

EXPLANATORY STATEMENT

Telecommunications Act 1997

Carrier Licence Conditions (Networks supplying Superfast Carriage Services to Residential Customers) Declaration 2014

Issued by the Authority of the Minister for Communications

Legislative Basis

Subsection 63(2) of the *Telecommunications Act 1997* (the Act) provides that the Minister may, by written instrument, declare that a particular carrier or class of carriers is subject to licence conditions as specified in the instrument.

Purpose of the Declaration

The purpose of the Declaration is to impose new obligations upon carriers operating designated telecommunications networks supplying superfast carriage services or specified broadband services to residential customers.

The obligations imposed on specified carriers require that a carrier:

- provide wholesale services on a non-discriminatory and equivalent basis during an interim period (1 January 2015 to 30 June 2015), and
- in the long term (1 July 2015 to 31 December 2016), the specified carrier:
 - be required to comply with general separation and supply obligations, and
 - layer 2 wholesale service obligations.

Given the nature of the carrier licence conditions in this Declaration, the intention is that the Australian Competition and Consumer Commission (ACCC) would have the lead role in enforcing the obligations in it.

Background

In April 2009 the then Government established NBN Co to build and operate a new National Broadband Network (NBN). The Government decided that the NBN would be a wholesale-only network, operated by NBN Co, which was required under legislation to offer open and non-discriminatory access to all retail service providers. This decision reflected concerns that in the past, the fixed-line local access network could be the focus of conduct that stifled competition and that the dominant provider, as a vertically integrated provider of wholesale and retail services, had both the incentive and ability to favour its own retail operations over those of its competitors.

In addition to ensuring the NBN would be a wholesale-only, open access, non-discriminatory network, the Parliament enacted legislation (Part 7 and 8 of the *Telecommunications Act 1997* – the Act). Part 7 and 8 required other new networks that were to provide download speeds of more than 25 Mbps ('superfast networks') to residential and small business customers to operate on terms similar terms to those applying to NBN Co.

These requirements were designed to ensure that, having made the significant structural changes to the industry through the creation of NBN Co and the structural separation of Telstra, these changes would not be undone by other new networks operating in the same way that had previously given rise to concerns.

The rules in the Act support competition in two ways. First, they mean that wholesale-only network operators are not unfairly disadvantaged in offering their services by having to compete with vertically integrated providers. Second, they mean service providers who do not (or cannot, in the case of Telstra, NBN Co and other new networks) own and operate certain network assets are not disadvantaged by having to compete with other operators who own their own networks and can advantage themselves over their competitors.

Importantly, the Act included exemptions designed to minimise disruptions to network operators with existing investments. For example, networks that were capable of supplying superfast carriage services before 1 January 2011 could be extended by less than 1 km from any point on the network.

In September 2013, TPG Telecom announced its intention to build a fibre-to-the-basement (FTTB) network with the potential to reach more than 500,000 premises in metropolitan areas in Sydney, Melbourne, Brisbane, Perth and Adelaide. The network primarily targets residential and small business customers. TPG is not a wholesale-only company and it does not have a non-discrimination regime in place. Although it has indicated that it will supply wholesale services over its network, it has yet to offer them to the market. However, it is not subject to Part 7 and 8 of the Act because it had a network (albeit one that was focussed on the business market) that was already capable of supplying superfast carriage services before 1 January 2011, and is extending that network by less than 1km.

On 11 September 2014, the ACCC announced that it did not consider TPG was in breach of Part 7 or 8. On the same day as the ACCC's announcement, the Minister for Communications announced that he would consult on a new carrier licence condition declaration relating to superfast networks.

The decision by the Minister to consult on a new licence condition declaration reflected concerns that carriers could use the exemptions under the Act to extend networks previously servicing business customers to service residential customers, contrary to the intention of the Act. This could allow them to operate FTTB networks on a vertically integrated basis, meaning they would have the ability and incentive to favour their own retail operations. This would re-introduce the competition issues that the rollout of the NBN and the structural separation of Telstra were meant to address.

The Government acknowledges that the ACCC's declaration inquiry on FTTB services is currently underway, but notes that the declaration process can take up to a year to complete. Moreover, even if the service is eventually declared, it will not be able to address concerns that a vertically integrated carrier may favour its own downstream operations.

The purpose of this new Declaration is to ensure that carriers who own or operate telecommunications networks that are technically capable of being used to supply

superfast carriage services to residential customers provide wholesale access to FTTB network infrastructure and do not discriminate in favour of their own retail operations at the expense of competitors.

The conditions set out in this Declaration are intended to close, at least in some part, the gaps in Parts 7 and 8 of the Act that result in certain networks not being subject to the same regulatory restraints as the NBN.

Consultation

On 14 October 2014, the Minister wrote to all existing carrier licence holders regarding the proposed declaration and provided them with an opportunity to comment on the proposed licence conditions. The Minister also issued a media release and a copy of the draft declaration was also published on the Department of Communications' website.

Eighteen submissions were received on the proposed licence conditions, including submissions from major service providers such as Telstra, TPG, iiNet, Amcom, Nextgen, Vocus and NBN Co, as well as submissions from smaller carriers such as BTelecom, Clublinks, First Path Networks, Index Telecom, LBN Co, OPENetworks, Oziplex and Puddlenet. The Department of Communications also discussed the draft declaration with the Australian Communications and Media Authority, the Australian Competition and Consumer Commission, the industry representatives Communications Alliance and the Competitive Carriers' Coalition and consumer group the Australian Communications Consumer Action Network. The Department also held meetings with individual carriers where appropriate.

Regulation Impact

A regulation impact statement is at **Attachment 1**.

Details of the accompanying Declaration

The Declaration is a disallowable instrument for the purposes of the *Legislative Instruments Act 2003*.

Details of the accompanying Declaration are set out in **Attachment 2**.

Statement of compatibility with human rights

A statement of compatibility with human rights for the purposes of Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* is set out in **Attachment 3**.

REGULATION IMPACT STATEMENT**Carrier Licence Conditions (Networks supplying Superfast Carriage Services to Residential Customers) Declaration 2014****Overview and Introduction**

Since the introduction of open competition in the Australian telecommunications market in 1997, policy-makers have grappled with the difficulties posed by making competition more effective. The market has been characterised by a single incumbent provider, Telstra, that was the former monopoly provider and owned a widespread 'local access network' (the network of lines connecting individual houses and businesses). Other market entrants found it difficult to compete against this established network by building their own competing fixed-line networks, because of the high fixed costs. Some networks were built, but tended to be concentrated in a few high-density areas in some cities. The local access network therefore has strong bottleneck characteristics.

In most areas of Australia competing providers instead sought access to Telstra's network to supply their own services. Access regimes are a well-established part of the regulator's toolkit. They are common in many jurisdictions overseas and ensure service-based competition. However, they create new sets of problems. In particular, the firm controlling the network has the incentive and ability to deny access to would-be competitors and potentially favour its downstream operations over those of its competitors. As a result, some of the negative characteristics of monopoly provision can be retained – in particular, prices that are higher than long-run production costs, which reduces demand and consumer benefits.

Assessments of the Australian telecommunications market have generally indicated that competition has not been as effective as might have been expected.¹ The competition issues focus around concerns that the incumbent was trying to raise its rivals costs by denying or delaying access, offering inferior quality services and charging prices that were higher than its own internal costs of supply. For example, the following issues have all been the focus of attention by the regulator, the Australian Competition and Consumer Commission (ACCC), at different times during the past fifteen years:

- price squeezes, with prices for wholesale services being higher than the incumbent's own retail prices;

¹ The Competition Policy Review (*Draft Report September 2014*, p.118) made the point that the absence of structural separation in telecommunications, and reliance on third-party access to a vertically integrated provider's network, 'has seen less fixed-line retail competition in telecommunications than might have been expected'.

- ‘capping’ of exchanges (the buildings where competitors connect their networks to the incumbent’s network) to prevent competitors supplying services in areas with high demand for broadband;
- upgrades to broadband services being made available to the incumbent well in advance of being supplied to wholesale customers (i.e., competitors);
- commercially-sensitive information on end-users of wholesale customers being accessible to the incumbent’s own retail staff; and
- widespread ‘gaming’ of regulatory processes and decisions to delay supply to competitors (or supply at regulated prices).

The rollout of the National Broadband Network (NBN) by NBN Co, and the structural separation of Telstra were intended, in part, to address these competition issues. Structural separation would reduce the incumbent’s ability to favour its own retail operations. The NBN would similarly operate on a wholesale-only and non-discriminatory basis and, over time, operate the local access network, meaning that the competition concerns just outlined should not be replicated.

Following its election in September 2013, the Abbott Government confirmed its commitment to the structural separation of Telstra and the rollout of the NBN, although it has directed NBN Co to adopt a faster and more efficient multi-technology mix (MTM) in rolling out the network.

The superfast network rules

In March 2011 the Parliament enacted legislation (Parts 7 and 8 of the *Telecommunications Act 1997*) to require new networks that were to provide download speeds of more than 25 Mbps (‘superfast networks’) to residential and small business customers to operate on an open access, wholesale-only and non-discriminatory basis. The networks were also required to offer a Layer 2 bitstream wholesale service.²

These requirements were very similar to those applying to NBN Co and were intended to ensure that where such networks are built and operated that they provide consumers with a choice of competing retail service providers and the benefits of that competition, in terms of service innovations and lower retail prices. As such they sought to provide consumers with the same types of outcomes that they should enjoy on the NBN. This acknowledges that in many instances there is only one fixed line network in a market, giving its owner bottleneck control over access to communications consumers. Even where there are multiple networks in a locality (i.e. infrastructure competition), it may be that the operator of one network controls access to a customer and the customer’s choice of retail provider, unless it is required to provide access to competitors.

The rules were also intended to create a more level regulatory playing field for NBN Co, enabling it to compete in the provision of infrastructure. As a result of this, NBN

² ‘Layer 2’ is a commonly-used term in the industry and refers to a particular layer in the network. A Layer 2 service will not have the characteristics of a retail service but forms a ‘raw’ foundation on which a wholesale customer can build advanced retail services.

Co would also be better able to cross-subsidise loss-making services, as required by the previous Government's operational model for the NBN (the Government now intends that these loss-making services be funded by a transparent, competitively neutral industry subsidy scheme).

The superfast network rules are quite complex and involve a number of exclusions. They do not apply to:

- satellite, mobile or wireless networks;
- transit networks (for example, the backhaul lines connecting towns and cities);
- local access networks supplying services to large businesses or government agencies;
- stages in real-estate developments, where the network operator had not rolled out before 1 January 2011, but had rolled out in other stages of the same development prior to that date;
- superfast networks that existed before 1 January 2011;
- connections of premises in close proximity to superfast networks as they existed at 1 January 2011; and
- extensions of superfast networks by less than 1km.

These exemptions were intended to permit existing investments to continue without being subject to the new rules; in effect, earlier networks were 'grandfathered'. However, the intention was that new networks, and any substantial extensions of existing networks, targeting residential or small business customers should be subject to the new rules. The competition concerns outlined above largely apply to local access lines connecting such customers.

TPG Telecom's rollout

On 17 September 2013 TPG Telecom announced plans to deploy a fibre-to-the-basement (FTTB) broadband network to an initial tranche of 500,000 residential and small business premises in five mainland capital cities (Brisbane, Sydney, Melbourne, Adelaide and Perth). It plans to do so by using a fixed-line fibre network which it acquired in November 2009. The network will offer very high-speed digital subscriber line (VDSL) services that can support download transmission speeds of more than 25 mbps. In this case the network will offer a newer version of VDSL, known as vectored VDSL2. 'Vectoring' reduces noise between lines in a single cable bundle and thereby permits a service provider to offer higher speeds than other types of digital subscriber line (DSL) technology.

The premises to be connected will mostly be within multi-dwelling units or multi-premises business centres, which will currently have in-building cabling and existing services supplied over Telstra's copper network. TPG's rollout would, in effect, replace Telstra's network at the basement of the building (if the building owner agrees) and then connect to existing in-building cabling.

TPG commenced supplying retail services over this network in September 2014. It is offering a service that is clearly a superfast carriage service, with a download

transmission speed of between 50 Mbps and 100Mbps service over the network.³ TPG has said it will provide a wholesale service over its network, but has yet to offer one to industry. It is not operating on a wholesale-only basis.

The ACCC has examined the compliance of the TPG network with the requirements of Parts 7 and 8. The ACCC has concluded that the network is not captured by the rules because it was already capable of being used to supply superfast carriage services to small business customers before 1 January 2011 and is not being extended at any point by more than 1km.

In this case, TPG is rolling out a network through a loophole that the Government did not anticipate in 2011. TPG's network prior to 2011 did not target residential customers. It is now extending a business network to target such customers. This is a regulatory failure as the legislation has not ensured that a superfast local access network targeting residential customers will operate on a wholesale-only and non-discriminatory basis.

There is the possibility that other carriers may propose networks such as that proposed by TPG. In discussions with the Government some service providers have indicated they may consider such a move, subject to future policy directions.

On 11 September 2014 the ACCC announced that it would commence a declaration inquiry into whether a superfast broadband access service like the type to be provided by TPG over its FTTB networks should be the subject of access regulation. The inquiry will consider whether regulation is necessary to ensure that consumers in TPG-connected buildings can benefit from competitive retail markets for high-speed broadband services.

In light of the decision by the ACCC, the Government is concerned that the competition objectives that Parts 7 and 8 were designed to achieve will not occur. Declaration by the ACCC of services on the TPG network and comparable networks will ensure that wholesale customers can gain access to a service, permitting service-based competition. However, declaration would not address the fundamental issue Part 8 is intended to address, namely the operator of a new superfast network having the incentive and ability to favour its own downstream retail activity over those of other competitors.

In this context on 11 September 2014, the Minister for Communications announced that he was proposing to consult industry on a new telecommunications licence condition, which would apply to all carriers. The licence condition would require owners of high-speed networks affected by the ACCC's declaration process to functionally separate their wholesale operations, and to provide access to competing service providers on the same terms as it is provided to their own retail operations. This licence condition would remain in place for two years. Effectively, the licence condition would seek to close the gaps in Parts 7 and 8 that have been identified by TPG's actions and the ACCC's decisions, while the Government considers longer-term options.

³ <http://www.tpg.com.au/fttb>.

This regulatory impact statement addresses the Minister's proposal to consider a new licence condition.

Problem definition and the case for action

Defining the problem

Vertical integration or separation

A key issue is whether a vertically integrated network will result in negative outcomes in terms of prices, service quality and availability. Where that vertically integrated network forms an access bottleneck history has shown that competition may not be effective, and therefore may have delivered less consumer welfare than might have been expected. As noted above, there have been concerns in Australia that, because Telstra both owned the local access network and competed with its wholesale customers to supply retail services to the same end-users, it had the incentive and ability to favour its own downstream operations over those of its competitors.⁴

Vertical integration can supply the owner of a monopoly network with strong incentives to undermine retail-level competition. As noted by two Australian economists:

After all, if there is a profit to be made at the retail level, the network owner would like to keep that profit for itself. If it is unable to do this by raising the network access fee to a monopoly level, then it will be tempted to undermine its retail competitors by reducing the quality of access services. As Australia's recent experience of telecommunications regulation shows, it is difficult, if not impossible, for a regulator to prevent such discrimination by an integrated network operator.⁵

Vertical separation rules have been used in other industries such as electricity and gas to address concerns about anti-competitive conduct between constituent parts of vertically integrated operations, when competing with other providers dependent on the vertically-integrated operator's network.

Imposing separation obligations on a provider would address these competition issues, but there is a trade-off in terms of reduced efficiency. Separation ensures that a firm's retail operations are set apart from its upstream network operations, and the more extensive and complete the separation, the greater the independence between retail and network operations. As a result, the greater the degree of separation the less ability the network operator has to discriminate in favour of its own retail arm. However, without regulatory intervention it is unlikely that market forces would lead a firm to separate its retail and network operations on a voluntary basis. Vertical integration can provide economic efficiency gains, especially in markets with what is known as 'asset specificity' – the need to invest in assets which cannot easily be adopted for an alternative use, as well as high levels of complexity or uncertainty in

⁴ By contrast, the general access regime in part IIIA of the *Competition and Consumer Act 2010* prohibits access price structures which allow a vertically integrated access provider to set terms and conditions that discriminate in favour of its downstream operations, except to the extent that the cost of providing access to other operators is higher: see paragraph 44ZZCA(b).

⁵ J. S. Gans and S. P. King (2010), 'Big Bang' Telecommunications Reform. *The Australian Economic Review* 43(2), p.182. A similar point was also made by the Productivity Commission (2001), *Telecommunications Competition Regulation*, Report No. 16, 21 September 2001, p.45.

production processes or market conditions. These are characteristics of telecommunications markets.

Clearly, a vertically-integrated network can provide benefits to consumers. Both Telstra and Optus rolled out competing local access networks in the 1990s, albeit in limited areas of five capital cities. They used a technology known as ‘hybrid fibre-coax’ or HFC, which allowed them to supply high-speed broadband services and Pay TV. In this case, consumers were able to gain access to new kinds of services and competition between the two networks arguably restrained prices on those networks.

The HFC networks have been upgraded to support higher-speed services, and have been extended on a local basis, but the footprint has not been significantly broadened to cover more cities and towns or more suburbs within the cities. That the industry has developed in this way probably reflects technological advances, which have led industry to deploy fibre more deeply into the network and then extract higher speeds from copper lines and cables. It may also reflect a strategic decision by some providers that it was cheaper to obtain access to the copper network than to roll out a competing network or to upgrade an existing competing network.

As a result, in most of Australia there is only one local access network, and limited prospects that competing local access networks will be deployed outside certain high-density areas of some cities. Ironically, TPG’s own network rollout, as far as the Government can ascertain, itself targets areas which already have competing HFC networks.

It is also important to point out that HFC networks have not been used to supply wholesale services. Telstra’s existing copper network has been used to supply wholesale services in areas with HFC networks. Although it is technically feasible to supply wholesale services over HFC, it appears that wholesale customers preferred to seek access to the copper network because this was more widespread. To supply services on a national basis, they only had to purchase one set of equipment and operate under one set of technical specifications; having to operate a different set (or even both) in areas with HFC networks would have added to their costs of doing business.

The key point to make then, is that vertical integration of course delivers benefits; but where a vertically integrated provider controls a bottleneck, the Government has to determine whether those benefits could be greater if the provider’s ability to discriminate against its wholesale customers is reduced.

Economists have long argued over the degree to which efficiency gains from vertical integration are outweighed by any efficiency gains from enhancing competition. It is fair to say that analytical work to date has been characterised by poor data and a difficulty in disentangling the actual impacts of integration or separation from the impacts of broader market forces. As a result, although a number of economists argue that vertical separation may lead to a reduction in consumer welfare, others argue the exact opposite, and none have as yet presented a convincing case.⁶

⁶ For examples of the different perspectives see M. Cave and C. Doyle (2007), ‘Contracting Across Separated Networks in Telecommunications. Lessons from Theory and Practice,’ *Communications and*

In this regard, there is some evidence from the United Kingdom which shows that fixed-line broadband prices for customers have reduced following separation of the incumbent and a shift to a non-discriminatory structure.⁷ It is not clear if this reduction in prices led to an overall increase in consumer welfare, although it would appear to be perverse to argue that it did not; few public policy areas could proceed if a reduction in prices for consumers could not be taken as evidence for such welfare increases. Consequently, it indicates that consumers would be expected to benefit from a more competitive retail market through lower prices and an increase in demand for high-speed services.

A key issue, as the Vertigan review recognised, is the scale of the network to be separated. Imposing separation on a network that covers a limited number of premises could mean that the costs of the separation would outweigh the benefits. However, separation could be warranted with new networks so long as the result did not deter efficient investment.⁸

Vectored VDSL2 issues

While there is scope for multiple VDSL services to operate on a copper bundle without vectoring, technical and financial issues will mean that only one fixed-line vectored VDSL2 network is likely to be connected to multi-dwelling units and business centres. In a submission to the Independent Cost-Benefit Analysis and Review of Regulation in March 2014, the industry representative body, Communications Alliance, pointed out that any local access network supplying services using vectored VDSL2 will only function at its maximum capacity if there is a single operator:

To reap the maximum performance benefits of vectoring and prevent service instability (e.g. dropouts) no more than one provider can offer vectored services within each cable sheath. This effectively means that there can only be one provider of VDSL2 network services in a node serving area or within a multiple dwelling unit or business centre development. This could be a wholesale-level provider, giving the opportunity for open access to enable other providers to offer services through the node.⁹

Strategies 68, pp.21-56; R. W. Crandall, J. A. Eisenach and R. E. Litan (2010) 'Vertical Separation of Telecommunications Networks: Evidence from Five Countries,' *Federal Communications Law Journal* 62, pp.493-540; SPC Network (2009) *Equivalence of Input and Functional Separation: A Framework for Analysis*, pp.35-37.

⁷ See J. G. Sidak and A. P. Vassallo (forthcoming), 'Did Separating Openreach from British Telecom Benefit Consumers?' *World Competition: Law and Economics Review* 38, pp.1-31. Sidak and Vassallo argue that long-run benefits may have been reduced, focussing in accordance with accepted economic theory on a reduction in network investment. It is curious, however, that they do not take into account the likely impact on investment of the Global Financial Crisis during the period in question (2008-2010) and also ignore significant network upgrades carried out by British Telecom since 2010.

⁸ Independent cost-benefit analysis of broadband and review of regulation (2014), *Volume 1 – National Broadband Network Market and Regulatory report*, p.79.

⁹ Communications Alliance (2014), 'Industry Paper on FTN and VDSL2 Regulation.' Submission to the Independent Cost-Benefit Analysis and Review of Regulatory Arrangements for the NBN *Regulatory Issues Framing Paper*, p3.

The technical performance of a vectored VDSL2 network is optimised if only a single carrier connects fixed-lines from a node to premises and then accesses internal cabling in those premises. There will be a clear advantage for any carrier that is the first to connect vectored VDSL2 to a multi-dwelling unit or business centre. That carrier would have first access to the internal cabling. Although a second carrier could conceivably seek to deploy vectored VDSL2 from the same location and use the same cable bundle, this would lead to a significant reduction in technical performance for all vectored VDSL2 networks running from that node. Building owners are unlikely to agree to allow a second carrier to connect equipment on this basis, because tenants are unlikely to want premises offering inferior quality services.

A carrier could connect its own fixed-line network to a building to which another carrier already supplies vectored VDSL2 by deploying an alternative technology, such as HFC or FTTP. However, in this case it would face significant additional costs. The costs of deploying new fibre cabling within apartment buildings are between \$450 and \$500 more per apartment than deploying fibre to the basement and using the existing in-building cabling.¹⁰ Any carrier deploying alternative network technologies may, therefore, be unable to recover its costs and compete with the vectored VDSL2 provider on price.

Given these issues, in a separate submission to the Independent Cost-Benefit Analysis and Review of Regulation, the ACCC noted that ‘the effective use of *vectoring*, and the accompanying higher data rates, requires a sole (monopoly) supplier. There may therefore be a need to reconcile technical difficulties with the objective of promoting competitive outcomes’.¹¹

A carrier that has connected a vectored VDSL2 network to premises does not have a statutory monopoly on access to those premises. However, the technical issues outlined above, and the resulting extra costs, mean that other service providers will be unlikely to duplicate the carrier’s network. Furthermore, building owners or managers are unlikely to permit competitive installations where such installations could see a degradation in the quality of services being provided to tenants. In practice, therefore, where a carrier is the first provider to roll out a vectored VDSL2 network to a building it may enjoy an effective monopoly on the supply of fixed-line infrastructure to that building.

Even where there are competing customer access networks, each network will control access to the customers connected to it. In this instance, competing service providers would need access to be able to service customers. Even where there are competing networks, the number is expected to be small. In these instances, it is envisaged there would be greater benefits for consumers from promoting further competition at the retail level.

Tenants in the building would still have access to alternative technologies such as wireless or mobile broadband. Those technologies are adequate for many consumer needs, but wireless and mobile technologies may not provide sufficient speed or

¹⁰ NBN Co (2013), *Strategic Review December 2013*, p.87.

¹¹ ACCC (2014), *ACCC Submission to the Independent Cost Benefit Analysis Review of Regulation Telecommunications Regulatory Arrangements Paper (s.152EOA Review)*, p.21 (emphasis in original).

bandwidth for business uses, and residential users may also consider that the low download limits (and corresponding high cost of usage over the download limit) of mobile technologies is less attractive than fixed-line technologies (which currently include unlimited download plans).

Why ACCC declaration does not address the competition issues

The advantages that a vertically integrated provider has would be reduced if it chooses to, or is required to, supply wholesale services so that other providers can access its network and supply competitive services to end-users. It is possible that the ACCC's declaration inquiry could result in the ACCC determining that it would be in the long-term interests of end-users for carriers with vectored VDSL2 networks to supply a wholesale service to other retail providers. However, the declaration process can take up to one year to complete, and the result is uncertain.¹² Moreover, the declaration process cannot ensure that vectored VDSL2 providers operate on a wholesale-only basis or supply wholesale services on a non-discriminatory basis.

Should the ACCC declare access to a service, the network operator ('the access provider') must supply that service to other carriers ('access seekers') in accordance with Standard Access Obligations (SAOs) set out in Part XIC of the *Competition and Consumer Act 2010* (CCA).

The SAOs require an access provider to supply a service and provide interconnection to an access seeker. In complying with the SAOs the access provider must 'take all reasonable steps to ensure that the technical and operational quality of the [service] is equivalent to that which the access provider provides to itself'.¹³ This has generally been interpreted narrowly – for example, 'technical and operational quality' may not cover many aspects of non-price terms such as timing of supply and provision of information. Furthermore, 'equivalent' in this section of the CCA does not mean 'same'. Access providers are able to offer their own downstream operations quite different terms and conditions from those they offer to access seekers. The CCA therefore allows non-NBN Co providers to discriminate in favour of their own operations.

Industry views

Some industry members are concerned that a vertically integrated provider should not enjoy an effective monopoly over access to multi-dwelling units and business centres. iiNet argued that such networks should be wholesale-only and open access.¹⁴

¹² Under Part XIC the ACCC must first conduct an inquiry to determine whether or not to declare a service (section 152AL); this process can take up to six months. If the ACCC decides to declare a service, it may make an access determination in relation to the service. It must make the access determination within six months after it commences a public inquiry into making the determination (section 152BCK).

¹³ Paragraphs 152AR(3)(b) and 152AR(5)(d) of the *Competition and Consumer Act 2010*.

¹⁴ iiNet (2014) *Cost-Benefit Analysis and Review of Regulatory Arrangements for the National Broadband Network. Telecommunications Regulatory Arrangements. Consultation Paper for the Purposes of Section 152EOA of the Competition and Consumer Act 2010. Submission by iiNet*, p.10.

Macquarie Telecom and Optus likewise argued that the 1km exemption under Parts 7 and 8 of the Act should be scrapped.¹⁵

These views were reinforced in industry comments on the draft instrument. iiNet and other providers like Open Networks supported the continued application of the Part 7 and 8 rules to the market.

The crux of the issue, therefore, is what action needs to be taken to ensure that carriers who were not previously supplying a large number of superfast carriage services to residential and small business customers, but who are now proposing to do so, and who are not subject to Parts 7 and 8 of the Act, supply wholesale services over their networks, and do not favour their own retail operations over those of their wholesale customers.

The case for action

TPG's proposal is not for a limited rollout. It is for an initial rollout affecting up to 500,000 premises, which indicates that it may extend its network further (the Department estimates that TPG's networks are within 1km of about 1.8 million premises, of which about 1 million are multi-dwelling units or business centres). The rollout is of such a scale that a significant proportion of premises in Australia will be affected. There are currently about 10 million fixed-line services in operation in Australia, and TPG's rollout could therefore have an impact on at least five per cent of those services. Should other carriers elect to make use of the statutory 1km exemption, a substantial percentage of the population could then be covered.

There is therefore a risk that, in the absence of action, carriers could roll out vectored VDSL2 networks on a vertically integrated basis and re-open the competition issues that led in part to the decision to deploy the NBN and seek the structural separation of Telstra. As discussed above, the telecommunications access regime cannot currently prevent a vertically integrated provider from favouring its own retail operations.

In this context, it is worth emphasising that policy in this area does not start from a clean slate. The Government made an election commitment to complete the NBN as quickly and inexpensively as possible, and determined to retain the structural separation of Telstra and requirements on NBN Co to operate as a wholesale-only provider offering non-discriminatory access to services. With these settings in place, Government action needs to be targeted to ensuring that they continue to operate effectively.

Overview of options

Five possible options have been identified to respond to the problem identified, although they would not all address the issues posed by the rollout of superfast local access networks targeting residential and small business customers that are not subject to sections 141 and 143 of the Act.

¹⁵ Macquarie Telecom (2014), *NBN Regulatory Review*, p.4; Optus (2014), *Submission in response to Review of Regulatory Arrangements for the National Broadband Network. Telecommunications Regulatory Arrangements*, p.21.

Option 1. Do nothing. End-users will have access to superfast carriage services, whether delivered by NBN Co or by another carrier over a vectored VDSL2 network (as explained above, it is unlikely that end-users will be offered competing fixed-line networks, given the costs and technical issues involved). Where the NBN is rolled out, retail providers will have access to a wholesale-only network supplying services on non-discriminatory terms. Where another carrier has rolled out a vectored VDSL2 network, that carrier could either supply wholesale services by choice or as a result of any declaration by the ACCC.

Option 2. Repeal Parts 7 and 8 of the Act. This would allow open competition for the provision of infrastructure to all types of customer bases. Different providers would be free to roll out local access networks in different areas of the country, on a vertically integrated or wholesale-only basis. NBN Co could compete with these providers. Part XIC of the CCA would apply, so the ACCC could declare services if it considered doing so would be in the long-term interests of end-users.

A variation to this option would be to retain Part 8 of the Act (but remove the 1km exemption), and establish a process whereby carriers could seek authorisation from the ACCC to operate on a vertically integrated basis. For example, carriers could submit undertakings to the ACCC, which could set out how a carrier proposes to ameliorate any competition issues. If accepted by the ACCC, the undertaking would effectively replace the Part 8 obligations. This is effectively the option proposed by the Vertigan review, which saw it as an intermediate position between imposing unqualified separation and non-discrimination requirements and any complete lack of these – the intermediate position would allow efficiency and competition issues to be balanced.¹⁶

Option 3. Apply the Act as intended. Amend the Act to remove the 1km exemption and references to a line that is ‘capable of being used to supply’ a superfast carriage service. New networks or local access lines were generally expected to be subject to Parts 7 and 8, and the Act should therefore be revised to capture the original intention of the legislation. A new date of effect would need to be set out (e.g. 1 January 2017). Part XIC would also continue to apply.

Option 4. The Minister could make a carrier licence condition (CLC). The CLC would apply to carriers that are not subject to sections 141 and 143 of the Act but supplying superfast carriage services to residential or small business customers (or residential customers alone). The CLC would require those carriers to establish legally- or functionally-separated retail and wholesale units, with the wholesale unit required to offer the same services to the retail unit, other carriers and service providers on the same terms and conditions. The CLC could also require carriers to offer a specific wholesale service. The CLC could be in place for a long or short period of time. It could be the mechanism of choice, or a transitional step to more permanent arrangements.

Option 5. Combine option 4 and another approach – a CLC could be an interim step while the Government considers longer-term arrangements.

¹⁶ Op. cit., p.80.

A further option could include the addition of a levy mechanism as canvassed in the original Explanatory Memorandum for Parts 7 and 8 and proposed in recommendation 11 of the *NBN Market and Regulatory Report* prepared by the Vertigan panel. While the Government considers this option needs to be examined further, it has not been examined in detail as part of this process because the Government needs to take prompt action to resolve the issue at hand and such a levy mechanism would require significant analytical and developmental work.

Regulatory impacts of options

The following criteria have generally been considered in assessing the costs and benefits of the different options:

- Does the option address incentives for a vertically integrated operator to favour its own retail operations?
- Does the option impose divestment costs on a carrier?
- Does the option impose ongoing or one-off compliance costs on a carrier?
- Does the option promote the early rollout of infrastructure?
- Does the option promote longer-term competition, and thereby create opportunities for greater operational and organisational efficiency, innovation and price reductions?
- Does the option create regulatory distortions because carriers would not be subject to the same regulatory obligations?

The impacts of the different options are also considered against different types of stakeholders, including consumers and industry (including NBN Co). Any regional/metropolitan differences are also set out.

Option 1 – Do nothing

Option 1 has the following advantages:

- Carriers will be free to make investment decisions based on the current legal framework, rather than risk having investments overturned by changes to the law.
- It allows the independent regulator to determine whether and what access services should be supplied over vectored VDSL2 networks.
- End-users may gain access to superfast broadband services more quickly, either because a carrier connects a vectored VDSL2 network before the NBN, or NBN Co re-prioritises its rollout.
- There are no ongoing or one-off divestment or separation costs.

The option has the following disadvantages:

- The option cannot ensure that a vertically integrated operator will not favour its downstream operations. The degree to which any provider favours its own operations could limit the degree to which competition provides benefits to consumers.

- For example, a vertically integrated access provider may have incentives to limit access seekers' access to information and innovative services, and to supply services at prices that favour its own operations.
- If NBN Co is to compete with vectored VDSL2 suppliers it will need to re-prioritise its existing rollout plans. It currently operates under a general direction from the Government that, where feasible, it should prioritise areas of greatest need in its rollout. The need to compete with vectored VDSL2 operators could mean that it needs to re-prioritise areas which have a less clear need for superfast carriage services, and that areas of greater need therefore must wait longer for these services.
- The option does not close a gap in the legislation that creates an artificial advantage for carriers over Telstra and other retail-only providers. Telstra is currently moving away from the supply of fixed-line services on a vertically integrated basis as required under its structural separation undertaking. However, while other providers operate on this basis, the same restrictions do not apply to other carriers, which will have incentives to create new effective monopolies where they have existing network assets.

Option 1 would not lead to any increase in compliance costs for industry on its own. An ACCC declaration inquiry could lead to changes in the nature of operations currently envisaged by carriers such as TPG, but this is an independent process.

Option 1 would have differing impacts on consumers. On the one hand, some consumers in some metropolitan areas will, as noted above, gain access to services more quickly. This could provide them with a benefit. On the other hand, some consumers could find themselves locked in to service provision through a single carrier – as noted above, their only alternative sources of supply would be mobile or wireless networks, which are unlikely to offer the same performance standards as fixed-line. This could especially be the case in providing access to new buildings; it matches problems experienced in some greenfield estates, where consumers have found themselves unable to gain access to the service provider of their choice because only a single provider was contracted to supply services. Where there is a single provider consumers could find themselves unable to gain access to particular services they require, and there would also be few incentives for that provider to reduce prices or develop new service offerings.

Industry could experience difficulty in gaining access to wholesale services where a vertically integrated operator rolls out a network using the loophole in the law, and given concerns that the operator will favour its own retail operations benefits for consumers from competition may not be as great as if competition were more effective. NBN Co would be likely to face greater competition in some areas, and if this reduces its revenues this could place pressure on its ability to earn a return on its investment. However, it is unclear whether this would be the case, as NBN Co would be expected to compete 'for the market' in the same areas, noting it is a wholesale-only, open access platform.

As history shows that competing local access networks are generally only rolled out in some cities, there are unlikely to be any impacts in regional areas. (While

competition in metropolitan areas could impact NBN Co's ability to cross-subsidise services in regional areas, this concern will be dealt with separately through the establishment of a transparent funding mechanism as part of the wider Vertigan response.)

Given the potential impacts of this option on competition and the artificial advantages created for carriers over Telstra and other retail-only providers, option 1's benefits appear to be less than its costs.

Option 2 – Repeal Parts 7 and 8 of the Act

Option 2 has the following advantages:

- It removes restrictions on carriers that make those carriers' investment decisions more complex. Carriers could be free to operate their own networks on a vertically integrated or wholesale-only basis as they saw fit. This is likely to restore incentives for investment in competitive local access networks targeting residential and small business customers.
- Such investments would allow carriers to compete more effectively with NBN Co, which would provide NBN Co with greater incentives to operate efficiently, innovate and provide services promptly.
- The option would also allow any efficiency benefits from vertical integration to be captured. In particular, vertically-integrated carriers may develop services and prices that reflect end-users' needs because they will have a more fundamental connection with end-users than a wholesale-only operator would have. There is a risk that wholesale-only entities can experience problems with the coordination of investment decisions with end-users' needs. That said, coordination problems can be addressed through ongoing mechanisms for consultation between the wholesale-only provider and access seekers who do have direct relationships with end-users, and through flexible contracting arrangements that permit access seekers to request new products. (Such mechanisms also mean the competitive risks of vertical integration can be addressed.)
- Option 3 does not confer any significant regulatory costs on industry. There may be some one-off costs as industry adjusts its business and operational systems to reflect the change in law, for example where carriers are currently complying with Parts 7 and 8 and then wish to change their business models, but these are unlikely to be significant. In any event, under this option, it would be a commercial decision for a carrier to change its business model.
- There are no ongoing or one-off divestment or separation costs.

The disadvantages of option 2 are similar to those under option 1, but the option would also mean that, where carriers currently comply with part 8 of the Act, those carriers would no longer need to operate on a wholesale-only basis. This option could therefore encourage more network operators to re-integrate, because they may consider that they are more likely to achieve a higher return on their investments through operating on a vertically integrated basis. This option therefore could have the perverse result of ensuring that only NBN Co and Telstra are truly structurally

separated, which therefore magnifies the fundamental policy concern that unequal obligations are imposed on a small subset of carriers.

If the Vertigan variation to this option (based on carriers submitting undertakings to the ACCC) were to be adopted, an additional layer of regulatory complexity and uncertainty would be set in place over and above the current arrangements. Carriers are likely to seek a more straightforward process, in which their operational choices are more clearly established and not subject to the whim of the regulator. That said, the variation to the option does provide a mechanism for any competition issues to be addressed up-front while allowing a carrier to retain any efficiency benefits of vertical integration and reduce the costs of divestment and separation.

Option 2's main weakness is that it would allow a vertically integrated provider to favour its own retail operations and create an unequal set of obligations on different carriers seeking to invest in infrastructure and market retail services. The option may therefore limit the effectiveness of competition where bottleneck infrastructure is rolled out (and as set out above, history shows that alternative local access networks are only rolled out in a limited number of areas, and the technical qualities of vectored VDSL2 may also mean that there will be a single provider of this technology in most if not all instances). In submissions on regulatory costings, some industry members considered that the benefits from option 2 would not be great, and would be countered by impacts on competition. It is unclear to what extent the efficiency gains from option 2 would be offset by the welfare losses from less effective competition; given that networks are likely to be rolled out in only a limited number of areas, and that the separation requirements under Part 8 in any event only affect a limited part of any service provider's operations, it is likely both that efficiency gains will in any event be fairly limited on a national scale, and that welfare losses will also be limited. On this basis, option 2 may be considered neutral.

The Vertigan variation to option 2 addresses the concerns about discrimination, but does add a new layer of uncertainty and regulatory complexity to investment decisions. As with the 'standard' option 2, however, impacts are likely to be limited given that competitive rollouts are likely to be limited to high-density areas of cities and legal separation obligations will only affect carriers targeting residential customers. The Vertigan variation may provide a mechanism for balancing efficiency and competition issues over the longer term, but as it would require legislation to implement and should not be imposed on a retrospective basis it is only likely to be able to be effective during 2016 or later. When implemented the variation could be considered to provide a net benefit.

Option 2 may ensure that some customers receive services more quickly and at a lower price, though as noted above this would be restricted to customers in certain metropolitan regions, albeit with restricted choice of retail providers. There would be unlikely to be any discernible benefit in regional areas or even in outer metropolitan areas. Industry members would receive benefits from being free to structure their operations in a manner that provides greater internal efficiencies. NBN Co would most likely face greater competition, but would be expected to respond to it, which could also help reduce prices for consumers in areas where NBN Co faces competition. The Vertigan variation would, when implemented, provide lower efficiency benefits for industry (because they may still be required to undergo some separation and put in place non-discrimination measures), but to the extent that this

makes competition more effective consumers may receive greater benefits than under the standard option 2.

Option 3 – Apply the Act as intended

Option 3 has the following advantages:

- The fundamental policy issues would be addressed – there would be no incentive for a carrier to seek to create an effective monopoly on local access where it has network assets, and no ‘dual’ system in which one set of obligations applies to Telstra but not to other carriers who may create effective monopolies.
- Any vectored VDSL2 networks would be wholesale-only and supply services on a non-discriminatory basis, because Part 8 of the Act would clearly apply as intended. Access seekers would have a level playing field and access to a sufficiently ‘raw’ wholesale service (a Layer 2 bitstream service) to develop innovative products for end-users.
- End-users would have access to a choice of retail providers, encouraging greater competition amongst service providers.

Option 3 has the following disadvantages:

- If carriers do not currently operate on a wholesale-only basis, option 3 would mean that they would have to structurally separate their operations in order to supply superfast carriage services to residential and small business customers. Carriers could face significant costs in divesting assets or business units, especially if the market were to take the view that any divestment was forced and therefore had the character of a fire sale. That said, the option provides a suitably long lead time (1 January 2017) for companies to adjust their operations.
- Separation costs could be significant. These would include establishing separate business, operational and IT systems, separating staff members and assets between the different businesses, negotiating supply contracts between the two businesses, establishing a new compliance regime to ensure that functions remain separate and establishing a new reporting framework. That said, the option provides a suitably long lead time (1 January 2017) to adjust their operations.
- To the extent that a requirement to operate on wholesale-only and non-discriminatory basis encourages carriers not to roll out networks in competition with NBN Co, this would deter carriers from seeking to roll out vectored VDSL2 networks before NBN Co (or as an alternative to NBN Co, for example in new developments). As a result, some end-users may not receive the benefits of high-speed broadband as quickly as otherwise (for example, because their premises are further down NBN Co’s schedule).
- Legislation can take a long time to pass through the Parliament and there can be no certainty for industry about future regulatory arrangements until it sees

the final form of the legislation. The option therefore does not provide short-term certainty for industry.

- The option does not address coordination problems caused by wholesale-only operators being cut off from end-users' needs, though as noted above this issue can be addressed through consultation and contractual mechanisms.

Option 3 would be more likely to restrict infrastructure rollouts targeting residential customers. To the extent that it does this it may limit benefits to customers such as lower prices and early access to new services, though such impacts would be limited to areas where such rollouts would be likely to have occurred. The option would, however, ensure that consumers would have a choice of service provider in these areas, and would not be locked in to a single provider. In this regard, the option is more likely to deliver service-based competition than the standard option 2.

The option would probably impose greater costs on industry than option 2, because not only would industry need to absorb costs from operating on a wholesale-only basis, but industry would not be free to extend existing networks grandfathered under the current law. Option 3 would also have the effect of constraining TPG Telecom's proposed rollout, which would need to be grandfathered at a point in time when new legislation could commence, creating further complexity and costs for TPG. However, to the extent that such networks were rolled out, consumers would enjoy the benefits of both higher speed broadband services and retail level competition.

Overall, the costs of option 3 could be quite significant but it should be emphasised that they are discretionary costs. Businesses will have a choice how to structure their operations. In other words, the regulatory costs of option 3 are only imposed if a carrier decides that it wishes to supply superfast carriage services to residential (and/or small business customers) on a vertically integrated basis.

Against these costs must be placed the benefits from ensuring that competition can develop adequately and that vertically integrated providers do not favour their own retail operations. Although those benefits are gained by access seekers, it should be noted that access providers who are required to operate on a non-discriminatory basis can continue to achieve profits from investments in network infrastructure. The benefits are difficult to quantify, but over the long term it could be argued that the benefits of imposing equitable arrangements that promote competition would include providing incentives for promoting innovation and lower overall prices for end-users.

Overall, the costs of option 3 would initially be higher than the benefits, though benefits would be delivered over the long-term. The option would not appear to provide as great a benefit as the Vertigan variation to option 2.

The regulatory burden measurement for this option is at Annex A.

Option 4 – Carrier Licence Condition

Option 4 has the following advantages:

- The fundamental policy issues would be addressed – there would be no incentive for a carrier to seek to create an effective monopoly on local access where it has network assets, and no 'dual' system in which one set

of obligations applies to Telstra but not to other carriers who may create effective monopolies.

- It is less intrusive than option 3. A vertically integrated provider could continue to operate on a vertically integrated basis, but would have to establish separate entities within its corporate structure along with strong ring-fencing arrangements to ensure that it did not favour its own operations. A carrier could still face significant one-off adjustment costs, but would not face divestment costs.
- The option addresses the issue of vertical integration and ensures that access seekers will have access, on a non-discriminatory basis, to services. It is therefore more likely to deliver benefits in the long term, through enhanced competition, than either option 1 or option 2.
- A CLC could be set in place fairly quickly, meaning that industry would gain legal certainty in a short period of time. By contrast, legislation can take some time to pass the Parliament and there is less certainty as to what its final shape may be.
- Coordination problems caused by wholesale-only operators being cut off from end-users' needs would be less of an issue because all business units would still operate under a single corporate entity and therefore some of the efficiency benefits of vertical integration are preserved..

The disadvantages of option 4 are similar to those under option 3, in particular in relation to one-off separation costs, though these would be less significant because a carrier could continue to operate on a vertically integrated basis. Carriers may face initial costs in setting up legally separate retail and wholesale business entities and in establishing separate business, operational and IT systems for those entities so that the wholesale entity does not discriminate in favour of the retail entity. They could also face costs in reallocating their existing workforce and finding new directors for separated companies.

These costs are expected to be largely one-off in that, once adjusted, the systems should not need to be reset every year. There would be some ongoing costs from compliance with the arrangements, including workforce training and reporting to a regulator. It is not clear how great the costs might be; the overall quantum would depend upon the degree to which existing retail and wholesale systems are separated and the number and complexity of the systems. The costs would largely fall in the areas of differentiating business and operational systems, and also in establishing new compliance and reporting frameworks to ensure that the functions, staff and management of the two business entities are clearly separated.

In the past, the costs of introducing functional separation elsewhere in the world have been quite significant. For example, the functional separation of British Telecom was estimated to have cost that carrier £153 million, largely through establishing Openreach as a separate entity and setting up new equivalence systems. Similarly, the functional separation of Telecom New Zealand was estimated to have cost that carrier

NZ\$200 million.¹⁷ However, in both of those cases the entity being separated was a highly integrated incumbent provider with national networks and many integrated lines of business developed over decades, with a wide mix of business and IT systems. The costs of imposing functional separation on a carrier with a much more limited scale and network are unlikely to be anywhere near these figures.

The Government also notes that major infrastructure providers are already required to be separated (i.e., Telstra, NBN Co) or are considering divesting local access networks (Optus). Only one provider, TPG Telecom, has announced it will roll out a substantial network targeting residential customers. Consequently, only that provider is likely to be effected significantly by option 4.

During consultation on the draft instrument smaller carriers noted that the costs of separation were excessive compared to the size of their business. One carrier, for example, noted it had only six staff and 1,500 customers, and that it would be difficult to create two separate entities. Other larger carriers noted that the separation costs could be material. One argued that the CLC could affect services in operation if it did not feel that it could comply with the CLC.

By contrast, another carrier argued that the separation costs would not be high. It pointed out that the majority of a carrier's networks would not be subject to regulation – for example, transit and backhaul networks and lines targeting business or government customers would be exempt from the rules.

In addition to exemptions for many aspects of a carrier's operations, the CLC could also lessen any burden on carriers by providing a transitional period before separation requirements took effect. For example, these could apply from 1 July 2015, meaning that a carrier would have time to adjust and would not need to terminate existing services.

Option 4 would be likely to deliver benefits for consumers by ensuring they are able to have a choice of competing retail providers. Service-based competition is also likely to put downward pressure on prices. For example, a carrier with an effective monopoly could charge \$60 per month or more for a high-speed broadband service. If it were assumed that with wholesale access and retail competition, the price could be pushed down to \$55 per month, this would represent a significant gain for consumers (6%)¹⁸. When this reduction is factored over a larger network the overall benefit becomes even more significant. For example, if a network covered 500,000 premises and had 80% take-up and retail competition led to a \$5 per month reduction in price for consumers, the total saving per annum for end-users would be \$24 million. Conversely, in the absence of retail level competition, this would be \$24 million captured by the network operator. This sum does not take any account of the savings from not having to rollout additional network infrastructure to compete, if indeed, this were economically viable.

¹⁷ *Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010. Explanatory Memorandum*, pp.30-31.

¹⁸ [To put such a price decrease in perspective, in its 2013-14 results announced on 3 December 2014, TPG indicated that its Consumer Broadband business had an underlying margin of 38% in 2013-14; see <https://www.tpg.com.au/about/pdfs/TPM2014AGMPresentation.pdf>, p.8]

With network rollouts only occurring in some areas of some cities, option 4's overall costs and benefits are likely to be restricted when compared to national operations. However, if vertically integrated providers are able to compete in those areas against businesses which are required to be structurally separated, those structurally separated providers could find themselves facing difficulties in competing effectively for two main reasons. Both NBN Co and Telstra have obligations which require them to operate on a national basis. Targeted infrastructure rollouts will naturally have a lower overall cost base than a national network and may therefore be able to charge much lower prices than their structurally separated competitors. However, those competitors need to be able to supply services in high density areas to gather sufficient revenues to fund their overall operations. If they have to lower prices they therefore could see a reduction in revenues, which challenges their ability to fund their regional obligations. Over the long term, therefore, pressure would be placed on services in regional Australia, which could lead to under-investment in those areas. (Thus a separate funding mechanism is being otherwise proposed by the Government in its response to the Vertigan review.) Option 4 will not prevent competition from taking place, but it does help level the playing field so that NBN Co and Telstra do not have a clear disadvantage in dealing with targeted rollouts in cities.

Over the long term, therefore, option 4 may deliver some benefits through facilitating national-scale service provision and investment. It may also, as with option 3, deliver benefits from ensuring equitable competition through a level playing field for retail providers. As noted under option 3, the benefits could involve fewer barriers to innovation and lower prices overall for end-users.

The greater benefits for industry that would be provided by option 2 need to be balanced against the potential reduction in benefits to consumers in a rollout area, in terms of less retail competition, and on a national scale. On this basis, option 4 could be considered to provide neutral to marginally positive benefits compared to costs.

Annex A outlines the regulatory burden measurement for this option.

Option 5 – Combine option 4 (short term) with long term legislative amendments

Option 5 simply recognises that the Government could choose to adopt a staged approach to the problems posed by the rollout of vectored VDSL2 networks on a vertically integrated basis. A CLC could set short-term arrangements while the Government develops the optimal long term solution. The CLC, in other words, would provide short-term certainty that a vertically integrated provider would not favour its own operations, while the Government determines its longer-term approach. That could be to repeal Parts 7 and 8 of the Act once the NBN is built and fully operational, or to retain Parts 7 and 8 but close down the 1km exemption or adopt the model proposed in recommendations 3 and 4 and/or 11 of the *NBN Market and Regulatory Report* by the Vertigan panel.

The compliance costs of this option would effectively be the same as those under option 4 – there would be one-off costs of establishing functionally separate businesses, and introducing systems to ensure non-discrimination. Extra costs would not be incurred if the law is later changed to permit carriers to submit 'vertical integration' undertakings under Part 8 of the Act (as suggested under option 2). However, if option 4 is adopted in the short term and option 3 is adopted in the long

term, then the overall level of cost for a carrier could be higher, because it may be required to undertake functional separation in the short term and potentially structural separation in the long term. Although the costs of this could be significant, against them must be placed the benefits from enhancing competition. Over the long term, those benefits are likely to outweigh the costs. However, these are matters that would be considered fully in moving to the long term solution.

The impacts of option 5 on stakeholders would depend on which particular approach is taken. If, for example, the decision were taken to have a CLC in place for two years with longer-term the current Part 8 rules (but with the 1km exemption removed), then there would be clear costs for industry, but also more effective retail competition long-term, which should mean benefits for consumers. If the decision were taken to have a CLC in place for two years and then move to the Vertigan variation to option 2 (the other major option before the Government), then there would arguably be lower costs for industry longer-term and similar benefits for consumers.

Consultation

There was extensive consultation in advance of the enactment of Parts 7 and 8.

As noted above, submissions in early 2014 to the Vertigan review generally supported a monopoly provider of vectored VDSL2 networks, but also supported that provider operating on a wholesale-only, non-discriminatory basis.

Under section 64 of the Act, before the Minister makes a CLC the Minister must provide a draft of the CLC to an affected carrier and invite the carrier to make a submission on the draft. The timeframe for the submission is 30 calendar days from the date the Minister provides the draft to the carrier. As a draft CLC on superfast carriage services could affect a number of carriers, on 14 October 2014 the Minister wrote to all licenced carriers in Australia, inviting submissions on the draft CLC. The Minister also issued a media release and the Department of Communications placed a copy of the draft CLC and the early assessment draft of the Regulatory Impact Statement on the Department's website.

Eighteen submissions were received on the draft CLC, and the Department also held discussions with the Australian Communications and Media Authority, the Australian Competition and Consumer Commission and the industry representative body, Communications Alliance, on technical and drafting matters. There was a diversity of views in submissions, but key themes centred on determining which types of networks should be exempt from the CLC; the nature of separation obligations and their likely costs; and technical issues with the proposed wholesale service set out in the CLC. Smaller carriers, as well as some larger ones, submitted that separation costs could be material, especially given the short timeframe to comply with the instrument (the draft CLC proposed a commencement date of 1 January 2015). TPG and some other larger carriers argued that a CLC would impose an undue financial and administrative burden on it.

Other businesses argued that separation costs are not material and that stronger separation requirements could be imposed. Several pointed out that the overall impact of the CLC on industry would be limited because only one carrier, TPG, was attempting to use a loophole in the law.

Five carriers provided submissions on the regulatory burden measurement costings.

The Department consulted the Australian Communications Consumer Action Network. That organisation did not make a submission but noted that it considered it important for customers to have a choice of providers and for the underlying networks to be wholesale-only. It also stressed the importance of services being available on a national basis. No other consumer groups made submissions on the draft CLC.

In finalising the CLC, the Minister considered these submissions. A number of changes were made to clarify which networks would be exempt, the nature of the wholesale service to be supplied, and also to reduce potential costs arising from separation obligations. Any carrier subject to the CLC will be given an extra six months (until 1 July 2015) before separation applies to existing networks, and the CLC also clarifies that existing corporate entities and systems can be used in meeting the separation requirements. This would greatly reduce any ongoing annual costs. Furthermore, amendments to clarify that some residential networks and wholesale activities are exempt from the CLC will also reduce the burden of compliance on industry.

In relation to regulatory burden measurement costings, the Department of Communications considers that the overall one-off cost should be increased in recognition of the likely impact on at least one carrier, and changes to other inputs. However, the Government considers that annual costs will be limited. The CLC will in effect apply to one service provider. It already has separate companies and operational support systems that it has gained through acquiring those companies. Those companies already have largely separate staff. The main annual costs to it would therefore be to appoint one new director to one company (because currently it has one shared director across its wholesale and retail companies) and fewer than five management staff (changes to operational support systems are included in the one-off costs). The Department has estimated annual costs to the firm of 20 per cent of its one-off implementation costs. Following consideration of feedback on costings, the Department now estimates the total costs over ten years at \$17.98 million. By comparison, the Department considers the potential gains from increased and effective competition at the retail level as a result of the proposed measures is likely to far exceed these costs, as illustrated by the example given on page 22.

Selecting the best option

The preferred approach is option 5. A CLC could be made in the short term and this addresses the fundamental policy issues and recognises the significant investments already made by the Government in the NBN and the structural separation of Telstra. The CLC would apply for a two-year period, and then the Government would adopt, in effect, the variation to option 2. New high-speed broadband networks targeting residential customers would be required to be structurally separated as a default, but industry would be able to submit undertakings to the ACCC containing functional separation and non-discrimination commitments. The ACCC could then authorise functional separation. This would preserve some efficiency benefits from vertical integration while also providing benefits for consumers from more effective retail competition. As outlined above, the variation to option 2 is likely to be marginally positive in terms of costs and benefits, and therefore option 5 would also have a marginally greater benefit than cost.

In the longer term, when the NBN is built and fully operational, the competition issues posed by vertically integrated providers rolling out local access networks that are effective monopolies are less likely to be as significant. Access seekers would have the NBN as an open access fall back in areas where a vertically integrated provider overbuilds the NBN. Accordingly, at that time the Government will review the Part 8 rules.

Implementation and evaluation

Option 5 would be implemented by the Minister making the CLC, which takes effect from the day after it is registered on the Federal Register of Legislative Instruments. The CLC would be a disallowable instrument.

The CLC could be imposed for a limited period of time (two years) while the Government considers the optimal long term approach and develops appropriate legislation.

The Government would evaluate the effectiveness of the CLC, including the nature of any impacts on carriers and on end-users, through its regular monitoring of industry circumstances and liaison with carriers and regulators.

Annex A – Regulatory Burden Measurement

The regulatory burden measurement of the different options is set out in the table below.

Options	Preferred	Regulatory Burden Measurement
1: Status quo	No	Neutral
2: Repeal Parts 7 and 8 of the Telecommunications Act.	No	Substantive savings – carriers would no longer be required to implement structural separation of their wholesale and retail business units. This would lead to significant cost savings. The measure would have wider operational benefits for firms that integrate but also substantial impacts on fair and effective retail competition.
3: Apply Part 7 and 8 as intended by removing exemptions giving rise to regulatory asymmetries.	No	Substantive costs – carriers operating under exemptions would be required to structurally separate their wholesale and retail business units. This would incur costs depending on their degree of vertical integration and complexity of legacy IT systems. The measure would also have wider substantive countervailing benefits in terms of supporting fairer and more effective retail competition.
4: Make a Carrier Licence Condition to achieve regulatory symmetry (this is a faster-to-implement and less onerous version of Option 3). This will require functional separation of wholesale and retail business units.	No	Substantive costs – carriers operating under exemptions would be required to functionally separate their wholesale and retail business units. This would incur costs depending on their degree of vertical integration and complexity of legacy IT systems. The measure would also have wider substantive countervailing benefits in terms of supporting fairer and more effective retail competition, while allowing firms to be integrated.
5: Combine option 4 (short-term and would apply until	Yes	Substantive costs – carriers operating under exemptions

<p>2017) with long term legislative amendments to repeal Part 7 and allow authorisation of functional separation under Part 8</p>		<p>would be required to functionally separate their wholesale and retail business units. This would incur costs depending on their degree of vertical integration and complexity of legacy IT systems. The short timeframe reduces the number of businesses this would impact upon. The measure would also have wider substantive countervailing benefits in terms of supporting fairer and more effective retail competition, while allowing firms to be integrated.</p>
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Assumptions (Option 1)

There is no change in regulatory burden for the status quo option.

Average Annual Regulatory Costs (from Business as usual)				
Change in costs (<u>\$million</u>)	Business	Community Organisations	Individuals	Total change in cost
Total by Sector	(\$0)	\$0	\$0	(\$0)

Assumptions (Option 2)

- This option would in theory result in substantive cost savings for business that would no longer be required to separate under Part 7/8 requirements – that is carriers not operating under the 1km exemption (because to those operating under the exemption these requirements do not currently apply and therefore they would not realise any such benefit).
- However, Telstra has already voluntarily undertaken to structurally separate and most major carriers have not indicated they are planning to roll out telecommunications infrastructure under Part 7/8 rules.
- As such there are no existing businesses that would experience benefit from this removal.
- Repeal would not affect NBN Co as NBN Co is established in legislation as a wholesale-only operator and could not move to a vertical structure even if Part 7 and 8 were removed.
- Consequently there is no change in regulatory burden for the option.

Average Annual Regulatory Costs (from Business as usual)				
Change in costs (\$million)	Business	Community Organisations	Individuals	Total change in cost
Total by Sector	(\$0)	\$0	\$0	(\$0)

Assumptions (Option 3)

- The outcome of amending legislation to apply Part 7/8 as intended achieves the same outcome as Option 5 (preferred). Option 5 is a faster version of Option 3.
- Similar to the explanation provided in Option 5 the Department considers only one operator would potentially be impacted by this option. The regulatory costs associated with this option are exactly the same as Option 5 (see attachment A for methodology is estimating separation costs. The method has estimated an affected carrier would incur a total cost of \$17.98 million over a ten year period. This translates to an annualised cost of \$1.8 million per annum.

Average Annual Regulatory Costs (from Business as usual)				
Change in costs (\$million)	Business	Community Organisations	Individuals	Total change in cost
Total by Sector	\$1.797	\$0	\$0	\$1.797

Assumptions (Option 4)

- The outcome of making a carrier licence condition is the same as Option 3 and Option 5.
- Refer to assumptions outlined in Option 5 and attachment A for methodology in estimating regulatory burden of separation.

Average Annual Regulatory Costs (from Business as usual)				
Change in costs (\$million)	Business	Community Organisations	Individuals	Total change in cost
Total by Sector	\$1.797	\$0	\$0	\$1.797

Assumptions (Option 5 – preferred)

- The Department considers that only one business at most will be impacted by the proposed Carrier Licence Condition instrument. Only one carrier has indicated it plans to expand its local loop footprint and provide superfast carriage services whilst operating under the 1km regulatory exemption. The remaining carriers that could operate under the 1km exemption have not expressed any desire to roll out new superfast networks to residential customers. Telstra has also voluntarily undertaken to structurally separate. Further, it is not certain that even one carrier would be impacted as the decision to proceed with its investments has not yet been made. However, for completeness the RBM costing has assumed that one business will be impacted by the Carrier Licence Condition.
- The Department considers that only one carrier would incur a cost to functionally separate as a result of the proposed CLC. The reasons for this are outlined below:
 - iiNet has advised it supports the rollout of the NBN and structural separation. Further, it has already entered into agreements with NBN Co for the sale of its FTTH assets in the ACT.
 - Optus is in the process of negotiating a potential transfer of the HFC network assets to NBN Co. Optus has also been a strong supporter of structural separation and has not indicated any desire to invest in further infrastructure (given it wrote down almost \$700 million on its HFC investments).
 - Telstra has voluntarily undertaken to structurally separate as part of the NBN definitive agreements.
 - Greenfield operators such as Opticomm are already structurally separated and have been for quite some time.
 - Further, there are no other carriers with the scale or capital that could undertake to roll out significant superfast broadband infrastructure within the proposed two year timeframe of the CLC.
 - Further, it would not be possible for a new entrant to be impacted by these rules because a new entrant would not have existing infrastructure that would enable them to operate as a vertically integrated service provider under the 1km exemption in Part 8. As such, a new entrant would be subject to the existing requirements of Part 7 and 8 and would need to be structurally separated.
- The affected carrier advised in its submission that it was already in the process of building a wholesale product platform. That is, a commercial decision to develop these systems and offer wholesale services to access seekers has already been made in the absence of any such regulatory requirement. This limits the substantive costs of achieving the outcome sought given business as usual costs already included development of provisioning and billing systems. Therefore, the costs incurred primarily arise from the need to ‘ring-fence’ wholesale and retail systems and workforce restructuring.

- To achieve legal separation the Department considers there is no need for the affected carrier to establish new companies because it already has separate corporations (by virtue of acquisition). Therefore corporate separation costs would primarily be driven by workforce planning and reappointment activities as well as the separation of some IT systems.
- In its submission the carrier did not offer any estimate of direct costs that would be incurred by undertaking separation. For this reason the Department has undertaken some analysis of experience in international jurisdictions to develop an estimate of potential costs – see Attachment A for method used to estimate costs.

Workings

Regulatory Burden and Cost Offset Estimate Table

Average Annual Regulatory Costs (from Business as usual)				
Change in costs (\$million)	Business	Community Organisations	Individuals	Total change in cost
Total by Sector	\$1.797	\$0	\$0	\$1.797
Cost offset (\$million)	Business	Community Organisations	Individuals	Total by Source
Agency	(\$22.02)	\$0	\$0	(\$22.02)
Are all new costs offset? <input checked="" type="checkbox"/> yes, costs are offset <input type="checkbox"/> no, costs are not offset <input type="checkbox"/> deregulatory, no offsets required				
Total (Change in costs - Cost offset) (\$million)		(\$20.223)		

The regulatory cost offsets noted in the above table have been identified within the Communications portfolio. These cost offsets relate to the Identity Checks for Prepaid Mobile Services reforms.

ATTACHMENT A

Method Used to Estimate the Costs of Structural and Functional Separation

The costs of structural or functional separation depend on a range of variables and circumstances specific to the context of the business that is undergoing separation. These factors include:

- The size of the business
 - *The larger the business the greater the cost to achieve separation. There are more products, systems, people and business processes to separate.*
 - *This should only account for the fixed-line portion of the business (either by assets or revenue). Information has been sourced from annual shareholder reports (prior to separation and indexed for inflation).*

- How established the business is as a vertically integrated entity.
 - *The degree of vertical integration and systems interdependence follows from the period of time a business has operated the more costly the process will be given business processes and systems are more integrated.*

- Corporate Structure
 - Whether the business has any natural organisational separation between its retail and wholesale divisions.

- The complexity of legacy IT systems.
 - *The older the IT systems the higher the cost of achieving functional separation of those operating and business systems. The financial sector is a perfect example of this.*

- Complexity of network asset ownership post separation.
 - *The more complex the asset ownership the greater costs in developing new systems to achieve the post separation regulatory outcomes.*

Estimating costs impacts of Carrier Licence Condition on the affected carrier

The method outlined here uses available data about separation costs for British Telecom (BT) and Telecom New Zealand to develop an estimate of the costs incurred by the carrier to implement the regulatory requirements sought under the proposed Carrier Licence Condition.

This estimate is developed by comparing the relative degree of size, complexity and vertical integration of the carrier in comparison to BT and Telecom New Zealand and making proportional adjustments in costs to reflect differences. The two cost estimates are then averaged to produce the cost estimate used in the RBM calculations.

Key assumptions in comparing the costs of BT and Telecom NZ to the potential costs of the carrier achieving functional separation:

- BT and Telecom NZ were long established vertically integrated providers operating since the early 1900s.
 - The carrier is relatively new (2007) and does not operate a substantial local access network.
 - A relative weight of 40 per cent was assigned to reflect comparative costs.
- BT and Telecom NZ had many legacy systems and complex IT arrangements. This is a highly significant driver of costs when logical and physical separation of IT systems is required.
 - The carrier operates a simple business model with very few products and little complexity.
 - It has also grown through acquisition and therefore has a number of constituent companies that could be used in establishing separated arrangements.
 - A relative weight of 30 per cent was assigned to reflect comparative costs.
- In terms of size of business the carrier is much smaller than BT and Telecom New Zealand and therefore we expect the costs of separation to be proportionally smaller. For example the carrier's fixed line revenues are
 - 2.723 per cent of inflation adjusted fixed-line revenue achieved by BT
 - 11.97 per cent of inflation adjusted fixed-line revenue achieved by Telecom NZ
- It is assumed that an affected business would incur ongoing annual costs of 20 per cent of their one-off separation costs (primarily arising from wages relating to functions separation – for example, appointing a new director).

See below for snapshot of working spreadsheet.

RIS (separate) - Carrier License Condition					
Cost of BT Separation	\$ 372,170,763	AUD (2014)			
Factor	Factors contribution to separation costs	BT (index)	Carrier	% weights	Total
Degree of vertical integration	30%	10	4	40.00%	\$ 44,660,492
Corporate structure	20%	10	8	80.00%	\$ 59,547,322
Complexity of IT systems	50%	10	3	30.00%	\$ 55,825,614
Size of business	Adjustment factor	\$22,378,895,549	\$500,000,000	2.23%	
Estimated costs for Carrier					\$ 3,575,543
Cost of Telecom NZ Separation	\$ 180,000,000	AUD (2014)			
Factor	Factors contribution to separation costs	Telecom NZ (index)	Carrier	% weights	Total
Degree of vertical integration	30%	10	4	40.00%	\$ 21,600,000
Corporate structure	20%	10	8	80.00%	\$ 28,800,000
Complexity of IT systems	50%	10	3	30.00%	\$ 27,000,000
Size of business	Adjustment factor	\$4,177,438,499	\$500,000,000	11.97%	
Estimated costs for Carrier					\$ 9,264,050
Implementation Cost (one off)					\$ 6,419,797
Ongoing costs (20%)					\$ 1,283,959

**See working spreadsheet for calculations.

**The % weights reflect a reduction in costs in proportion to the less integrated and complex nature of the carrier's business compared to the highly integrated incumbents BT and New Zealand Telecom.

Attachment 2**Details of the *Carrier Licence Conditions (Networks supplying Superfast Carriage Services to Residential Customers) Declaration 2014*****Section 1 – Name of Instrument**

Section 1 of the Declaration provides that the name of the instrument is the *Carrier Licence Conditions (Networks supplying Superfast Carriage Services to Residential Customers) Declaration 2014*.

Section 2 - Commencement

Section 2 provides that the Declaration commences on 1 January 2015.

Section 3 - Expiry

Section 3 provides that the Declaration expires on 31 December 2016. It is anticipated that this will give sufficient time for the Government to consider longer-term options in respect of the regulatory reform of Parts 7 and 8 of the Act.

Section 4 - Definitions

Subsection 3(1) sets out the key definitions used in the Declaration.

ABN has the meaning given in section 41 of the *A New Tax System (Australian Business Number) Act 1999*.

Act means the *Telecommunications Act 1997*.

The term *associate* has the same meaning as in Division 3 of Part 8 of the Act. The rules in Division 3 of Part 8 of the Act would be applied to ascertain if a person is an associate of the specified carrier who owns and/or operates a designated telecommunications network. The use of the concept of ‘associate’ in the context of this Declaration provides for an expansive reach consistent with the Government’s objective of ensuring that the new carrier licence conditions have sufficiently wide application to address those concerns it is intended to address. Use of the ‘associate’ concept is specifically designed to address concerns that carriers could establish contrived corporate structures to avoid the licence conditions in this declaration.

The concept of *business customer* is central to telecommunications infrastructure expressly excluded from the definition of ‘designated telecommunications network’. This Declaration is intended to capture networks that are targeting residential customers, rather than local access lines that supply such services wholly or principally to business or government customers. This reflects the fact that, historically, the fixed-line residential local access network has been the focus of competition concerns.

The term ‘business customer’ in this context means:

- any legal person that carries on a business or enterprise from a premises, and
- has an ABN for the business or enterprise.

If a person satisfies both of the above limbs, that person will be characterised as a ‘business customer’. The exclusion of any incidental occupation of the place of business for occasional use as residence is intended to cover live-in managers and fly-in fly-out accommodation for business premises such as mining sites.

The term ***declared service*** has the same meaning as in Part XIC of the *Competition and Consumer Act 2010* and is relevant to the condition set out in subsection 6(7) of the Declaration which requires the wholesale company to supply, upon reasonable request by another carrier, a Layer 2 Wholesale Service over the designated telecommunications network at all times during which the Layer 2 Wholesale Service is not a declared service. On 11 September 2014, the ACCC advised that it was commencing an inquiry into whether a superfast broadband access service should be declared and therefore made subject to access regulation. In the event that the ACCC declares a Layer 2 Wholesale Service of the same nature and with the identical characteristics of the Service as defined in this Declaration, the obligation to supply the Layer 2 Wholesale Service will no longer apply.

The term ***designated telecommunications network*** is central to the operation of the application provision under section 5 of the Declaration and captures those networks which are subject to the carrier licence conditions set out in section 6. The definition concentrates the obligations on that part of a fixed-line telecommunications network made up of local access lines or parts of local access lines. This indicates that the Declaration therefore only applies to fixed-line networks (and not, for example, wireless, satellite or mobile technologies) but also only applies to a specified portion of a typical fixed line network, the local access lines. ‘Local access line’ is defined to have the same meaning as in section 141D of the Act. Section 141D clarifies that a local access line forms part of the infrastructure of a local access network. A local access network has the meaning generally accepted within the telecommunications industry. Consequently, a local access line would include drop cables and distribution lines, but would not include backhaul or transmission lines and would not include a line which is on the customer side of the boundary of a telecommunications network (i.e. customer cabling).

A designated telecommunications network must be used, or be technically capable of being used, to supply superfast carriage services. The term ‘superfast carriage service’ is defined in the section 141 of the Act and means a carriage service where:

- (a) the carriage service enables end-users to download communications; and
- (b) the download transmission speed of the carriage service is normally more than 25 megabits per second; and
- (c) the carriage service is supplied using a line to premises occupied or used by an end-user.

For the avoidance of doubt, a service that is ‘technically capable’ of being used to supply a superfast carriage service is one that can supply a download transmission rate above 25 megabits per second. If a network is capable of being used to supply a download transmission rate above 25 megabits per second, but has been throttled back to supply a lower transmission rate, it would still be considered to be technically capable of being used to supply a superfast carriage service.

The concept of a superfast carriage service is another key component of the Declaration. The Declaration only targets local access lines that are used to supply

such services. It does not, therefore, target local access lines that do not supply such services, such as lines supplying plain old telephone services or asymmetric digital subscriber line (ADSL) services.

Paragraph (a) of the definition does not specify the class of customers serviced by the designated telecommunications network. This class of customers is established in the application provision under section 5 of the Declaration, which states that a specified carrier becomes subject to the Declaration if one or more local access lines forming part of the designated telecommunications network are used by the specified carrier or any of its associates to supply a superfast carriage service to residential customers.

The definition of designated telecommunications network then sets out three general categories of networks that are designated or not designated. In the first place, a designated telecommunications network is *not* subject to sections 141 or 143 of the Act. In the second place, the designated telecommunications network is *not* the subject of a ministerial exemption in force under section 141A or section 144 of the Act. If networks are already captured by these existing provisions, the intention is that they be regulated under them and not subject to any further rules being put in place through the licence conditions in this Declaration.

Section 141 of the Act imposes requirements on suppliers who use certain telecommunications networks to supply superfast carriage services to ensure that a Layer 2 bitstream service is made available on these networks. Section 141A provides the Minister with the power to exempt telecommunications networks from section 141. Section 143 of the Act imposes requirements on suppliers who use certain telecommunications networks to supply superfast carriage services to supply these services on a wholesale-only basis. Section 144 of the Act provides the Minister with the power to exempt telecommunications networks from section 143.

Ministerial exemptions have been provided for a number of networks under sections 141A and 144 of the Act. These include local access networks operated by Telstra in South Brisbane and 118 new housing estates, and local access networks operated by iiNet (through its TransACT subsidiary) in the ACT and regional Victoria.

There are seven specified types of exclusions in sub-paragraph (b)(iii) of the definition:

1. The national broadband network. This exclusion exists because NBN Co is already mandated by law to operate on a wholesale-only basis, and is therefore not subject to Sections 141 and 143 of the Act. The term ***national broadband network*** is defined in the Declaration as having the same meaning as in section 5 of the *National Broadband Network Companies Act 2011*.
2. A Specified HFC network. HFC networks have been excluded because they are currently not subject to sections 141 or 143 of the Act, but target residential customers. The existing HFC networks are not subject to the Act because they were in place before 1 January 2011 and they are therefore excluded for the sake of clarity. It is envisaged that the HFC networks of Telstra and Optus will be acquired by NBN Co and integrated into the NBN.
3. Local access lines that are used to supply carriage services to business customers, public bodies or large charity customers. The Declaration is intended to capture local access lines supplying residential customers, and this

exclusion therefore clarifies that any local access lines that are supplying business, large charity or public bodies will not be required to comply with the Declaration. Although Part 7 and 8 of the Act apply to networks that supply superfast carriage services wholly or principally to small business customers, this Declaration will not apply to networks that supply services wholly or principally to small business customers.

4. Fixed-line networks (or any part of such networks) in existence immediately before 1 January 2011 and which are situated in a real estate development project that is extended on or after 1 January 2011 to an area that was developed as another stage of the project. These networks would not otherwise be subject to the operation of Parts 7 and 8 of the Act as they would obtain the benefit of relevant statutory exemptions under subsections 141B(3) and 156(3) of the Act.
5. Fixed-line networks (or any part of such networks) in existence immediately before 1 January 2011 which prior to that date were used to supply carriage services wholly or principally to residential customers and which have not been extended on or after 1 January 2011. Such networks are not subject to Part 7 and 8 of the Act, and where they targeted residential customers prior to 1 January 2011 the exemption should continue.
6. Fixed-line networks (or any part of such networks) in existence immediately before 1 January 2011 which prior to that date were used to supply carriage services wholly or principally to residential customers and which are subsequently extended on or after 1 January 2011 by less than 1 kilometre from any point on the infrastructure of the network (as it stood immediately before 1 January 2011). Such extensions are not subject to Part 7 and 8 of the Act and, where the network originally targeted residential customers and the extended parts of the network continue to do so, will be exempt. However, a network that did not target residential customers before 1 January 2011 (for example, it supplied business customers) and is then extended after that date, and those extensions are used to supply superfast carriage services to residential customers, would not be an excluded network.
7. Fixed-line networks (or any part of such networks) owned and operated by the carrier that is the primary universal service provider and that were built or extended by less than 1km at any time between 1 January 2011 and 31 December 2014 to fulfil the universal service obligation. This exemption is provided because the primary universal service provider has built and extended networks after 1 January 2011 that are not currently subject to the Act in fulfilment of the universal service obligation, and it is difficult to classify these networks as servicing wholly or principally either business or residential customers.

The concept of ‘residential customer’ is not defined in the Declaration and is intended to have its common meaning, namely, persons who are supplied services at premises which are used or intended to be used as their permanent place of residence. The term ‘end-user’ is also used throughout the Declaration. While the concept of ‘customer’ refers to the person with whom a service provider has a contract to supply a service, an ‘end-user’ is a person who uses a service. They may be either a customer or another person, for example, a member of the customer’s family or an employee of the customer.

The term **eligible service** has the same meaning as in section 152AL of the *Competition and Consumer Act 2010*. These are listed carriage services or services that facilitate the supply of listed carriage services, where the service is supplied, or is capable of being supplied, by a carrier or carriage service provider (whether to itself or to other persons). Listed carriage services are defined by section 16 of the Act.

The legal separation condition under subsection 6(6)(l) of the Declaration imposes a constraint on what type of work is carried out by employees of a wholesale or retail company. The term **employee** is not defined exhaustively; rather, it is specified to include natural persons acting as agents, consultants or contractors.

The concepts of **large charity customer** and **public body** are used in sub-subparagraph (b)(iii)(C) of the definition of designated telecommunications network. The term ‘large charity customer’ refers to any customer that is an incorporated charitable organisation which employs more than 15 full time or equivalent employees. The term **public body** is defined in a manner consistent with its commonly understood meaning. These terms define types of customers, who because of their size, do not need to be covered by the carrier licence condition.

The term **Layer 2** has the same meaning as in the Open System Interconnection reference model for data exchange. It refers to a basic level of transport functionality.

The term **Layer 2 Wholesale Service** is used in section 6 of the Declaration and represents the type of service that network owners who are subject to the conditions under section 6 are required to supply. The definition specifies the required operational and technical characteristics of the Layer 2 carriage services. Some of the characteristics are similar to the service description of the Local Bitstream Access Service declared by the ACCC on 22 February 2012, in respect of services supplied using a designated superfast telecommunications network (i.e. those networks which are subject to the operation of Part 7 of the Act) and include:

- a downstream data transfer rate of 25 megabits per second (peak information rate);
- an upstream data transfer rate of 5 megabits per second;
- the ability to be used by a carrier or carriage service provider to supply services, including voice telephony, to an end user.

The term **local access line** has the same meaning as in section 141D of the Act. In the context of the Declaration, the term is used to identify those network elements that form part of a designated telecommunications network and supply carriage services. Typically they are the fixed lines running from a distribution point to the premises.

The term **multi-dwelling unit** means a building or buildings where multiple separate units for occupation (from time to time) as a place of residence or business are contained within one complex. For the avoidance of doubt, the following examples are not multi-dwelling units:

- two or more adjoining premises without a common entrance
- a collection of individual buildings which are each located on separate lots of a sub-divided block (for example, 15A Smith Street, 15B Smith Street), or
- a single dwelling unit and a granny flat which is located on a single block.

The term ***national broadband network*** has the same meaning as in Section 5 of the *National Broadband Network Companies Act 2011*.

The term ***operational support systems*** means any system for service activation, customer support, billing and service fault rectification and similar functions and includes systems for maintaining and recording customer information. The defining feature of an operational support system in the context of this Declaration is that it deals with the provision of services to customers, whether wholesale customers or retail customers. This is distinct from a ‘business support system’ which would, by way of example, provide corporate back-end services to assist with the efficient running of an organisation (such services could include accounting and financial services, human resource management services and email). Under subsection 6(6)(c)(i), a wholesale and retail company operating over a designated telecommunications network must operate separate operational support systems to ensure that neither company obtains a commercial or other advantage over competitors from shared operational support systems.

The term ***permitted discrimination grounds*** means discrimination against a carrier or carriage service provider by a specified carrier (or wholesale company) where it has reasonable grounds to believe that the particular carrier or carriage service provider would fail, to a material extent, to comply with an obligation that is reasonably necessary to protect the carrier’s legitimate interests. A note at the end of the definition provides further guidance as to what would be considered ‘permitted discrimination grounds’. This includes evidence of lack of creditworthiness or repeated failures by the particular carrier or carriage service provider to comply with similar terms and conditions offered by the carrier (or the wholesale provider as the case may be). The permitted discrimination is consistent with that allowed to other carriers providing access to services, for example, under section 151ARA of the *Competition and Consumer Act 2010*.

The term ***point of interconnection*** is defined to mean a point within a carrier’s telecommunications network for the interconnection of facilities by another carrier. A point of interconnection can be located in each State/Territory capital city in which the carrier operates the designated telecommunications network, at a place that is reasonably accessible to the other carrier, or can be located at another location as agreed between the carrier and the other carrier which is seeking access. The purpose of requiring a point of interconnection is to enable a wholesale customer to interconnect with a backhaul network at reasonable cost to the wholesale customer. It is envisaged that a specified carrier or its associate would nominate a point of interconnection in each capital city at a place that is convenient for handing over traffic to customers. For example, a specified carrier could use its existing data or colocation centres or other current points of interconnection to meet the requirements of the Declaration. However, the parties could negotiate interconnection at another location if this is more suitable to their needs. A key qualification, if a specified carrier offers interconnection at a single point of interconnection within a capital city, is that the point of interconnection must be reasonably accessible to the other carrier. This addresses any concern that wholesale customers could be required, for example, to interconnect at multiple and/or remote locations within a capital city, thereby imposing significant costs on those customers.

The term **primary universal service provider** has the same meaning given in section 12A of the *Telecommunications (Consumer Protection and Service Standards) Act 1999*. The term is used in this Declaration in the context of sub-subparagraph (b)(iii)(G) of the definition of a designated telecommunications network to define one of the networks that is exempt from the conditions of this Declaration. There is currently only one primary universal provider, Telstra Corporation.

One of the conditions under subsection 6(6) of the Declaration relating to the legal separation of the operation of the designated telecommunications network is that the wholesale company must not disclose protected wholesale information relating to any of its wholesale customers to the retail company or any of the retail company's employees unless authorised. The term **protected wholesale information** is defined to cover the following types of confidential information obtained by the wholesale company as part of supplying carriage services to a wholesale customer:

- information which identifies a wholesale customer or a customer of that wholesale customer;
- information that is commercially sensitive to a wholesale customer; or
- any confidential information or commercially sensitive information which is derived from any of the above two types of information (singular or aggregate) which would enable the identity of a wholesale customer (or a customer of that person) to be ascertained.

Consistent with the equitable doctrine of confidentiality, the definition excludes information which is already public. It also excludes information which has been edited to remove any identifying material or any confidential information.

The term **related body corporate** has the same meaning as in section 9 of the *Corporations Act 2001*.

The term **retail company** is used in section 6 of the Declaration. It refers to a company which supplies eligible services to end-user customers using the designated telecommunications network and negotiates and/or establishes supply contracts with those customers.

The term **specified broadband service** is defined in similar terms to the term **superfast carriage service** (see below). It is a carriage service with three characteristics – it enables end-users to download communications; its download transmission speed is normally 6 megabits per second or more; and it is supplied using a line to premises occupied or used by an end-user. The definition clarifies that the specified broadband service is supplied using a fixed-line network. The term is used in section 5 where it clarifies that a specified carrier would be subject to the Declaration if it offered specified broadband services using the designated telecommunications network.

The term **specified carrier** refers to a carrier that owns or operates a designated telecommunications network at any time on or after the commencement of this Declaration. A specified carrier captured under section 5 of the Declaration will be obligated to comply with the carrier licence conditions specified in the Declaration. The definition also clarifies that, where the context in the Declaration permits, a specified carrier may be the wholesale company that the specified carrier is required to ensure carries out wholesale functions. This statement is intended to clarify that in

some circumstances the specified carrier may choose to act as the wholesale company itself, whereas in other circumstances it may choose to task another company within the same corporate entity with the functions of the wholesale company.

The term *Specified HFC network*, refers to the second type of network which is excluded from the definition of ‘designated telecommunications network’. It captures fixed-line telecommunications networks which have optical fibre line components connecting nodes, and supplemented by coaxial cable connections from the nodes to the premises of end-users. The Declaration is not intended to capture HFC networks that were in existence prior to 1 January 2011, and for the avoidance of doubt and consistent with Parts 7 and 8 of the Act, any extensions to such networks made on or after 1 January 2011 are to be treated as forming part of a specified HFC network for the purposes of this Determination. This reflects the fact that such networks were already providing superfast carriage services before 1 January 2011 and were therefore not captured by Parts 7 and 8. Additionally, it is envisaged that the HFC networks operated by Telstra and Optus will eventually be integrated into the NBN where they will be operated on a wholesale-only and non-discriminatory basis.

The term *superfast carriage service*, as noted above, has the meaning given in subsection 141(10) of the Act. It plays a pivotal role in the Declaration, both in defining a designated telecommunications network, and in the application provision in section 5, which also relies on the concept of designated telecommunications network.

The term *universal service obligation* has the meaning given in section 9 of the *Telecommunications (Consumer Protection and Service Standards) Act 1999*.

The term *wholesale company* is used in section 6 of the Declaration. It refers to a company which supplies eligible services to carriers, carriage service providers and the retail company using the designated telecommunications network. The wholesale company may also supply other services such as service activation and provisioning, fault detection, handling and rectification and similar functions.

To aid the reader, a note is inserted at the end of section 4 indicating that the terms *carriage service, carriage service provider, carrier, customer cabling, customer equipment, facility, main distribution frame, real estate development project and telecommunications network* have the same meaning as in sections of the Act.

Subsection 4(2) establishes that where a specified carrier uses a designated telecommunications network to supply carriage services to either carriers or carriage service providers and those carriers or carriage service providers are:

- related body corporates of the specified carrier, or
- within the same group of companies as the specified carrier, and
- supply carriage services to residential customers,

the operations of the designated telecommunications network will not be treated as being on a wholesale-only basis for the purposes of the subsection 6(6)(a). This section is an anti-avoidance mechanism. It addresses situations where a carrier could create an associated company to act as the wholesale company. That wholesale company could operate the network and supply the Layer 2 Wholesale Service but no other eligible services to the retail company and other carriers and carriage service

providers. The carrier could itself supply eligible services to other carriage service providers within the same corporate entity on a wholesale basis, and those carriage service providers could then retail services to end-users. The carrier would technically be ‘wholesale-only’ and not therefore subject to the Declaration; in reality, however, the entire corporate entity would be vertically integrated.

Section 5 – Application

Subsection 5(1) specifies when the new set of carrier licence conditions under section 6 will apply. The trigger point is where any local access lines forming part of the designated telecommunications network (or part of such a network), as defined under the Declaration, are used by the specified carrier or any of its associates to supply a superfast carriage service or a specified broadband service to residential customers. There are therefore three key parts to this trigger: (1) the use of a designated telecommunications network, (2) the supply of a superfast carriage service or a specified broadband service, and (3) supply to residential customers. There does not need to be any construction, alteration or change to the network for the provisions to apply (in contrast to Parts 7 and 8 of the Act). The catalyst is the supply of superfast carriage services or specified broadband services using a local access line to residential customers at any time on or after the date of commencement of the Declaration.

‘Specified broadband services’ are included as an anti-avoidance measure. It is possible that a carrier could throttle its download transmission speeds so that its network offered services that were not superfast carriage services, even though the network is technically capable of being used to supply such services. As a result the application provision would be activated by the supply of a specified broadband service, defined in the Declaration as a carriage service which (amongst other things) has a download transmission speed of 6 megabits per second or more. Inclusion of the anti-avoidance measure removes any perverse incentive for a specified carrier to only provide lower speed broadband services on a network that is capable of providing superfast carriage services.

As stated above, one of the triggers for activating section 5 is when a network is a designated telecommunications network. The network must therefore be used, or technically capable of being used, to supply superfast carriage services. Networks that are not technically capable of being used to supply superfast carriage services, such as the majority of Telstra’s copper networks where used to supply plain old telephone services or asymmetric digital subscriber line (ADSL) services, will not therefore be captured even if they supply broadband services with a download transmission speed of 6 megabits per second or more because they are not capable of providing superfast carriage services.

A new broadband network, built after 1 January 2015, that is technically capable of being used to supply superfast carriage services would normally be subject to Part 7 and 8 of the Act and therefore not captured by the Declaration. Carriers would also be able to seek exemptions under the Act, and if such exemptions were granted the new broadband networks would also not be captured by the Declaration.

Section 6 – Class Licence Conditions

Subsection 6(1) sets out the dates in which certain conditions of the class licence are triggered and the timeframe in which specified carriers must notify the ACCC of compliance with those conditions. Importantly, this subsection establishes that there is a two-stage process in which the conditions in the Declaration are applied. The intention of this approach is to provide carriers affected by the Declaration with a reasonable amount of time to meet the conditions set out by the Declaration (particularly the functional separation requirements). Paragraphs 6(1)(a)-(c) operate as follows:

	Period of application	Applicable class conditions
Stage One	1 January 2015 – 30 June 2015	6(2) – Interim wholesale service offering requirements 6(3) – Non-discrimination and equivalence requirements 6(7), 6(8) Where the specified carrier chooses to offer a Layer 2 Wholesale Service during this period, it must comply with these subsections.
Stage Two	1 July 2015 – 30 December 2016	6(5), 6(6) – General separation and supply obligations 6(7), 6(8) – Layer 2 Wholesale Service obligations.

Stage one – From 1 January 2015 until 30 June 2015, specified carriers must comply with the conditions set out in subsections 6(2) and 6(3). These conditions require specified carriers to offer, or ensure that any of their associates (as relevant) offers, to supply eligible services over the designated telecommunications network (subsection 6(2)) to enable a carrier or carriage service provider to supply carriage services to an end-user. The specified carrier must offer these services on a non-discriminatory basis (subsection 6(3)). The supply of wholesale services includes services supplied from the specified carrier's point of interconnection to either of two points, as requested by a carrier or carriage service provider:

- (i) the main distribution frame of the relevant building; or
- (ii) an end-user's premises.

Interim wholesale service offerings

The interim wholesale service offering obligations ensure that the specified carrier (or its associate) will offer a service that uses the local access line (the designated telecommunications network) as well as backhaul to a point of interconnection. The obligations also provide wholesale customers with flexibility to request a service be supplied to:

- a customer's premises, in which case the supplying carrier would jumper the service at the building's main distribution frame for the wholesale customer, to provide a path to the premises, or
- the main distribution frame of the building, in which case the wholesale customer would arrange jumphering of the service (and access to intervening customer cabling) to connect a customer's premises.

These obligations include a requirement to supply information about the types of customer equipment needed to provide services to end-users. This is because certain

types of superfast network equipment many only operate effectively with specific types of network hardware. It is envisaged that the specified carrier would provide its potential wholesale customers with a 'white list' detailing appropriate customer equipment. There is also a requirement that the specified carrier supply proprietary equipment needed to enable the other carrier or carriage service provider to supply carriage services to an end-user. This covers the situation where the specified carrier operates a network with proprietary equipment not readily able to be sourced from the market. The carrier must also provide access to any necessary facilities and interconnection of those facilities. The obligations also include, where the specified carrier controls relevant customer cabling, access to that cabling. The obligations are intended to ensure that access is provided to all relevant services and equipment or facilities required by a wholesale customer to supply services to end-users.

In relation to sub-paragraph 6(2)(a)(ii), for the avoidance of any doubt, the specified carrier is not required to take responsibility for any equipment on the customer's side of the specified carrier's network boundary. This recognises that where a service provider or customer supplies its own customer equipment, it should be responsible for it. If the specified carrier needs to provide proprietary customer equipment for wholesale customers it is envisaged that the terms and conditions in relation to its supply would be set out in the relevant carrier's contract with its customer.

Typically customer cabling within a multi-dwelling unit would be controlled by the building owner or manager. However, it is possible that a carrier could, in some circumstances, control the cabling, for example, if it installs it itself or through an agreement with the building owner. Paragraph 6(2)(d) clarifies that, where a specified carrier or its associate controls the cabling in a multi-dwelling unit, wholesale customers must be able to access that cabling to supply end-to-end services. This requirement draws on Recommendation 3 of the Statutory Review under section 152EOA of the *Competition and Consumer Act 2010* undertaken by the Vertigan panel.

During the initial six month period from 1 January 2015 until 30 June 2015, a specified carrier, if it chooses to offer a Layer 2 Wholesale Service, must offer that Layer 2 Wholesale Service in compliance with subsections 6(7) and 6(8). Subsection 6(7) needs to be read down in this instances to be read as applying to the specified provider's wholesale operations, rather than the wholesale company. That is, the reference to 'wholesale company' in subsection (7) is to be taken as a reference to the wholesale operation of the specified carrier. If the specified carrier chooses to supply the service, it will also be submitting itself to the supply obligations under subsection 6(7). The specified carrier would also need to supply the service at the price specified in the Declaration at subsection 6(8). That is, not more than \$27 (GST exclusive) per month. This price is in relation to the use of the local access line; the specified carrier may add additional charges for backhaul to the point of interconnection. However these charges should not discriminate between the specified carrier's own retail operations and those of other carriers and carriage service providers seeking access.

Subsection 6(3) sets out the conditions relating to non-discrimination requirements that apply to the supply of services under stage one under subsection 6(2). The purpose of non-discrimination obligations is well established in telecommunications law. Effectively, the requirement for a carrier to provide services to another access seeker on the same terms that it provides those services to itself establishes a level

playing field in the market for services. This enables retail service providers to compete effectively, and ensures that the benefits of that competition can be passed on to the end-user.

Paragraph 6(3)(a) requires that, from 1 January 2015 to 30 June 2015, a specified carrier must take all reasonable steps to ensure that the technical and operational quality of the eligible services supplied to the carrier or carriage service provider is the same as that which the specified carrier provides to itself. That is, carriers and carriage service providers are to be given the same technical and operational quality of service that the specified carrier provides to its retail operations. This language is based on paragraph 152AR(3)(b) of the *Competition and Consumer Act 2010*. There it forms part of the Category A Standard Access Obligations, although in that context it is not part of a non-discrimination requirement. The obligation is set out here because a specified carrier may, at this point in time, still be vertically integrated (because it does not yet need to create separate wholesale and retail companies) and provides clarity as to basis on which services are to be supplied.

Additionally, under paragraph 6(3)(b) the specified carrier must not discriminate in favour of its retail operations in relation to the supply of an eligible service or in making any changes or enhancements to an eligible service. The intention of these provisions is to set out a clear non-discrimination obligation. The provisions are based on those at sections 152ARA and 152ARB of the *Competition and Consumer Act 2010*, which apply non-discrimination obligations to carriers or carriage service providers who supply Layer 2 bitstream services using a network that is subject to Part 7 of the Act, and who are also subject to the Category A Standard Access Obligations. Subsection 6(3) sets out that in supplying an eligible service, a specified carrier's non-discrimination obligation includes non-discrimination in respect of any price and non-price terms and conditions for such supply. Sections 152ARA and 152ARB of the *Competition and Consumer Act 2010* do not specify that the supply of a Layer 2 bitstream service includes price and non-price terms and conditions, because the drafting is intended to be inclusive. The drafting of this Declaration is not intended to limit those sections, but is included for the sake of clarity because the services under consideration are not declared services.

There is one exemption from the non-discrimination obligation – permitted discrimination grounds. These are defined under section 4 and mean discrimination against a carrier or carriage service provider by a specified carrier (or wholesale company, as the case may be) where it has reasonable grounds to believe that the particular carrier or carriage service provider would fail, to a material extent, to comply with an obligation. Examples of grounds for such a belief include, evidence of lack of credit worthiness and repeated failures by the particular carrier or carriage service provider to comply with similar terms and conditions.

The exclusion of permitted discrimination grounds matches a similar exclusion under subsection 152ARA(2) of the *Competition and Consumer Act 2010* and is intended to ensure that an exemption available under legislation for carriers subject to Part 7 of the Act will also be available under the Declaration.

Exception to interim wholesale service offerings

Subsection 6(4) establishes that the obligation set out under subsection 6(2) does not apply in respect of a particular local access line that forms part of a designated telecommunications network if all of the following circumstances apply:

- the local access line mentioned was being used by the specified carrier on 31 December 2014 to supply a carriage service to an end-user at premises owned or occupied by that end-user; and
- at the relevant time, the specified carrier is continuing to supply a service to the end-user at the relevant premises using the line.

The purpose of this subsection is to ensure that services in operation immediately prior to the commencement of the Declaration are ‘grandfathered’. In other words, during stage one (1 January 2015 to 30 June 2015), if the specified carrier cannot comply with the wholesale supply and non-discrimination obligations, it would be able to continue to supply services to existing customers on the designated telecommunications network. However, it would not be able to provide any services to new customers until it was able to comply with the Declaration.

The intention is that the exception in subsection 6(4) relates to individual active customers supported by local access lines, even if there are multiple prospective customers that could be serviced by a particular local access line, for example, running into a multi-dwelling unit. It is not intended that the exception apply to all potential customers in a building, simply because a local access line servicing a building is already being used to supply one or two customers. That is, the building as a whole is not excepted from the rules in subsections 6(2) and 6(3).

General Separation and Supply obligations

Stage two – From 1 July 2015 until 31 December 2016, specified carriers must comply with the conditions set out in subsections 6(5), 6(6), 6(7) and 6(8). These conditions require specified carriers to comply with general separation and supply obligations and obligations in respect of the supply of a Layer 2 Wholesale Service.

Subsection 6(5) establishes the requirement that a specified carrier must comply with the separation obligations set out in subsection 6(6) before it, or any of its associates, can use any local access line forming part of a designated telecommunications network, to supply a carriage service. For the avoidance of doubt, the exception in subsection 6(4) does not apply in relation to the obligations under stage two.

Subsection 6(6) sets out the conditions relating to functional separation which must be satisfied for the purposes of section 5 and subsection 6(5). The overarching principle is that a specified carrier’s retail company cannot supply eligible services it receives from the wholesale company unless those services are also offered by the specified carrier’s wholesale company to other carriers and carriage service providers on the same terms and conditions.

The conditions require that if the specified carrier is not operating the designated telecommunications network on a wholesale-only basis, it must have separate retail and wholesale companies to undertake the relevant functions. That is, it must have legal and functional separation. The conditions by which this separation and non-discrimination are achieved are set out under paragraphs 6(6)(a) to 6(6)(r).

Paragraphs 6(6)(a) and 6(6)(b) specify that the wholesale operations of the network must be conducted through the wholesale company and the retail operations must be conducted through the retail company.

Paragraph 6(6)(c) specifies that both the retail and wholesale companies must operate separate operational support systems. The meaning of operational support systems is set out in the definitions section. The paragraph also provides that the wholesale company and the retail company may have shared business and communications systems, but only if they are not used by the wholesale company in a manner which could have the effect, or potential effect, of discriminating in favour of the specified carrier's retail company.

Paragraphs 6(6)(d) and 6(6)(e) set out compliance and enforcement requirements relating to shared business and communications systems. Specified carriers are required under these subsections to demonstrate compliance with the requirement set out in 6(6)(c)(ii)(B) (relating to the use of shared systems) by providing a statutory declaration to the ACCC by 1 January 2016, 30 June 2016 and again on 31 December 2016. The statutory declaration must be made by a director or company secretary of the specified carrier. The ACCC may then decide to conduct an audit to verify the specified carrier's compliance with those requirements. If such a situation does arise, a specified carrier must provide all reasonable assistance and respond to any reasonable request made by the ACCC for the purpose of the audit. For the avoidance of doubt, it would be expected that the ACCC would be able to inspect relevant company records and the operation of relevant systems. Under section 151BU of the *Competition and Consumer Act 2010*, the ACCC can put in place record keeping rules relevant to its functions. It is envisaged that the ACCC could use these powers to assist it with enforcing the conditions of this Declaration.

Paragraph 6(6)(f) specifies that the wholesale company must operate a single business-to-business interface for use by its retail company and other carriers and carriage service providers for ordering eligible services. This facilitates the separation and non-discrimination objectives by ensuring the retail company uses the same business-to-business interface as other wholesale customers of the specified carrier's wholesale company.

Paragraphs 6(6)(g) and (h) specify that the wholesale company cannot perform any function of the retail company and vice versa.

Paragraph 6(6)(i) specifies that the offer and supply of eligible services to carriers and carriage service providers using the designated telecommunications network must be effected through the wholesale company. This is a key component of functional separation. A functionally separated wholesale company will be better placed to treat the specified carrier's retail company and other carriers or carriage service providers equally.

Paragraph 6(6)(j) specifies that when the retail company acquires services from the wholesale company, the offer and/or supply of eligible services to end-users using the designated telecommunications network can only be effected through the retail company. In other words, only the retail company can supply to end-users.

The conditions under paragraph 6(6)(k) require the wholesale company to publish its terms and conditions (price and non-price) for eligible services on its website. This is intended to be its reference offer. This will provide transparency to customers and to the retail company of the services that may be accessed, and the terms and conditions for the supply of those services. The requirement on the wholesale company to provide a copy of any reference offer ensures that the ACCC will have visibility of the wholesale company's standard terms and conditions. This will assist it to enforce the non-discrimination obligations. Although the ACCC is able, under Part XIC of the *Competition and Consumer Act 2010*, to gain information on access agreements between access providers and access seekers, this only applies to agreements in relation to services that have been declared under that Act. As a result, the ACCC may not otherwise be provided with information on the standard terms and conditions for eligible services supplied by the wholesale company. Under section 155 of the *Competition and Consumer Act 2010*, the ACCC would be able to use its powers obtain information, documents and evidence to gain further information from the wholesale company if that information is required for enforcement.

The conditions under paragraph 6(6)(l) and 6(6)(m) relate to the particular way in which the wholesale company must act in respect of its service offerings. Sub-paragraphs (i) to (v) set out straightforward supply obligations; these match those required in relation to interim wholesale service offerings. Paragraph (m) sets out non-discrimination obligations matching those in relation to the interim wholesale service offerings. The non-discrimination obligations are intended to emulate some (but not all) of the non-discrimination obligations that apply to carriers in respect of declared services under sections 152ARA and 152ARB of the *Competition and Consumer Act 2010*.

The wholesale company (established by the specified carrier) must not discriminate when supplying an eligible service (including the Layer 2 Wholesale Service) in favour of the retail company established by the specified carrier, or between carriers and carriage service providers. The wholesale company must also not discriminate when carrying out any related activities, such as enhancing an eligible service, developing an eligible service or providing information about any of the related activities. As is the case under paragraph 6(3)(b) (relating to interim wholesale service offerings) the drafting specifies that the obligations include the non-price and price terms and conditions of supply. A general obligation not to discriminate when supplying an eligible service would cover the terms and conditions of supply, but the Declaration specifies non-price and price terms and condition to provide clarity that this is indeed the case. Permitted discrimination grounds are also available to the wholesale company, as is the case in relation to interim wholesale service offerings, but only in relation to its supply to other wholesale customers (carriers and carriage service providers). There is no provision for permitted discrimination grounds when the wholesale company supplies services to the retail company, because it would not be likely that the wholesale company would refuse to supply an associated corporate entity on the grounds that that entity was (for example) not creditworthy.

Sub-paragraph 6(6)(m)(iii) specifies that the wholesale company must not discriminate between wholesale customers, being carriers and carriage service providers. The sub-paragraph is intended to make clear that a wholesale company cannot discriminate between its wholesale customers, whether carriers of carriage service providers, just as it cannot discriminate between them in favour of its

associated retail company (as provided for in sub-paragraphs 6(6)(m)(i-ii). That is the wholesale company is required to provide all its customers with the same terms and conditions. This is not intended, however, to prevent the wholesale company offering a range of wholesale products and packages, with varying terms and conditions, providing those products and packages are equally available to all its wholesale customers (and prospective customers).

Paragraphs 6(6)(n) to 6(6)(p) contain provisions requiring separate directors, senior management and employees. They are designed to prevent the retail and wholesale companies from being advantaged over their competitors as a result of sharing such personnel. A key issue in this regard is the sharing of information (other than protected wholesale information) held by an employee or director. For example, this may relate to rollout plans and pricing proposals originating within the wholesale business or proposed marketing activity on the part of the retail company. The restrictions also recognise that a potential conflict of interest would arise if a director was on the board of both the wholesale company and the retail company and would hold commercial-in-confidence information about the retail company's competitors (who are also the wholesale company's wholesale customers). This would represent a breach of fiduciary duty. Similarly, the requirement for the two companies to have separate senior management and employees is intended to remove the possibility that a manager or an employee of one company could also work for the other company, and hold commercial-in-confidence information that could advantage the other's operations. Separation of the workforce, by contrast, should ensure that employees' and managers' incentives are limited to promoting the success of their particular company.

Information security measures in paragraphs 6(6)(q) and 6(6)(r) are necessary to ensure that the wholesale company, unless authorised, does not share information regarding its wholesale customers (and their customers) with its associated retail company, for the commercial advantage of that company. Paragraph 6(6)(q) deals with the provision of protected wholesale information by the wholesale company directly to the retail company. Paragraph 6(6)(r) deals with the circumstance where protected wholesale information is provided to an associate other than the retail company (e.g. a holding company providing head office functions). In these circumstances paragraph 6(6)(r) prevents the associate providing the protected wholesale information to the retail company.

Layer 2 Wholesale Service Supply Obligation

Subsection 6(7) sets out the obligation that where a Layer 2 Wholesale Service is not a declared service, a specified carrier must offer to supply, upon reasonable request by another carrier or carriage service provider, a Layer 2 Wholesale Service using the designated telecommunications network. This service is based on the basic service that must be offered under Part 7 of the Act. By excluding services that are 'declared services' from the operation of this licence condition, this means that if a Layer 2 Wholesale service is later declared by the ACCC under Part XIC of the *Competition and Consumer Act 2010*, at any time the Declaration is in force, the conditions under subsection 6(7) and 6(8) will no longer apply.

The supply obligation under subsection 6(2) of the Declaration ensures that, during stage one (1 January 2015 to 30 June 2015) the specified carrier or its associates must

offer to supply eligible services to other carriers or carriage service providers using the designated telecommunications network. During stage one the specified carrier would not have a specific obligation to offer to supply a Layer 2 Wholesale Service but could choose to do so. If it chooses to offer to supply a Layer 2 Wholesale Service during stage one, then the specified carrier or its associates must comply with subsections 6(7) and 6(8).

The requirement to offer to supply ‘upon reasonable request’ is included because there may be circumstances in which a specified carrier is prevented from supplying a Layer 2 Wholesale Service using the designated telecommunications network. For example, if a carrier or carriage service provider seeking access to a service imposes unreasonable conditions on the purchase of the service (i.e. refusing to pay the charges specified in the reference offer made under paragraph 6(6)(k)), this would not amount to a reasonable request that the specified carrier or its wholesale company is compelled to fulfil.

Subsection 6(8) sets the maximum price of \$27 per month (exclusive of GST) for the supply of the Layer 2 Wholesale Service. The price is based on the price that the ACCC has set under its declaration of the Local Bitstream Access Service in respect of networks subject to Parts 7 and 8 of the Act. The price is in relation to the use of the local access line. Consequently, the price does not include backhaul to the specified carrier’s point of interconnection. However these charges should not discriminate between the specified carrier’s own retail operations and those of other carriers and carriage service providers seeking access.

Attachment 3**Statement of Compatibility with Human Rights**

Prepared in accordance with Part 3 of the
Human Rights (Parliamentary Scrutiny) Act 2011

Carrier Licence Conditions (Networks supplying Superfast Carriage Services to Residential Customers) Declaration 2014

The *Carrier Licence Conditions (Networks supplying Superfast Carriage Services to Residential Customers) Declaration 2014* (the Declaration) is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview of the declaration

The Declaration has been made by the Minister for Communications (the Minister) under subsection 63(2) of the *Telecommunications Act 1997* (the Act).

The Declaration sets out new obligations on specified carriers owning or operating networks supplying, or capable of supplying, superfast carriage services to residential customers.

There are two stages to the Declaration, designed to ensure there is an adjustment period wherein interim obligations apply before specified carriers are required to operate using separate wholesale and retail companies.

Importantly, the requirement for a specified carrier to operate separate retail and wholesale companies does not take effect until the Declaration has been in place for six months. This provides affected carriers with a reasonable period of time to transition to the new arrangements, without significantly disrupting their existing operations or services received by end-users.

From 1 January 2015 to 30 June 2016, a specified carrier falling under section 5 of the Declaration is required to:

1. provide services to other carriers or carriage service providers that it provides to its own retail operations, and to not discriminate in favour of its own retail company with regard to the supply of those services (unless it has reasonable grounds to so), and
2. if it chooses to offer to supply a Layer 2 Wholesale Service, do so upon reasonable request from a carrier or carriage service for a wholesale price of no more than \$27 per month.

Following this interim period, from 1 July 2015 to December 31 2016, a specified carrier falling under section 5 of the Declaration is required to:

3. undertake its wholesale and retail functions in relation to its supply of services to residential customers using a designated telecommunications network through separate wholesale and retail companies and separate systems and personnel;
4. supply services and access to related facilities and equipment to wholesale customers (carriers and carriage service providers) on the same basis its wholesale company supplies them to its retail company; and
5. offer to supply a Layer 2 Wholesale Service, upon reasonable request from a carrier or carriage service, for a wholesale price of no more than \$27 per month. .

No human rights issues were raised during consultation on the draft Declaration.

The imposition of the new class carrier licence conditions does not raise any human rights issues.

Human rights implications

This legislative instrument does not engage any of the applicable rights or freedoms.

Conclusion

This legislative instrument is compatible with human rights as it does not raise any human rights issues.