

## Regulation Impact Statement

### Entities to which NBN Co's wholesale-only obligations apply

#### 1. Issues which give rise to the need for action

On 24 February 2010, the Government released exposure drafts of the National Broadband Network Companies Bill 2010 (NBN Co Bill) for public comment. This draft legislation defined an NBN corporation to mean:

- (a) NBN Co; or
- (b) NBN Tasmania; or
- (c) a company that is a wholly-owned subsidiary of NBN Co.

A number of stakeholders objected to this definition, stating that NBN Co could purchase a controlling stake in a retail provider and use that provider to offer retail services, thereby avoiding its obligations<sup>1</sup>. There is also nothing to prevent NBN Co from establishing a subsidiary and then selling a small share in that company to another carrier or service provider.

In its submission to the Department, Telstra commented that NBN Co could own 99.9% of a retail provider and that:

“NBN Co could, consistently with the Bill, be little more than a holding company which majority owns and controls one or more vertically integrated retail providers. This outcome appears directly contrary to the Government's separation objectives.”

The definition in the draft bill was proposed to give NBN Co the flexibility to invest in and divest itself of assets, flexibility considered especially important during the roll-out of the NBN. For example, it is possible that NBN Co may wish to purchase a retail provider because it could use the physical assets of that provider (such as fibre, ducts, buildings or other network equipment) to expedite the roll-out of the NBN. As the Government had stated that it intended to retain majority ownership of NBN Co until roll-out is complete (therefore having full oversight of the company's operations), it was considered that a more restrictive definition of an NBN corporation was unnecessary. The explanatory material to the draft bill noted that the Government could use its power as shareholder to require NBN Co to seek its approval for any acquisitions.

The draft bill also relied on existing legislation to ensure that any acquisition in or divestment by NBN Co would not allow the company to avoid its obligations. Section 50 of the *Trade Practices Act 1974* (TPA) prohibits mergers that would have the effect, or be likely to have the effect, of substantially lessening competition in a market. Merger parties are not legally required to notify the ACCC of a merger and

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<sup>1</sup> NBN Co is required to offer wholesale-only services on open and equivalent terms to all access seekers. This requirement is set out in the draft NBN legislation.

merger parties can proceed without seeking regulatory consideration. Merger parties have three avenues available to have a merger considered and assessed:

- the ACCC assesses the merger on an informal basis;
- the ACCC assesses an application for formal clearance of a merger; and
- the Australian Competition Tribunal assesses an application for authorisation of a merger.

The ACCC grants formal or informal clearance if it forms the view that a merger would not substantially lessen competition in a market.

If the ACCC does not grant formal or informal clearance, parties can still proceed with the merger, but may face court action under s. 50.

The Australian Competition Tribunal may grant authorisation if it is satisfied that the proposed merger is likely to result in such a benefit to the public that the merger should proceed.

If NBN Co were to acquire shares in the capital of a corporation, and similarly if a third party were to acquire shares in NBN Co, the ACCC can provide formal clearance for such a transaction. In making its decision the ACCC is required to consider a number of criteria, including “the nature and extent of vertical integration in the market”. Consequently, the ACCC could scrutinise share transactions to ensure that NBN Co’s wholesale-only status is maintained. However, under section 50 the ACCC is not required to address NBN Co’s non-discrimination and transparency obligations, which are proposed to be established under the draft Telecommunications Legislation Amendment (National Broadband Network Measures – Access Arrangements) Bill 2010 (NBN Access Bill).

The non-discrimination obligation prohibits discrimination between access seekers, with the exception of limited circumstances (discrimination is permitted in relation to creditworthiness, if it aids efficiency and all access seekers with like circumstances have an equal opportunity to benefit; or in grounds or circumstances specified in a legislative instrument made by the ACCC). The transparency obligation requires NBN Co not to offer a service unless it has published all its terms and conditions for that service on its website, and also requires NBN Co to publish a detailed summary of any changes it makes to its standard terms (for example, because the different terms could aid efficiency). The transparency obligation ensures that access seekers at all times know what NBN Co’s service offers are and what the standard terms and conditions are, and whether they have an opportunity to receive different terms and conditions that have been supplied to another access seeker.

The issue examined in this Regulation Impact Statement (RIS) is whether NBN Co should be permitted to invest in corporations and divest itself of shares in subsidiaries, and if so, what measures should be in place (if any) to ensure it meets its wholesale-only obligations.

### ***Background***

On 7 April 2009, the Government announced its plan to establish a new company to build and operate the National Broadband Network, NBN Co, in part to address long-standing competition issues in the telecommunications market, brought about by the dominance of the vertically and horizontally integrated incumbent, Telstra. It is the Government's intention that NBN Co offer wholesale-only services on open and equivalent terms to all access seekers.

The NBN Co Bill forms part of a package of legislation designed to reform the telecommunications access regime. This package includes the NBN Access Bill and the Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2009 (CCS Bill).

On 6 May 2010, the Government released the NBN Implementation Study. The Implementation Study does not address the issue of NBN Co's acquisition of, or sale of shares in, a subsidiary company, but it does recommend that the Government retain full ownership of NBN Co until the NBN roll-out is complete (Rec.58). The Implementation Study also recommends that NBN Co be prohibited from investing in retail telecommunications providers and content service providers, subject to special transitional ownership provisions to permit the acquisition of assets (Rec.69). The Implementation Study also recommends that ownership caps of 15 per cent in relation to shareholdings in NBN Co, subsidiaries of NBN Co or any company resulting from structural separation of NBN Co should be introduced once the Commonwealth begins to sell down its stake in the Company – subject to practical control tests (Rec.83).

## **2. Objective**

The Government's objective is to ensure that:

1. NBN Co has the flexibility to invest in and divest itself of assets as necessary, especially to facilitate the cost-effective roll-out of the NBN;
2. NBN Co's wholesale-only and other obligations are effectively applied, especially after the Government sells down its stake in the company; and
3. Regulatory arrangements for NBN Co are simple and efficient, and stakeholders also have certainty how the regulatory arrangements will apply.

## **3. Options (regulatory and/or non-regulatory) that may constitute viable means for achieving the desired objective(s)**

Five alternative options (regulatory and non-regulatory) have been identified to address the Government's objectives. All could in practice meet the Government's objective, although with variable degrees of effectiveness. These are:

- A. Do nothing – rely on existing Commonwealth shareholder powers and ACCC oversight.

- B. Limited regulation – require the ACCC to grant formal clearance of all acquisitions/divestments involving NBN Co and to consider NBN Co’s non-discrimination and transparency obligations.
- C. Quasi-regulation - include a requirement in NBN Co’s constitution for NBN Co to seek approval from its shareholders before investing in a retail provider or selling any shares in a subsidiary.
- D. Regulation - Broadening the current bill – include a definition of an NBN corporation to be a company in which NBN Co holds a controlling stake.
- E. Legislated prohibition - prohibit NBN Co from investing in a retail provider, except for the purpose of acquiring its assets.

For the purpose of clarity, it should be noted that all suggested options, apart from Option A (‘do nothing’), would be applied in addition to regulation which is existing or already proposed; they are not proposed to operate instead of existing or already proposed measures. Furthermore, Options B and C could be combined.

*Option A - Do nothing – rely on existing Commonwealth shareholder powers and ACCC oversight.*

Under Option A, there would be no legislative or regulatory change. NBN Co would be able to invest in and divest itself of assets, unless the transaction breached section 50 of the TPA.

*Option B - Limited regulation – require the ACCC to grant formal clearance of all acquisitions/divestments involving NBN Co and to consider NBN Co’s non-discrimination and transparency obligations during the clearance process.*

Option B would build on Option A, so that, through an amendment to the TPA, the ACCC would be required to grant formal clearance of all mergers and acquisitions involving NBN Co, and in doing so, would also need to take into account the impact of the transaction on NBN Co’s ability to meet its non-discrimination and transparency obligations. In other words, the ACCC would be required to grant formal clearance of a transaction through which NBN Co acquires a share in a corporation, or a corporation acquires a share in NBN Co, or purchases of assets by NBN Co. Furthermore, the ACCC would, in addition to the existing criteria under section 50 of the TPA, also need to take into consideration whether NBN Co’s non-discrimination and transparency obligations would be affected by a proposed transaction. These obligations were described in section 1.

*Option C –Quasi-regulation - include a requirement in NBN Co’s constitution for NBN Co to seek approval from its shareholders before investing in a retail provider or selling any shares in a subsidiary.*

Under Option C, NBN Co would be required to seek approval from its shareholders prior to investing in a retail provider or selling any shares in a subsidiary. This mechanism would ensure that, while the Commonwealth owned NBN Co, any

transaction is considered by the shareholder Ministers prior to it taking place to allow shareholder Ministers to determine if the transaction was acceptable.

Under the *Competition Principles Agreement 1995*, the Commonwealth must conduct a review prior to privatising a public monopoly. Such a review could assess whether this measure would be likely to guarantee NBN Co would meet the Commonwealth's objectives regarding retail ownership by NBN Co once the Commonwealth lost control of the company. If the measure was considered ineffective, the review could make further recommendations at that time.

*Option D – Regulation - Broadening the current bill – include a definition of an NBN corporation to be a company in which NBN Co holds a controlling stake.*

Under Option D, the definition of an NBN corporation would be broadened to include a company controlled by an NBN corporation. The provision would define 'control' in accordance with the CCS Bill (i.e., if NBN Co has 15 per cent or more of a company, or there are other informal controls on the company's Board, then NBN Co is considered to control it), to ensure consistency within telecommunications regulations.

If a company is defined as being controlled by NBN Co, and thus considered to be an NBN corporation, legislation would need to include appropriate transitional period arrangements to allow that company's Board to adjust to its new obligations. Otherwise, there is a risk that the company's status could be changed without the shareholders being given an opportunity to adjust.

*Option E – Legislated prohibition - prohibit NBN Co from investing in a retail provider, but provide a statutory power to the ACCC to grant formal clearance of a purchase by NBN Co of a retail provider on condition that it is solely for the purpose of acquiring that retail provider's physical assets. NBN Co would also be prohibited from selling any shares in a subsidiary company unless cleared by the ACCC.*

Under this option, NBN Co could not buy a single share in a carrier or service provider, but could, if it wanted to purchase a company for the purpose of acquiring its physical assets, seek formal clearance from the ACCC under a new mechanism inserted into the TPA, to purchase the company outright. As part of this process, NBN Co may need to submit undertakings to the ACCC to divest any retail operations. NBN Co would likewise be prohibited from selling any shares in a subsidiary company in the absence of clearance by the ACCC. The amendments to the TPA would also require the ACCC to consider, under the clearance process, the effects of any transaction on NBN Co's non-discrimination and transparency obligations.

#### **4. Impact assessment**

This section discusses the advantages and disadvantages of the five options identified above in terms of the objectives discussed in section 2 and their impact on stakeholders, namely:

- NBN Co as the access provider;

- customers of NBN Co;
- competitors of NBN Co; and
- consumers as ultimate users and beneficiaries of telecommunications services.

*Privatisation:*

In considering the advantages and disadvantages of the options identified in section 3, it is important to note the different motivations that are likely to drive NBN Co Board decisions:

1. when it is controlled by the Commonwealth; and
2. when it is no longer controlled by the Commonwealth.

While NBN Co is still Commonwealth-owned, the risk of the company becoming vertically integrated or otherwise forming relationships with entities that may give rise to conflicts, and thereby recreating the problems that the telecommunications reform legislation is designed to address, is considered to be minimal. However, once the Commonwealth begins to sell down its stake in NBN Co, it will have less power to control NBN Co and there will be greater opportunity for such relationships to develop.

The following criteria are considered in analysing the five options provided in section 3:

- Action required (intrusive versus non-intrusive action)
- NBN Co's flexibility to invest in and divest itself of assets
- Effective application of NBN Co's obligations
- Cost to the tax payer
- Likely industry perception

The merits of each option against the identified criteria are presented in the table below.

<b>Option</b>	<b>Action required</b>	<b>Retains existing flexibility for acquisitions in and divestment by NBN Co?</b>	<b>Effective application of NBN Co's obligations?</b>	<b>Represents value for money to the tax payer?</b>	<b>Likely industry perception</b>
(A) Rely on existing Commonwealth shareholder powers and ACCC oversight.	None	Yes.	<p>Partial.</p> <p>Companies can seek clearance from the ACCC for acquisitions of shares in another company or its assets.</p> <p>Under section 50 of the TPA, the ACCC can grant formal clearance of an acquisition if it does not substantially lessen competition. However, in an acquisition involving NBN Co the ACCC is not required to consider NBN Co's non-discrimination and transparency obligations and therefore this option would not guarantee NBN Co remains a wholesale only business.</p>	May allow NBN Co to purchase retail providers to reduce the overall cost of the NBN build. There remains a risk that a fundamental goal of the NBN policy and the Commonwealth's significant investment (non-conflicted, open and equivalent access) may be compromised.	Access seekers may consider that this option permits NBN Co to avoid its obligations and enter retail markets. Industry has indicated that it would like more action to be taken, to prevent NBN Co avoiding its obligations. Clarifying that section 50 of the TPA applies to NBN Co may allay some concerns.

Option	Action required	Retains existing flexibility for acquisitions in and divestment by NBN Co?	Effective application of NBN Co's obligations?	Represents value for money to the tax payer?	Likely industry perception
			This approach would need to be reviewed prior to the Commonwealth selling down its stake in NBN Co.		
(B) Require the ACCC to grant formal clearance of all acquisitions and divestments involving NBN Co and to consider NBN Co's non-discrimination and transparency obligations as part of the clearance process.	Regulation (limited amendment)	Yes, but subject to a new stricter process.	<p>Partial.</p> <p>Option B would extend the safeguards in Option A, by requiring the ACCC to grant formal clearance of all transactions involving NBN Co, including consideration of whether any such transaction compromises NBN Co's non-discrimination and transparency obligations.</p> <p>The ACCC could still, however, grant formal</p>	<p>Allows NBN Co to purchase retail providers to reduce the overall cost of the NBN build (provided the transaction is cleared by the ACCC).</p> <p>More numerous and wide ranging ACCC processes could be required at a cost to the Commonwealth.</p>	Likely to go some way to allaying industry concerns that NBN Co may be able to avoid its obligations.



Option	Action required	Retains existing flexibility for acquisitions in and divestment by NBN Co?	Effective application of NBN Co's obligations?	Represents value for money to the tax payer?	Likely industry perception
			clearance of a transaction, that placed NBN Co in control of another entity, with a risk that NBN Co could, in the long term, use that entity to circumvent its obligations.	<p>To the extent that the ACCC's costs are increased, these would be recovered from industry through carrier licence fees, and therefore ultimately passed on to end-users.</p> <p>There remains a risk that a fundamental goal of the NBN policy and the Commonwealth's significant investment (non-conflicted, open and equivalent access) may be compromised.</p>	
(C) Include a	Quasi-	No. Shareholder	Partial	Allows NBN Co to	Approach likely to be

<b>Option</b>	<b>Action required</b>	<b>Retains existing flexibility for acquisitions in and divestment by NBN Co?</b>	<b>Effective application of NBN Co's obligations?</b>	<b>Represents value for money to the tax payer?</b>	<b>Likely industry perception</b>
<p>requirement in NBN Co's constitution for NBN Co to seek approval from its shareholders before investing in a retail provider or selling any shares in a subsidiary.</p>	<p>regulation</p>	<p>Ministers would assume responsibility for determining if an acquisition or disposal should take place, rather than the Board.</p> <p>Removes flexibility from NBN Co and introduces additional (new) role for shareholder Ministers.</p>	<p>This option requires NBN Co to seek approval from shareholders prior to acquiring shares in a retail provider or selling shares in a subsidiary.</p> <p>This option would become ineffective as the Commonwealth sells down its shares, and possibly on a change in Shareholder Ministers (as shareholders have the power to change the company's Constitution)</p> <p>The effectiveness of this mechanism depends on the judgment of shareholders.</p>	<p>purchase retail providers to reduce the overall cost of the NBN build (provided it is not disallowed by Shareholder Ministers or the ACCC).</p> <p>Additional processes would be required within Government, meaning there would be a related cost to the Commonwealth. These costs are impossible to quantify, but would involve increased resourcing required to consider all NBN Co's</p>	<p>seen as lacking transparency by industry, and also ineffective on privatisation (therefore, requiring some other mechanism).</p> <p>May provide an effective transition mechanism, until Option D is implemented.</p>

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				<p>transactions and provide advice (including legal and economic advice).</p> <p>Delays arising from the approval process could lead to NBN Co incurring increased costs, which would be passed on to access seekers and ultimately to end-users.</p>	
(D) Include, in the NBN Co Bill, a definition of an NBN corporation as a company in which NBN Co holds a controlling stake	Regulation (broadening the current bill).	Partial. NBN Co can invest and divest but any company that will be deemed as "controlled" by NBN Co is subject	Largely.  Option D would apply to ownership scenarios in which NBN Co invests in retailers, or sells shares in its subsidiaries to other	Allows NBN Co to purchase retail providers to reduce the overall cost of the NBN build.  Does not add to	Industry is likely to welcome this option as it ties NBN Co more stringently to its obligations by ensuring entities that NBN Co controls are

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		<p>to the NBN obligations. Any companies in which NBN Co has a non-controlling interest would not be covered by NBN Co obligations.</p>	<p>carriers or service providers. It would also cover joint ventures between NBN Co and another carrier or service provider. Under the draft NBN Companies Bill, NBN Co's obligations only flow through to wholly-owned subsidiaries of NBN Co. Industry commented that NBN Co could sell shares in a subsidiary to another carrier, thereby allowing that subsidiary to avoid the NBN Co obligations.</p> <p>Option D ensures that corporations that are controlled by NBN Co are subject to NBN Co's obligations.</p> <p>These are entities in which</p>	<p>existing regulatory authorisation mechanisms and is efficient, and therefore would not add to costs for NBN Co, access seekers or end-users.</p> <p>Provides a strong mechanism to deliver a fundamental goal of the NBN policy and the Commonwealth's significant investment (non-conflicted, open and equivalent access).</p>	<p>subject to NBN co's wider objectives.</p> <p>Transactions that resulted in NBN Co not having a controlling interest could also be monitored by Shareholder Ministers if necessary.</p>

Option	Action required	Retains existing flexibility for acquisitions in and divestment by NBN Co?	Effective application of NBN Co's obligations?	Represents value for money to the tax payer?	Likely industry perception
			<p>NBN Co is in a position to ensure its wider obligations can be applied. NBN Co would not be in a position to ensure its wider obligations are met by an entity it did not control.</p> <p>Option D provides a strong incentive to NBN Co to divest itself of any retail assets as soon as possible. Once NBN Co controlled a retail provider, if that provider continued to supply retail services NBN Co would be in breach of its obligations and subject to penalties for breach of its carrier licence conditions. A carrier is required to comply with conditions of a licence (section 68 of the <i>Telecommunications Act</i>)</p>		

Option	Action required	Retains existing flexibility for acquisitions in and divestment by NBN Co?	Effective application of NBN Co's obligations?	Represents value for money to the tax payer?	Likely industry perception
			<p>1997 [TA]) and breach of this requirement constitutes a breach of a civil penalty provision. The pecuniary penalties for breach of civil penalty provisions are further set out in Part 31 of the TA and set a maximum pecuniary penalty on a body corporate of \$10 million for each contravention. Consequently, to avoid this, NBN Co is likely to structure any acquisitions so that retail activities are ring-fenced and divested before NBN Co purchases a controlling stake.</p>		
(E) Prohibit NBN Co from investing in a retail	Regulation (legislated	Limited. NBN Co would generally	Yes. Option E would generally prevent NBN Co	NBN Co would have limited ability	This option was suggested by some

<b>Option</b>	<b>Action required</b>	<b>Retains existing flexibility for acquisitions in and divestment by NBN Co?</b>	<b>Effective application of NBN Co's obligations?</b>	<b>Represents value for money to the tax payer?</b>	<b>Likely industry perception</b>
<p>provider except for the purpose of acquiring a retail provider for the purpose of acquiring its assets, or selling any shares. Include a new process for clearance of potential acquisitions and divestments by the ACCC.</p>	<p>prohibition)</p>	<p>not be able to invest in retailers and other carriers or service providers or divest without direct clearance from the ACCC. This would limit NBN Co's flexibility to make purchases in a commercial market.</p>	<p>having an interest in another entity, thereby limiting situations in which it could breach its obligations or be subject to a conflict of interest. Any transactions would be subject to strict ACCC oversight.</p>	<p>to purchase stakes in other companies, thus limiting this option as a means of rolling out its network in a cost effective manner.</p> <p>Option E adds a layer of complexity and uncertainty as the ACCC could be required to consider an acquisition anyway under section 50. If a dual regulatory process was put in place, this would add to regulatory costs for the ACCC and create delays for NBN Co in being able to roll-out the NBN. To</p>	<p>stakeholders. However, it would also limit NBN Co's ability to engage with industry players interested in transactions.</p>

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				the extent that these delays create costs, these would be passed on to industry and end-users.	



## **5. Consultation**

The Government announced on 7 April 2009 that it would introduce legislation covering NBN Co's governance and access arrangements. On 3 July, the Minister invited submissions on the National Broadband Network's legislative framework and by 30 July, more than 30 submissions had been received.

These submissions were used to inform the Government's approach to the NBN legislation and on 24 February 2010 the Minister issued exposure drafts of the National Broadband Network Companies Bill 2010 and the Telecommunications Legislation Amendment (National Broadband Network Measures – Access Arrangements) Bill 2010.

Submissions in response to the exposure drafts closed on 15 March 2010 and more than 20 submissions were received.

On 6 May 2010, the Government called for submissions on the NBN Implementation Study. More than 50 submissions were received.

Industry response is largely in favour of prohibiting NBN Co from any investment in retail service providers, believing it to be inconsistent with the Government's stated objectives for NBN Co.

Some stakeholders conceded that NBN Co's investment in retail providers may be necessary, but wanted strict ring-fencing provisions to apply during a set divestment period.

The Competitive Carriers Coalition (CCC) was the only stakeholder to acknowledge the ACCC's existing powers under section 50 of the TPA. However, it did not consider these powers to be sufficient. The CCC called for strict ring-fencing measures to be introduced, along with an obligation for the ACCC to consider all of NBN Co's proposed acquisitions of retail providers - including whether an acquisition will adversely impact on NBN Co's obligations.

## **6. Conclusion**

Option A would deliver NBN Co the flexibility to acquire shares in the capital of a corporation or divest itself of shares in a subsidiary, but the TPA only requires a decision maker to consider whether the transaction results in a substantial lessening of competition, and not whether a transaction would allow NBN Co to avoid its non-discrimination and transparency obligations.

Option B seeks to fill the gap in Option A by requiring the ACCC to consider all transactions involving NBN Co and to include matters impacting on NBN Co's equivalence obligations as part of its considerations..

Option C delivers the outcomes of Option A, but adds a formal process to ensure that shareholders are made aware of, and must approve, all share transactions. While NBN

Co is owned by the Commonwealth, this is considered to be an effective mechanism for ensuring NBN Co meets its obligations. The effectiveness of this mechanism depends, however, on the judgment of shareholders.

Option D restricts NBN Co's flexibility to acquire shares in the capital of a corporation or divest itself of shares in a subsidiary to a degree, by ensuring that any subsidiary that it does not wholly own, but controls, will be subject to NBN Co's obligations.

Option E tightly confines NBN Co to its obligations but may limit its opportunities and flexibility in acquiring necessary assets in commercial markets. It would also involve additional clearance processes. This would lead to duplicative processes if the ACCC was required to consider both a section 50 assessment and a separate assessment in relation to NBN Co's obligations.

On balance Option D is the preferred approach, noting that shareholder ministers would also be able to monitor smaller transactions that did not result in NBN Co having control of an entity.

## **7. Implementation and review of the preferred option**

Options D will be implemented through the NBN Co Bill.

Operation of the proposed arrangements will be subject to ongoing review. The Government is also considering Recommendation 78 of the Implementation Study that an independent review of the telecommunications market and the regulatory framework for the NBN be undertaken following completion of the network and prior to its proposed privatisation. Such a review, which could be undertaken by the Productivity Commission, would also be expected to look at the matters covered in this RIS.