore plays a key role.

In relation to NBN Co's Wholesale Broadband Agreement (WBA), which is an SFAA, access seekers raised two broad and related concerns.

The first is that the SFAA sits outside the regulatory hierarchy and so it is not clear how it relates to the other instruments in the hierarchy, which set terms and conditions, or whether NBN Co is obliged to incorporate any ACCC decisions into an SFAA.

The second issue relates to the ability to obtain regulatory recourse while an access agreement based on an SFAA is in effect. In the hierarchy, an ACCC access determination would not apply to the extent that it was inconsistent with the access agreement based on an SFAA. NBN Co's response to this problem has been to shorten the term of its access agreements so that access seekers can gain access to any regulated terms and conditions at the end of each access agreement term.

The panel considered whether the current use of SFAAs by NBN Co can be improved and, if so, how. In particular, the panel considered the following questions:

- does NBN Co's potential position in the market-place mean its SFAA should formally be reflected in the hierarchy;
- does NBN Co's potential market power mean there should be scope for access seekers to have recourse to the ACCC in relation to NBN Co access agreements; and

- are additional processes needed to ensure access-seeker concerns can be effectively addressed before they enter into access agreements with NBN Co?

SFAA processes may be seen as problematic because of NBN Co's ability to split its terms and conditions between its SAU and SFAA. This has the potential to cause complexity and confusion, particularly in terms of the hierarchy of terms and conditions – noting that there is also scope for the ACCC to make BROCs and access determinations. However, allowing the terms to be set in a range of instruments with different levels of regulatory involvement and potentially different timeframes allows for flexibility. For example, locking in a particular non-price term in an SAU may be inappropriate, but placing it in an SFAA may provide for the term to evolve over time in response to market developments.

Submissions

Several submissions expressed concern that NBN Co's market power – particularly in the long term once its network is constructed – may encourage it to issue SFAAs on a 'take it or leave it' basis. It is open to access seekers to approach the ACCC to seek regulatory intervention before signing an access agreement, unless a term or condition has already been approved as part of the access provider's SAU. However, given the time the ACCC would need to intervene and the need for access seekers to maintain continuity of service, access seekers remain concerned that they will have to accept the terms in the SFAA on a take it or leave it basis.

Specifically, Optus stated that "NBN Co has used the hierarchy provisions to force access seekers to sign an agreement in circumstances where there is not full agreement on all matters, because the alternative is refusal to supply the service" (p.13).

TPG said "the hierarchy arrangements complicate the process of deciding on contracting… to the extent that an SFAA results in the creation of an access agreement that is effectively forced onto an access seeker (in that the access seeker has no commercially acceptable option but to enter into the access agreement), that access agreement should rank lower in the hierarchy" (p.3) and argued that the processes can be improved by giving "the SFAA a formal place in the hierarchy, logically below access determinations and access seekers the ability to obtain regulatory recourse while an access agreement based on an SFAA is in effect" (p.7).

VHA argued "the SFAA process in Part XIC does not work effectively as the ACCC cannot review the SFAA to ensure that the terms are reasonable" (p.14). VHA further argued that SFAAs should be replaced by reference offers.

The CCC argued that too much trust had been put into NBN Co as a wholesale-only supplier without recognising the market power it has in negotiations with access seekers. This has led to industry dissatisfaction in negotiating access agreements. The CCC submitted that "the current hierarchy of instruments is inconsistent with the principles underlying the NBN policy.

That is, the policy recognises that the national access network has bottleneck characteristics and needs to be regulated as a monopoly. This contrasts with the hierarchy, which is effectively a throw-back to the negotiate/arbitrate model" (p.4). The CCC argued that giving access seekers certainty that they could gain regulatory redress if the terms offered in access agreements are unfair would encourage commercial resolutions.

The ACCC recognised access seekers' concerns that they could be offered agreements on a 'take it or leave it' basis, but noted that NBN Co's access agreements were limited to two years in its SAU, and if the need was urgent, the ACCC could make BROCs subject to the SAU. The ACCC argued that "wholesale change to the legislative hierarchy is not warranted given the disruption that this could cause" (p.24).

Panel's view

NBN Co and access seekers should be encouraged to enter into access agreements and when they do so they should be bound by them for their duration. As well as being reflective of commercial practice generally, this is necessary to provide certainty for both parties and is consistent with firms taking responsibility for their operations and for the agreements they reach. In this context, there should not be recourse to the ACCC on the terms of an access agreement once it is settled. By 'settled', however, the panel means that there are no outstanding issues on the part of the parties or the regulator. That is, the agreement is not just in place but accepted by the parties. In this context, there is a significant degree of inequality in bargaining power between NBN Co and access seekers; there should therefore be a mechanism for access seekers to approach the ACCC before an access agreement is settled, where third-party intervention is required.

The panel is concerned that NBN Co, which will be the sole infrastructure provider in many areas of Australia, will increasingly be in a position to exercise monopoly power with respect to the negotiation of access agreements, based on its SFAA (that is, its WBA). Therefore, access seekers should be afforded an opportunity to approach the ACCC to make decisions on aspects of an access agreement before it is considered finally settled and hence beyond the reach of further ACCC intervention.

As it stands, if an access seeker considers a term or condition of an SFAA is oppressive, unreasonable or unfair, it can raise it with the ACCC in advance of having to sign an access agreement. It is then open to the ACCC to make BROCs or an access determination (including an interim access determination) which would apply to the extent they were not inconsistent with NBN Co's SAU. However, the pressure of time may militate against this option.

As an alternative to the current arrangements, the panel believes access seekers should be able to sign an access agreement with NBN Co on a conditional basis, pending resolution of any outstanding issues by the ACCC. This could involve access seekers placing caveats on

specific clauses that they contend are inappropriate. NBN Co would be obliged to provide service under the agreement, notwithstanding the conditional acceptance by the access seeker, for a specified period of time (subject to the broader provisions which allow NBN Co to discriminate against parties that are not credit worthy). The ACCC would then be required to decide on the matters being disputed within that specified period, for example, three to six months after the access agreement is signed. It could do this by issuing BROCs or an access determination. The specific clauses that were disputed would, in effect, be replaced by the corresponding provisions in the BROCs or access determination, back-dated to when the access agreement was signed by the access seeker. Such rights would rebalance NBN Co's expected market power as a monopoly provider of access infrastructure in large parts of Australia.

It is important that an access seeker can seek to have BROCs or an access determination made to its sole benefit, for example, on the basis that it alone should benefit from commitments it is prepared to make to NBN Co. While this would clash with the existing non-discrimination obligations applying to NBN Co, the panel is recommending these be significantly relaxed (see section 3.8). The ACCC would be able to decide whether the decision in BROCs or an access determination applied specifically to the parties at issue or should be generally available to all access seekers. There is flexibility within the current BROCs and access determination framework to allow this, in that BROCs and access determinations usually have general application but can also be applied to individual access providers and/or seekers.

An alternative approach would be for pre-existing access agreements to continue in place until the ACCC resolved any issues with proposed new agreements, with the ACCC determined terms and conditions applying to the new agreements.

To be clear, the operation of the legislative hierarchy and access agreements in situations other than where NBN Co is the access provider should not change. That is, NBN Co-specific arrangements should apply in this area.

While there is clearly a risk that access seekers could seek to caveat all provisions of an agreement, they would not be able to challenge matters that the ACCC had already accepted in approving an SAU. Access agreements are intended to be based on negotiations and the only issue of concern is to provide a suitable means to resolve intractable disputes. Moreover, NBN Co could seek greater certainty by including more provisions in an SAU and reduce the risk of challenge through constructive engagement with its customers. The ACCC should also be empowered to dismiss claims that it considers trivial or vexatious or in relation to which it has already made a decision. While such disputes would involve considerable costs for access seekers, which in itself would act as a deterrent, the ACCC might also be empowered to levy a charge (including taking a bond) for consideration of a dispute. Consistent with the recommendations in sections 3.9.5 and 3.9.6, such ACCC decision-making

should be subject to procedural fairness and merits review to the extent practicable. Again, the costs involved here would act as a deterrent to gaming.

Such an approach is similar to the negotiate-arbitrate process that was replaced in 2010-11, but it is not a reversion to the negotiate-arbitrate model. Rather, it provides a potentially important degree of commercial flexibility within a framework where the terms and conditions of access are largely determined by prior regulation. In that framework, the provision of access by NBN Co takes place against the background of an SAU that has been considered and approved by the ACCC. As a result, the SAU serves much the same purpose as an access determination under the revised framework. Furthermore, to the extent that access seekers remain dissatisfied with terms and conditions outside those in the SAU, it is open to the ACCC to make access determinations in relation to them. Set against that broader context, while the proposed mechanism associated with access agreements does introduce an element of negotiation with a backstop of arbitration, it does so to provide a potentially important degree of commercial flexibility.

To the extent that NBN Co may be concerned about the uncertainty and potential costs that such a regime may bring, in addition to seeking to engage constructively with access seekers, it could consider including in its SFAA (or SAU) a mechanism by which it simply passed through ACCC decisions on matters not inconsistent with its SAU.

In conclusion, arrangements should be put in place to enable carriers and service providers to have effective recourse to the ACCC for a specified period on the terms and conditions of an access agreement they are entering into with NBN Co and which they consider are unreasonable. Part XIC should be amended to achieve this, unless NBN Co can put in place arrangements that achieve the same effect through its SFAA or SAU.

Recommendation 11: Arrangements should be put in place to enable carriers and service providers to have effective recourse to the ACCC for a specified period on the terms and conditions of an access agreement they are entering into with NBN Co and which they consider are unreasonable.

It is not clear that much would be gained from adding SFAAs to the formal regulatory hierarchy, particularly given the changes to the NBN non-discrimination obligations proposed in section 3.8. The SFAA is simply a template for an agreement. If it is agreed to unchanged, it becomes an access agreement. If there are intervening regulatory or commercial decisions, these would apply and would be reflected in the access agreement. The same would hold whether or not the SFAA was incorporated in the hierarchy, presumably at its bottom. However, formally incorporating the SFAA in the hierarchy would have the effect of endorsing its contents as a legally binding starting point for negotiations. This would unnecessarily remove some of the commercial flexibility that now exists. It also seems likely that if an SFAA had this status, access seekers would want its contents approved by the ACCC, a process

largely duplicating the burden of SAU approval while robbing the SFAA of the flexibility it is intended to provide. It is therefore the panel's view that SFAAs should not be formally included in the legislative hierarchy of terms and conditions under Part XIC.

3.7 Standard access obligations

Where a service has been declared, the SAOs require a wholesale service provider to supply the service to an access seeker upon request, subject to specified limitations and exceptions. There are two types of SAOs: those pertaining to access providers other than NBN Co (Category A SAOs); and those pertaining to NBN Co as a wholesale-only company (Category B SAOs). The SAOs set out key principles for providing access to a declared service. The Category A SAOs specify principles in relation to technical and operational quality, fault detection and rectification, ordering and provisioning, billing information and interconnection of facilities.

In meeting the SAOs, NBN Co must not discriminate between access seekers except in very limited circumstances, for example, where an access seeker is not creditworthy. NBN Co's non-discrimination obligations are specifically tied to its SAOs. These include explicit obligations on NBN Co not to discriminate in favour of itself in supplying a declared service (s.152AXC(7)). However, NBN Co has certain exemptions in Division 16 of Part XIB from these non-discrimination obligations where it is reasonably necessary to achieve uniform national wholesale pricing.

Similar requirements to those applying to NBN Co currently apply to the supply of a Layer 2 bitstream service by superfast network operators.

3.7.1 Ongoing usefulness of the standard access obligations

The SAOs are the key requirement on access providers, that is, the obligation to provide access to a declared service in a form that allows an access seeker to use the declared service to provide its own carriage or content service. The additional elements of the SAOs set out how access providers are to supply the service to access seekers. The panel considered whether the SAOs need to be revised, and if so, what the SAOs should cover.

Submissions

Submissions were divided on whether the status quo should remain or the scope of SAOs modified.

The ACCC noted that there did not "appear to be a case for increasing the regulatory impost on network operators by extending the standard access obligations generally, when the current SAOs are operating well and the ACCC can make further regulatory terms as

appropriate based on a case-by-case consideration" (p.12). TPG similarly argued "where greater levels of equivalence are required for a service proposed for declaration, appropriate inquiries and industry consultation should take place to weigh the regulatory costs against the anticipated LTIE gains" (p.4).

iiNet and Macquarie Telecom both suggested that the SAOs should be expanded to include a requirement on a wholesale service provider to provide services on a fully equivalent basis to that which it supplies itself.

VHA suggested that, if a reference offer regime applied, "the SAOs could be replaced by statutory requirements for the content of reference offers (including non-discrimination obligations), perhaps with detail prescribed by regulations" (p.15).

Panel's view

Some submitters argued that the SAOs have not resulted in the equivalent supply by Telstra of services to access seekers and to its retail division. However, there are alternative regulatory options open to the ACCC in this regard, such as the power to include additional requirements on access providers in access determinations and Telstra's interim equivalence and transparency arrangements under its SAU. In this context, generally increasing the requirements imposed by the SAOs would be unnecessary and would risk regulatory overreach. No changes are required in this area.

It is important that where the SAOs apply to services that are supplied by a carrier to itself, that supply is understood to include the services or underlying capabilities that are available internally for use, rather than being limited to those for which formal supply arrangements are in place. The panel understands that this is the general interpretation of the provisions.

3.7.2 Application of Category B standard access obligations

Category B SAOs, which only apply to NBN Co, were introduced in 2011 so that the SAOs better aligned with NBN Co's wholesale-only status and to reflect the fact that NBN Co may want to make service offerings in advance of it having active declared services, that is, services that are actually being provided. Unlike Category A SAOs, which apply to active declared services (that is, the declared services that the access provider actively provides to itself or others), the Category B SAOs apply to all declared services.

While the fundamental characteristics of Category A and Category B SAOs are similar, they differ in several important ways. If a service provider supplies a service to another service provider or to itself and that service is declared, then that service provider must supply the service in accordance with the declaration. The key difference is that under the Category A SAOs, the service provider can offer itself different terms and conditions of supply; it only

needs to ensure that the technical and operational quality of the supply to third parties is 'equivalent' to that which it provides to itself. In this context, 'equivalent' does not mean 'the same'. By contrast, under the Category B SAOs, NBN Co cannot offer itself different terms and conditions of supply; such differences are explicitly excluded under s.152AXC(7).

Given the differing treatment of NBN Co as a wholesale-only provider under the Category B SAOs, the panel was interested in whether other wholesale-only providers should be subject to similar rules under the Category A SAOs when they are supplying services to other persons that they are not supplying to themselves. A second issue, is how the proposed relaxation of the non-discrimination obligations on NBN Co (section 3.8) will affect the Category B SAOs, including in relation to services that NBN Co was supplying to itself (for example, dark fibre) if those services were to be declared.

Submissions

Submissions were divided on whether Category B SAOs should be extended to other wholesale-only carriers.

Telstra stated that they "generally represent an appropriate formulation of the non-discrimination principle for a non-vertically integrated upstream provider in NBN Co's position" (p.18).

NBN Co argued that if it was to face infrastructure competition then "other competing providers should face the same regulatory framework as NBN Co, in order to create a level playing field and ensure that the long-term interests of end-users continue to be met. For example, other providers should be subject to the same Standard Access Obligations as NBN Co and required to offer services on a wholesale basis" (p.7).

On the other hand, TPG argued for the status quo stating that "the NBN Co is a unique organisation. It is, at least initially, funded by taxpayers and benefits from legislated competitive advantages. It is different to other access providers who may have wholesale-only obligations. Those entities and their shareholders have assessed the risks and made an election to invest capital in the market. They should not have the same constrictions as the NBN Co" (p.4).

VHA argued for Category B SAOs to be abolished on the basis that such distinctions increase the complexity of Part XIC and create anomalies. It saw no reason for differential treatment of wholesale providers (p.7-8).

The ACCC expressed indifference on this issue stating that "… if a provider is already wholesale-only – and not providing services to itself – the practical consequence of that network provider being subject to Category A rather than Category B SAOs is minor" (p.12).

Panel's view

There are four main issues to consider.

First, whether 'active declared services' or just 'declared services' should be subject to SAOs.

Second, how equivalence standards should be set where an access provider, typically a wholesale-only provider, supplies a service to others but not to itself.

Third, how equivalence standards should be set where an access provider, supplies services to itself as well as others.

Fourth, how the SAOs should apply to NBN Co with the proposed relaxation of its non-discrimination obligations, particularly in relation to services it is supplying to itself and which are declared, so that it needs to supply the services to others.

While these issues are discussed below in terms of whether services are supplied by wholesale-only providers, including NBN Co, and integrated retail providers, the issues really revolve around whether the services to be supplied to others are also being supplied to the provider itself, meaning benchmarks for supply can be set.

In approaching the issues, the panel has been guided by three key objectives: maximising regulatory consistency, providing access seekers with baseline standards and providing flexibility by allowing discrimination where it would aid efficiency or has otherwise been authorised by the ACCC.

'Active declared services' versus 'declared services'

As a matter of principle, the panel's preference is for the maximum degree of regulatory symmetry between providers, including NBN Co and others. It therefore looked at whether the SAOs should apply to active declared services, as is the case with the Category A SAOs, or any services that are declared with respect to NBN Co, as is the case with Category B SAOs.

The long standing approach for providers other than NBN Co has been to apply the Category A SAOs to active declared services, which ensures that a provider cannot be forced to supply a service it is not already providing. By contrast, the approach taken with NBN Co recognises that it is a start-up and a service provider established by the Government to achieve particular outcomes and, therefore, it may be appropriate to require it to supply services that are not yet active.

In practice, most NBN Co services are, and are likely to be, declared by virtue of NBN Co either publishing an SFAA or including a service in its SAU, indicating a willingness on its part to supply the service. Therefore the difference should remain and no change is required in this area.

Equivalence standards in the absence of self-supply

In the case where an access provider supplies a service to another person but not itself, the Category A SAOs do not define effective benchmarks for the supply of that service. This is because the provider is not supplying the service to itself and therefore it cannot be required to supply it to other parties at the same technical and operational quality that it supplies it to itself or to provide associated ancillary services. In other words, the fact that the access provider does not supply the service to itself means there is not a benchmark that defines what is meant by 'equivalence'.

Rather than design explicit but inflexible rules to deal with this scenario should it arise, it should be left to the ACCC to set a benchmark of equivalence between access seekers that would apply in relation to the supply of relevant declared services by wholesale-only providers. The ACCC would do this as part of its service declaration. In doing so, it should be required to take account of the costs the benchmark imposes on the access provider and will need to be satisfied that the current and likely costs are consistent with the access provider's legitimate interests and that those costs are outweighed by benefits. The standard the ACCC sets should be a benchmark that is available to access seekers and it should be open to access seekers to agree other arrangements that exceed this benchmark.

Equivalence standards where there is self-supply

In cases where an access provider is supplying a service to another person that it is also supplying to itself, the Category A SAOs are clear that the service should be supplied at a technical and operational quality equivalent to that on which the access provider supplies the service to itself. Associated ancillary services are also to be made available to access seekers. Other terms and conditions are open to determination by the ACCC or commercial negotiations.

Given these arrangements are long-standing, well understood, support Australia's international obligations, and provide an effective baseline for access and scope for flexibility, they should not be altered.

Category B SAOs and relaxation of NBN Co's non-discrimination obligations

In the case of services supplied by NBN Co, there would still be Category B SAOs but their operation should be more consistent with the proposed operation of the Category A SAOs. Their operation also needs to take account of the non-discrimination obligations proposed in section 3.8.

Where NBN Co is supplying services to others but not itself, NBN Co should be required to include in its SFAA (or SAU) minimum terms and conditions in relation to operational and

technical quality; moreover, these provisions in an SFAA, but only these SFAA provisions, should be subject to ACCC approval. In the event that NBN Co fails to include such terms and conditions or it is unable to satisfy the ACCC, the ACCC should be able to specify those terms and conditions.

Where the service concerned has been declared by the ACCC, the minimum standards of equivalence should be set by the ACCC as part of its declaration instrument. Again, however, the standards should be a minimum that is available to access seekers but it should also be open to access seekers to agree other arrangements. In all of these instances in which the ACCC was setting equivalence standards, the ACCC would be required to meet the tests specified immediately above.

The arrangements here differ slightly from those proposed in relation to the Category A SAOs because all services NBN Co supplies must be declared but they are not all declared by the ACCC. Consistent with the proposed changes to NBN Co's non-discrimination obligations in section 3.8, NBN Co would otherwise be able to offer different terms and conditions to different access seekers where it aided efficiency or has otherwise been authorised by the ACCC.

In the situation where NBN Co is supplying a service to itself and that service is declared (whether through NBN Co's own actions or those of the ACCC), NBN Co would need to offer to supply the service at a technical and operational quality equivalent to that at which it supplies the service to itself. NBN Co would also need to supply any other associated ancillary services it supplies to itself. These requirements should align with those under the Category A SAOs. Again, these standards should be understood to be minima which parties should be able to negotiate away from if they wish to. However, other terms and conditions on which NBN Co supplies to itself and others would be subject to the same new discrimination principles generally applying to supply by NBN Co.

The panel therefore concludes that:

- both Category A and B SAOs should be retained on the basis Category B SAOs apply to NBN Co for all declared services, not just active declared services;
- both Category A and B SAOs should cover services that are self-supplied by access providers and that self-supply defines the benchmark for the operational and technical quality and the associated ancillary services that are supplied to others;

- services that are not self-supplied but are declared by the ACCC should have minimum equivalence standards[8] defined in the ACCC's declaration decision; and
- where NBN Co is supplying a service to others that it does not supply to itself, it should define its minimum equivalence standards in its SFAA (or SAU) and these should be approved by the ACCC, otherwise the standards should be set by the ACCC.

Recommendation 12: SAOs should be amended as follows:

a) where an access provider (whether NBN Co or another) is supplying to others a service that it supplies to itself – so there are equivalence benchmarks that can be set by the provider supplying the service to itself – the service should be offered for supply at a technical and operational quality equivalent to that at which it is supplied to itself and with associated ancillary services (effectively the current requirement under the Category A SAOs);

b) where an access provider (whether NBN Co or another) is supplying to others a service declared by the ACCC that it does not supply to itself – so there are no equivalence benchmarks set by the provider supplying the service to itself – the ACCC should set minimum equivalence standards as part of its access declaration. The ACCC should be required to take account of the costs the benchmark imposes on the access provider and will need to be satisfied that the current and likely costs are consistent with the access provider's legitimate interests and that those costs are outweighed by benefits;

c) where NBN Co is supplying to others a service that it does not supply to itself – so there are no equivalence benchmarks set by the provider supplying the service to itself – NBN Co should specify minimum equivalence standards in its SFAA (or SAU), with these being approved by the ACCC. Alternatively, the ACCC should set its own standards where NBN Co fails to set acceptable standards, with the general non-discrimination provisions modified as proposed in section 3.8 otherwise applying to NBN Co; and

d) the parties should be able to negotiate away from these standards.

The proposed new arrangements are summarised in Table 1.

8 By 'minimum equivalence standards' the panel means the operational and technical quality at which the service is supplied and the associated and ancillary services also supplied, as reflected in paragraph 152AR(3)(b) and (c) of the CCA. The standards are minima in the sense that they are available to all parties but parties can negotiate away from them.

Table 1: Proposed benchmark arrangements for standard access obligations

<table>
<tr><th></th><th></th><th>Service supplied to others but not supplied to itself</th><th>Service supplied to others that is also supplied to itself</th></tr>
<tr><td rowspan="2">Cat A SAO</td><td>Retail providers (active declared services)</td><td rowspan="3">Benchmark standards to be set by the ACCC as part of the service declaration.</td><td rowspan="4">Technical and operational quality equivalent to that supplied to self.

Associated ancillary services to be offered.

Variations to the minimum standards and other terms and conditions negotiable.</td></tr>
<tr><td>Other wholesale-only providers (active declared services)</td></tr>
<tr><td rowspan="2">Cat B SAO</td><td>NBN Co (service declared by ACCC)</td></tr>
<tr><td>NBN Co (service declared by SFAA or SAU)</td><td>Benchmark technical and operational quality in SFAA or SAU for ACCC approval; or otherwise determined by ACCC.</td></tr>
</table>

3.7.3 Exemptions

Where a service has not been declared, an access provider may seek an exemption from the SAOs that would apply in the event that the service was to be declared in the future. Exemptions provide the access providerwith greater certainty on how an important new service might be regulated in the future. If the ACCC considers that granting an anticipatory exemption would meet the LTIE test, it may give an anticipatory individual exemption to a single carrier or an anticipatory class exemption to members of a specified class of access providers.

Previously, access providers could apply for an ordinary individual exemption from the SAOs in respect of a service that was declared at the time of the application. This provision was repealed in 2010 on the basis that an access determination (see section 3.9.3) could exempt an access provider, or class of access providers, from some or all of the SAOs in respect of a declared service.

The panel considered whether anticipatory exemptions have an ongoing role to play and, if so, whether the existing arrangements can be improved and whether ordinary individual exemptions for services that are declared should be reinstated.

Submissions

The ACCC noted that "anticipatory exemptions alongside special access undertakings are the primary regulatory mechanisms for providing certainty for new services" (p.19).

Telstra acknowledged that ordinary exemptions were "removed because of criticisms about costs, delays and gaming". Telstra was not seeking the restoration of ordinary exemptions but argued that, as an alternative, Part XIC should include explicit deregulation criteria (p.3).

Panel's view

Subject to the considerations below, there is not a compelling case for reintroducing ordinary exemptions, given the discretion available to the ACCC to carefully target the scope of service declarations – as is done in the declaration of the domestic transmission capacity service, for example – and to exempt service providers from obligations arising from access determinations. The proposed ability of market participants to seek merits review of ACCC decisions on access determinations (see section 3.9.5) can help ensure that where exemptions would be appropriate, they can be obtained. As a result, ordinary exemptions should not be reintroduced.

However, were the government not to provide for effective review on the merits of ACCC access determinations, ordinary exemptions should be reintroduced, as a means of limiting the risk of regulatory over-reach.

As far as anticipatory exemptions are concerned, they should continue to be available as they are a mechanism for providing certainty in relation to the regulation of new services. In short, subject to effective merits review of ACCC decisions being introduced, no changes are required in this area.

3.8 Non-discrimination requirements

Closely related to the operation of the Category B SAOs are the non-discrimination obligations on NBN Co under ss.152AXC and 152AXD of the CCA. Under these provisions, NBN Co must not discriminate between access seekers except in limited circumstances, that is, where NBN Co has reasonable grounds to believe the access seeker would be likely to fail to comply with the relevant obligation. Such circumstances would include when an access seeker is not creditworthy and where an access seeker has repeatedly failed to comply with the terms and conditions of access. The effect of this requirement is that terms and conditions of all services provided by NBN Co must be equally available to all access seekers so that all services are offered on an open access and equivalent basis. Other operators of superfast networks (as defined in Parts 7 and 8 of the Telecommunications Act) are currently subject to similar rules.

The ACCC has published guidelines on the operation of the non-discrimination provisions. As noted above, importantly s.152AXC(7) strictly prohibits NBN Co from favouring itself in relation to the supply of declared services.

Submissions

VHA argued in its submission that the failure to treat different operators differently can in itself give rise to discrimination. An example of this is NBN Co's Connectivity Virtual Circuit, which access seekers pay for according to the aggregated bandwidth they require for their end-users in each Customer Service Area. This capacity is sold in large blocks, which means that providers with a small number of customers must pay for the base level of capacity whether they use it or not. VHA therefore argued that "NBN Co's offer suite must maintain sufficient flexibility to foster the emergence of new consumer services and new telecommunications business models" but on the proviso that this should only take place under ACCC oversight (p.12) and NBN Co "must establish a process that ensures that requests for improvements or changes to its reference offer are appropriately considered and that non-discrimination is not used to justify inertia or lack of flexibility" (p.11).

Several other submissions recognised the merits in allowing NBN Co greater discretion in exercising non-discrimination. However, they also argued that the current provisions should remain in force. iiNet said "discrimination can lead to outcomes that will promote economic efficiency (useful discrimination) [but] can also lead to outcomes that will harm competition where it is based not on efficiency but on negotiation power (harmful discrimination)" (p.13). iiNet concluded "on balance, prohibiting discrimination completely is the best approach to take because it is the option that leads to the biggest net gain" (p.14).

TPG favoured leaving the provisions unchanged, arguing that it "does not accept that the requirement to collect access agreements and publish statements of differences represents a significant burden on the NBN Co or the ACCC. Those requirements create the necessary disincentive to discriminatory agreements. TPG does not accept that a lack of vertical integration would result in there being limited discrimination against certain RSPs [retail service providers]. The telecommunications market has been long dominated by larger players. With the 'new world' presented by the NBN, those larger players should not be given better terms than smaller participants" (p.4).

The CCC expressed a similar view "it is crucial for the health of downstream retail markets that NBN Co is precluded from discriminating against downstream customers. There is the potential for some RSPs, in particular Telstra, to negotiate a different and superior set of prices, terms and conditions for access services because it has other services that NBN Co might wish to acquire, such as transmission. While this might be commercially attractive to NBN Co, such a situation would entrench Telstra advantage in retail markets. This would be inconsistent with policy goals" (p.4).

The ACCC argued that, while the non-discrimination provisions "may have a role to play during the transitional period, they may limit NBN Co's ability to take advantage of efficiencies and should be subject to review once the transition to the NBN has occurred" (p.24).

NBN Co submitted that the non-discrimination obligations should be subject to an efficiency exception, arguing that "an almost blanket restriction on discrimination by NBN Co is inefficient and is likely to be against the public interest.... There are fundamental differences between the incentives of a vertically integrated monopoly and a vertically unbundled monopoly, such that the incentives of a vertically unbundled monopoly are more likely to be aligned with the public interest; a vertically unbundled monopoly has no interest in discriminating in ways that would reduce competition in downstream markets, such that an upstream monopoly will not necessarily discriminate in favour of larger retailers; an ability to discriminate would provide NBN Co with the ability and incentive to reduce the costs and risks of its rollout through coordinating its investments with the downstream investments of access seekers" (p.27).

Panel's view

NBN Co's non-discrimination obligations have the potential to curb its ability to take advantage of efficiencies. For example, it may be efficient for NBN Co to offer different price terms to access seekers that are prepared to undertake investments that reduce the costs to NBN Co of providing access, or are willing to enter into significant contractual commitments that enhance the take-up of NBN services and make NBN Co's revenue stream more certain. The current non-discrimination provisions may also reduce access seekers' incentives to develop innovative service offerings, knowing that whatever they negotiate with NBN Co will have to be offered on the same terms to their competitors.

Against the costs of the non-discrimination obligations must be set potential benefits in reducing the risk of anti-competitive conduct. This raises a number of complex issues.

For example, the ACCC has argued on numerous occasions that the risk of anti-competitive discrimination is inherently related to vertical integration and that, in the absence of vertical integration, such discrimination, should it occur, would be readily identified and controlled through other instruments, including the general competition laws. Indeed, this argument has been at the heart of the ACCC's case for structural separation. Were that argument accepted, it is not clear why the specific restrictions on discrimination by a structurally separated entity would yield benefits that exceed their costs.

However, as a matter of economics, it is not only a vertically integrated entity that can have significant incentives to discriminate in dependent markets in ways that are potentially welfare-reducing. For instance, a vertically separated entity may discriminate so as to reduce the risk of entry into its own market or so as to share with a retail service provider the rents

available through the creation or maintenance of market power in the retail market. As a result, the panel cannot accept the simplistic argument that vertical integration alone creates the risks, or that structural separation eliminates the risks, that discrimination poses.

At the same time, the panel recognises that discrimination can have significant efficiency benefits, for instance, in better allocating the burden of recovering joint and common costs. Moreover, the gains associated with discrimination may be especially valuable in a context where fixed costs are very high relative to variable costs, though the efficiency claims generally made in that respect (which go to notions of Ramsey pricing) need to be heavily qualified in the case of intermediate inputs and in situations where an upstream dominant firm faces the threat of fringe entry.

Rather, the strongest case for allowing discrimination to occur is that it may replicate some of the incentives for innovation that would occur in a vertically integrated firm: for example, by ensuring that an RSP that bears special risks in innovating receives greater rewards than those RSPs that merely imitate its conduct if and when it succeeds. In that way, allowing greater scope for discrimination would help reduce some of the costs of structural separation, enhance the scope to coordinate risky upstream and downstream investment and partly restore incentives for the development of innovative services. But given NBN Co's potential market power, this would need to be complemented by measures that can safeguard against conduct that reduces welfare by distorting downstream competition. Obviously, those risks would be greatly reduced if changes in market structure resulted in greater competition; but were such changes not to occur, there is a difficult balance to be struck.

Taking the need to achieve such a balance into account, the panel believes non-discrimination requirements should remain in place but should be amended to allow NBN Co to differentiate its service agreements where this provided genuine economic efficiencies or if the ACCC justified it occurring in particular circumstances. The scope for discrimination should extend to activities related to the supply of services, such as product development, again, where that discrimination aids efficiency.

Recommendation 13: Sections 152AXC and 152AXD of the *Competition and Consumer Act 2010*, which apply to NBN Co alone, should be replaced by provisions that allow discrimination by NBN Co where it aids efficiency or is otherwise authorised by the ACCC.

Understandably, there are concerns that NBN Co may use its scope to discriminate to favour its larger customers. Whether that would occur is difficult to say. For example, under the Definitive Agreements, Telstra has certain obligations to use NBN Co services that other RSPs do not have. To that extent, NBN Co may be more concerned about ensuring those other RSPs use its services than with Telstra's choices, at least during the period covered by the DAs. Moreover, strengthening the smaller RSPs may serve NBN Co's interests by reducing the

bargaining power Telstra would have in the longer run. These factors can mitigate any incentive on NBN Co's part to systematically favour Telstra, or for that matter, Optus.

However, the risk of discrimination being anti-competitive cannot be fully ruled out. In principle, one approach to dealing with those risks would be to more precisely limit the allowed forms of discrimination. For example, the requirement could be imposed that any volume discounts must be available to a substantial number of access seekers. In practice, restrictions of this kind have rarely proved effective at balancing the benefits and risks of discrimination, and have more often simply given rise to unnecessary complexities (and ultimately, the drawing of largely arbitrary lines) in the rules' implementation.

That is why the panel recommends there be a relatively general test, couched in terms of efficiency, which leaves the burden on NBN Co to make out the relevant efficiencies, along with a provision for *ex ante* clearance of any agreement that substantially differs from NBN Co's standard terms and conditions. As an added precaution, the panel also recommends that the clearance process involve disclosure obligations. These requirements are likely to better meet the policy objective than seeking to more precisely limit the allowed forms of discrimination in the statute itself

ACCC scrutiny of NBN access agreements

There is the potential for parties to be harmed by agreements that are discriminatory and cannot be justified on efficiency grounds. Relevant parties would have incentives to implement such agreements but affected parties would not be aware of them in the absence of appropriate disclosure mechanisms. The ACCC needs to have powers to deal with this issue. At least for as long as NBN Co has so substantial a degree of market power, it is preferable that the ACCC be able to intervene *ex ante* because of the potential for harm and the costs that might be incurred in unwinding agreements once their implementation had commenced.

Given the recommendation that the non-discrimination provisions be relaxed, it would be prudent to continue reporting requirements, which in the face of the concerns expressed by some of NBN Co's larger customers about the existing arrangements, would maintain a very high level of accountability and transparency. However, those reporting requirements should be tailored to the new non-discrimination rules.

NBN Co would need to publish and lodge with the ACCC a statement of difference where an agreement differed from its SFAA in anything other than an insubstantial way, subjecting the agreement to ACCC scrutiny. NBN Co would not need to publish the details of material it considers commercial-in-confidence, subject to ACCC agreement. Affected parties would be given opportunities to object to the ACCC about a proposed agreement. The ACCC would be given a time-limited power to reject the agreement on the basis it had reason to believe the

discrimination was not based on demonstrable efficiency benefits or was otherwise contrary to the long-term interest of end-users. The panel considers the ACCC should have three months to identify and notify NBN Co of any concerns and six months in total to make a final decision.

The panel also considers there would be benefit in allowing – but not requiring – either NBN Co or the provider who is party to an agreement to seek clearance of the agreement from the ACCC in advance of it coming into effect. As is the case with the process for merger and acquisition approvals, this would give the parties certainty (effectively a 'safe harbour') that the agreement would not be subject to future challenge or rejection.

Recommendation 14: NBN Co should be required to publish and lodge with the ACCC a statement of difference where a proposed agreement differs from its SFAA in anything other than an insubstantial way, subjecting the agreement to ACCC scrutiny.

Affected parties should have the opportunity to object to the ACCC about an agreement.

Parties to the agreement should also be able to seek prior clearance from the ACCC.

The ACCC should be able to reject the agreement on the basis it has reason to believe the discrimination is not based on demonstrable efficiency benefits or is otherwise contrary to the long-term interest of end-users.

Streamlining current statement of differences reporting requirements, consistent with wider industry reforms, as proposed by NBN Co, would not be appropriate at this time, unless that streamlining could be effected without undermining the efficacy of the control mechanisms the panel proposes.

In the longer term, if NBN Co faces effective competition, the non-discrimination provisions should be removed altogether on the basis that competitive tensions will be sufficient to prevent NBN Co from disadvantaging certain customers. The non-discrimination provisions should, in other words, be revised if and when the market structure evolves towards greater competition. However, they should not be relaxed further than the panel proposes unless competitive pressures become an effective constraint on NBN Co's market conduct.

Recommendation 15: In the longer term, if NBN Co faces effective competition, the non-discrimination provisions should be removed altogether on the basis that competitive tensions will be sufficient to prevent NBN Co from disadvantaging certain customers.

3.9 Access determinations

Changes to the operation of access determinations were a key element of the 2010 reforms and the panel was interested in how these had been accepted by industry.

In general, once a service has been declared via a public inquiry or in compliance with a statutory requirement, the ACCC must hold an inquiry into making an access determination in respect of the service. The access determination sets out the terms and conditions of supply of the service, including the terms on which the SAOs are delivered. It must include price-related terms and may include non-price terms.

In respect of services which are declared as the result of an SAU being accepted or by virtue of an SFAA being published, the ACCC may make an access determination (to the extent consistent with the SAU) but is not required to do so.

In making an access determination, the ACCC must consider a range of criteria, including the LTIE, the legitimate business interests and relevant investments of the access provider, the direct costs of providing access, operational and technical requirements and the economically efficient operation of the service, network or facility.

The CCA is deliberately broad in outlining the scope for determining the terms and conditions of supply of a declared service. An access determination may set different terms for specified access providers or access seekers. It may also exempt, either in whole or in part, different access providers from the terms of the access determination.

The ACCC may include 'fixed principles' provisions in an access determination that have the effect of locking in those provisions for a period that is longer than the period of the access determination. In the 2011 access determinations for fixed line services, fixed principles provisions were used to specify the framework for estimating wholesale prices using a particular costing approach until 2021.

In certain circumstances where an access determination is not in force, the ACCC must make an interim access determination which applies until a final access determination is made. In making an interim access determination, the ACCC is not required to hold a public inquiry or to consult with relevant parties in accordance with normal rules of procedural fairness.

3.9.1 Effectiveness of access determinations

The access determination model of setting access terms and conditions was introduced in 2010 to replace the 'negotiate-arbitrate' model, which had been heavily criticised by most stakeholders. The principal criticism of the negotiate-arbitrate model was that it allowed the dominant access provider to unduly extend the regulatory process, creating uncertainty for access seekers and allowing it to favour its own retail business. At the same time, access seekers had few incentives to enter into binding commercial agreements with Telstra, as they were unlikely to secure less favourable terms from notifying an access dispute and might benefit by doing so. Overall, there was little in the negotiate-arbitrate model that made for timely and effective agreements to be reached.

Taking that history as given, the panel considered whether access determinations remain an effective method in setting access terms and conditions.

Submissions

Submissions largely supported the access determination framework.

Macquarie Telecom observed that "empowering the ACCC to make access determinations has been effective in reaching timely regulated outcomes … Macquarie does not believe that a reference offer model would be better than the Part XIC model"(p.7). Nextgen was also "supportive of the access determination model, and considers this preferable to a 'reference offer' model which would undo earlier work focussed on achieving a 'level playing field' for access"(p.5). Telstra noted that "in the current transitional environment, the current access determination provisions are broadly appropriate" (p.19).

TPG supported access determinations but noted that for some non-price terms and conditions the product the carrier offers does not align exactly with the terms of an access determination, limiting an access seeker's ability to rely on it. TPG also argued that "reference offer models may present a useful structure for access providers who are presenting new services to the market. Reference offers should not be available for services that are currently being covered by access determinations" (p.5).

The ACCC argued that it "does not consider that a 'reference model' that would replace the access determination model is necessary. Although the access determination framework has only been in place for a few years, experience to date is that it has generally worked well. Introducing further legislative changes, departing from this model, could introduce unnecessary regulatory uncertainty with unclear benefits" (p.13).

In contrast, VHA argued strongly for reference offers rather than access determinations, stating "the current use of ex ante determinations has 'outsourced' commercial negotiation and agreement to the ACCC… [this] requires complex commercial terms to be addressed by a regulator with imperfect information. The potential for regulatory error is therefore very high indeed. Moreover, errors are difficult to identify and impractical to reverse…. [Further, the] onus is placed entirely on the ACCC to develop a complete regulatory solution with no meaningful requirement for access providers to assist in the development of a workable solution". VHA argued that "an Undertaking process (properly managed) places the onus on access providers and requires access providers to deliver sufficient information to the ACCC to prove their case. Access providers are required to engage with access seekers to develop suitable proposals" (p.7).

Panel's view

There is strong, though not unanimous, support among submitters for the continuation of the current access determination framework. The introduction of access determinations has resulted in increased regulatory certainty and there are no clear benefits to moving to an alternative regulatory model. As such, no change is required in this area.

That said, there are merits in the arguments put by VHA, particularly concerns about the risk of regulatory error involved in placing these powers in the ACCC. However, the panel has sought to better manage those risks by providing for merits review of ACCC decisions as discussed in section 3.9.5, rather than by altering the broad approach of relying on access determinations.

3.9.2 Criteria for access determinations

The panel considered whether the criteria for making an access determination should be revised and, if so, to what end.

The criteria for making an access determination are largely carried forward from the criteria that previously applied to the resolution of arbitrations. This includes the LTIE and seeks to balance the interests of both providers and users of a service. The panel considered whether the criteria achieved the balance sought or whether any adjustments are required.

Submissions

Macquarie Telecom argued the "criteria for making access determinations are satisfactory and are likely to remain so, thereby obviating the need for change. That is, Macquarie is not aware of any sub-optimal access determination which was made as a result of the criteria on which it was made" (p.7).

Optus noted the criteria were long-standing and had worked well in the past. It further argued that "to change the criteria would risk creating uncertainty to the industry" (p.24).

Panel's view

The criteria for making access determinations are well established and understood by both the ACCC and industry. In the absence of any clear or compelling argument for change, there should be no change to the current criteria.

However, Part IIIA of the CCA is currently under review. As a general matter, it would not be desirable for the criteria under which access charges are set in Part XIC to differ from those in Part IIIA, unless there were compelling reasons for those differences. Therefore once the review of Part IIIA is completed, the Government should consider the scope to align, to the degree practicable, the access pricing criteria in Part XIC with those in Part IIIA.

Recommendation 16: In relation to the matters that the ACCC must take into account when making access determinations, once the review of Part IIIA of the CCA is completed, the Government should consider the scope to align, to the degree practicable, the access pricing criteria in Part XIC with those in Part IIIA.

The ACCC needs to ensure its approach to access determinations does not treat NBN Co more favourably than other access providers. In setting access charges in an access determination, the ACCC should therefore be required, along with other factors, to take account of the manner in which it sets charges for NBN Co. For example, if fixed principles apply to NBN Co, the ACCC would need to take account of the general desirability of ensuring consistency in approach among access providers and hence consider whether it is reasonable for those fixed principles to apply in the case at issue.

Recommendation 17: In setting access charges through an access determination for infrastructure providers other than NBN Co, the ACCC should be required, along with other factors, to take account of the manner in which it sets charges for NBN Co.

3.9.3 Different terms and conditions for different parties

The access determination provisions were intended to provide the ACCC with greater flexibility in how determinations apply to individual access providers and access seekers or classes of such. This was viewed as a more efficient approach than the previous model of providing exemptions from the SAOs. It also allows the SAOs to be more carefully targeted where this is appropriate.

The panel considered whether the ACCC should have the power to specify different terms and conditions for different access providers and access seekers.

Submissions

Submissions supported the ACCC retaining this power.

TPG, for example, submitted "that this is a more efficient approach than the previous model of providing exemptions from the SAOs" (p.5), while Macquarie Telecom argued "that this is appropriate in the case of access providers, particularly where a given access seeker controls significant bottleneck network infrastructure" (p.8).

Panel's view

There is no reason to remove the existing arrangements relating to the differential application of terms and conditions in an access determination. As noted earlier, the panel is not recommending the ACCC be required by law to take into account SMP in making decisions. However, the ACCC has the scope to have regard to the degree of market power held by an access provider in relation to a declared service when considering whether to exempt that provider from the terms of an access determination made in respect of that service. That allows the ACCC to tailor the reach of its decisions, where the benefits of doing so outweigh the costs.

3.9.4 Methodology for determining prices

Part XIC does not prescribe the methodology to be employed by the ACCC in setting access terms and conditions. Instead, the ACCC undertakes extensive consultation with industry on this issue, as evidenced, for example, in relation to the regulation of fixed services.

The panel considered whether the methodology for determining wholesale prices should be specified in legislation. If so, should this be at a high level (for example, cost-based approach) or a more detailed level (for example, building-block methodology)? The panel also considered whether use of Ministerial pricing determinations to provide guidance to the ACCC should be encouraged. Should specific guidance be provided to the ACCC, for example, on how to take account of embedded cost-related subsidies when determining prices? Should the ACCC consider non-price factors such as positive and negative externalities?

Submissions

Submissions were opposed to restricting the ACCC's flexibility by setting the methodology in legislation.

For example, TPG submitted "it is important that the ACCC retain a relatively high degree of flexibility to consider the issues in determining wholesale pricing. As is currently the case, submissions as to the appropriate process and model can be made and decided upon by the ACCC. Where limitations of a particular model are found (and there are always some limitations), they can be reviewed at the next appropriate time. TPG would therefore not support additional legislative direction" (p.5).

Panel's view

The existing criteria provide a high level of flexibility for the ACCC to exercise as circumstances arise. At the same time, that flexibility increases uncertainty and the risk of the regulator inappropriately altering the approach it adopts.

These concerns have been to some extent addressed by the scope to implement fixed principles in SAUs (see section 3.11.4), which will be enhanced by the panel's recommendations in that respect. Additionally and importantly, the reintroduction of merits review provides an additional measure of control against the inappropriate use of regulatory discretion. Subject to those recommendations being adopted, there is not a compelling case for imposing a pricing methodology on the ACCC and change is not required this area.

However, were the panel's recommendation in respect of reintroducing full and effective merits review not adopted, clearer guidance should be provided in legislation to the ACCC as to the setting of access charges. Specifically, the criteria should be amended to specify the use of a 'building blocks' methodology, thus aligning the pricing regime with that in other regulated industries.

Finally, as noted in section 3.9.2, there is merit in aligning, to the degree practicable, the access pricing criteria in Part XIC with those in Part IIIA.

Ministerial pricing determinations and their future role are discussed in section 3.12.

3.9.5 Merits review and access determinations

ACCC decisions in relation to access determinations are not subject to merits review by the Australian Competition Tribunal, although they are subject to judicial review. This is consistent with the absence of merits review for arbitration determinations under the previous negotiate-arbitrate framework; arbitration determinations had originally been subject to merits review, but this was removed in 2002 in light of the significant delays that had resulted from the review process. While arbitration determinations were not subject to merits review, merits review continued to apply to exemption applications and access undertakings until 2010.

The introduction of merits review could potentially lead to a number of access determinations being reviewed, imposing increased regulatory cost, uncertainty and delay. However, this concern needs to be balanced against the possible benefits flowing from merits review of access determinations, including reduced error costs and improved incentives for due care to be taken in first-instance decision-making.

Submissions

Submissions were divided on this issue.

Macquarie Telecom "strongly rejects the reintroduction of merits review in connection with access determinations" (p.8). "In Macquarie's view, given the historical use of merits review by the incumbent, the absence of a merits review is the preferred situation" (p.9). "Macquarie's firm view, is that the benefits of merits review…can only ever be realised where there is a true equality of bargaining power between access seekers and access providers. Such equality of bargaining position is only ever likely to be achieved in the Australian communications market when (and if) the structural separation process has been fully completed" (p.9).

Optus also opposed the introduction of merits review for access determinations, arguing that "elimination of merits reviews has significantly improved the efficiency and timeliness of the access regime and reduced the cost of participation in the industry" (p.26).

TPG submitted that it did "not believe access determinations should be subject to merits review, given the extensive consultation that is conducted prior to each determination" (p.5).

The ACCC noted that, prior to the removal of the procedural fairness requirement, "repeated challenges to arbitrations and undertakings were highly resource-intensive and time-consuming … since the reforms to the negotiate-arbitrate framework combined with the removal of merits review the process has had less disputation and worked to deliver timely, certain, results." The ACCC also drew attention to the significance of the form that a merits review process might take, arguing "review mechanisms should not merely duplicate the effort and expertise of the regulator and recognise that the regulator, not a review body, is generally best placed to conduct consultation processes and achieve the aims of open and transparent decision-making"(p.19).

In contrast, Telstra argued "it is a fundamental principle that where private parties' interests are affected by decisions of Government and regulators, those decisions should be subject to review. Merits based review is also regulatory best practice because it incentivises better decision making and promotes accountability" (p.19). Telstra also argued that the risks of regulatory gaming and delay can be addressed by "learning from the experiences of the past and designing a more efficient review process" (p.5).

VHA also argued for reviews of decisions, stating that "the quality of ACCC decisions should be assessed periodically via independent review by an industry expert, thereby ensuring accountability is maintained. There should be an independent assessment every four years of the overall economic impact of Part XIC decisions from the perspective of the objectives of Part XIC. The ACCC should be required to have regard to the recommendations of such independent assessments when it makes future decisions" (pp. 9-10).

The CCC also proposed regular independent reviews of industry performance which could offer an assessment of any Part XIC decisions made by the ACCC. In the view of the CCC, this approach would be preferable to the restoration of merits review as it argues that "there is every reason to believe that [gaming by Telstra] would resume should the merits appeal process be restored" (p.4).

Panel's view

The primary feature of Part XIC is that it affords the ACCC a high level of regulatory discretion. That discretion was intended to address the rapidly evolving nature of telecommunications, in a context where it was believed the development of infrastructure-based competition would eventually greatly reduce the need for industry-specific access regulation. However, it now seems likely that industry-specific access regulation will remain in place for many years to come and that the regulatory regime will be a primary factor shaping Australia's broadband future.

Given that, the panel is concerned that the wide-ranging discretions that the regime vests in the ACCC mean that the risks and costs of regulatory error are potentially very high, with virtually no checks and balances in place to curb any resulting harms. As a matter of principle it is inappropriate, and offensive to the norms of good government, that regulators should be left to regulate themselves.

That is not to dispute the fact that regulatory delay itself carries cost for both industry and end-users. However, bad decisions taken quickly are not preferable to ensuring good decisions are taken, especially given the role those decisions play in determining the future of Australian telecommunications. Moreover, the panel believes that even were there reviews initially, and associated delays, the decisions reached in those reviews would help guide the process from then on, so that delays would not persist. Finally, the absence of appropriate control mechanisms may reduce regulators' incentives to ensure the quality of their decisions, underscoring the importance of ensuring effective oversight of the regulators themselves.

All of these factors have contributed to the quality of decisions made under the competition provisions of the CCA, which have long been subject to full merits review (for instance, in respect of merger authorisation). The precedents set in those reviews have been of great importance in enhancing the predictability and effectiveness of those provisions.

It is therefore appropriate that decisions of enduring impact be subject to regulatory oversight and decisions in relation to access determinations should be subject to merits review. This principle should also apply to anticipatory exemptions and SAUs.

To minimise the potential for unnecessary regulatory costs, uncertainty and delay, merits review should be carefully limited in scope and application, subject to those limitations not

undermining the effectiveness of the process of providing independent, transparent and rigorous scrutiny of regulatory decision-making. The limitations, in other words, should only serve to prevent clearly unnecessary costs and delays in the review process, but should not curtail the scope to seek review of all the claimed errors in a decision. Moreover, any merits review process must have regard to the inter-related nature of decisions on services that are supplied over common infrastructure and to the need for consistency of approach throughout that infrastructure.

Given some similarities between the issues in the energy and telecommunications sectors, any revised arrangements that apply to decisions made by the Australian Energy Regulator could serve as a useful starting point for developing arrangements under Part XIC, with suitable adjustments to reflect the multilateral nature of Part XIC processes. However, that is subject to ensuring that those arrangements allow for the substantive merits of decisions to be tested; in other words, were the merits review arrangements for energy networks substantially wound back, they would no longer meet the panel's objective, which is to provide an opportunity for the timely and effective correction of material regulatory errors.

Where regulatory decisions are expressly short term in nature, such as with interim access determinations and BROCs, merits review should not apply.

Recommendation 18: When the ACCC makes decisions of enduring impact, these should be subject to regulatory oversight. Specifically, decisions in relation to access determinations, anticipatory exemptions and SAUs should be subject to full and effective merits review, subject only to the limitations in scope and application required to prevent clearly unnecessary delays to regulatory decisions.

Were the panel's recommendation on merits review not accepted, this would have important impacts for other elements it has considered. In particular, in the absence of merits review, other means would have to be relied upon to ensure predictability and accountability in regulatory decision-making.

Recommendation 19: Were the Government not to proceed with reintroducing full and effective merits review as proposed in Recommendation 18, then it should:

a) introduce pricing principles into Part XIC of the CCA, including a general requirement to adopt a 'building block' approach to price determination;

b) reintroduce ordinary exemptions and ordinary access undertakings, thus allowing access providers to secure certainty over the terms and conditions of access; and

c) introduce a legislative requirement for the ACCC's discharge of its responsibilities to be subject to review, no less often than every five years, by the Productivity Commission.

That said, the panel emphasises the importance it attaches to merits review as a crucial way of 'regulating the regulator'. By its nature, the dynamic nature of telecommunications makes a highly prescriptive approach to regulation inappropriate. However, this creates corresponding risks associated with broad regulatory discretion and regulatory error. It is far better to control those risks through appropriate merits review processes than by making the legislative framework more prescriptive and hence less flexible.

3.9.6 Procedural fairness and interim access determinations

There are limited circumstances in which the ACCC may make an interim access determination and their purpose is to provide regulated terms and conditions for a service in the period before a first access determination is made. As there are time limits for making access determinations, interim access determinations (IADs) are of limited duration.

The panel considered whether it would be possible to preserve the effectiveness of the interim access determination provisions while also imposing procedural fairness requirements.

Submissions

Optus considers it would be quite difficult to preserve the effectiveness of IADs while also imposing procedural fairness requirements (p.26). Macquarie Telecom took a similar view, noting that it did "not believe that making IADs subject to procedural fairness requirements is warranted" (p.9). TPG also opposed making interim access determinations subject to procedural fairness (p.5).

In contrast, Telstra argued that interim access determinations should be subject to procedural fairness, arguing that this would "not unreasonably impair the operation of those processes" and that "the requirements of procedural fairness for an [interim access determination] or a [binding rules of conduct] process will be more limited than in a [final access determination]" (p.19).

Panel's view

In principle, procedural fairness requirements should apply to regulatory decision making, unless there is a strong justification for removing them.

Procedural fairness requirements should be applied to interim access determinations in circumstances where it would be practical for the ACCC to meet those requirements; at the same time, where urgency precludes those requirements from being met, the time limited nature of those determinations and the fact that final determinations would be subject to

merits review means it is appropriate for the ACCC to have the scope to depart from the procedural fairness requirements.

Unfortunately, the panel understands that is difficult to craft a legal test that both requires procedural fairness to be met when it can, but allows the ACCC to over-ride it when urgency justifies doing so. Accordingly the panel proposes there be a requirement on the ACCC to make reasonable efforts to consult affected parties in such decision-making but the failure or inability to do so should not invalidate the decision concerned. This principle should apply to interim access determinations and binding rules of conduct.

Recommendation 20: Part XIC of the CCA should be amended so that the ACCC must make reasonable efforts to consult with affected parties, including in relation to interim access determinations and binding rules of conduct (BROCs) but the mere fact it fails to do so should not invalidate the decision by the ACCC.

3.10 Binding rules of conduct

Where the ACCC considers there is an urgent need, it may make BROCs setting out the terms and conditions on which access providers must comply with the SAOs. BROCs may only be made in relation to declared services and are more limited in scope than access determinations.

In making BROCs, the ACCC is not required to hold a public inquiry or to consult with relevant parties in accordance with normal rules of procedural fairness. However, BROCs must have a duration of no more than 12 months and the ACCC must commence an inquiry to make or vary the relevant access determination within 30 days of making a BROC.

In effect, BROCs were designed to allow the ACCC to deal with urgent problems relating to the supply of declared services without the delays necessarily caused by normal consultation requirements. No BROCs have been made to date.

3.10.1 Ongoing role of binding rules of conduct

The panel considered whether the power to make BROCs should be removed, retained or expanded.

Submissions

The ACCC observed "that its experience strongly suggests that having recourse to [BROCs] provides a useful means to consider swift action to address potentially detrimental conduct in already regulated markets. This is particularly important given the dynamic nature of such

markets and the risk of anti-competitive conduct during the transition to the NBN. Although the circumstances in which BROCs would be made by the ACCC are necessarily few given the requirement that there must be an 'urgent' need to intervene, nonetheless they provide an important regulatory 'check' " (p.14).

The retention of BROCs was supported by other submitters, with the exception of VHA, who argued that BROCs could be replaced by competition notices which could apply to a contravention of Part XIC (p.16).

Panel's view

There is general support in submissions for the maintenance of BROCs, notwithstanding the fact that the ACCC has not made any BROCs to date. There is no clear or compelling reason for their removal but their role should be reconsidered in the context of reviewing the continuing relevance of Part XIB. The panel is not convinced there is merit in retaining both BROCs and competition notices. If they were to be retained, the scope of Part XIB should be narrowed so it only covers conduct that could not be more effectively regulated through BROCs.

Recommendation 21: The role of BROCs should be reconsidered in the context of reviewing Part XIB of the CCA (see Recommendation 2).

3.10.2 Procedural fairness and binding rules of conduct

The ACCC will only be able to make BROCs if it considers that there is an urgent need to do so. If an issue is not urgent, the ACCC must address it by varying the relevant access determination.

In this context, the panel considered whether it would be possible to preserve the effectiveness of BROCs while also applying procedural fairness requirements.

Submissions

The majority of submissions were of the view that BROCs should not be subject to procedural fairness. The ACCC submitted that it did not consider procedural fairness appropriate "as it would interfere with the effectiveness of BROCs as an 'urgent' form of intervention. However, the requirement for the BROC to expire after 12 months and that the ACCC should substantively consider the issue through a variation inquiry into an access determination should be retained. This provides an appropriate opportunity for review" (p.14).

Similarly, TPG argued that BROCs "should not be subject to merits review or procedural fairness, otherwise their effectiveness is likely to be undermined" (p.6). iiNet also submitted "that the nature of the power means that for BROCs to be effective, the ACCC must be able to take speedy action so procedural fairness is not appropriate" (p.15).

In contrast, Telstra argued that BROCs "should be subject to both procedural fairness and peer review and mandatory consultations" (p.21). Telstra's arguments about the operation of procedural fairness requirements for interim access determinations also applied to BROCs.

Panel's view

Consistent with the recommendation on interim access determinations, procedural fairness requirements should apply in principle to regulatory decision making, unless there is a strong justification for removing them. Procedural fairness requirements should be applied to BROCs but this requirement should be waived in circumstances where it would not be practical for the ACCC to do so. Again, the panel recognises that it is difficult to balance these two points legally. Accordingly the panel proposes there be a requirement on the ACCC to make reasonable efforts to consult affected parties in such decision-making, but the failure or inability to do so should not invalidate the decision concerned. This position is reflected in Recommendation 20.

3.11 Special access undertakings

Where a service has not previously been declared – or in the case of a service provided by NBN Co, has not been declared following a public inquiry and no access determination applies – an access provider can lodge an SAU with the ACCC, setting out its proposed terms of access for the service. The terms of access must set out how the access provider will comply with the applicable SAOs. If the SAU is accepted by the ACCC, the provider must supply the service on the terms set out in the SAU.

An SAU may provide for the ACCC to perform certain functions or exercise certain powers in relation to the undertaking, for example, it may enable the ACCC to make decisions on adjustments to the terms and conditions of supply within certain pre-determined parameters.

Similarly to access determinations, an SAU may contain fixed principles provisions.

In broad terms, in assessing an SAU, the ACCC must consider whether its terms and conditions are 'reasonable'[9] and whether any conduct specified in the SAU is in the LTIE. In considering

9 The criteria for assessing whether terms and conditions are 'reasonable' are set out in s.152AH of the CCA.

whether the terms and conditions are reasonable, the ACCC must have regard to similar criteria used in making an access determination, including the LTIE.

3.11.1 Ordinary access undertakings

Previously, access providers could lodge an ordinary access undertaking with the ACCC, setting out their proposed terms of access for the supply of a declared service. This provision was repealed in 2010 on the basis that its use had effectively reduced regulatory certainty and consumed considerable resources for all parties.

Ordinary access undertakings had been intended to promote regulatory certainty but it was considered that they had failed to do so in practice. The panel sought comments on whether ordinary access undertaking provisions should be reinstated and, if so, the reasons why they would be more effective in promoting regulatory certainty than was previously the case.

Submissions

The ACCC argued against reinstating ordinary access undertakings. While noting that "access undertakings that are only available to providers of certain services gives rise to a potential inconsistency," the ACCC argued that assessing undertakings was a resource intensive activity and that the use of up front access determinations "has facilitated consistent regulatory outcomes for all parties and improved regulatory certainty for access providers" (p.16).

Similarly, Optus argued that "to reinstate provisions on ordinary access undertaking would provide Telstra or other access providers the opportunity to engage in regulatory gaming. It therefore follows that eliminating access undertaking will only promote effectiveness and efficiency of the regime" (p.27).

In contrast, VHA argued that they are a mechanism for greater industry involvement in regulation, as was seen in NBN Co's SAU. VHA submitted that the "role of access undertakings should therefore be (re)elevated within Part XIC and the regulatory procedures for approving and administering access undertakings significantly improved. Provided the assessment process is managed effectively, access undertakings promote certainty and ensure regulation is closely aligned with the commercial requirements of access providers and access seekers. VHA believes that the access undertaking regime creates clear incentives to adopt realistic commercial solutions. In order for an access undertaking to be accepted, the access provider must be able to establish before the ACCC that its position is commercially reasonable, particularly as access seekers will have the ability to express their views during public consultation. This means that access [providers] will be encouraged to develop transparent consultation mechanisms to demonstrate that they have evaluated the needs of access seekers" (p.9).

Panel's view

The panel has considerable sympathy with VHA's submission, notably in terms of the scope access undertakings provide for a more commercially-oriented process than that associated with access determinations. As well as being better attuned to industry realities than a regulator-driven mechanism may be, such an approach could reduce the risk of regulatory error.

Nonetheless, the panel has sought to control the risk of regulatory error by providing for effective review on the merits of the regulator's decisions. Conversely, were merits review not provided for, ordinary access undertakings should be reinstated, along with the pricing principles outlined at Recommendation 19.

3.11.2 NBN Co's use of special access undertakings

The panel considered whether NBN Co should continue to be permitted to submit SAUs in relation to declared services (while other access providers are not). After nearly three years of consultation and development, the ACCC accepted an NBN Co SAU for its fibre, satellite and fixed wireless services in December 2013. NBN Co's SAU is a vehicle for it to gain greater regulatory certainty about how it can operate its business and recover its investment. It also offers certainty to access seekers and the ACCC in terms of NBN Co's commitments.

NBN Co's ability to submit an SAU in relation to services that are already declared reflects the special restrictions to which it is subject. Specifically, NBN Co can only supply declared services; moreover, the mere fact of NBN Co including a service in an SFAA results in that service being declared. As a result, were NBN Co not able to submit an SAU in respect of a declared service, it could not issue an SFAA in respect of a new service without eliminating its ability to submit an SAU covering that service.

NBN Co has therefore been allowed to submit SAUs in respect of services that are declared by virtue of their inclusion in an SFAA. In line with the rules applying to other carriers, once an NBN Co service has been declared by the ACCC as a result of an access inquiry or is the subject of an access determination, NBN Co is no longer able to submit an SAU in relation to that service.

If NBN Co could not lodge SAUs, in the absence of any other mechanism, it would be necessary to rely on the ACCC making access determinations under the existing access regime, which would make it no different from any other provider of declared services. In this context, the panel considered whether NBN Co's scope to submit an SAU should apply as it does to other access providers.

Submissions

With the exception of Optus and Nextgen, submitters broadly supported NBN Co's ability to submit an SAU.

The ACCC argued that its assessment and acceptance of NBN Co's SAU demonstrated that "special access undertakings can be an effective and flexible tool that can provide certainty before investment decisions are made, while balancing the interests of access seekers and end-users of the service." The ACCC also noted that "the SAU was accepted in the context of the ACCC's ability to make access determinations and binding rules of conduct under Part XIC to address ongoing issues as they may arise, including on prices for new products and non-price terms and conditions. If the supporting Part XIC framework is substantially varied or removed, the long-term regulatory framework as contained in the SAU may no longer be considered to be in the long-term interests of end-users" (p.15).

NBN Co argued that "the SAU model is an appropriate methodology (used as part of the hierarchy of regulatory instruments) for regulating and setting terms and conditions of access to NBN Co's services, and accordingly it is not necessary to consider an alternative methodology or approach to determining prices at this stage" (p.17).

In contrast Optus argued that "the NBN Co SAU should be removed. Instead, the ACCC should use the access determination to set the relevant access terms in relation to the declared services supplied by NBN Co" (p.27). Similarly, Nextgen did not support NBN Co's ability to make SAUs in relation to declared services. Nextgen also noted that "the hierarchy of terms needs to be revisited so that the option for regulatory recourse in respect of an SAU exists" (p.6).

Panel's view

There are benefits associated with the SAU process including the scope it affords an access provider to propose terms and conditions that best reflect its business needs. This reduces the risk of regulatory error as compared to the access determination process.

At the same time, the decision to accept or reject an SAU lies with the ACCC through the application of the test as described above. In considering NBN Co's SAU, for example, the ACCC conducted a process that subjected NBN Co to several rounds of public consultation. As such, the SAU can be seen as a means for access seekers and the ACCC to actually shape some of NBN Co's terms, conditions and processes.

There are substantial benefits in NBN Co being able to propose an SAU as it promotes certainty for both NBN Co and other service providers, noting that any SAU is subject to ACCC approval. The current arrangements provide a clear role for the ACCC to intervene in services not covered by an SAU, thereby allowing access seekers to receive access to NBN Co services on reasonable terms and within a reasonable timeframe. The proposed reintroduction of

merits review would enhance this process by providing a safeguard against regulatory error in the determination of those terms and conditions.

3.11.3 Special access undertaking criteria

The criteria for assessing a proposed SAU are similar in nature to the criteria that apply to the making of an access determination and seek to balance the interests of both providers and users of a service. The panel considered whether the criteria for assessing an SAU achieve the balance sought or whether they should be amended and, if so, to what end.

Submissions

Submissions broadly agreed that the criteria for approving an SAU were adequate.

Telstra said "the SAU provisions, including as they apply to NBN Co, are appropriate in the existing transitional environment" (p.19). Macquarie Telecom stated that "despite the somewhat protracted and complicated process for access seekers negotiating with NBN Co in respect of the NBN SAU the SAU process itself is not inherently flawed" (p.10). Nextgen suggested "rather than reconsidering the criterion on which this assessment was based…there is a more pressing need to revisit the SAU which was established as the basis upon which the SAU was developed has changed significantly" (p.6).

For its part, NBN Co argued "the changes proposed by the ACCC in a Notice to Vary should be limited to those changes to the SAU that are necessary to satisfy the ACCC that the SAU would be reasonable (and otherwise compliant with the statutory criteria for accepting an SAU) if varied as proposed in the notice….". Further, NBN Co argued that "once the ACCC has issued a Notice to Vary, if the access provider lodges a varied SAU within a nominated period, this should be considered by the ACCC as if it were the original SAU lodged in circumstances where the variations either adopt the content of the ACCC's Notice to Vary, or address the substance of the ACCC concerns giving rise to the Notice to Vary. This would provide the access provider with additional flexibility in how it responds to the underlying ACCC and access seeker concerns in regard to the original SAU, without having the restart the SAU assessment process. This change would not limit the ACCC's decision-making power in any way" (p.29).

Panel's view

Most submitters did not take issue with the process or criteria for approving the SAU. As the party putting forward the SAU, however, NBN Co has raised a number of issues that require consideration. These are discussed below.

Changes in a notice to vary should be essential

The SAU should first and foremost be the work of the party proposing it, while recognising it needs to be accepted by the ACCC as the independent regulator according to specified criteria and due process. If the ACCC considers a proposed SAU needs to be varied to make it acceptable to the ACCC, the variations it requires should be limited to those that are, as a matter of fact, essential to meet the statutory tests that the ACCC needs to apply.

The ACCC should not include matters it thinks are desirable but are not clearly indispensable for the SAU to be reasonable under the circumstances. For example, the ACCC required NBN Co to include in its SAU a requirement that consumer representatives be included in the Product Development Forum (PDF). While the panel understands the reason why this was done, it is not clear that it was essential to the operation of the SAU or the PDF. Arguably in a structurally separated market, the views of consumers should be articulated via their RSPs.

Recommendation 22: A notice to vary an SAU should be confined to matters that are, as a matter of fact, essential for the ACCC to be satisfied that the SAU will pass the relevant thresholds for acceptance, recognising that this involves a degree of judgement by the regulator.

SAU submitter should have flexibility in responding to a notice to vary

NBN Co considered access providers should have flexibility in amending an SAU in response to a Notice to Vary, providing they deal with the substantive issues raised by the ACCC. The panel is sympathetic to this argument on the basis that the access provider should generally 'hold the pen' when it comes to an SAU. However there is a risk that an access provider will not satisfy the ACCC, delaying a definitive outcome. This, in itself, should provide an incentive for the SAU provider to meet the ACCC's requirements, even if in a more flexible way.

On balance the panel considers that the legislation should be amended to give the person providing an SAU flexibility in responding to a notice to vary, noting the ACCC will still have to assess the SAU subject to the statutory tests applying. In other words, the amendment should make it clear that the party providing the SAU has a requirement to meet the substance of a notice to vary, and should do so in the manner which best matches the circumstances, rather than its variation necessarily adopting a specific form.

Recommendation 23: Part XIC of the CCA should be amended to give the person providing a special access undertaking flexibility in responding to a notice to vary, noting that the ACCC will still need to assess the special access undertaking using the statutory tests it must take into consideration.

Assessment of 'conduct' versus 'terms and conditions'

In the ACCC's consideration of NBN Co's SAU, some effort was required on the ACCC's part to distinguish between 'terms and conditions' and 'conduct' so that each could be assessed according to different criteria in s.152CBD. Under that provision, 'conduct' needs to be assessed using the LTIE test, while 'terms and conditions' are assessed using the reasonableness test. This approach could unnecessarily complicate and delay the SAU assessment process. The Government should amend the provisions for the assessment of 'terms and conditions' and 'conduct' in SAUs to simplify and accelerate the assessment process. A preferable approach may be for the ACCC to have to be satisfied that the SAU as a whole is reasonable, including whether it will promote the LTIE. The ACCC could take a holistic approach in reaching this view, considering both terms and conditions and conduct in doing so.

Recommendation 24: The Government should amend the statutory criteria for the assessment of 'conduct' and 'terms and conditions' to simplify and accelerate the SAU assessment process.

3.11.4 Fixed principles

Under s.152CBAA of the CCA, submitters of SAUs have the option to include fixed principles. If the ACCC has previously accepted an SAU that contains fixed principles that are in effect, the ACCC must not reject another SAU or a variation to the SAU for the same service 'for a reason that concerns' those fixed principles. The SAU may also provide that one or more specified circumstances are qualifying circumstances in relation to the fixed principles. The qualifying circumstances set out the conditions in which the restriction on the ACCC (that is, the requirement that it must not reject a later undertaking on the basis of the fixed principles) does not apply. Fixed principles enable a provider to establish longer term certainty, which is particularly important for an asset such as a fixed telecommunications network which typically requires a long period to recoup initial construction costs.

For the ACCC to accept a fixed principle, it will need to be certain of its meaning and its long-term implications. Equally, the access provider putting forward the fixed principle wants to be confident the principle will provide the regulatory certainty and continuity intended. However, as worded, the phrase 'a reason that concerns' is an inherently open concept that may encompass a broad range of other issues within an SAU. Consequently, unless a fixed principle is very narrowly and precisely defined, it is unlikely the ACCC will find it acceptable.

Submissions

Submissions from the ACCC and Optus supported fixed principles in their current form. The ACCC said "fixed principles are an important mechanism to provide regulatory certainty to network operators where it is appropriate to do so. The ACCC considers they are a preferable regulatory mechanism to provide certainty, and that providing more prescription in the CCA itself would be inappropriate" (p.18). Similarly, Optus supported "the fixed principles powers within Part XIC. It enables the ACCC to provide ongoing certainty to industry that a consistent cost methodology will apply over time" (p.27).

NBN Co suggested clarifying the language, arguing that while it supported fixed principles on the basis they provide long-term certainty, their application in practice was challenging. NBN Co observed that operation of the phrase 'for a reason that concerns' may constrain the ACCC's discretion and that "this is particularly the case where a proposed high-level fixed principle involves an element of judgement or discretion on the part of the access provider". Therefore, NBN Co argued that the language in s152CBAA could be revisited, "in particular, to address concerns about its potential application to fixed principles involving the exercise of discretion by an access provider" (pp.29-30).

Panel's view

The fixed principle concept provides an opportunity for potential investors in telecommunications infrastructure to establish SAU terms that cannot be used to reject future undertakings. In this sense, it adds to the mechanisms by which carriers can increase the certainty that they will be able to recoup costs prudently incurred. This corrects an important flaw in the 1997 regime, namely the lack of certainty about future access pricing and the absence of any assurance that prudently incurred costs would be recovered.

The panel is therefore strongly supportive of the fixed principles concept. Additionally, it is appropriate that the fixed principles in NBN Co's SAU align with the 'building block' methodology used to set access charges with the approach generally used in other regulated industries. Having accepted that approach in the context of the NBN Co SAU, it would be highly desirable for the ACCC to also apply it in any access determination, thus avoiding potentially inefficient inconsistency between the treatment of NBN Co and that of other regulated entities. Indeed, there should be an onus on the ACCC to justify any such differences in treatment.

Precisely because the panel attaches such importance to the certainty fixed principles can provide, it is concerned to ensure the mechanism is effective. In that context, constraining the ACCC's ability to reject a variation to an SAU because of 'a reason that concerns' a fixed principle is too expansive and is likely to deter the ACCC from accepting fixed principles.

Given this wording, the ACCC has been very cautious in accepting all but narrowly defined fixed principles, limiting the practical utility of the fixed principle concept.

To address this issue, s.152CBAA should be amended so that the ACCC cannot reject a variation to an SAU on the basis that it includes a fixed principle the ACCC has already accepted, or on the basis of either the application of a fixed principle that has been accepted or a consequence of a fixed principle that has been accepted. The relevant test is that there is a clear causal relationship between a fixed principle and its applications and its consequences and if this is the case, the ACCC should not be able to reject a variation to an SAU. For example, if a fixed principle bears on the calculation of charges and the application of the fixed principle meant a charge would be calculated in a certain way, the charge would be covered by the fixed principle.

By narrowing the scope of fixed principles in this way, the ACCC will have more certainty about the implications of accepting fixed principles and will be more prepared to accept them. The same approach should be applied in the other provisions related to fixed principles.

Recommendation 25: In relation to fixed principles:

a) s.152CBAA of the CCA should be amended so that the ACCC cannot reject a variation to an SAU on the basis that it includes a fixed principle the ACCC has already accepted, or on the basis of either the application of a fixed principle that has been accepted or a consequence of a fixed principle that has been accepted;

b) an equivalent approach should be applied in relation to the use of fixed principles in access determinations as provided for in s.152BCD; and

c) the ACCC should be required to have regard to relevant fixed principles already approved in an SAU in assessing an SAU put forward by another carrier or where the ACCC proposes to include fixed principles in an access determination, with a view to maximising consistency of approach.

3.12 Ministerial pricing determinations

The Minister may make a Ministerial pricing determination (MPD) setting out principles dealing with price-related terms and conditions relating to the SAOs for a declared service. Access determinations, BROCs and SAUs have no effect to the extent that they are inconsistent with a MPD. No MPD has ever been made.

The panel considered whether the power to make MPDs should be repealed or retained as a reserve power only. The panel considered whether there were any circumstances in which MPDs could be used without the independence of the regulator being undermined.

Submissions

The CCC considered the provision for MPD to be "anachronistic and inconsistent with the industry's need for a consistently and independently regulated market. It is unclear when or how a Ministerial pricing decision would be needed and appropriate" (p.7).

Similarly, Optus submitted that it saw "little merit in this power in the current market and acknowledges the risk that it could undermine the independent regulator…. and give rise to a conflict of interest between the Minister as an owner of NBN Co… and the requirement to set prices that promotes the LTIE" (p.28).

Macquarie Telecom argued that while "it is not appropriate for governments to be involved in detailed administrative matters essentially because the necessary expertise does not reside within the Ministry, … the power to make such a determination should remain as a reserve power. This is because this provides a discipline for the ACCC to ensure that the pricing methodologies that it adopts need to be appropriate for the circumstances in which they are applied" (p.10).

VHA argued for transparency obligations to be attached to the use of MPDs, such that the "Minister should not be permitted to issue an MPD without undertaking public consultation and consulting with the ACCC. In order to reduce any scope for adverse political interference, greater political transparency and accountability is required. Similarly, the reasons for the MPD and the views of the ACCC should be published and tabled in Parliament as well as the MPD itself. A regulation impact statement should also be formally tabled" (p.17).

Telstra commented that there would continue to be a potentially valuable role for MPDs, noting that "it is not unusual to have a role for the Minister in an access related process, for example, the Ministerial roles in the Part IIIA declaration process and the Migration Plan Principles, Network and Services exemption and SSU Guidance instruments" (p.22).

Panel's view

While submitters were divided on the appropriateness of MPD provisions, they are a desirable safety net. Where a pricing issue bears directly on policy, it is not inappropriate for the Minister to provide policy guidance to the regulator, much as the Council of Australian Governments' Standing Council on Energy and Resources does to the Australian Energy Market Commission. The MPD offers a mechanism for that guidance to be provided transparently and without pre-determining the substance of the regulator's decision in a particular instance. Moreover, MPDs are a disallowable instrument and are subject to the legislative requirements under the *Legislative Instruments Act 2003*, providing further accountability for their use. As a result, MPDs should be retained as a reserve power and no changes should be made in this area at this time.

3.13 Access agreements and hierarchy of terms

Access providers and access seekers may negotiate agreements for access to declared services on commercial terms. NBN Co has an SFAA that provides the basis for access agreements, which it enters into with wholesale customers. Other access seekers may have similar documents for commercial reasons. Access agreements may also rely in part on regulated terms, that is, access determinations, BROCs or SAUs.

Part XIC establishes a legislative hierarchy, in that terms and conditions of access have priority depending on where they are set out. An access agreement has priority, an SAU follows, then BROCs, then an access determination. Terms in an access determination will apply where they are not inconsistent with an access agreement, SAU or BROCs.

Access agreements have been given priority over other arrangements on the basis that access agreements enable parties to reach agreement on terms and conditions that are mutually beneficial but which differ from regulated terms.

Where an SAU is accepted by the ACCC, the access provider has a reasonable expectation that it has regulatory certainty about the terms and conditions on which it will provide access. As such, an SAU has precedence over BROCs and access determinations. Access providers should nonetheless be allowed the opportunity to reach agreement with an access seeker on different terms and conditions where that is mutually beneficial.

The purpose of BROCs is to address urgent problems with the supply of a declared service, even if there is already an access determination in place in relation to that service. This purpose can only be achieved where BROCs take precedence over access determinations.

The panel sought views on whether the hierarchy of terms was set correctly and if not then how should it be set.

Submissions

Submissions were strongly divided on this matter.

NBN Co submitted that the "the hierarchy of regulatory instruments that govern NBN Co's provision of services is now well understood and, broadly speaking, works well. Despite some early difficulties stemming from the fact that the regime was initially not well understood, industry participants are now familiar with how the hierarchy operates. NBN Co submits that Part XIC should continue to give primacy to commercial agreements. The current model promotes certainty for both access seekers and access providers, who would otherwise be unsure of whether their negotiated agreements would be re-opened" (p.16).

Telstra also was of the view that "it is appropriate for access agreements to continue to have primacy in the regulatory framework" (p.21).

The ACCC noted that "in practice, the ability for access seekers to have recourse to regulated terms may be constrained by contracting and bargaining practices of the network provider. However, the ACCC considers that the current regime can work as intended to allow parties to negotiate different terms while preserving the effectiveness of regulated intervention" (p.23). The ACCC noted the commitments by NBN Co to offer access agreements based on the SFAA for two-year periods and by Telstra to pass through pricing decisions made under Part XIC by "agreeing to supply regulated services [under its structural separation undertaking] on terms that included reference prices as per a rate card that would include rates based on Part XIC decisions" (p.23). The ACCC concluded that "there are mechanisms within the existing framework to ensure effective regulatory recourse and that wholesale change to the legislative hierarchy is not warranted given the disruption that this could cause" (p.24).

iiNet argued that it was "not necessary to change the order of the Part XIC hierarchy. What is required is to have a more refined approach to access agreements and create a mechanism that promotes an outcome where the access agreements that sit at the top of the hierarchy are genuine agreements that are not the result of an exercise of unequal bargaining power by an access provider" (p.16).

TPG argued that "to the extent that an SFAA results in the creation of an access agreement that is effectively forced onto an access seeker (in that the access seeker has no commercially acceptable option but to enter into the access agreement), that access agreement should rank lower in the hierarchy" (p.3).

Nextgen argued that "it is inappropriate for access agreements to have ongoing primacy over regulatory instruments and there is a need for greater regulatory oversight of NBN Co than what current arrangements provide." Nextgen argued that the hierarchy should be BROCs, SAUs, access determinations and access agreements. It also argued that SFAAs should be included in the hierarchy (p.6).

Macquarie Telecom noted that it had "a four year history of strongly objecting to the current legislative hierarchy from the time it was first introduced … Macquarie has always maintained that ACCC decisions and processes should generally have primacy over existing commercial arrangements unless the parties decide against incorporating the relevant ACCC decision or process into their arrangements subsequent to the regulatory decision being handed down" (p.10). Similar views were expressed by the CCC.

Optus also argued that the priority given to access agreements in the regulatory hierarchy should be removed. It noted that "prior to the 2010 amendments … operators relied upon contract law to mutually agree to terms that precluded regulatory remedies subject to other beneficial concessions. Optus is not aware that the absence of such provisions caused

particular problems with the operation of access arrangements in the industry … In some circumstances these agreements expressly excluded either party's right to seek regulatory recourse … The key point to note is that the decision to exclude regulatory recourse over the relevant matters was a mutual decision. If one party did not wish to proceed, both parties had to rely on regulatory determinations" (p.13). Optus concluded that "there is merit in removing reference to access agreements prevailing over access determinations, BROCs and SAUs … It has not operated in the way Parliament intended and is proving to be more of a hindrance than a benefit in industry engagement" (p.14).

Panel's view

Since the process of liberalisation began, Australian telecommunications policy has sought both to secure the benefits that commercially negotiated agreements could bring – in terms of ensuring 'fitness for purpose' of the access framework and minimising the burden on and of regulation – and to provide effective regulatory mechanisms where an imbalance of bargaining power would make commercial negotiations unviable or inefficient. Securing the right balance between these somewhat competing objectives has never proven easy, and remains an area of contention.

Cognisant of the history, the legislative hierarchy, whatever its imperfections, represents an improvement over earlier approaches. It allows regulation to set the underlying framework but also provides for access agreements – which are only entered into because they offer benefits to both parties and, hence, achieve gains from trade – to be a credible mechanism available to market participants. Restructuring the hierarchy so as to weaken the status of those agreements would effectively deprive them of their role, as they would be unduly vulnerable to parties seeking to re-open agreements whenever doing so was in their immediate interests. Such an approach would invite opportunism, at the expense of credible, bilateral, commitments.

The panel is not convinced that purely contractual arrangements could, as Optus submits, provide an alternative to the role the primacy of agreements plays in the hierarchy. On the contrary, a shift to reliance on such arrangements might be deeply problematic, most obviously in respect of NBN Co. Moreover, the experience under the 1997 regime highlighted the difficulties such contracts could pose when they interacted, in complex and at times unpredictable ways, with the regulatory mechanisms the regime imposed.

Nonetheless there are issues with the negotiation of access agreements with NBN Co. Therefore, changes have been recommended in section 3.6, whereby access seekers would be afforded an opportunity to approach the ACCC to make decisions on aspects of an access agreement. That would address these issues, correcting what amounts to a current imbalance of bargaining power. Subject to those changes being made, the current hierarchy should be maintained.

4. Rules about operations of NBN corporations

Section 152EOA of Part XIC also requires a review be conducted of Division 2 of Part 2 of the NBN Companies Act, as well as the rest of the Act as far as it relates to Division 2 of Part 2.

Division 2 of Part 2 sets out rules to focus NBN Co's activities (and activities of NBN corporations) by specifying the:

- types of persons to whom it can supply services;
- types of services and goods it can supply;
- arrangements for functional separation, should it be required; and
- restrictions on the type of investments it can make.

4.1 Supply of eligible services on a wholesale-only basis

To give effect to NBN Co's wholesale-only obligation, the general rule is that NBN Co must not supply an eligible service to another person unless the other person is a carrier or a service provider.

The panel considered whether the general requirement that NBN Co only supply to carriers and service providers is an effective means of giving effect to its wholesale-only obligation. One possible concern was that given the barriers to becoming a licensed carrier in Australia are not high, larger corporations may seek to subvert the wholesale-only requirement by establishing a direct relationship with NBN Co. Examples of potential cases include large retail outlets, financial institutions and the bodies responsible for managing the larger sporting codes. This type of activity could subvert NBN Co's wholesale-only status and disadvantage genuine RSPs.

Submissions

Submissions all agreed that NBN Co should remain a wholesale-only operator.

Optus said "maintaining NBN Co's wholesale-only status should remain a fundamental principle of the NBN framework. It was one of the original objectives for the rollout of the NBN, and remains a crucial pillar towards achieving structural separation" (p.6). Optus also suggested that NBN Co should be restricted to wholesale fixed services.

Telstra expressed concerns that the wholesale distinction may need to be tightened, saying "the dividing line between NBN Co's upstream monopoly and downstream competitive activities is too ill-defined and porous. NBN Co should be unambiguously prohibited from

operating at the retail level in line with the Government's public commitment that it will be a wholesale-only network" (p.24). It noted that this should "be strengthened to apply to capacity which the carrier or CSP uses to resupply third parties and for related ancillary uses (e.g. network management)" (p.25).

iiNet similarly argued for the wholesale-only requirement to be tightened so that NBN Co was "restricted from selling services except to a carrier or carriage service provider on condition that the carrier or carriage service provider does not supply NBN services to end-users within its immediate circle" (pp.16-7).

On this issue, NBN Co submitted that "even where large corporate customers do purchase services from NBN Co for their own internal use, that is, not for retail purposes, NBN Co remains a wholesale-only provider, as its products are not sold in a form suitable for end-user consumption (except in a small subset of cases). Corporate customers which are prepared to meet the requirements of being a carrier or a carriage service provider are entitled to become a customer of NBN Co and to compete with other entities meeting those requirements, increasing the level of retail competition in the market" (p.18).

Panel's view

It is appropriate for NBN Co to be structurally separated and it should maintain its wholesale-only status. However, an inherent consequence of structural separation is the need to define boundaries between 'wholesale' and 'retail' activities. Those boundaries are inevitably arbitrary, impose costs and have the scope to distort investment, innovation and competition.

On the specific issue of whether the rules need to be tightened to prevent large corporate bodies becoming direct customers of NBN Co, the panel broadly accepts the arguments put by NBN Co. In many areas NBN Co will be the sole fixed line service provider. The provision of telecommunications services to large corporations in Australia is a well contested and competitive market, with RSPs generally providing high quality value-added services. It is therefore unlikely that corporations would seek out a direct relationship with NBN Co, with all the costs and difficulties that imposes. However, if the performance of service providers is such that it becomes an attractive option for end-user firms to deal directly with NBN Co, it is not clear that it should be closed off to them. On the contrary, doing so would merely perpetuate the retail underperformance that had induced by-pass and, in the process, unnecessarily increased costs to business.

Additionally, placing further restrictions on NBN Co's line of business activities may have unforeseen consequences and unnecessarily restrict NBN Co's ability to develop innovative business models.

Last, but not least, there is no evidence of this area actually posing problems. Absent such evidence, it is inappropriate to increase the already considerable regulatory burden on the industry.

As a result, no change should be made to the rules associated with the ability of large corporate bodies to obtain carrier licences.

Should a situation eventuate where large corporate customers do seek to by-pass retail providers as a matter of course and acquire services directly from NBN Co for their own internal use, the Government should be prepared to investigate the operation of the retail market as that conduct would suggest the market is not operating efficiently.

Recommendation 26: In relation to NBN Co's wholesale-only obligations, the Government should be prepared to investigate the operation of the retail market should a situation eventuate where large corporate customers seek to by-pass retail service providers as a matter of course and acquire services directly from NBN Co for their own internal use.

4.2 NBN Co's ability to supply to utilities

An exception to the general wholesale-only rule is that NBN Co can directly supply services to a number of utilities, including transport authorities, electricity supply bodies, gas supply bodies, water supply bodies, sewage service bodies, storm water drainage services bodies and state or territory road authorities.

The exception is designed to assist utilities with the management of their networks, for example, through operating smart metering and smart grids. Utilities must still acquire NBN services for communications purposes other than network management from an intermediary service provider. Utilities are not permitted to re-supply the service they acquire from NBN Co. This exemption has not yet been used but as the NBN becomes the predominant network in large parts of Australia, its ability to support utility companies' services is likely to increase.

These arrangements were included in the NBN Companies Act in recognition of the practical synergies that the NBN, as a ubiquitous national network, could provide other utilities. It also reflected the fact that utilities operate extensive communications networks of their own, which, but for statutory exemptions, would require them to have carrier licences. That is, if this statutory exemption did not apply to them, they would still be eligible to be supplied by NBN Co as carriers.

The panel considered the issue of whether supply to utilities would effectively constitute supply to a class of end-users, inconsistent with NBN Co's wholesale-only mandate. As NBN Co's wholesale customers are able to resupply NBN Co services to utilities, it may be

argued that NBN Co has the capacity to compete with its own downstream customers, creating a possible conflict of interest that was inconsistent with the wholesale-only model. It was largely due to such concerns that Parliament included these arrangements in the review provisions in s.152EOA. In this context, the panel considered whether NBN Co should continue to be eligible to supply services to specified classes of utilities.

Submissions

Submissions from NBN Co and Macquarie Telecom argued that no change was required.

Telstra, Optus, TPG and VHA, however, argued that these provisions should be removed. Telstra argued there was "no 'market failure' justification for NBN Co being involved in the supply of these services" (p.25). Optus argued that it "would not be appropriate for utilities to be both in a position to procure NBN services directly from NBN Co and RSPs — this would undermine the structurally separated market structure that would have led to the requirement for NBN Co to operate as a wholesale-only provider in the first place" (p.7). In TPG's view, "the telecommunications market will be condensed and competitive. No class of customer should be removed from the addressable market by being effectively handed to NBN Co" (p.7-8). VHA said "NBN Co should not be permitted to supply to utilities, except to the extent those utilities are carriers or carriage services providers" (p18).

The Broadband Today Alliance suggested that the scope of the provisions should be broadened, stating that "Local Governments should be included as a specific class of utility who can obtain direct supply from NBN Co. [They] provide non-commercial services for Public Safety…" (p.1).

Panel's view

Allowing utilities to access services directly from NBN Co is consistent with utilities operating extensive communications networks of their own for which, were it not for statutory exemptions, they would need carrier licences. If they were carriers they would be eligible to secure services from NBN Co.

Utilities are limited in the purposes for which they can use NBN Co services under the exemptions and there are potential synergies between NBN Co's network and those of the relevant utilities. Utilities are still able to access services from carriage service providers, which creates an incentive for access seekers to tailor products to the utilities market. Therefore, the panel does not support change to the statutory exemptions available for the direct supply of services from NBN Co to utilities.

4.3 NBN Co's ability to deal with end-users

As a wholesale-only provider, NBN Co is generally prevented from supplying services to end-users. This is fundamental to the wholesale-only model and aims to prevent it competing with its wholesale customers and advantaging itself over them. However, there may be circumstances when there could be advantages in NBN Co having some discretion to deal directly with end-users. In offering network extensions to communities, fibre on demand and installing parts of its network (for example, network termination devices), there may be benefits in NBN Co clearly being able to deal directly with end-users for reasons of effectiveness and efficiency.

To the extent that NBN Co could operate better by dealing with end-users, its supply would not necessarily displace RSPs and could indeed be to their benefit (were NBN Co best placed to provide those services).

In this context, it could be argued that it would be desirable to provide NBN Co with the scope to so deal with end-users, potentially subject to narrowly confined conditions. Alternatively the view could be taken that all such engagements should take place through retail providers separate from NBN Co. Again, the need to make these distinctions, which in practice are inevitably somewhat arbitrary, is an inherent consequence of structural separation.

The panel considered whether there are circumstances where NBN Co might be perceived as needing to deal directly with end-users and, if so, the rules that would apply where it was permitted to do so.

Submissions

Submissions from Optus and Macquarie Telecom argued strongly for the restriction on supply to end-users to remain in place. Optus stated that "NBN Co should continue to be excluded from providing services directly to end-users, without exception. This is fundamental to the wholesale-only model and contributes towards ensuring that non-discrimination obligations continue to be adhered [to]" (p.7). Optus noted that there are circumstances where NBN Co may need to deal directly with end-users, including external communication and technician work, "there should be a general understanding that interactions with end-users must be conducted in consultation with RSPs and with the knowledge of RSPs" (p.8).

VHA added that "The only exception to this requirement should be where a retail provider becomes insolvent and NBN Co is required to advise customers of this, including their ability to select another retailer" (p.18).

The Broadband Today Alliance argued "NBN Co should be able to deal directly with end-users for the purposes of fibre network extension and fibre on demand" (p.1).

The TIO argued that there are limited circumstances where it may be appropriate for NBN Co to deal directly with end-users, specifically "to provide tailored information about the status of their connection. NBN Co's involvement need not be disruptive; instead, both NBN Co and the RSP may both stand to benefit in managing end-user expectations and efficiently providing information without double handling". The TIO therefore recommended "that any rules for the operation of NBN Co do not preclude its ability to deal with end-users in appropriate circumstances, and in particular where this may assist in resolving an end-user complaint. This is consistent with NBN Co's current Complaint Management Policy" (pp.1-2).

NBN Co suggested that the NBN Companies Act restrictions required clarification to ensure it is "permitted to supply goods or non-communications services to any person, provided that that supply is connected with or is necessary or incidental to the mandate of NBN Co as expressed in the statement of expectations from the Government. Alternatively, NBN Co suggests that the NBN Co Act could be amended to provide relaxation of the prohibitions by means of a regulation or a rule made under the NBN Co Act that permits a particular prescribed activity. Using a regulation or a rule would not result in mission creep for NBN Co: both legislative instruments would be subject to disallowance by Parliament and would therefore involve appropriate transparency" (p.30).

Panel's view

By necessity NBN Co has some limited interaction with end-users, for example, in providing rollout or other information, installing equipment or migrating customers to the NBN. However, there is a distinction between supplying services directly to end-users and engaging with them in activities ancillary to the supply of those services by RSPs. NBN Co should not supply services directly to end-users as this would undermine the wholesale-only model; but other supportive contact with end-users is acceptable and, indeed, desirable in most instances to advance the interests of end-users. Such contact can help alleviate some of the costs structural separation imposes in complicating the supply chain that links end-users to the network provider.

There is no evidence that NBN Co has been leveraging this interaction to its own advantage and, given its wholesale-only status and other line of business restrictions, it is difficult to see how it would have the means and motivation to do so. Moreover, were NBN Co to act in ways that had the purpose, effect or likely effect of leveraging its market power, the ACCC would have ample powers to intervene through Part XIB as well as under the general competition provisions of part IV of the CCA. Therefore, there is no need to change the existing arrangements. However, the Government should continue to monitor NBN Co's activities and, if concerns arise, then it should consider providing either itself or the ACCC with the power to set appropriate rules of conduct relating to any NBN Co dealings with end-users.

Recommendation 27: In relation to NBN Co dealing with end-users, the Government should continue to monitor NBN Co's activities and, if concerns arise, then it should consider providing either itself or the ACCC with the power to set appropriate rules of conduct relating to any NBN Co dealings with end-users.

4.4 Restricting NBN Co to the supply of Layer 2 services

NBN Co was required by its original statement of expectations in December 2010 to operate at the lowest practical layer of the Open Systems Interconnection (OSI) stack with a view to limiting its operational footprint and stimulating wider industry investment and innovation. While this explicit restriction is not included in the current Government's statement of expectations, NBN Co has indicated its ongoing intent to manage its network in this way, subject to necessary operational exceptions. For example, to supply satellite services efficiently NBN Co is providing some functionality at Layer 3 in the OSI stack. These arrangements are now confirmed in NBN Co's SAU.

The issue of whether NBN Co should be limited to Layer 2 by a licence condition has been examined previously. This was not seen as necessary because NBN Co's network has been fundamentally designed and is being built to operate at Layer 2. The issue that arises here is whether NBN Co should be limited by law to a particular level of functionality or whether this can be dealt with satisfactorily by Government direction and ACCC oversight, noting NBN Co's SAU is now in place and that licence conditions can be imposed on NBN Co to limit its operation if required.

The panel considered whether NBN Co should be limited by law to operating at the lowest possible layer of functionality in the OSI stack, this primarily being Layer 2 although potentially being Layer 3 in some instances. The panel requested stakeholders to provide reasons why this limitation should or should not apply and views as to the benefits or risk involved.

Submissions

Submissions were largely in favour of limiting NBN Co to Layer 2 in legislation.

Optus argued that "for regulatory certainty and consistency with other related legislative requirements and obligations, this (Layer 2) limitation should be incorporated into the NBN Corporations Act" (p.9). Nextgen said that such a course "would provide a degree of certainty for all parties within Australia's telecommunication sector, enabling investments to be made in the pursuit of business objectives without the risk of any future competition from NBN Co as a result of some change in NBN Co's strategy or direction" (p.7).

VHA argued "NBN Co should be limited by law to supplying at layer 2" but that exceptions to this could be sought from the ACCC" (p.18). The ACCC came to a similar conclusion, arguing that "it is reasonable to restrict the layer in which NBN Co will supply services through regulation or Ministerial directions." The ACCC noted that, generally, specifying services in legislation reduces flexibility to respond to changing market conditions. "However, given that the NBN Companies Act reflects the governance arrangements for NBN Co, it would not be inappropriate to specify the services that NBN Co will supply in this Act" (p.29).

iiNet and TPG argued for NBN Co to be restricted to Layer 2, without committing to whether this should be through legislation. iiNet stated that "it is appropriate that NBN Co not be allowed to provide services any higher than Layer 2. In addition to this, iiNet believes that serious consideration should be given to requiring NBN Co to provide access at Layer 1….iiNet believes that access to Layer 1 opens up an extra dimension of competition at the retail level" (p.17). TPG said "The expectation of a competitive RSP market will only be met if the NBN Co is not limiting the RSP's scope to establish attractive products for end-users. We consider that the NBN Co should therefore operate at the lowest possible layer of the OSI stack" (p.8).

NBN Co argued against legislative constraint in this area because its "operational footprint is already adequately constrained, so as to stimulate wider industry investment and innovation, but can be expanded if necessary and appropriate" (p.20).

Panel's view

The current arrangements, which do not strictly confine NBN Co to Layer 2, provide the company with scope to offer wholesale services that are of value to both access seekers and end-users on an efficient basis, including the examples of satellite and multicast services. Moreover, were NBN Co to expand its service offerings in ways that distorted competition, the ACCC's Part XIB powers could be brought into play, along with the economy-wide competition provisions of the CCA. As a result, the case for change has not been made out.

Again, the Government should monitor NBN Co's behaviour and stand ready to adopt suitable measures were NBN Co found to be operating in higher than necessary layers of the OSI stack and, by that means, overly restricting innovation or distorting market conditions in service delivery.

Recommendation 28: In relation to NBN Co being legally limited to Layer 2, the Government should monitor NBN Co's behaviour and stand ready to adopt suitable measures were NBN Co found to be operating in higher than necessary layers of the Open Systems Interconnection (OSI) model.

4.5 Supply of other goods and services

The panel considered whether specific restrictions on NBN Co in relation to the supply of goods and services should be strengthened or relaxed.

NBN Co is prevented from supplying content services and non-communications services and goods that are not for use in connection with the supply by an NBN corporation of an eligible service. Non-communications services are services that do not involve the supply, or are not incidental to the supply, of wholesale carriage services. Incidental services enable the supply of services to end-users, such as facilities access services or access to NBN Co's operational and business support systems. NBN Co may also provide both intellectual property rights and commercial/technical advice, but only in connection with the supply of eligible services, goods related to eligible services, or facilities. These restrictions are designed to ensure NBN Co remains focussed on its core business of providing next generation wholesale broadband services, particularly in the access network. However, the restrictions do significantly limit NBN Co's opportunities to operate in other markets.

Submissions

Submissions from Optus, TPG and Macquarie Telecom argued for the restrictions to remain in force.

In its submission Optus also expressed concerns about NBN Co entering the mobile backhaul market and "strongly supports the inclusion of a new section in the NBN Corporations Act that explicitly restricts NBN Co's activities to where a natural monopoly exists — for example, the provision of broadband services to fixed locations" (p.8).

NBN Co argued that "it is impossible to foresee future technological changes that might make the prohibition in s17 [of the NBN Companies Act] irrelevant, or an unnecessary hindrance to NBN Co providing a wholesale service demanded by industry. For this reason NBN Co submits that, at the least, s17 should be subject to an exception prescribed in regulation or rule made under that section" (pp.30-1).

Panel's view

There are not compelling arguments for either strengthening or relaxing the restrictions on NBN Co's supply of goods and services. There is some merit, however, in NBN Co's argument that there could be developments that arise that warrant modifications of the constraints that apply to it and it should be possible to deal with these through regulations, rather than always having to return to Parliament to seek amendments of the Act. The scope to make these changes through regulation should be introduced, noting that regulations are subject to

rigorous development processes and are subject to disallowance by either House of Parliament.

Recommendation 29: In relation to line of business restrictions on NBN Co, the NBN Companies Act should be amended to enable NBN Co's field of operation to be expanded through regulations, noting that regulations are subject to rigorous development processes and disallowance by either House of Parliament.

There is potential benefit in NBN Co being able to leverage its IP and systems to offer a generic service to enable network providers to interface with RSPs. This could assist access seekers to gain access to wholesale services from non-NBN networks. This could be potentially useful in servicing new developments. Such a service would need to be operated at arm's length on a non-discriminatory basis. That is, it would not be able to favour NBN Co services over those of competitors. However, such a service could be offered in other ways including by private sector wholesale intermediaries.

Recommendation 30: NBN Co should be able to offer a generic service to enable network providers to interface with retail service providers to assist access seekers to gain access to wholesale services from non-NBN networks.

4.6 Current and future NBN Co products

As part of the s.152EOA Review[10], the panel was required to consider the types of eligible services that have been, are being, or are proposed to be, supplied by NBN Co. The panel notes that many of the key issues relating to NBN Co's pricing and products were considered in depth by the ACCC and industry through the process of developing NBN Co's SAU, which was accepted by the ACCC in December 2013.

Given this recent and extensive process and the panel's general reluctance to second guess the judgments of the ACCC on particular matters, it has approached this matter with some caution. It recognises, however, that this review provides a useful opportunity to consider broader issues relating to NBN Co's services and service development, as does the panel's broader terms of reference.

NBN Co offers a range of access products over its fibre, fixed wireless and satellite networks to facilitate the supply of communications services to end-users. All the products and associated pricing NBN Co was offering at the time it submitted its varied SAU in November 2013 are

10 Paragraph 152EOA(1A)(b) of the CCA

included in the ACCC approved undertaking. Further details on these products and the specific terms and conditions of access are included in the WBA.

NBN Co's basic access service, the NBN Access Service, requires wholesale customers to purchase each of the following four basic services:

- a physical user network interface at the end-user's premises;
- a network to network interface between NBN Co's network and the wholesale customer's backhaul network;
- the Access Virtual Circuit (AVC), which carries traffic to and from a customer's Network Termination Device; and
- the Connectivity Virtual Circuit (CVC), which provides capacity for the transport of data from all the end-users associated with one of NBN Co's wholesale customers within a Customer Serving Area to the POI.

The basic product is offered at a range of speed tiers and combinations, along with different traffic class options.

NBN Co offers a variety of other services, including a multicast product (which provides an access seeker with the capability to provide video services to end-users) and business grade services (which typically provide high-speed symmetrical speed services and enhanced service levels such as shortened repair timeframes).

NBN Co continues to develop new products and the SAU requires NBN Co to annually publish an Integrated Product Roadmap that sets out the products NBN Co expects to introduce during the subsequent three years[11]. New products that NBN Co currently expects to develop include higher grade business services, other multicast products, further improvements in service levels and fibre backhaul to mobile radiocommunications towers. With the new technology platforms associated with the MTM model, new products will need to be considered.

The SAU establishes the NBN Co PDF, providing details of the required consultation between NBN Co, access seekers and consumer advocacy groups on the details of new products.

NBN Co is able to withdraw products by providing access seekers and the ACCC with 24 months of written notice. The SAU contains the factors NBN Co must have regard to in seeking to withdraw a product and includes provisions preventing NBN Co from withdrawing

11 The most recent Integrated Product Roadmap was published in April 2014 and is available at http://www.nbnco.com.au/content/dam/nbnco/documents/Integrated-Product-Roadmap.pdf

products and introducing similar products to circumvent price controls. The ACCC is able to prevent the withdrawal of products providing it has considered a range of issues relating to the commerciality of the product and the long-term interests of end-users.

Submissions

Submissions to the s.152EOA Consultation Paper did not contain significant comments on NBN Co's current product range or its product development processes.

However, the ACCC noted NBN Co could have "some incentives to bias product development towards the interests of particular access seekers" but observed that the "operation of Part IV and Part XIB could prevent certain types of discriminatory anti-competitive conduct" (p.25).

VHA supported the Product Development Forum, stating that NBN Co's "commitment to a transparent decision-making process as the appropriate way to offer services in a transparent and non-discriminatory way", and that this ensures "all access seekers can participate in ensuring that NBN Co is responsive to the industry's needs". Further, VHA argued that "NBN Co should continue to be encouraged to offer a range of choices for access seekers" (p.12).

Telstra was critical of product development to date, arguing that NBN Co and industry have had "insufficient focus on developing the range of products necessary to enable a migration of all services to the NBN and to meet the needs of end-users, in particular business customers, on the NBN" (p.4 of Regulatory Framing Paper submission). In particular, Telstra noted that NBN Co had not issued any white papers for Special Services, which encompass a range of business data services, ISDN, payphones and traffic lights (pp.6-7 of Regulatory Framing Paper submission).

Panel's view

The existing processes for assessing the suitability of NBN Co's existing product suite have been adequate. Given the ACCC's scrutiny of the SAU and that this undertaking was subject to extensive stakeholder consultation, there has been appropriate transparency in relation to NBN Co's existing products and the process for developing new products and withdrawing existing products. The conferral of powers on the ACCC gives it an ongoing role.

Some issues about product definition were raised in the SAU assessment process and with the panel. These tended to focus not on what products NBN Co was offering but on products it was not, or the prices and other terms and conditions of supply. Product definition issues tended to focus on the availability of an open pipe product, dark fibre, and the relative roles of the AVC and CVC. These matters have been considered by the ACCC in its assessment of

the SAU. It does not appear that any new substantive issues have been raised since the SAU was approved in December 2013.

In reviews conducted about Division 16 of Part XIB[12], concerns were expressed about the need for RSPs on the NBN satellite platform to interconnect at all 121 points of interconnection to provide national coverage. In NBN Co's Fixed Wireless and Satellite Review[13] it has indicated it would look at moving to a single point of interconnection for such services.

The panel is satisfied that the suite of products currently being offered to access seekers was examined by the ACCC in its assessment of the SAU. As such, the product suite provides flexibility for RSPs to offer the broadband products currently demanded by end-users.

However, as a vertically separated entity, NBN Co's incentives in developing services are not necessarily aligned with those of end-users. The absence of effective competition compounds the problems.

In principle, the PDF processes create an opportunity for access seekers to provide input on the services that will enable them to meet their own customers' demands. The forum rules, as established in the SAU, also ensure a degree of transparency in the product development process. At this stage, it is too early in the product development cycle to determine the practical success of NBN Co's consultation processes. Rather, given the time required to develop and market access products, it is likely that the success or otherwise of the PDF will not be fully understood for some years.

It should remain in NBN Co's interests to continue constructive engagement with its customers. It expected that NBN Co will seek to vary its SAU to accommodate the MTM model. This will provide the ACCC with an opportunity to consult with stakeholders on the success of the product development provisions. Long term, product development is so fundamental to the operation of the sector, it will be subject to ongoing scrutiny by the ACCC as well as access seekers. As the ACCC notes in its decision on the SAU (p.75), "the SAU includes provisions which acknowledge that the SAU does not affect the ACCC's ability to declare a service under Part XIC of the CCA. These provisions are intended to reduce any

12 Independent review of Division 16 of Part XIB of the CCA, published in December 2013, is available at www.communications.gov.au/consultation_and_submissions/previous_consultation_and_submissions/review_of_the_division_16_part_xib_of_the_competition_and_consumer_act_2010. The ACCC review of the policy and process for identifying the NBN POIs, also published in December 2013, is available at https://www.accc.gov.au/publications/nbn-points-of-interconnection.

13 Review report available at http://www.nbnco.com.au/about-us/media/news/broadband-connections-in-the-bush-to-triple-says-nbn-report.html

uncertainty about the ACCC's ability to declare services and set terms and conditions for these services."[14]

With regard to the development of services to support the migration of legacy services from the copper network to the NBN, the panel agrees with Telstra that NBN Co has made insufficient progress in this area. Providing a smooth transition for business services and minimising the disruption of services such as traffic lights and payphones should be a focus for the Government and NBN Co. Service provision will potentially be further complicated by NBN Co's delivery of fibre-to-the-node (FTTN) and hybrid fibre-coaxial (HFC) technologies.

Recommendation 31: In relation to eligible services, NBN Co should prioritise the development of white papers associated with services required to support the 'Special Services' identified in Schedule 4 of Telstra's Migration Plan and that this task should be substantially completed by the end of 2015.

4.7 Restrictions on investment activities

In general, NBN Co may only invest where the investment relates to the supply of telecommunications services or goods in connection with the supply of telecommunications services. NBN Co may also invest in shares in a carriage service provider (subject to its wholesale-only and divestment obligations[15]) or in Commonwealth, State or Territory securities (or as otherwise prescribed by regulations made under the *Financial Management and Accountability Act 1997).* Again these restrictions are designed to focus NBN Co on its core activities.

The panel considered whether these restrictions on NBN Co investments activities are appropriate and effective, and whether should they be strengthened or relaxed.

Submissions

Optus supported the continuation of restrictions on the investment activities undertaken by NBN Co, noting that they could be strengthened because of concerns that "this provision currently allows NBN Co to effectively become a shareholder in any company that is engaged in the business of supply of a carriage service, for example this can include an RSP who purchases an NBN eligible services to supply to its end-user" (p.10).

14 ACCC, NBN Co Special Access Undertaking Final Decision, 13 December 2013

15 Under Schedule 1 of the NBN Companies Act, an NBN corporation can control a retail service provider for up to 12 months. This was intended to enable it to build its network through acquisitions if this was considered appropriate, on the basis the retail operations would be divested within 12 months.

Optus also expressed concerns that NBN Co could enter into a joint venture with another party, including an RSP, but that the joint venture would not be subject to the rules applying to NBN Co. As such the joint venture could potentially prefer a downstream operator that is a participant in the joint venture or related to it.

VHA argued that "NBN Co should be expressly permitted and encouraged to enter into public private partnerships, outsourcing arrangements, joint ventures and other co-operative ventures where consistent with optimising NBN deployment" (p.19).

Panel's view

NBN Co's existing investment restrictions have proved effective in focussing the company on providing wholesale communications services. Therefore, at this stage, there is no need to change them.

The Government should be mindful of Optus's concern about NBN Co potentially investing in an RSP or entering into an investment with an RSP. Should either of these eventualities arise, appropriate measures to deal with any conflict should be put in place, particularly noting the proposal in section 3.8 that NBN Co's non-discrimination obligations be relaxed.

Recommendation 32: If the Government accepts the panel's recommendations to relax NBN Co's non-discrimination obligations, in the event that NBN Co proposes to invest in a retail service provider, even on a transitional basis, the Government should impose additional measures to ensure that NBN Co does not favour that retail service provider over others.

If NBN Co participates in a joint venture, the joint venture should operate subject to the rules generally applying to NBN Co, including the non-discrimination rules and related disclosure requirements. This should be the case whether NBN Co has control of the joint venture or is a subordinate partner, unless NBN Co's role and stake is so clearly *de minimis* as to make these requirements unnecessary. That is, to the extent to which the venture operates in any market related to the market in which service providers resupply NBN Co's services, it should be wholesale-only and subject to the proposed non-discrimination rules.

NBN Co should not be able to use joint venture mechanisms to circumvent the basic principles that are intended to regulate its operations. Other entities that would be party to a joint venture need not be disadvantaged by such rules if they know in advance that this is the basis on which any joint venture would proceed.

Recommendation 33: In relation to investment activities, if NBN Co participates in a joint venture, then the joint venture should operate subject to the rules generally applying to NBN Co.

4.8 Other NBN Co issues

Section 152EOA only requires a small and specific part of the NBN Companies Act to be reviewed. However, the panel was conscious that the NBN Companies Act contains a number of other significant provisions that are relevant to its wider review role. These include, for example, provisions relating to the functional or structural separation of NBN Co (ss.23-32), its public ownership and privatisation (ss.44-68) and control of ownership following its privatisation (ss.69-74). Such provisions are directly relevant to this review's second term of reference relating to the optimal long-term ownership and regulatory arrangements for NBN Co.

An important part of the governance of NBN Co is the arrangements applying to it under the *Public Governance, Performance and Accountability Act 2013* [16] and the associated governance rules.

In this context, the panel invited stakeholders to raise any issues with these wider arrangements.

4.8.1 Long term ownership of NBN Co

The ACCC's submission stated that the NBN Companies Act "does not restrict downstream carriers from purchasing a controlling stake in NBN Co (for example, when NBN Co is privatised). Rather, the Act allows the Minister to make regulations to restrict NBN Co from entering into an 'unacceptable private ownership or control situation'. The ACCC considers that the optimal approach to ownership restrictions would be to establish up-front ownership caps in legislation, as this would eliminate any possible future tension in having to set ownership restrictions through regulation while at the same time seeking to maximise the value of NBN Co through privatisation. For example, ownership caps of 5 per cent (per company) may be an appropriate level to minimise the incentives for NBN Co to discriminate in favour of particular downstream providers. However, the ACCC recognises that the current arrangements have the flexibility to impose ownership restrictions in the future, close to the time when private ownership of NBN Co may occur and the structure of the industry at that time" (p.28).

16 The *Public Governance, Performance and Accountability Act 2013* comes into effect on 1 July 2014, creating a single framework Commonwealth for entities previously operating under the *Financial Management and Accountability Act 1997* and the *Commonwealth Authorities and Companies Act 1997*. Prior to this date, the relevant NBN Co governance arrangements were provided by the *Commonwealth Authorities and Companies Act 1997.*

The panel concluded that before any further restrictions were placed on the ownership of NBN Co, it would be prudent to observe how the market developed, particularly in light of the move to a MTM model and the consequent negotiations with Telstra over copper and HFC access. Further, this issue needs to be considered in the context of the longer term competitive structure of the market, on the basis that certain restrictions may be more appropriate in particular circumstances than others. Moreover, given the strict statutory conditions placed on NBN Co in relation to privatisation, the panel considers that restrictions on its future ownership will be fully considered in light of the relevant facts, including the state of the market, in the lead up to privatisation. As a result, no change is required in this area.

4.8.2 NBN and the Customer Service Guarantee

Telstra expressed concerns about the difficulties for RSPs in meeting Customer Service Guarantee (CSG) requirements in an NBN environment. Telstra's concern was essentially that RSPs are subject to CSG requirements at the retail level in relation to timeframes for connecting and restoring services and keeping appointments but they are increasingly dependent on NBN Co to meet those timeframes. By contrast, NBN Co is not subject to corresponding wholesale obligations other than set out in its contracts. As a consequence RSPs face a significant regulatory risk but have little scope to mitigate it. Similar concerns were raised by access seekers during the development of the SAU.

While the issue is complex, Part XIC is relevant in that NBN Co's performance in connecting and restoring services and keeping appointments could potentially be regulated as non-price terms and conditions using Part XIC.

While the panel recognises Telstra's concern, it considers there are a number of mechanisms already in place that can be used to address them. In approving the SAU, the panel understands the ACCC specifically excluded these matters so that they remain subject to ACCC regulatory oversight. The panel also understands there are mechanisms to introduce wholesale CSG-style requirements in the *Telecommunications (Consumer Protection and Service Standards) Act 1999* if required. Finally, the panel notes that the Government has been consulting on possible reforms to the CSG regime to reduce the regulatory burden on the industry.[17] The panel therefore considers no other changes are required in this area.

17 See the Consultation Paper on the Proposed Telecommunications Deregulation Bill No.1 2014 at http://www.communications.gov.au/deregulation/telecommunications_deregulation_bill_no.1_2014

4.8.3 Migration arrangements

Looking to the future, Telstra raised in its submission the issue of further migration of services from existing networks to the NBN and ensuring there are smooth migration processes, including for so-called legacy services. In light of the issues to date with the rollout of the NBN, the panel appreciates why Telstra is raising the issue. The difficulties that have been experienced are inherent in structural separation and require effective remedies. The panel believes this will be as true for the MTM environment as it has been for the fibre to the premise (FTTP) environment.

While the panel appreciates the significance of this issue, it is not convinced it needs to be dealt with – or can readily be dealt with – through the regulatory framework. Rather, as Telstra's submission indicates, the issues involved in such a large scale migration as the NBN necessarily involve NBN Co, all RSPs and other parties. The panel considers appropriate multi-stakeholder processes should be developed. It understands the Government is looking at this approach and supports this work continuing with a view to improved migration processes being put in place.

Recommendation 34: In relation to NBN migration arrangements, including in a future multi-technology mix environment, appropriate multi-stakeholder processes should be developed with a view to improved migration processes being put in place.

Attachment A - Terms of Reference

The purpose of the *Independent cost-benefit analysis and review of regulation* is to analyse the economic and social costs and benefits (including both direct and indirect effects) arising from the availability of broadband of differing properties via various technologies, and to make recommendations on the role of Government support and a number of other longer-term industry matters.

Information flowing from the *NBN Co Strategic Review* should be considered as input to this analysis/review.

The review is to report to the Government within six months of these terms of reference being received on the following questions:

1. What is the direct and indirect value, in economic and social terms, of increased broadband speeds, and to what extent should broadband be supported by the government?

    a. This should consider the economic and social benefits of bringing forward improvements in broadband speed and the respective benefits of alternative / potential technologies.

    b. It should also consider the extent to which market pricing mechanisms can capture the value of benefits (including benefits to Australian governments).

2. What are the optimal long-term ownership and regulatory arrangements for NBN Co?

    a. This should include coverage of the requirements of the statutory review of the telecommunication industry access arrangements required under the *Competition and Consumer Act 2010*.

3. How should the activities of NBN Co be constrained given its mandate to efficiently build, operate and maintain a wholesale-only access network?

    a. This should include consideration of the issues associated with infrastructure based competition and the economic benefit of alternatives.

    b. Recommendations should be made on the structure of the Australian wholesale broadband market, including regulatory arrangements.

4. How should NBN Co's capital investment, products and pricing be reviewed and regulated?

    a. This should consider advice on how products should be structured to promote efficiency, consumer choice and competition.

    b. This should also consider, in the context of NBN Co's proposed pricing structure, the extent to which retail price controls should be continued.

Glossary

ACCC	Australian Competition and Consumer Commission
AVC	Access virtual circuit
BROCs	Binding rules of conduct
CCA	*Competition and Consumer Act 2010*
CCC	Competitive Carriers' Coalition
CSG	Customer service guarantee
CVC	Connectivity virtual circuit
DSLAM	Digital subscriber line access multiplexer
FTTN	Fibre to the node
FTTP	Fibre to the premises
HFC	Hybrid fibre-coaxial
IAD	Interim access determination
LTIE	Long-term interests of end-users
MPD	Ministerial pricing determination
MTM	Multi-technology mix
NBN	National Broadband Network
NBN Companies Act	*National Broadband Network Companies Act 2011*
NBN Co	NBN Co Limited
OSI	Open Systems Interconnection
PDF	Product development forum
RSP	Retail service provider
SAOs	Standard access obligations
SAU	Special access undertaking
SFAA	Standard form of access agreement
SMP	Significant market power
TEBA	Telstra exchange building access
Telecommunications Act	*Telecommunications Act 1997*
TIO	Telecommunications Industry Ombudsman
ULLS	Unconditioned local loop service
VDSL	Very-high-bit-rate digital subscriber line
VHA	Vodafone Hutchison Australia
WBA	Wholesale broadband agreement