

## Chapter 2

### The Operational Separation of Telstra

Operational separation is simply designed to produce some transparency in the dealings between Telstra's wholesale division and its retail businesses, and then to ensure that there is some equivalence of dealing in those dealings between its wholesale and retail businesses and Telstra's other wholesale customers.

... the law has always said to Telstra you shall not behave anti-competitively, it is recognised that Telstra has a dominant position in telecommunications and a monopoly over the fixed line network .... All that this operational separation is designed to do is to make it easier for Telstra and for the ACCC to determine whether or not Telstra is behaving anti-competitively.<sup>1</sup>

2.1 The Explanatory Memorandum of the Competition and Consumer Issues Bill acknowledges the dominant market position of Telstra, and the need for its competitors to be able to access and interconnect with infrastructure owned by Telstra. The Explanatory Memorandum states that:

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.

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.<sup>2</sup>

2.2 The Competitive Carriers Coalition (CCC) submitted:

Telstra continues to be vertically integrated such that it owns and controls the monopoly bottleneck elements of the network, most importantly the customer access network. It is also the most horizontally integrated telecommunications company in the world, according to the ACCC.

Telstra's integration creates a powerful incentive and the ability for it to leverage the market power it derives from this monopoly asset ownership in such a way as to disadvantage competitors in retail markets.<sup>3</sup>

2.3 In the interests of enhancing competition in the telecommunications sector, the Government is determined to remedy this situation by ensuring that Telstra's competitors are treated fairly and transparently in comparison with Telstra's retail

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1 Mr Graeme Samuel, ACCC, *Committee Hansard*, 9 September 2005, p. 4.

2 *Telecommunications Legislation Amendment (Competition and Consumers Issues) Bill 2005, Explanatory Memorandum*, p. 2.

3 Competitive Carriers Coalition, *Submission 6*, p. 3.

business units. As the Minister set out in her statement to the Senate, *Telecommunications for the Future*:

A major plank of the Government's competition reforms is a requirement on Telstra to introduce operational separation. The objective of operational separation is to provide equivalence and transparency to Telstra's wholesale customers. It is designed to fit within Australia's existing regulatory framework and to fit with Telstra's business arrangements.

Operational separation will ensure and demonstrate that Telstra treats its wholesale customers fairly. The new arrangements include internal wholesale pricing mechanisms for Telstra which will ensure its retail businesses receive no more favourable treatment than its wholesale customers.<sup>4</sup>

2.4 Schedule 11 of the Competition and Consumer Issues Bill provides the framework under which the details of operational separation will be agreed and implemented by Telstra. The Bill sets out the aim and objectives of operational separation to which Telstra must give effect.

The aim of operational separation is to promote the principles of transparency and equivalence in relation to the supply by Telstra of wholesale and retail services. To achieve this, the Bill requires that Telstra must prepare and comply with an operational separation plan. The plan must be directed towards achieving this aim and a series of stated objectives. The draft operational separation plan must be approved by the Minister before it becomes a final operational separation plan. If Telstra contravenes a final operational separation plan the Minister can require it to prepare a rectification plan. Breach of a rectification plan would be a breach of Telstra's carrier licence, and would enable enforcement action by the ACCC.<sup>5</sup>

2.5 Proposed section 54 of the *Telecommunications Act* gives the Minister the power to determine:

- the matters that must be addressed in an operational separation plan; and
- which services must be covered by operational separation.

2.6 Whilst the details will be finalised following consultation, there are key elements of the plan that the Government has insisted must be part of operational separation:

- Telstra must provide equivalent standards of service to its retail business units and its wholesale business units;

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4 Senator the Hon Helen Coonan, Minister for Communications, Information Technology and the Arts, *Telecommunications for the Future*, 8 September 2005, p. 6.

5 *Telecommunications Legislation Amendment (Competition and Consumers Issues) Bill 2005*, Explanatory Memorandum, p. 3.

- the services covered must include all the essential services relied upon by the company's competitors including the unconditional local loop, wholesale ADSL, and local call resale;
- Telstra must develop contractual arrangements for the supply of services from Telstra's network business units to Telstra's retail and wholesale business units;
- separate business units must have separate staff incentive programs, separate premises, and secure information systems; and
- Telstra is required to establish a Director of Equivalence to monitor and report to the Board on Telstra's performance against its operational separation obligations.

### **Comments on operational separation**

2.7 Telstra representatives expressed concern over the operational separation provisions of the Bill. Ms Kate McKenzie, Managing Director, Regulatory, Telstra, told the Committee:

The operational separation provisions in particular are complex, costly and uncertain—and anything that increases systemic costs decreases shareholder value ... We support the sale bill. We certainly do not support the operational separation provisions; we think there are some major difficulties with them.<sup>6</sup>

2.8 However, this position was not widely supported, with most witnesses supporting enhanced transparency between Telstra's wholesale and retail units. Mr Tom Amos from ATUG said:

ATUG supports the introduction of operational separation of Telstra. Operational separation in telecommunications has significant benefits for the industry and end users. ATUG believes operational separation is a positive step for better end-user services when it forms part of the further sale process of Telstra and when combined with the appropriate telecommunications policy and regulatory framework.<sup>7</sup>

2.9 The ACCC told the Committee that while it 'welcomes changes which would increase transparency and equivalence in the way Telstra provides key access services to its own downstream operations relative to those of its competitors',<sup>8</sup> there were some process issues which may merit further examination to ensure that the model reflected the Government's intention to have a robust set of equivalence obligations.

2.10 Similarly, Mr Paul Fletcher from Optus said:

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6 Ms Kate McKenzie, Telstra, *Committee Hansard*, 9 September 2005, p. 66; p. 72.

7 Mr Tom Amos, ATUG, *Committee Hansard*, 9 September 2005, p. 24.

8 Mr Graeme Samuel, ACCC, *Committee Hansard*, 9 September 2005, p. 4.

We consider that there is a lot of potential in the operational separation measures in this legislation, but the government, we believe, needs to do some more work to ensure that its policy intentions are realised.<sup>9</sup>

2.11 Mr Havyatt from AAPT claimed that the ACCC did not support the operational separation model outlined in the legislation:

I do not know if everyone else in this room understands regulatory language in the way I do, but I heard Graeme Samuel today in this room say 'the ACCC does not support these amendments'. For him to have answered in the way that he did makes it abundantly clear, to me at least, that the ACCC does not support these amendments.<sup>10</sup>

2.12 The Committee notes that Mr Samuel did not say this and believes that Mr Havyatt misrepresented what Mr Samuel said. What Mr Samuel did say was that:

The Government's proposed model for the operational separation of Telstra maintains the balanced approach of the existing regulatory regime. The proposal recognises that Telstra is in the unique position, through its monopoly over the local access network, of being able to stifle competition and innovation by frustrating its competitors investment plans. For this reason, the ACCC welcomes changes which would increase transparency and equivalence in the way Telstra provides key access services to its own downstream operations relative to those of its competitors.<sup>11</sup>

2.13 Furthermore, Mr Willett from the ACCC said that:

The bottom line is that, subject to the resolution of the issues that Mr Samuel referred to, the ACCC believes this model can lead to an appropriate set of operation rules.<sup>12</sup>

2.14 Mr Samuel outlined five principal issues, which in the ACCC's opinion 'require further examination as the operational separation plan is developed by Telstra and government':<sup>13</sup>

- the precise details of the operational separation plan and Telstra's obligations in relation to that plan;
- the scope of services that will be subject to the operational separation plan;
- the enforcement regime associated with compliance or, more importantly, non-compliance with the operational separation plan;
- the powers to investigate whether or not compliance has occurred; and

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9 Mr Paul Fletcher, Optus, *Committee Hansard*, 9 September 2005, p. 32.

10 *Committee Hansard*, 9 September 2005, pp 25-26.

11 *Committee Hansard*, 9 September 2005, p. 4.

12 *Committee Hansard*, 9 September 2005, p. 9.

13 *Committee Hansard*, 9 September 2005, p. 6.

- the development by the working party proposed—that is, the working party of Telstra, the ACCC and the department—of the internal wholesale pricing and the pricing equivalence regime.<sup>14</sup>

2.15 Several other witnesses also raised these issues during the hearing. Each of these issues is discussed in turn below.

### ***Details of the operational separation plan***

2.16 While the majority of witnesses supported the Government's proposal of operational separation, many were concerned that the Bill did not specify how operational separation should occur and that Telstra itself would primarily be responsible for the development of this plan.<sup>15</sup>

2.17 Proposed sections 51-58 provide for the process of preparation of the operational separation plan. Proposed section 51 deals with the contents of a draft or final operational separation plan. Under proposed section 52, it would be a condition of Telstra's licence that it provide a draft operational separation plan to the Minister within a certain timeframe. The draft operational separation plan must be approved by the Minister before it becomes a final operational separation plan (proposed sections 54-56).

2.18 Proposed section 53 requires Telstra to undertake a public consultation process in relation to a draft operational separation plan. In particular, it requires Telstra to publish a notice in newspapers in each state and territory inviting comments on the draft plan within 30 days. Telstra would also be obliged to make a copy of the plan available on its website. Under proposed subsection 53(2), when giving a draft operational separation plan to the Minister, Telstra would need to give the Minister a copy of any comments it has received in relation to the draft plan.<sup>16</sup>

2.19 Despite these requirements, the CCC submitted:

The Bill places responsibility for the development of an operational separation plan primarily with Telstra. The CCC does not believe that Telstra can be expected to present a proposal that would be credible in circumstances where it has indicated that it plans to wind back its wholesale activities. Further, the CCC understands that those wishing to comment on the Telstra proposal would be required to provide its comments to Telstra, and that Telstra would be responsible for considering the comments and taking them into account in its final draft.

The CCC submits that it is fanciful to believe that Telstra would give proper regard to the comments of competitors. Further, there is no formal

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14 Mr Graeme Samuel, ACCC, *Committee Hansard*, 9 September 2005, p. 4.

15 Consumers' Telecommunications Network, *Submission 5*, p. 3.

16 *Explanatory Memorandum*, p. 90. Note that there are also requirements for public consultation on any variations of the final operational separation plan (proposed section 57).

mechanism whereby those submitting comments to the Telstra plan can present those comments to the ACCC and the Minister and be sure that they will receive proper consideration and that valid criticisms of the Telstra plan contained therein will be incorporated in changes required by the Minister.<sup>17</sup>

2.20 Similarly, Optus in its submission argued that the arrangements gave too much discretion to, and relied too heavily on, the co-operation of Telstra.<sup>18</sup>

Telstra gets to prepare the operational separation plan, which gives it a huge opportunity to white-ant and undermine what is intended in the legislation.<sup>19</sup>

2.21 While the detail is not set out in the legislation, the Explanatory Memorandum to the Bill does provide significant guidance on what the Government considers would be necessary in an operational separation plan to effectively meet the objectives of the legislation.

2.22 Further, the ACCC, appearing before the Committee, agreed that it would not expect the legislation itself to contain the precise details of a draft operational separation plan.<sup>20</sup>

### ***Designated services***

2.23 The Government has recognised that there are services that have not been declared, but which need to be embraced by the operational separation framework - both on price and non-price terms and conditions - in the interests of effective competition.<sup>21</sup> Proposed section 50A defines a ‘designated service’ for the purposes of proposed Part 8. Designated services are referred to in the objects of proposed Part 8 (in proposed paragraph 48(2)(a)).

2.24 A ‘designated service’ is defined as an eligible service that is specified by the Minister in a written determination under proposed subsection 50A(1). A designated service is a new category of service and is a subset of eligible telecommunication services. The Minister will determine an initial list of designated services. The Explanatory Memorandum suggest the following services should be included:

- unbundled local loop services;
- local carriage service;
- line sharing service;

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17 Competitive Carriers Coalition, *Submission 6*, p. 6.

18 Optus, *Submission 16*, p. 3.

19 Mr Paul Fletcher, Optus, *Committee Hansard*, 9 September 2005, p. 32.

20 *Committee Hansard*, 9 September 2005, p. 9.

21 Competitive Carriers Coalition, *Submission 6*, p. 4.

- wholesale ADSL (layer 2);
- public switched telecommunications network service originating service; and
- public switched telecommunications network service terminating service.<sup>22</sup>

2.25 Optus noted that these services all relate to residential services and that the proposed list of services should be extended to include access services to small business and corporate markets. As competitors rely on Telstra's infrastructure to enable them to provide end-to-end services in the business segment, Optus argued that additional services that should be included are:

- Access Transmission Leases which are declared;
- Business Grade DSL; and
- Data Access Radial (DAR).<sup>23</sup>

2.26 A representative from DCITA explained:

I think we have an indication of some products in the explanatory memorandum, but we have not finally settled that list yet. The reason for that is that, in terms of the designated services, which are the services you are talking about, we have a focus on those key wholesale services that wholesale customers particularly rely on to compete effectively with Telstra. At the same time, we want to identify the retail services that are provided by Telstra's retail business unit to correspond to those wholesale services. While we have some initial ideas on that, Mr Fletcher from Optus stressed quite strongly that we have to have a very detailed matching process to make sure that we have those comparisons right and that we have got the proper wholesale and retail services that will enable an effective comparison and effective performance measures to be put in place.<sup>24</sup>

2.27 The CCC noted that the legislation does not allow for the Minister to designate new services, that are regulated by the ACCC through actions to ensure compliance with the competition rule. Rather, the CCC argued it allows Telstra to be provided with an 'effective veto on the Minister by requiring the Minister to seek and receive the written consent of Telstra'.<sup>25</sup> Mr David Havyatt from AAPT told the Committee:

But the real concern is what happens after the first list, because after the first time the minister lists the designated services the provisions of the bill are that only active declared services can be designated by the minister, unless Telstra agrees. So, if Telstra were to introduce a new service—such as a higher speed ADSL service that they actually were even going to provide in the wholesale market but did not want to have the regulatory

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22 Optus, *Submission 16*, pp 4-5.

23 Optus, *Submission 16*, pp 4-5.

24 Mr Simon Bryant, DCITA, *Committee Hansard*, 9 September 2005, p. 103.

25 Competitive Carriers Coalition, *Submission 6*, p. 4.

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regime applied to—they could just say to the minister, ‘No, it is not going to be a designated service.’<sup>26</sup>

2.28 The CCC submitted that the Minister should be able to act on the advice of the ACCC to add new services to the list of designated services,<sup>27</sup> and suggested that this a matter the Government may wish to give consideration to.

### ***Enforcement action***

2.29 Under Schedule 11 of the Competition and Consumer Issues Bill, proposed section 69A of the *Telecommunications Act* would give the ACCC the power to give Telstra a remedial direction where Telstra has contravened, or is contravening, a standard licence condition set out in proposed Part 8 of Schedule 1 to the *Telecommunications Act*.<sup>28</sup> However, under proposed subsection 55(3), compliance with a final operational separation plan (OSP) is not a carrier licence condition. As a result, the ACCC could not issue a direction to Telstra if Telstra did not comply with the OSP.<sup>29</sup>

2.30 Rather, if Telstra contravened a final OSP, the Minister could require Telstra to prepare a rectification plan under proposed clause 59. Under proposed clause 65, Telstra would be required to comply with the final rectification plan. By virtue of section 61 of the *Telecommunications Act*, breach of a rectification plan would be a breach of Telstra’s carrier licence, and would allow for enforcement action by the ACCC.<sup>30</sup> If Telstra has contravened, or is contravening, the rectification plan, the ACCC would be able to direct Telstra (under proposed section 69A) to comply with the rectification plan. Alternatively, or after having issued a remedial direction, the ACCC, the ACMA or the Minister would be able to commence proceedings in the Federal Court seeking recovery of a civil penalty in relation to Telstra’s failure to comply with a condition of its carrier licence. Therefore, the ACCC may only take action if Telstra is in breach of a rectification plan, rather than the OSP itself.<sup>31</sup>

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26 Mr David Havyatt, *Committee Hansard*, 9 September 2005, p. 35.

27 Competitive Carriers Coalition, *Submission 6*, p. 4.

28 Note that under proposed section 69B, Telstra could apply to the Australian Competition Tribunal for review of remedial directions issued by the ACCC under proposed section 69A.

29 *Explanatory Memorandum*, pp 78-79 and 91; DCITA, *Committee Hansard*, 9 September 2005, pp 85-86.

30 *Explanatory Memorandum*, pp 93-95; DCITA, *Committee Hansard*, 9 September 2005, pp 85-87. Note the rectification plan must be approved by the Minister: see proposed sections 59-62.

31 *Explanatory Memorandum*, pp 76 and 95; ACCC, *Committee Hansard*, 9 September 2005, p. 4.



2.31 Several submissions and witnesses expressed concern about these provisions, particularly that the OSP was not a licence condition and, therefore, not in itself enforceable.<sup>32</sup> For example, Ms Karen Lee expressed concern that:

As a result, there does not appear to be any incentive to comply with the terms of the final plan or even prepare a draft plan. There is no possible application of a financial penalty for non-compliance. Failure to comply with the plan may result only in a direction from the Minister requiring Telstra to prepare a rectification plan ... if the final operational separation plan is not treated as a condition then the powers given to the ACCC under clause 69A are meaningless. They apply only in relation to breaches of final rectification plans.<sup>33</sup>

2.32 Some suggested that the contents of the OSP should be a licence condition.<sup>34</sup> For example, law lecturer Ms Karen Lee suggested that:

... clause 55(3) should be deleted and/or some penalty mechanism should be inserted if Telstra fails to comply with the terms of the final operation separation plan and/or rectification plan. The entire provision as drafted gives Telstra too much scope to play the system with negative consequences for competitors to Telstra.<sup>35</sup>

2.33 Mr Paul Fletcher, from Optus, highlighted the low penalty for failure to comply with the OSP:

The action they can take is to seek the imposition of a civil penalty for Telstra's breach of its licence condition. The maximum civil penalty is \$10 million. There may well be circumstances where Telstra considers that it is rational to simply accept that penalty.<sup>36</sup>

2.34 AAPT also raised the question of the role of the ACCC, saying 'the real question is: what is the role of the ACCC in all this?'<sup>37</sup> However, Mr Havyatt later said: 'I am more than happy to support the Government's decision to introduce operational separation in the Australian marketplace.'<sup>38</sup>

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32 Mr Havyatt, AAPT, *Committee Hansard*, 9 September 2005, p. 27; Mr Forman, CCC, *Committee Hansard*, 9 September 2005, p. 28; Mr Fletcher, Optus, *Committee Hansard*, 9 September 2005, pp 33 and 36-41; Mr Karen Lee, *Submission 13*, pp 5-6; Optus, *Submission 16*, pp 2-4.

33 *Submission 13*, pp 5-6.

34 See for example, Mr Thomas Amos, ATUG, *Committee Hansard*, 9 September 2005, p. 25; Mr Fletcher, Optus, *Committee Hansard*, 9 September 2005, p. 41.

35 *Submission 13*, pp 5-6; see also Optus, *Submission 16*, p. 3.

36 Mr Paul Fletcher, Optus, *Committee Hansard*, 9 September 2005, p. 34.

37 *Committee Hansard*, 9 September 2005, p. 27.

38 *Committee Hansard*, 9 September 2005, p. 39.

2.35 Optus proposed that Telstra should be legally required to comply with the OSP, and that the 'unnecessary and time-consuming step of the rectification plan' should be removed. Optus further suggested there should be a 'private right of action to sue Telstra to enforce its compliance with the plan so that Telstra's competitors can choose to take private legal action against Telstra to enforce a breach.'<sup>39</sup>

2.36 However, Telstra also expressed concern about the primary enforcement role being transferred to the ACCC, which is consistent with the fact that Telstra does not support operational separation at all.

2.37 Similarly, the CCC submitted their concern that under the Bill's regime, 'the Minister becomes responsible for making decisions that would be expected to be the responsibility of the independent regulator.'<sup>40</sup>

2.38 A representative from DCITA acknowledged that in the first instance responsibility for the enforcement of the operational separation regime rests with the Minister. However, the representative also pointed out that the ACCC would be involved in providing advice to the Minister in relation to those matters.<sup>41</sup>

2.39 Representatives from DCITA further explained that this enforcement regime was appropriate because it gave Telstra an opportunity to rectify its behaviour:

The philosophy, if you like, is: 'This is about Telstra's internal operation, let's give them a chance to get it right in the first instance. If they don't get it right in the first instance then we can come in and be quite prescriptive about how they should do it, and then that will be a breach of the licence conditions if they do not get it right in that circumstance.'<sup>42</sup>

2.40 The Committee notes that the model of separation put forward in this legislation does seem to contain the critical elements necessary to the Government's intentions. While there is concern about where the enforcement powers lie, there is no doubt that the model is enforceable. However, the Committee notes that the arrangements are to be reviewed by 2009, and suggests that the effectiveness of the enforcement arrangements be considered as part of the review.

### ***Powers to investigate***

2.41 Key concerns raised during evidence relating to the ACCC's powers to investigate compliance included:

- the timing of the ACCC's role; and

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39 Mr Fletcher, Optus, *Committee Hansard*, 9 September 2005, p. 33; see also pp 37-38 and 41; and Optus, *Submission 16*, pp 3-4, 6.

40 *Submission 6*, p. 6.

41 *Committee Hansard*, 9 September 2005, p. 104.

42 *Committee Hansard*, 9 September 2005, p. 86.

- the relationship between the OSP and Parts XIB and XIC of the TPA.

2.42 Some were concerned that the ACCC only became involved in enforcement towards the end of the enforcement process. For example, Mr Tom Amos of ATUG observed that:

ATUG is worried that the ACCC does not come into the picture until the very end, after the event, and only to pursue breach of licence action. How will we know if there has been a breach? We believe that continuous in-confidence disclosure should be part of this. An annual report to the government is not enough. We believe that the existing ACCC and ACA reports are effectively reports tabled post event and do not achieve this. The minister as enforcer is not a particularly good concept.<sup>43</sup>

2.43 Similarly, Mr Forman of the CCC stated:

We also cannot see that there is any power for the ACCC to investigate a breach of the [operational separation] plan, so how a breach is established is open to question.<sup>44</sup>

2.44 In relation to ACCC's powers to investigate breaches of the OSP, a representative from DCITA pointed out that:

The key part of the bill which we intend to use to ensure the ACCC has adequate monitoring and investigation powers is 51(1)(d), which, in establishing the plan, requires Telstra to comply with the requirements that the minister determines, and we would expect that the minister would determine a range of measures to ensure that there is appropriate opportunity and power for the ACCC to investigate and be aware of all of the activities under the plan. Also, there is 51(3), which provides for the plan to give administrative decision-making powers to the ACCC.<sup>45</sup>

2.45 Another concern raised in this context was the relationship between the OSP and Parts XIB and XIC of the *Trade Practices Act 1974* (TPA).<sup>46</sup> The Explanatory Memorandum states:

Schedule 11 also amends Parts XIB and XIC to insert provisions that would require the ACCC, when performing its functions or exercising its powers under either Part XIB or XIC, to have regard to Telstra's conduct in accordance with the licence condition relating to operational separation, to the extent that that conduct is relevant to the functions being performed or the power being exercised. These amendments provide a linkage between

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43 Mr Thomas Amos, ATUG, *Committee Hansard*, 9 September 2005, p. 25.

44 *Committee Hansard*, 9 September 2005, p. 28.

45 *Committee Hansard*, 9 September 2005, p. 104.

46 Mr Thomas Amos, ATUG, *Committee Hansard*, 9 September 2005, p. 25; Mr Forman, CCC, *Committee Hansard*, 9 September 2005, p. 28; Ms Eason, CEPU, *Committee Hansard*, 9 September 2005, p. 30.

the operational separation licence condition and Parts XIB and XIC where Telstra's conduct in accordance with the licence condition is relevant.<sup>47</sup>

2.46 Similarly, the ACCC pointed out that it would retain its powers under Part XIB of the TPA where it has reason to believe there is anticompetitive conduct.<sup>48</sup> In particular, Mr Samuel explained that:

The role of the ACCC, of course, will be to administer part XIB and particularly the application of a competition notice in the event that the ACCC forms the view or has reason to believe that Telstra has engaged in anticompetitive conduct in any particular set of circumstances. The operational separation plan is designed to facilitate the ability of the ACCC to determine whether or not anticompetitive conduct has been engaged in.<sup>49</sup>

2.47 However, Mr Amos of ATUG expressed concern that the 'privately developed' operational separation plan could effectively overtake Parts XIC and XIB of the TPA:

This provision seems to override the existing ACCC powers to determine any competitive conduct. Since the plan is going to be developed by Telstra alone, as we see it at the moment, it seems ludicrous to us at ATUG that such a plan might be allowed to override the ACCC access pricing principles and the price squeeze determinations.<sup>50</sup>

2.48 Mr Amos also highlighted Telstra's ability to engage in regulatory gaming:

...there seems to ATUG to be a possibility for delay, obfuscation or gaming ...Giving such a central role to the operational separation plan developed by Telstra alone is too broad and the implications still remain unclear and worrying.<sup>51</sup>

2.49 Similarly, Mr Forman of the CCC suggested that this:

...is the kind of change we fear that Telstra and the team of 180 lawyers that were referred to earlier will drive a truck through to the extent that the XIB and XIC processes may be fundamentally and profoundly altered to the point where they are no longer functioning.<sup>52</sup>

2.50 However, a representative from DCITA felt that there had been 'some confusion, understandably, in the discussion today with the other carriers about how

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47 Proposed section 151CP; see also *Explanatory Memorandum*, pp 3 and 95; and DCITA, *Committee Hansard*, 9 September 2005, pp 86-87.

48 ACCC, *Committee Hansard*, 9 September 2005, p. 5.

49 ACCC, *Committee Hansard*, 9 September 2005, pp 5-6, 11.

50 Mr Thomas Amos, ATUG, *Committee Hansard*, 9 September 2005, p. 25.

51 Mr Thomas Amos, ATUG, *Committee Hansard*, 9 September 2005, p. 26.

52 *Committee Hansard*, 9 September 2005, p. 28.

this framework interacts with parts XIB and XIC and the competition framework.<sup>53</sup> The representative argued that:

It is not about replacing the access regime ... It is about trying to get transparency and certainty about those retail prices and how Telstra operates at the retail level, and how that interfaces and compares with and is equivalent to what happens for wholesale customers.<sup>54</sup>

***The internal wholesale pricing and the pricing equivalence regime***

2.51 A price equivalence framework will be established under OPS to check that Telstra's retail business units face an equivalent cost of the use of core network services as those incurred by wholesale customers facing the same inputs. Telstra will retain its current flexibility to introduce, re-negotiate and vary its wholesale prices to its customers, but will be required to re-benchmark its internal prices to actual prices periodically.

2.52 The Committee understands that a working group consisting of Telstra, the ACCC, and the Department of Communications, IT and the Arts is being set up to resolve the issues that relate to the following components of the price equivalence framework:

- setting the benchmark price;
- technical issues surrounding the testing of anti-competitive conduct for the retail pricing protocol; and
- interaction of the framework with the regulatory regime.

2.53 The CCC highlighted the processes of the working group and the development of the plan as problematic primarily because the ACCC did not have a formal advisory role, and the Minister was not required to take note of the deliberations of the working group. Mr David Forman told the Committee:

We do not see a legislative link in relation to the working group that develops pricing. We do not see a linkage between the output of that group and the ministerial decision process, which ultimately will be the mechanism by which the prices are set. In the absence of that, it is hard to see what regard the minister has to have to those deliberations or what is the basis upon which those decisions are made. More broadly, and this goes to the role of the ACCC, there seems to be an absence of a formal advisory role for the ACCC in a number of places where we would expect it to be in relation to the planning and in relation to the pricing issue that I just mentioned.<sup>55</sup>

2.54 Similarly, Mr Tom Amos from ATUG argued:

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53 *Committee Hansard*, 9 September 2005, p. 86.

54 *Committee Hansard*, 9 September 2005, p. 87.

55 Mr David Forman, CCC, *Committee Hansard*, 9 September 2005, p. 28.

A group that includes the ACCC, DCITA and Telstra, with an expert facilitator, has been set to develop the principles for the establishment of an internal wholesale price. This group will also seek to establish formal understandings about the use of internal wholesale prices in assessing whether any competitive behaviour exists. This process will provide internal wholesale pricing that the ACCC has identified as important to the role of enforcing compliance under XIB of the TPA. To us, this provision seems to override existing ACCC powers to determine any competitive conduct.<sup>56</sup>

2.55 Mr Amos went on to raise further concerns over the reporting of equivalence. The Committee was told:

We have an issue with equivalence between the internal wholesale price faced by Telstra's retail business units and the wholesale prices paid by Telstra's competitors for designated services. We ask: how would we ensure during the period that this is the case when it is post event reporting? Annual reporting, we believe, may be too late.<sup>57</sup>

2.56 Another concern raised with the Committee was the possible length of time involved in setting prices. It was noted that the ACCC had been engaged in discussions with Telstra for over two years in regard to access undertakings under Part XIC of the TPA.<sup>58</sup>

### **The Committee's view**

2.57 The Committee notes that there are some concerns about the model of operational separation as outlined by Mr Samuel of the ACCC and expanded upon by some witnesses. However, to quote Senator Brandis, these may be false concerns:

The first of them was the precise detail of the plan. There was always bound to be the development to an increasingly high level of sophistication of the detailed plan. That could hardly be expected to be legislated for in the statute with specificity. The scope of services, which was the second issue he identified, is essentially a definitional issue. The third, the enforcement regime—and this is the point of my questions—is that we would not expect that to be radically different from what is already provided for in different circumstances in the existing act. The same, I suspect, could be said about his fourth issue—that is, investigative powers. The fifth issue, which is specific to the operational separation model—that is, the development of wholesale pricing and a pricing equivalence regime—is provided for by the working party between Telstra, the ACCC and the department.<sup>59</sup>

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56 Mr Tom Amos, ATUG, *Committee Hansard*, 9 September 2005, p. 25

57 Mr Tom Amos, ATUG, *Committee Hansard*, 9 September 2005, p. 25.

58 Mr Ed Willett, ACCC, *Committee Hansard*, 9 September 2005, p. 8.

59 Senator Brandis, *Committee Hansard*, 9 September 2005, p. 17.

2.58 While there is a range of views on some aspects of the proposed model, it does allow the Government's objectives to be fulfilled. Mr Samuel confirmed that the legislation provides a 'framework within which an appropriate operational separation plan can be developed.'<sup>60</sup>

2.59 The Committee also notes that there was a strong view that operational separation would bring real benefits. The ACCC concluded that operational separation should bring benefits for competitors, the economy as a whole and consumers.<sup>61</sup> When specifically asked whether the ACCC believed operational separation would have benefits for Telstra, Mr Willett said:

Yes, it believes it does because the commission considered that part of the good management of an organisation as large and as complex as Telstra is understanding the cost and appropriate terms and conditions for the supply of network services.<sup>62</sup>

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60 *Committee Hansard*, 9 September 2005, p. 9.

61 *Committee Hansard*, 9 September 2005, p. 11.

62 *Committee Hansard*, 9 September 2005, p. 10.

