

TREASURY EXECUTIVE MINUTE

Minute No.

12 October 2009

Treasurer

TELSTRA'S SUBMISSION TO SENATE COMMITTEE INQUIRY INTO TELECOMMUNICATIONS REGULATORY REFORMS

Timing: Your Office requested briefing on Telstra's submission, which was lodged on 9 October 2009.

Recommendation:

- That you note the background briefing on Telstra's submission to the Senate Standing Committee on Environment, Communications and the Arts' Inquiry into the Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2009. (Telstra's submission is at Attachment A.)

Noted

Signature:

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KEY POINTS

- The Bill amends the *Trade Practices Act 1974* (TPA) to improve telecommunications competition regulation and consumer safeguards, and presents measures designed to provide incentives for Telstra to structurally separate on a voluntary basis.
 - Functional separation will apply should Telstra not voluntarily structurally separate. In order to access new radiofrequency spectrum, Telstra will need to structurally separate and divest its Foxtel and hybrid fibre coaxial (HFC) network.
- Telstra opposes the passage of the Bill in its current form — it suggests significant amendments and that the Senate delay debate until after discussions between Telstra and Government over the National Broadband Network (NBN) and the completion of the NBN Implementation Study.
 - We do not consider this to be unexpected given the degree of shareholder concerns recently publicly expressed. Telstra is in discussions with the Department of Broadband, Communications and the Digital Economy on the Bill and with NBN Co on the NBN.
- Telstra suggests that a major premise for the Bill, a need to address Telstra's ubiquity, vertical and horizontal integration and an associated detrimental impact on competition, is inaccurate. Telstra cites declines in certain service prices, levels of integration in overseas markets, competition in certain markets and a purported lack of domestic competitor investment to support its argument.
 - The Bill and submissions received on regulatory reform measures (including from the ACCC) cite opposing concerns and instances of negative impacts arising from Telstra's market position.

Functional separation

- Telstra argues that functional separation will divert management and resources from migration to the NBN; take time; and be detrimental to networks, investment and customers. It prefers 'embedding equivalence in Telstra's new network and IT systems' – arrangements that could be considered a stronger form of operational separation.
 - If functional separation is pursued, Telstra proposes the addition of principles in the Bill (for example, a requirement that it not be unduly burdensome and not require physical separation of information systems and networks). Further, it proposes that Ministerial discretion over the services subject to functional separation be removed thereby limiting the regime to services currently regulated under Part XIC of the TPA.
- We support functional separation of Telstra, but note that full vertical structural separation is the most desirable outcome (see below).
 - The ACCC agrees with our views on this matter, noting that any form of separation short of separate ownership is a significantly weaker means of addressing any competition concerns arising from vertical integration.

Structural separation

- Telstra states that while it will continue to talk with the Government, it cannot agree to structural separation if it fails to give fair value to, and is not in the best interests of, its shareholders.
- Telstra proposes the deletion of provisions in the Bill related to structural separation and divestiture of its Foxtel and HFC interests in order to participate in spectrum auctions. Telstra argues that:
 - There is no policy rationale behind the Government denying it access to spectrum, and that it would make the mobile market less competitive given its investment and innovation record in the market. Further, consumers particularly those in rural areas would be hurt given the limited provision of services by other carriers and hence competition in such areas.
 - For Foxtel/HFC, Telstra refers to the ACCC's submission on regulatory reform as suggesting fewer pro-competitive benefits from the divestiture of its HFC network and the potential to increase concentration in media markets with by divesting Foxtel.
 - : The ACCC submission stated that requiring Telstra to divest its HFC network could introduce a new infrastructure-based competitor in the telecommunications sector. Further, the 'fewer pro-competitive benefits' would arise where the NBNC0 is independent of Telstra.
 - : The ACCC considers Section 50 of the TPA (mergers and acquisitions) already provides a suitable framework to deal with competition issues arising from the increasing convergence of the telecommunications and media sectors.
- The Government has taken this approach as it considers that Telstra will maintain a significant degree of market power even when the NBN is in operation. This approach will provide further incentives for Telstra to structurally separate, and goes some way towards

addressing concerns over Telstra's market power across different service platforms in the event that it chooses not to do so.

Parts XIB and XIC of the TPA

- Telstra considers that the changes to the access and anticompetitive conduct regimes in Parts XIB and XIC of the TPA will significantly increase regulatory uncertainty by providing the ACCC with wide powers without including any guidance or prescription on the use of these powers.
- It considers these amendments will not provide the telecommunications industry with the guidance and clarity it requires during a period of significant transition in the roll out of the NBN.

Consumer safeguards

- Telstra also proposes a number of changes to the Bill relating to competition and consumer safeguards.
- Further background is at [Additional Information](#).

Contact Officer:

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ADDITIONAL INFORMATION

Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2009

- The Bill:
 - requires Telstra to undergo functional separation, or provide an undertaking acceptable to the ACCC to structurally separate;
 - requires Telstra to divest its Foxtel interests and hybrid fibre coaxial (HFC) network, and provide an acceptable undertaking to structurally separate, if it wishes to participate in advanced wireless broadband spectrum auctions;
 - amends the telecommunications access regime in Part XIC of the TPA to enable the ACCC to determine up-front terms and conditions for declared services;
 - amends procedural fairness requirements for the competition notice rules in Part XIB of the TPA; and
 - strengthens the application of the consumer safeguards, and introduce a threshold that would exempt smaller carriers from paying certain telecommunications industry levies.

Telecommunications competition

- Telstra argues that competition concerns with Australia's telecommunications market are erroneous based on:
 - extensive competitive entry – the most recent data from ACMA indicates that there are currently 172 licensed carriers in Australia, with 17 new entrants in the last year and over 670 internet service providers;
 - price reductions – the most recent ACCC data identified for the 2007-08 year a 5.5 per cent decline in the real prices for fixed line services, including an 11 per cent decline in long distance charges, a 5.4 per cent decline in the prices for mobile services and a 5.4 per cent decline in prices for DSL broadband;
 - substantial product innovation – including faster mobile broadband offers and a vast array of business services such as cloud computing;
 - significant customer turnover; and
 - amongst the most advanced, highly automated wholesale processes and systems offered by an incumbent anywhere – including British Telecom after 4 years of separation.
- Telstra's arguments do not distinguish between competitive and regulated services and by not including market share do not clearly indicate Telstra's dominance over smaller competitors in regulated markets. For example, the OECD in its *2008 Economic Survey: Australia* states:

“The broadband sector, which is regulated by the ACCC, is dominated by the incumbent, Telstra, which was privatised at the end of 2006. This company has more than two-thirds of the market and plays a major role on all platforms for access to these services. Telstra controls over 80% of the sector that uses digital subscriber line (DSL)

technology, and it owns the copper telecommunications network. It also owns more than 50% of cable-related infrastructure and has a strong presence in mobile services that use wireless technologies. This impedes competition between technologies, yet such competition is fruitful as it encourages product differentiation. Indeed, Telstra has little incentive to develop new services for each of these platforms, which would tend to lower the value of its current assets (i.e. copper network) and reduce income earned on other networks.”

- In its *Telecommunications Safeguards Report 2007-08* the ACCC observed high levels of concentration in fixed PSTN, retail fixed broadband and mobile services.
 - The ACCC notes that where competition has emerged this has depended upon the regulatory mechanisms in the access regime and has been achieved incrementally as Telstra’s competitors have built up customer bases.
 - The ACCC also stated that the price reductions for fixed voice services for residential customers and mobile services were likely to relate to ‘bucket’ subscription plans and bundling discounts.
- We do agree with Telstra on a failure of investment in the telecommunications industry, a market failure reflected in the Government’s decision to develop the NBN.

Separation

- Telstra’s vertically integrated structure, which allows it to leverage off its ownership of its bottleneck copper network in downstream contestable markets, means that the company enjoys a high degree of market power in the provision of key fixed-line services, including voice services and broadband. Importantly, it provides Telstra’s wholesale business with the ability and incentive to favour its retail businesses, to the detriment of consumers and other telecommunications carriers.
- Regulatory consultations conducted in 2008 and more recently in response to the *National Broadband Network: Regulatory Reform for 21st Century Broadband* Discussion Paper have highlighted that the current operational and accounting separation measures have not worked effectively. Most of the 130 submitters called for structural or stronger functional separation of Telstra.
 - Telstra is currently subject to operational and accounting separation requirements. Both arrangements have been generally regarded as unsuccessful, as neither technique has fully removed Telstra’s incentive to engage in anti-competitive tactics. The ACCC in particular has been critical of operational separation.
- Functional separation provides a much stronger form of separation than the current operational separation regime and is similar to regimes introduced in the UK and more recently in New Zealand. It could enable Telstra to retain limited economies of scale and scope as a vertically integrated supplier where services are not regulated, such as in the mobile sector. It would, however, have much more stringent separation arrangements between Telstra’s network and wholesale arms from Telstra’s retail arm for regulated services.
 - Functional separation does not entirely remove all of Telstra’s incentive to discriminate in downstream markets but will promote equivalence and transparency in Telstra’s dealings with competitors.

- Structural separation would directly address Telstra's commercial incentive to favour its downstream arms by separating Telstra into distinct legal entities with separate ownership.

Spectrum

- Telstra does not support being restricted from access to spectrum unless it vertically and horizontally separates. Telstra considers that the NBN will deliver the preferred industry structure and that wireless is not a regulated service.
- In addition, Telstra argues that restrictions to spectrum will undermine competition in the mobile market and deprive consumers of an upgrade path. It also considers that such restrictions will not assist the Government in achieving any objectives in regard to the NBN.
- Participation in the spectrum auctions and Telstra's ownership of Foxtel and the HFC network are being linked under the proposed approach to create an incentive for Telstra to address concerns with both horizontal and vertical integration.
 - The potential exclusion of Telstra from spectrum auctions could also lead to reduced competition in those auctions, with associated revenue implications.

Changes to the access regime in Part XIC of the *Trade Practices Act 1974*

- Telstra supports changes to the telecommunications access regime that would align the access regime with other regulated industries, in particular moves to use a Regulatory Asset Base (RAB) approach.
 - Telstra sees resolving the cost of the underlying copper network for access pricing purposes as key to improving regulatory certainty.
- However, it considers the changes to Part XIC will increase regulatory uncertainty by granting extensive price-setting powers and discretions to the ACCC, but not including any guidance or prescription on the use of these powers.
 - Telstra prefers the procedure in gas and electricity markets, where the regulatory framework is specified by the Australian Energy Markets Commission or the Ministerial Council on Energy and the implemented by the regulator.
- Telstra opposes the absence of merits review for decisions under Part XIC. It considers that this would only be appropriate where a regulator is provided a very limited discretion and accordingly is not appropriate where the ACCC has such a wide discretion to set prices for the telecommunications industry.
- The Government has moved to streamline the telecommunications access regime. Since the introduction of Part XIC in 1997, its operation has been criticised by many in the industry as being overly protracted, and vulnerable to 'gaming' by parties with an incentive to delay or damage new entrants. Building on extensive consultations with industry, regulatory agencies and the public, the Bill will significantly reform the access regime to address these problems.

Changes to the anti-competitive conduct regime in Part XIB of the *Trade Practices Act 1974*

- Telstra does not support the removal of the requirement to consult or provide procedural fairness before the ACCC issue a competition notice (this notice provides prima facie evidence of anticompetitive conduct when it is prosecuted in court).

- Telstra considers there is no policy justification for not adhering to procedural fairness in issuing an administrative instrument that may be potentially damaging to the recipient's interests.
- The Government decided to remove the requirement to consult or provide procedural fairness on the basis that the consultation process prior to the issuing of a competition notice can delay enforcement action. These delays may lead to irreversible damage to the parties that are affected by any alleged anticompetitive conduct.
 - The amendment does not remove the opportunity for affected parties to argue their case before the ACCC. It continues to be the case that no penalties may be applied until the conduct has been proved to be anticompetitive before a court.

Competition and consumer safeguards

- Telstra proposes a number of changes to the Bill relating to the Universal Service Obligation (USO), including:
 - reinstating the qualification that the universal service provider be required to supply standard telephone services to end users only 'to the extent necessary';
 - : According to Telstra, such a qualification will avoid duplicate infrastructure investment.
 - reinstating the qualification that the universal service provider 'take all reasonable steps' to fulfil the obligation; and
 - : Telstra argues that it is unrealistic to apply an absolute obligation in a country with such geographic and climatic diversity as Australia.
 - subjecting new Ministerial powers with respect to Standard Telephone Services and Payphones to a requirement of reasonableness.
- Telstra considers that a requirement of reasonableness should be applied to the new Ministerial power to set retail performance benchmarks. It also considers that wholesale performance benchmarks be deleted as a wholesale provider may not have end-to-end control of the services provided over its infrastructure.

TELSTRA'S SUBMISSION

[Attachment not released - public document]