



Submission by AAPT Limited & PowerTel Limited

in response to

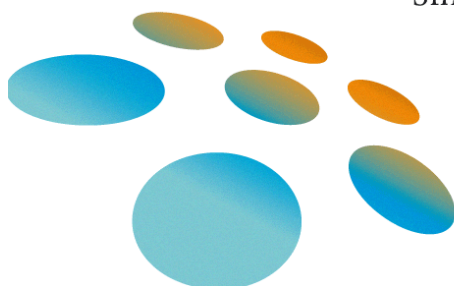
the Minister for Broadband, Communications and the Digital Economy

Invitation for Comments on a

National Broadband Network Regulatory Framework

25 June 2008

PowerTel
Simply Business



Introduction

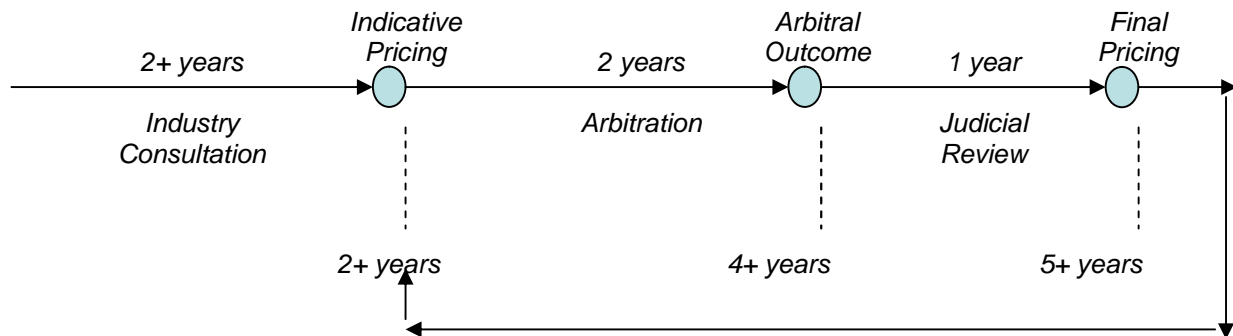
1. AAPT and PowerTel¹ welcome the opportunity to respond to the Minister for Broadband, Communications and the Digital Economy invitation for submissions on the appropriate regulatory framework in a National Broadband Network (NBN) environment. AAPT is putting forward this submission as an access seeker to the NBN.

Failure of the current regulatory framework

2. The current state of the Australian telecommunications regulatory framework is one of significant anti-competitive conduct, gaming and uncertainty.
3. Attempts to restrain the misuse of market power and anti-competitive conduct have largely been unsuccessful. Access seekers have battled to gain access to the Telstra network on reasonable terms and conditions, with negotiations often failing which results in costly and lengthy legal battles.
4. Pricing principles intended to provide a framework for negotiations have also been ineffective. They have done little to prevent the anti-competitive behaviour of the incumbent with Telstra having 47 matters before the courts earlier this year².
5. Such behaviour highlights the fact that rather than attempt to negotiate reasonable terms and conditions of access, Telstra has increasingly used the legal system to resolve regulatory issues. This has been at great cost to access seekers who are ultimately forced to pass these costs on to consumers in the form of higher prices.
6. It can take some time for the Australian Competition and Consumer Commission (ACCC) to form a concluded view on what the indicative price should be for declared services. Complex cost models need to be built, made available for industry wide review and inputs need to be refined. This process can take up to two years.
7. In the case of Unbundled Local Loop Service (ULLS) and Line Spectrum Sharing (LSS), Telstra simply refused to accept the ACCC's indicative prices. This led to a flood of ULLS and LSS arbitrations which took almost another two years to finalise. Telstra then refused to accept the arbitral outcomes which led to a flood of Federal Court administrative law appeals expected to take a year to finalise.
8. At the end of this whole process, the ACCC's indicative prices have expired and so the ACCC published new indicative prices for the period ahead. Telstra again refused to accept these new indicative prices. As a result access seekers have been bound up in a very expensive and continuous loop of arbitrations and appeals (as depicted in the diagram below) with no certainty about what the wholesale price of ULLS and LSS will be.

¹ Throughout this submission, references to AAPT should be taken to be references to both AAPT and PowerTel.

² On 6 May 2008 Telstra was reported to have 1 matter before the Full Federal Court, 13 matters before the Federal Court, 33 matters at the Administrative Appeals Tribunal and 18 Access Disputes.



9. This uncertainty has a significant dampening effect on investment by access seekers and consequently there is a significantly reduced level of infrastructure based competition at the retail level. Ultimately, it is consumers who suffer as a result.
10. Furthermore the courts have noted that facilities based competitors do not provide effective competitive constraint on Telstra's behaviour in most telecommunications markets³. In a rapidly changing market access seekers cannot afford to spend time and money negotiating access to the network as time spent negotiating is forgone opportunities.
11. Acknowledgement of the failure of the current regime has also been highlighted by Graeme Samuel, Chairman of the Australian Competition and Consumer Commission. In a recent Senate Estimates hearing Mr Samuel noted that the current operational separation of Telstra does "not promote the objective of equivalence which was the fundamental objective of the plan in the first place" and further that the additional reporting requirements aimed at improving transparency have been of "limited benefit" and have been at a "highly aggregated level"⁴.
12. Mr Samuel proceeded to say that:
"in summary, we [the ACCC] would have to say that the regime is fundamentally unduly complex. There is a lot of discretion left to Telstra. There are limited self-regulatory mechanisms and unduly convoluted processes to implement any corrective action if a problem is identified".
13. Such regulatory uncertainty leads to investment uncertainty which ultimately disadvantages consumers as they do not receive the benefits enhanced competition such as lower prices and the ability to access more innovative services that further investment would provide.
14. AAPT submits that it is clear that the current regulatory framework is inefficient and ineffective. With the imminent construction of the NBN, now is the opportune time to ensure the regulatory framework is appropriate by fostering a competitive market environment which is in the long term interests of end users.
15. AAPT considered that it is inevitable that a NBN will involve a monopolistic market structure as duplication of network infrastructure is unlikely to be economically viable. Consequently, the continuation of the current regulatory regime in a NBN environment will only serve to undermine the competitive outcomes achieved to date.

³ Telstra Corporation Limited (no 3) Australian Competition Tribunal (17 May 2007) at [79] and [80].

⁴ Commonwealth of Australia, Proof Committee Hansard 'Senate Standing Committee on Economics Estimates' (Budget Estimates), Thursday, 5 June 2008, p45

16. In fact, AAPT considers it may even increase the level of anti-competitive behaviour given the additional complexity of access issues since it is not possible to unbundle the access network in a NBN. The Competitive Economics Group (CEG) also supports the view that the level of anti-competitive behaviour may increase in a NBN environment without changes to the regulatory regime⁵.
17. As the complexity of access to the network increases, non-price discrimination becomes more attractive to the network provider. Non-price discrimination is also easier to implement and more effective.
18. Furthermore, higher fixed costs associated with the building of the network and the variety of services to be supplied over the network increase the incentives for price discrimination in downstream markets⁶. As such, the level of anti-competitive conduct in a NBN is likely to increase unless considerable changes are made to the current regulatory regime.
19. Moreover, continuation of the current market structure cannot hope to provide competitive market outcomes going forward. Evidence has shown that a network provider who is conflicted between shareholders requirements on the one hand and regulatory and statutory requirements on the other, pays little consideration to access seekers. Ultimately, it is consumers who pay for the conflicting interests of the current network provider through higher prices and poor quality services.
20. More regulation in a NBN environment however, is not the answer. What is required is appropriate regulation and the alignment of incentives to encourage market forces ensure efficient and competitive outcomes.

Key regulatory principles

21. In devising a regulatory framework that will provide the right incentives to encourage competitive outcomes, AAPT submits there are a number of key principles that need to be considered, and implemented. These are:
 - Level playing field
 - Appropriate regulation
 - Ability to differentiate products
 - Transition path and addressing the issue of stranded assets
 - Framework that aligns incentives to encourage network investment to enable further innovation

Level playing field

22. The most fundamental principle underpinning an appropriate NBN regulatory framework is ensuring a level playing field for all access seekers. A level playing field means:

⁵ Competitive Economics Group (CEG) 'Structural Separation for a National Broadband Network, A Report for SingTel Optus', 2008 p14

⁶ ibid

- Equivalence of price and non-price terms and conditions for example provisioning, billing and fault rectification
 - Reasonable equivalence of the terms included in other carriers contracts
 - Ability to differentiate retail products.
23. More simply, a level playing field means the telecommunications network owner will provide telecommunications products and services on a truly equivalent basis so that access seekers are receiving the same wholesale products, at the same time, at the same prices, and using the same processes to acquire these products and services.
24. Furthermore, with a level playing field, the network owner is incentivised to maximise traffic on the network in order to recover the cost of the investment. In maximising traffic, the unit cost of providing products and services is reduced, resulting in lower prices for consumers.
25. A level playing field also provides transparency as well as certainty and predictability of outcomes and behaviour. Such an environment encourages investment by access seekers and network providers. With greater levels of investment there is also likely to be greater levels of competition given the investments are likely to be aimed at reducing prices and/or providing more innovative services.
26. However, while a level playing field does not exist, the risk of investment failure will remain high and access seekers will be deterred from making otherwise economically efficient and beneficial investments.

Appropriate regulation

27. AAPT submits the ACCC needs to have the lead oversight regulatory role in a NBN environment given their depth of experience and involvement in these issues to date. Furthermore, the ACCC has experience in regulating industries that have well functioning markets and are appropriately regulated such as the gas and electricity sectors.
28. AAPT submits the task of the ACCC as the regulator should be to perform oversight functions of the operation of the network (such as access terms and conditions, quality of service by ensuring appropriate maintenance and continued investment in the network) as well as to set appropriate wholesale prices.
29. AAPT notes that to regulate a vertically integrated entity, such as currently exists, places a significant strain on the Government's resources. It requires considerable time and is costly. AAPT questions whether the ACCC would be able to effectively regulate a network provider that is vertically integrated in an NBN environment when the task becomes increasingly difficult. The likelihood of increased anti-competitive conduct in a NBN environment will make achieving competitive market outcomes substantially harder.
30. The ACCC would need significantly more resources to perform their duties. However, even then the ACCC would suffer from information constraints as it does today, given the likelihood of a monopolistic market structure. As such the ACCC is unlikely to be able to efficiently and

effectively regulate the network owner so as to achieve competitive market outcomes as this requires a greater degree of market information.

31. In a structurally separated environment however, the need for regulation is greatly reduced as the incentive for the network provider to behave in an anti-competitive manner is minimised. There is also a greater degree of transparency and accountability to key stakeholders which ensures more information is disseminated in a timely manner.

Ability to differentiate products

32. A significant amount of the competition that exists today is the result of access seekers investing in duplicate network infrastructure in order to access the network, ie facilities based competition.
33. While this has been beneficial in encouraging innovation and lowering consumer prices, it is unlikely this form of competition will exist in a NBN environment as duplicate infrastructure is not likely to be economically viable, or practical, given the size of nodes/cabinets.
34. It is therefore essential that access seekers are able to differentiate their product in the downstream market. With a level playing field access seekers are accessing the same wholesale products on the same terms and conditions and for the same price. Without the ability to differentiate products, a competitive market will not exist.
35. Competition in downstream markets through product differentiation has enormous benefits. As noted by CEG, “the greater the potential for innovation [essentially through product differentiation such as various applications, service platforms and content] in the downstream market, the more valuable to society is vibrant competition in that market”⁷. CEG also notes that innovation would be promoted in a structurally separated environment because the threat of the downstream buyer being denied access by the upstream supplier would be removed⁸.
36. In providing consumers with the choice of services it is also essential that consumers have the choice to purchase unbundled services. Consumers should not be penalised and forced to pay for services they do not desire and do not choose today.

Transition path and addressing the issue of stranded assets

37. AAPT welcomes the initiative of the Government to allow for bids to be submitted on a modular basis. Modular bidding will provide for efficient and rational use of existing networks by enabling them to be part of the NBN where appropriate. In doing so, a network owner will be incentivised to optimise volume on the network and achieve the lowest unit cost. Allowing over-build and duplication of the network will raise units costs which ultimately results in higher prices for consumers.

⁷ Competitive Economics Group (CEG) ‘Structural Separation for a National Broadband Network, A Report for SingTel Optus’, 2008 p18

⁸ Ibid

38. AAPT also submits that the construct of the NBN should be to firstly provide services to currently under-served areas. That is, the network should be constructed on the basis of 'rolling-in' infrastructure from areas with low speed broadband towards areas which currently have higher speed broadband. This is in contrast to a model of 'rolling-out' infrastructure from areas of high speed broadband to areas with low speed broadband.
39. Such a roll-in will best serve the interest of consumers who are most disadvantaged with respect to access to higher speed broadband, which underpins the objective of the Government's broadband initiative – to provide higher speed broadband services to all Australians⁹.
40. Rolling-in the NBN according to a well formulated transition path will reduce the incidence of stranded assets as owners of existing infrastructure will be able to retire their investments in the most economically efficient manner.
41. Ensuring a well formulated transition path, which includes the use of existing infrastructure assets where appropriate, or enabling infrastructure owners to retire assets in an appropriate manner, will provide certainty to asset owners. This could potentially reduce the need for compensation.
42. Consideration also needs to be given as to how to transfer customers to the NBN. AAPT believes this process should be mandatory where consumers are well informed as to the products and services they are able to purchase. However as noted above, consumers should not be disadvantaged and required to purchase product and services they do not desire and do not choose today.

Framework that encourages future network investment

43. It is imperative that the NBN regulatory framework encourages future network investment. There is little point spending billions of dollars of public and private sector funds on a network that is quickly outdated simply because the regulatory construct does not provide the incentives for investment.
44. Network investment can be defined to mean investing to maintain the network or investing to upgrade the network for example with higher speeds or the ability to deliver innovative and new services. Both forms of investment are important and while incentives may exist to invest in maintaining the network in order to meet quality of service standards, it is particularly important that investments aimed at upgrading the network are encouraged.
45. Consumers will greatly benefit from continued investments in the network. Not only will they receive a reliable quality of service, they will also benefit from the innovative services and delivery solutions that will arise from continued network investment.
46. Regulators in the European Union are currently devising ways of encouraging such essential investment. Incentives include part ownership of the network so that network providers and access

⁹ Senator Conroy has noted that 98 per cent of Australians will receive broadband speeds 40 times faster than current speeds with the remaining 2 per cent of Australians receiving a standard of service that is as close as possible to that offered by the new network. (Senator Conroy's media release 'Government Committed to FTTN national network', 7 December 2007.

seekers have a vested interest in ensuring the network is running at optimal efficiency and delivering innovative products and services to consumers that maximise the return on their investment.

The Appropriate regulatory framework

47. AAPT submits that the most efficient and effective way to implement these key regulatory principles which provide the appropriate regulatory framework for the NBN is through structural separation. Regulation alone of what will continue to be a monopolistic market structure is not sufficient and structural remedies are required.
48. Structural separation appropriately aligns the incentives of the network provider so as to encourage competitive market outcomes. Without the correct alignment of incentives a network owner will continue to push the limits of conduct and find ways to advantage its own operations and disadvantage those of access seekers.
49. AAPT submits that structural separation will greatly remove the incentive for the network owner to discriminate in an anti-competitive manner against access seekers. This will lead to greater certainty over access prices, more effective competition and increased investment.
50. In providing the right incentives for network providers to behave in a competitive manner, structural separation reduces the need for regulation. Furthermore, the increased transparency inherent with structural separation provides greater certainty to access seekers.
51. It is sometimes contended that vertical separation undermines coordination and leads to a dampening of investment. However AAPT submits there is no evidence on which to base this assertion¹⁰.
52. It is clear that the most efficient and effective way to regulate next generation networks and in particular the NBN is through structural separation. The previous Minister for Communications, Information Technology and the Arts has recently acknowledged that a stronger separation regime should have been introduced¹¹. As noted above, the ACCC as the regulator have also acknowledged the failure of the current arrangements, which left unchanged are likely to result in more harmful anti-competitive behaviour in a NBN environment.
53. Moreover, the experience of British Telecom (BT) clearly highlights the need to appropriately align incentives so as to ensure competitive outcomes. As noted by John Pluthero, CEO of Cable & Wireless UK (one of BT's main wholesale competitors)

“The creation of Openreach [the access network services company formed as a result of functional separation] is fundamentally flawed because if Openreach were to work properly, the way the regulator wants it to, you are asking the main board of directors of BT to make decision that are not in the best interests of shareholders. I find it odd that anyone would have thought it could be possibly work given that structure and the fundamental conflict involved¹²”.

¹⁰ Doyle, Chris ‘Structural separation and investment in the National Broadband Network environment’ 2008

¹¹ Communications Day, 13 May 2008

¹² Doyle, Chris ‘Structural separation and investment in the National Broadband Network environment’ 2008 p2

54. This conflict resulting from the misalignment of incentives is also impacting on consumers who have rated the company as a “below average” supplier and have not observed any improvements in service quality since Openreach was established¹³.
55. It is clear that in order to achieve competitive outcomes network providers and access seekers must be handed the appropriate incentives. These incentives can only be achieved through structural separation of the network in a NBN environment.

Conclusion

56. AAPT submits that it is clear that the current regulatory regime is both inefficient and ineffective. It does little to mitigate the anti-competitive conduct of Telstra as the largest network provider and instead results in an environment fraught with anti-competitive conduct, gaming and uncertainty.
57. Pricing principles intended to provide a framework for negotiations have been ineffective. The negotiate-arbitrate model has failed resulting in more legal battles that are increasingly lengthy and costly.
58. The failure of the current regulatory framework has not gone un-noticed. The Chairman of the ACC has acknowledged its failure and the previous Minister for the Telecommunications industry has acknowledged that a stronger [and effective] separation regime should have been introduced in order to assist in achieving competitive outcomes.
59. In moving to a NBN environment now is the opportune time to implement the appropriate regulatory framework that is efficient and effective.
60. However, more regulation is not the answer, appropriate regulation is. AAPT submits that by ensuring the alignment of incentives within the appropriate market structure, the appropriate regulatory framework will be achieved.
61. The appropriate and essential market structure for Australia in a NBN environment is structural separation of the network provider.
62. Structural separation supports the key regulatory principles that ensure effective competition. That is, structural separation:
 - provides a level playing field for access seekers,
 - requires less regulation as competitive incentives are incorporated in the market structure,
 - provides the ability for access seekers to differentiate their products; and
 - encourages future network investment.

¹³ Competitive Economics Group (CEG) ‘*Structural Separation for a National Broadband Network, A Report for SingTel Optus*’, 2008 p15

63. Structural separation has worked well in other utility industries for example the electricity and gas industries and it is evident that it is essential for it to be implemented in the telecommunications industry.
64. AAPT submits that given the importance and need to implement the key regulatory principles above, a failure to implement these principle and a structural separation model in Australia is a failure to deliver competitive outcomes which are in the long term interests of end users.