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16 June 2010

Mr Stephen Palethorpe
Committee Secretary
Senate Select Committee on the National Broadband Network
PO Box 6100
Parliament House
Canberra ACT 2600

By email: broadband.sen@aph.gov.au

Dear Mr Palethorpe

Questions on Notice from the ACCC's 4 June 2010 appearance

Please find attached responses to the questions taken on notice by the Australian Competition and Consumer Commission at its 4 June 2010 appearance before the Senate Select Committee on the National Broadband Network.

I can be contacted on _____ should you wish to discuss.

Yours sincerely

Brian Cassidy
Chief Executive Officer

Senate Select Committee on the National Broadband Network

ANSWERS TO QUESTIONS ON NOTICE

Australian Competition and Consumer Commission

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Question 1 (Hansard Ref: NBN 39–40)

CHAIR—... I understand one of the submitters to our inquiry [**Dr Ross Kelso, Submission 137ii**] has alerted us to the issue of the Intra Government Communications Network, which is acronymed as ICON. Has the commission given any thought to what might happen if ICON, which is the government internal communications network, were rolled into NBN—whether it forms part of the NBN or whether ICON might remain separate? I appreciate these are not decisions for you to make, but I just wonder whether that has come across your radar at all and, if it has not, could I perhaps ask you on notice to give some thought to whether that would have any impact on any of the policies that you administer on behalf of Australia.

Mr Riordan—No, it has not arisen and, yes, we will take it on notice.

...

CHAIR—I think, as I say, someone alerted us to that and I have not really focused on it. I understand the government has its own fibre network and one wonders what might happen with that going forward with NBN and whether it then raises issues.

Mr Pearson—We would take that on notice. I have had nothing to do with it at all; it has not crossed my desk at all.

Answer:

If ICON was to be rolled into the NBN, any impact would depend on the detail of any such arrangement. In the absence of any detail of an arrangement between NBN Co and ICON, the ACCC would be speculating as to the impact (if any) the arrangement would have on the legislation administered by the ACCC.

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Question 2 (Hansard Ref: NBN 44–45)

Topic: NBN Co's Access Undertaking

CHAIR—Do you feel you can tell us about that or do you feel that you are bound by some confidentiality?

Mr Riordan—Maybe we could take it on notice and I could check that with NBN Co. to see if they would be happy for us to—

CHAIR—You might say to NBN Co. too that I will be checking what they said at estimates, because my recollection is that less than two weeks ago at estimates—and I might be wrong—they really did not know how long this was going to last. So, if they have written to you, I would be interested in the date of their letter and would be assured that NBN Co. would not have deliberately misled the Senate. But I had better check my facts before I make comments like that.

Answer:

The ACCC sought NBN Co's consent to the ACCC providing the committee with the further information it held on NBN Co Tasmania's initial pricing arrangements.

NBN Co has advised the ACCC that it does not consent to this information being provided, noting its belief that it is prevented by non-disclosure agreements from revealing any further detail regarding its current Tasmanian pricing, beyond what Mike Quigley has already outlined during Senate Estimates.

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Question 3 (Hansard Ref: NBN 46–47)

Senator FISHER—Is the ACCC concerned that, if the government’s financing is based upon a rate of return—basically the bond rate or thereabouts—that will give NBN Co. an unfair competitive advantage in the marketplace?

Mr Riordan—I am not sure whether it does directly have that effect.

Senator FISHER—But it could?

Mr Riordan—Maybe we should take it on notice. I think there would be a lot of factors we would need to reach a view on before we could answer that question.

Mr Pearson—I think a one-liner to that might get us in trouble. It is a little more complex than that.

Senator FISHER—In answering that question, can you turn your mind to the differentials in terms of service and geography that feed into that.

Mr Pearson—Yes.

Answer:

The manner in which NBN Co is financed is a matter for NBN Co and the Government.

NBN Co’s financing arrangements could potentially have implications for competition in markets in which NBN Co operates, as well as downstream markets.

However, much more information regarding markets structures and likely dynamics would be required before any conclusions could be drawn on the likely effect that any such financing arrangements might have for competition.

It is not necessarily the case that access to funds at close to the bond rate would be ‘anti-competitive’, in accordance with the meaning given in the *Trade Practices Act 1974* (TPA).

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Question 4 (Hansard Ref: NBN 51)

Senator FISHER—How do you characterise your percentage of authorisation approvals as opposed to section 50 approvals? How do you describe that? I am trying to work out whether it would be unusual if you had to go the public interest route.

Mr Pearson—I do not know of one merger that has come in since I did one about 13 years ago. I would have to take that on notice. Section 50 authorisations are very rare. General authorisations are very common and authorisations around section 45 agreements or understandings are very common, but the actual merger is fairly uncommon. I could take that on notice, but I think the last one I worked on was Davids-QIW

Answer:

In response to an application for authorisation, the ACCC may 'authorise' businesses to engage in anti-competitive arrangements or conduct when it is satisfied that the public benefit from the arrangements or conduct outweighs any public detriment. Authorisation provides immunity from legal action under the TPA and there is a statutory timeframe of six months within which the ACCC must make its decision.

The types of anti-competitive conduct that may be authorised includes conduct that might constitute:

- a cartel provision
- an exclusionary provision (primary boycott)
- an anti-competitive agreement
- a secondary boycott
- exclusive dealing
- resale price maintenance.

It is also possible to apply for authorisation of mergers that might otherwise breach section 50 of the TPA, but are able to demonstrate that there are public benefits that outweigh the competitive detriment. Since the legislation was changed in January 2007, applications for merger authorisation must be made to the Australian Competition Tribunal. To date, there have been no merger authorisation applications made to the Tribunal. The last merger authorisation that was considered by the ACCC prior to the legislation change, related to the Little Company of Mary Health Care Ltd's acquisition of St Vincent's Hospital Launceston Ltd in 2005 (see <http://www.accc.gov.au/content/index.phtml/itemId/744767/fromItemId/401858>).

All other mergers that are reviewed by the ACCC are considered on the basis of whether the acquisition is likely to breach section 50 (that is, whether it is likely to result in a substantial lessening of competition in a market/s). The ACCC must take into account the non-exhaustive list of merger factors in subsection 50(3) of the TPA. There is both a statutory merger clearance system (since its introduction in January

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2007 there have been no applications received) and a non-statutory or informal merger clearance system (which is well recognised and utilised). The test applied is the same in each but they differ in terms of the level of immunity provided by each form of clearance, the timeframes for review and appeal rights.

The vast majority of mergers that potentially raise competition concerns will be reviewed by the ACCC under the informal merger clearance system. It is generally recognised that merger authorisation tend only to be contemplated when it is clear that a merger is likely to raise significant competition concerns and the merger parties claim that there are public benefits that outweigh these concerns. Merger authorisation is the only forum in which public benefits can be considered in a section 50 context.

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Question 5

NBN Co has indicated that it will submit an access undertaking to the ACCC within a few months time:

- a) Can the ACCC outline how many staff it has allocated to assess NBN's access undertaking?
- b) Does the ACCC have any further details as to when it may expect to receive NBN's access undertaking?
- c) Since the NBN undertaking is yet to be submitted, can the ACCC explain what the staff who are allocated to assess the NBN access undertaking are currently doing?
- d) What is the maximum time period the ACCC would allow the undertaking to apply for?
- e) In its decision on the G9 special access undertaking in 2007, the ACCC laid down some statements of principle as to how it would approach an undertaking for a national broadband network. Do those statements remain applicable?
- f) How long is it likely to take to assess the undertaking and to issue draft and final decisions?

Answer:

- a) The ACCC is funded for 27 full time positions in relation to the NBN and associated industry structure issues. There are currently 17 staff whose day-to-day work is to prepare for the access undertaking to be submitted by the NBN Co. and to prepare for any functions that might be allocated to the ACCC as a result of any new legislation that may come into effect – such as the Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2009 and the exposure drafts of the National Broadband Network Companies Bill 2010 and the Telecommunications Legislation Amendment (National Broadband Network Measures – Access Arrangements) Bill 2010.
- b) The current expectation is that NBN Co is likely to lodge a special access undertaking (SAU) with the ACCC during 2010.
- c) ACCC staff are currently engaging in pre-lodgement discussions with NBN Co about various aspects of its SAU. This interaction is within the usual course of business, and the ACCC has previously engaged with Telstra and the G9 in similar discussions.
- d) The TPA does not outline a maximum period for which an SAU may apply. Therefore the ACCC would need to assess whether a proposed time period for an SAU meets the reasonableness criteria in section 152AH of the TPA in the context of the terms and conditions proposed in the SAU.

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- e) The applicability of the principles outlined in the ACCC's draft decision on the G9 SAU, to an SAU submitted by NBN Co will depend on the precise content of the SAU proposed by NBN Co. Each SAU is likely to contain unique terms and conditions particular to the circumstances in which it is lodged and therefore the ACCC will assess each SAU on its own merits in accordance with the legislative criteria as set out in section 152CBD of the TPA.

- f) Under section 152CBC of the TPA, the ACCC has a six month statutory timeframe in which to make a decision to accept or reject an SAU. If the ACCC does not make a decision within this timeframe, under subsection 152CBC(5) of the TPA, the ACCC is taken to have made a decision to accept the undertaking.

For the purpose of calculating the six month timeframe, certain periods of time are disregarded. For example, section 152CBC(6) (b) of the TPA states the ACCC may disregard time in relation to requests for further information.

In addition, section 152CBC(7) of the TPA provides that the ACCC may, by written notice given to the carrier or carriage service provider, extend or further extend the six month period so long as the extension or further extension is for a period of not more than three months and a notice is issued explaining why the ACCC has been unable to make a decision on the undertaking within the legislative time period.

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Question 6

Under section 152AH of Part XIC of the Trade Practices Act, the ACCC will be required to have regard to NBN Co's direct costs of providing broadband services in assessing NBN's access undertaking:

- a) The ACCC has routinely used a total service long run incremental cost (TSLRIC) methodology to determine service costs in the telecommunications sector and a weighted average cost of capital in other capital intensive sectors. Does the ACCC accept that an internal rate of return is an appropriate methodology for assessing NBN Co's direct costs?
- b) Is the ACCC of the view that, were it to adopt an internal rate of return methodology, that it would satisfy its statutory obligations to assess NBN's direct costs under Part XIC?
- c) Would an internal rate of rate methodology appropriately account for NBN's direct costs, taking into account its debt and equity levels, risk profile, and market risk premium?
- d) Does the ACCC believe that a return of 6.3 per cent is likely to reflect NBN's Co's capital and debt costs given that the ACCC's own modelling assessed Telstra's post tax weighted average cost of capital at 8.83 per cent and the Australian Energy Regulator adopts a market risk premium of 6.5 per cent?
- e) The NBN Implementation Study clearly indicates that 6.3 per cent is an appropriate rate of return for NBN Co. Was the ACCC consulted on this rate of return?
- f) Is the ACCC concerned that the government's financing of NBN Co, based on a rate of return that is at best only marginally above the long term bond rate, will provide it with an unfair and potentially anti-competitive price advantage in some or all of its service and geographic markets?

Answer:

- a) Section 152AH(1) of the TPA requires the ACCC to assess the reasonableness of particular terms and conditions of an SAU having regard to, amongst other things, the direct costs of providing access to a declared service.

In calculating 'direct costs', the ACCC has in the past used a total service long run incremental cost (TSLRIC) methodology. This methodology requires the ACCC to look at a number of different costs, including the operating costs of providing the service, depreciation, and the weighted average cost of capital (WACC), i.e., required return on the capital invested.

Across all of the industries regulated by the ACCC and the Australian Energy Regulator (AER), the WACC is adopted to estimate the regulated firm's cost of capital. The internal rate of return of a project or a firm is a different concept to

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the regulatory WACC and is not a concept that has been accepted by the ACCC in making its regulatory decisions.

- b) The direct costs of providing access to a service is one of many criteria to which the ACCC must have regard in making regulatory decisions under Part XIC of the TPA. In the context of a return on capital, this particular criterion simply requires the ACCC to consider the risks of the access provider's investments and the actual financing arrangements that the access provider is subsequently able to secure. An internal rate of return (IRR) of a project or firm is a different concept as it focuses on the likely financial returns (the margin between expected costs and revenues) arising from investment, rather than the costs of financing it. Hence, considering only an IRR of the project would be unlikely to satisfy the direct cost criterion.
- c) As outlined in the response to question 6(b), an IRR methodology relates to the expected returns (the margin between expected costs and revenues) arising from investment, rather than the costs associated with financing a project.
- d) NBN Co's financing costs will depend upon the financial arrangements it secures.

In making regulatory decision under Part XIC of the TPA, the ACCC will assess what it considers would be a reasonable return for a business such as NBN Co, with NBN Co's actual financing arrangements likely to be an influential factor to inform that decision.

There are a number of variables that may affect what a reasonable regulated cost of capital for NBN Co may be — e.g. network design, the overarching regulatory pricing framework, the length of time over which costs are recovered, whether more costs are recovered early in the project's life or later, the proportion of funding which is subsidy and what proportion of costs are recovered from which users.

Similarly, as each business and sector is different, there is potential for NBN Co's WACC to differ from the rates of return that have been allowed for other regulated businesses. As NBN Co has not yet lodged an SAU, the ACCC does not yet have the information before it to comment on what a reasonable regulated cost of capital for NBN Co ultimately may be.

- e) The ACCC was not consulted by the Lead Advisor on the 6.3 per cent rate of return for NBN Co outlined in the Implementation Study.
- f) The manner in which NBN Co is financed is a matter for NBN Co and the Government.

NBN Co's financing arrangements could potentially have implications for competition in markets in which NBN Co operates, as well as downstream markets.

However, much more information regarding market structures and likely dynamics would be required before any conclusions could be drawn on the likely effect that any such financing arrangements might have for competition.

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It is not necessarily the case that access to funds at close the bond rate would be 'anti-competitive', in accordance with the meaning given in the TPA.

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Question 7

Under section 152AH of Part XIC of the Trade Practices Act, the ACCC will be required to have regard to NBN Co's economically efficient operation in assessing NBN's access undertaking:

- a) The NBN duplicates a large number of assets that already exist in the backhaul and fibre to the node networks of Telstra, Optus and Vodafone. Is the ACCC convinced that the duplication of fibre networks by NBN Co represents allocative, dynamic and productive efficiencies? [Note: all 3 components of efficiency are used by the ACCC, so need to stress the three components]
- b) Is the ACCC of the view that a government financed and run national telecommunications company is likely to promote efficient investment in broadband infrastructure?
- c) Does the ACCC believe that fibre to the node can deliver high speed broadband services comparable to the services of NBN?

Answer:

- a) The ACCC must be satisfied that the terms and conditions of any potential SAU lodged by NBN Co are reasonable. Economic efficiency (including allocative, dynamic and productive) is just one consideration the ACCC examines in assessing the reasonableness of an SAU under the TPA.

The ACCC notes that duplication can in some circumstances be efficient whilst in others it may be inefficient. On the one hand, the ACCC has previously expressed the view that duplicating a telecommunications access network – in that case a fibre to the node (FTTN) network – with a network of exactly the same functionality would likely be inefficient.

On the other hand, it could be efficient to build a wholesale-only fibre to the premises (FTTP) access network and backhaul network, in areas currently served by a vertically-integrated FTTN access network and backhaul network, as these networks will have different characteristics.

The ACCC does not currently have the information before it to determine where duplication of existing networks by NBN Co may occur and whether any such duplication would be efficient or inefficient, as no SAU providing this information has been lodged with the ACCC.

- b) In carrying out its regulatory functions under Part XIC of the TPA (i.e. conducting declaration inquiries and assessing undertakings and exemptions), the ACCC must consider, amongst other things, whether an infrastructure company promotes efficient investment in infrastructure for an access service supplied or likely to be supplied. Whether or not a national telecommunications company promotes efficient investment in broadband infrastructure does not depend on whether it is government or privately owned. As NBN Co has not yet lodged an SAU, the ACCC does not yet have the information before it to

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comment on whether NBN Co's operations are likely to promote efficient investment in broadband infrastructure.

- c) A fundamental difference between a fibre to the node (FTTN) network and a Fibre to the Premises (FTTP) network such as that proposed by NBN Co, is that FTTN networks continue to utilise copper lines (between the node and the premises), whilst in FTTP networks the fibre extends right out to individual premises. The continued use of copper lines places limitations on the ability of FTTN networks to provide high speed broadband services comparable to those able to be provided under a FTTP network.

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Question 8

In relation to unbundled services (unconditioned local loop service and line sharing service):

- a) Does the ACCC consider that unbundling has been a successful policy in fostering competition and innovation in the delivery of broadband services?
- b) What have been the consequences for price and innovation of unbundling?
- c) What is happening to the number of customers taking services provided by non-Telstra operators using unbundling?
- d) If the NBN becomes the monopoly infrastructure owner, will retailers be able to acquire unbundled services from NBN? What does the Implementation Study say about when, if ever, this might occur?
- e) Will there be a phase during which retailers are unable to deliver services based on unbundled inputs?
- f) What is this likely to mean for downstream competition during this phase?

Answer:

- a) The ACCC considers that unbundling in the form of the unconditioned local loop service (ULLS) regulation has contributed to fostering competition in the form of lower prices and innovation in telecommunication services by providing access seekers with greater control over their business and products.
- b) The ACCC's 2007–08 annual report on the change in telecommunications prices noted that the average prices for fixed-line telephone services have fallen by approximately 32% in real terms since 1997.¹ The ACCC considers that unbundling is likely to have contributed to this result by enabling access seekers to make efficient investment in DSL infrastructure and offer their own DSL services.

The ACCC considers that unbundling has also contributed to innovative and differentiated services to consumers. For example investments in DSL technology via unbundled lines have enabled access seekers to successfully launch innovative products, including naked DSL services.

That said, the 'competitive footprint' created by unbundling is restricted to metropolitan areas.

- c) The number of services supplied by means of unbundled access is increasing. For instance, in 2008-09 the take up of ULLS lines grew by 33 per cent.
- d) The Implementation Study recommends that NBN Co be required to deploy fibre topologies that support the ongoing needs of multiple stakeholders, including service providers who may seek access to layer 1 services, anticipating the

¹ ACCC, *Changes in the prices paid for telecommunications services in Australia 2007-08*, June 2009 p. 101

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likelihood of future unbundling requirements.² The Implementation Study concludes that a home-run topology should be preferred over a shared topology, for a reasonable cost premium, as it will be resilient to future developments in technology and demand (including fully enabling physical unbundling).³

The Implementation Study recommends that the Government not require NBN Co to unbundle layer 1 services before network roll out is almost complete.⁴

Whether retailers will be able to acquire unbundled services from NBN Co in the future, will be contingent upon the network design decisions NBN Co makes.

- e) There may be a phase during which retailers may be unable to deliver services on unbundled inputs if the legacy copper network is decommissioned and NBN services are not then unbundled.
- f) As a wholesale-only service provider, NBN Co will not have an incentive to discriminate between downstream retail service providers (RSPs). Further, NBN Co's network will be able to support the full range of services previously supported on unbundled copper loops. So long as NBN Co offers all RSPs access to its wholesale services on a non-discriminatory and equivalent basis, then competition in downstream retail markets should not be adversely affected.

² Lead advisor (McKinsey & Company and KPMG), *Implementation Study for the National Broadband Network*, 5 March 2010 p 462: Recommendation 71

³ Lead advisor (McKinsey & Company and KPMG), *Implementation Study for the National Broadband Network*, 5 March 2010 p 187

⁴ Lead advisor (McKinsey & Company and KPMG), *Implementation Study for the National Broadband Network*, 5 March 2010 p 472: Recommendation 75