

The Auditor-General
Audit Report No.20 2009–10
Performance Audit

The National Broadband Network Request for Proposal Process

**Department of Broadband, Communications and the
Digital Economy**

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of Australia 2010

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Canberra ACT
3 February 2010

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit in the Department of Broadband, Communications and the Digital Economy in accordance with the authority contained in the *Auditor-General Act 1997*. I present the report of this audit and the accompanying brochure. The report is titled *The National Broadband Network Request for Proposal Process*.

Following its presentation and receipt, the report will be placed on the Australian National Audit Office's Homepage—<http://www.anao.gov.au>.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ian McPhee', with a long horizontal flourish extending to the left.

Ian McPhee
Auditor-General

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
Canberra ACT

AUDITING FOR AUSTRALIA

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Abbreviations

ACCC	Australian Competition and Consumer Commission
ADSL	asymmetrical digital subscriber line
AGD	Attorney-General's Department
AGS	Australian Government Solicitor
ANAO	Australian National Audit Office
CPGs	Commonwealth Procurement Guidelines
DBCDE or department	Department of Broadband, Communications and the Digital Economy
DEEWR	Department of Education, Employment and Workplace Relations
DFAT	Department of Foreign Affairs and Trade
DIISR	Department of Innovation, Industry, Science and Research
DITRDLG	Department of Infrastructure, Transport, Regional Development and Local Government
Finance	Department of Finance and Deregulation
FTA	free trade agreement
FTTN	fibre-to-the-node
FTTP	fibre-to-the-premises
Labor	Australian Labor Party
Mbps	megabits per second
Minister	Minister for Broadband, Communications and the Digital Economy

NBN	National Broadband Network
OIL	Office of International Law in the Attorney-General's Department
Panel	NBN RFP Panel of Experts
PM&C	Department of the Prime Minister and Cabinet
RFP	Request for Proposal
SME	small and medium enterprise
Treasury	Department of the Treasury
WTO	World Trade Organization

Glossary

cut-over	Cut-over is the exclusive or near-exclusive access to, and use of, Telstra's customer access network by a non-Telstra provider.
fibre-to-the-node (FTTN)	FTTN technology uses optical fibre running from Telstra exchanges to nodes. The nodes contain xDSL equipment that provide broadband services to individual homes and businesses along copper wires.
fibre-to-the-premises (FTTP)	FTTP technology uses optical fibre running from Telstra exchanges through an optical splitter to individual premises.
Telstra's customer access network	Telstra's pillars and copper wires from pillars into individual premises (as illustrated at Figure 2.1 in Chapter 2)
x Digital Subscriber Line (xDSL)	xDSL provides digital data transmission over copper wires of a local telephone network. Copper-based broadband services are provided on xDSL equipment (either Telstra's or another provider's) located at Telstra exchanges along copper cabling to Telstra's customer access network. The most popular version of consumer-ready DSL is asymmetric digital subscriber line (ADSL).

Summary

Summary

Background

1. In March 2007, the Australian Labor Party (Labor) released its broadband election policy to increase broadband internet speeds for 98 per cent of Australians by up to forty times. Labor considered that its national broadband network (NBN) would deliver significant national economic benefits and new services for the benefit of many consumers, particularly those in rural and regional areas. Labor committed that, in government, it would:

- partner with the private sector to deliver a fibre-to-the-node (FTTN) NBN over five years to 98 per cent of the population with minimum speeds of 12 megabits per second (Mbps);
- within a six-month timeframe, undertake a competitive assessment of proposals from the private sector to build the network;
- ensure competition in the sector through an open access network that provides equivalence of access charges and scope for access seekers to differentiate their product offerings;
- put in place regulatory reforms to ensure certainty for investment; and
- make a public equity investment of up to \$4.7 billion.¹

2. To meet the new Government's tight timeframe, the then Department of Communications, Information Technology and the Arts (now the Department of Broadband, Communications and the Digital Economy (DBCDE or the department)) provided early advice to the Government on the implementation of its broadband election commitments. The Government agreed in January 2008 to conduct a Request for Proposal (RFP) process to select a proponent(s) to build, operate and maintain the NBN. The Government's broadband policy reflected its election commitments, but broadened the technology choice to any fibre-based solution (using FTTN or fibre-to-the-premises (FTTP) architecture). Further, it did not specify a

¹ Australian Labor Party 2007, *New Directions for Communications: A Broadband Future for Australia—Building a National Broadband Network*, pp. 4 and 19. Before the 2007 election, the current Minister for Broadband, Communications and the Digital Economy also announced (while in Opposition) a six-month timeframe to undertake the competitive assessment process.

preferred form for the Government's investment in the network, that is, the contribution could have been as an equity investment or some other form of funding. In parallel with NBN RFP process, the Government invited proponents, industry and public interest groups to provide submissions to the Commonwealth on regulatory issues associated with a fibre-based network, including consumer safeguards.

3. There was significant public and industry interest in the NBN RFP process and its potential outcome. The department assessed the potential for litigation during the process and at its conclusion as high. Consequently, the department identified the need for the process to be conducted within a strong probity framework and for decisions to be informed by appropriate specialist advice. In the first half of 2008, the department progressively engaged specialist advisers to assist in developing and conducting the RFP process, including: probity adviser; investment, financial and commercial adviser; technical adviser; legal adviser; and regulatory economic adviser.

4. On 11 March 2008, the Minister announced the membership of the Panel of Experts (Panel), chaired by the department's then Secretary, that would assess the NBN proposals and put forward recommendations to the Minister for the preferred proponent(s). The Minister also invited industry and public submissions to assist in the development of the RFP document. The RFP document was approved by the Minister and released on 11 April 2008. The document expressed the Government's broadband policy parameters as criteria against which proposals would be assessed, rather than as mandatory requirements. The RFP sought both national proposals and State/Territory-based proposals, covering individual States or Territories, as part of a national solution. Potential proponents were required to meet pre-qualification requirements by 23 May and lodge proposals by 25 July 2008. A subsequent addendum to the RFP process extended the closing date to 26 November 2008.

5. Eight parties met pre-qualification requirements², although one party subsequently withdrew. The department and the proponents held four rounds of bilateral meetings between June and November 2008 to outline the progress

² To be eligible to lodge a proposal, potential proponents were required to lodge with the department a \$5 million bid bond and sign a confidentiality agreement by 23 May 2008. For ease of reference, those potential proponents that met pre-qualification requirements have been referred to as proponents in the report.

of proposal development, and to clarify aspects of the RFP process and its requirements.

6. On 26 November 2008, proposals were received from six proponents—four national proposals and two State/Territory-based proposals. The national proposals generally put forward FTTN as the principal technology for providing connections to premises. The department determined that five of the six proposals met the RFP's minimum conditions for participation, and these proposals proceeded to the assessment phase. Telstra's proposal was excluded from the RFP assessment process because it did not meet minimum conditions for participation. The proposal did not include a Small and Medium Enterprise (SME) Participation Plan.³

7. On 20 January 2009, the Panel's Evaluation Report to the Minister advised that the three remaining national proposals had been assessed in accordance with the RFP document and that none offered value for money for the Commonwealth. The Panel further concluded that there was no prospect that the proponents would be able to refine their proposals sufficiently to provide value for money. As a consequence, and in accordance with the RFP document, the Panel's assessment of State/Territory-based proposals did not proceed beyond a preliminary review. In conjunction with its Report, the Panel submitted separate advice to the Minister on how the Government's objectives might be achieved outside the parameters of the RFP. Its primary proposition was that FTTP was a preferable, albeit more costly, technology to FTTN, and that the Government should explore incentive schemes to encourage the roll-out of FTTP.

8. On 7 April 2009, the Minister terminated the RFP process. All proponents were immediately advised of the Minister's decision and the Government's new policy approach. The Prime Minister, the Treasurer, the Minister for Finance and Deregulation and the Minister jointly announced the establishment of a new company to build and operate a new super-fast NBN (National Broadband Network Company Ltd). At the same time, the Minister released the Panel's observations from the Evaluation Report. The Panel observed that each proposal contained attractive elements and, collectively,

³ The RFP minimum conditions of participation were that proposals: be in English; use Australian legal units of measurement; include a completed and signed proponent's declaration; meet the conditions relating to the submission of multiple proposals; and include a SME Participation Plan.

they provided a good evidence base for the Government to move its policy agenda forward. The Panel also observed that:

- proposals lacked committed private sector funding;
- none of the national proposals was sufficiently well developed to present a value-for-money outcome;
- no proposal submitted a business case that supported the roll-out in five years of a NBN to 98 per cent of Australian homes and businesses with a Government contribution of \$4.7 billion;
- FTTN is unlikely to provide an efficient upgrade path to FTTP;
- there was a risk of liability to pay compensation to Telstra for exclusive or near-exclusive access to Telstra's customer access network; and
- proponents sought excessive regulatory restrictions on competitors building and operating their own fibre-based networks in competition with the NBN (that is, overbuild protections).

9. The department offered oral debriefings to all proponents that met the minimum conditions for participation and returned bid bonds to all proponents, although there was some delay in one instance.

Audit objective and scope

10. On 21 April 2009, Senator the Hon. Nick Minchin, then Shadow Minister for Broadband, Communications and the Digital Economy, wrote to the Auditor-General requesting consideration be given to conducting an audit of the NBN RFP process. Issues raised included the outcome of the process; whether amendments were made to the RFP documents relating to non-compliant bids; Telstra's exclusion from the process; the costs associated with the RFP process for both the Government and bidders; and the refund of bonds paid to bidders.

11. After conducting a preliminary review, the Auditor-General decided to undertake a performance audit into the NBN RFP process. The objective of the audit was to examine key aspects of the NBN RFP process, including:

- the background to and conduct of the RFP process;
- management of key risks associated with the process and outcome; and
- stakeholder consultations.

12. The audit examined DBCDE's management of key aspects of the:

- implementation of the NBN RFP process from the time of the election of the new Government on 24 November 2007 to the release of the RFP document on 11 April 2008 (Chapter 2); and
- conduct of the NBN RFP process after the release of the RFP document to the termination of the process on 7 April 2009 (Chapter 3).

Overall conclusion

13. Labor went to the Federal Election in November 2007 with a commitment to create a national FTTN broadband network, with construction to begin by late-2008. Following the swearing in of the new Government in December 2007, the department gave priority to developing and implementing this election commitment. The Government's approach was to pursue a process that maximised competitive tension between potential proponents and promoted innovation to achieve the best outcome and best use of up to \$4.7 billion in government funding. It has been generally acknowledged within the telecommunications sector that this amount was the level of funding sought by Telstra from the former Government in 2005 to upgrade its equipment to build a FTTN network covering 98 per cent of Australia's homes and businesses at speeds of 12 Mbps.

14. After considering advice on the pros and cons of conducting the process in one rather than two stages, the Government concluded that a one-stage process was appropriate and its risks could be managed. The alternative, adopting a multi-stage process, would have been the more conventional approach for conducting tender processes of this size, nature and risk, particularly when seeking innovative solutions. Proponents contacted by the ANAO considered that the two-way dialogue an expression of interest stage in a two-stage process generates, would have better informed the RFP process and the RFP document, increasing the likelihood of a successful outcome. The main disadvantage of multi-stage tendering is the additional time required to approach the market, or particular proponents, more than once, which was a factor considered by the Government given the tight timeline envisaged for the assessment process.

15. The department identified the likelihood of many of the key risks to a successful outcome to the RFP process when assisting the Government to settle the details of its broadband policy, although some were not fully analysed at the time. These risks included the sufficiency of government funding to attract commercially-viable proposals capable of acceptance, the potential payment of

'just terms' compensation to Telstra for the compulsory acquisition of the right to use its assets should a non-Telstra proposal be successful,⁴ and the uncertain regulatory environment. The primary means of addressing these and other risks was to design the RFP process to maximise flexibility, minimise mandatory requirements and allow proponents to offer innovative solutions.

16. National proponents were asked to submit binding proposals against the 18 Commonwealth objectives for the NBN and other evaluation criteria, and outline the regulatory changes necessary to facilitate their proposals. The process left open the prospect that a proposal may be acceptable even though it did not meet all objectives and criteria. The competitive assessment process was expected to determine the NBN that the market could build and operate. Although the RFP document met the requirements of the Commonwealth Procurement Guidelines (CPGs), there was insufficient time to fully address specialist advisers' concerns that a lack of detail in the RFP put at risk attracting binding offers. Nevertheless, the RFP document was drafted so that it could be varied to address risks and issues as and when they arose during the process.

17. Throughout the process, the department kept the Minister informed of progress, including:

- updated appraisals of most risks to the process, and the likelihood of a successful outcome;
- possible scenarios including their likelihood and consequences; and
- summarised feedback from proponents on the elements likely to feature in their proposals and the challenges posed by the RFP.

18. After the announcement of the RFP process, potential proponents were initially concerned that the proposed timeframe would be insufficient to prepare and lodge fully developed proposals. However, the proponents considered that their concerns were addressed when the RFP timeline was extended to allow them time to consider carriers' network information. Proponents advised that the RFP's flexibility gave them significant scope to submit eligible proposals with innovative technical solutions. However, they found it difficult to develop competitive and commercially-viable proposals

⁴ Section 51(xxxi) of the Australian Constitution provides the Parliament with the power to make laws with respect to the acquisition of property on just terms.

that would be acceptable to the Government, while not necessarily meeting all the objectives and other criteria.⁵

19. Proponents requested guidance on the relative importance of the Commonwealth's objectives, evaluation criteria and the regulatory changes that would (or would not) be accepted. However, as the Government had no determined preference for the NBN within its stated objectives, further advice on these issues was not forthcoming beyond that included in the RFP document. As a consequence, proponents found the bilateral meetings with the department and its specialist advisers of limited value. State/Territory-based proponents considered that the late clarification of the way their proposals would be assessed under the RFP disadvantaged their proposals and, if received earlier, may have influenced their decision to participate in the RFP process.

20. The RFP document saw FTTP as the future platform of the network to meet future customer demand and service developments to at least 2020 and beyond. However, after the RFP had been issued, the department received unsolicited advice from the Australian Competition and Consumer Commission that FTTN was not a stepping stone towards FTTP. Most FTTN expenditure would be on equipment that becomes obsolete under a FTTP network platform. A FTTN network could also serve to delay FTTP if the successful proponent was not under significant competitive pressure and could therefore delay further investment until they had fully recovered their initial investment.

21. As the RFP open period progressed, it became increasingly obvious to the department that the likelihood of a successful outcome was reducing. Initially, the department and its advisers considered that the RFP process was unlikely to attract binding offers capable of acceptance, necessitating some form of 'second stage'. In mid-August 2008, the department first noted possible options for progressing the Government's broadband policy within, subsequent to, or outside of, the RFP process. By late-October 2008 and prior to the RFP closing date, alternative methods of delivering the Government's broadband policy began to be looked at more formally, should the RFP process

⁵ The objectives were competing and, at times, conflicting. For example, the RFP asked proponents to build and operate an NBN that: covered 98 per cent of all Australian homes and businesses; offered speeds of 12 Mbps; enabled low access prices while allowing proponents to earn a return on investment commensurate with risk; and provided the Commonwealth with a return on its investment (Objectives 1, 2, 11 and 13).

not result in any acceptable proposals. By this time, it had become apparent that:

- the global financial crisis was having an adverse impact on proponents' ability to attract funding for their investment in the NBN;
- Telstra was seeking certain assurances from Government, including in relation to the confidentiality of its bid information and potential regulatory solutions, before committing to lodging a proposal;
- some members of one pre-qualified consortia announced their withdrawal from the consortia; and
- non-Telstra proponents were unlikely to propose a national technical solution that would not require Telstra's equipment, or submit a viable business model that took into account potential compensation to Telstra of some billions of dollars for the compulsory acquisition of the right to use its equipment.⁶

22. Although not guaranteeing a successful outcome, the flexibility within the RFP process meant that the Government could have varied the RFP document and process when it became apparent that:

- proponents were looking for clearer direction and were unlikely to submit proposals that met all the Commonwealth's objectives and other evaluation criteria; and
- the global financial crisis was impacting on the proponents' ability to finance their proposals.

23. Proponents would have had an opportunity to submit better developed and more competitive proposals had they received:

- greater clarity as to how the information requested was to be used when assessing proposals against the RFP's multiple objectives and criteria;
- guidance as to the relative importance of the evaluation criteria and Commonwealth's objectives; and/or

⁶ The ANAO has not disclosed the range of potential compensation in view of the commercial sensitivities attaching to such estimates.

- a clearer understanding of the Government's regulatory intent for the NBN.

Providing the clarity and guidance proponents sought would most likely have necessitated an extension to the Government's timetable for the RFP process.

24. The NBN evaluation plan, which was approved by the Panel and the Minister before the closing date for proposals, comprehensively set out the assessment process and aligned with the RFP document. Nevertheless, its development proved to be a complex and time-consuming exercise. The Panel, assisted by the department, specialist advisers and other Australian Government departments and agencies, assessed NBN proposals in accordance with the evaluation plan. The then Secretary's decision to exclude Telstra's 12-page proposal from the assessment process was informed by comprehensive legal advice. The Panel assessed the remaining national proposals against the six evaluation criteria and determined that nearly all criteria were either met to a marginally acceptable standard or failed.

25. The conclusions and recommendations in the Panel's Evaluation Report are supported by appropriate evidence. The Panel's published observations of the process generally represent the reasons for the non-selection of a national proponent, as well as provide some advice to the Government on policy options for going forward. In separate advice to Government at the conclusion of the Panel's role in the RFP process, the Panel identified FTTP as the preferred technology for the NBN. Although more expensive, the Panel identified a number of 'hidden' costs in FTTN proposals, including potential compensation to Telstra, risk of obsolescence and reduction in competition through requested regulatory changes.

26. The Government's choice of a fibre-based technology platform for the NBN and the quantum of government funding available to the successful proponent(s) meant that Telstra's assets, including its customer access network and ducts from the exchange, were a critical dependency for the success of the NBN RFP process. It was generally accepted that the only other technology for a national fibre-based network, FTTP, would require a significantly greater government contribution to be commercially viable. Analysis by DBCDE as the RFP progressed determined that, although a FTTN network could co-exist with copper-based broadband networks, the amount of government assistance on offer meant it was unlikely to be commercially viable for reasons that included its ability to attract enough customers to cover its costs and that it would still require access to Telstra's customer access network.

27. As a consequence, Telstra was inherently well-placed to lodge a competitive (and potentially successful) proposal. Non-Telstra proposals were likely to present significant risks, including:

- the payment of substantial levels of compensation to Telstra for the compulsory acquisition of the right to use its assets; and
- potential regulatory changes that would restrict other entities (mainly Telstra) building a parallel fibre-based broadband network (which could be inconsistent with Australia's international trade obligations, and therefore at odds with the Government's broadband policy).

28. Despite the RFP process's complexity and short timeframe, the Panel and the department conducted the formal process well, within the parameters of the Government's broadband policy and in accordance with the CPGs. As the RFP process progressed, the department advised the Minister that the prospects of a successful outcome were reducing. At the end of the RFP process, there were no successful proposals.

29. The RFP process has come at a significant cost to the Government and proponents, with costs incurred being in excess of \$30 million. DBCDE's costs were some \$17 million and the proponents' costs (where advised) ranged between \$1 million and \$8 million. In reviewing the process employed and in light of the outcome, there are a number of observations that can be made:

- early in the process, most NBN stakeholders considered that a two-stage process to select proponent(s) for the NBN would have improved the prospects of a successful outcome and may have reduced proponents' costs;
- requesting proponents to outline their preferred regulatory environment for their NBN was unusual for an RFP process and made a complex commercial transaction considerably more complicated;
- a non-Telstra proposal was unlikely to build and operate a commercially-viable NBN in circumstances where the proponent was responsible for the risk of paying compensation to Telstra;
- the global financial crisis significantly reduced the prospects of a successful outcome by affecting the viability of the proposed NBNs; and
- using FTTN technology for the network limited its potential scalability.

30. The department has informed the ANAO that the Government was made fully aware of all of the key risks and their significance for a successful outcome to the RFP process. While it is the case that the key risks and their broad significance were identified in early advice to the Government, the department did not fully assess the consequences of some of these risks until relatively late in the RFP process. These included, in particular, the possible magnitude of: the potential payment of compensation to Telstra should a non-Telstra proposal using FTTN technology be successful; and the consequences for investment in FTTN equipment, which largely would become obsolete, should the network be upgraded to FTTP technology. The design of the Government's approach to the market would have been better informed had the department provided timely advice on these issues ahead of the RFP process being settled.

31. As it was, the Government decided to seek binding offers from the market through a one-stage RFP process and give proponents wide scope to request regulatory changes to facilitate their proposals. This approach was not conventional for a competitive assessment process of this size, nature and risk. Given the amount of government funding on offer, Telstra was the proponent most likely to be in a position to build and operate a viable fibre-based NBN. The likely impact on the prospects of a successful RFP outcome had Telstra lodged an eligible proposal, is indeterminate. As the outcome of the RFP process showed, no other proponents were successful either.

32. The audit has not made any recommendations to the department as the RFP process has been finalised. Nevertheless, the audit emphasises the importance of departments gaining, as early as possible, a sound understanding of the implications of those risks that are critical to the success of major tender processes, amongst the many risks that are required to be managed. This is particularly challenging in a one-stage process that is seeking binding offers.

Formal comments on the proposed report

33. Summary comments received on the proposed report from the department and the former Secretary of the department are reproduced below, along with further ANAO comment. Appendix 1 contains the full formal responses received.

Department of Broadband, Communications and the Digital Economy

34. The NBN RFP process was designed to meet the policy commitments of the Government, particularly with regard to the priority attached to implementation. It also provided maximum flexibility for Proponents to develop innovative proposals. The Department welcomes the ANAO's conclusions that the Department conducted the RFP process well, within the parameters of the Government's broadband policy and in accordance with the *Commonwealth Procurement Guidelines*.

35. The Department notes the ANAO conclusions that the Department identified the key risks to a successful outcome to the RFP process, kept the Minister informed of progress throughout the process, and that there was a strong commitment to the timeframe.

36. The Department disagrees with the ANAO's view on analysis of the compensation risk. More detailed analysis of the possible compensation that could become payable would not have materially altered the RFP process or its result. The Department agreed with the Government a defined implementation approach in regard to the Government's NBN policy and kept the Government well informed of the key risks.

Former Secretary of the department and Chair of the Expert Panel

37. The former Secretary and Chair of the Expert Panel considers that the Request for Tender process was in accordance with the Government's policy and guidelines and conducted well, in a professional and impartial manner. The ANAO report reaches the same conclusion.

38. For clarity, the Department's work in late 2007 on the cost of the NBN stopped when the Minister stated that the work should be discontinued.⁷ I do not agree with the ANAO's conclusions regarding moving to FTTP at an earlier stage and question the practicalities of the ANAO's suggestion that a credible estimate of the possible compensation cost could have been available very early in the process.

⁷ The ANAO notes that this comment relates to the *Sufficiency of government funding* sub-section in Chapter 2, and paragraph 2.48 in particular.

ANAO comment

39. The comments by the department and former Secretary concerning the risk of potential compensation payable to Telstra do not sufficiently recognise the department's responsibility to provide the best information it can, in the time available, to inform decisions on new policies and key matters arising. The department considered the compensation risk was 'significant' for a FTTN solution but did not estimate the quantum of this risk until relatively late in the process. Consequently, the department was not in a position to provide early advice to the Government on its likely impact on the viability of non-Telstra proposals, having regard to the Government's proposed contribution. While an estimate of any compensation range, understandably, would be broad and caveated, there was a need, earlier in the process, to put some dimensions to the 'significant risk' that a non-Telstra solution may require the payment of compensation to Telstra. The estimate of the potential cost of compensation developed by the department 10 months into the RFP process was some billions of dollars. The compensation risk had a considerable bearing on the outcome of the process following the exclusion of Telstra. No other national proponent was able to meet the Commonwealth's objectives and accept the potential compensation costs.

40. Estimating the potential compensation could have begun early in the process by using publicly available information and engaging specialist expertise, and been updated when better information became available (as noted in paragraph 2.57). While recognising the approach to delivering the NBN would be a decision for the Government, information on the scale of potential compensation would have better informed, and may have influenced, the Government's approach.

41. Concerning the former Secretary's comment on FTTP technology, the ANAO has not suggested that the focus of the RFP process should have moved to FTTP at an earlier stage. Rather, the ANAO considers that the department should have informed the Government earlier that FTTN does not provide a cost-effective migration strategy to a future FTTP network (as noted in paragraphs 2.77 and 2.78).

Audit Findings and Conclusions

1. Background

This chapter provides the context for and summarises the NBN RFP process and its outcome. The audit's objective, scope and methodology are also outlined.

Introduction

1.1 Broadband is seen world-wide as a critical enabling technology that is driving productivity gains. Broadband infrastructure represents a new growth platform for productivity, business development and Australia's economy. In Australia, there is currently a range of high-speed broadband services available including those provided over hybrid fibre coaxial cable and digital subscriber line technology (for example, ADSL and ADSL2+) using copper cabling. However, these fixed terrestrial services are limited in reach, serving predominantly densely populated areas. Consumers in less populated areas receive broadband services by wireless terrestrial networks or satellite. The situation in Australia is not unique and, like Australia, other countries around the world are working to rollout high-speed broadband networks.⁸

The Australian Labor Party's election commitment

1.2 In March 2007, the Australian Labor Party (Labor) released its broadband election policy to increase broadband internet speeds for 98 per cent of Australians by up to forty times. Labor considered that its National Broadband Network (NBN) would deliver significant national economic benefits and new services for the benefit of many consumers, particularly those in rural and regional areas. Labor committed that, in government, it would:

- partner with the private sector to deliver a fibre-to-the-node (FTTN) NBN over five years to 98 per cent of the population with minimum speeds of 12 megabits per second (Mbps);
- within a six-month timeframe, undertake a competitive assessment of proposals from the private sector to build the network;

⁸ Fibre-to-the-node (FTTN) or fibre-to-the-premises (FTTP) networks are being planned or rolled out in countries including the United States of America, Canada, Singapore, Japan, South Korea, Germany and France.

- ensure competition in the sector through an open access network that provides equivalence of access charges and scope for access seekers to differentiate their product offerings;
- put in place regulatory reforms to ensure certainty for investment; and
- make a public equity investment of up to \$4.7 billion.⁹

1.3 Following Labor's election to government on 24 November 2007, the then Department of Communications, Information Technology and the Arts (now the Department of Broadband, Communications and the Digital Economy (DBCDE or the department)) began advising the newly-elected Government on the implementation of its broadband election commitments.

1.4 The Government agreed in January 2008 to conduct a Request for Proposal (RFP) process to select a proponent(s) to build, operate and maintain the NBN. The Government's broadband policy reflected its election commitments, but broadened the technology choice to any fibre-based solution (using FTTN or fibre-to-the-premises (FTTP) architecture). Further, it did not specify a preferred form for the Government's investment in the network, that is, the contribution could have been as an equity investment or some other form of funding.

1.5 There was significant public and industry interest in the process and its potential outcome. In parallel with the NBN RFP process, the Government invited proponents, industry and public interest groups to provide submissions to the Commonwealth on regulatory issues associated with a fibre-based network, including consumer safeguards, relevant to the outcome of the NBN process.

NBN RFP process and timeframes

NBN governance framework

1.6 The Government decided to establish a Panel of Experts (the Panel) to oversee the competitive assessment process and to recommend to the Minister for Broadband, Communications and the Digital Economy (the Minister) proponent(s) capable of successfully rolling out the NBN. An

⁹ Australian Labor Party 2007, *New Directions for Communications: A Broadband Future for Australia—Building a National Broadband Network*, pp. 4 and 19. Before the 2007 election, the current Minister for Broadband, Communications and the Digital Economy also announced (while in Opposition) a six-month timeframe to undertake the competitive assessment process.

interdepartmental committee, chaired by DBCDE, was also established to monitor and facilitate whole-of-government coordination.¹⁰

1.7 DBCDE was to manage the NBN RFP process and established the NBN Taskforce for this purpose.¹¹ The department assessed the potential for litigation during the process and at its conclusion as high. Consequently, the department identified the need for the process to be conducted within a strong probity framework and for decisions to be informed by appropriate specialist advice. The department engaged the Australian Government Solicitor (AGS) as its NBN probity adviser in early January 2008. Further specialist advisers were progressively engaged by the department from March to May 2008, including: investment, financial and commercial adviser; technical adviser; legal adviser; and regulatory economic adviser.

1.8 As the RFP process progressed, DBCDE established the NBN Steering Committee and working groups, which included representatives from DBCDE and specialist advisers, to manage the RFP process in accordance with the Government's broadband policy. In addition, particular departments and agencies, such as the Department for Foreign Affairs and Trade (DFAT) and the Australian Competition and Consumer Commission (ACCC), were tasked with providing advice related to their areas of expertise to the department and the Panel.

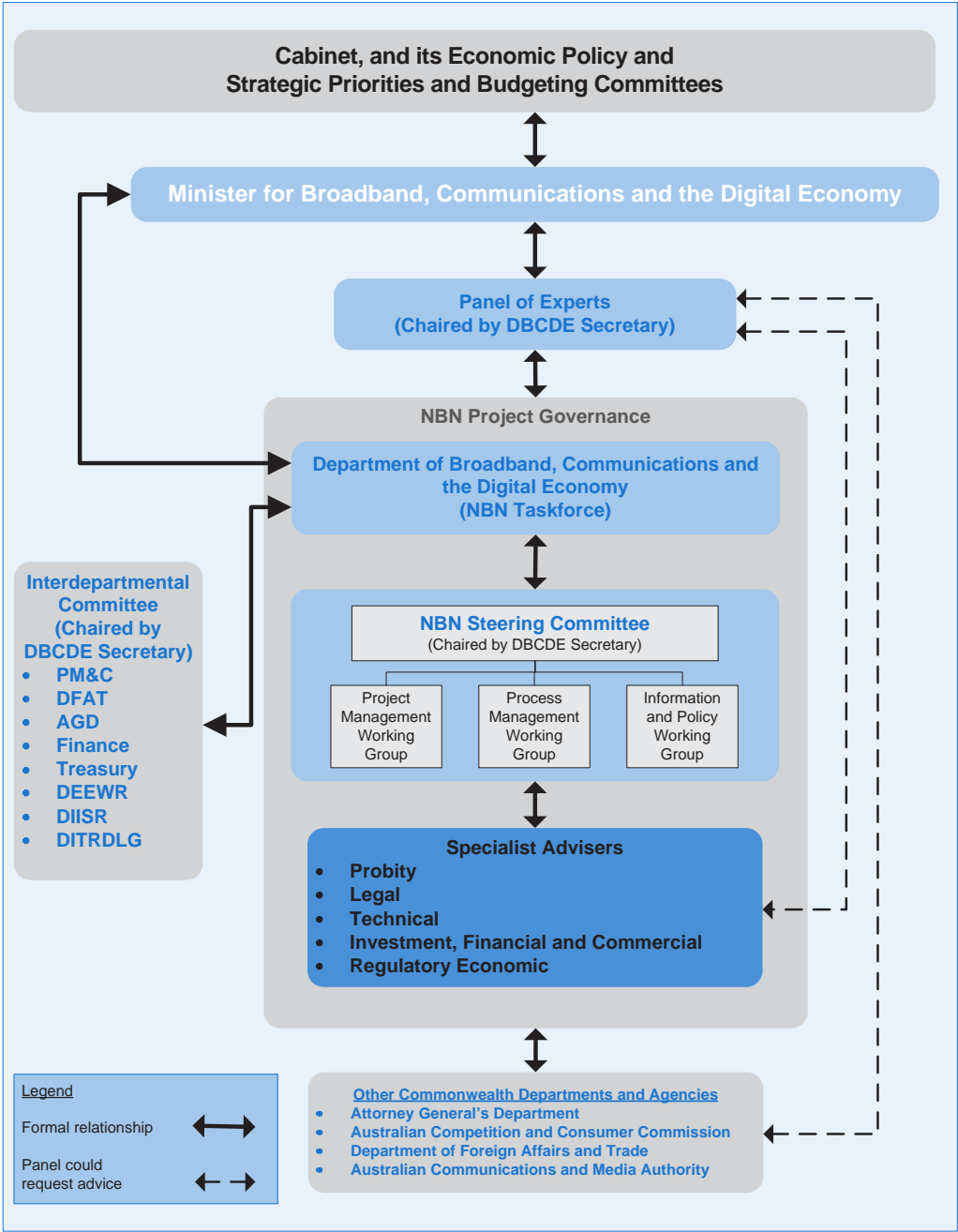
1.9 The department regularly briefed the Minister throughout the NBN RFP process and he approved the RFP document and evaluation plan. The governance framework established for the NBN project is illustrated at Figure 1.1.

¹⁰ The interdepartmental committee consisted of representatives from DBCDE and the Departments of the Prime Minister and Cabinet (PM&C); the Treasury; Finance and Deregulation (Finance); Foreign Affairs and Trade (DFAT); Attorney General's (AGD); Education, Employment and Workplace Relations (DEEWR); Infrastructure, Transport, Regional Development and Local Government (DITRDG); and Innovation, Industry, Science and Research (DIISR).

¹¹ For the purposes of this audit, the NBN Taskforce has been referred to as DBCDE or the department.

Figure 1.1

NBN governance framework



Source: ANAO analysis of DBCDE information

Overview of the RFP process

1.10 On 11 March 2008, the Minister announced the membership of the Panel, which was chaired by the department's then Secretary. The Minister also invited industry and public submissions to assist in the development of the RFP document. After considering the comments and views of the Panel and specialist advisers, and the industry and public submissions, the Minister approved the RFP document and released it on 11 April 2008.

1.11 The RFP sought both national proposals and State/Territory-based proposals, covering individual States or Territories, as part of a national solution. The RFP document expressed the Government's broadband policy parameters as criteria against which proponents would be assessed. There were six evaluation criteria, one of which assessed the extent to which proposals met the Commonwealth's 18 objectives for the NBN (which are outlined in Appendix 2). The RFP set very few mandatory requirements to maximise flexibility for proponents and encourage innovation (see Appendix 3 for the RFP's minimum conditions for participation).

1.12 To be eligible to submit a proposal, the RFP document required potential proponents to meet the pre-qualification requirements by lodging a \$5 million bid bond with the department and signing a confidentiality agreement by 23 May 2008. Meeting pre-qualification requirements also permitted potential proponents to: receive RFP addenda and clarifications; be invited to bilateral meetings with the department; and be eligible to receive network information. Proponents were originally required to lodge proposals by 25 July 2008, but an addendum to the RFP process extended the closing date to 26 November 2008.

1.13 Eight parties met the pre-qualification requirements of the RFP document, although one party subsequently withdrew. The department held four rounds of bilateral meetings with proponents between June and November 2008 to determine the progress of proposal development, and to clarify aspects of the RFP process and its requirements.

Evaluation by the Panel

1.14 On 26 November 2008, the department received proposals from six proponents—four national proposals and two State/Territory-based proposals. The national proposals generally put forward FTTN as the principal technology for providing connections to premises. The department determined that five of the six proposals met the RFP's minimum conditions for

participation, and these proposals proceeded to the assessment phase. Telstra's proposal was excluded from the RFP assessment process because it did not meet the minimum conditions for participation. The proposal did not include a Small and Medium Enterprise (SME) Participation Plan.

1.15 On 20 January 2009, the Panel provided its evaluation report to the Minister advising that the three remaining national proposals had been assessed in accordance with the RFP document, and that none offered value for money for the Commonwealth. The Panel further concluded that there was no prospect that the proponents would be able to refine their proposals sufficiently to provide value for money. Both State/Territory-based proposals were assessed in accordance with the evaluation plan as having met the minimum mandatory requirements. However, at least one national proposal had to be assessed as offering value for money before State/Territory-based proposals could be considered for incorporation into a national solution. Consequently, the State/Territory-based proposals were not considered further in the evaluation process.

1.16 In conjunction with its Report, the Panel submitted separate advice to the Minister on its views on how the Government's objectives might be achieved outside the parameters of the RFP. Its primary proposition was that FTTP was a preferable, albeit more costly, technology to FTTN, and that the Government should explore incentive schemes to encourage the roll-out of FTTP.

RFP process conclusion

1.17 On 7 April 2009, the Minister terminated the RFP process and announced the Government's new policy approach. The Prime Minister, the Treasurer, the Minister for Finance and Deregulation and the Minister jointly announced the establishment of a new company to build and operate a new super-fast NBN (National Broadband Network Company Ltd). At the same time, the Minister released the Panel's observations from the Evaluation Report. The Panel observed that each proposal contained attractive elements and, collectively, they provided a good evidence base for the Government to move its policy agenda forward. The Panel also observed that:

- proposals lacked committed private sector funding;
- none of the national proposals was sufficiently well developed to present a value-for-money outcome;

- no proposal submitted a business case that supported the roll-out in five years of a NBN to 98 per cent of Australian homes and businesses with a Government contribution of \$4.7 billion;
- FTTN is unlikely to provide an efficient upgrade path to FTTP;
- there was a risk of liability to pay compensation to Telstra for exclusive or near-exclusive access to Telstra's customer access network¹²; and
- proponents sought excessive regulatory restrictions on competitors building and operating their own fibre-based networks in competition with the NBN (that is, overbuild protections).

1.18 All proponents were advised of the Minister's decision. After the RFP process was terminated, DBCDE offered oral debriefings to all proponents that had met the RFP's minimum conditions for participation. Three proponents received debriefings during May and June 2009, all of which were attended by the probity adviser.

1.19 Proponents were also advised of the steps to follow to finalise the administrative arrangements for the NBN RFP process, including the return of the bid bonds. All bid bonds have been returned to proponents, although there was some delay in one instance. The key milestones in the RFP process are summarised in Table 1.1.

¹² Figure 2.1 in Chapter 2 illustrates Telstra's customer access network, in the context of copper-based and fibre-based broadband technologies.

Table 1.1

Key milestones in the RFP process

Date	Key milestone
March 2007	Labor releases its broadband election commitment document <i>New Directions for Communications: A Broadband Future for Australia—Building a National Broadband Network</i>
24 November & 3 December 2007	Labor wins Federal Election and is subsequently sworn-in by the Governor-General
8 January 2008	DBCDE engages NBN probity adviser
21 January 2008	Government agrees to broadband policy
11 March 2008	The Minister announces appointments to, and terms of reference for, the Panel
March to May 2008	DBCDE engages NBN specialist advisers: <ul style="list-style-type: none"> • investment, financial and commercial adviser (17 March 2008) • legal adviser (17 March 2008) • technical adviser (20 March 2008) • regulatory economic adviser (6 May 2008)
11 April 2008	RFP document that was approved by the Minister released publicly. Closing date set as 25 July 2008 (but later revised to 26 November 2008)
23 May 2008	Potential proponents required to lodge with the department a bid bond of \$5 million and a signed confidentiality deed, to be eligible to submit a proposal
26 November 2008	<ul style="list-style-type: none"> • The Minister approves the evaluation plan for the RFP process before the closing time for the lodgement of NBN proposals • Closing time for the lodgement of NBN proposals
13 December 2008	The then DBCDE Secretary excludes Telstra from the RFP process after the Panel resolved that its proposal had not met the minimum conditions of participation
20 January 2009	<ul style="list-style-type: none"> • The Panel provides its Evaluation Report to the Minister • Covering letter to the Panel’s Evaluation Report provided to the Minister (which included suggestions on how the Government’s objectives might be achieved outside the parameters of the RFP)
7 April 2009	<ul style="list-style-type: none"> • The Minister terminates the NBN RFP process • The Minister releases to the public the ‘observations’ from the Panel’s Evaluation Report • The Prime Minister, the Treasurer, the Minister for Finance and Deregulation and the Minister announce enhanced NBN using FTTP technology
23 October 2009	The Minister tables in the Parliament an extract of the Panel’s Evaluation Report that includes all but the individual proposal assessments, value-for-money assessment and report appendices

Source: ANAO analysis of DBCDE documents and publicly available information

ANAO's previous audit coverage

2008 preliminary review of the NBN RFP process

1.20 In May 2008, the Auditor-General received correspondence from the Hon. Bruce Billson MP, then Shadow Minister for Broadband, Communications and the Digital Economy, raising concerns in relation to the fairness, transparency and value for money of the NBN procurement process. In light of this correspondence, the ANAO undertook a preliminary review of the development of the RFP documentation for the NBN process and the probity arrangements in place.

1.21 On 22 May 2008, the Auditor-General responded to Mr Billson concluding that, to date, and recognising that it was early in the NBN procurement process, nothing had come to the ANAO's attention to suggest that the arrangements put in place did not provide the basis for the RFP process to accord with the Commonwealth Procurement Guidelines (CPGs) (see Appendix 4). The Auditor-General also committed to including the NBN RFP process as a potential audit topic in the ANAO's *Planned Audit Work Program 2008–09*.

2009 preliminary review of the NBN RFP process

1.22 On 21 April 2009, Senator the Hon. Nick Minchin, then Shadow Minister for Broadband, Communications and the Digital Economy, wrote to the Auditor-General requesting consideration be given to conducting an audit of the NBN RFP process. Issues raised included:

- the outcome of the process;
- whether amendments were made to the RFP documents relating to non-compliant bids;
- Telstra's exclusion from the process;
- the costs associated with the RFP process for both the Government and bidders; and
- the refund of bonds paid by bidders.

1.23 After conducting a preliminary review, the Auditor-General decided to undertake a performance audit into the NBN RFP process. On 4 June 2009, the Auditor-General wrote to the Minister, Senator Minchin and the Secretary of DBCDE, advising that a performance audit, as foreshadowed in the ANAO's *Planned Audit Work Program 2008–09*, would be undertaken.

Audit objective, scope and methodology

1.24 The objective of the audit was to examine key aspects of the NBN RFP process, including:

- the background to and conduct of the RFP process;
- the management of key risks associated with the process and outcome; and
- stakeholder consultations.

1.25 The audit examined DBCDE's management of key aspects of the:

- implementation of the NBN RFP process from the time of the election of the new Government on 24 November 2007 to the release of the RFP document on 11 April 2008 (Chapter 2); and
- conduct of the NBN RFP process after the release of the RFP document to the termination of the process on 7 April 2009 (Chapter 3).

1.26 During the audit, the ANAO:

- reviewed key files and documents relating to the implementation and conduct of the NBN RFP process, and the outcome;
- wrote to proponents seeking their comments on their observations of the NBN RFP process; and
- interviewed DBCDE staff and key stakeholders (including members of the Panel, specialist advisers, the ACCC, proponents and the Minister).

1.27 The formal proposed report was issued to the Minister, department and former Secretary of the department in November 2009. Consistent with the requirements of the *Auditor-General Act 1997*, all were given a period of 28 days to provide comments on the proposed report. Formal comments were received from the department and former Secretary and have been incorporated into the relevant areas of the report.

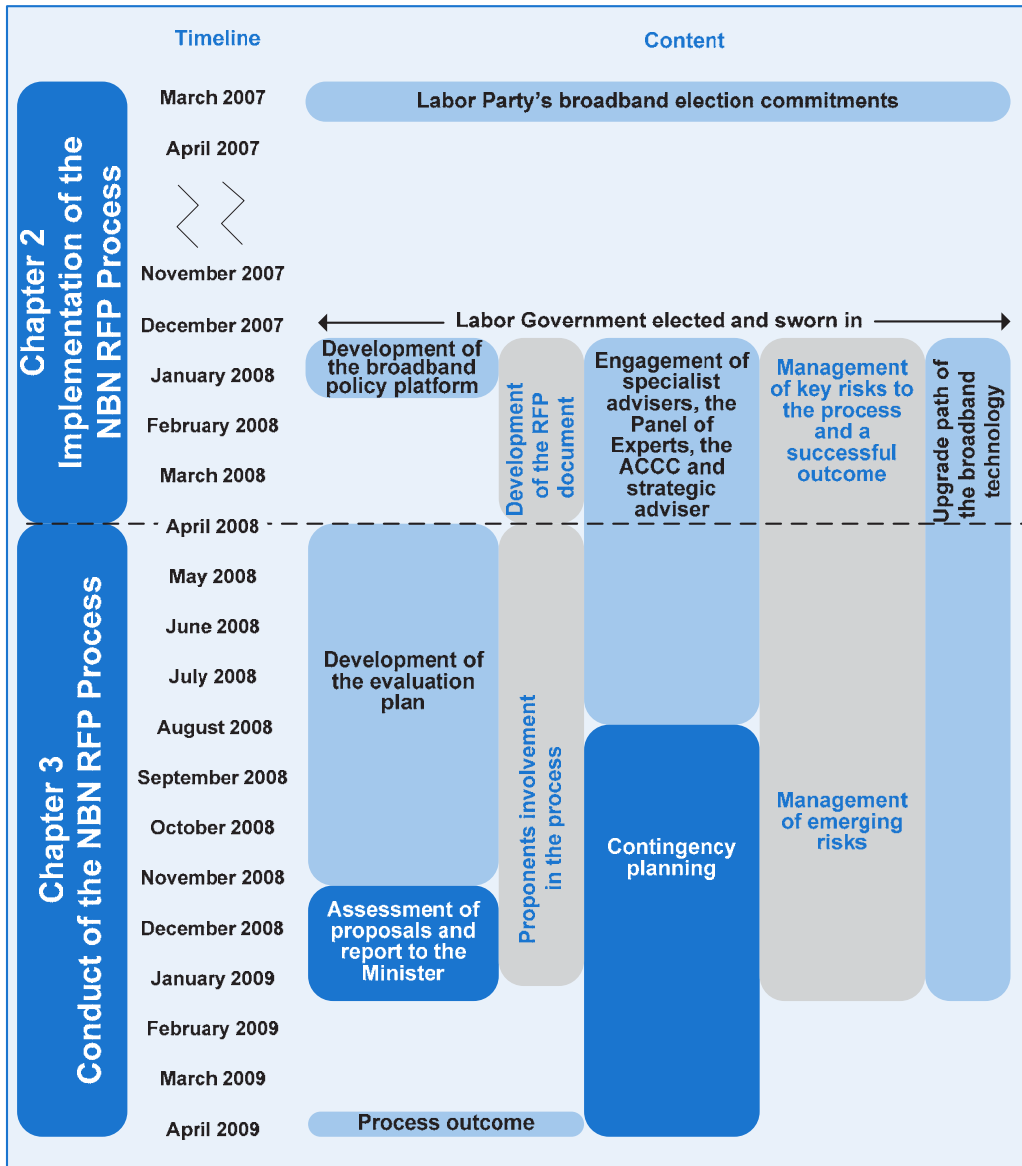
1.28 The audit was conducted in accordance with ANAO auditing standards, at a cost to the ANAO of approximately \$390 000.

Report structure

1.29 The report structure is outlined in Figure 1.2.

Figure 1.2

Report structure



Each content box above represents a section in Chapters 2 and 3 of this report, and the associated timeframe over which they applied in the NBN RFP process.

Source: ANAO

2. Implementation of the NBN RFP Process

This chapter discusses the key elements of the NBN RFP process from Labor's announcement of its broadband election commitments in March 2007 to the release of the RFP document in April 2008. The management of key risks to the process and a successful outcome are also examined.

Introduction

2.1 The implementation of the NBN RFP process began with the election of the Labor Government on 24 November 2007 and continued to 11 April 2008 when the RFP was issued. The conduct of the RFP process commenced from the later date and is discussed in Chapter 3. This chapter examines the:

- development of the broadband policy platform;
- engagement of specialist advisers, the Panel and strategic adviser to advise and assist the department and the Government;
- development of the RFP document;
- management of the key inherent risks to the process and a successful outcome; and
- upgrade path for the broadband technology.

Labor's broadband election commitments

2.2 In March 2007, Labor released its broadband commitments for the next Federal Election. These are outlined in paragraph 1.2 in Chapter 1. It has generally been acknowledged within the telecommunications sector that this election commitment was primarily based on a Telstra presentation to the former Government in 2005. Telstra indicated then that it could deliver a Next Generation broadband network with speeds of 12 Mbps to 98 per cent of Australian homes and businesses within three to five years if Telstra received a \$4.7 billion contribution from the Government, plus certain regulatory reforms

and concessions.¹³ Telstra's own contribution to a broadband network with these specifications was unclear.¹⁴

Development of the broadband policy platform

2.3 On the election of the Labor Government, the department submitted to the new Minister an incoming government brief that identified implementing the Government's broadband election commitments as the department's top priority. The brief outlined what the department saw as the key issues that would need to be addressed. These included:

- establishing a competitive assessment process that would deliver expedited outcomes while mitigating risks of legal challenge, maximising competitive tension and enabling genuine industry and public consultation;
- setting key deliverables for the competitive assessment process that would balance the need for certainty for potential bidders against the need for flexibility for Government to optimise competitive tension and outcomes;
- identifying the scope of regulatory concessions that may be sought by bidders to facilitate investment and any regulatory requirements of Government to promote open access and retail competition; and
- assessing the potential legal, policy and financial risks for the Commonwealth.

2.4 The Government's approach to implementing its NBN election commitment was to pursue a process that maximised competitive tension between potential proponents and promoted innovation to achieve the best outcome and best use of up to \$4.7 billion in government funding. Subsequent to the Government's early consideration of policy options in December 2007, the department assisted the Minister to settle the details of the Government's broadband policy in January 2008. The Government's broadband policy reflected its election commitments, but:

¹³ Telstra 2005, *The Digital Compact and National Broadband Plan*, released to the Australian Stock Exchange on 7 September 2005.

¹⁴ Telstra's presentation advised that for a broadband network with speeds of 6 Mbps, it would contribute \$3.1 billion of its own funds and require \$2.6 billion from the Government.

- sought a FTTN- and/or FTTP-based solution, as opposed to the former only; and
- the Government's contribution to the NBN could take forms other than an equity investment.

2.5 The very short timeframe for getting the Government's broadband policy approved limited the opportunity for the department to conduct substantive consultations during its preparation, apart from receiving policy comments from other Australian Government departments. Nevertheless, the department brought to bear insights obtained from:

- a proposal put forward by the G9 consortium¹⁵ to the ACCC in May 2007 to construct and operate a FTTN broadband access network, which would initially cover five mainland capital cities (see Appendix 5); and
- the former Government's 'Expert Taskforce' process¹⁶, to the extent that it had conceptual similarities to the current Government's policy direction.

2.6 During the formulation of the policy, the AGS advised that a successful outcome from the competitive assessment process could take the form of a procurement. The Government accepted this advice and agreed that the process be conducted in accordance with the CPGs.

2.7 Construction of the NBN was expected to be underway by the end of 2008. The indicative timeframe between issuing and closing an RFP was less than three months (March to May 2008), with the assessment of proposals, contracting of the successful proponent(s) and the passage of any legislation necessary to implement their proposal(s) expected to take up to a further six months (June to November 2008). The Minister accepted that the six-month

¹⁵ At the time, the G9 consortium comprised most of the major telecommunications companies operating in Australia, excluding Telstra, namely AAPT, iiNet, Internode, Macquarie Telecom, Optus, PowerTel, Primus, Soul and TransACT. On 21 June 2007, the ACCC released to the public a discussion paper on, and a copy of, a special access undertaking lodged by FANOC Pty Ltd (a company formed by the G9 consortium).

¹⁶ In June 2007, the former Minister for Communications, Information Technology and the Arts established the Expert Taskforce to develop and manage the process for assessing proposals for the rollout of new commercial open-access high-speed broadband network infrastructure in capital cities and major regional centres. The former Government was not proposing to make a financial contribution, but indicated that, on its acceptance of binding commitments from proponents, the Government would introduce legislation into Parliament to support the proponent(s) investment. The Expert Taskforce process was terminated on the election of the Labor Government.

timeframe for the process announced prior to the 2007 election was challenging and may need to be extended.

Adoption of a one-stage process

2.8 As part of the development of the Government's broadband policy, the Government received advice about whether the RFP process should be conducted in one or two stages. The Government was advised that, although a one-stage process accorded with the CPGs, it:

- may not maximise competitive tension;
- could lead to a complicated assessment of very different proposals; and
- required providing as much direction as possible to potential proponents (including acceptable regulatory parameters).

The Government was further advised that first seeking expressions of interest before a second tender stage would better determine the scope of proposals and any necessary regulatory improvements, and facilitate a competitive dialogue with potential proponents.

2.9 Reasons for favouring a one-stage RFP process were that the likely participants in the process were well known, and an expression of interest stage would extend the process with little added value and bring forward potential proponent's deadlines, thus favouring those already prepared. The Government concluded that a one-stage process was appropriate. It considered that the risks associated with a one-stage process could be managed, and governance arrangements were put in place for the process as illustrated by Figure 1.1 in Chapter 1.

2.10 Specialist advisers engaged after the finalisation of the Government's broadband policy considered that a one-stage RFP process for a project like the NBN was unusual. The alternative, adopting a multi-stage process, would have been the more conventional approach for conducting tender processes of this size, nature and risk. Procurement guidance within the Australian Public Service notes that multi-stage tendering may be a more successful approach when looking for innovative options or when the full procurement specifications are not known at the start of the process.

2.11 Seeking expressions of interest under a multi-stage process may have provided the Government with a better understanding of the capacity of proponents to meet the expected requirements of the RFP process. In this context, proponents contacted by the ANAO considered that the two-way

dialogue an expression of interest stage in a two-stage process generates, would have better informed the RFP process and the RFP document, increasing the likelihood of a successful outcome. Multi-stage tendering can also be a mechanism to constrain costs and risks for both parties. For example, for major and highly-complex Defence capital acquisition projects, the Government has sought to reduce the risk profile of each project by adopting a two-pass approval process with spending proposals being brought forward in two tranches.¹⁷

2.12 The main disadvantage of multi-stage tendering is the additional time required to approach the market, or particular proponents, more than once. This was a factor considered by the Government given the tight timeline envisaged for the assessment process.

2.13 The ANAO notes the contrast between the competitive assessment processes for the NBN and similar overseas projects, such as the Singapore Government's tender to design, build and construct a Next Generation Network. The Singapore project proceeded to an RFP process in December 2007 after extensive industry consultation and a pre-qualification expression of interest phase with potential proponents, which lasted a year. The successful proponent(s) from the Singapore RFP process were announced nine months after the release of its RFP document.

2.14 The NBN policy document acknowledges that there were numerous significant risks to obtaining a successful outcome from the process. These are discussed later in this chapter.

Engagement of specialist advisers, the Panel of Experts, the ACCC and strategic adviser

Specialist advisers

2.15 Early in the RFP process, the department considered that it required a strong probity focus, to mitigate the risk of legal challenge both during the process and following the selection of the successful proponent. In early January 2008, DBCDE engaged the AGS, from the department's existing panel of consultants, to be the probity adviser for the process. The probity adviser

¹⁷ See Audit Report No.48 2008–09, *Planning and Approval of Defence Major Capital Equipment Projects*, which examined the Department of Defence's progress in implementing this process.

developed a Probity Plan for the RFP process that outlined the arrangements to be put in place to facilitate a process that met strict probity principles.

2.16 DBCDE identified in its incoming government brief the need to engage expert advisers to provide commercial, technical, economic, regulatory and legal advice during the competitive assessment process for NBN. The role of the specialist advisers was to provide DBCDE and the Panel with a full range of expert advice throughout the process, including: the establishment of the process; development of the process documentation (including the RFP and evaluation plan); release of the RFP document; assessment of proposals; negotiations; and decision making.

2.17 Recognising that specialist advisers could assist in providing specialist advice to the Government to inform key decisions, the department canvassed options to truncate the normal process of engaging specialist advisers given the Government's urgency for the NBN process to proceed. However, the Department of Finance and Deregulation advised that the requirements of the CPGs had to be followed. Within a week of this advice, the department issued the request for tenders for the specialist advisers. After a thorough evaluation process, oversighted by its probity adviser, the department engaged the following advisers:

- KPMG as the investment, financial and commercial adviser (17 March 2008);
- Corrs Chambers Westgarth as the legal adviser (17 March 2008);
- Gibson Quai-AAS as the technical adviser (20 March 2008); and
- Frontier Economics as the regulatory economic adviser (6 May 2008).

2.18 Within the context of the tight RFP process timeframe, the engagement of the regulatory economic adviser occurred significantly later than other advisers. This was because of delays in the assessment process and protracted contract negotiations. The department considers that there was no adverse impact on the conduct of the RFP process.

2.19 Prior to their appointment, each specialist adviser signed a conflict of interest declaration, confidentiality deed and private interest declaration, and agreed to comply with the probity plan. The department engaged all specialist advisers in accordance with the CPG requirements. Given these requirements, specialist advisers were generally engaged in a timely manner.

Panel of experts

2.20 On 21 January 2008, the Government agreed to establish the Panel to conduct a competitive assessment process and recommend to the Minister proponent(s) considered capable of successfully rolling out the NBN. At this time, the Government also decided that the Panel would:

- be chaired by the then Secretary of DBCDE; and
- include the Secretary of the Treasury and up to six members from the private sector with strong skills and experience in public policy, investment, technology, the communications industry and/or regulatory economics.

2.21 DBCDE provided final advice to the Minister in late February 2008 on five prospective panel members from the private sector. The probity adviser interviewed the prospective Panel members, assessed the risks of potential members having an actual or perceived conflict of interest, and conducted probity searches through publicly available information.

2.22 In accordance with the Government's broadband policy, the Minister consulted the Prime Minister, the Deputy Prime Minister, the Treasurer and the Minister for Finance and Deregulation on the proposed members for the Panel. Prior to their appointment, all panel members signed conflicts of interest declarations, confidentiality deeds and private interest declarations, and agreed to comply with the probity plan.

2.23 On 11 March 2008, the Government appointed the Panel, whose terms of reference included:

- being consulted on the RFP document prior to its release;
- assessing the proposals according to the process and evaluation criteria set out in the RFP;
- negotiating with proponents, as appropriate, about their proposals, consistent with the RFP; and
- providing a report to the Minister with recommendations on preferred proponent(s) within eight weeks of the receipt of proposals.

2.24 The Panel was also tasked to have regard to public submissions on regulatory issues relating to the NBN as well as receiving submissions from industry and the public to assist in the development of the RFP document.

Further comments on the work undertaken by the Panel are provided throughout the report.

Australian Competition and Consumer Commission

2.25 The ACCC is responsible for the competition and economic regulation of telecommunication markets, as well as emerging new technologies that compete with or complement traditional communication services, including the regulation of the customer access network bottleneck. The ACCC administers the telecommunications specific competition notice and access regimes, parts XIB and XIC, within the *Trade Practices Act 1974*. It also administers other provisions contained in the *Telecommunications Act 1997* and related legislation.

2.26 Under the NBN RFP process, the ACCC was assigned a specific role that was not its usual regulatory function. The ACCC was to draw on its expertise to:

provide the Panel with ongoing advice on Proposals, including advice on issues such as wholesale access services and prices, access arrangements, proposed legislative or regulatory changes and the likely impact of Proposals on pricing, competition and the long-term interests of end users in the communications sector. (RFP Clause 10.4.2)

The ACCC provided advice to the Panel, via information papers and presentations, from March 2008 onwards.

Strategic adviser

2.27 In August 2008, the then Secretary of DBCDE engaged an individual, who was also a member of the Panel with substantial commercial experience, to provide strategic advice to the department in relation to the NBN process. This included providing advice on strategic issues, including commercial matters, and their interrelationship with other issues that may arise during the RFP process to select a proponent. This strategic adviser role was in addition to, but separate from, the individual's role as a member of the Panel. The probity adviser did not raise issue with this dual role.

Development of the Request for Proposal document

2.28 The department started to develop the RFP document in parallel with the development of the Government's broadband policy.

Structure and format of the RFP document

2.29 As previously discussed, the Government accepted advice that the process should be conducted in accordance with the CPGs as it was possible for the successful outcome to involve a procurement by the Government. Although DBCDE began preparing a draft RFP in late 2007, AGS, on its engagement in early January 2008, prepared the initial working draft, with the assistance of the department's legal group. The draft RFP had been prepared to follow the structure of an open Request for Proposal and, consistent with the Government's policy, it set very few mandatory requirements to maximise flexibility for proponents (see Appendix 3). The RFP was also designed to meet the Government's requirement for a one-stage process.

Input from specialist advisers, Commonwealth departments and agencies, and the Minister's office

2.30 As mentioned earlier, the majority of specialist advisers were not contracted until mid-March 2008, which was less than one month prior to the release of the RFP. This allowed little time for:

- specialist advisers to review and provide comment on the draft RFP document (which occurred over a matter of days, rather than the usual weeks or even months); and
- the department to take up their comments in the final RFP document.

2.31 As the specialist advisers and members of the interdepartmental committee became more involved in reviewing multiple drafts of the RFP document, concerns were raised that the NBN was a major project and more time should be taken to improve the level of guidance in the RFP document. Specialist advisers considered that, if there was insufficient detail in the RFP, the Government would not attract binding offers. In this context, sound practice is for request documents to contain all information necessary to allow potential suppliers to prepare and submit responsive submissions. Specialist advisers referred to the need for the RFP document to provide:

- the Commonwealth's minimum terms and conditions of contract; and
- possible commercial structures.

2.32 The department advised the Minister that the timeframe for the release of the RFP document made it difficult to add additional details. In the time available, the department included in the RFP document the Commonwealth's indicative risk allocation table as a proxy for its minimum terms and

conditions of contract.¹⁸ The department considered that specialist advisers' concerns could be addressed more thoroughly after the release of the RFP document by issuing further guidance to potential proponents, as addenda to the RFP.

2.33 The Minister and his office were involved in the development of the RFP document, receiving and commenting on multiple drafts and receiving briefings on emerging issues and areas of concern. This included the development of the 18 Commonwealth objectives and other evaluation criteria against which the Panel would assess proposals.

Submissions from industry and the public

2.34 Over a two-week period in March 2008, the Government sought formal submissions from industry and the public to assist in the development of the RFP. The Panel considered over 150 submissions and DBCDE advised the Minister of the issues raised and the extent to which they had been incorporated into the draft RFP document, as appropriate. The issues raised included:

- pricing issues—consumers focussed on retail pricing, State/Territory Governments raised the issue of backhaul pricing and industry commented on access pricing issues;
- modular bids—State/Territory governments and local governments supported state or regional bids or the integration of state networks into the NBN;
- some form of separation—the majority discussed forms of structural separation for the network;
- the need for network data to be made available; and
- measures to boost competition such as an access pricing regime to encourage competition at the wholesale and retail level.

The final RFP document

2.35 The department provided the Minister with a copy of the final draft of the RFP on 9 April 2008 and noted that if issues emerged once the RFP was

¹⁸ The indicative risk allocation table identified 53 risks during the construction and operational phases of the NBN and whether the Commonwealth considered that the risks should be borne by the contractor, the Government or shared by both.

released, there was the option to issue addenda. The department also noted in its briefing that potential proponents and stakeholders might criticise the lack of guidance in some areas. The final RFP contained provision for the Commonwealth to release details of commercial terms for the implementation of the NBN for those proponents who met pre-qualification requirements (which is discussed further in Chapter 3). AGS also provided probity advice during the development of the RFP and signed off the RFP document.

2.36 The indicative timetable between issuing and closing the RFP was three and a half months (April to July 2008), with the assessment of proposals and Government's decision on the successful proponent(s) expected to take a further three months (August to October 2008).¹⁹

2.37 In accordance with the Government's broadband policy, the Minister obtained the agreement of the Prime Minister, Minister for Finance and Deregulation and the Treasurer on the RFP document prior to its release. On 11 April 2008, the RFP document was released on Austender, as required by the CPGs.

2.38 The RFP document outlined, amongst other things, the:

- role of the Panel, specialist advisers, the ACCC and other Australian Government departments and agencies in the process;
- six evaluation criteria, in no order of importance, one of which was the extent to which proposals met the Commonwealth's 18 objectives for the NBN (see Appendix 2);
- factors considered in a value for money assessment of proposals (see Appendix 2);
- pre-qualification requirements and minimum conditions for participation (see Appendix 3 for minimum conditions);
- procedures for proponents to request further information;
- guiding principles for any bilateral meetings between the Commonwealth and proponents;
- procedures for managing confidential Commonwealth, proponent and network information; and

¹⁹ Subsequently, the closing date for the RFP was extended by four months to 26 November 2008, to allow all proponents at least 12 weeks to consider carriers' network information.

- information requested by the Commonwealth that proponents should include in their proposals.

Conclusion

2.39 The Minister and his office had a substantive role in the development of the RFP document and approved its release in April 2008. Throughout the development of the RFP there was a strong commitment to release the document on time to enable the Government to deliver on its election commitment. The RFP document met the requirements of the CPGs and was signed off by all specialist advisers. However, there was insufficient time to fully address specialist advisers' concerns that a lack of detail in the RFP put at risk attracting binding offers.

Management of the key risks to the process and a successful outcome

2.40 The Government's desire to quickly implement its election commitments limited the department's consultations with, and input from, NBN stakeholders during the development of the Government's broadband policy. The Government's broadband policy identified, rated and outlined mitigation strategies for the significant risks the department foresaw to the process and a successful outcome. In summary, these related to the short timeframe for the competitive assessment process, availability/provision of network information to proponents, process management issues, post-RFP issues, legal challenges, sufficiency of government funding, and significant compensation to Telstra for the acquisition of the right to use its equipment. DBCDE considered that all risks could be mitigated, but not eliminated, through a robust process that incorporated strong probity measures, expert advice, rigorous assessment criteria, a rigorous assessment process and strong performance guarantees and safeguards.

2.41 The primary means for addressing risks was to design an RFP process to maximise flexibility, minimise mandatory requirements and allow proponents to offer innovative solutions. National proponents were asked to submit binding proposals against the 18 Commonwealth objectives for the NBN and other evaluation criteria, and outline the regulatory changes necessary to facilitate their proposals. The RFP process left open the prospect:

- for varying the RFP document to address risks and issues as and when they arose during the process; and

- that a proposal may be acceptable even though it did not meet all objectives and other evaluation criteria.

The competitive assessment process was expected to determine the NBN that the market could build and operate.

2.42 Many of the identified risks never materialised or were appropriately managed so that they did not adversely impact on the RFP process and outcome. For example, legislative changes were implemented to the *Telecommunications Act 1997* to obtain network information from all carriers, and the closing date for proposals was extended to allow all potential proponents sufficient time to consider the network information. Throughout the process, the department informed the Minister of the status of these risks and possible outcome scenarios, including their likelihood and consequences.

2.43 The Government's approach to, and decisions taken during, the RFP process, which took into account departmental advice, were not sufficient to mitigate two of the identified risks—the sufficiency of government funding and significant compensation to Telstra—from adversely impacting the RFP outcomes. The ANAO considers that the risks associated with regulatory flexibility also had a significant bearing on the NBN outcome. The context for, and implications of, these risks are discussed below.

Sufficiency of government funding

2.44 As noted earlier, it has generally been acknowledged that Labor's broadband election commitment was based on a Telstra presentation to the former Government in 2005. At that time, Telstra advised that it could upgrade its equipment to deliver a broadband network that would meet the parameters of Labor's election commitment with a government contribution of \$4.7 billion.

2.45 The NBN incoming government brief advised that the cost of a FTTN NBN was 'likely to be very significant' and, that under current technology, would require using Telstra's network. The brief also indicated that proponents' business cases for extending FTTN technology to the most remote sections of the 98 per cent of Australia's homes and businesses could be 'extremely problematic, even with a major capital contribution by the Government'. At that time, the department advised the Minister that it would continue to develop cost estimates for a FTTN rollout, based on expert technical and financial advice.

2.46 In December 2007, the department advised the Government that Telstra estimated that the total cost of the upgrade project had risen to \$12 billion,

would take eight years rather than five to rollout, and would require multiple technologies (not just FTTN) to cover 98 per cent of Australian homes and businesses. Telstra further estimated that a \$4.7 billion government contribution, in conjunction with its own contribution, would allow it to reach only 95-96 per cent of homes and businesses.²⁰ In September 2008, the department advised the Minister that various industry and media commentators had speculated publicly (between March and June 2008) on the cost of building a FTTN network, with most cost estimates in the range of \$10 billion to \$20 billion.

2.47 The Government's contribution to the network relative to its total cost was always critical to its success. The contribution had to be a sufficient incentive to encourage the market to build a network that would at least meet (and preferably exceed) the Government's specification. Such cost estimates would commonly be based on sensitivity analysis being applied to various scenarios and assumptions using available information sources (for example, the aforementioned Telstra cost estimates, the G9 consortium's proposal to construct and operate a FTTN Broadband Access Service dated May 2007 (see Appendix 5), and expert industry advice). Information on cost estimates could also be used to inform the Government of any significant changes in assumptions and project risk management strategies.

2.48 The then Secretary informed the ANAO that, following discussions with the Minister, the department did not undertake any further work to estimate the likely cost of constructing a NBN to the Government's specifications. The Minister's position was that the department's estimates would be heavily caveated, costly to undertake and a poor second best to what proponents provided. The department further noted that:

- the Government had determined that its contribution to the NBN would be up to \$4.7 billion;
- proponents would determine the cost of building their networks, factoring in the Government's contribution and their required regulatory environment; and
- the RFP document did not restrict proponents from seeking more than \$4.7 billion from the Government (although those that did would not

²⁰ Presentation to Government by Telstra in December 2007.

have been assessed as favourably on the cost-related objectives/criteria as those who sought no more than \$4.7 billion).

Potential for significant compensation to Telstra

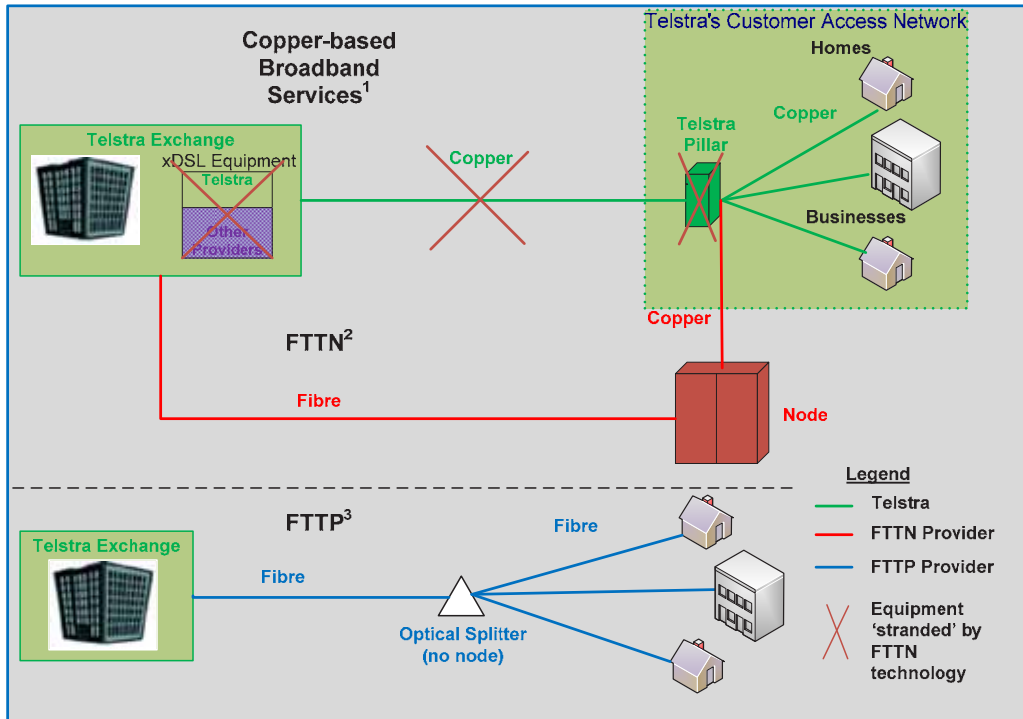
2.49 In the incoming government brief, the department advised the Government that non-Telstra proposals were likely to seek regulatory changes to gain exclusive (or near-exclusive) use of Telstra's customer access network (that is, 'cut-over'). Such a scenario would require the use of Telstra's ducts between exchanges and the nodes, and Telstra's copper network between the nodes and premises. Figure 2.1 illustrates copper-based and fibre-based broadband technologies. The department further advised that cut-over may be considered under the Australian Constitution (s.51(xxxi)) as a compulsory acquisition of Telstra's property, for which Telstra would be entitled to 'just terms' compensation.

2.50 The department consistently advised the Government that there was a significant risk that a non-Telstra solution may require the payment of compensation to Telstra. During the development of the Government's broadband policy, the department advised the Minister that any compensation claim was likely to extend beyond the value of Telstra's customer access network to include the loss of earnings from the asset. However, the courts would ultimately determine the size of any compensation (in the absence of a negotiated settlement). The department did not attempt to quantify or provide some order of magnitude for this significant risk until relatively late in the RFP process.

2.51 Under its broadband policy, the Government was seeking a national FTTN- and/or FTTP-based network. A FTTP NBN would not give rise to the cut-over of Telstra's network and therefore would avoid the associated compensation risk. However, it was generally accepted that a national FTTP network would require more Government funding than the \$4.7 billion that was on offer.

Figure 2.1

Illustration of copper-based and fibre-based broadband technologies



Note 1: Copper-based broadband services are provided on xDSL equipment (either Telstra’s or another provider’s) located at Telstra exchanges along copper cabling to Telstra pillars. From the pillars, copper wires provide broadband services to individual homes and businesses.

Note 2: FTTN technology involves using fibre running from Telstra exchanges to nodes. The nodes contain xDSL equipment that facilitate broadband services to individual homes and businesses along copper wires. Under a FTTN technology solution, xDSL equipment in exchanges, copper cabling to Telstra’s pillars, and the pillars themselves, are no longer used to provide broadband (and telephony) services (illustrated by ‘X’ above).

Note 3: FTTP technology involves using fibre running from Telstra exchanges through an optical splitter to individual homes and businesses using fibre.

Source: ANAO based on DBCDE information

2.52 The department attempted to manage the Telstra compensation risk by requesting that proponents factor into their proposal how they would address any appropriate claims for compensation to parties who may have been affected by the rollout and operation of their NBN. The department also considered that there was a possibility that:

- Telstra could be the successful proponent, making compensation a non-issue;

- non-Telstra proponents could develop and propose a technical solution that could avoid the cut-over issue;
- non-Telstra proponents could propose access charges (payable to Telstra for the use of its network) that would be sufficient to cover the cost of potential compensation; and/or
- a successful non-Telstra proponent could enter into an agreement with Telstra.

2.53 After the RFP was issued, the department also determined that, although a FTTN network could co-exist with copper-based broadband networks, it was unlikely to be commercially viable with the amount of government assistance on offer. Reasons included the ability of any new network to attract enough customers to cover costs and that it would still require access to Telstra's customer access network (that is, the copper cabling from Telstra pillars into homes and businesses).

2.54 During the RFP process, a decision by the High Court of Australia on 6 March 2008 concerning other carriers' access to Telstra's customer access network²¹ suggested to some industry participants that cut-over would not constitute an acquisition of property requiring compensation being payable to Telstra. However, legal advice sought in late-April 2008 and obtained early the following month by the department advised that the circumstances of the High Court matter and cut-over were sufficiently different to indicate that there was still a significant risk that cut-over would require compensation being payable to Telstra. This legal advice was conveyed to the Minister.

2.55 In September 2008, DBCDE sought and received advice on the legal principles for estimating the compensation that may be payable to Telstra for cut-over of its customer access network. The department's regulatory economic adviser used this legal advice and proponents' feedback from the bilateral meetings and market soundings to quantify, for the first time, estimates of the amount of compensation that could be payable to Telstra.²² Estimates of the potential compensation range were some billions of dollars and thus significant in the context of the likely cost to construct an NBN.²³

²¹ Telstra Corporation Limited v The Commonwealth [2008] HCA 7.

²² The regulatory economic adviser began providing qualitative advice soon after their engagement in May 2008 on the factors that could feature in the calculation of potential compensation to Telstra.

²³ The ANAO has not disclosed the range of potential compensation in view of the commercial sensitivities attaching to such estimates.

Panel members advised that they were surprised by the magnitude of the potential compensation that could be payable.

2.56 Calculating a range of potential compensation was a complex exercise, involving analysis and judgment. The department advised that it was not possible earlier in the process to credibly quantify the potential compensation that could be payable in the absence of:

- the compensatory legal principles advice, which was informed by the High Court’s decision; and
- a detailed understanding of non-Telstra proposals (including their proposed access payments to Telstra).

2.57 The timing of the High Court’s decision was unknown to the department at the time of implementing the Government’s policy and RFP process. The ANAO considers that it would have been prudent for the department to have sought earlier legal advice on the compensation issues to assist in quantifying the potential range of compensation payable. To this end, engaging a subject matter expert for this specific task and using available information sources, such as the contents of the G9 consortium’s proposal to construct and operate a FTTN Broadband Access Service dated May 2007 (see Appendix 5), may have assisted. These estimates, based on possible scenarios, could have been updated over time when better information became available on compensation factors.

2.58 By late-October 2008, and after the second round of bilateral meetings and market soundings, the department informed the Minister that all national non-Telstra proposals, except one²⁴, were going to propose the cut-over of Telstra’s customer access network to their FTTN NBNs. The national proposals lodged by non-Telstra proponents were, in the main, as expected by the department. Although one proponent claimed to have developed a technical solution to avoid cut-over, the Panel considered its proposed implementation still posed a compensatory risk.

2.59 The national non-Telstra proposals lodged in late November 2008 were either silent on the issue of cut-over compensation, or implicitly or explicitly transferred the compensation risk to the Commonwealth. The proposals were

²⁴ One proponent advised that it was intending to propose a different delivery model. The department considered this model would pose challenges for the proponent to demonstrate that it could meet some of the Commonwealth’s objectives for the NBN.

assessed as posing a significant or high compensation risk, with the potential compensation range of a similar order of magnitude to the estimates obtained by the department in September 2008. Consequently, the Panel considered that:

- no proponent could accept the cost risk and continue to have a viable business case; and
- there was a significant or high risk that the Commonwealth would be required to contribute significantly more than \$4.7 billion.

2.60 The Government's choice of a fibre-based technology platform for the NBN and the quantum of government funding available to the successful proponent(s) meant that Telstra's assets, including its customer access network and ducts from the exchange, were a critical dependency for the success of the NBN RFP process.

2.61 The department and the former Secretary advised the ANAO that the Minister and the Government were kept fully informed of the Telstra compensation risk throughout the RFP process, and that the Government proceeded in the full knowledge of its likely consequences. Departmental records indicate that it consistently reinforced to Government throughout the RFP process that compensation to Telstra was a risk likely to materialise. Nevertheless, the ANAO considers that earlier advice to Government on the possible magnitude of the potential Telstra compensation would have provided the Government with a greater appreciation of the consequence of this key risk, including its relativity to the likely cost of the network, and potential impact on a successful outcome. This information would have better informed, and may have influenced, the Government's approach to delivering the NBN.

NBN regulatory flexibility

2.62 Labor's broadband election commitments indicated that the Government would put in place regulatory reforms to ensure certainty for the successful proponent's investment in the NBN. The Government's broadband policy and the RFP document were consistent with these election commitments. The incoming government brief submitted to the Minister advised that all proponents would be seeking regulatory certainty before committing to any FTTN investment as an outcome of the assessment process. However, the department did not formally identify the uncertain regulatory

environment as a risk to the RFP process during the development of the Government's broadband policy in January 2008.

2.63 The department, Panel and the Government recognised that the regulatory framework that would apply to the new network would be critical to its financial viability and management, the structure of the industry, consumer outcomes, and competition. The RFP invited proponents to detail any proposed legislative or regulatory changes necessary to facilitate their proposals, so long as the changes would not jeopardise the Commonwealth's objectives for the NBN. Panel members and specialist advisers contacted by the ANAO considered that the wide scope given to proponents to propose their NBNs' regulatory environment was unusual for an RFP process.

2.64 The department considered that the opportunity for proponents to put forward regulatory changes made a complex commercial transaction more complicated and increased the likelihood of receiving conditional proposals. Each proponent found it difficult to put forward a proposal that they thought would be acceptable to the Government, given:

- an extensive choice (and no preferences) for the potential regulatory regime that would support their proposed NBN; and
- its importance to the viability of their proposals.

2.65 The department informed the Minister that potential regulatory changes remained the critical issue for all proponents at the bilateral meetings. Proponents expressed doubt that the Government was prepared to accept the regulatory conditions included in their proposals. The department advised proponents that they would be informed of any particular 'no go' regulatory areas, of which there were none.

2.66 National proposals included a range of requested regulatory changes, some of which the Panel considered to be an improvement on the current regulatory arrangements. However, the Panel's assessment of national proposals indicated that proponents' requested regulatory changes, overall, were either marginally acceptable or undesirable. Those changes viewed less favourably by the Panel included cut-over of Telstra's customer access network (discussed above) and overbuild protections (discussed below).

2.67 As the RFP progressed, the department kept the Minister informed that the flexibility provided in the RFP for proponents to propose the regulatory environment for their NBN was posing difficulties for them. Greater guidance to proponents on the Government's regulatory intent for the NBN would have

given them the opportunity to request regulatory environments more acceptable to the Government. However, this would most likely have necessitated an extension to the Government's timetable for the RFP process, depending on its content and when it was provided in the process.

Conflict with the Commonwealth's objectives for the NBN

2.68 The Government's broadband policy document noted that the RFP process would allow potential proponents to seek various regulatory changes to facilitate their network rollouts, including prohibiting other carriers from rolling-out and operating competing networks (that is, overbuild protections). Non-Telstra proponents were likely to propose overbuild protections as their NBNs would require much of the broadband traffic currently serviced by copper-based broadband networks to be commercially viable. However, before the RFP document was finalised, the department became aware that overbuild protections could be inconsistent with one of the Commonwealth's objectives for the NBN—'consistency with Australia's international obligations'.

2.69 During the RFP process, DFAT and the Office of International Law (OIL) in the Attorney-General's Department advised DBCDE on the extent to which the various potential regulatory changes that proponents may put forward would be consistent with Australia's international obligations. This included advice in relation to agreements under the auspices of the World Trade Organization and in relation to Australia's free trade agreements. The potential consequences of inconsistencies with international and bilateral trade obligations are described in Table 2.1.

2.70 As the RFP progressed, the department explored various scenarios with DFAT and OIL to determine the extent to which the international market access obligations applied to the NBN project. DFAT and OIL also assessed proposals against the international obligations objective on behalf of the Panel. Their assessment of the proposals indicated that the overbuild protections proposed could be inconsistent with Australia's international trade obligations.

2.71 The department knew early in the RFP process that the overbuild protections that non-Telstra proponents were likely to seek could jeopardise the achievement of one of the Commonwealth objectives for the NBN, which would be at odds with the Government's broadband policy. The department informed the Government in September 2008 that overbuild protections could potentially breach international trade obligations.

Table 2.1**Commentary on the potential consequences of inconsistencies with international and bilateral trade obligations**

Any inconsistency with international law will typically be determined by assessing any measures put in place by the Government against the relevant obligations. Measures can include legislation, regulations and sub-ordinate instruments such as Ministerial Determinations as well as practices and other actions by Government.

If the construction and operation of the NBN is not consistent with Australia's international obligations, it is possible that another Government may bring a dispute against Australia including under the auspices of the World Trade Organization (WTO) or under the dispute settlement mechanisms of a free trade agreement (FTA).

WTO and FTA dispute settlement provisions initially seek to resolve differences through consultations. However, if this fails, a dispute panel may be convened to assess the merits of the dispute. If Australia were to lose a dispute, it may be expected to change the offending measure. The consequences for not doing so could include a requirement to pay compensation or the imposition of similar trade measures against Australia.

Source: Department of Broadband, Communications and the Digital Economy

2.72 Based on past experience, the department was confident that by working with DFAT, a way could have been found to achieve the outcome sought by proponents that was consistent with international trade obligations. Throughout the RFP process, proponents received no information regarding the potential implications of international trade obligations for their proposals.

Conclusion

2.73 The Government's broadband policy had some key risks that posed significant challenges for the department to deliver a competitive assessment process and a successful outcome for the NBN. Although many risks were appropriately managed, some could not be sufficiently mitigated within the stated parameters of the RFP process.

2.74 The limited opportunity of other stakeholders, including industry and other Australian Government agencies, to provide input into the development of the Government's broadband policy, constrained the department's ability to consider their views and the associated implications for a successful RFP process.

2.75 In parallel with developing the RFP process, the department could have better analysed some key risks that had an adverse impact on a successful outcome. This analysis would have meant that it was better positioned when giving advice to Government. These risks included:

- *sufficiency of government funding*—by analysing the commercial viability of a network that would meet all Commonwealth objectives and criteria using cost estimates put forward by industry representatives and commentators, and assessing whether the government’s contribution would be likely to be sufficient to attract acceptable proposals;
- *significant compensation to Telstra*—by assessing the magnitude or possible range of the potential cost of cut-over compensation, and its likely impact on the viability of non-Telstra proposals; and
- *NBN regulatory flexibility*—by advising the risk that (i) the wide scope for proponents to propose the regulatory environment for their NBNs would decrease the prospects of a successful outcome; and (ii) at least one critical regulatory change that non-Telstra proposals were likely to seek could be at odds with the Government’s broadband policy.

2.76 The department and the former Secretary informed the ANAO that the Government received clear advice on the full range of risks likely to arise in implementing its NBN election commitment and the consequences of those risks for the process. The Government made a decision to proceed on a course consistent with its election commitment in the full knowledge of the likely risks and consequences. The former Secretary further informed the ANAO that the Minister accepted early in the conduct of the RFP process that it may not result in the receipt of binding offers capable of acceptance. However, the Minister wanted to see the outcome of the RFP process before deciding upon subsequent steps to achieve the Government’s broadband election commitments.

Upgrade path of the broadband technology

2.77 The Government’s broadband policy indicated that proposals would be assessed in terms of the proponent’s capacity to deliver, operate and continue to invest to maintain and upgrade the proposed networks and services. The RFP document requested proponents build and operate a fibre-based NBN and demonstrate a clear upgrade path for the network to meet future consumer demands and service developments to at least 2020, and preferably beyond. One of the objectives against which NBN proposals would be assessed was that it ‘has sufficient capacity to meet current and future demand and has a

specified upgrade path within clear timeframes, consistent with international trends'. FTTP was viewed as the future platform of the NBN.²⁵

2.78 However, in May 2008, after the release of the RFP document, the ACCC provided unsolicited advice to the Panel and the department that FTTN networks do not provide a cost-effective migration strategy to a FTTP network. The ACCC identified that expenditure on the installation and maintenance of nodes (which could account for as much as 90 per cent of the NBN cost) is of no benefit to a FTTP network. A FTTN network was not so much a stepping stone towards a future FTTP network, but a distinct alternative for a NBN.

2.79 The ACCC's report to the Expert Panel in January 2009 effectively confirmed its earlier advice that:

- FTTN is not a stepping stone to FTTP, as the nodes deployed are made obsolete in a FTTP rollout. Funds spent on nodes (estimated at between \$8-10 billion) are therefore essentially wasted once a decision is made to transition to a FTTP network (unless the operator has had sufficient time to recover the nodes' capital costs); and
- the investment of significant funds into nodes could serve to delay FTTP if the successful proponent is not under significant competitive pressure and can therefore delay further investment until its node costs are fully recovered.

2.80 The Panel's assessment of national proposals found that all did not clearly demonstrate an upgrade path for their networks or there were significant risks to achieving the specified upgrade path. The Panel's Evaluation Report agreed with the ACCC's assessment that a FTTN network was unlikely to provide an efficient upgrade path to FTTP.

2.81 The department advised the ANAO that the RFP did not mandate a network upgrade path to a FTTP platform. An upgrade path within a FTTN solution was possible, through improvements to computer hardware and software, a refreshment of the copper cabling and/or more nodes closer to customers. In addition, the department and the Chair of the Panel advised the

²⁵ FTTP has been long considered by industry as the optimal method for delivering broadband services. However, its significant cost has prevented its large scale rollout beyond heavy-traffic areas. Schedule 2 to the RFP document (clause 1.1.9(a)(iii)) says that 'Proponents should detail the technology upgrade path for the NBN, for example to 2020, addressing the potential to use the proposed network as the platform for the eventual provision of fibre-to-the-premises (FTTP) ...'.

ANAO that the Government's RFP process was seeking proposals using either FTTN or FTTP technology. The Government saw FTTN/FTTP as acceptable alternatives, not necessarily sequential stages. As a consequence, the Panel's observations regarding the upgrade path, should therefore be seen in the context of advice to government on policy going forward after it concluded there were no acceptable proposals, with a key consideration being the Commonwealth's exposure to potential compensation to Telstra under a FTTN solution.

2.82 The ANAO considers that the Government would have been better informed about its proposed approach to an NBN and potential scalability to cater for future demands, had the department recognised, prior to the release of the RFP, that FTTN did not provide an efficient upgrade path to FTTP technology.

3. Conduct of the NBN RFP process

This chapter discusses the key elements of the NBN RFP process after the issue of the RFP document in April 2008 to the Minister's termination of the process in April 2009. The management of the key emerging risks that arose while the RFP was open is also examined.

Introduction

3.1 After the Government issued the NBN RFP document in April 2008, the key steps to take the process forward included:

- developing an evaluation plan;
- managing proponent interactions;
- managing emerging risks;
- contingency planning in the event that the RFP did not produce a successful outcome;
- assessing proposals and reporting to the Minister; and
- advising the outcome.

Development of the evaluation plan

3.2 The department recognised that the development of an evaluation plan was a critical component of the NBN RFP process. It was also recognised that documented evaluation processes had to be in place prior to the receipt of proposals to ensure that the outcomes of the evaluation process could be defended. While the Government had overall responsibility for the assessment process and issuing of the RFP, the Panel (with assistance from the department and its advisers) was responsible for assessing the proposals in accordance with the process and evaluation criteria set out in the RFP document.

Initial drafting of the evaluation plan

3.3 The development of the evaluation plan began soon after the release of the RFP. A first draft of the plan was prepared by the probity adviser in April 2008 and provided to DBCDE, other specialist advisers and the Panel for comment and further development. The initial draft plan outlined a three-step process for evaluating proposals that explicitly considered risk in accordance with the Australian standards on risk management. Consistent with a complex

evaluation process such as the NBN, the probity adviser considered that it was common practice for risk to be assessed as a discrete component of the evaluation criteria (for example, each criteria would have a risk score, based on an assessment of likelihood and consequence). For this reason, the probity adviser proposed providing extensive guidance in the evaluation plan to maximise rating consistency and process transparency.

3.4 On the Panel’s instructions, the department extensively reworked drafts of the evaluation plan between May and July 2008, in consultation with AGS and specialist advisers. As the RFP process progressed, the probity adviser and the department refined how risk assessments would integrate into the evaluation ratings. The final evaluation plan streamlined the assessment process into a single step and was less explicit on the consideration of risks by integrating it into the ratings against the evaluation criteria (see Table 3.1). The department cited the short evaluation timeframe as one reason for the revised approach to assessing proposals. The Panel also noted that it wanted sufficient flexibility to make a holistic assessment of proposals without the evaluation process being overly formulaic or prescriptive.

Table 3.1

Rating scale for individual proposal assessment

Rating	Description
HIGH	Proposal fully meets and exceeds criterion including in relation to risk
HIGH/MEDIUM	Proposal fully meets and marginally exceeds criterion including in relation to risk
MEDIUM	Proposal fully meets but does not exceed criterion including in relation to risk
MEDIUM/LOW	Does not meet criterion in all respects, however is of a sufficient standard to be broadly or marginally acceptable including in relation to risk
LOW	Proposal fails to meet the criterion including in relation to risk
<p>Note: In reaching its conclusion on the final rating to be applied to each criterion, the Panel will consider and document whether the approach proposed by a Proponent(s) would expose the Commonwealth to risks. In the event that these risks are considered to be material then the rating against a particular criterion will reflect that judgement, and the reasons for reaching this conclusion will be documented. Where the risks are assessed as being not material, the reasons for forming this view will also be documented.</p>	

Source: NBN Evaluation Plan

Consideration of how objectives and evaluation criteria were to be assessed

3.5 In early-August 2008, DBCDE conducted an evaluation workshop to draw on the collective knowledge of departmental staff and specialist advisers in considering issues associated with conducting the NBN evaluation as well as assigning roles and responsibilities to take the work forward.

3.6 Between August and October 2008, evaluation discussion papers were prepared by the specialist advisers (with comments from DBCDE) for each Commonwealth objective of the NBN and each of the remaining five criteria. The purpose of the discussion papers was to:

- identify the issues and information from Schedule 2 of the RFP that would be considered in the evaluation of each objective/criterion; and
- identify any methodology issues that may need to be resolved before proposals were received.

3.7 The evaluation discussion papers commented, to some extent, on most of the key risks and issues that related to a successful outcome discussed in Chapter 2 as follows:

- *significant compensation to Telstra*—proposed that any compensation costs from a proposal should be met by the proponent on top of the proponent's contribution for the roll-out and operation of the network;
- *NBN regulatory flexibility*—notes that proposals may request overbuild restrictions, but does not acknowledge that these could be inconsistent with Australia's international trade obligations, and would therefore be at odds with the Government's broadband policy; and
- *upgrade path of the broadband technology*—does not acknowledge the limitations of the scalability of a FTTN network to a FTTP network;

3.8 Determining how each objective/criterion was to be evaluated was a complex and time-consuming exercise. DBCDE and the specialist advisers identified that there were many references and cross-references to requested documentation and information within the RFP document. The 18 Commonwealth and other five evaluation criteria objectives were not

mutually exclusive. Information provided by proponents to address one objective/criterion could also be relevant to other objectives/criteria.²⁶

3.9 The ACCC was consulted throughout the development of the evaluation plan. In accordance with its ongoing advisory role to the Panel, the ACCC provided the Panel with presentations and briefing papers on issues such as: the regulatory environment; key access pricing issues; and the impact of equivalence requirements (such as vertical integration). These presentations assisted the Panel to get a better understanding of the regulatory environment's key issues and how the ACCC intended to evaluate proposals. They also helped inform the Panel's assessment of proposals (discussed below).

3.10 Throughout the RFP document, but particularly in Schedule 2, proponents were asked to provide documentation to support their proposal. The department also provided proponents with a checklist that listed clause-by-clause the information the RFP sought from proponents. The department considers that this guidance was adequate. However, proponents were not aware of the extent to which the documentation they provided would be used to address multiple objectives and criteria during the Panel's assessment of their proposals.

The final evaluation plan

3.11 Multiple drafts of the evaluation discussion papers were provided to the Panel for its consideration and comment. Once finalised, the discussion papers formed the content of the final evaluation plan in terms of matters that the Panel would have regard to in the assessment of each objective/criterion. Members of the Panel approved the evaluation plan on 24 November 2008. The evaluation plan was approved by specialist advisers, including the probity adviser, by 25 November 2008, and by the Minister on 26 November 2008.

3.12 The evaluation plan contained detailed information on:

- the role of the Panel, the department, specialist advisers, and other Commonwealth departments and agencies, throughout the process²⁷;

²⁶ For example, Evaluation Criteria 4—*the cost to the Commonwealth of the Proposal*—had links and relationships to one objective and three evaluation criteria, as identified by DBCDE and the specialist advisers. Objective 13 relates to the return on the Government's investment of up to \$4.7 billion, while Criteria 2, 3 and 5 all related to calculating the risk-adjusted Net Present Cost of the proposals (to the extent that assessments were quantifiable).

- the logistics of how proposals would be received, handled, stored and accessed;
- the process of assessing applications, including the initial screening, individual assessment, and value-for-money assessment of each competitive proposal;
- how communications with proponents would be handled during the assessment process, including proposal presentations and clarification of the proposals' contents; and
- how proposals would be assessed and scored against each of the six criteria and 18 Commonwealth objectives (where one criterion encapsulated the assessment of proposals against the Commonwealth objectives).²⁸

3.13 Ideally, an evaluation plan is developed in parallel with the development of the RFP document. However, work on the NBN evaluation plan began after the RFP document was issued. It was finalised a few days before proposals were to be submitted.

Conclusion

3.14 The evaluation plan aligned with the RFP document, and with the evaluation discussion papers providing a link between the two documents. The plan was comprehensive and set out how the Panel (with assistance from the department, the specialist advisers and the ACCC) would assess proposals using the information requested of proponents. Nevertheless, the evaluation discussion papers provided the Panel with little insight into how some of the processes' key risks and issues may affect a successful outcome.

3.15 The ANAO recognises that competing deadlines was a constant feature of the RFP process. Nevertheless, had the evaluation plan been finalised earlier in the process, the department would have been in a better position to provide greater clarity to proponents on the extent to which the information requested

²⁷ The NBN evaluation plan provided for input to be sought from the following Commonwealth departments and agencies: ACCC; Attorney-General's Department and other security agencies; Department of Foreign Affairs and Trade; Australian Communications and Media Authority; Department of the Treasury; Department of Finance and Deregulation; Department of Innovation, Industry, Science and Research; Department of Education, Employment and Workplace Relations; Department of Environment, Water, Heritage and the Arts; Department of Resources, Energy and Tourism; AGS; and the Solicitor-General.

²⁸ All objectives and criteria were not weighted.

was to be used when assessing proposals against the RFP's multiple objectives and criteria. Proponents could then have been given the opportunity to submit better developed and more competitive proposals.

Proponents involvement in the process

3.16 A number of interactions occurred with potential and actual proponents between the release of the RFP document (11 April 2008) and the end of the evaluation timeframe (21 January 2009). The basis for these interactions was established by the RFP document, and was intended to help ensure that the proposals they received:

- met the expectations of government;
- represented value for money;
- would assist the evaluation of proposals; and
- provided a mechanism for debriefing proponents after the evaluation process.

3.17 Mechanisms were also outlined in the RFP for proponents to interact with the department and its advisers throughout the process and the Panel after lodgment of proposals. These included:

- the ability to seek clarifications to the RFP document;
- bilateral meetings with DBCDE and specialist advisers;
- providing clarifications on their proposals, as requested by the Panel; and
- proposals presentation to, and host site visits for, the Panel.

In addition, market soundings were taken of potential proponents by the strategic adviser during the preparation of proposals. Proponents were also offered debriefs after the termination of the process (which is discussed later in this chapter). Appendix 6 outlines the dates of key interactions with proponents.

3.18 Interactions between the department and proponents were designed to ensure that all (potential and actual) proponents were treated equitably throughout the process and in accordance with the parameters of the RFP. All significant interactions were overseen by the probity adviser. Proponents commented to the ANAO that the department conducted the process in a professional and impartial manner.

Clarifications register, addenda and clarifications

3.19 Questions relating to the RFP were directed to a designated DBCDE officer on an ongoing basis and recorded in a clarifications register. These questions were managed and responded to by DBCDE where appropriate. Where specialist advice was required, DBCDE directed questions to the appropriate specialist adviser. The entries in the clarifications register formed the basis for issues covered in bilateral meetings and those requiring a formal addendum or clarification to the RFP document. The department documented the clarifications proponents sought and the responses provided.

3.20 Over the period 9 May to 14 November 2008, DBCDE issued two addenda and 33 clarifications to the RFP document. All addenda and clarifications were vetted by the probity adviser as being consistent with the RFP. The first addendum (issued 25 August 2008) inserted new clauses in the RFP that related to the introduction of new members of pre-qualified consortia and giving them access to network information. The second addendum (issued 3 September 2008) related to adjusting the closing dates for proposals (to account for the release of network information), proponents' ability to submit alternate proposals, and internet protocol readiness. The extension to the RFP timeline to allow proponents extra time to consider carriers' network information addressed their initial concerns that the timeline would be insufficient to prepare and lodge fully developed proposals.

3.21 According to media reports, the Minister indicated in April 2008 that 'the Government was willing to accept "non-compliant" bids' under the NBN RFP process.²⁹ However, the RFP document was not amended to allow for the assessment of proposals that did not meet the RFP's minimum conditions of participation.

3.22 After the first round of bilateral meetings in mid-June 2008, clarification was sought on the process for revising national proposals to take into account a State/Territory-based proposal. On 18 July 2008, DBCDE responded by referring the proponent back to the RFP document. DBCDE subsequently obtained specialist advice on options for incorporating State/Territory-based proposals into national proposals. After considering the advice, the department decided to issue a clarification on this matter (vetted by the

²⁹ Australian IT, *National broadband network undermined*, 21 April 2008, <<http://www.australianit.news.com.au/story/0,25197,23572294-15306,00.html>> [accessed 23 October 2009].

probity adviser as being within the parameters of the RFP) on 19 September 2008, some three months after initial concerns were raised.³⁰ Both State/Territory-based proponents advised the ANAO that they considered that:

- their proposals were disadvantaged by the assessment process outlined in the RFP clarification; and
- earlier notice of the contents of the clarification may have influenced their decision to participate in the RFP process.

Bilateral meetings

3.23 Four rounds of bilateral meetings were held with pre-qualified proponents from June to November 2008. The meetings were an opportunity for DBCDE to learn more about proponents' plans for the NBN and the types of proposals likely to be received. For the proponents, the meetings were an opportunity to explore the Government's policy and process requirements under the RFP. Probity protocols were developed for the bilateral process and, consistent with the RFP, the meetings were subject to oversight from the probity adviser. The investment, financial and commercial adviser provided support for the bilateral meetings, managed their conduct and drafted correspondence to proponents. Two proponents did not attend all rounds of bilateral meetings.

3.24 Prior to the bilateral meetings, proponents were asked to identify those issues they would like to discuss at the meetings. These were generally of a financial, commercial, legal, technical, regulatory or process nature. Issues were discussed and DBCDE provided responses and took questions on notice. Minutes of the bilateral meetings were prepared. After each round of meetings, DBCDE provided proponents a common summary of all significant discussion(s) and responses to questions on a non-attributable basis. Documentation supporting the bilateral meetings evidence that the summaries sent to proponents were representative of the issues raised by individual proponents.

³⁰ The clarification indicated that national proponents whose proposals were assessed as capable of providing value for money would be requested to submit a revised proposal that excised areas covered by State/Territory-based proposals assessed as possibly assisting the Commonwealth to achieve the best outcome. Any revised proposals would be 'combined with' the aforementioned State/Territory proposals and the combined proposals assessed against the Commonwealth's objectives and other evaluation criteria.

3.25 The response to most questions raised by proponents was to refer them to the relevant section of the RFP document. DBCDE advised that proponent's were seeking guidance on the Government's preferences within the broad stated parameters of the RFP. However, as the Government had no specified preference, it was unable to provide this guidance. Two areas where DBCDE provided supplementary guidance for discussion was in respect of financial modelling and commercial terms. The latter was explicitly mentioned in the RFP document as an area where further guidance could be forthcoming. However, the department advised proponents that as this guidance was provided late in the process, it was indicative only and would not form part of the evaluation of proposals.

3.26 On 20 August 2008, the department advised the Minister that a recurring theme among proponents was the difficulty they were facing in developing and financing their proposals, given the flexibility of the Government's process. Some of the key issues raised in the bilateral meetings by proponents were the relative importance of evaluation criteria and the need for more regulatory certainty (such as access to third-party infrastructure and wholesale pricing arrangements).

3.27 The bilateral meetings allowed DBCDE to gain insight into the proposals being formed by proponents. However, proponents indicated to the ANAO that the meetings were of limited value. The department was unable to elaborate or provide additional insight into the RFP, the Commonwealth's objectives or the desired outcome. Proponents indicated that a reciprocal flow of information to gain a clearer understanding of the RFP, or changes to the RFP that would better align with the Commonwealth's objectives, would have been more helpful.

Market soundings

3.28 The RFP document outlined that during the RFP process the Commonwealth had the ability to seek information from a proponent as to its proposal. In May 2008, the investment, financial and commercial adviser agreed to 'sound out' all potential proponents known to be interested in submitting a proposal. The 'soundings' were aimed at determining whether the proponents were likely to lodge a bid bond. DBCDE was keen to better understand what, if any, issues were impacting on these considerations. Potential bilateral meeting dates were discussed and potential proponents were given the opportunity to raise issues and discuss their views regarding

the process. It was envisaged that the market soundings would be a 'listening exercise' and be less formal than the bilateral meetings.

3.29 The notes of these discussions were provided to the probity adviser for review. Some of the issues mentioned by proponents included the:

- insufficiency of the timeframe to respond to the RFP;
- inadequacy of network information;
- lack of definitive tender evaluation criteria (in respect of their weighting or relative importance, and potential trade-offs);
- inability of proponents to lodge binding proposals;
- lack of certainty surrounding regulatory issues; and
- importance of bilateral meetings.

3.30 In September and October 2008, DBCDE's strategic adviser and one of the specialist advisers conducted further market soundings. Again, this process was overseen by the probity adviser. After the second round of market soundings, DBCDE had a reasonable idea of what each proponent intended to submit and the particular issues and themes relating to each proposal. The Minister was informed of the results.

Post lodgement clarifications, presentations and site visits

3.31 After proposals were lodged, the RFP document provided that the Panel could seek clarification or additional information on proposals to assist the evaluation process. The Panel and probity adviser reviewed potential questions to proponents drafted by DBCDE and the specialist advisers before they were sent to the proponents. The probity adviser reviewed all proponents' answers to questions, commenting on the extent to which they represented 'bid repair' (as opposed to a clarification) and therefore should be ignored during the assessment process. This probity oversight ensured that the clarifications and any information provided for evaluation was consistent with the requirements of the RFP document.

3.32 All proponents who met the RFP's minimum conditions for participation presented their proposals to the Panel face to face. The probity adviser provided probity protocols to govern the conduct of the NBN presentations and was consulted regarding the proposed questions asked at the presentations. Both the Panel and proponents found the presentations to be worthwhile.

3.33 All proponents were given the opportunity to host site visits or technical demonstrations, where DBCDE, specialist advisers and available Panel members could attend. There were four site visits and one technology demonstration held at a neutral venue. The probity adviser developed protocols for site visits and technology demonstrations, which included being consistent with confidentiality requirements and recording all discussions held and clarifications received. From the documented records of site visits and the technology demonstration, these protocols were followed.

Management of emerging risks

3.34 DBCDE advised the ANAO that the nature of the RFP process warranted a flexible approach to managing inherent and emerging risks. Accordingly, risks were identified and addressed at a number of different management fora, some of which were established specifically to manage aspects of the NBN RFP process. The primary fora used to govern and manage the project and its risks at various times during the NBN RFP process included:

- departmental meetings with the Minister (at least weekly), who reported to Cabinet through its Economic Policy Committee and the Strategic Priorities and Budgeting Committee;
- Panel meetings (monthly at first, then more frequently), with the Minister receiving a briefing after each by the Chair and another member on rotation;
- ad-hoc high-level strategic discussions between the then DBCDE Secretary and the Secretary of the Department of the Prime Minister and Cabinet and, at times, the Secretaries of the Departments of Finance and Deregulation, and the Treasury;
- meetings of the interdepartmental committee established for the process (generally monthly);
- meetings of the departmental steering group (generally every three to four weeks) and its working groups (generally weekly or fortnightly, when needed);
- whole-of-NBN project team meetings (fortnightly when needed);
- daily meetings between the then Secretary and the relevant departmental SES officers;
- daily meetings between DBCDE and specialist advisers; and

- quarterly progress reports to the Cabinet Implementation Unit in the Department of the Prime Minister and Cabinet.

3.35 The project's governance and management framework (outlined in Figure 1.1 in Chapter 1) provided sufficient avenues to identify, assess and, where necessary, escalate emerging risks to those best able to approve treatment options. The department was able to address and sufficiently mitigate many risks that emerged as the conduct of the RFP progressed. However, three emerging risks, in particular, arose that had the potential to adversely impact a successful process outcome:

- non-weighting of the evaluation criteria;
- proponents' access to finance; and
- Telstra not submitting an eligible proposal.

The context for, and implications of, these three risks are discussed below.

Non-weighting of the evaluation criteria

3.36 The Government approved the six evaluation criteria, one of which was the extent to which proposals met the 18 Commonwealth objectives for the NBN. Criteria were not specified in any order of importance (see Appendix 2 for a list of the Commonwealth's objectives and evaluation criteria). Further, all objectives were not complementary. Some objectives competed and conflicted with each other. For example, proponents would have found it challenging to meet all of the following objectives for the NBN:

- cover 98 per cent of all Australian homes and businesses (Objective 1);
- offer broadband services with a minimum 12 Mbps dedicated downlink transmission speed over each connection provided to a premises (Objective 2);
- enable low access prices that reflect underlying costs while allowing proponents to earn a rate of return on their investment commensurate with the risk of the projects (Objective 11); and
- provide the Commonwealth with a return on its investment of up to \$4.7 billion (Objective 13).

3.37 With one evaluation criterion encompassing all 18 competing (and sometimes conflicting) objectives, it was difficult to see how the Panel would arrive at a single overall rating that would be representative of the qualitative assessments against the objectives (see Table 3.1 above for the ratings scale).

This approach had the potential to reduce the transparency of the assessment process. However, for each national proposal, the Panel's (primarily) qualitative assessments against the majority of the objectives were consistent, leading to a representative overall rating.

3.38 Proponents faced considerable difficulty in developing commercially-viable networks capable of meeting all 18 objectives and other evaluation criteria. Advice from specialist advisers throughout the RFP process raised the issue of weighting the objectives and other evaluation criteria. Proponents had also sought guidance from DBCDE on the weighting or preference that would apply to the different objectives and criteria in the RFP. The specialists' advice and proponents' comments were conveyed to the Minister. However, further advice beyond that appearing in the RFP document was not forthcoming. The Government had decided and reaffirmed that it did not want to weight the objectives and the evaluation criteria. The reasons for this included:

- the parameters set by the election commitment did not specify an order of importance for the NBN's objectives and criteria;
- weighting of the criteria and objectives would not lead to the best competitive proposals against the RFP's parameters; and
- the Government had no pre-established preferences and left it to proponents to determine the trade-offs in meeting the RFP's objectives/criteria.

3.39 The Panel followed the parameters set by the Government for the RFP and assessed proposals with all objectives and criteria non-weighted. Proponents advised that the RFP's flexibility gave them significant scope to submit eligible proposals with innovative technical solutions. However, they also found it difficult to develop competitive and commercially-viable proposals that would be acceptable to the Government, while not necessarily meeting all the objectives and other criteria.

Proponents' access to finance

3.40 From the outset of the RFP, it was anticipated that proposals would involve a significant non-government (that is, private) funding component to deliver an NBN. The organisations would generally fund this non-government component (likely to be in the billions of dollars) through the raising of finance from domestic and/or international debt and equity markets.

3.41 Throughout late-2007 and 2008, there were a number of economic and financial market indicators that suggested equity markets were deteriorating and it was becoming increasingly difficult for organisations to access debt funding. DBCDE's strategic adviser raised this issue with the department in late-June 2008, and the issue was first recorded on the project's risk register in August 2008.

3.42 The magnitude of the global financial crisis was largely unanticipated globally and heightened towards the latter stage of the RFP process. When the global financial crisis crystallised in September 2008 (see Table 3.2), DBCDE asked its investment, financial and commercial adviser to prepare a discussion paper on the current financial and economic environment and the impact for the NBN project. In particular, the ability of a proponent to raise \$15 billion.³¹

Table 3.2

A brief overview of the global financial crisis and its impact on world financial markets

The global financial crisis is generally acknowledged to have originated from the United States (US). Throughout 2007, there was a rise in loan defaults in a significant sector of the US capital market (the sub-prime mortgage market). In late-2007, global financial markets experienced a period of significant volatility, as the strains from the sub-prime mortgage market in the US spilled over into other credit markets. There was also significant volatility in global share and currency markets.

In early- to mid-2008, volatility in global financial markets continued. In early September 2008, the failure or near-failure of a number of significant financial institutions in the US and Europe triggered further declines in equity prices, exceptional volatility across a range of markets, and the significant tightening of credit lending in a number of countries.

By late-2008, world financial markets had come under severe stress. The world economy also experienced a marked contraction in late-2008 and early-2009. The sharp and synchronised nature of the downturn was largely accounted for by the substantial falls in consumer and business confidence that followed the financial events in September 2008.

Source: ANAO summary of Statements on Monetary Policy by the Reserve Bank of Australia (February 2007 to May 2009)

3.43 The discussion paper indicated that there was some concern over the ability of proponents to effectively source both the debt and equity project funding required. However, without completing any credit analysis of the

³¹ DBCDE determined the amount of \$15 billion to be a rough estimate of the total cost of building an NBN, based on feedback from proponents.

respective proponents or the likely operating and structural considerations in relation to the NBN project itself, it would be difficult to determine the respective capacities of proponents to raise the required external debt and/or equity funding to support the delivery of the NBN. The paper noted recent comments from Standard and Poors (an international credit rating provider) that suggested Telstra would have the capacity to access capital to complete the NBN project.

3.44 DBCDE considered that its options for managing the risks to the RFP process caused by the global financial crisis were limited without varying the parameters of the RFP. The RFP process proceeded unchanged.

Telstra not submitting an eligible proposal

3.45 As previously noted, the Government's election commitment was primarily based on a proposal put forward by Telstra to the former Government in 2005 to upgrade and extend its equipment. DBCDE therefore considered that Telstra would have a strong interest in the NBN RFP process as it was inherently well-placed to lodge a competitive (and potentially successful) proposal.

3.46 Early in the conduct of the RFP process, indications from the market were that Telstra would lodge a proposal and was confident of being successful. However, as the RFP progressed, Telstra increasingly indicated that it wanted the Government to provide particular assurances before committing to lodging a proposal. About a month before the closing date for proposals, DBCDE became aware that Telstra may decide to withdraw from the process.

3.47 At the closing date for proposals, Telstra lodged a 12-page NBN proposal with DBCDE and released a copy to the public at the same time. Telstra's proposal outlined what would be achieved by the fully detailed bid that had been prepared, but not submitted.

3.48 Telstra considered that its 'summary' proposal met the existing terms of the RFP and that, if concerns could be addressed to its satisfaction, more detailed dialogue was possible. The four issues identified by Telstra related to the:

- lack of clarity around possible further separation of Telstra (into wholesale and retail operations);
- 12-month period over which a proposal must be capable of acceptance;
- proposed commercial terms issued by the Commonwealth; and

- potential use of information contained in Telstra's proposal 'to assist separation and harm Telstra'.

3.49 Telstra's first three issues were a function of the parameters set at the start of the NBN RFP process by the Government:

- proponents were invited to detail any legislative or regulatory change necessary to facilitate their proposals, and the Government had not indicated any particular 'no go' regulatory areas;
- proposals, once lodged, would constitute an offer that was open to acceptance for a period of not less than 12 months, although 'acceptance' required an executed agreement between the proponent and the Commonwealth; and
- due to the late provision of the Commonwealth's indicative commercial terms to proponents through a discussion paper, proponents were not asked to respond to them as part of their NBN proposals.

3.50 Telstra's last concern was the 'downstream' use of its confidential information inside or outside of the RFP process. The department advised that this issue was considered and discussed with its legal advisers when first raised by Telstra. The department's response to Telstra on this issue before the closing date for proposals reaffirmed that the arrangements set out in the RFP to handle proponents' confidential information were consistent with relevant Commonwealth policy, including the CPGs. The department considered appropriate confidentiality requirements were in place for the recipients of proponents' confidential information (including the probity plan, the general obligations of Commonwealth employees, and the deeds of confidentiality for the Panel and advisers). The department also considered that a more substantive response would have exposed the Commonwealth to unnecessary risk for reasons that included:

- the extent of Telstra's confidential information would only be known when it submitted its proposal; and
- the RFP indicated that other departments and agencies would examine proposals and provide advice to the Panel as part of the evaluation of proposals.

Decision to exclude Telstra from the RFP process

3.51 As previously noted, Telstra's 'summary' proposal did not include a Small and Medium Enterprise (SME) Participation Plan.³² After receiving legal and probity advice, the Panel resolved that Telstra's proposal did not meet the minimum conditions for participation and should therefore be excluded from the RFP evaluation process. The then Secretary made the decision to exclude Telstra on behalf of the Commonwealth. The ANAO considers that the likely impact on the NBN assessment process and the prospects of a successful outcome had Telstra lodged an eligible proposal, is indeterminate.

3.52 The department advised the ANAO that it considers that Telstra's positioning did not lessen competitive tension during the RFP process. Throughout the process, the department kept the Minister informed of Telstra's concerns and stated position, and various scenarios of the RFP outcome, including their likelihood and consequence.

Conclusion

3.53 As the RFP progressed, most of the risks and issues that emerged were sufficiently addressed and mitigated, but some were not, which was to the detriment of the RFP process and the prospects of a successful outcome.

3.54 Although not guaranteeing a successful outcome, the flexibility within the RFP process meant that the Government could have varied the RFP document and process when it became apparent that:

- proponents were looking for clearer direction and were unlikely to submit proposals that met all of the Commonwealth's objectives and other evaluation criteria; and
- the global financial crisis was impacting on the proponents' ability to finance their proposals.

However, this would most likely have necessitated an extension to the Government's timetable for the RFP process—with the timetable already being an important consideration for the Government.

³² In summary, the RFP minimum conditions of participation were that proposals: be in English; use Australian legal units of measurement; include a completed and signed proponent's declaration; meet the conditions relating to the submission of multiple proposals; and include a SME Participation Plan. See Appendix 3 for the RFP's expression of its minimum conditions of participation.

3.55 DBCDE kept the Minister informed of specialist advisers' and proponents' views concerning the desirability of weighting the RFP's objectives and other evaluation criteria. However, the Government reaffirmed that objectives and criteria had no order of importance.

Contingency planning

3.56 As the RFP open period progressed, it became increasingly obvious to the department that the likelihood of a successful outcome was reducing. Initially, the department and its advisers considered that the RFP process was unlikely to attract binding offers capable of acceptance, necessitating some form of 'second stage'. Reasons noted at the time included the:

- Government's unknown preferences in respect of regulatory aspects of the NBN and network ownership;
- ACCC's unknown future determinations in respect of wholesale pricing structures;
- potential impact on the process from the inclusion of State/Territory-based proposals within other proponents' national proposals; and
- ability of proponents to raise debt and equity finance in the currently constrained markets.

When advised of this in July 2008, the Minister noted that more than one stage may be required, but wanted the RFP to progress without change to see the best that the market could produce within the NBN's stated parameters.

3.57 Feedback from proponents during the bilateral meetings and market soundings had indicated that most proponents were having difficulty developing a proposal that would be acceptable to the Government. This was mainly related to their ability to propose a regulatory environment for the NBN and to the non-weighting of objectives and criteria. Throughout the process, the department kept the Minister informed of summarised feedback from proponents on the elements likely to feature in their proposals and the challenges posed by the RFP.

3.58 In mid-August 2008, the department first noted possible options for progressing the Government's broadband policy within, subsequent to, or outside of, the RFP process. By late-October 2008 and prior to the RFP closing date, alternative methods of delivering the Government's broadband policy

began to be looked at more formally, should the RFP process not result in any acceptable proposals. By this time, it had become apparent that:

- the global financial crisis was having an adverse impact on proponents' ability to attract funding for their investment in the NBN;
- Telstra was seeking certain assurances from Government, including in relation to the confidentiality of its bid information and potential regulatory solutions, before committing to lodging a proposal;
- some members of one pre-qualified consortium announced their withdrawal from the consortium; and
- non-Telstra proponents were unlikely to propose a national technical solution that would not cut-over Telstra's equipment, or to submit a viable business model that took into account the potential significant compensation to Telstra for the compulsory acquisition of the right to use its equipment.

The probity adviser also considered it appropriate for the Government to consider contingency options while the RFP process progressed.

3.59 The Department of the Prime Minister and Cabinet, in conjunction with the department, prepared a paper for the Prime Minister setting out broad options for the Government to build an alternative network. The pros and cons of each option were canvassed, along with their financial and legislative consequences.

3.60 On 19 December 2008, the Acting Prime Minister wrote to the Minister requesting his department (in close consultation with the Departments of the Prime Minister and Cabinet, and the Treasury) prepare for the Government a paper outlining contingency options in the event the RFP process did not identify an acceptable proposal.

Assessment of proposals and report to the Minister

Initial screening of proposals received

3.61 By the RFP closing date (12:00 noon on 26 November 2008), NBN proposals were received from six pre-qualified proponents:

- four national proposals from Acacia Australia Pty Ltd, Axia NetMedia Corporation, Optus Network Investments Pty Ltd, and Telstra; and

- two State/Territory-based proposals from the Tasmanian Government and TransACT Capital Communications Pty Ltd, in respect of Tasmania and the ACT, respectively.

No late proposals were received.

3.62 As previously noted, the Panel and the department, on the basis of legal and probity advice, reached the preliminary view that Telstra's proposal did not meet the minimum conditions of participation set out in the RFP and should be excluded from further consideration. After informing Telstra of its preliminary view and considering Telstra's response and further legal advice, the Panel's and DBCDE's preliminary view became their final view. On 14 December 2008, the then Secretary of DBCDE informed Telstra that its proposal was excluded from further consideration in the RFP process.

Individual proposal assessment

3.63 Two of the three remaining national proposals proposed using FTTN as the principal technology for their NBNs, supplemented by FTTP, wireless and satellite technologies. The other national proposal proposed a different delivery model that involved rolling out a core transmission network, which provided a platform for other carriers to provide connections to premises. The two State/Territory-based proposals proposed using various combinations of FTTP, FTTN and wireless technologies for their part of the NBN.

3.64 Proposals were assessed in accordance with the evaluation criteria set out in the RFP document and the evaluation methodology contained in the evaluation plan. Proponents were asked to:

- present their proposals to the Panel in Canberra on 13 and 15 December 2008;
- address post-lodgement clarifications of their proposals; and
- demonstrate their proposals' technical aspects to the Panel at site visits in mid-January 2009.

3.65 In accordance with the evaluation plan, other Australian Government departments and agencies examined the full proposals or relevant sections of the proposals, as appropriate. Beforehand, officers involved in the assessments made conflict of interest declarations, were probity cleared by AGS, and agreed to abide by the NBN probity plan. They provided advice to the Panel (in respect to their relative areas of expertise) that was taken into account in the proposal assessments.

3.66 Ratings allocated to the three national NBN proposals by the Panel across five of the six evaluation criteria were either MEDIUM/LOW or LOW. The ratings for the remaining evaluation criterion were either MEDIUM or MEDIUM/LOW. Table 3.1 earlier in this chapter outlines the five-point rating scale used by the Panel to assess proposals.

Value-for-money assessment

3.67 Having regard to the assessments and the ratings given to each proposal, the Panel considered that none of the national proposals was sufficiently well developed to present a value-for-money outcome. All proposals were seeking Government contributions of more than \$4.7 billion in nominal terms. None represented a binding or firm offer from the proponents. All contained preconditions that would require significant negotiation before a contract could be executed and rollout of the network could commence. The Panel was also concerned that regulatory and legislative changes sought by some could give rise to significant risks for the Commonwealth, including: compensation to Telstra; reducing competition; and inconsistency with Australia's international obligations. Given the limited detail in the proposals, the Panel found that it was unable to reach conclusive views on their affordability.

Assessment of State/Territory-based proposals

3.68 Both State/Territory-based proposals were also assessed in accordance with the evaluation plan as having met the minimum mandatory requirements. However, given that none of the national proposals was assessed as capable of providing value for money, in accordance with the RFP, the State/Territory-based proposals were not considered further in the evaluation process.

Panel's conclusions

3.69 The Panel completed its NBN Evaluation Report and gave it to the Minister on 20 January 2009. The Panel concluded that none of the national proposals submitted offered value for money for the Commonwealth and there was no prospect that the proponents would be able to refine their proposals sufficiently to provide value for money. The Panel's Evaluation Report was 'signed-off' by the specialist advisers who certified that:

- their assessments were conducted in accordance with the evaluation plan;

- within the scope of their roles, all relevant issues had been addressed; and
- the Evaluation Report satisfactorily reflected the reports that they prepared.

3.70 The probity adviser also certified that:

- the evaluation was undertaken consistently with the RFP, approved evaluation plan and associated security protocols; and
- the Evaluation Report and its recommendations was defensible from a probity perspective.

3.71 The Report was accompanied by separate advice to the Minister putting forward the Panel's 'thoughts on how the Government's objectives might be achieved outside the parameters of the RFP'. Principal among them was the preference of FTTP over FTTN as the preferred technology for the NBN. In this respect, the Panel considered that the Tasmanian Government's proposal, which had a FTTP component, had some merit as a test case. Although FTTP is more expensive, the Panel's evaluation noted hidden costs in FTTN proposals, which included potential compensation to Telstra, risk of obsolescence, and reduction in competition from requested regulatory changes. Other issues commented on by the Panel included the desirability of: a competitive wholesale backhaul network; third-generation satellites; and high-speed wireless broadband.

Conclusion

3.72 The Panel, assisted by the department, specialist advisers and other Australian Government departments and agencies, assessed NBN proposals in accordance with the evaluation plan. The Panel's Evaluation Report is an accurate reflection of the proposal assessments, which have been adequately documented. Despite the RFP process' complexity and short timeframe, the Panel and the department conducted the formal process well, and in accordance with the CPGs. However, the Panel did not recommend any proposals to the Minister.

Process outcome

3.73 On 7 April 2009, the Minister terminated the RFP process. All proponents were immediately advised of the Minister's decision and the Government's new policy approach. The Prime Minister, the Treasurer, the Minister for Finance and Deregulation and the Minister jointly announced the establishment of a new company to build and operate a new super-fast NBN (National Broadband Network Company Ltd). At the same time, the Minister released the Panel's observations from the Evaluation Report, which have been summarised at paragraph 1.17 in Chapter 1. The Panel's published observations of the process generally represent the reasons for the non-selection of a national proponent, as well as provide some advice to the Government on policy options for going forward.

Debriefing of proponents

3.74 After the RFP process was terminated, DBCDE offered oral debriefings to all proponents who had met the RFP's minimum conditions for participation. Three proponents accepted and received debriefings, all of which were overseen by the probity adviser. Proponents were debriefed against the evaluation criteria set out in the RFP. The debrief reports fairly encapsulated the Panel's assessment of the proposals. The oversight by the probity adviser also provided a sound control mechanism for the debriefings to be conducted in accordance with the RFP document.

Refund of bid bonds

3.75 The RFP required potential proponents to lodge a \$5 million bond in the form of an unconditional and irrevocable bank guarantee in favour of the Commonwealth by 23 May 2008. The bond was to be provided as security against any liability to the Commonwealth arising from proponents breaching their obligations under the RFP.

3.76 When the Commonwealth terminated the RFP process on 7 April 2009, proponents were advised the following day of the steps to follow to finalise the administrative arrangements for the NBN RFP process, including the return of their bid bond. Proponents were required to execute three copies of a Deed of Acknowledgement as well as a Statutory Declaration to certify that the proponent had:

- complied with and fulfilled all obligations under the rules, including in relation to access, storage and handling of, Protected Carrier Information; and
- complied with the rules with respect to the destruction of Protected Carrier Information.

3.77 All proponents have completed their Deed of Acknowledgement and Statutory Declaration and had their bid bonds returned, although there was some delay in one instance. The proponent concerned had advised DBCDE in its Statutory Declaration that it had accessed certain protected carrier information after the termination of the RFP. After obtaining legal advice, DBCDE considered that the breach of the *Telecommunications Act 1997* was of a technical nature and relatively minor. The carrier whose information was accessed has been notified of the incident and has reserved its rights to take further action. In December 2009, the department returned the bid bond but advised the proponent that the Commonwealth also reserved its rights to take action against the proponent should it itself become the subject of action by the carrier concerned.

Cost of, and reflections on, the NBN RFP process

3.78 The RFP process has come at a significant cost to the Government and proponents, with costs incurred being in excess of \$30 million. Expenditure incurred by the department alone amounted to some \$17 million, including \$11.0 million for RFP-related consultancies and \$0.6 million for the private sector members of the Panel. Proponents' costs (where advised to the ANAO) ranged between \$1 million and \$8 million.

3.79 In the context of developing the Government's revised broadband policy approach, the Minister noted a number of lessons learned from the NBN RFP process, including that:

- none of the national FTTN proposals was able to satisfactorily address the significant risk for the Government of a major compensation liability arising from the use of Telstra's customer access network;
- the ACCC advised that billions of dollars of FTTN expenditure would be on equipment not used in a FTTP network (that is, the nodes), which could serve to delay the commercial rollout of FTTP; and

- the global financial crisis affected the ability of proponents to secure funding for what was estimated as being an \$11-15 billion project to build a FTTN network.

3.80 The department has informed the ANAO that the Government was made fully aware of all of the key risks and their significance for a successful outcome to the RFP process. While it is the case that the key risks (and their broad significance) were identified in early advice to the Government, the department did not fully assess the consequences of some of these risks until relatively late in the RFP process. These included, in particular, the possible magnitude of: the potential payment of compensation to Telstra should a non-Telstra proposal using FTTN technology be successful; and the consequences for investment in FTTN equipment, which largely would become obsolete, should the network be upgraded to FTTP technology. The design of the Government's approach to the market would have been better informed had the department provided timely advice on these issues ahead of the RFP process being settled.

3.81 As it was, the Government decided to seek binding offers from the market through a one-stage RFP process and give proponents wide scope to request regulatory changes to facilitate their proposals. This approach was not conventional for a competitive assessment process of this size, nature and risk. Given the amount of government funding on offer, Telstra was the proponent most likely to be in a position to build and operate a viable fibre-based NBN. The likely impact on the prospects of a successful RFP outcome had Telstra lodged an eligible proposal, is indeterminate. As the outcome of the RFP process showed, no other proponents were successful either.



Ian McPhee
Auditor-General

Canberra ACT
3 February 2010

Appendices

Appendix 1: Formal comments on the proposed report

Department of Broadband, Communications and the Digital Economy³³

Within the context of a process that the ANAO recognises was conducted well, it has in a number of instances outlined some risks to a successful outcome where in its view the Department could have variously provided earlier advice to Government, undertaken more thorough analysis and/or sought to quantify the financial magnitude of the risk.

The Department provided clear advice to the Government on the full range of risks likely to arise in implementing its NBN election commitment (including the risks identified by the ANAO) and their consequences. Risks included that the Government's contribution of up to \$4.7 billion could be insufficient relative to the total cost of constructing the network, that compensation payable to Telstra could be very significant, increasing the Government's total contribution, and that the regulatory requests from Proponents could be too great.

Estimating possible compensation that may be payable to Telstra was problematic. Until there was some measure of clarity as to both the intended approach of non-Telstra Proponents to utilising Telstra infrastructure and to the proposed arrangements to recompense Telstra for that use, meaningful compensation estimates could not be developed. Without this detail, any estimates of possible compensation would have been highly speculative and consequently not useful in assisting the Government to make any judgements as to the likely outcomes of the RFP process. Once the Department obtained a degree of insight as to Proponents' plans in regards to both their proposed use of Telstra's network and their approach to compensating Telstra, it commissioned work to quantify the possible compensation exposure these approaches implied.

The risks posed by the considerable regulatory flexibility afforded Proponents in the RFP document (and the absence of 'no go' areas) were an inherent consequence of providing maximum flexibility and scope for innovative proposals. Until proposals were settled and lodged it was not possible to analyse in a balanced way the regulatory risks and benefits a particular proposal may have contained. To the extent that regulatory flexibility posed a risk it also represented an opportunity for Proponents to develop innovative proposals with potentially attractive elements.

³³ The ANAO has responded to some of the points raised by the department in paragraphs 39 and 40 of the Summary.

It is also important to note that the Expert Panel, in its report to the Government, noted the rapid deterioration in the global economy during the RFP process, including that there had been a once-in-75-year deterioration in capital markets that severely restricted access to debt and equity funding. As a result, the Panel found all national Proponents either found it very difficult to raise the capital necessary to fund an NBN roll-out without recourse to substantial support from the Commonwealth or withheld going to the market until they had certainty that their proposal may be acceptable to the Commonwealth.

The Department considers that the future fibre upgrade path was one of a number of objectives the Government determined proposals would be assessed against. The newly elected Government's election commitment was to implement an NBN using fibre-to-the-node (FTTN) architecture. However, consistent with its approach of allowing maximum flexibility to Proponents in developing proposals, the Government decided to seek proposals incorporating other network architectures, including fibre-to-the-premises (FTTP).

In seeking proposals using either FTTN or FTTP technology the Government was indicating that it saw those as acceptable alternatives, not necessarily sequential stages. The issue of efficient upgrade paths to FTTP became a material consideration only after proposals had been evaluated and it became clear that compensation liabilities attending FTTN projects could see their initial overall cost approach that of a FTTP network.

Former Secretary of the department and Chair of the Expert Panel³⁴

“The former Secretary and Chair of the Expert Panel considers that the Request for Tender process was in accordance with the Government’s policy and guidelines and was conducted well, in a professional and impartial manner. The ANAO report reaches the same conclusion.

For clarity, the Department’s work in late 2007 on the cost of the NBN stopped when the Minister stated that the work should be discontinued.

In relation to the suggestion from the ANAO that the focus should have moved to FTTP at an earlier stage, the key issue was cost. A FTTN option that did not raise compensation issues could have come forward in the request for proposal process (see paragraph 2.52). That did not occur, and therefore the more expensive but superior technology option of FTTP was of heightened interest to the Government. The Government changed its policy to one based predominantly on FTTP.

The former Secretary questions the practicalities of the ANAO’s suggestion that a credible estimate of the possible compensation cost could have been available very early in the process. As ANAO notes, the Department had wanted to take on advisers in a speedy way but the Department of Finance and Deregulation ruled that out. The High Court decision in March 2008 had to be analysed by experts and a credible framework of principles drawn up and estimate derived, in light of the Department’s understanding of proposals being developed by proponents. The risk of compensation was consistently raised in all key briefings to the Minister, and in material to other Ministers.”

³⁴ The ANAO has responded to some of the points raised by the former Secretary in paragraphs 39 to 41 of the Summary.

Appendix 2: Commonwealth's objectives and evaluation criteria for the NBN and value for money assessment criteria

Commonwealth's objectives for the NBN

The Commonwealth's objectives for the NBN project are to establish a national broadband network that:

1. covers 98 per cent of Australian homes and businesses;
2. is able to offer broadband services with a minimum 12 Mbps dedicated to downlink transmission speed over each connection provided to a premises;
3. supports symmetric applications such as high-definition video-conferencing;
4. is able to support high quality voice, data and video services;
5. uses fibre-to-the-node or fibre-to-the-premises network architecture;
6. enables uniform retail prices on a national basis;
7. is rolled out and made operational progressively over five years from the date of execution of a contract between the Commonwealth and successful Proponent;
8. continue to promote the long-term interests of end-users;
9. has sufficient capacity to meet current and foreseeable demand and has a specified upgrade path within clear timeframes, consistent with international trends;
10. facilitates competition through open access arrangements that ensure equivalence of price and non-price terms and conditions, and provide scope for access seekers to differentiate their product offerings;
11. enables low access prices that reflect underlying costs while allowing Proponents to earn a rate of return on their investment commensurate with the risk of the project;
12. provides benefits to consumers by providing choice to run applications, use services and connect devices at affordable prices;
13. provides the Commonwealth with a return on its investment of up to \$4.7 billion;

14. is compatible with the Government's related Fibre connections to Schools initiative;
15. meets the Government requirements for the protection of Australia's critical infrastructure;
16. is consistent with national security, e-security and e-safety policy objectives including compliance with laws relating to law enforcement assistance and emergency call services;
17. is consistent with Australia's international obligations; and
18. facilitates opportunities for Australian and New Zealand small and medium enterprises (SMEs) to provide goods and services to the project.

Evaluation criteria

Within the framework of an overarching value-for-money assessment, the evaluation criteria against which Proposals were assessed are:

1. the extent to which the Proposal meets the Commonwealth's objectives for the NBN project;
2. the capacity of the Proponent to roll-out, maintain, upgrade and operate the network;
3. the nature, scope and impact of any legislative and/or regulatory changes that are necessary to facilitate the Proposal;
4. the cost to the Commonwealth of the Proposal;
5. the acceptability to the Commonwealth of the contract terms and conditions proposed by the Proponent and the extent to which the Proposal departs from the Commonwealth's notified commercial terms (if any); and
6. the extent of the Proponent's compliance with the RFP.

Value for money assessment

Value for money in the context of this RFP process is a comprehensive assessment that takes into account the costs, benefits and risks of a Proposal, individually and relative to other Proposals, and balances these factors and recognises trade-offs between them. The value for money assessment includes consideration of:

1. the overall costs and benefits of the Proposal (including long-term costs and benefits) to the Australian community as a whole;
2. the extent to which proposed legislative and/or regulatory changes may be required to implement the Proposal and the acceptability of those changes to the Commonwealth;
3. affordability, national security and strategic considerations relating to the NBN project;
4. the cost to the Commonwealth of the Proposal; and
5. other whole of government considerations.

Appendix 3: RFP minimum conditions for participation

Extract from the NBN RFP document

10.8 Minimum Content and Format Requirements

10.8.1 Subject to clause 5.4.2 [unintentional errors of form in a Proposal], the Commonwealth will exclude a Proposal from further consideration if the Commonwealth considers that the Proposal does not comply with the following requirements:

1. Proposals are written in English (see clause 9.1.1);
2. measurements are expressed in Australian legal units of measurement (see clause 9.1.2);
3. the Proposal includes a completed and signed Proponent's Declaration (see Schedule 1); and
4. clause 9.3.3 [conditions relating to the submission of multiple proposals].

10.9 Conditions for participation

10.9.1 The Commonwealth will exclude a Proposal from further consideration if the Commonwealth considers that the Proponent does not meet the following conditions for participation:

1. SME Participation Plans Proponents must prepare a Plan demonstrating how they will provide full, fair and reasonable opportunity to Australian and New Zealand SMEs to supply goods and services to the NBN Project. Details of the information that should be provided in SME Participation Plans are provided in Schedule 2. Plans should be similar to Australian Industry Participation (AIP) Plans. Further information on AIP Plans can be obtained from the AIP Plan page of the website of the Department of Innovation, Industry, Science and Research: ([http://www.innovation.gov.au/section/Industry/Pages/Australia nIndustryParticipationAIP.aspx](http://www.innovation.gov.au/section/Industry/Pages/Australia%20IndustryParticipationAIP.aspx)).

Proponents must submit a Plan to be recommended for funding. Proponents will be expected to abide by any commitments they make in their Plans and report on the implementation of their Plans.

Appendix 4: Response to the Hon. Bruce Billson MP regarding the 2008 preliminary review of the NBN RFP process



Auditor-General for Australia



File Reference: F2008/709

22 May 2008

The Hon. Bruce Billson MP
Shadow Minister for Broadband, Communications and the Digital Economy
PO Box 501
FRANKSTON VIC 3199

Dear Mr Billson

Re: National Broadband Network Program

Thank you for your letter dated 6 May 2008 raising concerns in relation to the fairness, transparency, probity and value for money of the National Broadband Network (NBN) procurement process.

In light of your correspondence, the Australian National Audit Office (ANAO) has undertaken a preliminary review into the development of the request for proposal (RFP) documentation for the NBN program and the probity arrangements in place. To this end, we have received cooperation from the Department of Broadband, Communications and the Digital Economy (DBCDE) in our consultations and discussions with them, and our review of key documentation (including the RFP and the addenda issued to 16 May 2008 on AusTender). It is important to emphasise, though, that we have not undertaken a full audit at this time and, for this reason, the assurance given through this correspondence is necessarily limited.

Under the NBN program, the Government, in partnership with the private sector, proposes to build a Network designed to deliver a dedicated downlink transmission speed of at least 12 megabits per second over each connection provided to a premises, using fibre-to-the-node or fibre-to-the-premises architecture. This service is expected to be available to 98 per cent of Australian homes and businesses. The Government has indicated that it will make a funding contribution of up to \$4.7 billion to establish the NBN.

On 11 April 2008, the Government issued the RFP for the NBN program. DBCDE advised that the NBN process:

- involves a one-stage selection process to meet a commitment made by the current Government during the 2007 election campaign to roll-out a national broadband network, commencing in 2008;
- is being conducted as a competitive assessment process to maximise the outcome for the Commonwealth and the wider Australian community;

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- has significant flexibility in terms of possible solutions that proponents may put forward to meet the NBN objectives;
- is being conducted in accordance with the principles of the Commonwealth Procurement Guidelines;
- involves an evaluation process by a Panel of Experts, comprising Commonwealth and private sector members selected by the Government, with assistance from specialist advisers providing legal, commercial, regulatory and technical advice; and
- receives advice from the Australian Government Solicitor (AGS) in its capacity as Probity Adviser.

There is significant flexibility designed into the NBN proposal process, allowing the Commonwealth to respond to changing circumstances. The RFP provides this flexibility, for example:

- the Commonwealth published a planned timetable for the RFP process at *cl. 1.2.3*, but notes that it is indicative only and may be subject to change at the Commonwealth's discretion;
- the Commonwealth may extend the Closing Time to lodge proposals (*cl. 4.1.2*);
- the Commonwealth may amend this RFP or the RFP process at any time. If the Commonwealth does so prior to the Closing Time, the Commonwealth will inform Proponents (*cl. 5.2.1*);
- the Commonwealth may terminate the RFP process at any time if the Commonwealth determines that none of the Proposals submitted represent value for money or that it is otherwise in the public interest to do so (*cl. 5.3.1*);
- if any additional evaluation criteria are intended to be applied in evaluating proposals, the Commonwealth will notify Proponents who will be given an opportunity to respond (*cl. 10.3.5*); and
- the Commonwealth may, at its absolute discretion and without providing reasons, change the structure or timing of the RFP process (*cl. 11.2.1.4*).

DCBDE considers that a flexible approach is necessary to manage the uncertainties surrounding the proponent selection process. These include the timing of when Network Information will become available to all proponents and unforeseen issues arising from any bilateral meetings that may be held with proponents. By this process, the Commonwealth is also seeking to attract the best possible proposals and maximise competitive tension.

DBCDE has developed an Implementation Plan for the competitive assessment process of the NBN program. The Implementation Plan contains a risk management strategy that identifies and assesses a number of risks to the successful implementation of the NBN program and identifies current or future strategies to mitigate the risks. The ANAO noted that the risk assessments and mitigation strategies have been updated as the NBN program has progressed.

Consistent with the principles of the Commonwealth Procurement Guidelines, arrangements are in place to treat all participating potential suppliers equitably. As you have indicated, it is important that the tender process is conducted in a competitive, transparent and proper manner, with realistic and non-discriminatory timelines and obstacles to potential proponents.

Consistent with sound practice, a Probity Adviser (AGS) has been engaged to advise and guide DBCDE and its advisers on the processes and probity of the NBN program as a whole, including compliance with, and the monitoring of, the Probity Plan. Departmental records and our enquiries indicate that the Probity Plan has been designed to help achieve the following

process and probity principles of: fairness and impartiality; consistency and transparency of process; an appropriate competitive process; security and confidentiality; the identification and management of actual, potential and perceived conflicts of interest; compliance with legislative obligations and Australian Government policies and decisions; and establishing and maintaining a clear audit trail.

DBCDE receives monthly reports from the Probity Adviser on probity activities and any advice that has been provided. These reports indicate that the Probity Adviser has been closely involved and regularly consulted during the establishment of the NBN program, development of the RFP documentation and on other related program matters as required. The Probity Adviser has also provided advice on the composition of the Panel of Experts and provided formal probity sign-offs for the appointment of: the investment, financial and commercial advisers; the technical adviser; the regulatory adviser; and the RFP document. The Probity Adviser informed the ANAO that there was sufficient opportunity to consider, and provide advice on, the probity of all key steps and activities on the NBN process to date.

Your correspondence raised a concern that the RFP requires proponents to lodge a \$5 million bond at least two months before the closing date of proposals as security against any liability to the Commonwealth arising from a breach of confidentiality obligations. Subject to meeting bond conditions, the bond is refundable on execution of a contract with the successful proponent(s). DBCDE has indicated that it received specialist advice that a bond helps to eliminate vexatious and frivolous bidders and provides a mechanism to identify bidders before the RFP closing date.

You also raised a concern that the Government is prepared to accept non-compliant bids. Amendments to the RFP would be required for non-compliant bids to be accepted. The ANAO notes that the RFP provides the flexibility to make such amendments, should the Government choose to do so. We also understand that the Probity Adviser would comment on any proposed addenda wording.

Another of your concerns relates to critical information about existing network infrastructure not yet being available to potential proponents. In this regard, the ANAO notes that the RFP, as issued on 11 April 2008, envisaged that proponents would have access to Network Information in 'May-June 2008' (*cl. 1.2.3*). An addendum to the RFP issued 16 May indicated that Network Information will be made available as soon as possible after 23 May 2008 to those proponents that have lodged bid bonds and confidentiality deeds (*RFP Clarification Number 3*). This would have allowed proponents a maximum of nine weeks to access this information and to prepare their proposals to meet the original RFP closing date of 25 July 2008. The timing of proponent's access to Network Information is dependent on the implementation of amendments to the *Telecommunications Act 1997*, which Parliament has recently passed. In parallel with this process, DBCDE is seeking Network Information from telecommunication carriers on a voluntary basis.

After the RFP was issued, DBCDE received specialist technical advice that proponents would need at least 12 weeks to consider network dimensioning, design and costing in developing their proposals. The Minister advised in his media release today that proponents will be given 12 weeks to lodge their proposals from the date all material is made available. This has extended the closing date to lodge proposals beyond 25 July 2008, to a date yet to be fixed. DBCDE advised that before the RFP was issued, the technical adviser, while agreeing that the overall timetable was tight, did not express specific views on the time that should be allowed for proponents to consider Network Information and prepare proposals.

To provide you with timely advice, the ANAO has particularly focused on the processes that are in place to provide the Minister with assurance that the RFP has been appropriately developed in the light of the Government's policy objectives. The Probity Adviser has

provided a formal probity sign-off (with appropriate caveats) for the RFP document. The Minister approved the release of the RFP on the basis of advice from his department, and the sign-off by the Probity Adviser.

Given the Government's commitment to commence the roll-out of the Network in 2008 and its desire to accommodate a range of proposals, it was necessary to adopt a one-stage selection process and include flexibility in the RFP process to cater for any contingencies and unforeseen circumstances that may arise. Perhaps understandably, this flexibility to allow the Commonwealth to respond to changing circumstances has created some uncertainty for proponents in terms of addressing the Commonwealth's requirements, and the timetable for responding. Any decisions made to vary the existing RFP requirements should clearly have regard to the framework established by the Commonwealth Procurement Guidelines, referred to earlier.

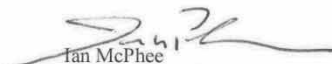
DBCDE advised that it is aware of the importance of providing proponents with sufficient time to prepare their proposals for what is a large-scale national infrastructure project with significant economic and social implications. DBCDE indicated that the advice it provides to the Minister on this and other program related matters has been, and will continue to be, guided by the advice received from its specialist advisers.

To date, and recognising that it is early in the NBN procurement process, nothing has come to our attention to suggest that the arrangements put in place do not provide the basis for the RFP process to accord with the Commonwealth Procurement Guidelines. The most significant matter noted by the ANAO was the importance of providing proponents with sufficient time to respond to the RFP following their access to the specified Network Information. The Minister, in his media release today, gave a commitment to proponents on this matter that accords with the advice provided by the NBN's technical adviser.

Given the materiality of the NBN program, I will include the RFP process of the NBN program as a potential audit topic in the ANAO's *Planned Audit Work Program 2008–09*. However, as with other potential audits listed in the Program, a decision on whether an audit into the NBN RFP process will proceed will be made during 2008–09, dependent on available resources and other competing priorities at the time.

I have provided a copy of this letter to the Minister for Broadband, Communications and the Digital Economy, his departmental Secretary and the chair of the Joint Committee of Public Accounts and Audit. We will also place a copy of this letter on our website in due course.

Yours sincerely



Ian McPhee
Auditor-General

Appendix 5: G9 consortium's proposal for a FTTN broadband access network

On 30 May 2007, FANOC Pty Ltd (FANOC), a company formed by the G9 consortium of telecommunication companies, lodged a special access undertaking with the ACCC under s.152CBA of the *Trade Practices Act 1974*. FANOC sought the ACCC's acceptance of its special access undertaking in respect of the terms and conditions of access to FANOC's prospective FTTN Broadband Access Service.

FANOC proposed to build an initial network that would cover approximately four million homes in the five mainland capital cities, using ADSL2+ technology (capable of achieving speeds of up to 24Mbps under the proposed configuration), for an initial capital cost of approximately \$3.6 billion. The network would be able to be transitioned to a VDSL (Very high bit-rate DSL) network over time when there is sufficient consumer demand for very high speed broadband services. VDSL allows speeds of up to 50Mbps within the planned architecture.

On 21 June 2007, the ACCC released to the public a discussion paper on, and a copy of, FANOC's special access undertaking. The ACCC received and published four submissions in response to the discussion paper. On 26 September 2007, the ACCC requested further information on FANOC's special access undertaking, which was provided on 20 November 2007.

On 17 December 2007, the ACCC issued a Draft Decision on FANOC's special access undertaking. The ACCC's draft view was that it was:

- satisfied that the special access undertaking was consistent with the standard access obligations in s. 152AR of the Trade Practices Act; and
- not satisfied that the terms and conditions in the special access undertaking were reasonable, having regard to the legislative matters in s. 152AH of the Trade Practices Act, on the grounds that:
 - the initial prices for the first three-year access period may be in the appropriate range; but
 - the terms and conditions of access give FANOC too much discretion, without sufficient regulatory oversight, to determine price and non-price terms and conditions for the 15-year special access undertaking period.

The ACCC sought submissions from interested parties by 4 February 2008. One submission was received.

On 10 March 2008, FANOC formally withdrew its special access undertaking. Consequently, the ACCC did not proceed to a final decision on the terms and conditions proposed in the undertaking.

Source: ACCC

Appendix 6: Timeline of proponent involvement

Date	Proponent Involvement
11 April 2008	RFP released and communications register opens for potential proponents
early-mid May 2008	First round of market soundings
9 May 2008	First formal RFP clarification released (Number 1 of 33)
23 May 2008	Potential proponents each lodged with the department a \$5 million bid bond and signed confidentiality agreement
10-12 June 2008	First round of bilateral meetings held. Summary of discussion sent to proponents on 24 June
31 July to 4 August 2008	Second round of bilateral meetings held. Summary of discussion sent to proponents on 20 August
25 August 2008	Addendum number one released (network information)
3 September 2008	Addendum number two released (closing times)
September/October 2008	Second round of market soundings
7 October 2008	Indicative financial model template provided to proponents
13-17 October 2008	Third round of bilateral meetings held. Summary of discussion sent to proponents on 14 November
21 October 2008	Commonwealth's indicative commercial terms released to proponents
6-7 November 2008	Fourth round of bilateral meetings held. Summary of discussion sent to proponents on 21 November
8 November 2008	Evaluation checklist provided to proponents
14 November 2008	Last formal RFP clarification released (Number 33 of 33)
19 November 2008	Last inquiry recorded on the communications register
26 November 2008	Closing time for the lodgment of the NBN proposal
13 and 15 December 2008	Proponent presentations to Panel
19 December 2008	Post-lodgment clarification questions provided to proponents. Responses due 5 January 2009
early-mid January 2009	Site visits by the Panel
7 April 2009	Proponents informed of termination of RFP process
8 April to 16 December 2009	Arrangements made to conclude RFP process, including the return of bid bonds to proponents
May-June 2009	Debriefings for proponents

Source: ANAO analysis

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