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Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010

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Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010

Date introduced: 20 October 2010

House: House of Representatives

Portfolio: Broadband, Communications and the Digital Economy

Commencement: Various dates as set out in Section 2 of the Bill

Links: The links to the Bill, its Explanatory Memorandum and second reading speech can be found on the Bills home page, or through http://www.aph.gov.au/bills/ . When bills have been passed they can be found at the ComLaw website, which is at http://www.comlaw.gov.au/ .

History of the Bill

The Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2009 (the 2009 Bill) was introduced into the House of Representatives on 15 September 2009 during the term of the 42nd Parliament. However, that Bill lapsed on 19 July 2010 when the Parliament was prorogued. A digest was prepared in respect of the 2009 Bill.[1]

The Telecommunications Legislation Amendment (Competition and Consumers Safeguards) Bill 2010 (the Bill) contains some additional provisions which were not included in the 2009 Bill.

Purpose

The Bill makes material amendments to the main four Acts that regulate the consumer protection, competition and licensing in telecommunications markets.[2] 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

1. Economics Section, 'Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2009', *Bills digest no. 63, 2009–10*, Parliamentary Library, Canberra, 11 December 2009, viewed 11 November 2010, http://www.aph.gov.au/library/pubs/bd/2009-10/10bd063.pdf
2. *Trade Practices Act 1974*, *Radiocommunications Act 1992*, *Telecommunications Act 1997* and *Telecommunications (Consumer Protection and Service Standards) Act 1999*. Minor consequential changes are made to the *National Transmission Network Sale Act 1998*.

- 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, and
- 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.

Background

Australian telecommunications sector

History

Previous Australian Governments failed to structurally separate the existing telecommunications monopoly.[3] Telstra (the incumbent) remained a vertically and horizontally integrated telecommunications network prior to its privatisation and prior to the liberalisation of the market, despite the recommendations of the Hilmer report.[4] Instead, the Government chose to introduce competition to the sector and apply intensive conduct regulation via the access regime under Part XIC of the *Trade Practices Act 1974* to the privatised integrated incumbent.[5]

While resulting in substantial net benefits to society, the incremental reforms implemented from 1991 onwards have resulted in an Australian telecommunications sector that continues to be subject to relatively highly concentrated ownership of network infrastructure and to high barriers of entry, while heavily dependent on regulatory mechanisms to attempt to promote and maintain competitive outcomes.[6]

Thus, the predictions of the Hilmer report regarding liberalisation and privatisation of a monopoly market, in the absence of structural separation of the incumbent, have come to fruition. Telstra remains highly vertically and horizontally integrated and while still subject to accounting and operational separation[7] provisions, the incentive for Telstra to discriminate against competitors in

3. A definition of structural separation can be found in the appendix.
4. F Hilmer, M Raynor and G Taperell, *National Competition Policy: Report by the Independent Committee of Inquiry*, AGPS, Canberra, August 1993, viewed 16 November 2010, http://ncp.ncc.gov.au/docs/Hilmer-001.pdf
5. L Jones, 'Trade Practices Amendment (Telecommunications) Act 1997', *Bills digest, no. 89, 1997–97*, Parliamentary Library, Canberra, 5 February 1997, viewed 16 November 2010, http://www.aph.gov.au/library/pubs/bd/1996-97/97bd089.htm
6. JS Gans and SP King, ''Big Bang' telecommunications reform', *The Australian Economic Review*, vol. 43, no. 2, 2010, pp. 179–180, http://onlinelibrary.wiley.com/doi/10.1111/j.1467-8462.2010.00591.x/pdf
7. A definition of accounting, operational and functional separation can be found in the appendix.

favour of its retail operation remains.[8] This Bill has been introduced with a view to addressing the issues believed to be a result of that vertical and horizontal integration. That premise is examined below.

Telecommunications sector outcomes

Despite the regulatory environment and access regime, the telecommunications market structure continues to result in relatively high prices (by global standards), data caps, and consumer complaint levels that grow on a yearly basis.

In explaining this outcome, Gans and King point to the Australian Competition and Consumer Commission's (ACCC's) recent observations regarding the state of the Australian telecommunications sector:

> the telecommunications sector in 2007–08 demonstrates the extent to which competition is hindered by the industry's underlying structural features, with very high concentration levels being observed and high, specialised and largely 'sunk' investment costs continuing to impose high barriers to entry for competitors.[9]

Based on the ACCC's view, Gans and King argue that this concentrated market structure has resulted in muted competition and that the core competitive impediment is the concentrated ownership of the network infrastructure.[10] That is, the problem has largely involved the concentrated ownership of the fixed-line network infrastructure, and a subsequent lack of infrastructure based competition, and not simply the ability of Telstra to favour its retail operations, as is the Government's view.[11]

If this is the case, structural separation of Telstra under the current access regime may not address the problem of concentrated ownership of the network infrastructure as it does not alter the ownership of that infrastructure in any way. It merely results in a fixed-line network operator with a majority share of the wholesale market and no retail arm (evidence from the electricity sector suggests this outcome is likely to present some negative externalities (see below)).

In short, highly concentrated fixed-line infrastructure ownership and its associated incentives (apart from those associated with its retail operations) are likely to remain after the structural separation of Telstra.

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8. J Hunter, *Australian Competition and Consumer Commission (ACCC) ITU Asia Pacific training conference presentation,* Australian Communications and Media Authority (ACMA), p. 21, viewed 16 November 2010, http://www.acma.gov.au/webwr/_assets/main/lib311250/transformation_of_aust_telecomms.pdf
9. Australian Competition and Consumer Commission (ACCC), *ACCC telecommunications reports 2007–08*, Commonwealth of Australia, 2009, viewed 16 November 2010, http://www.accc.gov.au/content/index.phtml/itemId/877087
10. JS Gans and SP King, ''Big Bang' telecommunications reform', *The Australian Economic Review*, vol. 43, no. 2, 2010, p. 180, http://onlinelibrary.wiley.com/doi/10.1111/j.1467-8462.2010.00591.x/pdf
11. Explanatory Memorandum, Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010, p. 1.

If the goal of the Bill is to remove the ability of Telstra to favour it retail operations, the Bill is likely to succeed. However, if the purpose of the Bill is to increase the incentives for infrastructure based competition, and subsequently increase the associated benefits to consumers of lower prices and technological innovation, international experience and economic literature indicate that such outcomes may not be realised through implementation of this Bill alone. Put differently, structural separation alone is unlikely to achieve the intended aim of this Bill, namely, the development of effective infrastructure based competition in the sector. This is particularly true if the access regime has resulted in a strong disincentive for the incumbent and its potential competitors to invest in infrastructure, as a result of excessively low access prices to the incumbent's existing fixed-line infrastructure network.

The telecommunications access regime

The access regime in the Australian telecommunications sector has been criticised for reducing the incentive for competitors to compete via investment in their own infrastructure. It has been argued that third party access regimes have tended to produce not a competitive market but rather it's very opposite, because they provide a strong incentive (via access prices that are too low) for competitors to merely rely on the incumbent's facilities, rather than invest in and build their own.[12]

The lack of fixed-line infrastructure investment by Telstra's competitors through time, as observed by the ACCC, coupled with the argument that Telstra has reduced investment in the access network, provide prima facie evidence in favour of the argument that with respect to incentives for infrastructure based competition, access prices under the current regime have been too low, as opposed to too high. In addition, access prices are almost certainly lower than what they would be in the absence of the existing access regime and may have been lowered at rates greater than those in the US, Canada and the EU.[13]

Indeed, similar incentive based outcomes (in relation to retail price caps) were recognised in a 1999 report by the Productivity Commission entitled *International Benchmarking of Telecommunications Prices and Price Changes* which stated that:

> Price controls may be hindering the competitive process in some countries, including Australia (where) price caps on local service may be reducing returns in this market, making entry unattractive...[14]

International studies present further empirical evidence which indicates that low access charges result in the non-emergence of facilities-based competition, or where it has emerged, its failure to

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12. H Ergas, *Regulating Australian Telecommunications: Past Errors, Future Challenges*, Parliamentary Library seminar, 17 June 2009, p. 3.
13. ibid.
14. Productivity Commission (PC), *International Benchmarking of Telecommunications Prices and Price Changes*, Commonwealth of Australia, Melbourne, 1999, p. XXXII, viewed 16 November 2010, http://www.pc.gov.au/__data/assets/pdf_file/0015/9312/telecomsprices.pdf

develop. The hybrid fibre-coaxial (HFC) infrastructure investment experience of Optus may be an example of this. By contrast, comparative studies find little evidence that vertical or horizontal integration by the incumbent has any adverse effect on telecommunications outcomes. In addition, the international field experience is not supportive of structural separation as a means through which to stimulate competitive infrastructure investment or reduce prices.[15]

This has been found in the USA where their Federal Communications Commission (FCC) has acknowledged the need to incentivise spending in fibre networks including the need to allow the firms to recoup their investments. The FCC's current stance is an about-turn from its previous one, and reflects its preference for infrastructure-based competition after years of trying to push service-based competition rules that proved difficult to administer.[16]

The view of the regulator

The ACCC argues that the emergence of competition is dependent on the current access regime:

> the emergence of competition has depended upon the regulatory mechanisms in the access regime and has been achieved incrementally as Telstra's competitors have built up customer bases and are now investing in and installing infrastructure of their own in more densely populated areas.[17]

Implicit in this statement is the view that no firm exists with the requisite capital, or the willingness to invest their capital, in the construction of their own telecommunications infrastructure, in the absence of an existing customer base that has been developed, via regulated access to the incumbent's infrastructure.

However, the Optus experience negates such a view. It is also likely that competitive telecommunications sectors around the globe would provide further support to the view that a subscriber base developed via regulated access to the incumbent's infrastructure is not a prerequisite for overcoming barriers to entry. This in turn would lend further support to the argument of excessively low access prices as a disincentive to infrastructure investment being the impediment to competition here, as opposed to the vertical integration of Telstra alone.

Revision of the telecommunications access regime

The November 2010 *OECD Economic Surveys Australia* has welcomed the Government's attempt to revise the current Australian access regime. The OECD argues that in simplifying the access regime,

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15. Ergas, op. cit., p. 5.
16. E Chow, 'Fibre-to-the-home: Taking the plunge', *Telecommunications Journal of Australia*, vol. 57, number 2/3, 2007, p. 35.2, viewed 16 November 2010, http://publications.epress.monash.edu/doi/pdf/10.2104/tja07035
17. Australian Competition and Consumer Commission (ACCC), ACCC telecommunications reports 2007–08, Commonwealth of Australia, 2009, p. 3, viewed 16 November 2010, http://www.accc.gov.au/content/index.phtml/itemId/87708 7

the Government ought to reduce possibilities for discrimination between private telecommunications operators. However, the OECD notes that it would be prudent to maintain the possibility of a number of independent bodies conducting scrupulous reviews of the access pricing and conditions set by the ACCC and that this would be compatible with faster application of the regulations, if these parameters are set in advance.[18]

Structural separation as a solution?

While vertical and horizontal integration potentially can, and in some cases does, create scope for anti-competitive conduct, it also brings a wide range of benefits in terms of technical coordination, pricing efficiency and capacity to innovate. A recent *Telecommunications Policy* article entitled 'Structural separation versus vertical integration: Lessons for telecommunications from electricity reforms' finds that where it has been permitted, vertical integration in the electricity sector is rapidly re-emerging in response to failing wholesale-retail contracts between structurally separated firms and their retail providers. These failings have manifested themselves in poor wholesale price and quantity risk management, problems of adverse selection and strategic bargaining in the presence of asymmetric information and market power, forestalled investment (undermining supply insecurity) and company failures.[19]

The article also found that research into structural arrangements in the electricity sector increasingly suggests that vertical integration of wholesale and retail functions is the more natural and resilient industry structure. Indeed, vertical integration supports investment, mitigates market power and sustains retail competition. Research also highlights the (potentially destructive) role of excessive retail-level competition in undermining contracting, investment and durable retail competition.[20]

With respect to telecommunications, the article noted that while each country case needs to be considered individually, on the whole:

> Structural separation in telecommunications is likely to suffer from a number of the same key problems that complicate contracting in separated electricity sectors as well as its own industry specific problems. Furthermore, as in electricity, vertical (re-)integration in telecommunications

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18. Organisation for Economic Cooperation and Development (OECD), *OECD Economic Surveys: Australia 2010*, OECD Publishing, November 2010, Volume 2010/21, Supplement 3, p. 106, viewed 16 November 2010, http://www.oecd-ilibrary.org/economics/oecd-economic-surveys-australia-2010_eco_surveys-aus-2010-en
19. B Howell, R Meade and S O'Connor, 'Structural Separation versus vertical integration: Lessons for telecommunications from electricity reforms', *Telecommunications Policy*, vol. 34, no. 4, 2010, pp. 392-393, viewed 16 November 2010, http://www.sciencedirect.com/science?_ob=MImg&_imagekey=B6VCC-50B5WFK-1-1&_cdi=5951&_user=4962121&_pii=S0308596110000571&_origin=search&_coverDate=08%2F31%2F2010&_sk=999659992&view=c&wchp=dGLzVtz-zSkzS&md5=bbe3400b6ceca2fbdf222276c05e7beb&ie=/sdarticle.pdf
20. The consolidation of the Australian internet service provider industry through time provides possible support for the argument that excessive retail competition is not durable. Excessive retail competition through equivalent access to a single wholesale network infrastructure alone may therefore not necessarily be a desirable outcome for competition policy, based on historical experience.

> is likely to be a preferable solution to separation for resolving problems arising from asymmetric information and for sustaining retail competition.
>
> In addition, it is proposed that integration for both electricity and telecommunications is a preferable contracting solution to interventions such as regulating for contracts. Short-term static efficiency gains and some downstream dynamic efficiency gains with respect to innovation in downstream retail operations may be realised from separation, but at the expense of long-term investment, dynamic efficiency gains from innovation in and timely deployment of newer, more capable upstream network technologies and with the additional risk of inducing unsustainable retail competition.
>
> Hence while the aims of separation are sound, integration may in fact better serve their achievement. Although on-the-ground evidence at this stage is limited, it is expected that ongoing sector experience will serve to confirm these predictions. In the meantime, policy makers would well be advised to consider them as key points of concern when considering imposing structural reforms.[21]

While not identical to the Australian experience, Crandall and Sidak examined the effectiveness of structural separation of incumbent local exchange carriers in the United States in stimulating competition.[22] They found that while competitive local exchange carriers (CLECs) collectively had gained considerable market share since the passage of the *Telecommunications Act of 1996* (US), many new entrants had stumbled or failed.

Crandall and Sidak analysed, and subsequently rejected as unpersuasive, the putative benefits of mandatory structural separation, arguing that such regulatory intervention is unnecessary to prevent discrimination against unaffiliated retailers of telecommunications services. They found no evidence that mandatory structural separation would produce lower wholesale discounts (prices) or increase the CLECs' market share. In addition, they found that apart from producing no discernable benefits to consumers, mandatory structural separation would entail a substantial social cost in terms of forgone coordination of investment and production, and forgone economies of scope.[23]

OECD support for structural separation of Telstra

The November 2010 *OECD Economic Surveys Australia* states that the Government's decision to call the dominant operator's vertical integration into question is welcome, as it will stimulate competition in the digital subscriber line internet access sector, and it can be expected to yield substantial benefits, as shown by British Telecom's functional-separation experience.

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21. B Howell, R Meade and S O'Connor, op. cit., p. 393.
22. RW Crandall and JG Sidak, 'Is Structural Separation of Incumbent Local Exchange Carriers Necessary for Competition?', *Yale Journal on Regulation*, vol. 19, 2002, p. 1, viewed 16 November 2010, http://www.criterioneconomics.com/pdfs/gsidak_pdfs/Is-Structural-Separation-of-Incumbent-Local-Exchange-Carriers-Necessary-for-Competition.pdf
23. Economies of scope are achieved when the average total cost of production decreases as a result of increasing the number of different goods produced.

However, to the extent that the NBN represents a similar business model to a structurally separated Telstra, the OECD voiced concerns about potential limits to local access competition from building the NBN, and its adverse impact on the effectiveness of the broadband sector. In this regard the OECD stated that:

> The heads of agreement signed with Telstra (will) eliminate competition between the new fibre optic network and the existing technological platforms, the copper network and the country's main cable network. This implies a de facto restoration of a public monopoly over the supply of access to wholesale Internet services. Multiple empirical studies have stressed the value of competition between technological platforms for the dissemination of broadband services. Moreover, such a monopolistic incumbent could forestall the development of, as yet unknown, superior technological alternatives.[24]

Comments

It is possible that the concentrated market structure has resulted in muted competition and that the core competitive impediment is the concentrated ownership of the network infrastructure. It appears that the muted fixed-line infrastructure competition may, at least in part, be the result of access prices under the current access regime that are too low, as opposed to the ability of a vertically integrated Telstra to favour its retail operations over that of competitors, alone.

If this is the case, then structural separation alone is likely to remove the incentive for Telstra to favour it retail operations but is unlikely to result in increased incentives for infrastructure based competition by non-Telstra suppliers. This is particularly true if the current access regime is applied to any remaining fixed-line infrastructure, now, or in the future. Under this regime, competitors will have a strong incentive (via low access prices) to merely rely on the incumbent's facilities (infrastructure subject to an access regime) rather than invest in and build their own. The same issue (a lack of infrastructure competition) that has led to relatively high prices, data caps, and annual consumer complaint levels that grow on a yearly basis, may remain.

The ACCC views infrastructure based competition as the necessary prerequisite to achievement of the Government's objective of development of effective competition in the telecommunications sector. Moreover, the OECD reaffirms that multiple empirical studies have stressed the value of competition between technological platforms for the dissemination of broadband services. Development of effective competition and subsequent consumer benefits such as lower prices and technological innovation are the primary motivations of competition policy as intended by the Bill.

Basis of policy commitment

The National Broadband Network (NBN) initiative was announced on 7 April 2009. It concerned establishment of the National Broadband Network Company (NBN Co) to build and operate the new

24. OECD, op. cit., pp. 107-108.

high speed fixed-line fibre optic NBN. The NBN is tasked with the delivery of initially government funded wholesale-only, monopoly supply, of an open-access telecommunications network.

The NBN Co was tasked with implementing the Government's NBN initiative which comprised the following national outcomes:

- connection of 90 per cent of all Australian homes, schools and workplaces with broadband service speeds of up to 100 megabits per second (Mbps);
- connection of all other premises in Australia with next generation wireless and satellite technologies that will deliver broadband speeds of 12Mbps; and
- direct support of up to 25 000 local jobs every year, on average, over the 8 year life of the project.[25]

On 20 June 2010, the Government announced that it had entered into a financial heads of agreement with Telstra. Under this agreement, the structural separation of Telstra would occur via progressive migration of customer services from Telstra's copper and pay-TV cable networks, to the new wholesale-only monopoly network to be built and operated by NBN Co. The Agreement between NBN Co and Telstra, worth an expected value of $9 billion, will provide for:

- the reuse of suitable Telstra infrastructure, including pits, ducts and backhaul fibre, by NBN Co and
- the progressive migration of customers from Telstra's copper and pay-TV cable networks to the new wholesale-only fibre network to be built and operated by NBN Co.[26]

The financial heads of agreement is beneficial to the Government's NBN initiative as it prevents a vertically integrated Telstra from competing with NBN Co in the market place and therefore increases the likelihood that the NBN will be a commercially viable venture. According to the Explanatory Memorandum:

> the Bill provides the stronger legislative certainty that Telstra seeks in the transition of its business structure by setting out a clear process for Telstra to seek approval from its shareholders on a proposal for Telstra to migrate its fixed-line services to the NBN.[27]

In other words, the Bill provides a degree of certainty in Telstra taking the heads of financial agreement to a shareholder vote. A successful shareholder vote would allow for the compensatory

25. K Rudd (Prime Minister), W Swan (Treasurer), L Tanner (Minister for Finance and Deregulation) and S Conroy (Minister for Broadband, Communications and the Digital Economy), *New National Broadband Network*, media release, 7 April 2009, viewed 16 November 2010, http://www.minister.dbcde.gov.au/media/media_releases/2009/022
26. K Rudd (Prime Minister), L Tanner (Minister for Finance and Deregulation) and S Conroy (Minister for Broadband, Communications and the Digital Economy), *Agreement between NBN Co and Telstra on the rollout of the National Broadband Network*, media release, 20 June 2010, viewed 16 November 2010, http://www.minister.dbcde.gov.au/media/media_releases/2010/060
27. Explanatory Memorandum, op. cit., p. 2.

migration of its fixed-line services to the NBN, which could act to increase the return from, and therefore the commercial viability of, the NBN.

This was recognised in the November 2010 *OECD Economic Surveys Australia* report which noted that if the protocol agreement with Telstra was not implemented, an intensification of competition between fixed network platforms would probably limit the NBN take-up rate, while growing demand for mobile Internet services could also exert heightened competition.[28]

Timing of policy commitment

Telstra CFO John Stanhope has indicated that it could take until next June (2011) to bring the financial heads of agreement with NBN Co before its shareholders for a vote. In order to be beneficial to this process, the Bill would need to be passed prior to June 2011.[29]

In addition, according to Government documents obtained by *The Australian* newspaper under Freedom of Information laws, the heads of financial agreement between Telstra and NBN Co could be delayed unless the Government passes the Bill within the remaining two weeks of the spring parliamentary sittings (by 25 November 2010):

> The reintroduction and passage of the Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2009 (the Bill), incorporating the previously agreed government amendments, will drive the timing of Telstra and NBN Co being able to finalise the definitive agreements. Passage (is) required in spring 2010 sittings to enable NBN implementation to proceed.[30]

Committee consideration

The 2009 Bill was referred to the Senate Environment, Communications and the Arts Committee for inquiry and the report was released on 26 October 2009.[31]

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28. OECD, op. cit., p. 108.
29. P Wilton, 'Stanhope: Telstra aims to lock in NBN deal by June 2011', *Communications Day*, issue 3841, 23 September 2010, p. 2.
30. M Bingemann, 'Outstanding telco bill threat to deal', *The Australian*, 4 November 2010, viewed 16 November 2010, http://www.theaustralian.com.au/national-affairs/outstanding-bill-threat-to-deal/story-fn59niix-1225947503785
31. Details of the inquiry, the submissions and the final report can be found at: http://www.aph.gov.au/Senate/committee/eca_ctte/tlaccs/index.htm

Policy position of non-government parties and independents

Coalition

On 14 October 2010, *Commsday* reported that the Shadow Communications Minister, Malcolm Turnbull, had verified that the coalition would back the government's telecommunications sector reform legislation subject to key amendments being passed. These amendments are intended to remove the 'gun-to-the-head' provisions relating to spectrum determinations, ensure that the regulatory oversight applies to the NBN Co/Telstra deal and give Parliament the power to disallow Ministerial directions. They aim to also restore merit review and procedural fairness to the ACCC's enforcement of the new access pricing regime.

Malcolm Turnbull stated that the Coalition was committed to policies that were aimed at the delivery of fast, affordable broadband to all Australians but that this should be delivered in a manner that is cost-effective, promotes competition and imposes no greater cost on taxpayers than is absolutely necessary. He added that these goals would be assisted by a more competitive telecommunications industry and in that context the separation of Telstra's fixed line customer access network from its retail business would be a welcome development:

> The Coalition therefore has no objection to Telstra separating its retail and network businesses, but does not believe such a separation should occur under duress, or via a deal that is in breach of the nation's competition laws … Any restructure should be on terms which are fair to Telstra shareholders.[32]

The Shadow Communications Minister proposes a regulatory environment where the separated network company would be given regulatory certainty and the knowledge that as a regulated utility it would be able to charge prices aimed at delivering a reasonable rate of return on its assets, noting that this is the regime that is applied to other utilities such as gas, electricity and water.[33]

Senator Steve Fielding, Senator Nick Xenophon and the Australian Greens

On Friday 5 November 2010 it was reported in the *Australian Financial Review* that Family First Senator Steve Fielding recently dropped his criticism that the reform bill would 'put a gun to Telstra's head' by forcing the company to divide its wholesale and retail operations, a concern that was crucial to his delaying of the changes last year. The change in position came after Senator Fielding met with Telstra chief executive David Thodey to gain an assurance that the company was

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32. M Sandev, 'Coalition shifts ground on Telstra separation, agrees to back telco reform with amendments', *Communications Day*, issue 3865, 28 October 2010, p. 2.
33. ibid.

comfortable with the Bill. The same article reported that the Australian Greens and South Australian independent Senator Nick Xenophon support the overall aim of the Bill.[34]

Financial implications

According to the Explanatory Memorandum, the reforms which are contained in the Bill

> will have a moderate financial impact on administration costs for the ACCC and the ACMA, which will be funded by increasing the carrier licence charges levied by the ACMA under the *Telecommunications (Carrier Licence Charges) Act 1997*.[35]

Main issues

Structural separation

As discussed in the Background section, if the goal of the Bill is to remove the ability of Telstra to favour it retail operations, the Bill is likely to succeed. However, if the purpose of the Bill is to increase the incentives for infrastructure based competition, and subsequently increase the associated benefits to consumers of lower prices and technological innovation, as per the mobile telecommunications experience, then international experience and economic literature indicates such outcomes may not be realised, nor assisted through implementation of this Bill alone. This is particularly true if the access regime has indeed resulted in a strong disincentive to invest in infrastructure through low access prices to the existing fixed-line infrastructure.

ACCC oversight

Criticisms have been raised in relation to those parts of the Bill which enable the Australian Competition and Consumer Commission (ACCC) to allow the heads of financial agreement to proceed. It is possible that under the *Trade Practices Act 1974* (TPA), such an agreement could be disallowed. Specifically, where Telstra provides undertakings to structurally separate,[36] divest its hybrid fibre coaxial (HFC) cable network and divest its interests in Foxtel.[37]

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34. D Crowe, 'Telstra tells Fielding its happy with the NBN', *The Australian Financial Review*, 5 November 2010, p. 16, viewed 16 November 2010, http://parlinfo.aph.gov.au/parlInfo/download/media/pressclp/336506/upload_binary/336506.pdf;fileType=application%2Fpdf#search=%22Competition%20and%20Consumer%20Safeguards%

35. Explanatory Memorandum, op. cit., p. 8.

36. **Proposed subsection 577A(1)** allows the ACCC to accept a written undertaking given by Telstra regarding structural separation. Structural separation is regarded, under **proposed paragraph 577A(1)(a)**, as Telstra, at all times after the designated day, ceasing to supply fixed-line carriage services to retail customers in Australia using a telecommunications network over which Telstra is in a position to exercise control. Additionally, structural

Where such undertakings are accepted by the ACCC, the Minister would not proceed to make a legislative instrument (a spectrum determination) that would prevent Telstra from acquiring specified bands of spectrum, which could be used for advanced wireless broadband services.

The Bill facilitates at least two significant outcomes. First, the threat of a spectrum determination preventing Telstra from acquiring bands of spectrum for advanced wireless broadband services should it not provide an undertaking, that is accepted by the ACCC, to structurally separate and divest its HFC cable network and its interests in Foxtel. Secondly, it allows the ACCC to accept such an undertaking which is currently likely to be in contravention of the TPA.

Were the ACCC to accept such an undertaking and that undertaking to be performed, Telstra would effectively be compensated by the taxpayer in order to make redundant, existing operational network infrastructure (copper-line network subscribers and HFC cable network for internet subscribers), and thus limiting the infrastructure choices available to retailers and ultimately consumers. This would act to improve the commercial viability of the NBN but simultaneously move the telecommunications sector in the direction of the identified core impediment to competition, namely, the concentrated ownership of the network infrastructure.

The OECD warns against such action. It states that the Government:

> should not trigger a weakening of competition in wholesale broadband services to protect the viability of the government project. An alternative to this picking-the-winner strategy would be to let the market guide choices between the various Internet service options on the basis of prices that reflect costs, factoring in externalities that ought first to be evaluated. To that end, it would be desirable to maintain competition between technologies and, within each technology, between Internet service providers. This would be consistent with the planned vertical separation of Telstra and with other aspects of the reform that seek to promote competition.[38]

While the OECD states that maintaining competition between technologies is consistent with the vertical separation of Telstra, the vertical separation of Telstra and subsequent divestiture of its fixed-line copper and HFC cable networks' subscribers, with a view to nation-wide, fixed-line optic-fibre telecommunications infrastructure (outside of the approximately seven percent of premises in Australia with next generation wireless and satellite technology connections) is not consistent with competition between access technologies. This approach is identified by the OECD as a 'picking-the-winner strategy'.

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separation requires Telstra to ensure that a company over which Telstra is in a position to exercise control will not supply fixed-line carriage services to retail customers in Australia using such a telecommunications network after the designated day.

37. Explanatory Memorandum, Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010, p. 89.

38. OECD, op. cit., p. 109.

Any consequences of failure to pass

Should the Bill fail to pass, the probability that the financial heads of agreement will fail a Telstra shareholder vote is increased. Failure for Telstra to successfully put the financial heads of agreement to a shareholder vote will mean that the NBN would then have to compete with a vertically integrated Telstra and this would increase the probability that the NBN fails to operate as a commercially viable entity, that is, to operate on a commercial basis.

Key provisions

Part 1—amendments relating to Telstra

Structural separation

Item 30 of the Bill inserts **proposed Part 33** into the *Telecommunications Act 1997* (Telecommunications Act). Under this Part, Telstra has the 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)
- an undertaking about its hybrid fibre-coaxial networks,[39] and
- an undertaking to divest itself of its subscription television broadcasting licences—that is, its 50 percent interest in Foxtel.

Proposed subsection 577A(1) provides that the Australian Competition and Consumer Commission (ACCC) may accept written undertakings from Telstra about structural separation. This is expressed in terms of Telstra agreeing:

- not to supply fixed line carriage services to retain customers in Australia using a telecommunications network over which it exercises control and
- not exercising control of a company that supplies fixed-line carriage services to retail customers in Australia using a telecommunications network over which it exercises control.

The written undertaking is to take effect from a 'designated day', being 1 July 2018 or another day specified by the Minister: **proposed subsection 577A(10)**.

39. **Item 11** of the Bill inserts the definition of ***'hybrid fibre-coaxial network'*** into section 7 of the Telecommunications Act as a telecommunications network that is for use for the transmission of any broadcasting service, that is also capable of being used to supply an internet carriage service and the line component of which consists of optical fibre to connecting nodes, supplemented by coaxial cable connections from the nodes to the premises of end-users.

Proposed subsection 577A(6) empowers the Minister to set out in a written instrument matters to which, amongst other things, the ACCC must have regard in deciding whether to accept an undertaking from Telstra. Telstra is not entitled under **proposed subsection 577A(9)** to give an undertaking about its structural separation unless the Minister's instrument is in force. The ACCC must not accept an undertaking unless it is satisfied the undertaking provides for 'equivalence'[40] in relation to the supply by Telstra of services to its wholesale customers and its retail business units. The undertaking must also provide for monitoring of Telstra's compliance by the ACCC: **proposed subsection 577A(5)**.

Proposed section 577BC provides for Telstra to give a ***'migration plan'*** to the ACCC either as part of, or separate to, the written undertaking about structural separation. The migration plan (either in draft or final form) must set out first, the action to be taken by Telstra to cease to supply fixed-line carriage services to customers and secondly, the action to commence to supply fixed-line carriage services to customers using the national broadband network. **Proposed subsection 577BB(1)** allows the Minister to make a determination (which is not a legislative instrument)[41] about the migration plan principles for the purpose of the Act.

Proposed sections 577BDA–577BDC set out the conditions under which the ACCC may accept a draft migration plan.

The second undertaking which the ACCC may accept from Telstra is that it will not be in a position to exercise control of a hybrid fibre-coaxial network in Australia: **proposed section 577C**. Telstra must comply with the terms of this, and every other, undertaking set out in the Bill if it is accepted and in force: **proposed section 577CD**.

The third undertaking which the ACCC may accept from Telstra is that it will not be in a position to exercise control of a subscription television broadcasting licence: **proposed section 577E**. According to the Explanatory Memorandum, 'under such an undertaking, it is envisaged Telstra would no longer be able to actively participate in the subscription television market'.[42]

Where the ACCC considers that Telstra has breached an undertaking given under proposed sections 577A, 577C or 577E, the ACCC may apply to the Federal Court for an order. The types of order which the Court may make are listing in **proposed subsection 577G(2)**.

The Minister May, by legislative instrument, determine that the 'excluded spectrum regime' applies to Telstra. If the Minister does so, Telstra will not be allowed to supply services using a designated

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40. ***'Equivalence'*** means equivalence in terms and conditions relating to price, or the method of ascertaining price, and in other terms and conditions.
41. **Proposed subsection 577BB(4)** of the Bill.
42. Explanatory Memorandum, op. cit., p. 112.

part of the spectrum unless all three undertakings given by Telstra are in force.[43] This designated spectrum is assumed to be essential to its mobile broadband business.[44]

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

Functional separation

Item 31 inserts **proposed Part 9** into Schedule 1 of the Telecommunications Act which sets out the standard carrier licence conditions.[45]

The Minister may make a written determination requiring Telstra to prepare a draft functional separation undertaking **unless** a structural separation undertaking is in force under proposed section 577A.[46] A functional separation undertaking must comply with the 'functional separation principles' which are set out in **proposed clause 74**. If the Minister does make such a determination, a draft functional separation undertaking will come into force within 90 days of commencement (that is, the later of either the day after Royal Assent or immediately after the commencement of the Competition and Consumer Act 2010). The Minister may extend the time limit for the functional separation undertaking as long as the time does not exceed 18 months.[47] **Proposed clause 73** sets out those matters which must be included in a function separation undertaking. In particular the undertaking must contain provisions requiring Telstra to establish and maintain an Oversight and Equivalence Board.

If Telstra gives the Minister a draft functional separation undertaking, the Minister can approve it, vary it or replace it.[48] Before the Minister makes such a determination, the Minister *must* invite, and consider submissions from, the public and seek and have regard to the advice of the ACCC: **proposed subclause 77(3)**. Before the Minister varies or replaces the draft undertaking, the Minister *must* specifically invite and consider submissions from Telstra: **proposed subclause 77(4)**.

Once a functional separation undertaking becomes final, Telstra must comply with it, unless there is a structural separation undertaking in force.[49] **Item 51** of the Bill inserts **proposed section 105B** into the Telecommunications Act to provide that the ACCC must monitor and report each financial year to the Minister on the compliance by Telstra with a final functional separation undertaking.

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43. **Proposed section 577** of the Bill.
44. 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 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 or it and **proposed clause 85** of Schedule 2 prohibits Telstra from supplying a carriage service under a licence.
45. Because Schedule 1 of the Telecommunications Act will be amended by the **proposed Part 9**, the provisions are referred to as clauses, rather than sections.
46. **Proposed clause 75** of the Bill.
47. **Proposed subclause 75(5B)** of the Bill.
48. **Proposed clause 77** of the Bill.
49. **Proposed clause 82** of the Bill.

Importantly **items 57–59** of the Bill amend the Competition and Consumer Act 2010 (CCA)[50] to repeal and substitute Division 14 of Part XIB. The amendment will operate if there is a final functional separation undertaking in force. In that case, the effect of the amendment is that the ACCC must not exercise any power under Part XIB which would prevent Telstra from complying with the undertaking.

Part 2—telecommunications access regime

Part 2 of the Bill makes amendments to the telecommunications access regime which is contained in Part XIC of the CCA. The amendments to the Telecommunications Act and the *National Transmission Network Sales Act 1998* are consequential amendments.

Existing Part XIC allows the ACCC to declare services, with the consequence that the provider of the declared service must provide access on agreed terms, or if no agreement can be reached, terms arbitrated by the ACCC. Where a service is declared the ACCC determines pricing principles relating to that service, to which the ACCC must have regard when arbitrating an access dispute.[51] The Bill abolishes this 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 160 of the Bill repeals and substitutes Division 4 of Part XIC. **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. **Proposed sections 152BC–152BCD** deal with the content of access determinations. An access determination must specify an expiry date.[52]

Proposed section **152BCG** allows the ACCC to make an interim access determination. **Proposed sections 152BCH–152BCK** set out the processes for holding a public inquiry which must be followed prior to making an access determination. **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**.

Item 161 of the Bill repeals existing Subdivision A of Division 5 of the TPA[53] which provides for ordinary access undertakings. Access providers will no longer be able to give undertakings for active

50. The *Trade Practices Act 1974* will be renamed the *Competition and Consumer Act 2010* with effect from 1 January 2011.
51. R Miller, *Miller's Annotated Trade Practices Act*, 31st Edition, Lawbook Co., Pyrmont, 2010, p. 1349.
52. **Proposed subsection 152BCF(5**).
53. That is, sections 152BS–152CB of the Trade Practices Act.

declared services. Rather, access providers will only be able to give ***'special access undertakings'***. Existing section 153CBA defines a ***'special access undertaking'*** as being a written undertaking, given to the ACCC about the provision of access to a service, as long as the service is not a declared service.[54] Importantly a special access undertaking will prevail over any inconsistent ordinary access determinations or binding rules of conduct.[55]

Currently, certain decisions of the ACCC are subject to merits review in the Australian Competition Tribunal (the Tribunal). **Item 185** of this Bill repeals existing Division 8 of Part XIC of the Trade Practices Act—effectively abolishing merits review for certain decisions of the ACCC. However, the amendment does not take away any rights to judicial review under the *Administrative Decisions (Judicial Review) Act 1977*. **Item 186** is a consequential amendment which repeals Division 9 of Part XIC of the Trade Practices Act.

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 152** 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 177** repeals sections 152CE, 152CF, 152CG and 152CGA, which relate to these decisions.

Part 3—anti-competitive conduct

There are no substantive differences between the provisions in Part 3 of this Bill and those contained in Part 3 of the 2009 Bill. Essentially the Bill removes the requirement for the ACCC to undertake consultation before issuing a Part A competition notice. **Item 212** repeals existing subsections 151AKA(9) and (10) which require that the ACCC consult before issuing a Part A notice. **Proposed subsection 151AKA(9)** is inserted to provide that the ACCC is not required to observe the requirements of procedural fairness in issuing a Part A competition notice. The effect of this amendment is to deny an 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.

54. **Items 162–165** of the Bill make the necessary amendments to section 153CBA of the Trade Practices Act.
55. **Item 174** of the Bill inserts **proposed sections 152CBIA–152CBIB** of the Trade Practices Act to this effect.

Part 4—universal service regime

There are no substantive differences between the provisions in Part 4 of this Bill and those contained in Part 4 of the 2009 Bill. This part of the Bill amends the *Telecommunications (Consumer Protection and Service Standards) Act* (the Consumer Protection Act) which establishes a universal service regime (USO) to ensure that all people in Australia, wherever they reside or carry on business, have reasonable access, on an equitable basis, to standard telephone services, payphones, and prescribed carriage services.

Existing section 12C of the Consumer Protection Act requires a primary universal service provider to take all reasonable steps to, amongst other things, fulfil that service obligation. **Item 224** of the Bill deletes the phrase 'take all reasonable steps', to clarify that a service provider must comply strictly with service obligations.

Item 225 of the Bill inserts **proposed Subdivisions BA and BB** of Division 5 of Part 2 of the Consumer Protection Act. The amendment will insert **proposed sections 12EB-12EI**. **Proposed sections 12EB** and **12EC** authorise the Minister to make a written determination setting out performance standards and performance benchmarks for the universal service provider in relation to a standard telephone service to a customer. Similarly, **proposed sections 12ED** and **12EE** authorise the Minister to make a written determination setting out performance standards and performance benchmarks for payphone services. These written determinations are legislative instruments.[56]

Proposed section 12EF authorises the Minister to make a written determination setting out rules to be complied with by a USO in relation to the places or areas in which payphones are to be located. Such a determination is a legislative instrument.[57] There are 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 USO not to remove payphones in circumstances where the removal would breach a determination under proposed section 12EF, or the USO has breached a determination under section 12EG in relation to the removal.[58]

In addition to the amendments outlined above, **item 217** inserts **proposed section 6A** into the Consumer Protection Act to prevent the universal service provider from attempting to satisfy the universal service 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.

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56. **Proposed subsections 12EB(7), 12EC(5), 12ED(6)** and **12EE(5)** of the Consumer Protection Act.
57. **Proposed subsection 12EF(5)** of the Consumer Protection Act.
58. Under **proposed section 12EI** of the Consumer Protection Act a person adversely affected by a proposed payphone removal will be able to request the ACMA to issue one of a number of directions to the universal service provider, including that the payphone not be removed or that the payphone be reinstalled within a specified period.

Part 5—customer service guarantee

Existing Part 5 of the Consumer Protection Act contains the ***'customer service guarantee'***, so that where a carriage service provider contravenes a performance standard which has been set by the ACMA, the carriage service provider is liable to pay damages to the customer for that contravention. In that case, the amount of damages payable is calculated in accordance with a scale of damages determined by the ACMA.

The amendments proposed in Part 5 of the Bill will allow for performance standards and minimum benchmarks to be set for both wholesale and retail customers.[59] The retail performance standards and benchmarks are contained in **proposed sections 117B** and **117C**, whilst the wholesale performance standards and benchmarks are contained in **proposed sections 117D** and **117E**. These provisions will deal with a situation in which, for example, Optus is the retail provider of the phone service but Telstra is the wholesale provider of that service. In that case, the primary obligation may rest on Optus, but the satisfaction of it may depend on Telstra.

Existing section 120 of the Consumer Protection Act provides that a customer of a carriage service provider may waive, in whole or in part, their protection and rights under the customer service guarantee. **Item 235** repeals existing subsection 120(4) and inserts **proposed subsections 120(4)–(8)** which require that the customer's express agreement will be required before a provider may treat them as having waived their customer service guarantee rights. That waiver of rights must include a statement that summarises the consequences of the customer waiving the customer service guarantee. The Bill makes explicit that the customer service guarantee cannot be waived for a telephone service that is supplied in fulfilment of the universal service obligation.[60]

Part 5A—record-keeping rules

There was no proposed Part 5A in the 2009 Bill. This Part amends Part 27 the Telecommunications Act which concerns the ACMA's information gathering powers, and enables the ACMA to make record-keeping rules that apply to carriers and carriage service providers. The insertion of **proposed subsections 529(2A)–(2F)** of the Telecommunications Act will broaden the scope of existing section 529 expand the power to make record-keeping rules.

Part 6—priority assistance

There are no substantive differences between the provisions in Part 6 of this Bill and those contained in Part 6 of the 2009 Bill.

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59. **Item 229** inserts **proposed section 114A** into the Consumer Protection Act to define the terms ***'wholesale carriage service'*** and ***'wholesale customer'***.
60. **Proposed subsection 120(7)** of the Consumer Protection Act.

Item 245 of Part 6 of this Bill inserts **proposed Part 6** into Schedule 2 of the Telecommunications Act which contains the 'standard service provider rules'.

New Part 6 inserts an additional standard service provider rule—the provision of priority assistance for people with life-threatening medical conditions. Under the new Part, a carriage service provider must comply with the priority assistance code which is entitled Priority Assistance for Life Threatening Medical Conditions—or if that code is replace by another code—the replacement code.[61] Where a carriage service provider does not offer priority assistance, it must inform customers of the names of alternative providers from whom they can purchase such a service if they require it.[62]

Part 7—infringement notices

New Part 31B is inserted into the Telecommunications Act by **item 249** 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.

Proposed subsection 572F provides that the penalty amount specified in an infringement notice given to a corporation cannot exceed 60 penalty units[63] or $6 600. However, the Minister may determine different amounts for different kinds of 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 $10m are possible.

The remainder of proposed Part 31B is concerned with technical matters such as the content of infringement notices,[64] the avoidance of double counting where a single contravention amounts to breaches of more than two provisions,[65] the effect of the withdrawal of infringement notices,[66] and the appointment of 'authorised infringement officers'.[67]

Part 8—civil penalty provisions

Part 8 of the Bill makes clarifying amendments to the definition of ***'civil penalty provision'*** in section 7 of the Telecommunications Act. Currently, the definition lists all the provisions that

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61. Australian Communications Industry Forum, 'Priority Assistance for Life Threatening Medical Conditions', *Industry Code ACIF C609:2007*, Communications Alliance Ltd, 2003, viewed 15 November 2010: http://www.acma.gov.au/webwr/telcomm/industry_codes/codes/c609_2007_priority_assistance.pdf
62. **Proposed subclause 19(2)** of Part 6 of Schedule 2 to the Telecommunications Act.
63. According to section 4AA of the *Crimes Act 1914*, a penalty unit is equivalent to $110.
64. **Proposed section 572F** of the Telecommunications Act.
65. **Proposed section 572E** of the Telecommunications Act.
66. **Proposed section 572H** of the Telecommunications Act.
67. **Proposed section 572L** of the Telecommunications Act.

are civil penalty provisions. Under the proposed amendment, the new definition of ***'civil penalty provision'*** is any provision that is declared to be one in either the Telecommunications Act or the Consumer Protection Act.

Part 9—industry standards

There was no Part 9 in the 2009 Bill. Part 6 of the Telecommunications Act currently provides that the ACMA may determine an industry standard in certain circumstances. Item 253 of the Bill inserts proposed section 125AA to broaden the circumstances in which the ACMA may determine an industry standard. Under the proposed section the Minister can direct the ACMA to determine an industry standard that applies to participants in a specified section of the telecommunications industry and which deals with one or more specified matters relating to the telecommunications activities of those participants.

Appendix

Structural separation

Structural separation attempts to divide the competitive and monopoly bottleneck activities of the incumbent to restrict the incumbent from leveraging its market power from one market to another. Structural separation can occur at the vertical or horizontal level:

- Vertical separation — this refers to splitting wholesale and retail businesses of the incumbent. Separation of wholesale and retail parts of the incumbent means that it is easier to ensure that the wholesale business does not discriminate against retail competitors, and that it concentrates on attracting retail businesses on its network and
- Horizontal separation — this refers to the incumbent selling some or all of its ownership in a line of business to independent parties. Horizontal separation can lead directly to increased competition (for example, by allowing networks to compete against each other and by stopping the incumbent leveraging its market power in one line of business to another).[68]

68. The Allen Consulting Group, *Structural separation of Telstra — why it is needed, and what can be done*, Report to Competition Carriers Coalition, The Allen Consulting Group, 14 December 2006, p. 11, viewed 16 November 2010, http://www.dbcde.gov.au/__data/assets/pdf_file/0009/71757/5._CCC_Allen_report_270607.pdf

Functional, operational and accounting separation

The various models of functional, accounting 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. While separation of this kind may place some practical constraints on cross subsidisation, and facilitate regulation of the natural monopoly element, it will not be sufficient to remove potential incentives to misuse control over access to a vertically integrated element.[69]

Functional and operational separation models involve the imposition of conditions that are intended to mimic structural separation in its absence. 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 arm's 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. Functional separation allows the operator to continue to enjoy at least some of the benefits of vertical integration.[70]

69. Hilmer, Raynor, Taperell, op. cit.
70. Australia, Parliamentary Library, *Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2009*, Bills digest, no. 63, 2009-10, Parliamentary Library, Canberra, 2008, p. 9, viewed 16 November 2010, http://www.aph.gov.au/library/pubs/bd/2009-10/10bd063.pdf

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