



**TELSTRA CORPORATION LIMITED**

**Submission to the  
Senate Committee Inquiry  
into the  
National Broadband Network Companies Bill 2010  
and the  
Telecommunications Legislation Amendment  
(National Broadband Network Measures – Access  
Arrangements) Bill 2010**

February 2011

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## **Executive Summary**

The NBN initiative represents one of the most significant public infrastructure projects in Australia's history. To ensure its success and maximise the benefits of the NBN initiative, the legislative framework should enshrine key tenets of the Government's NBN policy and provide the right conditions for effective competition and efficient investment going forward.

At present, the National Broadband Network Companies Bill 2010 (**NBN Companies Bill**) and the Telecommunications Legislation Amendment (National Broadband Network Measures – Access Arrangements) Bill 2010 (**NBN Access Bill**) each contain a number of deficiencies that put the benefits of the NBN in jeopardy.

Telstra supports passage of the Bills, but believes that they should first be amended to ensure that the Government's policy is enshrined.

The key issues to be addressed are:

### **The NBN Companies Bill offers too many opportunities for scope creep**

It is a fundamental plank of Government policy that NBN Co should be a wholesale-only operator in order to address concerns about vertical integration in the telecommunications industry. The NBN Companies Bill requires important amendments to ensure that this occurs, as the present provisions are easily circumvented and would enable NBN Co to vertically integrate into retail corporate and government markets with little difficulty.

Further, as the ACCC has said, NBN Co should offer access at the lowest feasible layer in the network to enable its wholesale customers the maximum downstream control over cost, quality and innovation. An obligation to limit NBN Co to Layer 2 services should be imposed in the legislation (with limited specific exceptions) to ensure that over time, NBN Co does not engage in "scope creep". This will promote investment certainty for retail providers, which will assist the speed and extent of complementary investments in content and applications. It would enshrine in legislation assurances that NBN Co has given the industry.

### **The NBN Access Bill unduly restricts future competition**

A number of provisions of the NBN Access Bill have the potential for quite perverse unintended outcomes that would limit the scope for future competition and innovation, two of the benefits that the NBN initiative is intended to achieve. In particular:

- The provisions requiring regulation of all new superfast broadband networks risk damaging investment and foreclosing future network competition. Requiring regulation of new broadband networks before they are even built will create a powerful disincentive to investment in infrastructure and will discourage competition with NBN Co. Legislating for the regulation of particular services that may be supplied by efficient investors is also an unnecessary and unwarranted intrusion into the domain of the independent regulator.
- The non-discrimination provisions go too far, requiring a 'one-size-fits-all' approach that will stifle innovation and deny many of the gains that the NBN is being built to enable. These provisions should be amended to allow for discrimination by NBN Co where this aids efficiency.

While Telstra believes that the Bills should be passed, it is critical that these amendments are made to ensure that the right industry structures and incentives are put in place, to enable significant the benefits of the NBN to be achieved.

## A NBN Companies Bill

- 1 Telstra has two primary concerns with the NBN Companies Bill, as it is currently drafted. These relate to the scope of NBN Co operations and the potential for
  - (a) NBN Co's operations to extend beyond wholesale-only supply; and/or
  - (b) NBN Co to offer services above Layer 2.

### A.2 Importance of the wholesale only requirement

- 2 That NBN Co should offer only wholesale services is a fundamental policy tenet upon which the NBN is built. The Government's Statement of Expectations for NBN Co states:<sup>1</sup>

*To achieve a truly competitive telecommunications industry and in support of the NBN, the Government is implementing reform of the industry. **The establishment of NBN Co with a wholesale-only, open-access mandate is a key element of this reform.** The Government will improve the telecommunications regulatory framework through the introduction and amendment of key legislation. This will facilitate a competitive and well functioning telecommunications sector and assist NBN Co to fulfil its mandate. [emphasis added]*

- 3 Along with the provision of high-speed broadband, the primary rationale for the NBN is to address apparent concerns about vertical integration.<sup>2</sup> It is not possible for these concerns to be addressed with an NBN Companies Bill that places no real constraints on the development of a vertically integrated NBN Co.
- 4 The NBN Companies Bill should therefore provide a bright line which enshrines the Government's key policy of a 'wholesale only' NBN.
- 5 As explained below, the legislation as drafted fails to do this. The primary prohibition is highly permeable, and in any event is subject to express exceptions which will siphon off to NBN Co important retail applications and services revenue in major sectors of the economy.

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<sup>1</sup> Letter from Senator Penny Wong and Senator Stephen Conroy to Mr Harrison Young, 'Statement of Expectations', 17 December 2010, p2

<sup>2</sup> See for example, Joint Media Release, *New National Broadband Network*, 7 April 2009 at [http://www.minister.dbcde.gov.au/media/media\\_releases/2009/022](http://www.minister.dbcde.gov.au/media/media_releases/2009/022)

## The 'wholesale only' requirement in section 9 is deficient

- 6 Section 9 of the NBN Companies Bill only requires the recipient of the service to be a 'carrier' or 'carriage service provider' (CSP). It does not say anything about the use to which the service is to be put. It does not matter if the customer has no intention to on-supply the service, so long as the customer is a carrier or CSP. In fact, nothing in section 9 requires that the fundamental characteristic of wholesale supply -- participation in retail end-user markets via on-supply to the public -- be present at all.
- 7 The key problem is that statutory concepts of "carrier" and "carriage service provider" are, on their own, ill-suited to the important task of defining NBN Co's scope of business.
- 8 First, as to carriers, it is very easy for a customer to "convert" from a retail customer to a carrier, because a carrier licence can be readily obtained with minimal investment requirements, and there is no requirement that a person who holds a carrier licence actually use a network unit to supply services to the public. Once an entity becomes a carrier, NBN Co can supply that person, and the services supplied can be *self consumed* (by the entity or within its corporate group). This is a simple loophole enabling a corporate customer to buy communications services directly from NBN Co without being a retailer.
- 9 For example, a corporate customer that simply installs one line link between two properties (say, between offices situated across the road from each other) and uses that link as part of a corporate LAN would be able to source all of its fixed network telecommunications directly from NBN Co -- even though it is in no sense a wholesale customer of NBN Co.
- 10 Already, there appear to be a large number of licensed carriers who do not provide services to the public, but hold carrier licences for other reasons.<sup>3</sup>
- 11 While the Government's and NBN Co's current intentions have been stated, this legislative loophole means that if NBN Co's intentions or incentives change in future, it could assist existing or prospective customers to obtain a carrier licence as a means of tapping into the large enterprise services market.
- 12 Second, the concept of 'carriage service provider' is similarly permeable. It derives from the need to impose licence conditions on persons who supply telecommunications services to the public -- not to *limit and define* a class of persons, which is the present challenge. It therefore is not concerned to distinguish between the acquisition

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<sup>3</sup> See ACMA's *Eligible Revenue Assessment 2008-09 with Variation* dated 23 August 2010 (done for the purposes of assessing the universal service contributions) which shows numerous carriers with no 'eligible revenue'.

of services for re-supply to the public, and acquisition of services for internal consumption.

- 13 Such a distinction is necessary because an entity may become a CSP by reason of supply of one particular kind of service – for example, a supermarket chain that is a mobile reseller. Such an entity would operate under the CSP class licence, and – under the proposed NBN Companies Bill – could acquire *all* of its fixed services from NBN Co directly, even though they may be entirely unrelated to functions as a mobile reseller.
- 14 This is more than a theoretical possibility. There are a number of large entities that are already carriers or CSPs, and who could therefore be directly supplied by NBN Co under the proposed draft. For example, the current TIO membership (of which a CSP must be a member) includes:<sup>4</sup>
  - large corporate and business customers, including Woolworths, NEC Australia, Port of Brisbane and CBIT;
  - educational institutions, including University of Queensland IT Services and Sebastopol College, a community college in Ballarat;
  - Government agencies, including the Library Board of Victoria and South West Healthcare, which covers most Government health deliverers in south west Victoria; and
  - local government, including the Banana Shire Council and the Towong Shire Council.
- 15 To prevent direct supply by NBN Co to non-retailing entities, the wholesale-only requirement in section 9 should require that the carrier or carriage service provider is acquiring the services *for the purposes of on-supply* (i.e. as a wholesale customer) and not for its own self-consumption.
- 16 Such an approach would be consistent with the standard access obligations in Section 153AR of the *Competition and Consumer Act 2010*, which are imposed only upon the supply of declared services to a service provider in order that the service provider can provide carriage services and/or content services – which means services provided to the public - see sections 87 and 97 of the *Telecommunications Act 1997* (Cth).

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<sup>4</sup> See [http://www.tio.com.au/aboutmembership/members\\_search\\_engine.asp?strAbsolutePage=1](http://www.tio.com.au/aboutmembership/members_search_engine.asp?strAbsolutePage=1)

Recommendation: That the marked up words (below) be added to section 9 of the NBN Companies Bill, accompanied by any necessary explanation in the Explanatory Memorandum that links its meaning to the section 87 concept of supply to the public.

*A NBN corporation must not supply an eligible service to another person unless the other person:*

*(a) is:*

*(i) a carrier; or*

*(ii) a service provider; and*

*(b) acquires that service solely for the purpose of supplying:*

*(i) a carriage service to the public; or*

*(ii) a content service to the public.*

### **The exemptions to the wholesale only requirement in sections 10 to 16 are unjustified**

- 17 The exemptions to the wholesale only requirement are an example of the potential for "scope creep" that would compromise the Government's stated policy that the NBN will be a wholesale only network.<sup>5</sup>
- 18 The exemptions will allow NBN Co to compete at the retail level for the supply of these services, but there does not appear to be any meaningful justification for this. Worse still, the scope of the services that fall within the exemption are very broad. For example, it would be possible for NBN Co to supply services to a private rail operator (such as a mining company), provided the service is 'necessary or desirable for the workings of train services'. Arguably, all of the communications needs of a rail operator are 'necessary or desirable' for the workings of train services, so it is difficult to see how the proposed exception would put any limit whatsoever on the kinds of services that NBN Co could offer.

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<sup>5</sup> The Government notes in its Statement of Expectations that the wholesale-only mandate is a key tenet of its reforms to the telecommunications industry (Statement of Expectations, p2). However, the Implementation Study also warns of the potential for NBN Co to grow beyond its mandate through monopoly scope creep (NBN Implementation Study, p455)



- 19 The Explanatory Memorandum contains some material about the rationale for exempting these services (e.g. smart metering) but this is clearly not a meaningful restraint on the capacity that the proposed exemptions give to NBN Co to engage in large scale retail supply across the utilities sector (both to government owned and privately held utilities).
- 20 Nor does the Explanatory Memorandum offer any justification for why services like smart metering or traffic light co-ordination would need to be sourced directly from NBN Co, rather than from a carrier or CSP; or why NBN Co could not equally well facilitate the rollout of such services at the wholesale level rather than by direct retail provision. No basis for distinguishing these services from others that utilise Layer 2 inputs has been made out.
- 21 Inherent in the Government's decision to separate the provision of networks and services via a wholesale-only network entity is that NBN Co must not engage in supply to end users. Sections 10 – 16 are so broadly drafted that they place almost no constraint on the nature of the services that could be supplied, except as to the sector it is provided in.
- 22 Moreover, these services are representative of future machine-to-machine communications that are expected to be increasingly used by utilities for monitoring and management functions, and which represent a commercial growth opportunity for carriers and CSPs servicing those sectors. The proposed carve-outs would enable NBN Co to monopolise the future of this segment of the retail market, to the detriment of industry and end users.
- 23 It is important to distinguish the list of carve-outs in the NBN Companies Bill from the "immediate circle" exemptions in the Telecommunications Act.<sup>6</sup> Their purposes are quite different. The "immediate circle" exemptions are used to exempt companies who on-supply only to related entities (e.g. related companies, employees, etc ) from the need to obtain a licence that would regulate that on-supply. It expressly contrasts with the concept of "supply to the public", from which supply to the immediate circle is carved out.<sup>7</sup> In other words, it allows a buyer of telecommunications services to *on-supply* to related entities free of regulation that would apply if it supplied to the public. In essence, it recognises that these services are effectively self-consumed by the many parts of a large customer.
- 24 That is entirely different from the situation contemplated in the NBN Companies Bill, where the customers in question – specifically in the

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<sup>6</sup> Section 23 Telecommunications Act (Cth) 1997

<sup>7</sup> For example, section 88(4) and 97(2) carves out "immediate circle" supply from the meaning of "supply to the public" in the definitions of carriage service provider and content service provider; and section 456 carves out "immediate circle" supply from the requirement to comply with the Numbering Plan.

utilities sector - could *acquire* services from NBN Co *as if* they were wholesale customers on-supplying to retail customers, even if they do not in fact do so. The issue in question is not whether they need licences to on-supply services, but whether they should be acquiring services directly from NBN Co in the first place.

- 25 As explained in the section above, to the extent that services are on-supplied to the public, they are plainly wholesale in nature and should be able to be acquired directly from NBN Co by the retailer. But Telstra submits that there is a real risk that the exceptions in sections 10-16, being based only on the sector that the entity operates in, could be used by NBN Co to carve out a very large slice of the telecommunications sector, and a large sections of the economy, for its direct retail supply – contrary to the wholesale-only principle.

Recommendation: that the exemptions in sections 10 – 16 of the NBN Companies Bill be removed.

### **NBN Co should not be allowed to control a retail service provider**

- 26 The definition of “NBN corporation” would allow NBN Co to hold a controlling interest in a retail service provider for up to 12 months. In addition, there is a loophole in the definition that would effectively allow NBN Co to extend the period beyond 12 months by simply transferring the retail business into new company before the period expires.
- 27 Again, this is at odds with the Government’s wholesale only policy and there does not appear to be any meaningful justification for it.
- 28 If the intention is to permit NBN Co to acquire businesses in order to acquire infrastructure it needs for the NBN, this does not necessitate provision for NBN Co to control a retail service provider. It is not difficult to structure an acquisition such that the retail business is disposed of separately at the time of the acquisition. There is no need or justification for a twelve month (or any) grace period.
- 29 Not only would NBN Co be the network monopoly, but this would also allow NBN Co to actively intervene in downstream markets, using access to Government-backed funding, to selectively buy, consolidate and re-sell retail businesses, potentially restructuring those markets into the shape preferred by an upstream monopolist).

Recommendation: that section 1(2) and 1(3) be removed from Schedule 1 – NBN Corporations.

### A.3 Requirements for NBN Co to remain at Layer 2

- 30 Consistent with the ACCC's long-held view<sup>8</sup> that access should be given at the lowest feasible point in the network (to give access seekers more downstream control over costs, quality, innovation and differentiation) it is well accepted that the supply by NBN Co of a Layer 2 service would be optimal for the industry. NBN Co itself has represented to industry that this will be its focus.
- 31 However, there is no express requirement in the NBN Companies Bill for NBN Co to offer a Layer 2 bitstream service. As it is currently drafted, theoretically NBN Co could elect to offer only Layer 3 services.
- 32 There will be powerful incentives for NBN as a monopoly to move up the value chain - notwithstanding that Layer 2 access would be the most efficient way to promote competition (while also keeping NBN Co at a level that is high enough in the value chain to achieve effective vertical separation). As the Implementation Study<sup>9</sup> observed, there are:
- ... forms of monopoly conduct in which NBN Co may have an incentive to engage. In particular, [section 9.4 of the study] highlights the danger that NBN Co may be tempted to enter markets for other network elements, or even devices and content. If it were to do so, leveraging the advantages of its monopoly network, or merely of its implicit Government backing, it could distort those markets and reduce competition. **It is important that NBN Co be prevented from growing beyond its mandate.** [emphasis added].*
- 33 Telstra and other market participants need certainty that investment in services and infrastructure at higher network levels will not be undermined by NBN electing to move up the value chain. We already see evidence of this in NBN Co's proposal for bundled access and backhaul, which would involve it in Layer 3 functionality, and the statutory exemptions which would allow it to compete at the retail level for services supplied to specified utilities providers, infrastructure operators and government authorities.
- 34 The Government has only one opportunity to lay this foundation stone correctly. To do so, it must mandate a requirement for NBN Co to offer services only at Layer 2 or below.
- 35 With these considerations in mind, Telstra proposes an amendment to the NBN Companies Bill which would restrict NBN Co's ability to supply services above Layer 2. This proposed amendment provides an express prohibition on NBN Co supplying above Layer 2, applied

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<sup>8</sup> See for example, ACCC, *Fixed Services Review: a second position paper*, April 2007 at pages 22-24.

<sup>9</sup> Page 455, Implementation Study, 5 March 2010.

via its special carrier licence conditions in Division 6 of the NBN Companies Bill.

- 36 Telstra acknowledges that in limited circumstances, it may be necessary for NBN Co to engage with certain functions at Layer 3 in order to provide Layer 2 services to RSPs. Therefore Telstra has drafted a number of limited exceptions to the general prohibition which account for these circumstances. The specific circumstances that Telstra is aware of (and which are accounted for in the proposed drafting) are as follows:
- (a) Where NBN Co acquires an interim satellite service from a third party pending launch of its own satellite, it is likely that these services would include Layer 3 functionality. This could be addressed by providing a time limited exemption (say, until the end of 2015, when NBN Co proposes to have its own long term satellite solution) to allow NBN Co to resupply a satellite service which is above Layer 2.
  - (b) NBN Co's long term satellite solution will likely be required to support performance enhancement mechanisms. Satellite delivery presents certain challenges to quality of service and the industry has and continues to develop techniques such as frame management and buffering techniques which are necessary to improve service quality, and which operate at Layer 3 (for example, 'TCP spoofing' simulates acknowledgement messages and translates to protocols that are more suitable to the particular connection, in order to improve connection performance, and therefore may be considered to operate at Layer 3). However, it will be important to ensure that, when NBN Co is choosing between the range of quality enhancing techniques available, that it adheres to the principle that the satellite service should provide access at the deepest layer of the network feasible. If the service provided to wholesale customers does not fall strictly within Layer 2, it should at least emulate Layer 2.
  - (c) In some cases, the supply of a Layer 2 service may require a degree of Layer 3 "awareness" within the NBN. For example, multicast services may require IGMP or MLD signalling within the NBN for the purpose of establishing and clearing multicast service connections. (IGMP and MLD protocols are required to "snoop" content packets to work out where to send them, so that customers located in the same POI area can only access the content they have paid for.) However, this Layer 3 functionality is self consumed by NBN Co in the course of supplying the Layer 2 service to wholesale customers, and therefore ought not breach the proposed prohibition.

Recommendation: That the NBN Companies Bill be amended to account for these limited circumstances, through a number of carefully targeted exceptions to the general prohibition on supply above Layer 2.

After section 41(3), add:

(3A) An NBN corporation must not supply an eligible service to another person that is higher than Layer 2 in the OSI Reference Model.

(3B) Subsection (3A) has effect subject to subsections (3C), (3D), (3E) and (3F).

(3C) An NBN corporation may supply to itself functionality that is higher than Layer 2 in the OSI Reference Model without contravening subsection (3A), provided that use is for the sole purpose of supplying an eligible service to another person which is at Layer 2 in the OSI Reference Model.

(3D) An NBN corporation may supply an eligible service at a level in the OSI Reference Model which is higher than Layer 2 if that service:

(a) is a satellite service;

(b) is no higher than Layer 3 in the OSI Reference Model; and

(c) is supplied before the interim satellite service sunset date.

For this purposes, the **interim satellite service sunset date** is:

(d) 1 January 2016; or

(e) if the Minister, by legislative instrument, specifies another date – that other date.

(3E) An NBN corporation may supply an eligible service at a level in the OSI Reference Model which is higher than Layer 2 if:

(a) the service is a satellite service or fixed wireless service; and

(b) the functionality or features which cause the service to be treated as being above Layer 2 are provided or used by NBN Co to improve the transmission quality or reliability of the service;

and

(c) the service provides access to carriers and carriage services providers which is as close technically feasible to Layer 2

(3F) The Minister must not make an instrument under subsection (3D)(d) which specifies a date that is later than 1 January 2016 unless the Minister is satisfied that there are circumstances beyond the control of the NBN corporation, and each other NBN corporation, which will prevent the NBN corporation supplying a satellite service under subsection (3E) by:

(a) 1 January 2016; or

(b) if the Minister has previously specified a later date under subsection (3D)(d) – that other date.

(3G) For the purposes of this section, **OSI Reference Model** means:

(a) the Open System Interconnection (OSI) Reference Model for data exchange; or

(b) the industry classification model for data exchange which the Minister, by legislative instrument, specifies as the OSI Reference Model for the purpose of this section.

(3H) The Minister must not make an instrument under subsection (3G)(b) unless the Minister is satisfied that:

(a) the Open System Interconnection (OSI) Reference Model ceases to be in common usage; and

(b) the industry classification model to be specified in the instrument is the closest corresponding industry classification model for data exchange to the Open System Interconnection (OSI) Reference Model.

## **B NBN Access Bill**

### **B.1 Superfast broadband provisions**

- 37 The NBN Access Bill automatically subjects to regulation any new high-speed broadband network that may potentially compete with the NBN. Telstra considers that this:
- (a) Represents an unnecessary and unwarranted intrusion into the domain of the independent regulator; and
  - (b) Creates a powerful disincentive to investment in infrastructure and will make it almost impossible for network providers to compete with the Government-funded NBN Co.
- 38 Clause 94 of the NBN Access Bill inserts a number of new sub-sections into section 152AL of the *Competition and Consumer Act 2010*, requiring the ACCC to declare (and regulate) Layer 2 bitstream services supplied over a "designated superfast telecommunications network". A designated superfast telecommunications network is any network other than the NBN which is either rolled out or upgraded after 25 November 2010 and which is capable of supplying services with download transmission speeds that are "normally more than 25 megabits per second".
- 39 Competition from other high-speed broadband networks will only benefit consumers through lower prices and more innovative product offerings. It is unclear why the Government would want to include provision that would create such a powerful disincentive for new investment.
- 40 The Explanatory Memorandum indicates that these provisions are intended to provide for a "level playing field" and avoid "cherry picking". The EM states:

Amongst other things, the NBN Implementation Study identified that difficulties could arise for the delivery of the Government's NBN policy objectives as a result of NBN Co being subject to strict regulatory requirements while competing against other, less regulated, providers of superfast broadband. In particular, the Study noted the scope for competing providers to target high-income and low-cost, high-density areas, operate as vertically-integrated providers and advantage themselves over independent retail service providers (RSPs) on the NBN, and ignore technical specifications employed by NBN Co. This could mean that where other providers rolled out superfast networks in advance of the NBN, these would not deliver consumers in those areas the same benefits as the NBN. Moreover, by cherry-picking high-value markets such providers could undermine NBN Co's ability to deliver the Government's policy objectives for the NBN nationally. The Implementation Study therefore recommended that the

Government look at measures to provide a more level playing field for all superfast broadband networks...

- 41 If by “cherry picking” the Government means competitive entry in areas where this is efficient, then it is not clear why this should be discouraged. This type of so-called “cherry picking” has been a feature of telecommunications markets in Australia and around the world for the past two decades. Telstra’s competitors have been able to enter in precisely this fashion, without access obligations being directly imposed by legislation.
- 42 In any event, it should not be necessary to legislate for such obligations. In a competitive or properly regulated market, competitive entry will only occur to the extent that it is efficient – that is, where the market can bear a new entrant. The history of the industry since liberalisation demonstrates that competitive entry by new network operators will generally only be efficient in denser metropolitan areas – for example rollout of fibre infrastructure in CBD areas and certain metropolitan areas, and competitors (such as CBD fibre operators and Optus’ HFC network) have targeted those areas very effectively. Outside these areas, it may be that the economics of supply are such that having a single network operator is the most efficient outcome.
- 43 Telstra notes that *inefficient* cherry picking can occur in some cases where regulation is applied inconsistently. For example, where regulated charges create price disparities, takeup can be inefficiently high in some areas and inefficiently low in others. However, that is not the case when it comes to potential facilities-based competition, since deployment of new networks will be driven by economic considerations of demand and supply, rather than the structure of wholesale access charges. There is no reason to assume that competing broadband rollout would be economically inefficient and legislate against it.
- 44 In Telstra’s submission, the Government should be seeking to encourage efficient entry in all its forms, and thus promote competition. Discouraging new entry where this is economically efficient (labelled as “cherry picking”) will not benefit consumers over the long term.
- 45 In any event, Telstra considers that it is inappropriate for the legislature to target for declaration these particular networks which are most likely to compete with the NBN. Determining the scope of regulation which best promotes the consumer interest should be left to the regulator, the ACCC, which already has powers to regulate services provided over new high-speed broadband networks if it considers this to be in the long-term interests of end-users. There is no reason to bypass the tests that the ACCC would apply. The ACCC is already empowered to make such decisions; it is not clear why the Government sees a need to make the decision for them in respect of these particular networks.



- 46 In most other jurisdictions, such decisions are left to an independent regulator. The European Commission (EC) for example takes a particularly dim view of legislatures trying to fetter the discretion of a regulator in this way. In one European country where the legislature attempted to limit the discretion of the regulatory authority, the relevant legislation was successfully challenged by the EC under the European framework for telecommunications regulation. In 2009 the European Court of Justice (ECJ) held that the German Government breached its European treaty obligations when it sought to limit the discretion of its national regulator to assess new markets. The ECJ noted: <sup>10</sup>

It is clear from those provisions [of the European Parliament's Framework Directive] that the NRAs are required to promote the regulatory objectives referred to in Article 8 of the Framework Directive when carrying out the regulatory tasks specified in the common regulatory framework. Consequently... it is also for the National Regulatory Authorities and not the national legislatures, to balance those objectives when defining and analysing a relevant market which may be susceptible to regulation.

- 47 Telstra submits that in the present case, the decision on whether to regulate high-speed services should similarly be left to the regulator, rather than being taken by the legislature.

Recommendation: that section 86 of the NBN Access Bill, comprising the addition of all of Part 7 – Layer 2 bitstream services, be deleted.

## **B.2 Discrimination provisions**

- 48 The NBN Access Bill imposes a general obligation on NBN Co not to discriminate between access seekers in the price and non-price terms of supply (section 152AXC). In addition, section 152AXD has been added to provide that NBN Co is not to discriminate in undertaking specified additional activities, including developing a new service, extending facilities and providing information. Telstra considers that while section 152AXC is necessary to promote effective competition, section 152AXD is not. Section 152AXD over-engineers the requirements of non-discrimination and will have a counterproductive effect on downstream competition. NBN Co either will need to involve the ACCC in micro-managing its day to day activities or NBN Co will rigidly treat every access seeker the

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<sup>10</sup> European Commission v Federal Republic of Germany (Case C-424/07), paragraph 91

same in every process – in either case, placing a major constraint on efficiency.

- 49 These provisions go well beyond what is applied in comparable circumstances. For example, the non-discrimination obligations imposed on NBN Co go beyond those currently imposed on Telstra, a vertically integrated operator. This is counter-intuitive: given that NBN Co will not be vertically integrated, it begs explanation as to why it is necessary to impose behavioural rules that are stricter (or even as strict) as those currently imposed on Telstra.
- 50 The proposed requirements are also stricter than the non-discrimination provisions which apply, for example, as part of the Equivalence of Input rules in the UK separation model. In the UK, BT Openreach and BT Wholesale are permitted to build bespoke access products commissioned and funded by individual access seekers, provided that the product development process provides access seekers with an equal opportunity to commission bespoke products. This would be difficult under section 152AXD because NBN Co cannot discriminate in developing a new product (rather than the *opportunity* to develop a new product) and NBN Co must not discriminate in the supply of information about the development of a new product (which suggests that other access seekers have to be told about the bespoke product request, destroying any prospect of legitimate first mover advantage and with it the incentive to innovate).
- 51 Section 152AXD contemplates a vanilla, one size fits all world in which competitors are denied the opportunity to pull away from the pack through innovation or ingenuity - the very antithesis of the technological opportunities and economic gains made possible by the NBN. Instead of opening opportunities for new and unimagined products to meet changing consumer demands, section 152AXD stifles the provision of bespoke solutions. This is not in the interests of industry or consumers, and will prevent efficiency gains being across a broad section of the economy that is downstream of the NBN.
- 52 Non-discrimination should not be an end in itself, but rather a means to promoting competition. In many circumstances, differential treatment of customers (i.e. discrimination) will be economically efficient and welfare enhancing, particularly where end-user preferences are heterogeneous.<sup>11</sup> Offering specialised and differentiated products may also enhance competition if it provides for entry by new players targeting niche markets or rewards

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<sup>11</sup> In particular, where different end-user preferences can be identified and catered to, discrimination on price or other product features will be economically efficient. In this situation, all consumers are supplied with the product they desire at a price that reflects their willingness to pay, up to the point where demand meets supply (Tirole J (2003), *The Theory of Industrial Organization*, MIT Press, 14<sup>th</sup> Ed, Chapter 3).

innovation by existing players. Examples of discriminatory activities which may aid efficiency include:

- (a) Reductions in unit prices for customers buying large quantities (volume discounts) or confer cost savings (e.g. through aggregation), which may allow suppliers to take advantage of scale economies in the supply of these customers, and enable those suppliers to compete more intensely for marginal customers.
- (b) Discrimination between airline customers based on their desire for flexibility (and level of comfort). This allows the airline to identify customers who are more flexible with their travel arrangements and design schedules accordingly.

- 53 Given that the regulator already has a range of powers to regulate conduct that is anti-competitive, it is unnecessary and counter-productive to further legislate against discriminatory conduct, because such conduct lies at the foundation of many efficiency-enhancing arrangements that would be jeopardised as a result.
- 54 Indeed if NBN Co is constrained by the proposed section 152AXD from offering discounts to its customers who aggregate the demand of smaller customers, the inefficient outcome would be either additional costs imposed on NBN Co if these smaller customers do deal directly with NBN Co or reduced competition in downstream wholesale and retail markets if they do not.
- 55 For the reasons above, Telstra considers that the prohibitions on discrimination in the proposed section 152AXD will not promote competition and will unduly restrict innovation. Further, the restrictions on price discrimination unduly restrict NBN Co's ability to develop efficient pricing structures.

Recommendation: That section 152AXD should be removed entirely, and section 152AXC should be amended to offer a general allowance for efficient forms of discrimination. To this end, section 152AXC(4)(c) should be removed so that subsection 4 simply reads:

*The rule in subsection (1) does not prevent discrimination if:*

*(a) the discrimination aids efficiency; and*

*(b) all access seekers with like circumstances have an equal opportunity to benefit from the discrimination.*

Alternatively, in the event that section 152AXD is not removed altogether, a similar provision to 152AXC(4) (as amended above) should be included to allow NBN Co to engage in the types of activities in 152AXD(1) where this aids efficiency.

