NBN CO SPECIAL ACCESS UNDERTAKING FOR THE NBN ACCESS SERVICE

Vodafone Hutchison Australia

SUBMISSION TO THE AUSTRALIAN COMPETITION & CONSUMER COMMISSION

January 2013

This submission is made by Vodafone Hutchison Australia Pty Limited (**VHA**) in response to the Consultation Paper issued by the ACCC in November 2012 relating to the new Special Access Undertaking (**SAU**) proposed by NBN Co Limited and NBN Tasmania Limited (together **NBN Co**).

As outlined in VHA's previous submissions, the National Broadband Network (**NBN**), the Government's recent legislative reforms, and Telstra's Structural Separation Undertaking (**SSU**) provide a vital and unprecedented opportunity to start to deliver a more level competitive playing field in Australia's telecommunications market. These reforms together address some of the legacy policy concerns associated with the serious structural deficiencies of the Australian telecommunications market. VHA supports those reforms.

Building on this, NBN Co's SAU is the critical regulatory instrument that would ensure the success of the new regulatory regime and the effective long-term success and management of NBN Co. The SAU has a number of important functions:

- first, the SAU should provide long-term regulatory certainty to NBN Co, thereby reducing regulatory risk in cost-recovery and reducing financing costs for NBN Co over the life of the NBN;

- second, the SAU should provide commercial certainty to wholesale customers of NBN Co by establishing the parameters for supply and the ground rules for the development of sustainable and effective long-term commercial relationships;

- third, and most importantly, the SAU should outline the long term commercial framework that NBN Co proposes to operate. To ensure that these arrangements are sustainable and enforceable the SAU needs to devolve critical oversight powers to the ACCC (and establishes the basis for the use of these powers) to ensure the effective operation of the telecommunications access regime in Part XIC of the CCA over the 30 year term of the SAU.

The SAU should provide greater certainty and effectiveness in relation to regulatory oversight, not weaken current rights and obligations. It is a misnomer to assert that comprehensive regulatory oversight will engender a dependence on the ACCC to determine the appropriate terms of supply, or that it will result in high levels of industry disputation. Regulation does not create disputes, commercial behaviour does. In reality, an effective oversight regime ensures that all parties have the framework and incentives to behave reasonably and that due care is made to endeavour to meet legitimate interests. The greatest danger to sustainable commercial relationships would occur if NBN Co had sole discretion to make decisions affecting the industry.

With this in mind VHA's reaction to the new SAU is as follows:

- The new SAU is notably more balanced in its approach than the previous draft. NBN Co has made significant improvements. On the whole the SAU's modular structure and many of the proposed commitments delivers a comprehensive and workable framework for the long-term regulatory arrangements for the operation of the NBN. While important elements of the SAU need to be adjusted, the overall proposed structure of the SAU (and much of the content) is appropriate.

- VHA agrees with the Competitor Carrier Coalition's submission that the 30 year term the SAU should seek to establish lock in of the minimum number of matters necessary to establish a long term framework under which NBN Co is able to meet its objectives, including the ability to recover its costs. In practical terms this is likely to include matters which establish the Long-Term Revenue Constraint, the Initial Cost Recovery Account, methodology for calculation of the RAB and certain other rules for the Replacement Module phase (and therefore be open to ongoing regulatory oversight).

- As raised in previous submissions, VHA's primary concern is that the ACCC's oversight role needs to be improved in some key areas before the SAU is accepted. If NBN Co is not held accountable, it potentially has the incentive and ability to act in a manner inconsistent with the long-term interests of end users. If this is not resolved then the length and scope of the SAU would need to be significantly curtailed.

- A number of elements of the SAU currently incorporated as fixed principles in Module 0 or 2 are more appropriately subject to future independent review and recourse. This would ensure that the detailed terms in the SAU continue over the 30 years to promote the relevant matters in Part XIC, including the LTIE. In VHA's view many elements of Module 2 (particularly the pricing elements) should more properly reside in the ongoing Replacement Modules and therefore be subject to periodic oversight.

- With this in mind, our submission proposes some adjustments particularly in regard to the pricing commitments. If these issues are addressed, then new SAU otherwise addresses most of VHA's previously stated concerns. VHA's specific concerns with the drafting of the new SAU, relate to the:
  - interplay with the proposed Standard Form of Access Agreement (SFAA);
  - the nature of the discretions provided to NBN Co in the SAU;
  - ability for NBN Co to withhold the provision of services it is capable of providing; and
  - lack of regulatory oversight for NBN Co pricing.

- Given these remaining issues, VHA submits that the ACCC should use its powers under section 152CBDA of the *Competition and Consumer Act 2010 (Cth)* (**CCA**) to require NBN Co to make a small number of critical refinements to the SAU. VHA has identified these refinements in this submission.

A. the vital importance of a sustainable SAU

NBN Co's proposed SAU is unprecedented in its length, scope and importance. It would become the critical document that will shape the telecommunications regulatory and commercial landscape in Australia for the next 30 years. It is therefore crucial that it be carefully considered by the ACCC.

VHA recognises that given the size and ubiquity of the NBN project, there is merit in establishing long term certainty for essential elements of the NBN business case and to provide certainty for industry about how NBN Co intends to operate. In doing so, it is crucial that the SAU establishes

- an environment that sustains healthy commercial relationships; and
- an appropriate engagement framework that ensure fair and balanced processes that will resolve what will be inevitable and important commercial disagreements,

It is therefore critical that the SAU creates the appropriate incentives and continues to maintain meaningful regulatory restraints on NBN Co (at least as great as those currently capable of being imposed under Part XIC). The proposed term of element of the SAU makes it all the more important that an appropriate balance is struck that protects the long-term interests of end users. The SAU will determine consumer welfare and shape the nature of competition in the Australian telecommunications sector for the next 30 years.

The modular structure of the SAU should be used to strike the appropriate balance between the need to provide NBN Co with the certainty it needs to support its investment, capital and long-term cost recovery requirements against the risk of inadvertently creating circumstances that constrain the evolution of dynamic communications markets over time.

B. The new SAU must achieve the correct regulatory balance

The new SAU must achieve the correct regulatory balance. The consequences of the SAU striking a balance that too heavily favours NBN Co will be amplified over the 30 year term of the SAU and could cause very serious aggregate detriment to access seekers and Australian consumers.

We support NBN Co's objective that the SAU should enable NBN Co to agree with the ACCC, in advance, a regime that provides long-term regulatory certainty to NBN Co, but also that processes and commitments are established that deliver certainty and sustainability for access seekers. This includes all necessary regulatory constraints appropriate to NBN Co's role as a provider of services over natural monopoly infrastructure.

As mentioned above, it is VHA's view that the SAU should ensure greater certainty in relation to commercial interactions and regulatory oversight, not **weaken** the relative bargaining strength of access seekers or the level of regulatory oversight. Any SAU that effectively weakens the level of ACCC oversight of NBN Co relative to the standard application of the Part XIC regime is contrary to the long-term interests of end users and cannot therefore be accepted by the ACCC.

For the SAU to sustain NBN Co over the proposed 30 year period, the SAU needs to address three fundamental concerns:

- NBN Co will own and control natural monopoly access infrastructure. The history of wholesale monopolies demonstrates that such owners may have the incentive and ability to use their substantial market power to raise prices, reduce volumes or investment, restrict service offerings, retain unreasonable discretions, and shift costs and risks to wholesale customers (and hence ultimately to end users). VHA understands the policy rationale for creating the NBN to deliver a national access infrastructure but it must have the appropriate oversight to deliver the benefits.

- While NBN Co claims that its wholesale only mandate will mitigate any abuse of market power, history indicates that monopolies in any form may still give rise to serious competition concerns. As the ACCC will be well aware, many of the electricity distribution companies alleged to be inflating prices only operate in upstream markets.

- In any event, NBN Co will likely be partially or fully privatised during the 30 year term of the SAU. Any new private owner of NBN Co will have every incentive to maximise revenues and shift risk and cost to access seekers. The ACCC should bear this in mind.

C. VHA has four key remaining concerns

VHA's key concerns with the new SAU are as follows:

1. The interplay between the SAU and the Standard Form of Access Agreement (SFAA) must be reasonable

NBN Co's new mechanism for regulatory recourse is an improvement from the previous SAU because it enables the ACCC to ultimately determine SFAA terms in the event of commercial disagreement. However, the proposed mechanism, as currently drafted, is heavily weighted in favour of NBN Co. Indeed, in some instances, the proposed mechanism actually weakens the ACCC's oversight powers to issue Access Determinations (**AD**) and Binding Rules of Conduct (**BROC**) relative to the powers that would exist in the absence of the SAU.

VHA recognises that NBN Co as a wholesale-only provider, whose very success is dependent on the success of its customers, has strong motivations to deliver for the market. The SAU's consultation mechanisms demonstrate a commitment by NBN Co to engage with industry. On the whole they are welcome proposals. However, disagreements will occur and NBN Co's actions may limit the full benefits of the NBN.

As currently drafted, at the end of the product development process, the pricing development process and the mechanisms to establish operational process NBN makes the final call. In most circumstances NBN Co's decision will be acceptable, however if there are legitimate competition concerns NBN Co should not be the final arbiter. VHA believes that the ACCC needs to be able to undertake its legislative function effectively.

For example, the current pricing levels proposed by NBN Co are largely acceptable (and this is welcome). But pricing structures may need to change (as they have in broadband over the last eight years). As it stands, there is no ability for the industry (or indeed, NBN Co) to seek a restructure of NBN Co's pricing. The most glaring example in the SAU is that there is no certainty whether CVC pricing will fall as average usage increases. Further, concerns about the structure of NBN Co's pricing might arise. For example, as consumers seek faster speeds, higher bandwidth products (like the 100Mbps product) move away from being 'enterprise' products and become 'mass market' products and be priced accordingly. This transition would require appropriate oversight.

As identified above, any weakening of the regulation of NBN Co is not in the long-term interests of end users and is inconsistent with the intent of the Part XIC regime. VHA has therefore proposed a simple set of drafting amendments to practically resolve these issues and ensure that a sufficient level of ACCC oversight is maintained.

The ACCC has commented in the Consultation Paper that there are a number of alternative ways to obtain access to services supplied by NBN Co. However, none of these alternatives are realistic or practical. NBN Co is a monopoly and controls an essential facility. Quite rightly NBN is constrained by non-discrimination obligations but this means there will be limited ability to deviate from the SFAA. This means that without appropriate arrangements in place, access seekers could have no practical ability to negotiate with NBN Co and would instead have no choice but to accept a 'take it or leave it' offer in the form of the SFAA.

In short, the SAU is broad in scope and overrides any inconsistent AD or BROC. Court orders, if even available, would be extensively litigated and costly to obtain. In the absence of any realistic practical alternative, the SAU must ensure that the SFAA terms are reasonable and that important regulatory disputes are resolved with the assistance of the competition regulator.

2. NBN Co discretions must be exercised reasonably

The SAU and SFAA contain provisions that provide significant discretion to NBN Co. In some circumstances, NBN Co is not held accountable by the SAU in relation to the manner in which it may exercise these discretions. Rather, the SAU effectively removes the AD and BROC powers. These discretions could be exercised in a manner inconsistent with Part XIC objectives without recourse to the ACCC, including by unreasonably shifting cost and risk to access seekers (and hence consumers).

VHA has proposed some simple amendments to the SAU that will impose the necessary accountability on NBN Co. In the absence of these amendments, the SAU will materially weaken the level of regulatory oversight of NBN Co and hence will be inconsistent with the long-term interests of end users, so cannot be accepted by the ACCC.

3. NBN Co has the potential to restrict supply of services it is capable of providing

The promotion of competition in downstream markets is best achieved if NBN Co does not discriminate between the types of services offered over its network. The proposed SAU potentially provides NBN Co with the discretion to restrict supply of, or fail to provide, services that it might reasonably be expected to provide over infrastructure that is uneconomic to duplicate.

4. NBN Co pricing should be subject to appropriate regulatory oversight

NBN Co has included pricing methodology commitments in the SAU that will guide the exercise of NBN Co's pricing discretion. VHA welcomes the inclusion of these commitments. However, the current proposed commitments remain relatively weak. NBN Co continues to maintain significant pricing discretion in an environment where it will hold *de facto* monopoly pricing power. VHA has therefore suggested some drafting amendments to ensure that NBN Co pricing remains subject to appropriate regulatory oversight over the term of the SAU.

VHA's more detailed submissions on each of these issues are set out in the **Attachment** below.

VHA also notes the following additional issues identified by the ACCC in the Consultation Paper and agrees with the ACCC's conclusions:

- **Declaration of facilities access:** The Facilities Access service should be declared by the SAU as it is an eligible service (see section 4.2 of the Consultation Paper).

- **SAU should specify service levels principles and service levels should be open to full ACCC review:** While it may be too proscriptive to require service levels to be part of the SAU, there would be merit in establishing some principles in the SAU that outline how NBN Co would develop their service level metrics. There should also be full oversight by the ACCC of the application of these principles. As outlined in the ACCC's publication "*Access undertakings – A guide to Part IIIA of the Trade Practices Act 1974*" of 30 September 1999, the ACCC relevantly commented as follows in relation to the specific importance of service levels in circumstances where CPI-X price cap regulation is applied:

  > "One of the disadvantages of a price cap is that in providing an incentive to cut costs it may provide an incentive to cut service quality. Before accepting an undertaking relying on a price cap the Commission will seek justification from the service provider on... the adequacy of safeguards on service quality".

D. The ACCC should issue a section 152CBDA notice

Notwithstanding the key concerns identified above, the majority of the SAU is acceptable and the key concerns identified above can be readily addressed by NBN Co.

VHA submits that all of VHA's key remaining concerns could be addressed and resolved if the ACCC were to issue a notice under section 152CBDA of the CCA.

As the ACCC will be aware, a section 152CBDA notice enables the ACCC to given NBN Co a written notice stating that, if NBN Co:

- makes such variations to the original undertaking as are specified in the notice; and

- gives the varied undertaking to the ACCC within the period specified in the notice;

then the ACCC will consider the varied undertaking under section 152CBDA as if the varied undertaking had been given to the ACCC instead of the original undertaking.

VHA has set out in the **Attachment** some suggested drafting that could be included in a section 152CBDA notice to address VHA's concerns.

Given the fundamental long-term importance of the SAU, it is important that the ACCC maximises the level of industry engagement and identifies a solution that addresses the concerns of all stakeholders. Accordingly, VHA submits that the ACCC should undertake further industry consultation on the proposed draft of a section 152CBDA notice before it is formally issued to NBN Co.

We hope the ACCC finds this submission helpful. VHA is happy to discuss any aspect of this submission.

January 2013

ATTACHMENT

DETAILED SUBMISSION ON KEY ISSUES

1. The interplay between the SFAA and SAU

1.1 Key requirements

VHA's overriding requirement for the NBN Co regulatory framework is that the terms and conditions of any SFAA proposed by NBN Co, and hence any resulting Access Agreement based on that SFAA, must be commercially reasonable. It is the SAU that can ensure that NBN Co is required to deliver these reasonable commercial terms.

It is not in the long-term interests of end users (**LTIE**) for access seekers to the NBN to contract under unreasonable terms and that these are locked in for significant periods. Such terms have the effect of increasing risk and costs for access seekers, decreasing service quality and flexibility, and stifling innovation. Where NBN Co retains discretion that is not objectively qualified, it also has the ability to exercise that discretion in an unreasonable manner to further its own commercial objectives at the expense of the LTIE.

While NBN Co has addressed many industry concerns in its most recent draft WBA, there are also many issues that remaining outstanding. Some of these issues are fundamental, including the need for meaningful service levels (as identified by the ACCC itself in section 7.1 of the Consultation Paper). The SAU must provide processes to enable ongoing industry engagement on the terms of the SFAA and their Access Agreements.

As VHA identified in its earlier submissions, most jurisdictions with a telecommunications access framework utilise a "Reference Interconnect Offer" (**RIO**) mechanism. The RIO has a role akin to the SFAA as a standard form of agreement that an access seeker can immediately accept. Such jurisdictions require the RIO to be subject to independent review and regulatory sign-off. In the absence of Part XIC providing an equivalent express mechanism for ACCC endorsement of the SFAA, it is important that the SAU devolves sufficient powers to the ACCC to ensure such effective oversight occurs.

Indeed, the statutory intent of Part XIC is that NBN Co complies with the category B standard access obligations (**SAOs**) by supplying access to declared services on a reasonable basis. The SAU is an undertaking by NBN Co to supply declared services as required by the SAOs, so must necessarily also require NBN Co to offer to supply services under the SFAA on a reasonable basis. The requirement for reasonableness is further reinforced by sections 152CBD(2) and 152AH of the CCA.

VHA submits that the SAU cannot be accepted by the ACCC under the Part XIC regime unless and until the ACCC is satisfied that the SAU contains an adequate mechanism to ensure that the terms of any SFAA offered by NBN Co are reasonable. This issue is fundamental.

1.2 NBN Co's response to those concerns

In clause 6 of the new SAU, NBN Co has now proposed the following solution to address these concerns:

- NBN Co must publish and maintain an SFAA for the duration of the SAU Term (clause 6.3).

- NBN Co must ensure that the SFAA is aligned with the terms of the SAU for the duration of the SAU Term (clauses 6.1 and 6.2).

- Under Module 1, during the Initial Regulatory Period:

    - NBN Co must ensure that each SFAA has a term no greater than 2 years (clause 1B.1.3). NBN Co has stated in its explanatory material that it intends to enter into co-terminus Access Agreements with each access seeker based on the SFAA, each with a 2 year term.

    - If the ACCC makes an Access Determination (**AD**) or Binding Rule of Conduct (**BROC**), NBN Co will delay giving effect to that AD or BROC in the SFAA until the expiry of the 2 year term of that SFAA (clause 1B.2.2(b) and (c)).

    - If an AD or BROC expires during the SFAA term, NBN Co may immediately amend the SFAA and does not need to wait until the expiry of the 2 year term of that SFAA (clause 1B.2.2 (d)).

    - The AD and BROC powers of the ACCC are materially qualified, including requirements not to discriminate between Access Seekers and an effective exemption against NBN Co being required to amend any published SFAA during its 2 year term (clause 1B.2.2 (a) and (c)).

    - The powers of the ACCC to make AD or BROC in relation to facilities access services in an interconnection context under the SAOs are removed entirely and replaced with a self-contained regime (clause 1B.2.3).

1.3 Deficiencies in NBN Co's response

VHA commends NBN Co on proposing a solution in the SAU that addresses many of the concerns that VHA identified in its previous submissions.

However, the precise drafting solution that NBN Co has proposed is weighted heavily in favour of NBN Co. While NBN Co claims that an absence of ACCC oversight during the two-year term of an SFAA will increase regulatory certainty, it will also mean that there is no scope for the ACCC to address critical issues that arise during that time period. In effect, it will significantly strengthen the market power of NBN Co (or particular industry players) and remove an important aspect of NBN Co accountability during the two-year term of the SFAA.

As the ACCC will be aware, significant issues arise from time to time in the practical application of commercial contracts. In a competitive environment, parties can be expected to act reasonably to resolve such issues. However, in an environment where NBN Co wields effective monopoly power, there is no incentive for NBN Co to act reasonably. Regulatory accountability is therefore imperative.

Indeed, the inclusion of the mechanism for the ACCC to issue a BROC under Part XIC was intended to assist the ACCC to resolve matters that required urgent resolution. The Explanatory Memorandum to the *Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2009* explained as follows:

> "The ACCC will have the power to make binding rules of conduct for the supply of declared services which would apply either in addition to, or as a variation of, an access determination. Having such rules in place will allow the regulator to act quickly on issues affecting the supply of retail services."

NBN Co's current proposed approach in the new SAU has the practical effect of removing the ACCC's ability to issue BROCs. Accordingly, it is directly inconsistent with the intent of Part XIC. The ACCC will no longer be able to act quickly on issues affecting the supply of retail services.

VHA's understanding of ACCC processes is that the ACCC rarely, if ever, agrees to accept undertakings proposed by private parties that attempt to fetter the broad statutory powers of the ACCC. NBN Co's drafting clearly does seek to fetter the statutory powers of the ACCC by reducing the scope for the ACCC intervention in circumstances where it may be warranted.

Moreover, as identified above, the ACCC's regulatory oversight powers must be no less than those that would otherwise exist in the absence of the SAU. The SAU is intended to provide greater certainty in relation to regulatory oversight, not **weaken** the level of regulatory oversight. By fettering the ACCC's practical ability to issue AD and BROC to address urgent matters, the SAU is reducing the ACCC's regulatory powers to a level below that contemplated by the Part XIC regime. Such a material weakening of the ACCC's powers to regulate NBN Co is not in the long-term interests of end users.

More generally, there also remains a potential loophole in the drafting of the SAU caused by the application of section 152CBIC of the CCA. Section 152CBIC provides that an SAU has no effect to the extent to which it is inconsistent with an Access Agreement. It would be open, in theory, for NBN Co to include provisions in its SFAA (and hence included in an Access Agreement) that remove the application of key obligations imposed on NBN Co by the SAU, including to override the effect of clause 6 (Alignment of SAU with SFAA). For completeness, VHA recommends that this potential loophole is closed.

1.4 VHA's concerns regarding ACCC comments in the Consultation Paper

The ACCC has commented at pages 19-21 of its Consultation Paper that there are a number of alternative ways by which an access seeker can obtain access to services supplied by NBN Co, other than by executing an SFAA. The ACCC comments that:

- An access seeker and NBN Co can negotiate and agree to different commercial terms than those set out in the SFAA.

- An access seeker can request NBN Co to supply services on terms and conditions set out in an AD or BROC.

The ACCC then comments that "*it is a commercial decision for an access seeker to request NBN Co to enter into an Access Agreement that is the same as an SFAA*". The ACCC also comments that it expects access seekers to "*carefully consider the consequences of terms and conditions that are contained in an Access Agreement prior to executing it*".

VHA is concerned by these comments. With the greatest of respect, NBN Co is a monopoly and controls an essential facility. Access seekers have no practical ability to commercially negotiate with NBN Co and are instead faced with a 'take it or leave it' commercial offer from NBN Co in the form of the SFAA (titled the "Wholesale Broadband Agreement"). NBN Co could potentially refuse to entertain requests to enter into agreements on terms materially different from those of the SFAA.

Furthermore:

- The ability of an access seeker and NBN Co to negotiate and agree different commercial terms is subject to NBN Co's non-discrimination obligations. As a practical matter, it is highly unlikely that NBN Co would (or could) agree to provide more favourable terms to any access seeker

than set out in its SFAA, given that it may then be required to amend its SFAA to offer the same terms to all access seekers.

- Any AD or BROC does not apply to the extent that it is inconsistent with the terms of the SAU. However, the terms of the SAU are very broad indeed. The concept of inconsistency is amorphous and leaves much scope for interpretative disagreement. There is ample scope for NBN Co to argue that the terms or an AD or BROC are inconsistent with terms of the SAU, particularly where provisions of the SAU are phrased broadly and purport to 'cover the field'.

- An AD or BROC is not an Access Agreement. As a practical matter, it is not commercially realistic for an access seeker to request that supply occurs on the terms or the AD or BROC alone, particularly when aspects of the AD or BROC may not apply due to inconsistencies with the SAU. To the extent that an access seeker seeks to 'plug the gap' by adopting terms from the SFAA, NBN Co has no obligation to supply on those terms as they are not the complete SFAA. Accordingly, NBN Co can ignore any such request.

- An access seeker cannot argue that the AD or BROC amends the SFAA; hence supply should occur on the terms of an Access Agreement comprising the SFAA as amended by an AD or BROC. Clause 1B.2 of Module 1 of the SAU provides "*NBN Co will not be required to give effect to any Regulatory Determination by amending any existing published SFAA*". The statutory hierarchy then applies such that the SAU overrides the AD or BROC. Moreover, any ACCC directive in an AD or BROC that required any published SFAA to be amended could also be ignored by NBN Co with impunity.

- Notwithstanding all of the above, if it were actually possible as a matter of law (which is by no means clear) to require NBN Co to enter into an Access Agreement on the terms of an AD or BROC, then there are very significant practical issues of enforcement. The ACCC comments that affected persons and the ACCC can seek orders from the Federal Court. However, such orders would be impractical to obtain in most circumstances and, based on experience with Telstra, would be vigorously defended by NBN Co. Expensive, protracted and iterative litigation would be likely to result, imposing significant delay and expense to access seekers.

For all of these reasons, the SAU must contain an appropriately robust mechanism to ensure that the terms of the SFAA are reasonable at all times. A failure by the SAU to do so will lead to negative consequences for the industry and end users. VHA submits that this issue alone is sufficiently fundamental that the ACCC cannot accept the SAU unless it is properly addressed.

1.5 VHA's proposed solution

VHA believes that the deficiencies in NBN Co's response can be easily rectified: The SAU should recognise the ACCC may, in limited circumstances, seek to immediately apply AD and BROC to the industry. NBN Co should be required to give effect to those AD and BROC by amending its SFAA and by offering to amend its existing Access Agreements when this is appropriate. We agree this would only occur in limited circumstances, where delay would have a significant adverse effect on competition. These circumstances could be outlined in the SAU.

Such an approach is entirely consistent (and, indeed, was intended) by the Part XIC regime. The various artificial restrictions imposed by the SAU on the ACCC's powers should be removed and the ACCC should be constrained by the CCA alone, as intended by Parliament.

1.6 Proposed drafting for a section 152CBDA notice

To achieve this, VHA proposes that the ACCC should issue a section 152CBDA notice that directs NBN Co to make the following amendments to the SAU:

(a) Clause 1B.2 (Regulatory Recourse) of Schedule 1B of Module 1 of the SAU should be deleted and replaced with the following new version of clause 1B.2:

> "**1B.2 Regulatory Recourse**
>
> (a) NBN Co acknowledges that the ACCC may make, vary or withdraw an Access Determination or Binding Rule of Conduct that relates to the NBN Access Service or Ancillary Services (each a 'Regulatory Determination').
>
> (b) If any SFAA is inconsistent with any Regulatory Determination, NBN Co must amend that SFAA within 10 business days to ensure that it is consistent with that Regulatory Determination.
>
> (c) If any Access Agreement is inconsistent with any Regulatory Determination, NBN Co must offer to amend that Access Agreement within 10 business days to ensure that it is consistent with that Regulatory Determination.
>
> (d) NBN Co may include wording in any SFAA or Access Agreement that any amendment made pursuant to clauses (b) or (c) will only apply for the duration contemplated by that Regulatory Determination.
>
> (e) NBN Co acknowledges that any Regulatory Determination may decide terms and conditions in relation to the Facilities Access Service in connection with NBN Co's interconnection obligations under section 152AXB(4) of the CCA in connection with the NBN Access Service and Ancillary Services."

(b) a new clause 6.4 should be added to clause 6 (Alignment of Special Access Undertaking with SAU) of the main body of the SAU:

> "**6.4 SFAA must require NBN Co to comply with Special Access Undertaking**
>
> NBN Co agrees that it will include a clause in every SFAA that NBN Co will comply with the terms and conditions of this Special Access Undertaking."

The drafting above is much simpler than that proposed by NBN Co and would address all of VHA's concerns without imposing any artificial restraints on the ACCC's statutory powers.

As mentioned above, the SAU could also include a provision that would stipulate when the ACCC may seek to require amendment of Access Agreements. As outlined this should only be when the amount of time until the co-terminus of Access Agreements would mean that there would be a significant impact to competition and the long term interests of end users.

2. NBN Co discretions must be exercised reasonably

2.1 Key requirements

As identified in VHA's previous submissions, NBN Co has retained for itself significant subjective discretions in the SFAA/WBA. While the new SAU now contains a mechanism for the ACCC to issue AD and BROC to require the SFAA to be amended, this mechanism does not address the practical application of the terms of the SFAA on a daily basis. Where NBN Co retains discretion that is not objectively qualified, NBN Co has the clear ability to exercise that discretion in an unreasonable manner to further its own commercial objectives at the expense of the long-term interests of end users.

In the ACCC's *Final Determination – Model Non-Price Terms and Conditions* in October 2003 in relation to the determination of model terms and conditions under Part XIC, the ACCC set out the following principle regarding the need for discretions to be exercised objectively:

> "Finally, where a contractual term allows for a party to exercise discretion, as a rule, that discretion should be exercised on an objective, rather than subjective basis."

VHA considers that neither the SAU nor the WBA currently adopt an appropriate balance between, on the one hand, the legitimate business interests of NBN Co and, on the other hand, the LTIE and the interests of persons who have rights to use the declared services as required by section 152CBD(2). In effect, the WBA and SAU both contain inherent bias in favour of NBN Co at the expense of access seekers.

In the absence of any meaningful regulatory recourse provided in the SAU, NBN Co will not be accountable, contrary to the objectives of Part XIC.

VHA submits that the SAU cannot be accepted by the ACCC under the Part XIC regime unless and until the ACCC is satisfied that the SAU contains an adequate mechanism to ensure that the practical exercise of NBN Co's rights and powers under the SAU and any Access Agreement based on an SFAA, remain reasonable. As with the first issue identified above, this second issue is also fundamental.

2.2 VHA's proposed solution

While the issue identified above is fundamental, the drafting solution to the issue is relatively straightforward and the SAU can easily be amended to include that drafting solution:

- First, NBN Co should be required by the SAU to exercise all of its rights and powers under the SAU, and any Access Agreement based on an SFAA, on a reasonable basis in accordance with Part XIC objectives. Any failure by NBN to do so should constitute a breach of the SAU that could be the subject of appropriate enforcement action by the ACCC.

- Second, the SAU should require NBN to have regard to Part XIC criteria when resolving a dispute. Such an approach is adopted, for example, by the Facilities Access Code which requires parties to a dispute to have regard to the criteria the ACCC would normally apply to resolve a dispute under the Telecommunications Act. This may be a simpler approach than adopting NBN Co's pricing principles. The parties are also required to have regard to any relevant principles or guidelines issued by the ACCC that may be relevant to the arbitration of a dispute.

- Third, and as discussed above, the SAU should commit NBN to be bound by ACCC Access Determinations or Binding Rules of Conduct. The ACCC should be required to allow all consultation process and dispute mechanisms to be exhausted before considering intervening. In most cases if the NBN process has been undertaken correctly and NBN has acted reasonably then generally the ACCC would choose not to intervene. It is however important that the ACCC is able to be the final arbiter of the long term interests of end users; not NBN Co.

With these three additional protections in place, VHA could be confident that NBN Co discretions will be exercised reasonably and that NBN Co would be held sufficiently accountable for its daily activities.

2.3 Proposed drafting for a section 152CBDA notice

To achieve this, VHA proposes that the ACCC should issue a section 152CBDA notice that directs NBN Co to make the following amendments to the SAU:

(a) NBN Co must include the following new clause 1.3 in the SAU:

> "**1.3 Requirement to act reasonably and consistently with Part XIC**
>
> When NBN Co exercises any rights and powers under this Special Access Undertaking or any Access Agreement based on an SFAA, NBN Co agrees that it will act:
>
> (a) reasonably; and
>
> (b) in a manner consistent with the objectives of Part XIC."

(b) NBN must include the following new clause 1H.5.2 in Schedule 1H of Module1 of the SAU to replace the existing clause 1H.5.2:

> "**1H.5.2 Dispute resolution objectives**
>
> NBN Co will resolve Disputes:
>
> (a) in accordance with the Dispute Management Rules, to the extent applicable; and
>
> (b) in a manner that ensures that NBN Co complies with its obligations under Part XIC; and
>
> (c) in compliance with any written directions given by the ACCC to NBN Co."

3. Product oversight

3.1 Regulatory environment and role of the SAU

On the whole VHA welcomes the Product Development Forum arrangements established by NBN Co. We strongly support commitments by NBN Co to collaborate with industry to develop the products we need for our customers. We do however wish to raise a concern about potential unintended consequences of the interplay between the SAU and the ACCC's declaration power.

In summary:

- The SAU is limited in scope to the NBN Access Service and the Ancillary Services. The acceptance of the SAU would have the effect of 'declaring' these services under Part XIC. Given the current construct of NBN Co documentation, NBN Co has given itself discretion not to supply other services.

- VHA's proposed greater role for the ACCC identified above would partly address VHA's concerns by enabling the ACCC to issue AD and BROC that require the SFAA to be amended so that new products can be supplied. However, service descriptions are included in Attachment A of the main SAU and hence endure for the 30 year term of the SAU. The service descriptions require connection at a UNI-D or UNI-V port in a standard Network Termination Device. This connectivity may not be appropriate for some products.

From VHA's perspective, this conclusion is acceptable as long as:

(a) the ACCC still retains the power to declare new products and hence to require NBN Co to supply other products; and

(b) NBN Co would be required to comply with any AD or BROC issued by the ACCC that set out the terms and conditions on which NBN Co supplied a mobile backhaul product.

However, it is here that VHA has very significant reservations regarding the potential application of the SAU. These same reservations also apply in respect of any wholesale products that NBN Co were to supply, or be capable of supplying, at any point over the next 30 years that do not constitute "NBN Access Services" or "Ancillary Services" as currently defined in the SAU:

- It is clear from section 152AL(8F), that the ACCC may declare a service in respect of an NBN Corporation even if the service is, to any extent, covered by an SAU.

- However, significant uncertainty is created by the wording of sections 152CBIA and 152CBIB of the CCA which respectively provide that AD and BROC have no effect to the extent to which they are inconsistent with an SAU that is in operation. The uncertainty is compounded by the manner in which the SAU is expressed to be in relation to the NBN Access Service, Ancillary Services and Facilities Access Services (so that only these services are declared), but then contains a series of rights and obligations in respect of any other service that NBN Co may develop or offer over time. For example, the definition of "Product" is defined to include "*any new or varied product components introduced by NBN Co pursuant to Schedule 1I (Product Development and Withdrawal) or Schedule 2E (Product Development and Withdrawal).*

- In theory, it may be possible for NBN Co to argue that any AD or BROC that related to an aspect of a declared service that was already covered by the SAU, or for that matter any "Product" supplied by NBN Co, would be inconsistent with the SAU and hence of no effect. Given the length, complexity and scope of the SAU, as well as NBN Co's ability to modify the SAU over time, the scope for such arguments to be made by NBN Co should not be underestimated.

In summary, VHA is therefore concerned that NBN Co could rely on the inconsistency provisions in sections 152CBIA and 152CBIB of the CCA to leverage the wording and broad scope of the SAU so as to deny the ACCC the ability to effectively regulate NBN Co in relation to services not declared by the SAU.

3.2 VHA's proposed solution

VHA believes that the solution to this issue identified is very simple.

The SAU should contain a statement that no provision of the SAU is to be interpreted or applied in a way that is inconsistent with any AD or BROC issued by the ACCC in respect of any new declared service. However, a carve-out from this provision should be included in respect of the services that are already declared via the SAU.

The practical effect of this provision would be to enable the ACCC to declare new wholesale services, from time to time, over the 30 year term of the SAU. The ACCC would also retain its powers to set AD and BROC that apply to those new wholesale services.

Services that NBN Co could offer in the future in respect of which the ACCC may consider declaration could include, for example:

(a) backhaul services (noting, for example, that the DTCS is currently declared for entities that are not NBN corporations); and

(b) point-to-multipoint services (noting that analogue subscription television broadcast carriage services were historically a declared service).

In the interests of competitive neutrality, the ACCC should seek to ensure that NBN Co is subject to the same service declarations as entities that are not NBN Co where those entities are potential competitors in the supply of wholesale services.

3.3 Proposed drafting for a section 152CBDA notice

To achieve this, VHA proposes that the ACCC should issue a section 152CBDA notice that directs NBN Co to make the following amendments to the SAU:

(a) NBN Co must include the following new clause 2.3 in the main body of the SAU:

> **"2.2 Application of the SAU to other declared services**
>
> (a) Subject to clause 2.2(b), no provision of this Special Access Undertaking is to be interpreted or applied in a way that is inconsistent with any access determination or binding rule of conduct that is made by the ACCC in relation to any service declared by the ACCC pursuant to section 152AL(8) of the Competition and Consumer Act 2010 (Cth).
>
> (b) Clause 2.2(a) has no effect where the declared service is a service specified in Attachment A (Service Descriptions) to this Special Access Undertaking."

4. NBN Co pricing should be subject to regulatory oversight

4.1 Key requirements

In our previous submission, VHA noted that NBN Co had too much discretion to set pricing within its Long-Term Revenue Constraint in a non-transparent manner, creating a risk that it may set pricing to promote its own commercial interests. NBN Co had the ability to offer very low prices in contestable markets, and price very high in non-contestable markets, in circumstances well beyond those necessary to achieve a uniform national price.

NBN Co's significant pricing discretion could be exercised in a manner contrary to the LTIE. Accordingly, VHA argued that there was a need to include mechanisms in the SAU to prevent NBN Co exercising its discretion in a manner inconsistent with Part XIC objectives.

VHA argued that one way to achieve this result would be to provide for direct ACCC oversight of NBN Co pricing. However, VHA also considered that a more granular approach was also required that created the appropriate pricing incentives for NBN Co and provided greater long-term certainty to the industry. VHA proposed that pricing transparency should be increased and pricing principles should be applied. Such an approach would be more consistent with the approach in the electricity industry in which distribution network service providers must submit a pricing methodology for regulatory approval.

Under chapter 6A of the National Electricity Rules, for example, Transmission Network Service Providers must have in place an approved pricing methodology that allocates regulated revenue between categories of services and that determines the structure of prices that it may charge for each of the categories of services it provides. VHA argues that a similar approach should be adopted by NBN Co in its SAU.

Moreover, price discrimination and excessive pricing is not expressly prohibited in Australia, but rather relies on the application of sections 46 and 151AJ (2) of the CCA. These sections are much harder to apply in the absence of NBN Co vertical integration and are costly to enforce, even in the context of competition notices under Part XIB. Reliance on these sections alone is unlikely to provide effective regulatory constraints on NBN Co in relation to pricing matters if regulatory constraints are not included in the SAU.

Given these concerns, VHA proposed that NBN Co should include a *pricing methodology commitment* in the SAU for those markets in which NBN Co had substantial market power:

4.2 NBN Co's response to those concerns

In response to such concerns, NBN Co has now included a mechanism for greater pricing transparency and some key principles for the setting of prices, including the following elements:

- NBN Co will create Reference Offers for key all product elements required for the basic access offers. All other product elements are subject to Non-Reference Offers.

- Initial pricing has been included for all of the Reference Offers and a range of Non-Reference Offers. The initial pricing is capped for a 5 year period and that cap then increases on a CPI-1.5% basis for the remaining 30 year term of the SAU. The ACCC has no role in relation to that pricing.

- Where initial pricing is not specified in the SAU for Non-Reference Offers, that initial pricing will be determined with regard to initial pricing principles and will be subject to transparency via the publication of a pricing rationale statement and ACCC oversight. That pricing is then subject to the CPI-1.5% cap. The ACCC has no role in relation to the approval of that pricing.

- If the initial prices are set at $0, NBN Co may later introduce a full charge subject to ACCC oversight and recourse. That pricing is then subject to the CPI-1.5% cap.

- Beyond the 10 years, NBN Co's pricing is subject to the Long Term Revenue Constraint Methodology as well as the CPI-1.5% cap.

- Various exceptions apply to the CPI-1.5% cap to allow for price promotions and prices set on the basis of labour and materials.

4.3 Deficiencies in NBN Co's response

NBN Co's proposed solution partly addresses some of VHA's previous concerns. The new price commitments and the CPI-X caps are a welcome addition. However, the following concerns still remain:

- The current proposed pricing methodology for new products remains relatively weak and general in nature. NBN Co continues to maintain significant pricing discretion in an environment where it will hold *de facto* monopoly pricing power. The pricing methodology commitments do not provide a meaningful constraint on that pricing power.

- NBN Co is taking an unnecessarily broad interpretation of its obligations to achieve a uniform national wholesale price for the basic access service. There is also no restraint on price discrimination.

- The ACCC's role in the scrutiny of NBN Co pricing is constrained to the enforcement of the SAU. However, the obligations imposed on NBN Co by the SAU are vague and still allow significant discretion. As a result, there is limited opportunity for appropriate oversight.

- There is no ACCC oversight in the setting of initial prices and their effects on competition. Currently the SAU offers a procedural role for the ACCC with no ability for a merits based assessment. This is not a sustainable solution. Rather than avoiding regulatory disputes it would virtually guarantee it as there would be no objective mechanism to resolve disputes.

- The pricing of CVC is only subject to a review commitment, not a commitment to decrease charges.

- The 'X' factor in the CPI-X formula is fixed at 1.5% and there is no scope for periodic review. In industries where CPI-X price caps are applied, it is standard practice to undertake periodic reviews of the 'X' factor, typically every 3-5 years.

4.4 VHA's proposed solution

VHA believes that a number of adjustments are required in the existing drafting of the SAU to address VHA's concerns as identified above.

- First, the pricing principles for the determination of pricing need to be strengthened with regard to meaningful criteria, more consistent with the CCA criteria.

- Second, the SAU should not carve out initial product pricing from substantive regulatory oversight. We are quite comfortable for the SAU to proscribe the way the ACCC can assess pricing (e.g. provided the principles are improved it could be the same criteria that NBN Co is required to follow) but it must be able to play a role of assessing whether pricing is in the long term interests of end users.

- Third, pricing commitments should not continue beyond the term of Module 1 and be open to review in each Replacement Module. This provides NBN Co and industry with certainty and allows appropriate levels of flexibility.

- Fourth, NBN Co should be required to comply with ACCC directions to rebalance its prices if the ACCC considers that the current pricing is having a material adverse competitive effect in any market. When rebalancing prices, NBN Co should be permitted to exceed the CPI-1.5% cap if requested by the ACCC.

VHA believes that revisions ensure that NBN Co remains accountable to the ACCC for its pricing, yet also maintains the existing disciplines imposed on NBN Co by the new SAU.

4.5 Proposed drafting for a section 152CBDA notice

To achieve this, VHA suggests a range of adjustments to the SAU that removes a number of restrictions on the ACCC's ability to undertake reviews the NBN Co submits Replacement Modules. In other words, pricing commitments, principles and pricing and so on should not reside Module 2 but be open to assessment in the Replacement Module process. This restructure of the SAU would be VHA's preferred approach.

Alternatively, VHA proposes that the ACCC should issue a section 152CBDA notice that directs NBN Co to make the following amendments to the SAU:

(a) NBN Co should include the following new clause 4A in the main body of the SAU:

4A Regulatory oversight of NBN Co pricing

(a) NBN Co must comply with any written directions provided to it by the ACCC from time to time regarding the level of that 'X' factor used in the CPI-X pricing formula for the Individual Price Increase Limits set out in the Modules, provided that the ACCC does not require any 'X' factor to be amended more than once in any consecutive 3 year period. To avoid doubt, the initial 'X' factor is:

(i) the figure of 1.5% specified in clause 1C.4.1(b)(ii) of Schedule 1C of Module 1 for the Individual Price Increase Limit for a Reference Offer;

(ii) the figure of 1.5% specified in clause 1D.4.1(b)(ii) of Schedule 1D of Module 1 for the Individual Price Increase Limit of a Non-Reference Offer or Other Change; and

(iii) the figure of 1.5% specified in clause 2C.2.1(b)(ii) of Schedule 2C of Module 2 for the Individual Price Increase Limit.

(b) NBN Co must comply with any written directions provided to it by the ACCC from time to time that require:

(i) NBN Co to rebalance (via any combination of increases and/or decreases specified by the ACCC) any set of Prices, if the ACCC has reason to believe that the relative Prices are substantially lessening competition in any market; or

(ii) NBN Co to amend any Price, if the ACCC has reason to believe that the price level set by NBN Co is substantially lessening competition in any market; or

(iii) reduce the Maximum Regulated Price of the Connectivity Virtual Circuit Offer (TC-4) under clause 1C.4.2 of Schedule 1C of Module 1, if the ACCC has reason to believe that the Maximum Regulated Price set by NBN Co is substantially lessening Competition in any market.

(c) NBN Co is not required to comply with any written directions provided to it by the ACCC under clauses 4A(a), (b) or (c) to the extent that such directions would cause NBN Co to:

(i) contravene any provision of this Special Access Undertaking; or

(ii) prevent NBN Co from achieving uniform national wholesale pricing.

These requirements are not onerous and would not result in high levels of disputation. In many ways They would reflect existing obligations under Part IXB but would be able to be more effectively applied.