

Submission

National Broadband Network: Regulatory Reform for 21st Century Broadband

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A EXECUTIVE SUMMARY

1 Truman Hoyle welcomes the opportunity to make submissions regarding options for telecommunications regulatory reform in response to the Government's Discussion Paper, *National Broadband Network: Regulatory Reform for 21st Century Broadband*.

2 As a firm practising extensively in the areas of telecommunications law and competition law, the authors have considerable experience in the application of regulation, including the *Trade Practices Act 1974 (Cth) (TPA)* and the *Telecommunications Act 1997 (Cth)* to the conduct of business in the telecommunications industry, and, as such, we speak not just from a theoretical standpoint but also with the benefit of that practical experience.

3 In our submission:

- the guiding principle behind regulatory reform must be the establishment of “the most effective means for initiating and sustaining competition”¹ not just in connection with the proposed NBN but, most importantly, in the telecommunications industry generally;
- getting the structural aspects of the market right should be the first priority in terms of reform, from which all else should flow;
- regulation should be seen as a stepping stone towards a competitive telecommunications industry and not a substitute for the effective operation of legal market forces;
- the lessons of the past should inform regulatory reform, but not dominate it – regulation should be guided by principle, not solely by reaction to past bad experiences;
- the aim of regulatory reform should not be to enhance the power of the regulator but to minimise regulatory intervention once competition is established²;
- care needs to be taken to ensure that the regulator remains an arm's length provider of guidance rather than itself becoming “involved” in the market or the captive of certain sectors or market participants;
- regulation should result in transparency and certainty for all market participants with outcomes which are, or can be achieved without undue delay or compliance costs, while at the same time being sufficiently flexible to cope with changing technological and market conditions³; and
- above all, the focus should be on planning, in the longer term, for less, or less industry specific, regulation, rather than more.

¹ International Competition Network, Report of the ICN Working Group on Telecommunications Services , May 2006, p.1

² Report of the ICN Working Group on Telecommunications Services , May 2006, p22

³ Report of the ICN Working Group on Telecommunications Services , May 2006, p1.

4 The authors acknowledge that regulatory reform for both the transition to, and the operation of the National Broadband Network (**NBN**) will be a critical factor in the success of the network and the future of telecommunications in this country. However, for the reasons outlined in this submission, we caution against reform which:

- dwells overly much on a past which has been dominated by a prior incumbent, Telstra; and
- places in the hands of the regulator relatively unfettered powers not just to enforce its views as to compliance but which may have long lasting effects on market structure well past the time when the normal competitive principles and market forces could, and should apply.

With that end in mind, appropriate structural and regulatory reform should ensure that all market participants, including those which are currently smaller players or new entrants, can compete on their merits.

B GENERAL COMMENTS

5 This brief submission focuses principally on reforms as they relate to the structure of the market and Parts XIB and XIC of the TPA. Prior to addressing the specific matters raised, principally, in Chapter 3: Telecommunications Competition Framework, of the Government's Discussion Paper, the authors make the following general comments.

B.1 Regulatory reform – to what end?

6 Before embarking on a consideration of what, if any, regulatory reforms should be made it is worthwhile pausing to consider why, and for what purposes such regulation is and is not required.

7 In our opinion, regulation in this case is required both during the transition to the NBN and after its implementation:

- first and foremost, to ensure that competition flourishes in the industry;
- to protect and benefit consumers, which is consistent with the objectives of the TPA⁴;
- to assist in overcoming difficulties in obtaining access and interconnection, not just to the new network but to existing facilities and infrastructure while the network is being built;
- to provide guidance to market participants on what is and is not acceptable conduct towards each other, suppliers and consumers;
- to provide remedies for anti-competitive conduct in a timely and principled manner;
- to be forward looking, flexible and timely; and

⁴ See section 2 of the TPA which specifies the object of the Act to be “to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection”

- to facilitate a transition from regulation to competition in a fully functioning market;

8 Regulation should not:

- become a substitute for competition;
- protect competitors or classes of competitors over others;
- prop up the inefficient;
- shield economies of scale and scope from competitive forces or cloud the necessary signals or incentives to minimise costs, undertake efficient business practices and engage in innovative technological change that market forces provide⁵;
- focus on punishing the sins of the past;
- create compliance obstacles, whether through uncertainty, delays or cost;
- become fertile ground for gaming and obstruction;
- encourage regulatory overreach and error⁶ or lack of rigour on the regulator's part; or
- be exempted from review or its application from challenge.

B.2 Different times need different regulation

9 In our opinion a very clear distinction needs to be made between regulation which is to apply in the transition period and that which is to apply once the NBN is implemented.

10 If, as the authors submit should be the case, the structure of the market post implementation of the NBN is such that it facilitates competitive market forces, the nature of the regulation required is likely to be somewhat different (and, hopefully, more reliant on general competition and access principles and less on industry specific proscription) from that which exists today in the form of Parts XIB and XIC of the TPA. It should not be forgotten, also, that the implementation of the NBN will not alter many of the access, interconnection and other competition issues which currently arise in the telecommunications industry outside broadband and in respect of which some reform is undoubtedly required (eg in mobile and wireless networks).

11 During the transition period, however, there are also likely to be a number of factors which may require more "heavy handed" regulation to ensure against or correct any market distortion. Such factors could include incumbents attempting to shore up their positions in advance of the NBN (eg by tying customers to their networks or by securing terms of access to assets to be sold to NBNCo which enhance the value of those assets).

⁵ Report of the ICN Working Group on Telecommunications Services , May 2006, p 4

⁶ As the Productivity Commission found Part XIB had the potential to do in its 2001 Report: Telecommunications Competition Regulation

12 Until there is greater certainty regarding implementation of the NBN, and what is to occur in the transition period, including, importantly, matters such as the contribution, if any, of assets to the NBN by present or future market participants and the structure of the market itself, it would be premature at this time to conclusively determine the regulatory reform required. Suggestions are made, however in response to the specific questions raised in section C below.

B.3 The role of the regulator

13 The role and powers of the regulator, and how they are used by the particular regulator, are as important as the regulations themselves. Ideally, that role should be to enforce competition rules, where they are breached and to provide guidance on whether or not conduct will breach the rules⁷.

14 We submit that enhancement of the power of the regulator, in this case the Australian and Competition Commission (**ACCC**) should only occur where and when absolutely necessary and must always be accompanied by a right of review and challenge upon established legal principles.

15 Many of the calls for enhancement of the ACCC's powers (by, for example, allowing it to set binding rules of conduct with limited recourse to review, or to set prices for access) seem to be based on well placed concerns that the current Part XIB and XIC regime has not produced the results which those seeking to engage with, or, in some cases, curb, the power of Telstra have sought. The authors acknowledge that concerns that the present system is open to gaming and delays are valid concerns and that they must be addressed. However, regulatory reform which is intended to address a structurally different market place, should not have its sole basis in the problems of the past, nor should the powers of the ACCC be unduly enhanced for that same reason.

16 The risks of enhancing the ACCC's powers by reference to what the authors call the "Telstra experience", without appropriate safeguards, include a danger that:

- the ACCC will identify too closely with, and serve the interests of particular market participants or classes of participants, a phenomenon recognised as "regulatory capture"⁸;
- the market forces will either no longer operate or not develop sufficiently to deal with inefficient competitors;
- the industry will become more reliant on the ACCC to resolve impasses to the detriment of competition;
- the ACCC will become less rigorous in its assessment of conduct, knowing that its decisions are less open to challenge; and
- the ACCC will become maker and interpreter of policy, as well as prosecutor, judge and jury.

⁷ See comments in Report of the ICN Working Group on Telecommunications Services, May 2006, p1 and as recognised in other jurisdictions such as the United Kingdom (see OFT 417, Competition Act 1998: The application in the telecommunications sector

⁸ Report of the ICN Working Group on Telecommunications Services, May 2006, p 8

B.4 What needs to be done

17 In addition to the specific structural and regulatory matters discussed in section C below, we submit that the following must be addressed as part of the reform process:

- ***Industry analysis***

Currently, little more is known about the NBN other than that it will be a wholesale only, open access network, in which NBNCo will initially be government owned but which will move to privatisation five years after the network is built. While the results of the proposed Implementation Study will no doubt add flesh to the bones of the proposal, the authors submit that a review and analysis of the structure and operation of all aspects of the telecommunications industry now (against the backdrop of the NBN proposal), during the transition to the NBN, and after implementation of the NBN, should be undertaken with a view to identifying which aspects require regulation and of what nature and at which time or times.

The reason for this is to avoid the prospect of knee jerk or piecemeal reform taking place which does not address all issues or which does not adequately provide for the future. As we submit in section C.3, there are structural things which could be done to substantially address the current market distortions, however, this should not prevent a holistic and cautious approach to regulation being adopted which will better serve the industry and Australian consumers both now and in the future.

- ***Regulator performance analysis***

Much has been said about the failure of Parts XIB and XIC to achieve appropriate outcomes, including, importantly outcomes which address the power of Telstra and its “first mover” advantage as the prior incumbent. There is little doubt that some of the reasons for that failure can be laid at the door of the legislation itself and at the ability of parties to engage in regulatory gaming.

However, before further power is handed to the ACCC it is worth conducting a careful analysis of why the legislation has not achieved the ends sought. Is it because, as the Productivity Commission considered in 2001, Part XIB has had the “negative effect of encouraging regulatory error and overreach and deterring acceptable pro-competitive conduct”? Is it due to other factors, including those as simple as there being “insufficient material to substantiate the alleged conduct or to establish the requisite ‘reason to believe’ threshold”, which was the reason given by the ACCC in its 2006/2007 Telecommunications Report for the failure to pursue all 8 investigations into alleged anti-competitive conduct in that year.⁹

⁹ See section 1.2 of the report

It is difficult to understand the reasons for the lack of sufficient evidence which the ACCC cites when it is considered that the ACCC has a powerful armoury, in section 155 of the TPA, in terms of the ability to obtain information and documents where it suspects that there may be a breach of the TPA. That section 155 is used by the ACCC in telecommunications matters has been confirmed. For example, in answers given questions on notice to the Senate Economics Legislation Committee in November 2006, the ACCC confirmed that in the period from 1 July 2003 to 30 June 2006, 62 of the 1211 section 155 notices it issued were to telecommunications companies in relation to investigations into Part XIB breaches and a further 7 notices were to individuals in connection with such suspected breaches.

If those already substantial powers are not revealing sufficient evidence of breaches the question must be asked: is there justification for increasing the ACCC's powers to permit it to issue binding rules of conduct, based only on its concern that there has been a breach of the TPA?

In answer to those who propose a separate test focussing on equivalence/non-discrimination and transparency rather than application of competition tests by the regulator, we acknowledge that equivalence/non-discrimination and transparency are goals to be achieved but submit that they will be best achieved through application of competition law principles.

- ***A streamlined process for review of, and challenge to the regulator's decisions***

It is trite to say that, no matter what regulatory reform is introduced, at some time or other a party will be unhappy with the decision of the regulator. Both the ACCC and industry participants have complained about the processes which currently exist for review of the ACCC's decisions. Those complaints differ depending on which "side" is making the complaint and are aptly illustrated by the 2007 decision of the Federal Court in *Telstra Corporation Limited v ACCC (No 2)* [2007] FCA 493. In that case Telstra (successfully) complained that it had been denied procedural fairness by the ACCC when the ACCC issued a Competition Notice under Part XIB which differed on two matters of substance from the Consultation Notice it had previously issued. The ACCC saw the issue differently stating that the case "highlights the substantial procedural difficulties for the ACCC in the competition notice regime and in quickly addressing competition concerns in the telecommunications industry. The ACCC believes this decision may encourage the recipient of a notice to challenge procedural aspects instead of addressing the substantive underlying conduct"¹⁰.

- We submit that the powers of the ACCC, especially if they are to be increased in the manner suggested in the Government's Discussion Paper, must be subject to scrutiny and that participants in the telecommunications industry should not be denied their rights of review and challenge. The ability to challenge a decision, whether on

¹⁰ ACCC Press release dated 5 April 2007

the merits or on procedural matters, can accommodate the need for speed to which the ACCC refers by, for example, permitting the Australian Competition tribunal to review decisions and by setting short time frames in which such challenges are to be brought and determined.

C RESPONSE TO QUESTIONS RAISED IN THE DISCUSSION PAPER

18 It is not the intention of this submission to address each of the matters raised in the Government's Discussion Paper but rather to provide a high level review of those aspects which deal with competition law reform.

C.1 Part XIC access arrangements

19 This section of the submission addresses the following 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?*

20 It is to be hoped that the structure of the NBN and, in particular, the fact that it will be a wholesale only, open access network will reduce, if not eliminate the multitude of access disputes which are currently brought under Part XIC. Notwithstanding that hope, the authors recognise the need for an access regime which specifically addresses the issues facing the telecommunications industry.

21 We submit that the aims of the access regime should be:

- to facilitate access on just terms – that is, terms which are just, both for the access seeker and the access provider;
- to facilitate timely access;
- to prevent discrimination and promote equivalence (where the structure of the industry requires it);
- to prevent charging of excessively high prices for access; and
- to allow for speedy resolution of access disputes and avoid the delays occasioned by regulatory gaming,

without the regulator becoming a quasi-market participant itself.

22 The authors submit that achievement of the aims referred to above is best done by means of a modified negotiate-arbitrate model, which combines aspects of the two options referred to in the Discussion Paper and in which:

- there are clear and specific timeframes set in which negotiations must be concluded (unless extended with the consent of both parties) and in which the parties must commence and the ACCC must conclude any arbitration;

- the processes for conduct of arbitrations and review of undertakings are streamlined and subject to short timeframes;
 - the ACCC has access to details of the terms upon which access has been provided to other parties so as to facilitate the prevention of discrimination and the promotion of equivalence; and
 - the processes for challenge and review of ACCC decisions are not limited by subject matter but are streamlined to ensure that they are brought and determined promptly by either the Australian Competition Tribunal or the Independent Pricing and Regulatory Tribunal (**IPART**).
- 23 We do not favour a process which allows the ACCC to make up front determinations on price and, in this regard, we note the concerns expressed by the International Competition Network ¹¹ that price regulation in the industry “*may in fact distort the price structure away from the reality of underlying costs, thereby encouraging resource misallocation, overcapitalisation and dynamic inefficiency*”.

C.2 Anti-competitive conduct provisions

24 This section of the submission addresses the following questions:

- *Are Part XIB procedures too complex? If so, how could they be streamlined?*
- *Are consultation notices necessary?*
- *Would 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?*

25 In responding to these questions the authors note that:

- the provisions of Part XIB already represent a significant easing of the requirements for proof of a breach of Part IV of the TPA, particularly insofar as they do not require proof of purpose for breach of the prohibition on misuse of market power, only proof of the effect on competition and they effectively reverse the onus of proof through the ability to issue a competition notice;
- criticism of the Part based on failure of the ACCC to successfully prosecute anyone ignores the fact that similar criticisms have been made of section 46 of the TPA (found in Part IV) which have, in part been attributed to the need to prove purpose rather than effects , and that the ACCC has itself acknowledged that its failure to proceed to prosecution has been due to insufficient evidence to support the claim of breach;

¹¹ In its report on Telecommunications Services , May 2006, at pp 8 and 9

- the ACCC already has available to it the ability to seek injunctions to restrain conduct which it considers to be a breach of Part XIB (without the need to offer the usual undertaking as to damages required of applicants for injunctive relief).

It is submitted that, for these reasons, the success or otherwise of Part XIB should not be judged on the lack of successful prosecutions, nor should reforms be made which enable conduct to be treated as if it were a breach in the absence of clear and demonstrable proof of the same and without a mechanism to challenge such decisions of the ACCC.

- 26 We support the continuation of the Part XIB regime which allows for the issue of consultation notices prior to the issue of a competition notice. The reason for this is that such notices, properly issued serve an entirely appropriate function of alerting the recipient to the allegation of breach which may facilitate cessation of the offending conduct. While steps should be taken to expedite the process, we also support the introduction of a requirement that the ACCC give guidance to the recipient of such notices on how to rectify the alleged anti-competitive conduct as a means of further facilitating cessation of the offending conduct.
- 27 The abolition of the competition notice procedure and its replacement with empowerment of the ACCC to issue binding rules of conduct should not occur because, it is submitted, to do so places too much, unfettered power in the hands of the regulator, who becomes investigator, prosecutor, judge and jury all in one. To grant such a power to the ACCC has the potential to;
- allow it to issue what amounts to cease and desist orders without the exposure to scrutiny (including questions of legislative competence to do so) which such serious orders deserve;
 - invite lack of rigour on the part of the regulator, especially where its decisions and the reasons for them are not open to scrutiny;
 - result in a lack of clarity about the law which occurs through judicial consideration and testing of the issues;
 - deny justice and procedural fairness to recipients who do not have the opportunity to test the veracity of the allegations made against them;
 - substitute the opinions of the regulator, especially regarding market performance and characteristics, for those who may be better placed to assess and evaluate the same; and
 - distort the market.
- 28 Consistent with the approach to be adopted in respect of Part XIC, we submit that a streamlined process for challenge and review of ACCC decisions be introduced through the referral of disputes to the Australian Competition Tribunal in accordance with strict timeframes.

C.3 Separation Arrangements for Telstra

29 This section of the submission addresses the following questions:

- *What are the appropriate structural arrangements for Telstra during the transition to the NBN?*
- *Could measure 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?*

30 It is submitted that vertical separation of Telstra is an essential element in facilitating and sustaining competition in the telecommunications industry both in the transition to and after the implementation of the NBN. Most of the problems identified with Parts XIB and XIC stem from the very reason why they have been needed in the first place, namely, Telstra's position as the incumbent and the advantages which that has conferred on it. Those advantages include ownership of critical infrastructure, access to customers, economies of scope and scale, being able to be the first mover or delay implementation of newer technologies both for itself and to the market at large so as to preserve its existing revenues¹².

31 Many, but not all of the problems could be resolved by vertical and horizontal structural separation of Telstra. As has been recognised by the International Competition Network in its May 2006 report on Telecommunications Services¹³, "*Vertical separation can often lessen the incumbent's incentives to engage in anti-competitive practices. While the benefits of separation will depend on both the opportunities provided to competitors and the benefits that consumers would receive, the costs associated with mandated separation can be significant*".

32 We recognise that complete structural separation of Telstra will be difficult . However, we submit that the weaker forms of separation, including the accounting and operational separation regimes already in place, do not now, and will not address the issues. The ACCC has recognised the inherent limitations which accounting separation has in resolving anti-competitive conduct issues when it said that such separation does not have the ability to "*capture individual instances of discrimination, nor does it remove the incentive to discriminate. These incentives are difficult to ameliorate through regulation; rather, regulatory processes may need to be strengthened to lessen their impact*"¹⁴. For the reasons set out in this submission, rather than strengthen regulatory processes, we submit that structural separation should be preferred.

¹² An example is the delay in introduction of ADSL at a wholesale level and the subsequent reduction in its retail pricing.

¹³ At p 1

¹⁴ ACCC Telecommunications Report 2006/2007

C.4 Horizontal separation

- 33 This section of the submission addresses the following questions:
- *What restrictions, if any, should be imposed on future Telstra investment in the Australian media and communications sector?; and*
 - *Should Telstra be required to divest its hybrid fibre coaxial network?*
- 34 The Government has acknowledged that Telstra is “...one of the most integrated telecommunications companies in the world”. The authors submit that mere vertical separation of the wholesale and retail arms of Telstra will be insufficient to facilitate competition in the market.
- 35 It seems clear from the experience of other markets, notably North America, that cable TV networks have been able to compete with carriers particularly for the supply of broadband. Telstra’s ownership of 50% of Foxtel, together with its ownership of the hybrid fibre coaxial (**HFC**) network and the fixed line access network has, it is widely agreed, inhibited competition and led to counterproductive investment such as the cable roll out wars of the late 1990’s.
- 36 The existence of the proposed NBN seems likely to have profound effects on the markets for not only telecommunications but also media in ways which cannot yet accurately be foreseen. Telstra’s current dominance in the horizontal market for these services will likely continue or perhaps increase if its horizontal reach is not restricted. As a minimum we submit that Telstra’s control of the horizontal market be subject to interim regulation with a view to ultimate separation. However the authors are conscious that previous interim measures have failed and it is perhaps more appropriate to acknowledge Telstra’s existing power in both the horizontal and vertical market and address it through structural separation.
- 37 If Telstra disposes of some, or all, of its access network to NBNC_o or is otherwise vertically separated, a reduction of Telstra’s current market power will likely follow. It is unclear, however, from the current proposal whether the NBN is intended to be the monopoly supplier of wholesale network services, with no other party being permitted to provide the same services. If Telstra does not dispose of its access network into the NBNC_o, there will be competing wholesale network suppliers. It seems probable that even with an NBN, other smaller networks will continue to exist or be developed (e.g. the mobile or other wireless networks and potentially satellite providers). To leave Telstra with access to any significant portions of its network (whether its fixed line access network or the HFC) will, it is submitted, leave Telstra with a significant wholesale network which it may be able to use to restrict competition in the retail sector.
38. It also seems probable that the existing Telstra HFC network could be used by a powerful retail supplier such as Telstra to damage the cost effectiveness of a NBN by aggressively competing with it in the most profitable capital city markets, thereby undoing the effectiveness of the development of the NBN. For these reasons, we submit that horizontal separation of Telstra is required.

D CONCLUSION

The authors would be pleased to answer any questions in relation to this submission and can be contacted on the numbers and addresses listed below.

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