



Unwired Australia Pty Ltd

Submission in response to

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

Discussion Paper

The National Broadband Network:

Regulatory Reform for 21st Century Broadband

June 2009



Executive Summary

- The access regime for the NBN needs to guarantee access at a cost reflective price, but the opportunity to mimic markets for price setting should be retained.
- The access regime for services controlled by vertically integrated firms needs to operate on the assumption that firms use that vertical integration to favour themselves and that they have the opportunity and incentive to frustrate the access regime. Therefore in these circumstances the access regulator should be able to determine the terms of access.
- The access arrangements for the NBN need to be structured to ensure that the market power of a participant in the downstream market cannot be applied to secure favourable or discriminatory access.
- The structural separation of Telstra should be a policy objective. Functional separation should not be pursued as it does not materially improve on the current arrangements.
- If the Government is unable to find a way to enforce the separation and the divestiture then the regulatory regime needs to operate on the presumption that Telstra continues to choose to be organised in this way to exert their market power horizontally and vertically.
- Future competition limits on spectrum allocation should be based on the market power of applicants across all delivery platforms. This will ensure that wireless services continue to provide “inter-modal” competition.
- To secure inter-modal competition the Government needs to move to provide security of tenure to the spectrum used to deliver wireless services through point-to-multipoint technologies.
- Participants with significant market power in distribution platforms should be restricted from acquiring exclusive rights to content.
- The review of convergence issues related to the regulation of IPTV services needs to be brought forward from the foreshadowed 2011 review.

1. Introduction

This submission is made by Unwired Australia Pty Ltd in response to the Department of Broadband, Communications and the Digital Economy Discussion Paper *The National Broadband Network: Regulatory Reform for 21st Century Broadband* (the **Paper**). Unwired notes the bold vision contained in the NBN announcement, and the fact that it creates a myriad of regulatory policy issues.

The regulatory reforms required from the NBN can be broken down into four general categories, these are;

1. The regulatory reforms to facilitate the construction of the NBN.
2. The regulatory reforms to provide an open access regime for the NBN.
3. The regulatory reforms for the transition to the NBN, and
4. The regulatory reforms to recognise the further progress of “convergence” and the increasingly blurred distinctions between telecommunications and broadcasting.

The Paper considered all of these, though the issues to do with the regulation of the NBN itself, and of convergence (chapters 2 and 5 of the Paper) were discussed only briefly and were not matters on which views were particularly sought. The Paper focussed more on the competition regime (Chapter 3) and consumer safeguards (Chapter 4).

This submission will mostly focus on these elements relating to the “transitional” arrangements. We note that a discussion paper has been provided on the greenfield estates regulations, that Communications Alliance has commenced a discussion about the access regime to the NBN infrastructure and that many other issues will need to be progressed through the implementation study. While this submission mostly focuses on the Paper and the transitional issues Unwired believes there are five key elements that need to be highlighted for both the target NBN regime and the transitional regime, these are access regulation, the role of the access regulator (ACCC), structural separation, spectrum allocation, and convergence issues.

Access Issues

It is important that access to monopoly services, be that backhaul, NBN access services or legacy access services, can be guaranteed and provided at a cost-based price. In the submission Unwired notes the benefits of the market mimicking mechanisms of the negotiate/arbitrate model and suggests ways this model could be adapted for access to structurally separated services. However, where the access provider also competes in the downstream market that provider has both the opportunity and incentive to frustrate access and more deterministic approaches are required.

In addition Unwired notes that considerable confusion exists about the intention of points of interconnection to the NBN, and what parts of “backhaul” services will be provided by the NBNCo and what parts will continue to be acquired in the open market. We urge the Government to address this as an early component of the implementation study.

Structural separation alone cannot be relied upon to ensure equity of treatment of access seekers. There is a risk that may emerge from the market dominance of a firm in the downstream market.



A Telstra argument against structural separation has always been that other access seekers would suffer because Telstra retail would still be favoured as the largest customer.

Role of the access regulator

We can see no compelling reason for the access regulator to be anyone other than the ACCC, but we choose to make our comments about the role generically so that they can be understood to apply even if there is a change. Experience to date indicates the regulator needs to be properly resourced and empowered to make speedy and enforceable decisions.

This goal can be achieved by the move to final offer arbitrations as well as a power for the ACCC to simply determine terms of access in cases of vertically integrated access providers.

Structural separation

As noted above, vertically integrated firms that supply monopoly services have the opportunity and incentive to frustrate access. While the move to ensure the NBN will be built by a structurally separated firm this does not deal adequately with the legacy services.

Unfortunately the process of privatisation and the absence of generic divestiture laws limits the ability for the Australian Government to force the structural separation of Telstra. However, the submission argues that enforcing a version of functional separation is a pointless exercise. Instead the submission argues for variations to the approaches in service access, anti-competitive conduct and land access that differentiates the ways these regimes work depending upon whether the firm is a structurally separated access services provider or is vertically integrated and also participates in retail service delivery.

In short, the regime should assume that a firm that chooses to remain vertically integrated when it has market power in the upstream services does so for the purpose of using that market power anti-competitively.

Spectrum allocation

The Paper proposed that competition limits on spectrum allocation should take into account market power in all delivery platforms, not just market power in wireless services. Unwired supports this position but also notes that to provide effective inter-modal competition future spectrum allocations will need to be in significantly larger lots than has been the case previously.

In addition for the providers of wireless services to provide significant inter-modal competition it is necessary for the Government to move quickly to provide a means for securing tenure of spectrum assets, as to fail to do so will result in a stifling of investment in current generation broadband wireless services.

Convergence

A range of convergence issues have been raised in the Paper and submission. These include the need to restrict the ability of market participants who have market power in distribution systems from leveraging that power to develop market power in content provision. The submission proposes specific content acquisition limitations to ensure this cannot occur.

However, other convergence issues relate to the regulation of content services delivered over the NBN. Determination of how these should be treated and related considerations for the regulation of broadband services cannot be deferred until 2011. These are matters that will affect how people choose to invest in utilising the NBN.



The remainder of the submission is structured as follows;

- Section 2 will address the policy framework and the underlying assumptions of the transitional arrangements,
- Section 3 will address the requirements of the access regime,
- Section 4 will address the competitive conduct regime,
- Section 5 will address the separation arrangements for Telstra (and others),
- Section 6 will address the facilities access and land access regimes,
- Section 7 will address spectrum allocation, and
- Section 8 will briefly discuss aspects of convergence regulation.
- Section 9 is a brief conclusion.

Also attached to the submission is a short response to the questions posed in the Paper. Where appropriate these responses refer back to earlier elements of this submission.

2 The Policy Framework and the Transitional Arrangements

There are at times perceptions that the “regulatory” field in any area of economic activity is a kind of necessary evil, and that our acceptance of a market-based economy means we simultaneously think of regulation as a distortion. This way of thinking about regulation is focussed on the concept of regulation only to solve “market failures” though as John Kay has shown the market failure approach can justify almost any regulatory intervention.¹

There is an alternative view of regulation; in this view all markets are actually “made” by conscious design. This can be seen from the various models of supposedly open markets, all of which contain either explicit or implicit rules of the market.²

This does not mean that any regulation can be worthwhile, but it does mean that the simplistic models sometimes promoted by industry are extreme³. In this context it is an encouraging move for the Government to consider all the elements of the regulatory framework. One can expect that there will be a great deal of contentious views put forward, and that the natural tendency will be to attempt to defer many decisions or issues as a means of simplification.

This is, however, an artificial gain. All the aspects of the regulatory regime interact. As an example, it is common to consider the “economic regulation (access)” elements separately from the “consumer protection” aspects. However, they have a core intersection because the more effective the competition outcome is delivered through economic regulation, the lighter the load can be on regulation for consumer protection. The relation has been known to run the other way,

¹ John Kay ‘The failure of market failure’ *Prospect* August 2007. Available (for a fee) at http://www.prospect-magazine.co.uk/article_details.php?id=9709

² John McMillan *Reinventing the Bazaar: A natural history of markets* Norton. 2002.

³ Examples include the position taken by Communications Alliance in its submission on the Australian Consumer Law, and the submissions of Telstra and Optus to the Productivity Commission review of consumer protection policy.



that customer protection regulation can impede the development of competition by creating barriers to entry or by favouring one provider (for example the USO provider).

The transitional arrangements need to meet three potentially conflicting objectives.

1. That the end point of the transition consists of an industry with a structurally separated access company, vibrant competition between service providers and a reliance as far as practicable on the retail competition to deliver consumer outcomes.
2. That the transition to the NBN does not inhibit otherwise efficient investment,
3. That no industry participant can utilise its existing market power to frustrate the intent of the NBN policy.

The potential for conflict between these objectives can be seen if the process of achieving 3 results in excessive continued regulation in detail that could be difficult to remove once the NBN is delivered, or if the pursuit of 2 results in an outcome that creates the possibility for 3 to be compromised.

This necessitates a degree of vigilance in the prosecution of the reform agenda. It also necessitates a reverse of the usual “default” condition of leaving matters unchanged unless there is evidence of failure. In fact, the current circumstance is probably more deserving of an assumption that the existing regime needs to be changed rather than the reverse. As an example, it is probably clear that the regulation of “access” to the NBN should be different to the existing regime, therefore the existing regulation should be changed in such a way that access to anything “NBN-like” is subject to that same regime.

Similarly, the provision of an ongoing Government guarantee of the availability of services needs to be modelled on the provisions of the Communications Service Standard rather than a perpetuation of the USO and ABG. Indeed, a migration to that regime could be achieved immediately by specifying that the service available under the CSS is exactly the “standard telephone service” and “metro-comparable broadband” and that the programs the Minister has put in place to ensure their availability are the USO and the ABG.

3 The Access Regime

The discussion to follow suggests that the target access regime in the NBN environment should be based on a regime of negotiate/arbitrate with Final Offer Arbitration, and that this could be overlaid with an incentive regulation price cap for setting future prices.

For existing access services the negotiate/arbitrate model seems to have failed, the reference pricing work has largely been concluded and there will not be new services requiring price setting. For these services it would appear appropriate to change the legislation to set the ACCC as a price setter rather than an arbiter.

The existing access regime under Part XIC has come under a great deal of criticism which has been largely reflective of its use. As Graeme Samuel recently noted in his speech to the ATUG Regional Conference,

*Since 1997, the ACCC has been notified of a total of 157 telecommunications access disputes. This is in stark contrast to the three access disputes that have been notified to the ACCC across all other sectors of the economy.*⁴

He also highlighted the number of administrative law and other reviews of these decisions.

One potential interpretation of the difference between the telecommunications regime is the one favoured by Telstra and promoted by Henry Ergas in his book *Wrong Number*. This view is that the telco regime suffers serious flaws that makes it too easy for access seekers to apply to use and indeed too easy for the regulator to decide there is a role for the regulator.

An alternative view is proposed by many of the traditional access seekers that the regime is inefficiently slow creating too many rights for the access provider to insist first on negotiation, then to delay proceedings with undertakings and then to appeal decisions.

We have then conflicting views, Telstra believes the regime confers too many “rights” on the regulator, while the access seekers believe the regime confers too many “rights” on Telstra. It is actually possible that both views could be correct. To understand it we need to review the idea of economic regulation from first principles.

The creation of access regulation emerges from the observation that a provider with market power in a market has the incentive and the power to refuse to supply the product to a downstream participant who wishes to use the input. Ordinary competition law makes this refusal to supply an act of anti-competitive conduct; however under Australian law the only consequence of a refusal to supply case is the potential payment of damages to the firm denied supply.

The remedy fails to be sufficient as it does not create a sufficient incentive for firms to enter where they fear they may be refused supply. Hence a feature of competition policy was the creation of a regime for *ex ante* access regulation.

This, however, is not the full story. In areas of economic activity that have been considered subject to “natural monopoly” there has always been an acceptance of some need for price regulation.⁵ The need for price regulation has been based on the standard microeconomic conclusion that a profit maximising monopolist will price the service and constrain output to a level below that that would apply in a competitive market. The price in a competitive market is expected to be the marginal cost.

There were through the early parts of the twentieth century only two approaches to this problem of price setting. The first was a simple process of Government ownership of the regulated entity, and this was the common model in Australia. A problem with this model is that there is evidence that as a price setter the Government behaved like a profit maximising monopolist and benefited from the monopoly returns. This has the same deadweight loss consequences of a private monopolist but at least the presumption is that the Government puts the economic rents to a “public” purpose. (The public purpose has often been the further investment in the

⁴ Graeme Samuel, Chair ACCC, ‘National Broadband Network heralds new wave of telecommunications development’ speech to ATUG Regional Conference, Canberra, 21 May 2009

⁵ We need not consider here the precise definition of natural monopoly nor the circumstances under which it can occur. For the sake of the discussion it is sufficient to state it is a service that can be produced more cheaply by one supplier rather than two and regulation not only is used to regulate price but also to restrict competitive entry.

infrastructure. As an example, no taxpayer funds were spent on telecommunications and postal services after 1959).

The second process was the process used in the United States of “rate of return regulation” in which retail prices were set to explicitly limit the provider to a “reasonable” return on their investment. This process also has its limitations, the two most notable being that it creates no incentive for the firm to achieve additional efficiencies because any efficiency gets “confiscated” through the price setting process. Another is the Averch-Johnson effect that a firm under rate of return regulation has an incentive to invest in more assets than is efficient.⁶

The third method for the regulation of a monopoly was the approach of “incentive regulation” proposed by Stephen Littlechild⁷. The idea of incentive regulation is to place a cap on a basket of prices, and then require that the price of this basket be restricted to movement in the price level less an expectation of total factor productivity. The price level used is usually CPI, resulting in the CPI-X formula. There are a number of methodological issues. These include the use of actual CPI data with a forecast economy wide TFP, and the implicit assumption that initial prices do not include monopoly rents. The incentive regulation approach was used by the Australian Government when Telecom Australia was “corporatised” and it has endured in the form of retail price controls.

The development of competition policy in telecommunications was on an assumption that a deregulated market would put a competitive pricing constraint on the incumbent telco. It was, however, recognised that entry by new telcos could be impeded by the incumbent refusing to supply necessary access products. As the model of competition presumed was on long distance telephony based on the US model, the focus was on access to PSTN ingress and egress (or originating and terminating access). This looked just like the standard problem referred to earlier and the need for an *ex ante* right of access.

Policy makers never formed a view of the extent to which in the long run competition would ultimately be derived by full duplication of access networks, though an early Industry Commission study suggested the error cost of regulating as if there was always a monopoly was higher than the error cost of not regulating on the hope of competition.⁸ That is primarily the route policy makers have taken, not limiting telecommunications to services competition only but being open to the possibility of facilities based competition.

In this policy framework, the language settled on the need for a process that mimicked what might occur in a more competitive environment. That means it started with a negotiation between the parties and only if the parties couldn’t agree there was an opportunity to seek a regulated outcome. There was even the provision of a forum (the Telecommunications Access Forum) for resolving these matters between one or more sellers and collective buyers.

⁶ This is sometimes incorrectly referred to as “gold-plating”. Haverly Averch and Leland L. Johnson ‘Behavior of the Firm under a Regulatory Constraint’ *American Economic Review*. 1962 Vol. 52. no. 5. pp. 1052-1069.

⁷ Littlechild, S. C. (1983) “The Regulation of British Telecommunications’ Profitability” London: Department of Industry, reprinted in *The UK Model of Utility Regulation*, ed. I. Bartle, CRI Proceedings 31, University of Bath, September.

⁸ Robert Albon, Alexis Hardin and Philippa Dee 1997 *Telecommunications Economics and Policy Issues* Industry Commission Canberra See in particular Chapter 7. Available at <http://www.pc.gov.au/ic/research/information/teleeco>. In private conversation one of the author’s views have changed, stating now that they were “misled by the technologists”.

While there is a presumption that the incentives of access seekers and access providers were misaligned, there is a good theoretical argument for assuming they could be aligned. The access provider may have wanted a high access price, but if they set it above the efficient build cost the access seeker would simply build and destroy the economics. This was actually how the Optus HFC network came about (it did not have the expected effect because of the difficulties Optus had with the technology and some structural issues with the venture). The access seekers may seek a low price, but ultimately they do not want it so low that the access provider will not invest to increase capacity.

So the theory suggests it all should work. What went wrong? Rod Shogren, the first telecommunications commissioner at the ACCC, told a SPAN conference some years ago that when the ACCC received its first arbitration it realised that the Act didn't just require the ACCC to resolve the dispute but to do so by choosing a price that met a host of public policy considerations. This ultimately necessitated the Commission doing the kind of analysis as had been traditionally conducted in rate of return regulation, but rather than on the overall prices and historic costs of the regulated firm, the analysis was by service, and by necessity on hypothetical forward looking costs.

This then resulted in a process in which access prices were being set at a point well after when access first occurred. The consequence has been an *ex ante* access regime with *ex post* pricing.

The Productivity Commission reviewed this situation in 2001. They gave some consideration to a methodology referred to as "final offer arbitration" that is also called "baseball arbitration".⁹ The Commission proposed;

If the current negotiate/arbitrate model continues to face enduring problems after the present set of reforms, one option could combine features of FOA and arbitration that might work better than each in isolation. The ACCC would conduct an inquiry into pricing the relevant declared service, and would be required to provide an indicative price range that reflected the uncertainty over pricing methodologies and parameters. Parties would then post a price offer to the ACT (or a similar independent body) that would have to fall within the range found by the ACCC, and the ACT would determine which offer to accept. There would be no appeal. This process could be relatively speedy, directly confronts the genuine uncertainty over the 'right' price, while providing a discipline over price offers made under FOA.¹⁰

It would seem that all the scenarios of improving transparency of final decisions, of the Commission setting indicative prices at declaration and of facilitating the consideration of undertakings have been tried and failed. The prospect of Final Offer Arbitration should be developed, especially as it creates the prospect of achieving prospective rather than retrospective prices.

Another relevant consideration is the applicable timescale of the prices. The ACCC and industry have focused on the need for "certainty" and sought prices for three years. However, the reality

⁹ The process takes its name from its earliest use in settling baseball pay disputes. The simple concept is that both parties make their best and final offer and the arbitrator can choose one of the offers but not propose any other offer. A literature review prepared by the Californian Commission on Health and Safety and Workers' Compensation is available at <http://www.dir.ca.gov/chswc/BasebalArbFfinal.htm>

¹⁰ Productivity Commission *Telecommunications Competition Regulation: Inquiry Report* Canberra 2001 p. 357. Available at <http://www.pc.gov.au/projects/inquiry/telecommunications/docs/finalreport>

has been that the complexity of decision making results in these prices not providing any future certainty. The FOA structure allows for the idea of more frequent transactions between buyers and sellers as would also occur in a more competitive market.

Finally, theorists have continued to promote the validity of the incentive regulation structure. Laffonte and Tirole even recommended the idea of global price caps covering both retail and wholesale prices.¹¹ It is clear that price cap based incentive regulation can be effective where the provider is restricted to a single vertical role (i.e. is structurally separated).

It should be noted that the above discussion is focused on the question of “one-way” access, which is the kind of access where one party sells and the other buys. The ULL and WLR are both classic cases. PSTN OTA is a one-way access service if it is assumed they are only supplied to a market participating in “long distance bypass”. However the PSTN TA and MTAS services are both “two-way access” services when they deal with the interconnection of networks. A totally different analysis is appropriate to these markets that has not been satisfactorily explored in the regulatory regime (and will not be considered further here).¹² However, it should be noted that the question of interconnection of IP networks (what the access seekers of NBN access do with each other) is a two-way access issue.

As noted, this discussion suggests that the target access regime in the NBN environment should be based on a regime of negotiate/arbitrate with Final Offer Arbitration, and that this could be overlaid with an incentive regulation price cap for setting future prices.

The agency that engages in this activity need not be the ACCC and could easily be an industry specific market facilitation group.

For existing access services it would appear appropriate to change the legislation to set the ACCC as a price setter rather than an arbiter.

The issue of how to distinguish one regime from the other could be thought of as being about the technology, but ultimately the distinction is the industry structure that underpins the appropriateness of each regime.

We therefore propose that the (one-way) access regime should be differentiated by whether the access is to structurally separated services or services provided by vertically integrated firms. Where it is the former a reliance on negotiate/arbitrate with final offer arbitration and the use of incentive regulation using price caps should be adopted. Where it is the latter (including all the currently declared services) the ACCC should be empowered to set prices.

4 The Competitive Conduct Regime

It is a generally accepted position that the competitive conduct regime is not working effectively. The basis for that is that there is a perception that anti-competitive conduct has been engaged in and that the response to that conduct has been slow and/or ineffective.

To the extent this criticism may be valid, but the causes are twofold and are not the processes themselves. The first is that the threshold question of proof of anti-competitive conduct is, in the

¹¹ Jean-Jacques Laffonte and Jean Tirole *Competition in Telecommunication* MIT 2001 Pp 170-178

¹² *Ibid.* Pp179-216.



end, no easier under Part XIB than the usual s46 process. The second is that the relationship between the firms in the industry is such that a complainant firm usually needs to continue to be a customer of a firm complained about, and that the financial recompense (damages) is usually insufficient to justify bringing private actions.

To the extent that further improvement in the operation of the provisions may be desirable there appear to be solutions other than the procedural suggestions in the Paper. The first is being more explicit about the concept of a competition notice constituting *prima facie* evidence. Section 151AN of the *Trade Practices Act 1974* specifies that a Part B notice is *prima facie* evidence of the matters in the notice. It is not clear that this constitutes evidence of the events or the events and their consequential anti-competitive effects. Certainly the ACCC has managed cases under Part XIB on the assumption that in the concluding proceedings it is still their responsibility to “make the case” that the conduct is anti-competitive. A lay reading of the provision would be that the case would proceed on the basis of the notice having established a case and that the obligation was on the party receiving the notice to “make the case” that the conduct was NOT anti-competitive. Making it abundantly clear that the notice creates the reversal of the onus of proof would make the provision more effective.

A further consideration would be to provide greater clarity in the legislation to the courts and market participants of conduct that should be considered anti-competitive. In this clarification a further “presumption of guilt” should be included for circumstances where the firm suspected of engaging in misuse of anti-competitive conduct operates in more than one vertical element of the industry.

The second potential improvement is to change the consequences for a firm found to be engaging in anti-competitive conduct. It has become abundantly clear that the fines potentially imposed on the largest provider have not been perceived by that firm to be sufficient deterrence. There are a number of ways that the deterrence effect could be increased. In the context of the current discussion we suggest that the courts should be able to issue orders requiring the re-organisation of the offending firm including requirements to divest certain lines of business in circumstances where anti-competitive conduct has been found to occur. That is, the appropriate remedy may be to remove the future potential for the conduct rather than merely penalise it.

5 The Separation Arrangements for Telstra

The Paper makes it clear that this discussion is focussed on the separation arrangements that apply to Telstra through the transition to a structurally separated NBN. It does not address some similar questions that need to apply to the NBNC_o, and we will touch on these briefly.

To ensure that the NBNC_o does not start “migrating” downstream and sell directly to retail customers, it will be necessary to develop some bright line tests of the types of firms which can buy services directly from the NBNC_o and to which it may sell. This probably requires some kind of licensing regime. To ensure that retail customers don’t simply acquire licences then there needs to be a consequence of having a licence.

Currently individual licencing is restricted to carriers who acquire certain obligations and certain powers and immunities. They are, however, also taxed, primarily through the carrier licence fee and USO levy. Both of these charges are levied on a “carrier value added” basis. Were this model to remain the bulk of these fees would be paid by NBNC_o. An alternative is to levy these



charges on the parties who acquire services from the NBNCo. To ensure that NBNCo customers are not retail customers the levy could be assessed on the total revenue, irrespective of the source of the revenue, of the entities who acquire service (and their related parties as currently defined).

We now turn our attention to the ongoing structural problem as it relates to Telstra. This problem remains that Telstra has the opportunity and incentive to favour itself over its external customers. This difficulty is augmented by the regulatory difficulty in both ensuring equality of access in the access regime and monitoring anti-competitive conduct.

Neither the accounting nor operational separation regimes have been effective in overcoming the problem. Indeed the final form of the operational separation regime is not vastly different from the accounting separation regime.

There has been some interest in functional separation regimes wherein the parts of the business deal at full arms length with each other. This is the step one short of a full structural separation. However, it is hard to perceive a situation in which functional separation is an enduring solution. The single Board is required to make investment decisions in the retail and wholesale businesses, and these are quite different investment classes.¹³ As a consequence if there is effective functional separation, then one would expect the separated firm to prefer to be fully structurally separated.

A corollary of this is that if a firm claims to be “functionally separated” but does not intend to structurally separate it can be inferred that the functional separation is not fully effective.

The further corollary is that functional separation is at best a transitional arrangement, but that as a transitional arrangement it continues a tension between a policy outcome that sees the end point as structural separation and a private (possibly incorrect) incentive to ultimately re-integrate the firm.

The Paper raised additional questions about aspects of horizontal structure as well as vertical structure, most notably in relation to PayTV and other content related services. The Australian market has been quite distorted by the consequence of decisions that allowed the incumbent telecommunications provider to also become a PayTV provider.

This submission is not the place for a full analysis of this policy position, its historical origins and market consequences. What is relevant is the consequence for market structure, the fact that there has been inadequate “inter-modal” competition in broadband services, and observations about how market power can be created and amplified.

Where exclusive rights to content can be acquired by parties in a market where providers compete to be the connectivity provider one of two outcomes can occur. The first is a whirlpool wherein market power between the two areas of content and distribution amplify each other. The provider with the most number of connected end customers can afford to pay more for the exclusive rights to content, as a consequence of having more content the provider becomes more attractive as a supplier of connectivity hence acquiring a greater market share, and hence being able to acquire more content. Eventually the market “tips” to one in which there is only one distributor and acquirer of content.

¹³ David Hayatt ‘Why vertical structural separation is in the interests of incumbent telcos, and why they don’t see it’ *Telecommunications Journal of Australia*. Vol. 58. no. 1 May 208. Available at <http://publications.epress.monash.edu/doi/pdf/10.2104/tja08010>

This is a reasonable description of the activities in the PayTV market in Australia, the consequence of which is a monopsony in content acquisition, especially sports rights. None of the steps on the way constitutes an action that would or should be considered anti-competitive, but results in a non-competitive outcome. Consequently it is appropriate to consider public policy outcomes that restrict this outcome.

The scenario of tipping is not the only one. It is also possible that the result is “stalemate”. In this scenario two or more providers secure an amount of exclusive content, but the amount of content is not enough to encourage significant additional customers. As a consequence the market doesn’t seem to be growing, and content is not made available to operators. Without compelling content customers lose interest, existing content players aren’t getting traction and withdraw their content.

The third scenario is that there is no exclusivity in content. The possibility here is that the distributors put insufficient effort into promoting the service and content (fractured marketing) so scale is never achieved.

These scenarios are all relevant for the NBN because the technology of FTTP (especially GPON) could deliver both an IPTV data stream separate to the “internet” stream, and an RF television stream just like the PayTV stream. Before considering what structures need to apply to Telstra or other existing PayTV operations, a position needs to be developed on how a competitive market for television should emerge on the NBN. That policy consideration should include a consideration of whether the PayTV “voice” needs to be considered in the context of cross-media ownership restrictions.

It is widely recognised that Australia made a policy error in allowing its incumbent telco to build an HFC PayTV network in competition to the entrant telco. The ACCC in its report *Emerging Market Structures in the Communications Sector* recommended that Telstra be required to divest its HFC network and investment in Foxtel. Nothing seems to have changed in the intervening period to change that recommendation.

As discussed the NBN will see a new era of TV distribution become available. It will be a pity if that era does not achieve the potential of competition and diversity due to the inherited market structures. If Telstra is unwilling to divest its HFC and Foxtel assets, then it needs to be directly constrained from any active participation in content services delivered over the NBN.

It is clear that the model of exclusive content owned by connectivity providers is sub-optimal and immediate steps need to be taken to stop participants with significant market power in connectivity markets from acquiring exclusive content.

6 The Facilities Access and Land Access Regimes

The Paper discusses aspects of the facilities access regime and whether it needs to be aligned to the service access regime, in particular whether it should be aligned to the Part XIC process. There seems to be little benefit in such an alignment given that the default position in relation to facilities is that they are all effectively “declared”.

To the extent that alignment with XIC is otherwise warranted that would then relate to the process of achieving specific instances of access, either in terms of physically obtaining access or in terms of the price and non-price terms and conditions of access to the facility.



The industry did in the first four years have significant difficulties in the operation of the facilities access regime in relation to towers for radio-communications (mostly mobile). Two developments improved that situation. One was the co-operation between participants through the Mobile Carriers Forum, and the other was the decision by two operators to sell (structurally separate) their towers.

The first was a move taken by the industry to facilitate the processes of achieving local planning approval for new towers by demonstrating that the industry was maximising its use of new towers. It was also a response to concerns raised with the industry by the then Parliamentary Secretary over excessive use of the “low-impact facilities” powers.

These developments suggest that the facilities access regime (and indeed the land access powers) could benefit from a similar two track approach to that proposed for XIC. That is, where the facilities are owned by an enterprise that is structurally separated from the provision of retail services a negotiate/arbitrate model with final offer arbitration and possibly industry co-ordinated process could be used. Where the facilities are part of a vertically integrated firm competing in the retail market, and the firm therefore has both the incentive and opportunity to frustrate competition, then an agency properly empowered to determine the terms of access is appropriate.

Similarly the land access powers could be tailored to help achieve the outcome of an industry structure in which facilities are constructed by parties with an active interest in selling access to “all comers”. In his model the existing, or strengthened, land access powers would apply only to structurally separate facilities provision firms. Other builders would have powers in relation to maintenance and customer connection but not in relation to new facilities.

7 Spectrum Allocation

The Paper identifies the possibility of pursuing a different strategy for future spectrum auctions. The strategy envisioned is one which pays greater attention to the whole of the communications industry market structure rather than merely the component of it that is involved in wireless based (primarily mobile) services.

This consideration is highly appropriate. One of the implications of the deployment of the NBN will be the means left to providers to otherwise differentiate their market offerings. The ability to “bundle” a mobile network with NBN offerings could well be such a differentiator.

As a consequence the relationship between market power in mobile services and other sources of power becomes relevant. Further, as Unwired noted in its submission on spectrum trading the ongoing process of making more spectrum available to the largest network works against developing the competitive market in mobile services.

There is, however, another aspect of future spectrum allocations not thus far considered. This is the change in bandwidth requirements as a consequence of the move to mobile broadband. While various developments such as HSPA, WiMAX and LTE all provide higher network speeds, to convert these speeds to higher throughput still requires wider channels and hence greater spectrum allocations to each operator than has occurred in previous auctions..

This suggests that the approach to competition limits foreshadowed is not only appropriate but necessary, as there are likely to be fewer licences on offer not more. It also suggests that there will be benefit in considering two other policy options;

1. Requiring the successful applicants for additional IMT spectrum to build an “open access” network similar to the NBN.
2. Co-ordinating any the auctions of the 700MHz and 2.5GHz spectrum so that a larger number of sizeable lots can be made available simultaneously.

Unwired notes that the discussion about the 2.5 GHz band remains speculative as the band is not available until the television broadcasters are relocated for the ENG service. ACMA has as yet not identified any suitable home for the relocation of those services.

The other relevant policy consideration is to recognise that auctioning spectrum in the IMT designated bands isn't really an auction to find the highest and best use but a way to choose the provider of mobile services. As such the treatment of spectrum in the mobile and wireless access bands needs to be modelled on the “service licensing” model of the broadcasting bands rather than the spectrum licensing approach. The certainty over access to spectrum this provides will facilitate ongoing investment in network capability.

8 Aspects of Convergence Regulation

The Paper touches briefly of convergence issues but notes that “given the significant change that the National Broadband Network will bring to the sector, it makes sense to wait until the new arrangements are further advanced before launching a full scale review of convergence related issues”. While this sentiment is understood there are aspects of the regulation of convergence services that cannot be put off too far because they will impact immediately on investment decisions.

Specifically, IPTV is an often cited example of services that can be delivered over the NBN. This however raises important questions about the regulatory treatment of such services. If they look like or compete with the broadcasting services, should they be subject to the same restrictions on classification, advertising standards, and children's and Australian content requirements? Knowledge of the regulatory requirements will be essential for investments to be made in utilising the additional capabilities of the NBN.

While the services of economic interest are likely to be more general internet services, the successful adoption of the TV models could be argued by some as a key strategy to drive take-up of the service. Consequently, there will be an early need to resolve these issues.

9 Conclusion

This submission has focused on only some of the matters in the Paper. The focus on the access regime and anti-competitive conduct regime has sought to focus on a consistent transition to the requirements of the NBN. In particular we have focussed on the benefit of making the structural nature of the firm a determining feature on which of several alternative approaches should or could be employed.



Unwired believes the issues of convergence regulation need to be accelerated to ensure consistency of treatment of different content service provision businesses and to ensure that appropriate incentives exist to exploit the NBN.

Unwired looks forward to the opportunity of participating further in the deliberations of policy in relation to NBN deployment.



APPENDIX A – Response to Questions

Part XIC access arrangements - Questions

- How can the processes and procedures under Part XIC be improved? What are the relative merits of the options outlined or any alternative you favour?
- Are there elements of the different options which could be combined?

The provisions of Part XIC should be made contextually to the structure of the industry and in particular the structural elements of the providing firm.

Where the firm providing access is limited to only the vertical level in which the services are offered the regulatory task is merely the need to ensure pricing does not include excessive rents. A negotiate/arbitrate model with final offer arbitrations and ultimately price caps would suffice.

Where the supplying firm is vertically integrated then it has both the incentive and opportunity to frustrate the operation of the access regime and engage in regulatory gaming. In such circumstances it is appropriate to empower the ACCC to simply determine the terms of access. In addition there would be benefits in “locking in” the basic positions that apply to the services declared and the method of determining the price for the existing services delivered over the copper network.

Anti competitive conduct provisions - Questions

- Are Part XIB procedures too complex? If so, how could they be streamlined?
- Are consultation notices necessary?
- Would the introduction of binding rules of conduct on carriers who are subject to a competition notice or as an alternative to competition notices improve the operation of Part XIB?
- What are the relative merits of the options outlined?

The effective operation of the competitive conduct regime appears to be more affected by the evidentiary difficulty of establishing anti-competitive conduct and the consequences of establishing that the conduct has occurred than it is about the procedures to be followed.

While the various procedural amendments discussed in the Paper could speed up the processes none seems to result in better long run outcomes. Empowering the ACCC to issue binding rules of conduct would risk placing the ACCC in the shoes of the management of the offending firm. It may result in a rapid rectification, but may still be a sub-optimal outcome amongst a range of outcomes that could have rectified the behaviour.

The intent of the notice regime was that the offending behaviour would be rectified due to the consequences of not doing so. Simplifying the evidentiary issues in proving the conduct is anti-competitive - reversal of the onus of proof - and making the consequences of greater consequence is likely to have more effect.

Separation arrangements for Telstra - Questions

- What are the appropriate structural arrangements for Telstra during the transition to the National Broadband Network?



- Could measures be put in place to make the existing operational separation regime work more effectively? If so, what are they?
- If functional separation is adopted, what would be the key elements of such a framework? What would be the appropriate boundaries for separation?

Note: Questions about the existing regime relating to the criteria for the statutory review of operational separation are set out in Appendix A.

In the submission we have focussed on the operation of Part XIB and XIC and the consequences that should flow to structurally integrated firms. If vertical integration gives a firm greater opportunity and incentive to benefit from and engage in anti-competitive conduct or frustrating access, then the fact of integration should be treated as part of the evidence that the firm is engaging in such conduct.

Structural separation is essential. Functional separation is an inadequate remedy and should not be entertained. Cases where functional separation have been embraced by incumbent firms without moving to structural separation look to be attempts to “con” the regulators and policy process.

Horizontal separation - Questions

- What restrictions, if any, should be imposed on future Telstra investment in the Australian media and communications sector?
- Should Telstra be required to divest its hybrid fibre coaxial network?

Participants with significant market power in any distribution platform should be prohibited from acquiring exclusive access to content.

Facilities access regime - Questions

- Would making the facilities access regime consistent with Part XIC improve its operation?
- Should the facilities access regime be integrated within Part XIC? If not, why not?

The facilities access regime should follow the recommended changes to the Part XIC provisions and have different operation depending on the structural form of the owner of the facilities, as discussed in the submission.

Spectrum allocation - Questions

- Given the changes to the telecommunications industry resulting from the roll-out of the National Broadband Network, are competition restrictions necessary to limit access to valuable spectrum?
- How can the Government encourage competition between different technology platforms?

Competition limits on spectrum allocations need to consider the total position of participants in terms of distribution platforms.

In addition further allocations should be arranged so that the 2.5GHz and 700 MHz can be made available at the same time.



Universal access - Questions

- Would the Communications Service Standard approach proposed in the Glasson Report provide an effective and useful framework for safeguarding consumer outcomes into the future, including the National Broadband Network environment?
- What standards should be required of:
 - voice services
 - broadband
 - mobile services, and
 - payphone servicesunder a Glasson-style Communications Service Standard?
- How can reliability, connection and repair time standards for these services be established and enforced?
- In the context of the Government's announcement to establish an open access, wholesale-only National Broadband Network, should anyone be required to provide universal access to broadband services? If so, who? Should the role be contestable?
- Given the roll-out of the National Broadband Network and that the Australian Broadband Guarantee already provides a safety net, is it necessary to include broadband in a regulatory framework for universal access?
- Given that the Satellite Phone Subsidy Scheme already provides a safety net, is it necessary to include mobile services in a regulatory framework for universal access?
- What mechanisms should be in place to address and resolve access, reliability and other service issues faced by consumers and small businesses? What role should industry play?
- What information should be gathered and reported on as part of dealing with regulatory enforcement and resolution of consumer problems?

Funding - Questions

- How should the universal access regime be funded? Should the burden fall on one carrier or should it be spread further?
- How should any intangible benefits from being the Universal Service Provider be taken into account?
- If industry funding is preferred for universal access, should smaller carriers be required to contribute? If not, what should be the threshold revenue for exempting such carriers?

No views have been offered in this submission on these issues. However, we do note that the proposed Communications Service Standard could be implemented immediately with the standards being specified as the standard telephone service, the "metro-comparable broadband service" and the mobile satellite phone. The programs the Minister needs to put in place could be identified as the USO regime, the ABG and the Sat phone subsidy scheme.

This move would facilitate the re-specification of the standard and the revision of the arrangements to reflect the NBN deployment. The recommended CSS creates an effective and efficient model for this migration.

Funding of the CSS regime should be from consolidated revenue. The industry already contributes the additional tax raised from its services through the introduction of the GST in 2000. The additional revenue not offset from sales tax savings was at least \$2 billion p.a. from our customers. Industry specific taxes are known to be a distortion and inefficient.

Payphones, Funding - Questions

- Should universal service payphones be provided under a competitive process, such as under a competitive subsidy?
- Are there alternative mechanisms that could be used for providing universal service payphones?

Location and removal of payphones - Questions

- How should payphones be distributed around Australia?
- What controls should be placed on the provision, including location, and removal of payphones? Should there be a stronger role for local councils?
- Should the ACMA be given powers to set a minimum number of Universal Service Obligation payphones, and require Telstra to identify those payphones?
- Should the ACMA be allowed to set stronger rules regarding the provision, relocation and removal of payphones, especially in rural and remote areas?

No comments are offered on payphones, except to note that the Regional Telecommunications Review considered that payphones were also a service for inclusion in the CSS regime.

Connections and fault repair, CSG - Questions

- Does the Customer Service Guarantee need strengthening? If so, what changes should be made?
- Should working days be replaced with calendar days in repair timeframes?
- Should the service disruption criteria be tightened? If so, what mechanism should be put in place?

Connections and fault repair, NRF - Questions

- Does the Network Reliability Framework need strengthening? If so, what changes should be made?

No comment is offered on the CSG or NRF.

Retail price controls - Questions

- Should the Government continue to regulate Telstra's retail prices for voice telephony services in the transition to the National Broadband Network?
- If price controls should be continued, which services should be included?



- What individual services or groups of services should be capped in price controls?
- Should retail price controls be used in conjunction with the wholesale access regime (e.g. to regulate fixed-to-mobile prices)?
- In the longer term National Broadband Network environment, will retail price controls be required? If so, what form should they take? What services should they cover?

The submission discussed at length the history of retail price controls. The ongoing reliance on retail price controls constitutes a Government statement that the competition framework is not working effectively. In this regard Unwired has already noted in a submission to the ACCC that the ACCC's request that the Government implement a price control on fixed-to-mobile calls was an admission that the competition regime was not limiting Telstra's market power in fixed line voice services.

The only basis for continuing a retail price control is that the fixed line line-rental and local call retail prices are used by the ACCC to determine wholesale prices, and therefore competition does not work as an adequate restraint on these prices. Further Telstra has an incentive to increase the price of these services to cross subsidise its own long distance services and to raise rivals' costs. Therefore a retail price control needs to be retained on only those services where the retail price is used by the ACCC to determine the wholesale price.

However, were Telstra to structurally separate its access network such that its retail operations transparently acquired the same wholesale service as their competitors then retail price controls could, and should, be removed.

Community safeguards, Priority assistance - Questions

- Are priority assistance arrangements effective?
- Does the voluntary industry code provide a sufficient safeguard for consumers?
- Should provision of priority assistance be mandatory on all fixed line voice providers during the transition to the National Broadband Network environment?
- Should the Government extend the scope of the priority assistance criteria to include people with a disability?

Community safeguards, Emergency call services - Questions

Looking to the National Broadband Network environment:

- Who should be required to provide the emergency call service? When can any transition begin?
- If responsibility were ultimately transferred to the National Broadband Network company, what obligations should apply to the company as a wholesaler and to retail service providers?
- What are the merits of the options identified? Are there operational disadvantages with the emergency call service person being separate from a telecommunications service provider?
- If Telstra is not the emergency call person and Integrated Public Number Database manager, how and when should these responsibilities be transferred to the new provider?



Unwired has no comment on the priority assistance arrangements.

Unwired believes that no obligations should rest with an individual firm in the industry. In particular Unwired believes that the responsibility to be the “emergency call person” should be vested in a new national emergency service organisation to be jointly owned by the Federal and State Governments. That agency can make its own arrangements for the provision of its telephone services.

Unwired further believes that the operation of the IPND is an adjunct function of the operation of the telephone numbering regime. However, Unwired further believes that administration of numbering, naming and addressing schemes should be the responsibility of industry (as they are for domain names and IP addresses). Therefore the Government should take immediate steps to establish with industry a numbering administration to take over the IPND and numbering administration from the ACMA (in addition the allocation of other codes such as point codes and any other network routing code required in the industry).

Legacy services and the National Broadband Network - Question

- Will the National Broadband Network raise issues for legacy services on Telstra’s network? Why? If, so how should they be dealt with?

The users of these “legacy” services need to identify their need to migrate their services and make their own submissions on their needs. After all, they won’t get much joy if they try to buy a Telex either.

Opportunities for red tape removal - Questions

- Are there any broader implications from the proposals raised by Telstra, in its submission to the Productivity Commission?
- Should the proposals raised by Telstra in its submission to the Productivity Commission proceed?
- Will directory assistance services, including printed directories, be required in an increasingly online world and, if so, how would necessary services be best provided?

Customer Service Guarantee reporting and enforcement - Questions

- Should the ACMA’s informal monitoring benchmarks for carrier performance against the Customer Service Guarantee and priority assistance be made enforceable requirements subject to civil penalties?
- Should the level of penalties be increased?

The single biggest piece of red tape confronted by the telecommunications industry is its simultaneous obligations to the consumer protection regimes of ACMA as well as the Federal and State consumer protection provisions. While we note the intention of the Australian and State Governments to move to unify the consumer laws this still leaves telecommunications providers with obligations under two regimes. As an example, advertising is covered under ACMA registered codes as well as standard fair trading laws.



To the extent that the regime mentions either there are express provisions in s482 and s483 of the *Telecommunications Act 1997* that the SFOA provisions do not limit either state law or the *Trade Practices Act 1974*.

Unwired believes a far more effective approach would be to provide that (a) State fair trading law does not apply to the telecommunications industry and (b) that ACMA be the body charged with enforcing the provisions of Part 5 of the *Trade Practices Act 1974* in relation to the provision of telecommunications services. (We note that Communications Alliance in its submission on the Australian Consumer Law has sought the end to the double regulation by subjecting the industry only to the general consumer law and regulator. If that is perceived to be a better way to address the duplicated regulation we would support it).

We have no comment on CSG enforcement.

Appendix A: Review of operational separation - Questions

- How have the existing accounting and operational separation arrangements affected competition?
- Will these arrangements continue to be needed before, during or after the roll-out of the National Broadband Network?
- In what markets does Telstra hold a substantial degree of market power? Do the operational separation arrangements adequately deal with the risks created by market power?
- What technological developments (apart from the National Broadband Network) might reasonably be expected to have a significant impact on competition in telecommunications markets?
- How do the operational separation arrangements affect Telstra's commercial incentives for supplying wholesale eligible services?
- What are the costs and benefits of the operational and accounting separation regimes?
- How could the effectiveness of the current arrangements be improved? Would the options to enhance the current operational separation requirements described in chapter 3 improve confidence in the current arrangements?

We have no comment on the current separation arrangements. Unwired's view is that anything short of structural separation is inadequate.

