



Pre-RFP Submission to the Expert Panel

March 2008

Introduction

The Competitive Carriers' Coalition represents the interests of non-dominant telecommunications carriers in Australia. Members of the CCC have been the pioneers of the delivery of true broadband and 3G mobile services. All members of the CCC have progressed on the so-called ladder of investment to the point where the collective investment of the members is about \$5 billion.

Further, the CCC has been seeking to lead policy discussion in relation to the implications of the transition to a deep fibre network in Australia since it first organized a policy seminar on the issue in 2004.

The CCC welcomes the opportunity to contribute to the deliberations of the expert panel and the Government in relation to the proposed National Broadband Network and believes it has much to contribute.

The CCC believes that the primary issue of concern to policy makers in Australia should not be to preserve the current environment for telecommunications competition but to significantly enhance the conditions for competitive delivery of telecommunications services.

The CCC submits that it is beyond dispute that the Australian regulatory regime has failed to deliver competition comparable to that in those developed countries that are leading the world in service deployment and prices for telecommunications services. The evidence of this is in the prices consumers in Australia face for mainstream services compared to many other countries, including countries with similar demographic and geographic challenges, such as Canada. Australian fixed line services prices for small and medium sized enterprises are, for example, about 40% above the OECD average.

This situation stems from the current industry structure and the profit incentives that this structure presents to Telstra as the incumbent monopolist. The CCC believes that the transition to a deep fibre network must result in these fundamental market power issues being resolved.

1 Process for RFP Development

The RFP will be developed in a very tight timeframe yet will be the document that determines how much interest there will be among potential bidders for the NBN, especially overseas bidders.

The RFP will need to give sufficient clarity on a number of key issues before potential bidders will be willing to commit the substantial resources required to seriously participate in such a process. It is entirely possible, given the tight timeframes, that the RFP document might inadvertently omit necessary information, or inadvertently include requirements that lead to potential participants not proceeding to prepare a bid.

For this reason, the CCC strongly suggests that the Expert Panel release a draft RFP after March 30, and allow at least two weeks for responses to be received and considered before issuing a final RFP.

The CCC is conscious that the Government has advised the Panel that it wishes the processes to move quickly. However, we submit that the issuing of a draft RFP is prudent and will not necessarily delay bidders who are already committed to participating in the preparation of their documentation. Those bidders would be in a position to begin to prepare their response on the basis of the guidance provided by the draft RFP. Others who have some reticence, either because there is insufficient clarity provided by the draft or because the draft contains a condition that would preclude their participation, would be able to make representations to the panel on these matters before making a final decision not to go further.

2 Open Access Definitions

The CCC believes that the most important decisions in the NBN process will be those surrounding the requirement for open access.

The CCC considers this to be the fulcrum on which all future competition, and the possibility for the resolution of on going market failure in Australian telecommunications, will turn.

Further, the CCC believes that clarity around these requirements will be necessary before potential bidders that are now considering becoming involved in this process will go any further and commit to participating. It is crucial that the regulatory framework in relation

to the creation and promotion of sustainable competition is established when the RFP is released.

The CCC has for many years argued that structural reform of Australian telecommunications is necessary and overdue. Regulatory tools designed to provide competitors with access to the monopoly elements of the Telstra network have failed because Telstra's ownership and control of vertically integrated assets and businesses have resulted in it being an unwilling seller of this access.

The ACCC published in the so-called Emerging Markets report in 2003 that confirmed that it shared the concerns of the CCC. The Commission wrote that Telstra had the incentive and the ability to discriminate against competitors who required access to the monopoly network elements Telstra controlled, and that it did exactly that.

Developments in Australia and overseas since that time demonstrate that the verdict is in and that structural reform remedies to address these issues is a necessary part of any effective competition regime in telecommunications. The UK, New Zealand, Singapore and the European Union have all moved to introduce strong, effective structural reform. The US undertook structural reform some decades ago.

The ACCC, the European Regulators Group, the EU, BT (British Telecom) and others have all presented versions of the principles or key elements of functional separation, and a summary of many of the common elements appears below.¹

Jurisdictions where competition can be said to be most effective are characterized by an ongoing regulatory reform aimed at the incumbent operator and the market more generally. The recent international developments around structural remedies represent a "second wave" of reform of the legacy telecommunications network among those countries that have relied on regulated access in the past. It adds a structural reform element to the access regime – based in recent years on network element unbundling – that has underpinned regulatory measures to introduce competition.

A "third wave" of reform is beginning to emerge in response to the emerging investments or demands for investment, in fibre-based next generation access networks. While access to network elements is being pursued in many jurisdictions, it is clear that this is not substitutable for wholesale/retail separation. This third wave builds on wholesale/retail separation and reflects a more sophisticated understanding of what is necessary to create effective and sustainable retail competition to drive maximum consumer benefit.

It is clearly impractical and undesirable for multiple retailers to invest in their own deep fibre networks. But there is discussion about access to network elements in Next Generation Access Networks in addition to vertical structural separation measures to promote and protect future competition in these new broadband networks.

This approach is best illustrated by the instructions to participants in the Singapore NBN project. After more than a year of consultation and deliberation, bidding requirements

were released that seek to secure competition by requiring strict functional separation of wholesale and retail functions while promoting future market entry at the wholesale level by structurally separating ownership of passive network elements.ⁱⁱ

Singapore has mandated strict functional separation between wholesale and retail businesses along the line of the UK and structural separation of the ownership of the passive network elements. The rationale for this would seem to be that it anticipates that there is a need to control the market power of the wholesale business, which is a monopoly for as long as there is no ability for other entrants to build a rival wholesaler.

The owner of the structurally separated passive network elements would have an incentive to encourage an alternative wholesaler to enter the market by utilizing these bottleneck elements to counter the monopsony power of the wholesaler that it would face. But to make this wholesale entry viable, a robust retail market would in turn be necessary, and separation of wholesale and retail functions creates an incentive for the wholesaler to in turn encourage the development of robust retail competition and growth.

In the Australian context, the ACCC has already provided guidance about the level of ownership separation that it believes is the minimum required to support robust and sustainable competition in an NGAN context in its draft decision on the FANOC special access undertaking. While this is an opinion specific to the FANOC proposal, the principles underlying it can be applied broadly.

The FANOC undertaking anticipates some level of ownership of the network and wholesale business by retail telecommunications carriers. To satisfy the Commission that its previously stated concerns that vertical integration provides the network owner with the incentive and ability to discriminate against retailers in competition with its own retail business, FANOC proposed various controls over the way these FANOC shareholders could exercise their influence.

However, the Commission was not satisfied that these were sufficientⁱⁱⁱ. In its draft decision, the Commission said it was “not satisfied that the SAU provides a rigorous and unambiguous framework for sufficient separation between the ownership of the HFTP network and the downstream retail sector for the ACCC to accept FANOC’s claim that its governance model prevents *effective* vertical integration”.

The Commission went on to say that the most straightforward approach would be to prohibit ownership of the network by retailers. It suggested that as soon as any level of vertical ownership is allowed, the issue of establishing and monitoring safeguards against discrimination and cross-subsidisation, and providing a means of redressing such conduct, becomes crucial. It suggested that the FANOC undertaking required “greater safeguards to tighten ownership and control restrictions” and suggested that the provisions could have included:

- Setting out stricter control restrictions using specific triggers based on ownership or voting thresholds applying to both individuals and groups of access seekers so that non-compliance can be easily identified. Given the difficulties in identifying

maximum “safe” ownership thresholds, the ACCC would tend to take a cautious approach to determining these thresholds.

- Ensuring strict separation of directors, managers and employees of FANOC and the BAS manager as well as business and IT systems
- Requiring on going reporting on compliance with the Management Principles, including ownership interests and voting rights.

These comments set a standard that should guide the minimum requirements to protect competition for bidders in the RFP, providing consistency with the existing published opinion of the regulator. Given that the Government will require bidders to have their proposals accessed by the ACCC, the CCC submits that the RFP should include guidance for bidders that the preferred standard (as per the Commission’s opinion in the FANOC draft report) is that there is no ownership of the NBN by any participants in downstream markets. If there is to be some vertical ownership, the suite of controls over how that ownership can be exercised will be required to at least meet the standard described above, and reflect the established underlying principles of functional separation, as described below.

Further, the CCC submits that the expert panel should give serious consideration to replicating the requirement of bidders in the Singapore process that the underlying network elements be structurally separated from the wholesale business utilizing them. Such a provision would anticipate the undoubted regulatory conflict that will emerge in relation to pricing at the wholesale level, and encourage a network design that is forward looking and pro-competitive.

The CCC submits that the well understood and documented risk is that an NGAN is designed such that it makes network unbundling difficult. Further, it is also generally accepted that a fibre to the node/curb upgrade is a stepping stone to an eventual fibre to the premises access network, as has been encouraged by the Minister. The design of the FTTN can make such further upgrade difficult or easy. These risks can and must be ameliorated by the expert panel, and this could be affected by making clear in the RFP that the ownership and governance arrangements for the passive elements of the new network will be required to meet strict separation criteria. This would go some way toward removing the incentive for proponents to present a bid that uses technologies or architectures that make future competitive access difficult or impossible.

Contact

The CCC looks forward to contributing further to the NBN process.

If there are any questions or requests for further information, please contact:

David Forman
Executive Director
CCC Inc
david@ccc.asn.au

0438121114
02 62625821

Footnotes

ⁱ Definition and Elements of Functional Separation Used Internationally

Source: LA LETTRE DE L'AUTORITÉ DE RÉGULATION DES COMMUNICATIONS ÉLECTRONIQUES ET DES POSTES http://www.arcep.fr/uploads/tx_gspublication/lettre55-eng.pdf

Accounting separation: separate financial reporting for each of the operator's lines of business in its regulatory accounts.

Functional separation: creation of a separate business unit along with operational rules to establish Chinese walls between this new business unit and the incumbent operator's other operations.

Legal (or structural) separation: making the new business unit into a separate subsidiary.

Ownership separation: divestment by the operator of its newly created subsidiary (resale to different shareholders).

Elements of Functional Separation Employed in Various Jurisdictions

Several of the measures mentioned here are mandatory (accounting separation, creation of a business unit, etc.), while others are optional and can sometimes be applied to differing degrees. And, finally, some components can only be imposed in conjunction with others.

• Separation of functions

- Creation of a separate business unit "A", responsible for the production and supply of the products in question.
- Obligation to supply all operators under non-discriminatory conditions (equivalence/equality)
- Separation of operational support systems
- Separation of the brand (total = different name/partial = "A, a division of B")

• Separation of employees

- Employees are not permitted to work some of the time for A and some of the time for another department of the incumbent
- Restrictions on the movement of A's managers to the rest of the group
- Physically separate offices and places of work
- Pay incentives
- Code of conduct, notice boards, training

• Separation of information

- Limits on the flow of information between A and the other divisions (firewalls, Chinese walls)
- Implementation of separate access systems (information specific to the needs of the employee)
- Separation of information management systems

• Financial separation

- Accounting separation
- Separate budgets
- Financial autonomy

• Separation of strategies

- Separate management
- Separate management board, independent of the group
- Strategic investment decisions taken independently by A

• Monitoring of compliance with obligations/performance

-
- System for reporting breaches (integrated/independent)
 - Independent complaint handling committee
 - Sanctions applied in the case of default
 - Publication of performance indicators (by an independent body/third party certification)
 - Submission to the regulator of contracts signed between A and the incumbent (and/or alternative operators)
 - Publication of compliance reports (by the regulator/by a third party)

Conditions of a Functionally Separate Unit – BT Principles

Source: BT Presentation to ATUG 2008

1. Network separation
2. Management separation
3. Restriction on intra company/group influence
4. Reorientation of staff rewards and management incentives
5. Restrictions on where employees can work
6. Restrictions on flow of commercially confidential info
7. Transparent coordination of FSU return on assets
8. Functionally separate unit can not enter retail markets
9. Rest of company can not self supply products of FSU
10. Compliance provisions: KPIs, independent oversight

ii Singapore NBN Project – Structural Requirements for Bidders

Singapore will require that the NBN is separated according to what it describes as the “NBN Concept Layers”. These are the application layer (services such as voice, data and video that are acquired at the retail level), the transport layer (a wholesale data delivery service) and the network infrastructure layer (pipes, pits, fibres, buildings etc).

Source: Media Briefing - Next Generation National
Broadband Network for Singapore
(Next Gen NBN)

<http://www.ida.gov.sg/News%20and%20Events/20071211184512.aspx?getPagetype=20>

iii FANOC SAU draft decision

<http://www.accc.gov.au/content/index.phtml/itemId/788471/fromItemId/356715>