

25 June 2008

Ms Patricia Scott  
Secretary,  
Department of Broadband, Communication,  
and the Digital Economy

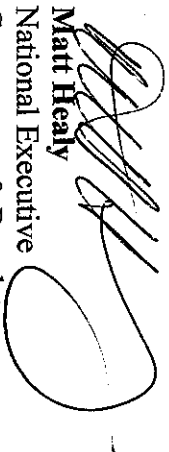
By email

Dear Ms Scott,

Please find attached Macquarie Telecom's submission to the Government's  
Regulatory Reform Process established in conjunction with the New Broadband  
Network initiative.

Macquarie Telecom would be please to provide the Department with a presentation of  
the key points contained in this submission.

Yours sincerely

  
Matt Healy  
National Executive  
Government & Regulatory

## 1. Executive Summary

Macquarie Telecom is pleased to respond to the Government's request for public submission on regulatory reform in the telecommunications sector. Whilst reform is already over due in respect of fundamental aspects of this critically important section of the economy, reform becomes even more urgent in the context of any new network build such as is envisaged in the Government's current initiatives.

Regulatory reform as part of the NBN initiative should deliver improved competition through:

- Ensuring structural separation of the NBN owner.
- Locking in the role of the Australian Competition and Consumer Commission (the Commission) in the oversight of price and non-price terms for access to the NBN.
- Providing the Commission with divestiture powers to remedy any future structural deficiencies in markets arising from the effects of new technological developments and related market power concentrations.
- Establish greater certainty for access seekers and access providers by replacing the existing "negotiate/arbitrate/undertake/litigate" regulatory cycle with clear and timely tariff approval arrangements.
- Establish clear and transparent "asset stranding" compensation arrangements over seen by the Commission.

## 2. Background

It is Macquarie Telecom's long held view that regulation in the telecommunications sector since the privatisation of Telstra, has not delivered the full potential of competition outcomes. Whilst "pockets" of competition have emerged, fixed line markets generally and broadband markets in particular have struggled to take competitive root. As a result, competition has suffered and in turn, consumer welfare has not been maximised.

At the heart of this failure is the structure of the sector. Telstra dominates the sector across all major markets.

That the former monopoly network was permitted to remain integrated as the ubiquitous fixed line operator and was also able to enter any emerging market, has proved to be a heavy weight dragging the sector and adversely impacting the wider economy. Pay TV services, mobile services, broadband, content and directory services in Australia are provided in markets that are sub-competitive because of the constraints on new entry imposed by the shadow of Telstra's significant market power. Having been gifted the ubiquitous copper network, inherited all the fixed line customers and having scale to undermine potential threat of new entry both in established markets and emerging ones, competition in Australia's telecommunication's markets was essentially still born.

Presented with the Government's New Broadband Network (NBN) initiatives, policy perseverance with the existing Regulatory model is destined to under-deliver potential



benefits to the Australian community. However, the NBN presents a real opportunity to tackle the structural impediments to effective competition that underpins our sector. The best opportunity to achieve this is to ensure that the NBN process delivers a ubiquitous fixed network from a provider that has no interest in favouring one retail operator over another. Overseas experience as well as experience in other network industries, makes abundantly clear that the most competitive markets will develop when the company that owns the NBN is separate from the company the retails services.

### **3. The “new monopoly” must be structurally separated**

It is noted at the outset that Macquarie Telecom is a member of the TERRIA consortium that is planning on bidding as a proponent in the NBN Request for Proposal’s process. That said, the matters dealt with in this submission are the views of Macquarie Telecom, are matters that should apply equally to regulatory arrangements applying to *whoever* is successful under the current NBN initiative.

The NBN request for Proposal (RFP) recognises the scale and scope of the Governments proposed NBN:

“Not only will the NBN provide the primary platform for delivering fixed high-speed broadband services, but it is also likely to provide the platform for basic services like voice as well as many other new and innovative services for decades to come.”<sup>1</sup>

As the existing ubiquitous copper network is recognised as a ‘bottle neck’ infrastructure by the Commission through its ongoing regulation of services like Unbundled Local Loop, it is clear that the upgrade to the copper network will also have these bottle neck characteristic. Just as there is one gas pipe to the home, one electricity connection and one mains water and sewage connection, the fixed broadband connection over the existing copper “last mile” has natural monopoly characteristic. That there will only be one of these significant FTTN networks is clear, further, that this new network would be an upgrade to the copper network is recently affirmed by Telstra’s Chairman as a single national network.<sup>2</sup>

### **4. Dealing with the root cause of regulatory failure rather than just the symptoms of market failure**

Vertical integration is at the heart of market failure in our sector. A fully integrated monopoly network owner that dominates retail markets has the incentive and the ability to undermine competition in downstream markets. This issue is the subject of number of studies. Macquarie Telecom would draw the Government’s attention to the reports set out in submissions by TERRIA and the Competitive Carrier’s Coalition

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<sup>1</sup> RFP at page 2, para 1.1.8

<sup>2</sup> Telstra press release Monday 23 June 2008, titled “Chairman’s Speaking Notes” at page 5 of 17

as well as the reports prepared by a some-time Telstra expert witness, Prof Martin Cave.<sup>3</sup>

The vertically integrated operator has no commercial interest in offering access. Even where access is mandated, there is a strong incentive to favour its related retail business to the detriment of competition. It has no driver to innovate, drive costs and therefore drive prices lower. It is driven to resist new entry.

Whilst the inefficiency of vertical integration are self evident and reflected in the lack of effective competition in fixed line markets in Australia, it is also telling that the present monopoly network owner has never identified the value of any possible “efficiency” that it claims vertical integration harnesses.

## 5. Ensuring Structural Reform

If vertical integration is the cause of market failure and lack of effective competition, then the NBN process allows for this market distortion to be fixed. Specifically, it must be a precondition of any winning NBN proponent that the network owner not be a retail service provider.

As a monopolist that controls such nationally important infrastructure, the NBN owner will have the ability and incentive to price access to the service without constraint to the detriment of end-users. To avoid this situation, and in recognition that competition is possible in downstream markets, regulation of the monopoly elements of the network is required.

## 6. What use are the existing regulatory “tools”?

Given Monopoly Characteristics, will existing regulatory “tools” is effective?

### 6.1 Operational Separation

Firstly, it is important to rule out regulatory tools that have already failed in the task of constraining monopoly behaviour on the copper network. Accordingly, an “operational separation” regime should be ruled out. It was a regulatory construct that industry and the incumbent considered ineffectual at the time it was introduced, and just this month the Commission advised a Senate estimates Committee that in its view, Operational Separation had been a failure.

### 6.2 Part XIC

Reliance on the existing “Negotiate/Arbitrate/Undertake/Litigate” model enshrined in Part XIC of the Trade Practices Act (TPA) is also essentially worthless. As best illustrated by the experience of ULL Access Seekers, notwithstanding the “open access” declaration placed on ULL services in 1997, some 11 years later the price of access is still uncertain. Telstra continues to demand access charges at a rate

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inconsistent with regulatory principles established over the decade. That is, Telstra is yet to agree offer ULL at the rate set by the Commission.

Such regulatory gaming by Telstra has been permitted through exercising its “rights” under Part XIC in forcing dozens of serial arbitrations, lodgement of numerous clearly unacceptable Access Undertaking, appealing rejected Undertakings through the Competition Tribunal, Federal Court reviews and ultimately failed High Court proceedings. Through this flawed Negotiate/Arbitrate/Undertake/Litigate statutory foundation, Telstra has ensured that its competitors costs are raised, business planning crippled by uncertainty and investment “chilled”. The standing of Australia in relation to the price, penetration and quality of retail broadband offerings does not compare well with other jurisdiction that we ordinarily compare ourselves with. To a large extent, his situation can be “sheeted home to the failure of the Part XIC Arbitration and “price setting” regime.

### **6.3 Part XIB**

Finally, there are ex-post regulatory tools set out in Part XIB of the TPA, which might be relied on to deal with anti-competitive conduct. Part XIB has an important role to play in deterring anti-competitive conduct, however, it requires tightening to ensure the Commission and adversely affected parties are able to quickly access remedies to likely breaches of the TPA. These provisions must be enhanced to better deal with the symptoms of misuse of market power.

There is therefore a need to recognise the failure of Operational Separation and Part XIC access provisions in particular to deliver effective competition in ULL related downstream markets. Further, there is a need to tighten and streamline Part XIB conduct provisions. Once these systemic considerations are dealt with, it is highly likely that Parts XIB and XIC, with the above amendments, might be built upon to deliver more effective regulation.

### **6.4 Further ACCC Involvement**

By dealing with the root cause of market failure, it would be possible to remove the current day-to-day oversight that the Commission has to perform. At present, the significant expertise that the Commission has developed in relation to regulating the sector is not effectively utilised. By dealing with incentives through structure, then the Commission is able to turn its expertise to oversight and review of adequacy of price and non-price terms and conditions of access and resolving inter-operator disputes in a timelier manner. The Commission ought to be empowered with divestiture powers and it ought to increase its monitoring function of the competitiveness of the markets generally.

Specifically in the NBN environment, it should also be the Commission’s function to determine the manner in which any compensation arrangements are struck in the context of operators having assets “stranded”. The “stranded asset” compensation issue arises principally due to the effect of the Government’s initiative and commitment of up to \$4.7billion toward the network roll-out. These two issues have the effect of bringing forward the useful asset life of recent DSLAM investments –

investments that have hitherto been promoted by Government policy and regulatory decision-making.

Whilst Macquarie telecom supports the Government's NBN initiatives, we are of the view that the effect on changes to the investment policy signals that this initiative produces also needs to be taken account of. As a result, a program for assessment of asset stranding compensation claims needs to be established and this program ought to be overseen by the Commission. It should also be an aspect of this compensation program for the Commission to permit NBN network plans to take account of ongoing utilisation of exchange based assets like DSLAMs. Clearly there is scope for early "closure" of local exchanges to have anti-competitive effects and this situation should be avoided and managed up front.