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11 December 2009, no. 63, 2009–10, ISSN 1328-8091

This Digest replaces an earlier version dated 19 November 2009 to delete some material in relation to Part XIB which was incorrect.

Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2009

Economics Section

Contents

Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2009

Date introduced: 15 September 2009

House: House of Representatives

Portfolio: Broadband, Communications and the Digital Economy

Commencement: Various dates as set out in the table in section 2 of the Bill.

Links: The relevant links to the Bill, Explanatory Memorandum and second reading speech can be accessed via BillsNet, which is at http://www.aph.gov.au/bills/. When Bills have been passed they can be found at ComLaw, which is at www.comlaw.gov.au.

Purpose

This Bill makes material amendments to the main four Acts that regulate the consumer protection, competition and licensing in telecommunications markets.[1] Significant changes are made in several areas to:

- improve the conditions for competition in telecommunications markets by causing Telstra to be structurally or functionally separated
- make changes to the telecommunications access regime to make it less susceptible to deliberate delay and obstruction
- remove a technical impediment to the operation of the anti-competitive conduct regime applying to telecommunications markets
- make the universal service obligation (USO) and customer service guarantee (CSG) clearer and therefore more enforceable
- extend the obligation to provide priority assistance to those with life threatening conditions to service providers other than Telstra
- enable breaches of civil penalty provisions—including some concerning the USO and the CSG—to be dealt with more quickly by the issue of infringement notices.

1. *Trade Practices Act 1974, Radiocommunications Act 1992, Telecommunications Act 1997* and *Telecommunications (Consumer Protection and Service Standard) Act 1999*. Minor consequential changes are made to the *National Transmission Network Sale Act 1998*.

While the Bill has been introduced at a time when the Government has moved to create a national broadband network (NBN), the Bill does not mention the NBN and none of the measures in this Bill are dependent on the NBN being built. This digest, therefore, gives only cursory attention to the NBN proposal where it is relevant. A short history of developments concerning the NBN, up to August 2009, is recorded in a digest for an NBN–related Bill.[2]

This digest deals with each of the measures in the order in which they appear in the Bill.

Part 1—Separation of Telstra

Introduction

In 1992, the Government appointed a committee to inquire into competition policy in Australia following the agreement by Australian Governments on the need for such a policy. In 1993, the committee published its report.[3] The Hilmer Report, as it became known (after the Chair, Professor Fred Hilmer), became one of the cornerstones of modern competition policy in Australia. As a result of the Hilmer Report, in February 1994, all the Governments of Australia established a National Agenda for microeconomic reform and, in April 1995, executed three intergovernmental agreements on a National Competition Policy for Australia.[4] Amongst other things, the agreements were concerned with setting out the structural, institutional and legislative changes that would be required to encourage competition in Australian markets.[5]

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2. J Chowns, *Telecommunications Legislation Amendment (National Broadband Network Measures-Network Information) Bill 2009*, Bills digest, no. 22, 2009–10, Parliamentary Library, Canberra, 2009, viewed 10 November 2009, http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22legislation%2Fbillsdgs%2FCSLU6%22

3. F Hilmer, M Raynor, G Taperell, *National Competition Policy: Report by the Independent Committee of Inquiry*, AGPS, Canberra, August 1993, viewed 4 November 2009, http://ncp.ncc.gov.au/docs/Hilmer-001.pdf

4. National Competition Council, *The Competition Principles Agreement; the Conduct Code Agreement; the Agreement to Implement the National Competition Policy and Related Reforms*, Compendium of Competition Policy Agreements, AGPS, Canberra, June 1998, viewed 4 November 2009, http://ncp.ncc.gov.au/docs/PIAg-001.pdf

5. An outline of the development of Australia's National Competition Policy is given in a publication by the Parliamentary Library; J Kain, I Kuruppu, R Billing, *Australia's National Competition Policy: Its Evolution and Operation*, E–Brief, Department of Parliamentary Library, Canberra, June 2001 (updated 3 June 2003), viewed 24 October 2009, http://www.aph.gov.au/library/intguide/econ/ncp_ebrief.htm

Two chapters of the Hilmer Report provide relevant background to this part of the Bill. Chapter 10 of the Hilmer Report concerns the reform of public monopolies and Chapter 11 concerns access to essential facilities.

In Chapter 10, the Hilmer Report acknowledged that public monopolies, as Telstra was then, commonly controlled facilities that had natural monopoly characteristics.[6] In Telstra's case, this included, at least, the copper wires running from customer premises to the Telstra exchange.

The Hilmer Report therefore recommended that all Australian Governments adopt a set of principles aimed at ensuring that public monopolies be subject to appropriate restructuring including the ownership separation of natural monopoly and potentially competitive activities.[7] This recommendation was manifested in clause 4 of the Competition Principles Agreement which says:

> **Structural Reform of Public Monopolies**
>
> Before a Party introduces competition into a sector traditionally supplied by a public monopoly, and before a Party privatises a public monopoly it will undertake a review into…. (c) the merits of separating the potentially competitive elements of the public monopoly.[8]

Such structural reforms have been made in sectors formerly dominated by public monopolies like gas, electricity, rail, ports and airports, but this Bill is the first authentic legislative attempt to give effect to the recommendations contained in the Hilmer Report relating to the telecommunications sector.

The Hilmer Report had recommended that, in two contexts, structural separation ought to be considered. First, when competition is being introduced into a market and secondly, when a public monopoly is being privatised.[9] In the telecommunications market, however, neither opportunity was taken.

The decision to introduce pro-competitive reforms to the telecommunications market in 1991 included a decision not to introduce structural separation for at least five years from the introduction of competition. This was due to a concern[10] that the recently-merged Australian and Overseas Telecommunications Corporation Ltd needed to be vertically integrated so as to be able to achieve economies of scale and scope to be able to compete

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6. A common definition of a natural monopoly is a situation in which one supplier of a service can satisfy the foreseeable demand in the market at a lower cost than two or more suppliers.
7. Hilmer, pp. xxx – xxxi.
8. Competition Principles Agreement, Clause 4(3)(c), 11 April 1995.
9. Hilmer, p. 215.
10. Hilmer, p. 221.

effectively in global markets.[11] In addition, during the process of Telstra's privatisation from 1996 to 2007, the Coalition government did not implement structural reform of the kind envisaged by the Hilmer Report. Instead, a telecommunications-specific access regime—Part XIC of the *Trade Practices Act 1974* (Trade Practices Act)—was introduced in 1997.

What is the problem that separation aims to solve?

In 1997, the telecommunications market was opened up to all entrants. In order to provide certain services in those markets, new entrants needed to have access to inputs that are provided over Telstra's network and, particularly, to that part of the network extending from Telstra exchanges to customer premises (known as the customer access network).

This part of the network is regarded as having natural monopoly characteristics and as being uneconomical to duplicate. Furthermore, it is regarded as an 'essential' or 'bottleneck' facility in the sense that access to it is required if a business is to compete effectively in downstream retail markets.

In addition to controlling this bottleneck infrastructure, Telstra is vertically integrated and competes in retail markets with the same businesses as those to which it provides wholesale network access.

Consequently, as the Explanatory Memorandum to the 2005 Bill of the same name says:

> Telstra's control of this infrastructure, combined with its market position, creates an *incentive and ability* for it to favour its own retail business in the provision of access to important services provided over this infrastructure.[12]

The Hilmer Report observed that:

> There are two broad alternatives for addressing concerns of these kinds. First, the natural monopoly element can be separated from the potentially competitive elements. Alternatively, the integrated structure could be left intact, and reliance placed instead on more intrusive regulatory controls to guard against cross-subsidisation and, where

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11. In 1991, the Australian and Overseas Telecommunications Corporation (AOTC) was incorporated and in February 1992 all the property and rights of the Australian Telecommunications Corporation and the Overseas Telecommunications Corporation (concerned with domestic and overseas telecommunications respectively) were merged in it. The AOTC later became Telstra. See T*elstra Corporation Limited v The Commonwealth [2008] HCA 7*, paragraphs 14-16, viewed 3 November 2009, http://www.austlii.edu.au/au/cases/cth/HCA/2008/7.html

12. Explanatory Memorandum, Telecommunications Legislation Amendment (Competition And Consumer Issues) Bill 2005, p. 2, viewed 3 November 2009, http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22legislation%2Fbillhome%2Fs480%22

> a vertical relationship is involved, the potential misuse of control over access to the natural monopoly element.[13]

Australia chose the second of these two options. In 1997, it introduced a set of rules to enable access to be given to certain services that have bottleneck characteristics (Part XIC of the Trade Practices Act) and to deal with anti-competitive conduct (Part XIB).

It is obvious, however, that an access regime cannot change the *incentives* that a vertically integrated access provider has to favour its own downstream retail operations and that the same incentives will manifest as resistance to an access regime that it perceives is at odds with its interests. This is because a vertically integrated company's incentive to discriminate arises not from a mere preference but from the legal and fiduciary duty that the board has to act in the best interests of the company as a whole. Legal and fiduciary duties are more than mere academic abstractions. These are duties over which shareholders can sue boards either at common law or, less problematically, under a statutory derivative action under the *Corporations Act 2001*.[14] Class actions—and the rising number of law firms that have expertise in prosecuting them—along with the availability of litigation funding mean that boards must take seriously these duties. The result is there may be some tension between this legal or fiduciary duty and the legal regime that gives its competitors the right to negotiate access to its network.

The result has been, according to the Explanatory Memorandum from 2005, that:

> the current regulatory regime has enabled competition to develop in the telecommunications market, but it has not fully prevented Telstra from discriminating in favour of its own retail operations.[15]

The object of separation is to curb this discrimination.

Horizontal structural separation—divestiture of HFC network and Foxtel

The preceding section dealt with anti-competitive incentives created by *vertical* integration. Telstra is also horizontally integrated which creates another set of competition-limiting incentives. In parts of Adelaide, Brisbane, Gold Coast, Melbourne, Perth and Sydney, Telstra owns and controls a cable network (the HFC network) *and* the copper access network. The cable network and the copper network are technically capable of delivering the same services—telephony, video/TV and internet access—to customers

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13. Hilmer p. 219.
14. Under section 236 of the *Corporations Act 2001*, a person (including a shareholder) may bring proceedings on behalf of a company against another party, including the board or a board member, to protect the interests of the company.
15. Explanatory Memorandum, Telecommunications Legislation Amendment (Competition and Consumer Issues) Bill 2005, p. 2.

in those areas. Furthermore, Telstra holds a 50 percent interest in Foxtel, a pay TV operator, which uses Telstra's HFC.

The Hilmer Report explained, in general terms, one problem created by horizontal integration:

> … irrespective of whether the natural monopoly element is integrated vertically or horizontally with the potentially competitive element, industry structures of this kind present opportunities for cross-subsidisation. Monopoly returns made in the monopoly market may be used to finance otherwise unprofitable prices in the competitive market, potentially driving out or disadvantaging competitors. Indeed, even the prospect of such conduct may deter competitive market entry unless appropriate safeguards are in place. This concern will be more pressing where the potentially competitive market is itself not highly contestable.[16]

In the particular case of Telstra, its ownership of the HFC network means that in those locations where it has two networks there is little or no incentive for it to allow competition to develop between the two platforms. For this reason, most other countries have restrictions on the ownership of two kinds of fixed networks in the same area.[17] Were Telstra to divest itself of the cable network as contemplated by this Bill, it is expected that better conditions for competition between the networks may be created.

Telstra's 50 percent interest in Foxtel creates incentives for it to have regard to its pay TV interests in making decisions about its own business and its use of its HFC cable. For instance, it may create incentives for it to: limit the kinds of services that it offers over its own copper network which might compete with Foxtel services and to refuse access to its cable network by other content providers. It also creates incentives for Foxtel to refuse access to content to other network owners because the availability of compelling content on competing networks can encourage demand for other telecommunications services delivered on those networks in competition with Telstra. Divestiture of Telstra's interest in the HFC network and its interest in Foxtel is therefore expected to open several pathways to competition.

Structural Separation—what is it and how does it work?

In 1993, the Hilmer Report said, 'where the owner of an 'essential facility' is vertically-integrated with potentially competitive activities in upstream or downstream markets … the preferred response … is usually to ensure that the natural monopoly elements are fully separated from potentially competitive elements through appropriate structural reforms'.[18]

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16. Hilmer, p. 219.

17. Explanatory Memorandum, Telecommunications Legislation Amendment (Competition and Consumer Issues) Bill 2009, p. 44.

18. Hilmer, p. 241.

By 'fully separated', the Hilmer Report meant that 'full separation at the level of ownership or control is required'.[19] This is 'structural separation'.

There is no single way to structurally separate a business but it will **at least** involve the separation of the bottleneck parts from the rest of the business. In this Bill, the model of separation is, prima facie, one in which the Telstra retail businesses are separate from all parts of the network that are used to provide fixed line retail services. This includes not just the bottleneck customer access network. However, the Minister can determine that some parts of the network can be retained by Telstra. This power could be used to allow Telstra to retain some or all of the parts of the network that are not bottleneck facilities. This approach (blanket ban on controlling any part of the network with a Ministerial power to modify the ban) should be regarded as prudent drafting treatment rather than necessarily signalling an intention that Telstra will not be able to hold any network assets.

Vertical structural separation addresses the *incentive* that a vertically integrated company has to discriminate against the competitors of its retail business. When the ownership and control of a bottleneck part of a business is separate from the other parts of the business, the legal and fiduciary duties of the board of each part are to that part alone. There will be no incentive to favour the former retail businesses over retail competitors by, for instance, cross subsidisation of the retail business by the bottleneck part of the business or by obstructing access by competitors. This is the critical point about structural separation. Structural separation aligns the legal and fiduciary duties of the owner of the bottleneck facility with the objective of the telecommunications access regime which is to provide for equivalent access—on both price and non-price terms—to downstream access seekers.

Functional separation—what is it and how does it work?

By contrast, the various models of functional and operational separation leave the separated business in common corporate ownership. Functional and operational separation are not terms of art: rather they represent a range of points on a spectrum of separation models that fall short of legal or structural separation.

Functional and operational separation models involve the imposition of conditions that are intended to *mimic* structural separation. These conditions include, for instance, requirements that the company operate its different business units using different staff, from different premises, with separate IT systems; that the company conduct its internal transactions in an arms length way; that the different operational or functional areas be 'ring fenced' so as to prevent, for instance, flows of information between business units and that, where the company has incentive schemes for employees, those schemes reward the performance of business units rather than performance of the company as a whole.

Structural separation addresses the problem of discrimination principally by changing the incentives faced by upstream wholesale access provider. Functional and operational

19. Hilmer, p. 220.

separation can never do this because of the overriding legal and fiduciary obligation of the board to the company as a whole.

Functional and operational separation do not, therefore, address the problem of discrimination in the same way as structural separation. Rather, the mechanisms by which functional and operational separation typically operate are first, by creating enforceable rules of conduct of the kind listed in the previous paragraph, the breach of which, if detected, is subject to penalties. Secondly, functional and operational separation aim to create transparency in the dealings between the functionally separated business units so that the regulator (the Australian Competition and Consumer Commission (ACCC) in Telstra's case) can see if those transactions are on equivalent price and non-price terms to those offered to the other downstream competitors. It can then exercise its powers—particularly those relating to anti-competitive conduct in Part XIB of the Trade Practices Act—if breaches of the law are apparent.

Separation—relevant provisions

Item 21 of the Bill inserts **proposed Part 33** into the *Telecommunications Act 1997* (Telecommunications Act) and **item 22** inserts **proposed Part 9** into Schedule 1 of the Telecommunications Act. Schedule 1 sets out the standard carrier licence conditions.

The Bill gives Telstra opportunity to give three binding undertakings:

- an undertaking to structurally separate its retail operation from all or some of its network ('the structural separation undertaking') (**proposed section 577A)**
- an undertaking to divest itself of its interest in Foxtel (currently 50 percent) ('the Foxtel undertaking') (**proposed section 577E**)
- an undertaking to divest itself of the pay TV cable network (that is, the hybrid fibre coaxial cable or HFC network) that it owns in Adelaide, Brisbane, Gold Coast, Melbourne, Perth and Sydney[20] that is used by it to provide internet access and telephony and by Foxtel (which is 50 percent owned by Telstra) to deliver pay TV ('the HFC undertaking') (**proposed section 577C**)

These undertakings are enforceable in the Federal Court (**proposed section 577G**).

If it does not provide all three undertakings, then, prima facie, it will not be allocated—and will not be able to use—the 'designated spectrum' that is assumed to be virtually essential to its mobile broadband business.[21] (The spectrum that Telstra will be barred

20. ACMA & ACCC, Communications Infrastructure and Services Availability in Australia 2008, ACMA, Canberra, 2008, p. 11, viewed 3 November 2009, http://www.acma.gov.au/webwr/_assets/main/lib310785/comms_infrastucture_and_svce_availability_in_aust_08.pdf

21 There are several ways that Telstra is prevented from using the designated spectrum: **proposed section 577J** prohibits the ACMA from allocating it to Telstra; **proposed section**

from acquiring or using is that spectrum that is expected to become available for wireless data services when analogue television transmissions cease. The Government has published a schedule for the cessation of analogue transmission.[22] However, if the Minister is satisfied that the structural separation undertaking is 'sufficient to address concerns about the degree of Telstra's market power in telecommunications markets', the Minister may make a declaration allowing Telstra to use the designated spectrum without requiring it to provide either or both of the other two undertakings.[23] Such a declaration is not a legislative instrument, and hence not subject to Parliamentary disallowance.

If Telstra chooses not to voluntarily structurally separate it will have to functionally separate.

The model of structural separation proposed by the Bill

Proposed section 577A of the Bill describes the kind of separation that is required of Telstra if it chooses to structurally separate. Prima facie, Telstra is barred from controlling any part of the network that is used in the provision of fixed line retail services to customers and from controlling a company that supplies fixed line retail services using a network that Telstra controls. This prohibition describes a model of structural separation under which Telstra's retail business and networks are separated. However, the Minister has a discretionary power to allow Telstra to retain a network (**proposed subsection 577A(11)**). The exercise of this power is via legislative instrument.

The result is that Telstra will become a retail provider of fixed line services which may, if the Minister allows, own some network assets that are used to provide those services. The rest of the network will end up in separate ownership which may or may not involve ownership by the National Broadband Network Company.

Technical details concerning functional separation

The provisions dealing with functional separation are to be inserted into Schedule 1 of the Telecommunications Act.

577K prevents another licensee from authorising Telstra to use it; **proposed clause 84 of Schedule 1** prohibits Telstra from being in a position to exercise control of it and **proposed clause 85 of Schedule 2** prohibits Telstra from supplying a carriage service under a licence.

22. S Conroy (Minister for Broadband, Communications and the Digital Economy), *Conroy sets digital TV switchover timetable*, media release, 19 October 2008, viewed 28 October 2009, http://www.minister.dbcde.gov.au/media/media_releases/2008/077

23. All of the provisions that prevent Telstra from being allocated or using the designated spectrum (**proposed section 577J**; **proposed section 577K**; **proposed clause 84 of Schedule 1** and **proposed clause 85 of Schedule 2)** include provisions that have the effect of exempting Telstra from requirement to give a Foxtel undertaking and/or an HFC undertaking if the Minister is satisfied that the structural separation undertaking sufficiently deals with competition concerns.

Regardless of whether it intends to offer a structural separation undertaking, Telstra will, subject to the possibility of an extension noted below, have to give the Minister a draft functional separation undertaking within as few as 91 days after commencement (which is the day after Royal Assent for these provisions) up to a maximum of 182 days after commencement (**proposed clauses 75 and 76 of schedule 1**).[24] However, if Telstra decides to give the Minister a structural separation undertaking—and that undertaking is in force—Telstra does not have to produce a draft functional separation undertaking (**proposed clause 76(2)**). The Minister may extend the period in which Telstra must produce a draft functional separation undertaking if he is satisfied that Telstra is preparing a structural separation undertaking or that the ACCC is considering one that Telstra has submitted to it (**proposed subclause 76(4)**).

If Telstra gives the Minister a draft functional separation undertaking, the Minister can approve it, vary it or replace it (**proposed clause 77)** at which point it becomes a final functional separation undertaking (**proposed clause 79**). Telstra must comply with a final functional separation undertaking (**proposed clause 82**) which is a carrier licence condition, breach of which is subject to a civil penalty.[25] Under other amendments made by this Bill, a breach may be dealt with by infringement notices.[26] If at any point, Telstra gives a structural separation undertaking that is accepted and is in force, it is no longer required to comply with the functional separation undertaking (**proposed subclause 82(2)**).

Before the Minister approves, varies or replaces the draft functional separation undertaking, the Minister *must* invite, and consider submissions from, the public and seek and have regard to the advice of the ACCC. Before the Minister varies or replaces the draft undertaking, the Minister *must* specifically invite and consider submissions from Telstra (**proposed clause 77)**.

A final functional separation undertaking can be varied on the Minister's own initiative or at the request of another person, including Telstra (**proposed clause 80**).

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24. Telstra must give the Minister a draft functional separation undertaking within 90 days of the coming into force of the Minister's first functional separation requirements determination which the Minister must ensure comes into force within 90 days of commencement of this Part (which is the day after Royal Assent). The Minister could cause the determination to come into force on any day between the commencement day and 90 days later (that is, between 1 day and 91 days after Royal Assent). In turn, Telstra has 90 days starting from but not including any day from day 1 to day 91 to give the Minister an undertaking. Therefore the minimum time it will have is 91 days and the maximum time will be 182 days.

25. Section 61 of the *Telecommunications Act 1997* provides that Schedule 1 sets out the carrier licence conditions. Section 68 provides that a carrier must comply with the carrier licence conditions and that this is a civil penalty provision.

26. Part 7 of the Bill deals with infringement notices.

A functional separation undertaking must comply with the 'functional separation principles' (**proposed paragraph 73(1)(a)**). The functional separation principles are set out in **proposed clause 74** and require that:

a) Telstra should supply its wholesale customers on a basis that is *equivalent* to the way it supplies its retail business units (**proposed subclause 74(a)**)
b) Telstra should maintain a single wholesale/network unit that is separate from its retail unit or units (**proposed subclause 74(b)**)
c) Telstra's retail unit or units should operated at arm's length from the wholesale/network unit (**proposed subclause 74(c)**)
d) Telstra should have systems, procedures and practices that give effect to the undertaking and that permit compliance with it to be monitored, measured, externally audited and reported upon (**proposed subclause 74(d)**), and
e) Telstra wholesale/network unit communicates to its wholesale customers the same information about proposed services as it does to its own retail business unit or units (**proposed subclause 74(e)**).

The functional separation undertaking must require Telstra to have an 'Oversight and Equivalence Board' that reports to the ACCC and the Telstra board about compliance with the undertaking (**proposed subclauses 73(b) and (c)**).

The functional separation undertaking must comply with a 'functional separation requirements determination' which must be made by the Minister (**proposed subclause clause 73(d)**). The functional separation requirements determination must come into effect within 90 days of the commencement of this part of the Bill (that is, the day after Royal Assent). The determination is to specify the requirements to be complied with in a functional separation undertaking and the manner in which they are to be complied with (**proposed clause 75**).

Consultation on this part of the Bill

Public Consultation

On 7 April 2009, the Government issued a discussion paper—'National Broadband Network: Regulatory reform for 21st Century Broadband'[27] — in which it canvassed options for dealing with Telstra's horizontal and vertical integration, amongst other matters.

27. Department of Broadband, Communications and the Digital Economy, *National Broadband Network: Regulatory Reform for 21st Century Broadband*, DBCDE, Canberra, April 2009, viewed 27 October 2009, http://www.dbcde.gov.au/broadband/national_broadband_network/regulatory_reform_for_21st_century_broadband

Committee consideration

On 17 September 2009, the Bill was referred to the Senate Standing Committee on Environment, Communications and the Arts for inquiry and report by 26 October 2009.[28]

Commentary on the Bill—support for separation

Structural separation has support from almost all parties with an expertise or experience in telecommunications policy. For example, structural separation is favoured by the ACCC,[29] Optus,[30] the Consumers Telecommunications Network,[31] the Competitive Carriers Coalition[32] (representing Hutchison Telecommunications, Macquarie Telecommunications, Verizon Business, PowerTel, TransACT, iiNet and Agile

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28. Details of the inquiry, including the submission and final report are at http://www.aph.gov.au/senate/committee/eca_ctte/tlaccs/index.htm

29. Australian Competition and Consumer Commission, Submission to the Department of Broadband, Communications and the Digital Economy, *Discussion paper: National Broadband Network: Regulatory Reform for 21st Century Broadband*, June 2009, p. 9, viewed 2 November 2009, http://www.dbcde.gov.au/__data/assets/pdf_file/0016/115405/Optus-Main.pdf

30. Optus, Submission to the Department of Broadband, Communications and the Digital Economy, *Discussion paper: National Broadband Network; Regulatory Reform for 21st Century Broadband*, June 2009, p.3, viewed 2 November 2009, http://www.dbcde.gov.au/__data/assets/pdf_file/0016/115405/Optus-Main.pdf

31. CTN, Submission to the Department of Broadband, Communications and the Digital Economy, *Discussion paper: National Broadband Network: Regulatory Reform for 21st Century Broadband*, June 2009, p.3, viewed 2 November 2009, http://www.dbcde.gov.au/__data/assets/pdf_file/0019/118090/Consumers_Telecommunications_Network_CTN.pdf

32. Competitive Carriers Coalition, Submission to the Department of Broadband, Communications and the Digital Economy, *Discussion paper: National Broadband Network: Regulatory Reform for 21st Century Broadband*, June 2009, p.5, viewed 2 November 2009, http://www.dbcde.gov.au/__data/assets/pdf_file/0004/115384/Competitive_Carriers_Coalition_CCC_-Main_.pdf

Communications),[33] Unwired,[34] and the Australian Telecommunications Users Group (ATUG).[35]

Commentary on the Bill—opposition to separation

Those opposed to the separation of Telstra under this Bill are mainly Telstra, some shareholders and those purporting to represent shareholder interests like funds and Australian Shareholders Association and the IPA.

Telstra views

Telstra is not enthusiastic about separation although it has probably moved on from the point at which it said it did not understand the reason for it: In a Senate Inquiry in 2005, Bill Scales, its then head of Corporate and Human Relations, when asked whether 'operational separation may be something that Telstra could accept depending on what it encompassed' said:

> We have not come to a view about that yet. It is an extremely complex issue. The question which we are always asking ourselves is: what are we trying to solve for? It is not clear to us yet what the issue is that we are trying to solve.[36]

In its submission to the Senate Inquiry into this Bill, Telstra remains opposed to forced separation. It says that the Bill 'is unnecessary and will make it harder to achieve the Government's core policy objectives in the telecommunications sector'.[37] If the Bill is to

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33. Membership of CCC taken from its website, viewed 4 November 2009, http://www.ccc.asn.au/members.htm

34. Unwired Australia Pty Ltd, Submission in response to the Department of Broadband, Communications and the Digital Economy, *Discussion paper: National Broadband Network: Regulatory Reform for 21st Century Broadband*, June 2009, p. 2, viewed 2 November 2009, http://www.dbcde.gov.au/__data/assets/pdf_file/0003/115347/Unwired.pdf

35. ATUG, Submission in response to the Department of Broadband, Communications and the Digital Economy, *Discussion paper: National Broadband Network: Regulatory Reform to 21st Century Broadband*, June 2009, p. 14, viewed 2 November 2009, http://www.dbcde.gov.au/__data/assets/pdf_file/0007/115369/Australian_Telecommunications_Users_Group_ATUG.pdf

36. Bill Scales, Head of Corporate and Human Relations, Telstra, Evidence to Senate Communications, Information Technology and the Arts References Committee, *Inquiry into performance of Australian telecommunications regime*, Senate Hansard, 4 May 2005, p. 80, viewed 2 November 2009, http://www.aph.gov.au/hansard/senate/commttee/S8287.pdf

37. Telstra, Submission to Senate Standing Committee on Environment, Communications and the Arts, Inquiry into Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2009, p. 1, viewed 26 October 2009, *https://senate.aph.gov.au/submissions/comittees/viewdocument.aspx?id=2414530d-9708-4ee5-b0c3-55927ed7de04*

proceed Telstra believes that 'it is only sensible that the Senate delay debate until after the conclusion of constructive discussions between Telstra and the Government over the NBN and the completion of the Government's NBN Implementation Study'.[38]

Shareholder views

In the public commentary about this measure, the loudest voices have been those of shareholders and those representing or purporting to represent them. Of the less hyperbolic criticisms the main allegations revolve around:

- shareholders having bought the shares without notice of the regulatory risks
- structural separation reducing the value of Telstra and therefore its shares which are owned by 1.4 million shareholders
- separation of Telstra increasing 'sovereign risk'.

Because shareholder concerns have attracted a good deal of media attention, some pertinent facts and observation are made about each of these points in the following sections.

Notification of regulatory risk in the issue documents for T1, T2, and T3

Telstra shares were sold to the public in three tranches in 1997, 1999 and 2006. The offer documents for each sale, which remain on the Telstra website, included statements about regulatory risk and the risk that a future Government may change the regulatory settings without having regard to the interests of shareholders. In the following section, the relevant parts of the offer documents are extracted.

The first Telstra sale in 1997 (T1)

For T1, the Telstra share offer document included five pages of 'investment risk'. This includes, under the heading 'Relationship with Commonwealth - Continuing Commonwealth control of Telstra', the following passage:

> The Commonwealth is also responsible for regulation of the telecommunications industry. The Commonwealth and its regulatory agencies, in carrying out their functions, have taken actions and may take further actions which constrain Telstra's conduct or affect its commercial operations. Telstra expects that the Government will continue to exercise its legislative and regulatory responsibilities and powers so as to promote industry competition and that the Government's separate interest in Telstra shareholder value will not be a determinative consideration in that context. There can be no assurance that the current or future governments will not take further

38. Telstra, Submission to Senate Standing Committee on Environment, Communications and the Arts, Inquiry into Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2009, p. 1.

> steps which alter Telstra's competitive position or that manner in which the Australian telecommunications industry is regulated.[39]

The second Telstra sale in 1997 (T2)

For T2, the Telstra share offer document included four pages of 'investment risk'. This includes, under the heading 'Regulatory Regime', the following passage:

> Telstra faces a number of regulatory risks in its business that could have an adverse effect on its operations and financial performance. These regulatory risks relate to the power of the Communications Minister and independent statutory regulators, principally the ACCC and the ACA. There is substantial uncertainty concerning the regulatory action that may be taken, Telstra's compliance costs and the effect this will have on the Company's business operations and profitability. Regulatory actions could also adversely affect Telstra's plans to upgrade and expand its networks.[40]

Under the heading 'Relationship with the Commonwealth – continuing Commonwealth control of Telstra' is this passage:

> The Government is responsible for the regulation of the telecommunications industry. The Government and its regulatory agencies in carrying out their functions have taken actions, and may take further actions, which constrain Telstra's conduct or restrict its commercial operations. Telstra expects that the Government will continue to exercise its legislative and regulatory responsibilities and powers to promote industry competition and that the Commonwealth's separate equity interest will not be a determinative consideration in that context.
>
> There is also a risk that current or future governments will take steps that further alter Telstra's competitive position or the manner in which the Australian telecommunications industry is regulated. In particular, the Government is required to commence a review of the telecommunications specific competition legislation before 1 July 2000 and this may lead to further competition regulation.[41]

The third Telstra sale in 2006 (T3)

For T3, the Telstra share offer document included, under the heading 'What are the key risks?' the sub-heading 'Regulatory Risks' which included this passage:

> - the Commonwealth has a broad discretion to impose additional regulatory obligations on Telstra, such as stricter controls on Telstra's retail prices or increasing the obligation to make certain uneconomic rural and remote

39. Telstra, Telstra share offer document, 1997, p. 34, viewed 25 October 2009 http://www.telstra.com.au/abouttelstra/investor/docs/t1_financial_information.pdf

40. Telstra, Telstra share offer document 1999, p. 17, viewed 25 October 2009 http://www.telstra.com.au/abouttelstra/investor/docs/t2_share_offer.pdf

41. Telstra share offer 1999, p. 20.

> services available without receiving what Telstra believes to be a fair contribution from its competitors[42]

On page 42 of the same document, under the heading 'Risk factors' and the sub-heading 'Regulatory Risks', this appeared in a table:[43]

Risk	Description	Risk Impact
Wide regulatory discretion	The Minister for Communications has a broad power to impose and vary licence conditions on Telstra. For example, the requirement to operate separate retail, wholesale and network business units (operational separation) places an additional burden on Telstra with many restrictions imposed on the way it runs its business. In addition, Telstra is subject to retail price controls and is obliged to make certain uneconomic services available in rural and remote areas, without receiving what in Telstra's opinion is a fair contribution to its costs from its competitors.	The real risk with operational separation, in Telstra's opinion, lies in the power of the Minister to determine the way Telstra conducts its business by directing it to vary its operational separation plan, subject to the aims and objects of the legislation which are very broad. These regulatory discretions could in Telstra's opinion be used with a significant adverse effect on Telstra

.

And on page 50 under Major heading 'Additional information' and sub-heading 'Commonwealth as shareholder and regulator', it states:

> The Commonwealth also has responsibility for regulation. The telecommunications regulatory regime is intended to promote the long-term interests of telecommunications consumers, including through promoting competitive telecommunications markets and encouraging economically efficient investment in infrastructure. The telecommunications regime supports industry self-regulation and is intended to minimise the financial and administrative burdens on the telecommunications industry.
>
> Since the market was fully opened to competition in 1997, consumers have benefited through a wider range of services and significant reductions in prices.
>
> The Commonwealth considers that the telecommunications industry is currently in transition to full competition and that appropriately targeted regulation is in place to facilitate this outcome. Overall, the regulatory legislation is settled. However, the Commonwealth has announced that it will review the telecommunications competition regulatory regime in 2009.[44]

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42. Telstra, Telstra 3 Share offer, 2006, p. 11, viewed 25 October 2009, http://www.telstra.com.au/abouttelstra/investor/docs/tls489_t3prospectus.pdf

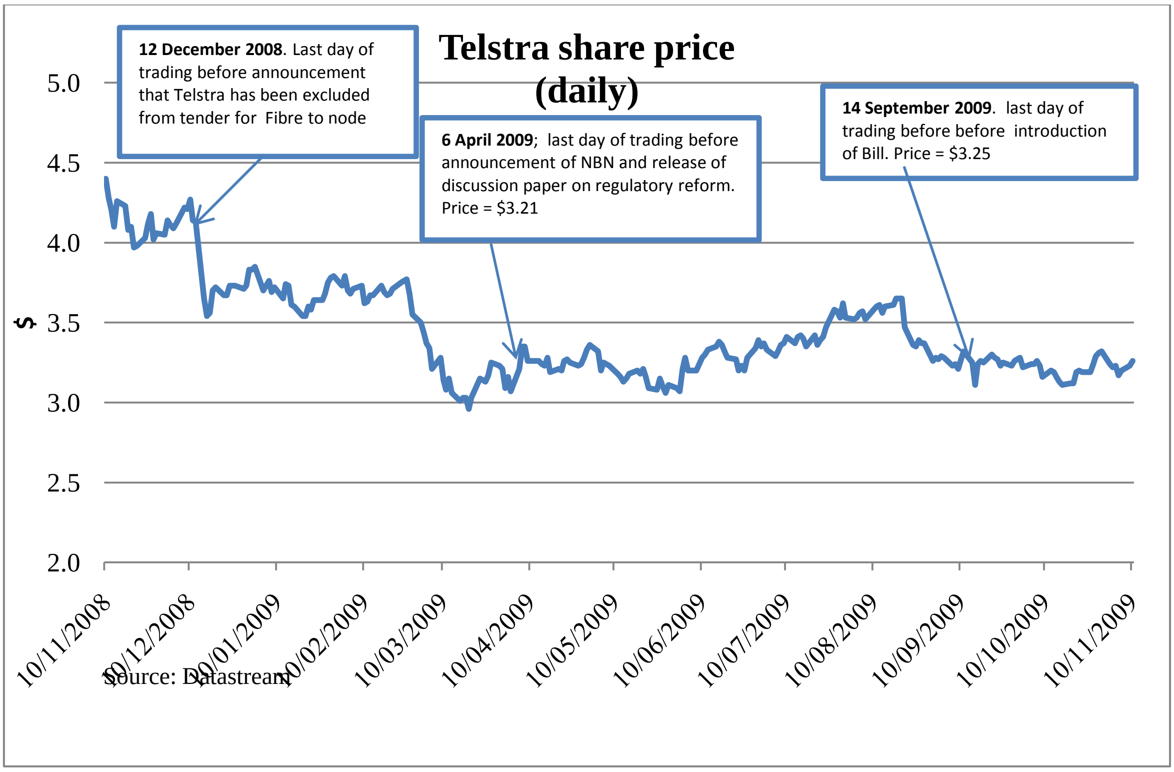
43. Telstra 3 share offer, p. 42.

44. Telstra 3 share offer, p. 50.

As is evident, in each of the Telstra share sale documents, regulatory risk was disclosed. However, none mentioned the risk of structural separation expressly. In any case, insofar as small individual shareholders are concerned, it is perhaps of academic interest only to lawyers whether disclosure was adequate. For institutional shareholders, it is another matter and it ought to be expected that they make themselves aware of the matters in the issue documents and the implications of them. As has been recorded elsewhere in this digest, the debate about the structural separation of Telstra can be traced back, at least, to 1993 with the publication of the Hilmer Report and it has arisen in debate regularly since then. It is not a new idea and it cannot have been beyond the consideration of institutional investors and their analysts.

Telstra's Shareholders and Telstra's share price

This graph records the Telstra share price over the last 12 months:



On the day before this Bill was introduced (14 September 2009), Telstra's share price closed at $3.25. On the day the Bill was introduced, it closed at $3.11. The day after that it closed at $3.24. Since then, it has dropped to $3.11 around the middle of October 2009 and in early November has returned to around the price on the day before introduction. That being the case, the introduction of the Bill has not materially affected the share price.

Nor has it changed materially from the 7 April 2009 on which day the Government announced that it would build a national broadband network and released a discussion paper in which it canvassed the kinds of reforms made by this Bill. There was, however, a decline in the price in the month before that day.

It is difficult, if not impossible, to isolate the causes of movements in share prices and no attempt is made to do so here. The point made here is only that the share price did not materially change with either the introduction of the Bill or the release of the discussion paper in which the Bill's reforms were canvassed.

It is therefore not clear how the argument can be sustained that the measures in this Bill are depriving Telstra shareholders of value.

In assessing the effect that any movements in Telstra share price has on shareholders it is instructive to look at the distribution of share ownership. The following table from the Telstra's most recent annual report sets out the position at 28 August 2009.[45]

Size of Holding	Number of Shareholders	%	Number of Shares	%
1-1,000	713,464	49.49%	413,841,686	3.33%
1,001-2,000	263,353	18.26%	382,231,011	3.07%
2,001-5,000	278,022	19.28%	884,384,642	7.11%
5,001-10,000	113,219	7.85%	781,855,963	6.28%
10,001-100,000	71,410	4.95%	1,585,921,800	12.74%
100,001 and over	2,479	0.17%	8,394,839,255	67.47%
Total	**1,441,947**	**100.00%**	**12,443,074,357**	**100.00%**

The number of shareholders holding less than a marketable parcel of shares was 14,183 holding 1,126,310 shares.

As can be seen of Telstra's 1.4 million shareholders almost 50 percent own fewer than 1000 shares with about 67 percent owning fewer than 2000. One inference that may be drawn from this is that this is probably the group that has a high proportion of unsophisticated 'mum and dad' shareholders who may have not appreciated the risks attendant in owning shares and whose interests may need consideration. However, the holdings of this same group are relatively small and so, even if the share price had declined as a result of the measures in this Bill, the effect on the value of the holdings of this group would not be such as to amount to the loss of a 'nest egg' as has been claimed.

In any case, fewer than 10 percent of the Australian population directly own Telstra shares. The argument that their interests should be accommodated in telecommunications policy amounts to a claim that they should continue to benefit from the monopoly profits that are said to be earned by Telstra at the expense of users of telecommunications services who provide those monopoly profits through higher usage charges.

45. Telstra, *Making a difference: annual report 2009*, p. 47, viewed 16 November 2009, http://www.telstra.com.au/abouttelstra/investor/docs/tls696_2009annualreport.pdf

An argument is made by some that a much larger number of Australians indirectly hold Telstra shares through superannuation funds and other funds, for instance, and that everyone is affected by Telstra's share price. This may or may not be factually correct but, even if it is true, some people will have large holdings and some little or none. This ought to require the proponents of this argument to make the case that people should take the benefits of Telstra's market position unequally according to their wealth rather than more equally through the benefits that a more competitive telecommunications market ought to bring. This case has not been made.

Sovereign risk

Arguments have been made that the attempt to structurally separate Telstra increases 'sovereign risk'. For instance, in its submission to the Senate inquiry into this Bill, the Australian Shareholders Association said:

> The ASA is concerned not just about the value destroying nature of the proposals for Telstra shareholders but also about the implications for investment generally. International investors in particular will consider Australia to have a much higher level of sovereign risk if this Bill is passed and the Government allowed to impose its will on a private company.[46]

The Australian Foundation Investment Company made similar observations:

> Governments of both persuasions have invested a lot of time and effort in assuring investors, both domestic and international, that Australia is a safe and stable place to invest with little sovereign risk. If the Parliament passes this legislation we think Australia's investment standing could be significantly diminished. Investors, particularly international investors, will perceive substantially heightened sovereign risk if the Australian Government can act arbitrarily in this way.[47]

Whether this properly describes sovereign risk is immaterial. Given that governments make laws that affect private property interests all the time, the thrust of the arguments seems to be that this Bill represents an *arbitrary* and *unforeseeable* modification of private property rights of Telstra shareholders.

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46. Australian Shareholders Association, Submission to Senate Environment, Communications and the Arts Committee, *Inquiry into Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2009*, p. 3, viewed 24 October 2009, https://senate.aph.gov.au/submissions/comittees/viewdocument.aspx?id=9d035194-242d-4586-a637-db308685eb15

47. Australian Foundation Investment Company, Submission to Senate Environment, Communications and the Arts Committee, *Inquiry into Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2009*, p. 3, viewed 24 October 2009, https://senate.aph.gov.au/submissions/comittees/viewdocument.aspx?id=75caf03d-e1c8-4a8d-94e6-5d7dfd6bb492

This argument is superficially attractive but does not bear close examination. This legislation is neither arbitrary nor unforeseeable. Separation, whether structural or something less, has been squarely in the competition policy sphere in Australia for at least fifteen years. It was recommended by the Hilmer Report in 1993 and addressed in the intergovernmental Competition Principles Agreement of 1995 and then effected in the electricity, ports, rail, airports and gas sectors. Furthermore, it has been raised in several —maybe all—inquiries concerning telecommunications since at least 1996.[48] The possibility that Telstra might be separated is not one that could not be foreseen by sophisticated investors.

Furthermore, the separation of Telstra is not arbitrary. Separation is a regulatory response to a particular problem that is reasonably easy to identify. The Hilmer Report signalled that structural separation ought to be considered for vertically integrated owners of essential bottleneck facilities. If this Bill is to signal anything to potential foreign investors about the likelihood of this happening to other companies, the criteria are even narrower: This Bill signals that this Government will consider structural separation of companies that (a) control bottleneck infrastructure that is an essential input in downstream markets, and (b) are vertically integrated and (c) are subject to an access regime that has not worked as intended according to the near unanimous views of access seekers and the regulator. The criteria could be narrowed further but even the identification of companies falling within this class would be straightforward for any sophisticated foreign investor.

Any consequences of failure to pass

The time at which this Bill is passed (assuming it is) could have marked consequences on the way that Telstra's separation is effected and possibly on the fate of the other amendments proposed in this Bill. This is likely why, at the time of writing, there is a considerable level of debate about whether a vote should be delayed until next year or in the two week sitting period ending 26 November 2009.

The Government and Telstra are reportedly negotiating privately over Telstra's involvement in the NBN. These negotiations include the possibility that Telstra will transfer network assets to the NBN Company or that it will migrate its customers over to the NBN Company over time. Both of these possibilities are mentioned in the Explanatory Memorandum to the Bill and both would amount to a kind of structural separation.[49] Importantly, if a vote on the Bill does not take place until next year, this

48 See for instance, Senate Environment, Communications, Information Technology and the Arts, Consideration of Telstra (Dilution of Public ownership) Bill 1996, Senate Hansard, para. 3.34, viewed 3 November 2009, http://www.aph.gov.au/Senate/Committee/ecita_ctte/completed_inquiries/1996-99/telstra/report/c03a.htm#structural

49. Explanatory Memorandum, Telecommunications Legislation Amendment (Competition and Consumer Issues) Bill 2009, p. 1.

leaves open the possibility that a commercial agreement of this kind will be arrived at prior to the commencement of the Bill.

The effect would be that the part of the Bill dealing with the separation of Telstra will become largely redundant and that part, at least, will no longer need to be brought before Parliament. The other parts of Bill would still stand. Whether the Government is minded to continue with them is another matter. That is to say, Telstra's opposition to the other measures in the Bill—the changes to the anti-competitive conduct regime in Part XIB of the Trade Practices Act, the increased powers of the regulator under the access regime in Part XIC of the Trade Practices Act, the tightening of the universal service obligation and the customer service guarantee—might play out in the negotiations with the Government over structural separation.

If, on the other hand, the Bill is passed this year, it is likely to precede the conclusion of negotiations which will then take place within the framework of the Bill. That is, Telstra will have to offer either a structural or functional separation undertaking. Although the framework currently presented in the Bill has shortcomings, it does, at least, offer some minimum standards for whichever of the two models of separation is chosen whereas a privately negotiated agreement might deviate materially from the principles underpinning the separation models in the Bill.

For instance, under the Bill, the ACCC has a formal role in assessing undertakings which it would not necessarily have in a privately negotiated agreement; there is a greater degree of transparency in the case of undertakings under the Bill than there would be if the agreement were reached outside of the Bill (although in the case of structural separation under the Bill, there is presently limited transparency) and the enforcement remedies for breaches of undertakings made under the Bill are stronger than for a commercially negotiated agreement. For functional separation undertakings, the Bill sets out principles with which the undertaking must be consistent. For structural separation, the minimum standards of separation are spelled out in **proposed section 577A** of the Bill. For both models of separation, the Minister may make instruments that must be published on the Department's website.

Furthermore, if the Bill is passed this year, the remaining parts of the Bill will not be at risk of falling, a risk to which they may be exposed if Part 1 of the Bill became redundant under the first scenario.

This is at least one reason why the timing of the vote on this Bill is important.

Concluding comments on Telstra's separation

This Bill has been introduced at a time when the Government has commenced work on a new national broadband network. However, the Bill does not mention the NBN and structural separation need not be justified on the basis of it. In fact, the separation of Telstra has been part of the political and policy debate about Telstra since 1996 when the

Coalition government came to power with the policy of privatising Telstra. This digest has therefore generally not dealt with the NBN.

Following the Hilmer Report's recommendations about the need to consider structural reforms of formerly publicly owned monopolies, such reforms were implemented in other sectors like the electricity, gas, rail, ports and airport sectors. Telecommunications stands out as an exception to this trend. Instead, the regulation of telecommunications has relied primarily on an access regime that many, including the regulator, regard as deficient.[50]

The length and complexity of Part 1 the Bill mask the simplicity of its intent which is to bring about the Government's preferred outcome: the structural separation of Telstra.[51] For at least one reason, however, the Bill does not directly impose structural separation. To do so would risk a time consuming challenge to the constitutionality of the Bill on the basis that such legislation might amount to a compulsory acquisition of property otherwise than on just terms.[52]

Rather, the Bill is framed in such a way as to provide Telstra with several incentives to voluntarily structurally separate; a *voluntary* structural separation being unlikely to offend the Constitutional prohibition on *compulsory* acquisition of property other than on just terms.

Only structural separation can remove the incentive faced by Telstra's network/wholesale business to favour its own retail operations over those of its retail competitors. Functional separation merely mimics some of the characteristics of a structurally separated business but can never alter the overriding incentive that Telstra has to act in the interests of the company as a whole.

The Government was fortunate to be faced with a situation in which Telstra's share price had collapsed following Telstra's exclusion, earlier this year, from a tender to build a fibre to the node network.[53] This circumstance, which was followed by the departure of the

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50. E Willet, ACCC Commissioner, Speech to Broadband Australia 2009 Conference, Sydney, 11 June 2009, p. 5.

51. S Conroy (Minister for Broadband, Communications and the Digital Economy), speech to CommsDay Summit, 14 October 2009, viewed, 25 October 2009, http://www.minister.dbcde.gov.au/media/speeches/2009/068/

52. Subsection 51 (xxxi) of the Commonwealth of Australia Constitution Act provides that the Parliament shall, subject to this Constitution, have power to make laws for the peace, order, and good government of the Commonwealth with respect to…the acquisition of property on just terms from any State or person for any purpose in respect of which the Parliament has power to make laws.

53. M O'Sullivan, 'ACCC case fuels fears of Telstra split', Sydney Morning Herald, 20 March 2009, p. 19, viewed 16 November 2009, http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22media%2Fpressclp%2FOR2T6%22

CEO and Chair, removed a considerable amount of the political risk in taking a firmer regulatory hand to Telstra. As events have unfolded, there have been loud complaints from shareholders but the Telstra share price has not materially changed from the time this Bill was introduced.

Whether structural separation is implemented successfully will depend to a large degree on the attitude of Telstra itself—particularly whether the Telstra Board considers this accords with its fiduciary and legal obligations. In many ways, the Bill attempts to make that assessment easier by making the structural separation option the most attractive option it can take.

There has been considerable pressure by the Government for this Bill to be considered and voted upon in the week ending 30 October 2009. There is nothing in the Bill itself that requires this. However, it is known that the Government, through the National Broadband Network Company is negotiating with Telstra for Telstra to sell or otherwise make available some or all of its network assets to the NBN Company.[54] An agreement of this kind could satisfy the requirements of structural separation and, if this Bill had not passed by that time, render the whole of Part 1 of this Bill unnecessary. The parts dealing with consumer protection, access regulation and anti-competitive conduct stand alone and could be considered later if there were no other constraints on the Government in allowing that to occur.

Part 2—Telecommunications access regime

Part 2 of the Bill makes amendments to the access regime in Part XIC of the Trade Practices Act.

Earlier in this digest, reference was made to the observation in the Hilmer Report that there are two ways of dealing with bottleneck services or facilities; structural separation or 'more intrusive regulatory controls to guard against cross-subsidisation and, where a vertical relationship is involved, the potential misuse of control over access to the natural monopoly element'.[55] As noted, Australia took the latter approach and, in 1997, introduced a set of rules to enable access to be given to certain services that have bottleneck characteristics (Part XIC of the Trade Practices Act) and to deal with anti-competitive conduct (Part XIB of the Trade Practices Act). At the time that was not an unusual approach in telecommunications markets around the world.

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54. D Crowe, 'Labor faces $25bn fight over Telstra network value', *Australian Financial Review*, 27 October, 2009, p. 1, viewed 16 November 2009, http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22media%2Fpressclp%2FNF1V6%22

55. Hilmer p. 219.

Part XIC—how it works now

In order to provide retail services to customers, Telstra's competitors need access to certain wholesale services that are provided over Telstra's network. Because Telstra is vertically integrated and operates in the same retail markets as those competitors, it usually has little incentive to provide access to those services on acceptable terms. The regulatory response under Part XIC has been to create legislated rights concerning access to certain services. Under Part XIC, access seekers are able to try to negotiate access and, failing that, have their disputes arbitrated by the ACCC. This is known as the 'negotiate-arbitrate' model.

Under Part XIC, a wholesale service falls into the regulatory net by being '*declared'* by the ACCC.[56] Declaration of a service obliges the service provider to supply the service on terms to be negotiated.[57]

If access is supplied, the wholesale service provider must comply with the 'standard access obligations' (SAOs).[58] The SAOs require the service provider to permit interconnection of facilities to enable the supply of retail service and to ensure access seekers receive equivalent technical and operational quality and timing of interconnection to that which Telstra provides itself.[59]

The ACCC may exempt service providers from some or all of the standard access obligations including for services that are yet to be provided.[60] These exemptions can be for existing declared services (ordinary exemptions) or for services that are not yet declared or even in operation (anticipatory exemptions).

If negotiation is not productive, there are two possible ways that the terms and conditions of access can be arrived at. A wholesale service provider may give the ACCC an undertaking setting out the terms and conditions on which it is prepared to provide access.[61] These undertakings can be for existing declared services (ordinary undertakings) or services that are not yet declared or even in operation (special undertakings). The ACCC must approve an undertaking before it becomes effective.

If there is no undertaking in place and the parties cannot reach agreement about access, either party may ask the ACCC to arbitrate the dispute. The ACCC—arbitrated terms and

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56. Division 2 of Part XIC of the *Trade Practices Act 1974*.
57. Section 152AY of the *Trade Practices Act 1974*.
58. Division 3 of Part XIC of the *Trade Practices Act 1974*.
59. Section 152AR of the *Trade Practices Act 1974*.
60. Sections 152AS, 152ASA, 152AT and 152ATA of the *Trade Practices Act 1974*.
61. Division 5 of Part XIC, of the *Trade Practices Act 1974*.

conditions are binding, but only on the parties to that dispute and only in relation to that particular dispute.

When arbitrating a dispute, the ACCC must have regard to the 'pricing principles' and, for a limited range of services, the 'model terms and conditions' that it is required to make.[62] Neither the pricing principles nor the model terms are binding on parties that are not in arbitration and, even in an arbitration, are merely matters to which the ACCC 'must have regard'.[63]

Part XIC—the problem to be fixed

The existing regime ostensibly reflects an attempt to strike a balance between the rights of access providers and access seekers and assumes that they both have a willingness to negotiate in good faith to arrive at commercial agreements about access.

However, the number of disputes that have been notified to the ACCC since 1997 (157 according to the Explanatory Memorandum[64]) shows that the legislature had either a naïvety about the incentives faced by access providers (notably Telstra) to obstruct access or, as Alan Fels, the former Chairman of the ACCC, recently alleged, a deliberate disregard for them. (He says that access regulation was deliberately kept weak in order to maximise the Telstra share price as the Commonwealth sold down its share to the public from 1996 to 2006.[65])

It has been observed that 'Telstra loathes the access rules. That is hardly surprising: if the access rules did not exist, Telstra could charge its customers much more to use the network.'[66] For this reason and because the complexity of the negotiate–arbitrate model in Part XIC provides considerable scope for obstruction and delay ('gaming') by access providers, Part XIC has not worked as it was meant to. For instance, access providers like Telstra can conduct negotiations so as to lead almost inevitably to time-consuming arbitrations by the Commission; can give undertakings to delay the arbitration of disputes, withdraw them and then lodge substantially the same undertaking later, at each point causing further delay; can seek review of all decisions of the ACCC in the Australian Competition Tribunal and take appeals on matters of law to the Federal Court.

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62. Sections 152AQA and 152AQB of the *Trade Practices Act 1974.*

63. Subsections 152AQA(6) and 152AQB(9) of the *Trade Practices Act 1974*.

64. Explanatory Memorandum, Telecommunications Legislation Amendment (Competition and Consumer Issues) Bill 2009, p. 46.

65. A Kohler, 'Interview with Alan Fels', ABC Inside Business, transcript, Australian Broadcasting Corporation, (ABC), 4 October 2009, viewed 3 November 2009, http://www.abc.net.au/insidebusiness/content/2009/s2704250.htm

66. P Fletcher, *Wired Brown Land? Telstra's Battle for Broadband*, UNSW Press Ltd, Sydney, 2009, p. 12.

As a result it has been observed that 'the negotiate–arbitrate model was disastrously unfit for purpose… Its manifest flaws were a major reason why competition in fixed line telecommunications remained so weak'.[67]

Relevant provisions

The changes made by the Bill address two main problems with the current access regime. First, the ACCC has the power to determine conditions of access arises only when it is arbitrating a dispute. The outcome of those arbitrations affects only the parties to that dispute and are not of general application. Secondly, the current regime is complex and offers many opportunities to obstruct or delay access including appealing administrative decisions to the Australian Competition Tribunal. The Bill deals with these problems in the following ways:

Setting conditions of access

The Bill abolishes the negotiate–arbitrate model and gives the ACCC the power to set terms and conditions for declared services for a period of three to five years. Parties can still, however, negotiate their own agreements but there will be no need for time consuming arbitrations as, in the absence of agreement, the terms and conditions of access will be those determined by the ACCC.

Item 116 of the Bill repeals existing Division 4 of Part XIC of the Trade Practices Act and inserts **proposed Division 4.** Within that new Division, **proposed section 152BC** gives the ACCC the power to make 'access determinations'. These are up-front determinations about the conditions of access—including the price of access—to declared services for a three to five year period. **Proposed sections 152BC, 152BCA, 152BCB, 152BCC** and **152BCD** deal with the content of access determinations.

In order to bring some flexibility into the operation of access determination, the ACCC is given two devices: First, it can include in an access determination a provision that is specified to be a 'fixed principles provision' (**proposed subsection 152BCD(1)**). Such a provision deals with the same matters that may be dealt with in an access determination but can operate beyond the term of the access determination (**proposed subsection 152BCD(2)**). The Explanatory Memorandum gives, as an example of a fixed principle, a provision dealing with the manner of calculating depreciation for the purpose of setting access prices.[68]

Secondly, to deal quickly with issues as and when they arise, the ACCC can make 'binding rules of conduct' (**proposed section 152BD**). These binding rules operate in addition to, or as a variation of, an access determination. Because they are to be used to deal quickly with issues, they have a shorter life than access determinations (up to 12

67. P Fletcher, p. 52.

68. Explanatory Memorandum, p. 48.

months under **proposed section 153BDC**) and the ACCC is not required to hold a public inquiry prior to making them as is the case with access determinations. The Explanatory Memorandum gives as an example of this kind of rule one concerning exchange access or service migration processes.[69]

Proposed section **152BCG** allows the ACCC to make an interim access determination. **Proposed sections 152BCH to 152BCM** deal with the processes for making an access undertaking which mainly involve requirements to hold a public inquiry. **Proposed section 152BCN** deals with the revocation and variation of access determinations.

In addition to being enforceable by the ACCC, access determinations and binding rules of conduct can be enforced in the Federal Court by an access seeker, a carrier or a carriage services provider (**proposed sections 152BCQ and 152BDH**).

Access seekers and providers can still negotiate different terms from those set out in an access determination. If there is a conflict between an agreement and an access determination, the determination is of no effect to the extent of the inconsistency (**proposed section 152BCC**).

Access providers will no longer be able to give undertakings for active declared services (ordinary undertakings) but will still be able to give undertakings for services that are either not yet in operation or not yet declared (special access undertakings). (**Item 117** of the Bill repeals sections 152BS–152CB of the Trade Practices Act which provide for ordinary access undertakings.) This evidently reflects the misuse of ordinary access undertakings to delay and obstruct the operation of the access regime.

The ACCC will no longer be able to grant exemptions from the standard access obligations for active declared services (ordinary exemptions) but will continue to be able to give exemptions for services that are either not yet in operation or not yet declared (anticipatory exemptions). (**Items 93** and **100** repeal sections 152AS and 152AT of the Trade Practices Act respectively which currently deal with anticipatory exemptions.)

The consequence of these changes is that the conditions of access will be determined in the following order: by agreement between the parties, but if there is no agreement, according to the terms of a special access undertaking but, if there is no undertaking, according to the binding rules of conduct, but, if they have not been made, then according to the terms of an access determination.

Abolishing merits review

Currently, certain decisions of the ACCC are subject to merits review in the Australian Competition Tribunal (the Tribunal). Access providers—notably Telstra—commonly appeal decisions to the Tribunal. It is alleged that Telstra appeals decisions in order to

69. Explanatory Memorandum, p. 48.

delay and obstruct the access regime, although the inference of bad faith that is often drawn may be exaggerated given that the Telstra Board's legal and fiduciary duties may require that it does so.[70] Whatever the reason, the effect is that access is delayed and uncertainty created for access seekers.

This Bill abolishes merits review for certain decisions of the ACCC but does not take away any rights to judicial review under the *Administrative Decisions (Judicial Review) Act 1977*.

The ACCC currently can make decisions about whether or not to give ordinary and anticipatory exemptions from the standard access obligations. This Bill takes away the power of the ACCC to give ordinary exemptions and, in relation to anticipatory exemptions, takes away the right to merits review. (**Item 108** of the Bill repeals sections 152AV, 152AW and 152AX which deal with appeals concerning exemptions.)

Also, the ACCC currently can make decisions about whether to accept or reject an ordinary access undertaking (that is, one in relation to existing declared services) or a special access undertaking (that is, one in relation to a service that is not yet in operation or declared). This Bill takes away the right of a person to give an ordinary access undertaking and, in relation to a decision about a special access undertaking, takes away the right to merits review. (**Item 128** repeals sections 152CE, 152CF, 152CG and 152CGA, which relate to these decisions.)

Part 3—Anti-competitive conduct

Part XIB—how it works

Part XIB of the Trade Practices Act prohibits a service provider with a substantial degree of market power from engaging in conduct which has either the effect or purpose of substantially lessening competition. This is known as the 'competition rule'.

Proceedings may be initiated in the Federal Court to enforce the competition rule. However, proceedings can be initiated only if the alleged anti-competitive conduct in relation to which Federal Court action is taken is of a kind that has been specified previously in a Part A competition notice that has been given to the alleged infringer and is still in force. Before the ACCC issues a Part A competition notice, existing subsections 151AKA(9) and (10) of the Trade Practices Act require that it must give the provider concerned a 'consultation notice' which describes the alleged anti-competitive conduct in summary form, and must give the provider an opportunity to make submissions.

There is an alternative to this process that involves the issue of a Part B competition notice but this process is not affected by this Bill and is not dealt with here.

70. Explanatory Memorandum, p. 46

Part XIB—the problem to be fixed

The Part A competition notice process can be manipulated in order to draw out the enforcement process with the effect of damaging competitors through anti-competitive conduct. In particular, the requirement to consult—by way of a 'consultation notice'—presents opportunities for challenge because consultation typically carries with it rights to procedural fairness, the elements of which, in practice, are difficult to define and therefore easy to contest.

Relevant provisions

The Bill removes the requirement for the ACCC to undertake consultation before issuing a Part A competition notice. (**Item 159** repeals subsection 151AKA(10) which currently requires that the ACCC consult before issuing a Part A notice.) This will deny the affected person the opportunity to delay the ACCC's enforcement activities on procedural grounds. The ACCC will still need to prove the substantive claims of anti-competitive conduct in the Federal Court.

The Bill also removes the requirement imposed on the ACCC at common law to provide procedural fairness when issuing a competition notice. (**Item 159** repeals subsection 151AKA(9) which currently requires procedural fairness.) There is a precedent for the denial of procedural fairness in existing subsection 152CPA(3) which was inserted in 2005.[71] In any case, procedural fairness is afforded at other stages in the enforcement process. First, the Part A competition notice must set out the specific allegations of anti–competitive conduct. Secondly, the ACCC can revoke the competition notice if it was issued in error. Thirdly, enforcement must be in the Federal Court where the allegations of anti-competitive conduct must be proved.

Application of Part XIB to content service providers

Part XIB is also amended to make clear that Part XIB applies to content services and not just carriage services.[72] Those who hold rights to content—particularly exclusive rights—can foreclose competition in both markets for content and in other markets. Part XIB is capable of dealing with such situations provided it clearly applies to content services. This is the reason for this minor, but important, amendment.

71. Inserted by schedule 12 of the *Telecommunications Legislation Amendment (Competition and Consumer Issues) Act 2005*, http://www.comlaw.gov.au/ComLaw/Legislation/Act1.nsf/0/EF7D9BB244FFE2F6CA25713A001E26C8/$file/119-2005.pdf

72. Section 7 of the *Telecommunications Act 1997* defines the term ***'carriage service'*** as a service for carrying communications by means of guided and/or unguided electromagnetic energy.

Part 4—Universal service obligation

The Universal Service Obligation (USO) has the objective of ensuring basic voice telephony and payphone services are reasonably accessible to all people on an equitable basis. The current primary USO provider is Telstra. Because the USO is provided at a loss (the amount of which is contested), Telstra is compensated out of the USO fund.[73] The Fund is made up of compulsory contributions by licensed carriers based on their 'eligible revenue'. Only carriers with eligible revenue above a prescribed minimum need contribute.

Compliance with USO requirement is a carrier licence condition for Telstra. Upon breach the Federal Court has the power to impose a civil penalty up to $10 000 000 for each breach.[74] However, the current requirements are imprecise and difficult to enforce because the obligation on the universal service provider is to take all *reasonable* steps to fulfil the relevant obligations.[75] Whether something is reasonable or not is largely up to Telstra to decide which creates scope for avoidance.[76]

This part of the Bill introduces more certainty into the USO obligations. This will improve the prospects for enforcement either by Federal Court action or by the issue of infringement notices, a new measure introduced by Part 7 of this Bill. Infringement notices may be issued for amounts of up to $1 980 000.[77]

Relevant provisions

This part of the Bill amends the *Telecommunications (Consumer Protection and Service Standards) Act* (the Consumer Protection Act) to include new requirements for the universal service provider to supply, on request from a customer, a standard telephone

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73. S Bartholomeusz, 'Universal service obligation review may offer solution to regulation impass', *The Age*, 28 June 2007, p. 10, viewed 16 November 2009, http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22media%2Fpressclp%2FMWHN6%22

74. Section 61 and Part 1 of Schedule 1 of the *Telecommunications Act 1997* makes compliance with the *Telecommunications (Consumer Protection and Service Standards) Act 1999* a carrier licence condition. Breach of a carrier licence is subject to a civil penalty (section 68 of the *Telecommunications Act 1997*). Part 31 of the *Telecommunications Act 1997* provides that civil penalties up to $10 000 000 may be imposed by the Federal Court.

75. Subsection 12C(1) of the Telecommunications (Consumer Protection and Service Standards) Act 1999.

76. Explanatory Memorandum, p. 67.

77. Under the new provisions in Part 7 of the Bill dealing with infringement notices, the maximum penalty that may be imposed using this mechanism is 18 000 penalty units. A ***'penalty unit'*** is defined in section 4AA of the *Commonwealth Crimes Act 1914* as being equivalent to $110.

services with characteristics and to performance standards determined by the Minister via legislative instrument (**proposed section 12EB** which is inserted by **item 175)**. The Explanatory Memorandum says that it is intended that performance standards will include maximum periods of time for new connections and fault rectification and reliability standards.[78] There are also new provisions providing minimum performance benchmarks that the universal service provider must meet in fulfilling its responsibilities (**proposed section 12EC**).

The Bill also provides the Minister with the power to specify, by a legislative instrument, rules and performance standards to which a primary universal service provider must adhere in relation to the supply, installation, maintenance and location of payphones (**proposed sections 12ED and 12EE**). In addition, there will be new rules in relation to public consultation and notification of proposals to remove payphones (**proposed sections 12EF, 12EG and 12EH**). The Australian Communications and Media Authority (ACMA) will have new powers to direct the universal service provider not to remove payphones (**proposed section 12EI**). People adversely affected by a proposed payphone removal will be able to request that the ACMA consider issuing directions to the universal service provider. In considering whether to issue such a direction, the ACMA will have regard to both the consultation and notification requirements as well as the rules about the location of payphones (**proposed section 12EI**).

The other important measure introduced is to prevent the universal service provider from attempting to satisfy the USO obligation by the provision of a mobile or a voice over internet protocol (VOIP) service unless, amongst other things, the customer has given informed written consent to such action (**proposed section 6A** which is inserted by **item 164**).

Part 5—Customer service guarantee

The Customer Service Guarantee (CSG) requires telephone companies to provide connections and fault rectification within the times set out in the rules. A failure to meet these performance service standards leads to the provider being required to make a payment to the customer for each working day that a connection or fault rectification is delayed.[79] Providers are currently subject to no other penalties for failing to meet the CSG standards.[80]

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78. Explanatory Memorandum, p. 5.

79. The amounts that are payable to customers for breaches of the CSG are set out on the website of the Telecommunications Industry Ombudsman, viewed 18 November 2009, http://www.tio.com.au/FAQ/csg.htm

80. This is because section 123 of the *Consumer Protection Act* has the effect that the requirement on a service provider to comply with the Act (breach of which would otherwise

The ACMA reports that the performance of providers, as measured against the CSG requirements, has been declining. One measure of this has been the increase in payments to customers which suggest that the current rates of compensation do not provide sufficient incentive for providers to fix problems in a timely fashion.[81]

Relevant provisions

Item 182 in Part 5 of the Bill amends the Consumer Protection Act to provide for the Minister to establish minimum CSG performance benchmarks (**proposed sections 117B and 117E**). Unlike performance standards which are concerned with setting standards for service for each individual, performance benchmarks are likely to be of general application. Hypothetically, for instance, a benchmark may require that a service provider rectify faults on time in, say, 95% of cases over a 12 month period.

A breach of the CSG standards—that is, those existing standards concerning times for connection and repair—will remain subject to compensation payments to affected customers and continue to be not subject civil penalties. However, a failure to meet the newly established minimum CSG performance benchmarks will be subject to civil penalties. As for the USO, these may be dealt with by the issue of infringement notices under a new scheme introduced by Part 7 of this Bill.

The Bill also provides for the Minister to establish new CSG timeframes for connections and repair that will apply to *wholesale* providers to assist retail providers of CSG services to meet CSG service quality standards (**proposed section 117D**). This will deal with a situation in which, by way of example, Optus is the retail provider of the phone service but Telstra is the wholesale provider of that service. In such a case, the primary obligation may rest on Optus, but the satisfaction of it may depend on Telstra.

The Bill also deals with the practice that has developed of providers deeming that CSG rights have been waived by, for instance, the inclusion of a term in the standard customer agreement. Under this Bill, a customer's express agreement will be required before a provider may treat them has having waived their CSG rights. In addition, there is a new requirement that a customer's waiver of the CSG must include a statement that summarises the consequences of the customer waiving the CSG (**proposed subsections 120(5)** and **(6)**).

To ensure consumers have the safety net of always being able to purchase a CSG service, the Bill makes explicit that the CSG cannot be waived for a telephone service that is supplied in fulfilment of the Universal Service Obligation (**proposed subsection 120(7)**).

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be subject to a civil penalty) does not include a requirement to comply with a service standard like this.

81. Explanatory Memorandum, p. 68.

Part 6—Priority assistance

Priority assistance services provide better phone connections and fault repairs for customers who have in their residence a person with a life threatening medical condition.

Relevant provisions

Item 191 of Part 6 of this Bill introduces **proposed Part 6** into schedule 2 of the Telecommunications Act which sets out the 'service provider rules'.

New Part 6 requires service providers to either offer a priority assistance service in accordance with an industry code (the 'Priority Assistance for Life Threatening Medical Conditions' Code made by the Communications Alliance)[82] or to inform customers of the names of providers from whom they can purchase such a service if they require it. Telstra will remain bound by clause 19 of its current carrier licence conditions to provide a priority assistance service.[83]

Part 7— Infringement notices

New Part 31B is inserted into the Telecommunications Act by **item 195** of Part 7 of the Bill to allow ACMA to deal with breaches of civil penalty provisions by issuing infringement notices rather than by initiating Federal Court action as is presently required. A civil penalty provision is a one that can be enforced by civil—rather than criminal—proceedings.

Infringement notices are a means of dealing with breaches quickly. A person receiving an infringement notice can pay the penalty specified or elect to have the matter dealt with in the Federal Court.

Relevant provisions

The penalty amount specified in an infringement notice given to a corporation cannot exceed 60 penalty units or $6 600 (**proposed subsection 572G**) but the Minister may determine different amounts for different contraventions up to a maximum of 18 000 penalty units (currently $1 980 000). This is less than the civil penalties that can be payable if a matter proceeds in the Federal Court where penalties of up to $10 000 000 are possible.[84]

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82. Communications Alliance, *Industry Code; Priority Assistance for Life Threatening Medical Conditions,2007*, viewed 27 October 2009, http://www.commsalliance.com.au/__data/assets/pdf_file/0011/1343/C609_2007.pdf

83. Explanatory Memorandum, p. 6.

84. Section 570 of the *Telecommunications Act 1997*.

The rest of this new part is concerned with technical matters such as the content of infringement notices (**proposed section 572F**), the avoidance of double counting where a single contravention amounts to breaches of more than two provisions (**proposed section 572E**); the effect of the withdrawal of infringement notices (**proposed section 572H)**; and the appointment of 'authorised infringement officers' (**proposed section 572L**).

Part 8—Civil penalty provisions

Part 8 of the Bill makes clarifying amendments to the definition of ***'civil penalty provision'*** in the Telecommunications Act. Currently, the definition lists all the provisions that are civil penalty provisions. However, since all of those provisions are, in their terms, also declared to be civil penalty provisions, the new definition simply refers to that fact. That is, the new definition of ***'civil penalty provision'*** is any provision that is declared to be one (**proposed section 7**).

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