



Submission in response to Issues Paper

Competition Policy Review

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Section 1. Executive Summary

- 1.1 The communications sector has made a significant contribution to the Australian economy. In 2012-13, there were 31 million mobile and 10 million fixed line connections. In addition, 14.3 million people had access to the internet in their homes, and a further 7.5 million accessed it via mobile devices.¹ The value of communications extends to other industries, including media, online e-commerce and banking, and economy wide productivity benefits. It is estimated that mobile broadband alone has contributed more than \$33 billion to the Australian economy in 2013.²
- 1.2 This contribution is expected to increase as new digital services that are becoming essential to the functioning of a modern economy are rolled-out. It is essential that competition in the communications sector is robust and sustainable.
- 1.3 Competition policy settings have been subject to detailed and separate focus within the communications sector. It has its own sections of the *Competition and Consumer Act 2010* (CCA) that provide for a separate access regime. These provisions were recently amended to accommodate the structural changes underpinning the roll-out of the National Broadband Network (NBN).
- 1.4 The NBN roll-out is subject to a strategic review initiated by the Australian Government. Elements of the roll-out are likely to change to ensure that the NBN meets the objectives of the Government's broadband policy. Notwithstanding any change in approach, some key policy settings underpinning the NBN must continue to apply. This includes;
 - (a) The structural separation of Telstra;
 - (b) That NBN Co should continue to operate as a wholesale-only provider of fixed line broadband services with access provided on open and non-discriminatory terms; and
 - (c) That the NBN should be subject to close oversight by the Australian Competition and Consumer Commission (ACCC).
- 1.5 These policy settings are vital for delivering a level playing field in the fixed line market and providing the opportunity for enhanced competition across other communications markets.

Future proofing the communications competition regime

- 1.6 However, the current reviews (Competition Policy Review and Vertigan Review of NBN) should look beyond the policy measures that are designed to deliver and regulate the NBN to the regulatory requirements of a converged market post NBN roll-out. In particular, there is an opportunity to future proof the regime as the communications sector increasingly evolves from infrastructure based competition to service based competition; and as convergence becomes a more embedded reality.

¹ ACMA, 2013, *Communications Report 2012-13*.

² CIE, 2012, *The economic impacts of mobile broadband on the Australian economy from 2006 to 2013: A Report prepared for the ACMA*.

- 1.7 In communications, similar to other infrastructure intensive sectors, competition and market power issues have been traditionally associated with control of infrastructure. NBN policy reforms separating ownership of the fixed line network from the provision of downstream retail services to end-users acknowledge this. Ownership of infrastructure, however, is not the only determinant of market power. In a post NBN world, market power may be derived from broader sources, including the ability to bundle services; to provide applications and content on an exclusive basis; or the ability to leverage scale of presence across multiple markets.
- 1.8 The current communications competition policy settings are ill equipped to deal with these broader sources of market power. Today there is really only one remedy available to the ACCC — it can regulate access to infrastructure. Moreover, rigidities inherent in specific purpose or narrowly defined regulatory or policy instruments can create opportunity for “gaming”. Thus, this form of regulation will still be necessary, but it will not address competition issues that are not derived from ownership of infrastructure. Optus submits this review should take the opportunity to enhance the telecommunications regulatory regime by providing the ACCC with a more flexible range of powers.
- 1.9 Optus proposes that Australia adopt a broader ex ante regulatory framework similar to that adopted in the European Union (EU), focusing on operators with Significant Market Power (SMP). Importantly it provides regulators with a broader range of remedies that can be used to address impediments to competition associated with that market power. This includes traditional access remedies, but it also includes other measures that can be applied in a proportionate way depending upon the specific circumstances, including:
- (a) Retail price controls, including measures to preclude bundling;
 - (b) Non-discrimination obligations; and
 - (c) Various forms of internal separation, including functional and structural separation.
- 1.10 The limitations of the current regime have previously been highlighted by the ACCC. In a report to the Minister for Communications in 2003, it identified that Telstra’s market dominance gave rise to competition concerns in the in the markets for Pay TV content and the bundling of communications services. However, the ACCC noted that it could not address these issues under its existing powers. The tools available under an SMP approach would provide the ACCC with the flexibility to address such competition concerns.
- 1.11 Optus further believes that adoption of an SMP approach would future proof the communications competition regime. Over time there is little doubt that the barriers to competition in communications markets are likely to change. Optus sees merit in allowing the ACCC greater flexibility to impose the full range of possible regulatory remedies with the requirement that it be proportionate to the problem identified. It is neither efficient nor effective to require legislative amendments in order to implement efficient remedies whenever a new competition problem is identified.

Structural remedies should be strengthened

- 1.12 In addition to the long term reform outlined above, Optus sees merit in strengthening the structural remedies already imposed within the fixed line communications market. The existing suite of regulations was designed based on a particular network design of the NBN that achieved a particular form of structural separation of Telstra. The proposed adoption of a multi-technology mix for the NBN with a greater reliance on Telstra infrastructure has the potential to undermine these fundamental structural reforms.
- 1.13 Optus submits that structural reform of Telstra is vital to ensuring effective competition in communications markets. Careful consideration needs to be given to the implications of a new Telstra/NBN Co deal on the structural separation arrangements of Telstra.
- 1.14 Optus notes that a number of possible models have been publicly canvassed for the multi-technology. Many of these are likely to result in a situation where Telstra Retail will purchase services from NBN Co that are based on access inputs that are largely controlled and/or operated by Telstra. Such an outcome would likely put Telstra in breach of the provisions of its structural separation undertaking and section 577A of the Act that:

Telstra will not supply fixed-line carriage services to retail customers in Australia using a telecommunications network over which Telstra is in position to exercise control.

- 1.15 Regardless of the specific circumstances of Telstra's compliance, Optus considers that there will be a strong case to revise the structural separation arrangements that apply to Telstra. If Telstra's engineers have a role to play in the day to day operation of NBN services, such as migration, provisioning and fault support then additional protections will need to be put in place to ensure that Telstra Retail cannot gain any advantage from these arrangements. Ultimately, this should involve a deeper form of separation within Telstra to ensure that its Retail units operate separately from any units that supply services to NBN Co.

Administration of merger approvals should be re-focused

- 1.16 Recent decisions and policy statements made by the ACCC give an indication that it may have a position against mergers that result in particular levels of consolidation in markets. This, in effect, gives market concentration issues a higher weighting than other relevant factors.
- 1.17 Optus observes that while market concentration is one of several factors to be taken into account when assessing if an acquisition lessens competition, there is nothing in the Act or in economic theory which gives extra weight, or special consideration, to the issue of market concentration.³ While the impact on market concentration should be considered when reviewing a merger, it should not be the primary factor in determining the level of competition for an industry. Other important factors, such as the suppliers' abilities to raise prices, barriers to entry and exit, and anti-competitive conduct, should be of equal importance. Indeed, there is a substantial body of literature that demonstrates market concentration is not the sole determining factor when assessing the impact on competition.

³ CCA, s. 50(3)

- 1.18 This is more likely to be an issue in infrastructure industries (such as communications, electricity and gas), where scale provides significant competitive advantages. In markets with large fixed and sunk costs, firms with significant scale advantages face lower costs. This is often a source of entrenched market power, making effective competition more difficult. Competition may often be promoted if there are fewer strong competitors with similar scale rather than one dominant and several weak competitors. In such markets, a focus on market concentration is unlikely to promote efficient mergers and is likely to restrict the ability of non-dominant firms to compete effectively. The public position of the ACCC against particular levels of market concentration provides another regulatory competitive advantage to incumbent providers, especially those that may already have significant market power. In essence, the ACCC is limiting the ability of non-dominant networks to compete in the market with an efficient cost base.
- 1.19 Optus considers there is merit to revise the merger provisions in the CCA to make clear the ACCC should not unduly place more weight on one consideration.

Section 2. Competition Policy Reform Priorities

- 2.1 On 14 April 2014, the Review Panel released its Issues Paper focusing on competition policy, with the central theme that:

*Competition is a key source of productivity and efficiency in markets – it can drive more competitive prices, deliver better choices for consumers, and raise living standards for all Australians.*⁴

- 2.2 This Review is a follow up to the original National Competition Policy Review (Hilmer Review) of 1993 which underpinned the development of the National Competition Policy (NCP). Since then, the NCP has “contributed to a surge in productivity, lowered prices in some important consumer product and service markets, and stimulated business innovation.”⁵
- 2.3 Optus considers that competition and productivity should continue to underpin the principles of any future competition policy reforms. Importantly, any reform within the telecommunications sector should recognise that it is a dynamic industry that has been and is still undergoing a period of change.
- 2.4 The fundamental elements of the NCP framework should continue. Further, Optus submits that this review should consider how to implement this framework within specific industries to reflect the key structural changes that may have occurred since implementation of the original NCP framework.
- 2.5 The telecommunications sector is a key example in which there have been significant structural and competitive changes in recent years. For example, the announcement of the NBN policy will continue to bring about significant structural and competitive changes to the industry landscape; requiring a transition from regulation of legacy networks to an open access broadband network. Another example is the ongoing convergence of traditional communications markets, including the growing trend to bundle products (such as mobile, broadband and Pay TV). Such changes indicate that a competition regime designed in 1997 may not be best placed to deal with emerging competition issues.
- 2.6 Notwithstanding the circumstances outlined above, the basic tenets outlined in the NCP framework should continue to be adhered.⁶ The relevant question for this Inquiry is how the legislative implementation of the NCP Framework should be updated to reflect experience gained and identification of new competition problems.
- 2.7 Optus provides its opinion on the ability of existing competition laws to deal with issues impacting upon the communications markets transiting from legacy networks to next generation IP-based networks.

⁴ The Australian Government Competition Policy Review, Issues Paper, 14 April 2014, p.iii

⁵ The Australian Government Competition Policy Review, Issues Paper, 14 April 2014, p.iii

⁶ The Australian Government Competition Policy Review, Issues Paper, 14 April 2014, p.11, Box 2

Priorities for reform agenda in telecommunications

Question 1 – What should be the priorities for a competition policy reform agenda to ensure that efficient businesses, large or small, can compete effectively and drive growth in productivity and living standards?

Question 12 – Is there a need for further competition-related reform in infrastructure sectors with a history of heavy government involvement (such as the water, energy and transport sectors)?

Question 13 – What are the competition policy reform priorities in sectors such as utilities, transport and telecommunications?

- 2.8 The telecommunications sector has undergone a number of regulatory reforms in recent years to address the future of competition within the sector, albeit focused on arrangements to facilitate the transition to NBN. It is therefore important that competition policy continues to address barriers to effective competition in *all* communications markets during the transition to, and after the deployment of the NBN.
- 2.9 Competition in telecommunications markets is governed by an ex post competition regime in Part XIB of the CCA and a facilities access regime under Part XIC of the CCA. Part XIC is the primary vehicle through which competition problems are addressed. While Part XIB is also available, it is rarely used, and experience demonstrates that the issues addressed in Part XIB seem better addressed through Part XIC remedies. The fundamental structure of competition regime has not altered since 1997, notwithstanding the significant changes in the industry.
- 2.10 Optus believes that the reforms within the telecommunications industry warrant a re-think of whether Part XIC should remain primarily a facilities access regime, or whether it should reflect an ex ante competition regulation regime. Optus supports the fundamental tenet of competition policy as expressed in the Hilmer Report — and later reaffirmed in the Productivity Commission’s 2001 Telecommunications Competition Regulation Inquiry — that competition regulation should address barriers to effective competition.
- 2.11 The priority for the telecommunications competition reform agenda is to ensure the regime remains effective during, and after, the fundamental changes to the industry during the deployment of the NBN and structural reform of fixed line networks.
- 2.12 This section discusses:
- (a) The need for competition regulation to focus on addressing barriers to effective competition;
 - (b) Access regimes are not able to address all competition concerns present, and likely to develop, in communications markets;
 - (c) Deployment of NBN necessitates a refocus of the existing communications competition regime;
 - (d) The need for more flexible remedies and a focus on dominant providers;
 - (e) The need for an ex ante competition regime; and

- (f) How an ex ante regime differs from the existing Part XIC regime.

Regulation should focus on barriers to effective competition

- 2.13 Well-functioning markets maximise consumer and producer benefits and allocate scarce resources to the highest value use. In an effectively competitive market, firms are not able to charge above long run average prices for sustained periods due to risk of new entry and customers switching to alternatives.⁷ However, not all markets are well-functioning. There may be a role for government intervention when markets are not subject to effective competition. The aim of competition policy is not to replicate the results of effectively competitive markets; rather it is to remove impediments to the development of effective competition. This was a reason why general competition law provisions do not regulate ‘high’ pricing.⁸
- 2.14 Consequently, the Hilmer Review recommended adoption of an access regime as a response to the potential for anti-competitive conduct due to integrated monopoly ownership of essential infrastructure. A telecommunications specific access regime was introduced in 1997, which addressed the fundamental competition problem of the vertical ownership of the legacy national fixed copper telecommunications network.
- 2.15 In recognition that significant market power arises from ownership of bottleneck infrastructure, the Government stated when introducing the telecommunications access regime:
- ... there remain good reasons for there to continue to be industry-specific competition regulation for telecommunications. The removal of regulatory barriers to entry does not automatically result in the appearance of normal competitive market structures.*
- Telstra continues to wield significant market power derived primarily from its historical monopoly position. There is also scope for incumbent operators generally to engage in anti-competitive conduct because competition in downstream markets depend on access to the carriage services controlled by them ...⁹*
- 2.16 This was the problem that Part XIC was designed to address and it has remained fundamentally unchanged in its purpose since then. In 2010, the operation of Part XIC changed from a negotiate-arbitrate model to direct regulation of price and non-price terms of access. But the fundamental operation of the regime did not change.
- 2.17 A key question for this review is whether this remains, and is likely to remain in the future, the sole driver of market power across *all* communications markets. Optus submits that market power exists across several communications markets and is caused by factors other than vertical ownership of bottleneck infrastructure. This trend is likely to continue as competition moves away from infrastructure layers towards content and services layer. For example, substantial market power may develop in communications markets as a result of platform control (e.g. Google Android or Apple iOS).

⁷ Hilmer Report, 1993, p.269. See discussion on monopoly pricing in Chapter 12.

⁸ Hilmer Report, 1993, p.269

⁹ Second Reading Speech, Trade Practices Amendment (Telecommunications) Bill 1996, pp. 1-3

- 2.18 This review should examine whether an access regime is the best remedy to address *all possible future* impediments to effective competition.

Access regimes cannot address all barriers to competition

- 2.19 The access regime under Part XIC has been successful in promoting competition through access to Telstra's fixed line networks. Arguably, the greatest success of Part XIC was the unbundling of the local loop, which enabled facilities based competition and the introduction of competitive broadband supply. The ULLS decisions achieved the objective of access regulation: promoting economic welfare by enabling competition at the deepest possible level. There is little doubt that unbundling increased the welfare of end-users through lower prices, higher quality and increased innovation.
- 2.20 That is not to say there have not been problems with the ability of Part XIC to deal with competition problems in communications markets. There are limitations to its application and some unintended consequences. For instance:
- (a) Declaration of domestic transmission has not promoted competition in the provision of IP service to corporate enterprise and government (C&G) end-users;
 - (b) Declarations have limited effect where a downstream market utilises regulated services as one of several bundled inputs into the final product;
 - (c) The effectiveness of declarations may be further limited due to convergence of traditional communications and broadcasting networks; and
 - (d) Declarations typically apply to all access providers not just dominant providers, unnecessarily increasing compliance costs and regulatory burdens.
- 2.21 The limitation of Part XIC access regime to address competition concerns in the communications sector has long been recognised. The ACCC published a detailed report in 2003 recommending a range of legislative changes to address competition issues in communications sector — see box 1 below.
- 2.22 The ACCC observed that Part XIC is limited in its ability to address competition concerns across all communications markets. Part XIC is limited in its ability because it does not address the underlying incentives of a firm to act in a manner inconsistent with the LTIE.¹⁰ The ACCC observed that Telstra's dominance gave rise to competition concerns in the market for Pay TV content and the bundling of communications services. And that this could not be effectively addressed through existing legislation, and recommended changes.

¹⁰ ACCC, 2003, *Report to Senator Alston on Emerging Market Structures in the Communications Sector*, p.34

Box 1 Competition issues in the communications sector

The Minister for Communications, in 2003, requested the ACCC report on potential competition issues arising from emerging market structures in the communications sector.

The ACCC noted that access agreements have some limitations in promoting effective competition.¹ It provided several recommendations to better address the identified competition concerns. These are outlined below.

Issue:	Recommendation:	Possible to use Pt XIC?
Telstra's ownership of HFC and FOXTEL	Divest HFC and 50% ownership of FOXTEL	No
Access to Pay TV content	Introduce regulation to increase access to Pay TV content for broadband networks	No
Access to Carriage for FTA retransmission	No recommended changes	Yes
Bundling of telecommunications and other services	Sees merit in ex ante clearance but no recommended changes at this stage	No

Source: ACCC, 2003, *Report to Senator Alston on Emerging Market Structures in the Communications Sector*

- 2.23 Telstra has used this market power to maintain its dominance across a range of communications markets. Telstra arguably remains the most dominant and the most integrated (vertically and horizontally) incumbent operator across the OECD countries. There has no doubt been some markets where the level of competition has improved — e.g. fixed broadband market where Telstra's market share is 'only' 42%¹¹ — but for many other markets, Telstra retains a market share well above 50% — markets share in retail fixed voice was 62%¹² at June 2013 and mobile market share has grown to 52%.¹³ In addition, Telstra (through its joint venture FOXTEL) has a market share over 95% in the Pay TV market.
- 2.24 Experience shows that Part XIC has been unable to address these concerns:
- (a) it could not prevent Foxtel and Telstra monopolising the Pay TV market;
 - (b) it does not appear to be able to prevent Telstra from offering low cost naked broadband services on the provision end-users forsake other regulatory rights;¹⁴ and

¹¹ ACCC, 2014, *Telecommunications Reports 2012-13*, p.26

¹² ACCC, 2014, *Telecommunications Reports 2012-13*, p.25

¹³ Including Q3FY2014 results for Optus (9.4m) and VHA (4.96m) and 1HFY2014 for Telstra (15.8m).

¹⁴ See the customer terms of the Belong ADSL product which prevent customers from using preselect services. <https://www.belong.com.au/customer-terms>

- (c) it appears Part XIC may not effectively deal with the bundling of products to extend monopoly power across horizontal markets.
- 2.25 These limitations are likely to become more pronounced as competition in communications markets moves to the service and content level rather than at the infrastructure level. Part XIC operates as an ex ante competition regime but with only one remedy: infrastructure access obligations.
- 2.26 Optus submits it is time to re-assess the reliance on access remedies to solve all competition problems in communications markets. Ultimately, the “*basis for policy concern in telecommunications is substantial market power*”.¹⁵ Historically, SMP has been derived from ownership of critical infrastructure. In the future, SMP may arise from other sources such as control of services or applications on an exclusive basis; bundling of services; or the ability to leverage scale across multiple markets.
- 2.27 Competition policy should be used to address the root causes of the substantial market power. Other regulatory options include rules against anti-competitive conduct, vertical separation (functional, accounting), access regime and price controls/monitoring.¹⁶
- 2.28 Optus submits that the competition regulator should have access to the full suite of remedies to address barriers to effective competition and significant market power problems.

NBN necessitates a refocus of the communications competition regime

- 2.29 The NBN will fundamentally reform the provision of fixed line broadband services in Australia. The NBN will be provided through a government-owned wholesale-only structurally separated company, which also has non-discrimination obligations. The central justification for government involvement in the NBN is that it solves the problem of vertical integration of natural monopoly fixed line telecommunications infrastructure.¹⁷
- 2.30 It is discussed above that Part XIC enables access to bottleneck infrastructure owned by vertically integrated operators. This is consistent with the views expressed in the Hilmer Report — that the first best solution to the problems arising from vertical ownership of natural monopolies is to separate downstream and upstream functions. Hilmer considered an access regime would be appropriate where structural reforms have not occurred.¹⁸
- 2.31 Optus submits that addressing the key purpose of Part XIC through structural remedies puts into question whether relying *solely* on an access regime is the best approach to address other competition bottlenecks currently existing, and likely to develop, in other communications markets. Optus believes that effective competition regulation would more likely rely on other regulatory remedies.
- 2.32 As seen above, Part XIC is not best placed to deal with significant market power that does not result from ownership of bottleneck infrastructure. Part XIC was not designed to be used as a broad ex ante competition regulation regime — even though it is commonly relied upon to

¹⁵ Productivity Commission, 2001, *Telecommunications Competition Regulation*, Report No. 16, p.17

¹⁶ Productivity Commission, 2001, *Telecommunications Competition Regulation*, Report No. 16, p.39

¹⁷ See the summary of this issue in ACCC, 2014, Submission to the Independent Cost Benefit Analysis Review of Regulation first issues framing paper, section 3

¹⁸ Hilmer Report, 1993, ch.11

do so. The ACCC has observed that Part XIC allows limited remedies in response to market power, some of which may not be applicable post NBN.¹⁹ The limitations of the existing competition regulation can be seen in the continual dominance of the ex-government owned incumbent operator Telstra across all communications markets. The failure to promote effective competition across the full range of communications markets was recognised by the ACCC in 2003 and remains a problem.

NBN reforms are not sufficient to address Telstra's continual dominance

- 2.33 Once completed, the NBN is intended to give effect to the separation of Telstra's fixed telecommunications network. This object is caveated that the arrangements between Telstra and NBN Co are currently subject to commercial negotiations and may change.
- 2.34 The impact of the separation though is limited. In effect, it is Telstra's retail consumer access network that is being separated from Telstra retail. Under the arrangement Telstra will:
- (a) disconnect customers connected to the copper network. Customer will migrate to NBN and are free to continue to use Telstra as service provider;
 - (b) maintain ownership of its HFC network and will still use it to deliver Pay TV and business services;
 - (c) maintain ownership of fibre optic access and backhaul links;
 - (d) continue its 50% ownership of FOXTEL; and
 - (e) will lease to NBN access to Telstra ducts, dark fibre backhaul links, and exchange space.
- 2.35 As a result, Telstra will receive an estimated \$98 billion in nominal pre-tax dollars over 50 years — rising from \$400 million in this financial year to \$1 billion in FY2019 (the last year of the new FAD).²⁰
- 2.36 While the NBN will result in structural changes in the consumer fixed line market, the NBN reforms will not address enduring market power of Telstra across other communications markets. The NBN does not address:
- (a) Telstra's dominance in content and Pay TV market. Telstra will maintain its 50% ownership and FOXTEL and will still be able to use its HFC to supply FOXTEL.
 - (b) Telstra's position in the retail mobile market, where it has 52% market share. Indeed, it is likely that the \$1 billion per annum received by Telstra could be used to continue to out-invest other mobile operators to defend its market position.
 - (c) Telstra's dominance and vertical integration in the Corporate and Government (C&G) market. Telstra has over 60% revenue share of the market, and will maintain ownership of transmission access and backhaul links that are used to supply services.

¹⁹ ACCC, 2014, Submission to Vertigan Review, Regulatory Issues Framing Paper, p.13

²⁰ CommsDay, 2014, <http://www.commsday.com/commsday-australasia/exclusive-nbn-co-payments-to-telstra-could-total-98-billion-confidential-advice>

Other providers will rely upon access to these links, thus enabling Telstra to continue to discriminate in favour of its retail C&G division.

- (d) The estimated \$1 billion per annum that Telstra will receive under the Infrastructure Services Agreement post completion of NBN. This will assist Telstra to maintain and extend its dominance in communications markets (including retail broadband market post NBN roll-out).

- 2.37 Further, it is likely that Telstra will maintain a dominant position in the provision of consumer fixed line services. Telstra currently has 42% market share in the retail broadband market²¹ and market share in retail fixed voice was 62% at June 2013.²² This is due to the first mover advantage Telstra has during the migration period to NBN, and the scale advantage likely to be gained due to NBN Co pricing. Telstra is likely to have the largest share of NBN services after migration. Telstra's market share of NBN will result in it facing a lower average cost per customer, and hence to maintain higher margins or lower prices.
- 2.38 Furthermore, Telstra will be in a position to bundle products across NBN, mobile, corporate and content to extend and maintain dominance across a range of communications markets. No other operator in Australia has the ability to bundle in such a manner. It is possible that Telstra could use bundled products to extend its dominance in key markets across to other markets.
- 2.39 This review should consider whether reliance solely on an access regime best addresses the future sources of significant power in communications markets.

There is a need for more flexible remedies and a focus on dominant providers

- 2.40 The central basis of competition policy is to identify an enduring competitive bottleneck and target it with proportionate regulatory options. The benefits of any intervention must outweigh the costs, and regulation should address the root problem not the symptoms.
- 2.41 As discussed above, over the last two decades competition policy has focused on regulated access to non-replicable infrastructure bottlenecks. In a world of legacy copper networks this was the appropriate response. Ultimately, however, this problem is being addressed through the deployment of the NBN — a national wholesale-only open access network — and structural separation of Telstra.
- 2.42 But this significant reform does not address impediments to effective competition in other communications markets. Optus submits there will still be a need for an ex ante competition regulation regime to deal with a lack of effective competition in other, and across several, communications markets. The NBN addresses legacy issues with access to fixed line services. It does not deal with competition issues arising in other communications markets (such as content or mobile) or the extension of market power across related markets (e.g. through the use of bundling). The ACCC has already noted that the effectiveness of Part XIC may be limited post NBN.²³

²¹ ACCC, 2014, *Telecommunications Reports 2012-13*, p.26

²² ACCC, 2014, *Telecommunications Reports 2012-13*, p.25

²³ ACCC Submission to Vertigan Review, Regulatory Issues Framing Paper, p.13

- 2.43 Importantly, Optus is not advocating for a specific remedy for a specific problem. Rather, Optus supports a regime which provides sufficient flexibility to address enduring competition problems (which may exist now, or may develop in the future) with a full range of potential remedies — which must be proportionate to the problem identified.
- 2.44 It is cumbersome and costly to have specific legislative provisions for specific remedies addressing individual examples of market power. Or require legislative changes whenever a new competitive bottleneck is identified. It would be more efficient and effective to have a regime that recognises an access regime is only *one* of the regulatory options; and allows other regulatory options including rules against anti-competitive conduct, vertical separation (functional, accounting), access regime and price controls/monitoring.
- 2.45 Optus sees merit in a flexible regime that allows introduction of proportionate remedies, while providing sufficient rigour to stop regulatory over reach.

An ex ante competition regime would address barriers to competition

- 2.46 This review should consider adopting an ex ante competition regulation regime similar to that used within the European Union (EU). Many of the processes and decisions will be similar to that under Part XIC — but the EU regime permits greater flexibility and a wider range of remedies. It allows the competition regulator to adopt proportionate regulatory remedies that address durable and non-transitory competitive bottlenecks.
- 2.47 The EU approach and the approach under Part XIC are outlined in figure 1 below. As a broad overview, the EU approach:
- (a) Begins with the identification of relevant economic markets (both wholesale and retail);
 - (b) Proceeds to assess the level of competition in the market;
 - (c) Where it is found not to be effectively competitive, operators that have significant market power are identified; and
 - (d) Allows regulators to impose a range of proportionate regulatory remedies on operators with SMP.
- 2.48 To some degree, Part XIC does act like an ex ante competition regime. Part XIC allows regulatory intervention where a market, or a related market, is not effectively competitive, and where regulation would promote competition. The ACCC limits intervention to where it can identify an enduring competition bottleneck. This process involves identifying economic markets and assessing levels of market power that exist within the market. Part XIC also allows the ACCC to limit obligations to those operators with market power — although this power is rarely used.²⁴
- 2.49 But there are some key differences, which Optus believes would improve the operation of the competition regime in communications markets. First, the EU approach places a positive obligation on the regulator to impose remedies only on operators with SMP. This is different

²⁴ SAOs for wholesale ADSL only applies to Telstra. ACCC, Final Access Determination No.1 of 2013 (WADSL), 29 May 2013.

to Part XIC which grants discretion to the ACCC to exclude some operators from access obligations. And second, it provides a flexible regime that allows introduction of proportionate remedies, while providing sufficient rigour to stop regulatory over reach.

Figure 1 Comparison of the European Union and Australian approaches

	European Union: ex ante regime	Australia: Part XIC of the CCA
General overview	<ol style="list-style-type: none"> 1. The European Commission identifies a number of relevant markets based on principles of competition law.²⁵ 2. Regulators assess if the market is competitive, taking into account the relevant upstream and downstream markets. 3. If the market is found to be uncompetitive, regulators then assess if there is an operator with SMP. 4. Impose remedies on SMP operator. 	<ol style="list-style-type: none"> 1. Declaration Inquiry (standard access obligations). <ol style="list-style-type: none"> a. In its declaration inquiry, it identifies the relevant upstream and downstream markets and assess if declaration will promote the LTIE. 2. Final Access Determination (access terms).
Regulate based on	<p>Markets (including services market and access to facilities). Three-criteria test:</p> <ul style="list-style-type: none"> - Presence of high and non-transitory structural, legal or regulatory barriers to entry; - Market structure does not tend towards effective competition within the relevant time horizon, having regard to the state of infrastructure-based and other competition behind the barriers to entry; - Competition law alone is insufficient to adequately address market failure(s) concerned.²⁶ 	<p>Declaration of specific carriage service:</p> <ul style="list-style-type: none"> - Promote the long term interest of end-users.
Who the regime applies to	<p>SMP operators only.</p> <ul style="list-style-type: none"> - Can also apply to a carrier when a carrier, jointly with the others, enjoys a position equivalent to dominance. <p>SMP criteria:²⁷</p> <ul style="list-style-type: none"> - Dominance; High market shares²⁸; overall size of the carrier; control of infrastructure not easily duplicated; technological advantages or superiority; absence of or low countervailing buying power; easy or privileged access to capital markets/financial resources; 	<p>Access Providers.</p> <p>Scope to apply SAOs to specific access providers, but this power is rarely utilised.</p>

²⁵ The EC has identified seven communications markets in which ex ante regulation may be warranted. This does not prevent member states from identifying other markets. See Recommendation 2007/879/EC (Recommendation on relevant markets).

²⁶ Note that EC has proposed amendments the Recommendation on Relevant Markets (2002/21/EC, Article 15) to specifically include the three criteria test. It is standard practice for NRAs to conduct three criteria test. See Connected Continent Regulation (2013/0309 (COD), Article 37.

²⁷ COM 2002/C 165/03 (SMP Guidelines)

²⁸ Although high market share alone is not sufficient to establish the possession of SMP, it is unlikely that a firm without a significant share of the relevant market would be in a dominant position on the market concerned. Thus, undertakings with market shares of no more than 25% are not likely to enjoy a (single) dominant position on the market concerned.

	product/service diversification (e.g. bundled products or services); economies of scale; economies of scope; vertical integration; a highly developed distribution and sales network; absence of potential competition; barriers to expansion; barriers to entry.	
Market definition	Based on competition law principles and methodologies.	Based on competition law principles and methodologies.
Remedies	Access obligations ²⁹ , Price control & cost accounting obligations ³⁰ , Transparency ³¹ , Non-discrimination ³² , Accounting separation ³³ , Functional Separation ³⁴ , Regulatory controls on retail services (including not to unreasonably bundle services) ³⁵ , and other obligations as the regulator sees fit. ³⁶ Over-riding obligation that any remedy must be proportionate to the objectives in the Framework Directive. ³⁷	Access obligations, access terms and conditions (price and non-price terms). No obligation for remedies to be proportionate to the problem.

Source: European Commission; *Competition and Consumer Act 2010*.

How would it differ from Part XIC?

- 2.50 Optus has identified three material differences between the current operation of Part XIC and an ex ante competition regime. These are:
- (a) Focus on markets rather than declaration of specific carriage services;
 - (b) Focus on operators with significant market power; and
 - (c) Greater range of remedies, most of which are less intrusive than access obligations.

Focus on markets

- 2.51 A focus on removing impediments to effective competition in economic markets rather than identifying communications carriage services which display bottleneck characteristics would enable the ACCC to take a more holistic view on communications markets.
- 2.52 Optus notes that there is a growing disconnect between the declaration of services and promotion of competition in specific markets. Some declared services relate to more than

²⁹ Access Directive, Article 12

³⁰ Access Directive, Article 13

³¹ Access Directive, Article 9

³² Access Directive, Article 10

³³ Access Directive, Article 11

³⁴ Access Directive, Article 13A

³⁵ Universal Service Directive, Article 17

³⁶ Access Directive, Article 8

³⁷ Recommendation on Relevant Markets (2007/879/EC), Para. 18; SMP Guidelines (COM 2002/C 165/03), Art.9, para. 117-8

one market — for example, declared domestic transmission services impacts backhaul transmission markets as well as the Corporate and Government (C&G) market that use transmission access services. On the other hand, many declared services impact upon the same downstream market — the fixed line communications market is impacted by the ULLS, WLR, LSS, LCS, PSTN OTA, and WADSL declarations.

- 2.53 Generally this approach has not been problematic due to effective management by the ACCC. But this is not always the case.
- 2.54 There are times when declaring a service does not pay sufficient regard for impacts in related downstream markets.
- (a) This can occur where technological or market changes occur that alter the way in which the market utilises the declared service. For example, the Domestic Transmission Capacity Service (DTCS) was declared on the basis it would promote competition in downstream transmission markets. Over recent years the DTCS has become a vital element in the provision of IP service to C&G end-users who require symmetric and uncontended data services. However, the Access Determination paid little regard to the impact of pricing elements of the DTCS had on the C&G market. As a result, the declaration has had little or no impact in addressing the lack of effective competition in this market.
 - (b) Or it can occur when a downstream market utilises regulated services as one of several bundled inputs into the final product. Thus allowing for cross-subsidisation across different input costs, and dampening of the impact of declaration. The competition problem may not be solved by setting cost-based rates for some bottleneck inputs but not others. For example, bundling fixed broadband access with competitive mobile services, or bundling of more than one fixed-line market together.
 - (c) Or its effectiveness may be limited due to convergence of traditional communications networks and broadcasting. For example, Telstra has a monopoly position in the market for premium live sports content through its ownership of FOXTEL. The bottleneck lies in access to the content not in access to carriage services that provide Pay TV. The ability of Telstra to bundle Fox Sports with communications products enables it to exploit its market position across to retail fixed and mobile communications. It appears Part XIC cannot effectively deal with this issue.³⁸
- 2.55 Further, Optus anticipates that in a NBN-based market, access to bottleneck infrastructure may not be the main form of market power. Access to content and services and an ability to bundle these may be the drivers of market power. Scale may also provide some access seekers with significant cost advantages in the provision of NBN. There is a real chance that in a NBN-based access world, Telstra could retain significant market power in related downstream markets and Part XIC will be unable to effectively deal with these concerns.

³⁸ This problem was identified in 2003 where the ACCC recommended legislative amendments. No amendments were made and the problem continues today.

Focus on operators with SMP

- 2.56 An ex ante competition regime applies obligations upon operators within specific markets that have SMP. Regulatory obligations are thus limited to operators that have the ability to exploit SMP to act and price independently of the market.
- 2.57 On the other hand, regulatory instruments made under Part XIC are typically applied to *all* providers of declared services irrespective of their market power. For instance, Optus is subject to the range of fixed line services access obligations even though it has less than 5% of fixed access lines. While Part XIC allows for application of access obligations to apply to specific operators, but this is not utilised by the ACCC. Only the Wholesale ADSL Access Determination exempts non-dominant suppliers. All other Declarations and Determinations apply to all providers of the service irrespective of the fact that Telstra remains the only supplier with SMP in the markets.³⁹ Exemptions for non-dominant suppliers should be the norm not the exception.
- 2.58 A clearer obligation on the ACCC to apply regulation only on operators with SMP would reduce the regulatory burden on industry. The Productivity Commission recommended that declarations should only apply to access providers with substantial market power.⁴⁰ There would be no detriment to end-users as non-SMP operators cannot act independently of the market and are bound by market discipline.⁴¹

Wider range of remedies

- 2.59 The inability of Part XIC to provide effective remedies to the range of competition problems present across all communications markets is a substantial flaw in the effectiveness of the regime. The ACCC has stated it is limited in its ability to impose structural remedies such as non-discrimination and separation obligations.⁴² The ACCC in 2003 identified the need for legislative amendments to address competition concerns in communications sector.⁴³ It is shown above the current separation of Telstra is dependent upon the roll-out of NBN and the *voluntary* undertaking put forward by Telstra.
- 2.60 The Productivity Commission's review of telecommunications competition regulation identified that the "*basis for policy concern in telecommunications is substantial market power*".⁴⁴ This leads to several broad regulatory options — an access regime is only *one* of the regulatory options. Other options include rules against anti-competitive conduct, vertical separation (functional, accounting), access regime and price controls/monitoring.⁴⁵
- 2.61 Optus supports a competition regime that allows the competition regulator to have a full range of remedies available. So long as the regulator adheres to regulatory best practice and ensures any remedy if proportionate to the problem identified, this will promote the LTIE.

³⁹ Exception is termination services, where all networks have market power on the market to terminate calls on their own networks.

⁴⁰ Productivity Commission, 2001, *Telecommunications Competition Regulation*, Report No. 16, Recommendation 9.4, p.283

⁴¹ An ability to act independent of the market is the key assessment for SMP.

⁴² ACCC, 2014, Submission to Vertigan Review, Regulatory Issues Framing Paper, p.13

⁴³ ACCC, 2003, *Report to Senator Alston on Emerging Market Structures in the Communications Sector*

⁴⁴ Productivity Commission, 2001, *Telecommunications Competition Regulation*, Report No. 16, p.17

⁴⁵ Productivity Commission, 2001, *Telecommunications Competition Regulation*, Report No. 16, p.39

- 2.62 A wider range of remedies could be imposed that better address the source of the market power. It is foreseeable that a range of competition problems may arise for which access obligations are not the most efficient or effective solution. For instance, in the C&G market, it may be efficient to impose broad non-discrimination wholesale obligations on Telstra; or obligations that prevent Telstra from offering sign-on and retention payments to clients. These obligations are not available under Part XIC.
- 2.63 Part XIC has a limited range of regulatory options. Upon declaration, the ACCC can only impose access obligations together with price and non-price terms of access. All declared services under Part XIC have the exact same remedy irrespective of the competition problem identified. In addition, the EU ex ante regime contains a requirement that the remedy be proportionate to problem. No such requirement exists in Part XIC.
- 2.64 Figure 2 below compares the remedies available under an ex ante regime and Part XIC. It can be seen that an ex ante competition regime would address the concerns raised by the ACCC. It would allow:
- (a) imposition of non-discrimination obligations;
 - (b) structural remedies, such as accounting, functional or structural separation;
 - (c) price controls at the level required to address bottlenecks.

Figure 2 Regulatory Remedies

Remedy	Ex ante competition regime	Part XIC of the CCA
Access Obligations	✓	✓
Price Controls	✓	✓*
Cost accounting obligations	✓	✗
Transparency	✓	✗
Non-discrimination	✓	✗
Accounting Separation	✓	✗
Functional Separation	✓	✗
Retail controls (incl. bundling)	✓	✗

* Price controls apply only for the terms and conditions of access

Source: European Commission; *Competition and Consumer Act 2010*.

- 2.65 Optus sees merit in allowing the ACCC greater flexibility to impose the full range of possible regulatory remedies with the requirement that it be proportionate to the problem identified. It is neither efficient nor effective whenever a new competition problem is identified to require legislative amendments in order to implement efficient remedies.

- 2.66 For example, future competition issues may arise where a communications provider supplies free access to fixed broadband if the end-user also subscribes to exclusive content available only with that provider. Under the SMP regime, the ACCC would be able to regulate after an assessment based on the three criteria test. Under the Part XIC regime, the ACCC may act if it promotes the LTIE, but there is an issue whether provision of content is a declarable service. Assuming the ACCC could regulate the service, under Part XIC the ACCC would not be able to address the bundling issue. Under the SMP regime, the ACCC would have access to full range of remedies, including non-discrimination obligations, restrictions on bundling, or some form of separation. Any remedy imposed would need to be proportionate to the problem identified.

Relationship to Part XIB

- 2.67 Optus acknowledges that one possible response available is that competition issues are best left to Part XIB. But Part XIB is fundamentally different from an ex ante competition regulation regime.
- 2.68 The primary purpose of Part XIB is to prohibit a service provider with a substantial degree of market power from engaging in conduct which has either the effect or purpose of substantially lessening competition.⁴⁶ However since its enactment in 1997, Part XIB has not been effective in restricting Telstra from engaging in anti-competitive conduct nor has it effectively promoted competition in relevant markets.
- 2.69 Part XIB is an ex post competition regime. The ACCC can only issue a Competition Notice or any person can only institute proceedings for damages and/or injunction if Telstra has already engaged in specific anti-competitive conduct. In other words, Part XIB is not about controlling Telstra's behaviour before it could engage in anti-competitive conduct but rather punish Telstra if it did engage in anti-competitive conduct.
- 2.70 The ACCC has in the past issued a number of Part A Competition Notices to Telstra, including:
- (a) May 1998 with respect to Telstra's anti-competitive conduct in the internet market — in place until June 1999. No action taken;
 - (b) August 1998 with respect to Telstra's customer transfer process. Three subsequent notices were issued and the ACCC commenced Federal Court action before the ACCC and Telstra reached a settlement agreement in February 2000;
 - (c) September 2001 with respect to Telstra's supply of wholesale and retail ADSL services to its wholesale and retail customers — in place until May 2002. No action taken;
 - (d) March 2004 with respect to Telstra's pricing behaviour on broadband services — revoked in February 2005 following agreement between Telstra and the ACCC; and
 - (e) April 2006 with respect to Telstra's pricing behaviour on wholesale line rental. In 2007, the Federal Court ruled that the Competition Notice was invalid on the basis of procedural fairness.

⁴⁶ Explanatory Memorandum, Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2009, p.53

- 2.71 As it shows, whilst the ACCC had in the past commenced actions against Telstra under Part XIB, no enforcement action has resulted and Telstra remains the dominant provider of fixed broadband and voice services.
- 2.72 Although amendments were made to Part XIB in 2009,⁴⁷ the ACCC has not issued any Competition Notice since. The ACCC in its Telecommunications Competitive Safeguard 2012-13 Report states that it undertook one investigation into alleged anti-competitive conduct under Part IV and Part XIB during the reporting period. However it concluded the investigation on the basis that there was insufficient evidence to substitute the claim. This therefore illustrates the high evidentiary burden placed in substituting the claim, bearing in mind that court proceedings are costly to run. Optus submits a competition regime without an effective penalty regime is unlikely to address anti-competitive behaviour.
- 2.73 Optus also notes that recent investigations into Wholesale ADSL⁴⁸ and Wholesale Line Rental⁴⁹ which were ultimately addressed by declaration under Part XIC. Similarly, in 2010 the ACCC took Telstra to the Federal Court for ‘capping’ its exchanges when in fact they were available for access. The Federal Court found that Telstra breached its access obligations under Part XIC and was fined for \$18 million.⁵⁰
- 2.74 This therefore shows that Part XIB has not been overly effective in preventing Telstra from engaging in anti-competitive behaviour. Rather, the ACCC has had to resort back to Part XIC to address competition issues.
- 2.75 Optus submits that Part XIB cannot be relied upon to regulate anti-competitive behaviour or incentives by the dominant operator. Optus supports reforms to Part XIC that would make it a more effective ex ante competition regime as the market migrates to a NBN-focused environment.

⁴⁷ Including, remove the requirement for the ACCC to undertake consultation before issuing a Part A Competition Notice; and clarify that Part XIB applies to content services supplied by carriers and CSPs.

⁴⁸ ACCC, 2012, *Telecommunications competitive safeguard 2011-12*, p.31

⁴⁹ ACCC, Media Release, Competition Notice Lifted, 2 March 2007

⁵⁰ ACCC, Media Release, \$18 million penalty imposed on Telstra, 28 July 2010

Section 3. Structural remedies should be strengthened

- 3.1 In addition to the long term reform outlined above, Optus sees merit in strengthening the structural remedies already imposed within the fixed line communications market. The existing suite of regulations was designed based on a particular network design of the NBN that achieved a particular form of structural separation of Telstra. The proposed adoption of a multi-technology mix for the NBN with a greater reliance on Telstra infrastructure has the potential to undermine these fundamental structural reforms.
- 3.2 Optus submits that structural reform of Telstra is vital to ensuring effective competition in communications markets. Telstra is set to receive significant funding due to reliance on its networks to supply the NBN. One estimate of NBN Co's liability to Telstra is around \$98 billion in nominal pre-tax dollars over 50 years — rising from \$400 million in this financial year to \$1 billion in FY2019.⁵¹ Absent strong structural remedies competition across many communications markets is likely to be damaged.
- 3.3 A key policy objective of the Government's NBN policy was to achieve structural separation in the fixed line market. This would be achieved in two ways:
- (a) NBN Co was established to construct and operate the NBN on a wholesale-only basis.
 - (b) Telstra has put in place an enforceable Structural Separation Undertaking (under section 577A of the *Telecommunications Act 1996*) that will require it to progressively disconnect services from the copper network as the NBN is rolled out. Under the arrangement Telstra will then seek access to fixed line services from the NBN consistent with all other RSPs. Until the NBN is rolled-out Telstra has also agreed to implement increased transparency and equivalence arrangements between its retail and wholesale customers.
- 3.4 There are, however, limitations to the structural separation arrangements Telstra has to implement:
- (a) Telstra can continue to operate its corporate fibre, backhaul and mobile networks on a fully integrated basis;
 - (b) Telstra will continue to operate its cable (HFC) network for the provision of pay TV services; and
 - (c) Telstra will supply under long-term agreements a number of services to NBN Co, such as duct access, exchange access and transmission services, worth more than \$1b per annum roll-out. These will form ongoing inputs to the NBN access services.
- 3.5 Notwithstanding these limitations, in practical terms the policy changes will achieve a form of structural separation. For mass market and small business broadband services, Telstra will rely on access to the NBN in the same way as all other service providers. Whilst the NBN

⁵¹ CommsDay, 2014, <http://www.commsday.com/commsday-australasia/exclusive-nbn-co-payments-to-telstra-could-total-98-billion-confidential-advice>

access service will draw on some underlying Telstra services and/or assets, these are unlikely to be able to provide any operational advantage to Telstra. The operations, maintenance and service support for NBN services will be controlled and managed by NBN Co staff.

- 3.6 However, with NBN Co's proposed change to a multi-technology approach the above separation arrangements are likely to become blurred. In particular, NBN Co has indicated that it will seek to deploy fibre-to-the-node (FTTN) based service that will utilise the legacy copper network. To achieve this outcome NBN Co will need to negotiate access to the Telstra copper network. Optus understands that a range of options are being considered by NBN Co from buying the copper network outright or alternatively leasing access to the copper, with Telstra retaining ownership. A recent article in the Australian newspaper indicated that Telstra wanted to retain control of the copper assets with David Thodey quoted as saying;

It's very important that we have optionality going forward so that we are not inadvertently put in a disadvantaged position. So, yes, (retaining control of a network asset) is an important consideration in the negotiations, but there's a number of ways that can be solved.⁵²

- 3.7 Regardless of who owns the copper it appears likely that Telstra may have an ongoing role to play in operating and maintaining the copper network on behalf of NBN Co. It is also conceivable that Telstra will have a role in deploying FTTN nodes on behalf of NBN Co and managing the cutover of services from current services to FTTN.

- 3.8 The multi-technology approach is likely to result in a scenario where Telstra Retail will purchase services from NBN Co that are based on access inputs that are largely controlled and/or operated by Telstra. Such an outcome would likely put Telstra in breach of the provisions of its structural separation undertaking and section 577A of the Act that:

Telstra will not supply fixed-line carriage services to retail customers in Australia using a telecommunications network over which Telstra is in position to exercise control.

- 3.9 Regardless of the specific circumstances of Telstra's compliance with this provision, Optus considers that there will be a strong case to revise the structural separation arrangements that apply to Telstra. If Telstra's engineers have a role to play in the day to day operation of NBN services, such as migration, provisioning and operational support then additional protections will need to be put in place to ensure that Telstra Retail cannot gain any advantage from these arrangements. This should go further than minor variations to Telstra's current Structural Separation Undertaking.

- 3.10 In the event that either Telstra continues to own the copper network and/or has a role in operating and managing the copper based assets on behalf of NBN Co then the following arrangements should apply to safeguard the principles of structural separation.

- (a) Telstra Retail should purchase access to NBN services through NBN Co on the same terms and using the same support processes as all other retail providers. This means

⁵² Bingemann, M., 2014, "Telstra wants to hold on to copper or cable network in NBN deal", *The Australian*, 24 May. Available at: <http://www.theaustralian.com.au/business/in-depth/telstra-wants-to-hold-on-to-copper-or-cable-network-in-nbn-deal/story-e6frgaif-1226929249535#>

that Telstra must order services through NBN Co and any faults or other operational enquiries must be managed through NBN Co;

- (b) Telstra must be required to set up a separate company (Net Co for present purposes) to manage the provision of assets and services supplied to NBN Co. This company should contain the network assets; systems and personnel that are required to provide and support any of the ongoing services supplied to NBN Co.
- (c) Telstra Net Co should only provide services to NBN Co; it should not provide services to the broader Telstra Group. Further, Telstra Net Co personnel (including its management) should only perform work for NBN Co and should not be allowed to carry out activities for other Telstra units. This will not only help to reinforce the principle of separation it would also prevent Telstra leveraging its NBN activities to drive cost advantages over other RSPs.
- (d) A formal access code should be established to support these obligations. This code should set out in transparent detail the controls in place to ensure that Telstra Retail cannot benefit from the supply of services by Telstra to NBN Co. These undertakings should be subject to periodic reporting and enforceable by the ACCC. As a minimum the rules should require that Telstra Net Co:
 - (i) Has a separate physical location from any other Telstra entity;
 - (ii) Keeps all information separate from any Telstra entity and is not disclosed to other Telstra entities except in specified circumstances;
 - (iii) Has separate staff from any other Telstra entity;
 - (iv) Has obligations not to disclose NBN Co commercial information to other Telstra entities except in specified circumstances;
 - (v) Has a separate Board from any other entity within Telstra, with sufficient delegations from the Telstra Board for the independent management of the Net Co in accordance with corporate plans and policies; and

3.11 Optus acknowledges that the multi-technology approach also contemplates NBN Co accessing the Optus HFC network. Optus considers that similar separation arrangements should apply to this arrangement in the event that Optus is both a supplier and acquirer of services over the HFC.

3.12 Optus notes that similar arrangements were implemented in Singapore in connection with the roll-out of its high speed broadband network. The OpenNet consortium of which SingTel was a member was awarded the contract to roll-out the fibre using certain existing assets of the SingTel network. To ensure there was effective separation, SingTel transferred the network assets used by the consortium into a neutral company, Asset Co, which was to be independently managed from SingTel.

Section 4. Government impediments to competition

- 4.1 The Issues Paper asks whether there are any unwarranted regulatory impediments to competition in any sector in Australia that should be removed or altered.
- 4.2 Optus submits that this review should take a wider view of what comprises government-imposed impediments to the development of effective competition. Governments can directly impact upon the ability of firms to compete on a level playing field through non-regulatory actions. For instance, where government is a large purchaser of services it may consistently preference one firm above others. Or, where government provides funding the conditions of funding could promote or limit level of competition in relevant markets.
- 4.3 This review should consider the significant level of government funding within the communications industry. Optus submits that the impact of this funding is to further entrench barriers to competition rather than to promote competition. This is particularly important in the communications industry where success in markets depends heavily upon the level of capital investments. Where the capital investment of one firm is paid for by government funding this can significantly distort competition.

Government industry funding can act as an impediment to competition

Question 2 – Are there unwarranted regulatory impediments to competition in any sector in Australia that should be removed or altered?

- 4.4 While competition in some key communications markets have improved over recent years, the competition regime has been unable to shift the dominant position of the ex-government owned incumbent operator
- 4.5 Telstra arguably remains the most dominant and the most integrated (vertically and horizontally) incumbent operator across the OECD countries. There has no doubt been some markets where the level of competition has improved — e.g. fixed broadband market where Telstra's market share is 'only' 42%⁵³ — but for many other markets, Telstra retains a market share well above 50% — markets share in retail fixed voice was 62%⁵⁴ at June 2013 and mobile market share has grown to 52%.⁵⁵ In addition, Telstra (through its joint venture FOXTEL) has a market share over 95% in the Pay TV market.
- 4.6 The market positions across the main communications markets provide Telstra a unique opportunity to bundle products and leverage market power across multiple markets.
- 4.7 Notwithstanding Telstra's dominant positions across multiple communications markets, Telstra has received, and continues to receive, substantial levels of government funding. This funding reinforces Telstra's dominance by effectively subsidising its investments in capital intensive markets.

⁵³ ACCC, 2014, *Telecommunications Reports 2012-13*, p.26

⁵⁴ ACCC, 2014, *Telecommunications Reports 2012-13*, p.25

⁵⁵ Including Q3FY2014 results for Optus (9.4m) and VHA (4.96m) and 1HFY2014 for Telstra (15.8m).

USO and rural funding scheme promotes Telstra to the detriment of the industry

- 4.8 Much of this funding has related to schemes designed to support the roll-out of infrastructure in regional areas. Few if any of these schemes have sought to enhance competition or at least ensure funds were allocated in a competitively neutral manner. Optus estimates that since 1997 Telstra has received approximately \$462M in direct Government funding.⁵⁶ In addition Telstra continues to receive subsidies from industry under the Universal Service Obligation (USO) arrangements that total some \$882 Million since 1997. As part of the policy changes made in connection with the roll-out of the NBN the delivery of the USO changed. In effect the Commonwealth entered into a contract with Telstra for the continued provision of the USO outside the fibre footprint.
- 4.9 Optus strongly disagreed with the USO policy changes at the time these were announced. They appeared to represent a significant missed opportunity to fundamentally change the delivery of the universal service with the roll-out of a new national, Government funded infrastructure. Given the significant structural changes being brought about through the NBN, the traditional USO framework is no longer required to deliver the Government's universal service policy objectives. The most efficient and effective response would have been to either remove or significantly scale back that framework. NBN Co will provide universal access and RSPs can meet the Standard Telephone Service obligations through the services provided over each of NBN Co's platforms. For example, the Fixed Wireless Broadband and Satellite services can and are being used to provide voice services.
- 4.10 Optus' concerns are:
- (a) First, the cost of meeting the USO will increase from \$160.5 million per annum to \$354 million per annum — an increase of 120%. Telstra's net USO funding (revenue received net of Telstra's contribution) also increases from \$59 million to \$192 million annually.
 - (b) Additionally, while industry contributions is capped at the 2011-12 levels until 2013-14, after this time it is estimated that industry contributions will need to be increased to cover any shortfalls in government contributions. This increase in cost is not justified by any additional consumer benefits; there is no change to the scope of the Universal Service entitlements enjoyed by consumers. Prior to the NBN USO agreement, industry paid Telstra \$59 million annually.⁵⁷ Under the new arrangements, beyond 2014-15 industry's contribution increases to around \$92 million annually.⁵⁸ This represents a 56% increase. In addition, the Government will provide an additional \$100 Million per annum to Telstra.
- 4.11 Optus submits that — contrary to Telstra's typical position — the USO does not impose any cost burden on Telstra.⁵⁹ Moreover, there is no cost-based justification for the 120% increase

⁵⁶ This includes funding from Federal and State Governments.

⁵⁷ Net amount taking into account Telstra's contribution. Total USO pool was \$160m, and Telstra contributed \$101m and industry made up the rest (\$59m).

⁵⁸ Total USO pool post 2014-15 is expected at \$345m. Of this, Telstra contributes around \$161m and Government \$100m. The remaining \$92m comes from industry.

⁵⁹ In particular, Telstra as the USP does not incur losses or net costs in serving existing connections in rural and remote areas — and so should not be subsidised for doing so — since:

- existing methods for calculating the cost of the USO are flawed and result in significantly inflated cost estimates;

in USO funding. Even if USO imposes cost on Telstra, the costs certainly have not increased by 120% over the last year.

- 4.12 Optus has long-standing concerns with the neutrality of the USO regime. These concerns have been magnified with the recent funding deal as part of the *contractual* agreement for Telstra to participate in the NBN project. Optus submits that competitive neutrality does not justify levying fees on one group of industry participants to effectively support the continued dominance of the incumbent operators. It would be appropriate for Telstra to self-fund its USO responsibilities.
- 4.13 The effect of the increased USO funding is that industry is funding the compensation to Telstra to participate in the NBN. This unjustified cost impost directly reduces the level of competition in related markets. This is not consistent with the policy objective of increasing competition in markets. It is even more discriminatory given that a commercial agreement between the Government and Telstra results in increasing costs on third party industry operators.
- 4.14 Optus repeats its view that the USO is a policy relic from the 1980's. With advances in fixed, mobile and satellite technology and availability there is ample scope for a new approach. The Government should review alternate opportunities to deliver USO, including;
- (a) Better use of the NBN fixed wireless and satellite services to provide standard telephone voice services;
 - (b) Use of mobile services to provide voice; and
 - (c) Consider competitively neutral funding models – for example, USO contributions could be paid in kind. As an example, Optus' annual USO funding could be invested into new mobile towers in regional areas. These towers would extend mobile coverage and could provide USO style voice services. An annual investment of this kind would help fund a significant number of new towers and would be a better policy response than Optus simply sending a cheque to Telstra.

NBN payments have the potential to damage competition

- 4.15 Optus is also concerned that significant public money is being paid to the dominant communications provider in order to ensure its participation in the NBN project. Such high payments are likely to help Telstra maintain its dominance in the market post NBN, and have the potential to undermine the pro-competitive intention of the NBN policy.
- 4.16 Telstra is set to receive substantial revenue from the Government and NBN Co as a result of participation in the roll-out of the NBN. The announcement of the Definitive Agreement expressed the payments as \$11 billion in post-tax net present value (NPV) terms in 2010

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- a significant proportion of the “costs” Telstra typically claims in respect of existing connections are not in reality costs faced by Telstra at all – the cost of serving existing connections should be estimated on the basis of ongoing operations and maintenance expenditure only;
 - Telstra's typical analysis is incomplete, since it receives revenues from customers in rural areas besides retail and wholesale line rental charges – hence the cost of connections in rural and remote areas is likely to be outweighed by revenues received by Telstra (including indirect revenue and intangible benefits of universal service); and
 - even if there were any net cost of providing the USO, which is unlikely, Telstra remains highly profitable and is more than capable of continuing its traditional internal cross-subsidy of rural lines.

value. The post-tax NPV value increases if looked at in recent nominal valuation. For instance analysts estimate it is equivalent to \$14 billion NPV in 2013 terms. Moreover, this analysis does not take into account different timings of payments and liabilities. It could be substantially higher if access payments are brought forward due to earlier roll-out of NBN under a FTTN model. In cash terms the value is substantially higher. Goldman Sachs calculated NBN Co's liability to Telstra at around \$98 billion in nominal pre-tax dollars over 50 years — rising from \$400 million in this financial year to \$1 billion in FY2019.⁶⁰

- 4.17 This level of funding provides Telstra with significant commercial advantage in the highly capital intensive communications markets. While Telstra will no longer own key elements of the fixed line network, it will control key transmission assets; mobile network; and will be able to acquire premium content. As a result, Telstra will be in a prime position as barriers to effective competition in communications markets move from the infrastructure layer of service and application layers.
- 4.18 As a result, Optus advocates a reform of the communications competition regulation regime away from an access regime to a wider SMP regime. As explained above, this provides greater flexibility to the ACCC to directly address non-infrastructure barriers to competition that are likely to arise in the future. The significant government funding of Telstra makes such barriers more likely.
- 4.19 Effective competition requires firms to face similar long run average cost curves, and in the case of industries with fixed costs, to face similar minimum efficient scale. Where one firm is afforded the ability to achieve efficient scale and faces a lower long run cost base than other firms, competition may be reduced.

⁶⁰ CommsDay, 2014, <http://www.commsday.com/commsday-australasia/exclusive-nbn-co-payments-to-telstra-could-total-98-billion-confidential-advice>

Section 5. Mergers and Acquisitions

Question 36 – Do the merger provisions of the CCA operate effectively, and are they being applied effectively by regulators and the courts?

- 5.1 The Issues Paper seeks inputs on whether the current merger provisions of the CCA are operating effectively; and whether the regulators and courts are applying the provision effectively.
- 5.2 Optus supports the legislative provisions relating to mergers and acquisition that provide for:
 - (a) Informal and formal clearance processes by the ACCC;
 - (b) An option for direct assessment of authorisation for a merger by the Australian Competition Tribunal (ACT);
- 5.3 The CCA prohibits mergers that would have the effect, or be likely to have the effect, of substantially lessening competition in a substantial market in Australia.⁶¹ The ACCC is able to clear a merger if it believes the merger will not substantially lessen competition. The ACCC process does not provide for any consideration of whether there are public benefits greater than the competitive detriment of the merger. Parties to the merger may decide to offer a court enforceable undertaking under s. 87B of the Act in order to address the competition concerns identified by the ACCC.
- 5.4 The CCA provides another avenue for parties to approve a merger. Parties can apply to the ACT to authorise a merger. The ACT can authorise a merger if it believes that it is likely to result in such a benefit to the public that it should be allowed to occur.⁶² The ACT may also approve a merger subject to conditions.⁶³ The ACT cannot retrospectively authorise a merger. The Tribunal must seek comments by the ACCC, and the ACCC may call witnesses, provide opinions, and cross-examine.
- 5.5 As noted above, Optus supports the process outlined above — a process where competition issues likely to raise concern can be discussed formally and informally with the competition regulator. And where there are sufficient concerns to be able to seek authorisation through an application to the ACT.
- 5.6 However, Optus does have concerns that the ACCC may have a position against certain types of mergers based purely on market concentration considerations. Recent decisions and policy statements made by the ACCC are suggestive of a position against mergers that result in particular market outcomes. For example, the Chairman has stated:

⁶¹ CCA, s.50

⁶² CCA, s.95AZH

⁶³ CCA, s.95AZJ

*When a merger is a “3-2” ... the parties should expect that the ACCC would take a long hard look at the merger ... In these circumstances, the ability of the two remaining firms to raise prices or reduce quality for consumers generally increases.*⁶⁴

- 5.7 Optus observes that while market concentration is one of several factors to be taken into account when assessing if acquisition lessens competition, there is nothing in the Act which gives extra weight, or special consideration, to the issue of market concentration.⁶⁵ While the Act places no emphasis on any one factor, the administration of s. 50 may be giving undue weight to issues surrounding market concentration.
- 5.8 The focus on market concentration to assess competition impact of a merger is also not supported by the economic literature. The literature raises doubt whether market concentration should be a factor given more weight than other relevant factors (like the ability to increase prices without incurring customer losses).⁶⁶ For example, Weisman (2007) concluded an emphasis on market concentration can lead policymakers to block mergers that enhance consumer welfare. Further, the risk of error is likely greatest in network industries, including communications.⁶⁷ Weisman (2007) specifically states that *“the use of market concentration as an indicator of market power is not reliable for network industries”*.⁶⁸ Similarly, Tirole (1988) warns against relying on concentration indices as *“they have no systematic relationship with economic variables of interest for assessing changes in cost, demand, or policy.”*⁶⁹
- 5.9 In markets with large fixed and sunk costs (such as communications), firms with significant scale advantages face lower costs. Competition may often be promoted if there are fewer strong competitors with similar scale rather than one dominant and several weak competitors. In such markets, a focus on market concentration is unlikely to promote efficient mergers and restrict the ability of non-dominant firms to compete effectively. Farrell and Shapiro (1990) found that mergers could lead to lower prices if it results in considerable economies of scale.⁷⁰ It is important for the government to distinguish between reduced rivalry and reduced competition in a merger, as only the latter unambiguously reduces consumer welfare.⁷¹
- 5.10 The public position of the ACCC on market concentration provides another regulatory competitive advantage to incumbent operators. In essence, the ACCC is limiting the ability of non-incumbent operators to compete in the market with an efficient cost base. It has the effect of discouraging or blocking mergers that would otherwise promote competition and outcomes for end-users.

⁶⁴ Sims, R., 2012, *Current ACCC Priorities*, speech to the Australia-Israel Chamber of Commerce, 13 September. See also, ACCC Press Release, *When three become two: Market concentration is a key factor*, NR 196/12

⁶⁵ CCA, s. 50(3)

⁶⁶ Farrell, J. and Shapiro, C., 1990, “Horizontal Mergers: An Equilibrium Analysis”, *The American Economic Review* Vol. 80, No. 1 (Mar), pp. 107-126; Mueller, D., 1985, “Mergers and Market Share”, *The Review of Economic and Statistics*, Vol.65(2), pp.259-67; Farrell, J. and Shapiro, C., 2010, “Antitrust Evaluation of Horizontal Mergers: An Economic Alternative to Market Definition”, *The B.E. Journal of Theoretical Economics*, Vol. 10(1), Article 9; Ordober, J., Sykes, A., & Willig, R., 1982, “Herfindahl Concentration, Rivalry, and Mergers”, *Harvard Law Review*, Vol. 95(8), pp. 1857-74.

⁶⁷ Dennis L. Weisman, 2007, “Market Concentration, Multi-Market Participation and Antitrust”, *Journal of Competition Law and Economics*, Vol.1(2), pp.233-57

⁶⁸ Weisman, D., 2007, p.235

⁶⁹ Tirole, J., 1998, *The Theory of Industrial Organisation*, MIT Press, Cambridge, p.223

⁷⁰ Farrell, J. and Shapiro, C., 1990, p.122

⁷¹ Weisman, D., 2007

Section 6. Administration of competition policy

Question 47 – Are competition-related institutions functioning effectively and promoting efficient outcomes for consumers and the maximum scope for industry participation?

- 6.1 Optus wishes to make two comments in relation to the operation of agencies engaged in competition regulation of the communications industry. These are:
- (a) Cost recovery arrangements may not promote efficient use of resources; and
 - (b) Use of technical regulations to impose competition remedies outside of competition regulations.

Cost recovery regimes should be reviewed

- 6.2 Optus primarily deals with the ACCC as the body administering Part XIC of the CCA. The costs incurred by the ACCC in the administration of its telecommunications responsibilities are recovered through an industry levy.
- 6.3 The Australian Government Cost Recovery Guidelines note while cost recovery can promote efficiency, it could also result in cost padding and inefficiency. The Guidelines advise that costs to be recovered should be the minimum necessary to deliver the service. A key element in ensuring efficiency is the transparency of recovery arrangements. The Guidelines recommend that agencies:
- (a) Articulate their broad objectives and explain how the costs meet them;
 - (b) Adopt costing models and methodologies that are sufficiently detailed to allow stakeholders to analyse production costs.⁷²
- 6.4 Optus broadly agrees with these principles of a well-functioning cost recovery regime. However, it is not immediately clear how the ACCC's regime adheres to the principles. There has been a significant increase in the ACCC's costs that are allocated to the communications industry in recent years, but with limited transparency of the reasons for such an increase.
- 6.5 The ACCC cost recovery programme is reported through the Cost Recovery Impact Statements prepared by ACMA for Annual Carrier Licence Charges.⁷³ The Statements contain a table relating to the ACCC fees and a few related paragraphs. It appears that the ACCC directly allocates the cost associated with the Communications Group, and also allocates a proportion of general overheads and the Regulatory Affairs Division. The latest statement is for financial costs in 2011-12. It shows that the direct cost of the Communications Group has increased by only 1.5% per annum since 2007-08. On the other hand, indirect costs have grown by 18% since 2007-08. Indirect costs represented 37% of total cost recovery fees in 2011-12, an increase from 25% in 2007-08.

⁷² Australian Government Cost Recovery Guidelines, 2005, Financial Management Guidance No.4, July

⁷³ ACMA, 2011, Annual Carrier Licence Charges Cost Recovery Impact Statements, available at: <http://www.acma.gov.au/theACMA/About/Corporate/Accountability/cost-recovery-impact-statements-acma>

- 6.6 The increase in fees have been justified as relating to:
- (a) Increase staff costs associated with NBN Co and regulatory reform of communications (2009-10);
 - (b) Additional staff result of new activities commenced, and increases in corporate overhead allocation (2010-11); and
 - (c) Additional staff due to new activities commencing, and new subscriptions to comprehensive telecommunications industry related knowledge providers (2011-12)
- 6.7 No further detail or consultation is entered into when setting the fees. The main driver of increased fees is the indirect allocation of corporate overheads. Optus submits that more information should be released on the method of allocation and corresponding reasons. It is not clear how, or if, increases in staff due to NBN and other new activities impacts indirect allocations.
- 6.8 Based on the available information, Optus questions whether increasing the proportion of ACCC corporate overheads to the telecommunications industry is consistent with Australian Government cost recovery principles. These concerns ultimately come down to a lack of transparency as to the composition of the costs incurred and reasons for the increases.
- 6.9 Optus sees merits in reforms to cost recovery regime that required agencies to engage with affected firms and to provide reasons for the costs incurred. Such transparency would promote the objectives of the cost recovery regime — and assist in ensuring that only efficient costs are being incurred.
- 6.10 To this end, Optus submits that the ACCC cost recovery function under the CCA be removed from the overall communications cost recovery process administered by the ACMA through the *Telecommunications (Carrier Licence Charges) Act 1997*. It should be costed and reported separately so as to ensure greater transparency and consultation with industry. Optus further submits there should be a legislative obligation on the ACCC to consult with and advise industry on the methodology and calculation of the fees incurred.

Australian Competition and Consumer Commission, Australian Competition Tribunal and other Federal regulatory agencies and bodies

Question 48 – What institutional arrangements would best support a self-sustaining process for continual competition policy reform and review?

Question 50 – What is the experience of businesses in dealing with the ACCC, the Australian Competition Tribunal and other Federal regulatory bodies?

- 6.11 The communications industry remains a highly regulated industry subject to oversight from numerous government agencies, including the ACCC, ACMA, Department of Communications, Telecommunications Industry Ombudsman (TIO), and potentially various State and Territory agencies. The CCA is the primary vehicle through which competition issues are addressed in the communications industry — and the ACCC is the agency responsible for competition and access regulation.

- 6.12 In recent times, however, Optus has experienced some examples of regulatory creep and overlap through the use of different legislation to impose competition-related remedies. Optus wishes to highlight to recent examples:
- (a) Access regimes are within the CCA and the *Telecommunications Act 1997*; and
 - (b) Use of technical regulations to impose competition-related remedies without a competition assessment.
- 6.13 The first issue relates to multiple regulations addressing the facilities access problem. Both Part XIC and the *Telecommunications Act 1997* (Telco Act) have powers relating to access to communications facilities and services. While there are slight technical differences in the type of access provided — Telco Act provides access to facilities and Part XIC provides access to services provided over communications facilities — there are significant differences. The most obvious difference is the requirement to conduct a competition inquiry under CCA and ensure that regulation promotes the long term interest of end-users (LTIE).
- 6.14 Optus is of the view that it would be beneficial to clarify the roles and responsibilities of agencies with regard the implementation of access regimes. For example, Schedule 3 of the Telco Act is designed to grant a right to install low impact facilities such as installing cable lines or base stations. There are limited rights for land owners to object.⁷⁴ The purpose of this is to prevent frustration of the installation of communications network. The decision on rights to access is delegated to either the TIO or the Federal Court. Both agencies over different procedures and different rights of appeal.
- 6.15 The regime permits the granting of access without any assessment of effective competition, or to identify related downstream markets that would benefit. There is no requirement that access decisions promote competition or are otherwise beneficial to consumers. There is no requirement for the access terms and conditions to be reasonable or efficient.⁷⁵ The TIO appears to be intervening in the commercial operation of a data centre without any finding as to the level of competition in the data centre market.⁷⁶ On the face of it, it would appear to be inconsistent with the approach under Part XIC and competition policy principles.
- 6.16 Optus is concerned that carriers are able to forum shop to find an agency and legislation which grants the ability to impose access obligations outside the competition policy framework.
- 6.17 In essence, both of these problems arise from regulatory creep, where new regulations are imposed without removal of old ones: and where a regulatory stocktake is rarely undertaken to identify multiple overlapping regulations.
- 6.18 Moreover, should regulatory best practice principles be followed these problems would not arise. Technical regulations would address a specific problem and would not permit

⁷⁴ See for example *PIPE Networks Pty Ltd v Commonwealth Superannuation Corporation* [2013] FCA 444 (16 May 2013), which confirmed that agreement of owners is not needed to install cable in multi-dwelling units.

⁷⁵ Under Schedule 3 there is an obligation to compensate for damage and financial loss. This is unlike Schedule 1 of the Telco Act that grants ACCC arbitration powers to set terms and conditions of access.

⁷⁶ In summary, the decision allows Megaport to install fibre links, cable links and cable racks within empty areas of PIPE Networks Data Centre. See TIO, *Decision under the Telecommunication Code of Practice 1997*, 2014/01/06023, 22 May 2014.

implementation of competition remedies. Similarly, there would be one access regime for communications and overlap would be identified and not permitted.

- 6.19 The second concern Optus has experienced is the potential for agencies to implement price controls through legislation other than competition legislation. As stated above, the industry is highly regulated and subject to both technical and competition regulation. Optus believes the intent of policy makers is for competition policy to be administered through the provisions and processes under the CCA. However, there have been examples where technical regulators have been suggested as a way to introduce competition remedies.
- 6.20 For example, there have been recent proposals put forward by ACMA to use the Numbering Plan under the Telco Act to impose specific fee schedules and designs upon the mobile industry. The proposal related to extend the requirement to set a certain call price equal to untimed local fixed calls to mobile calls. It had never been applied before, in recognition that mobile industry was competitive and never had the concept of local calls in the tariff design. In effect, the proposal was to utilise the Numbering Plan to regulate retail tariffs in the mobile market. This was proposed without any market definition; or assessment of the level of competition in the market; there was no finding of significant market power; there was no assessment of the impact on the efficient investment in, and use of infrastructure; and there was no assessment whether it promoted the long term interests of end-users.
- 6.21 Optus recommends that legislation be reviewed to identify technical powers that could be used to implement competition policy and to ensure that competition policy remedies (such as price controls or access obligations) be implemented only after proper assessment of markets and levels of competition. Further, there may be merit in granting the ACCC a review power over other agencies implementing competition policy inconsistent with the CCA.

Section 7. Response to other issues

- 7.1 The Issues Paper raises a number of questions on a number of restrictions and other impediments to competition across both the goods and services markets. The Issues paper raises question regarding the operation of general competition laws. Optus wishes to make comments on the following issues:
- (a) Restrictions arising from IP laws have an unduly adverse impact on competition Intellectual property; and
 - (b) Land use restrictions exert an adverse impact on competition.

Restrictions arising from Intellectual Property laws

Question 9 – Are there restrictions arising from IP laws that have an unduly adverse impact on competition? Can the objectives of these IP laws be achieved in a manner more conducive to competition?

- 7.2 In 2013, the Australian Law Reform Commission (ALRC) conducted an inquiry on Copyright and the Digital Economy (the ALRC Review). Specifically, the ALRC Review highlighted issues raised under Australian copyright law in relation to copyright protection.
- 7.3 Optus' submitted that the *Copyright Act*, and its current judicial interpretation, has moved copyright protection away from its original purpose and acts as an impediment to competition. The *Copyright Act* has been used to protect vested economic interests at the expense of wider economic and social benefits. Optus has had some recent experience with the application of the *Copyright Act*. Optus was prevented from offering a cloud-based personal video recorder service which is permitted in many other jurisdictions.
- 7.4 In this section, Optus outlines its TV Now proposition and recommended changes to the IP laws so as to promote competition. Optus supports the recommendations put forward by the ALRC.

Optus' TV Now proposition

- 7.5 Optus offered customers a service that enabled them to record free-to-air television programs and play them back on any one or more of four types of devices (a PC, an iPhone or iPad, an Android mobile device and other 3G mobile devices). The end-user was only able to record free to air broadcasts if they lived in one of five capital city broadcast regions and they could only record broadcasts available to their home broadcast region.
- 7.6 The end-user selected the program to record from an electronic program guide by pressing "record". The service then made 4 unique copies of the program for that end-user (in the relevant formats required for playback on multiple devices) which was stored on Optus' infrastructure rather than on the end-user's phone or computer. The end-user was unable to download or copy the recorded program. They could press "play" and watch the program on their compatible device but the recording would be deleted after 30 days.

- 7.7 In effect, the system worked in the same manner as a personal video recorder (PVR) located in one's home. The PVR made a recording at the request of the end-user and transmitted it back to the end-user to view when "play" was selected. The only real differences were the physical location of the infrastructure, and the lack of any physical connection between the recording and the viewing device.
- 7.8 The Full Federal Court found that the TV Now product did not fit within the relevant exemptions under the *Copyright Act*. The Court found that:
- (a) The maker of the recording was Optus or alternatively, Optus and the end-user. The Court's preferred view was that it was both Optus and the end-user such that they were jointly and severally responsible for the act of copying. In reaching that conclusion the Court described Optus as the "*main performer of the act...*"⁷⁷ and considered that Optus' role in the making of a copy was "*... so pervasive that, even though entirely automated, it cannot be disregarded when the "person" who does the act of copying is to be identified*".⁷⁸
 - (b) Optus could not invoke the "private and domestic use" defence in s. 111 in either case. In doing so the Court noted that there was nothing in the language or provenance of s. 111 to suggest that it was intended to cover commercial copying on behalf of individuals⁷⁹ and whilst the desirability of technology neutrality was acknowledged, the Court stated that "*no principle of technological neutrality can overcome what is the clear and limited legislative purpose of s. 111. It is not for this Court to re-draft this provision to secure an assumed legislative desire for such neutrality...*"⁸⁰
- 7.9 Optus' concern is that the state of the law as it now stands results in an arbitrary distinction between technologies which was not what was intended when amendments were made to the *Copyright Act* in 2006. As the state of the law currently stands:
- (a) Australians do not have access to remote storage PVRs such as Optus TV Now;
 - (b) Australia is out of step with copyright laws in other developed countries; and
 - (c) The *Copyright Act* does not give full effect to the amendments introduced in 2006 which were stated to be intended to make the Act technology neutral.

Implications for PVR use in Australia

- 7.10 Following the Federal Court judgement, there must be doubt about the legality of other recording systems such as FOXTEL iQ and TIVO. For example, Giblin argues that by finding that the PVR provider makes a recording by providing an automated system enabling other

⁷⁷ *Singtel Optus Pty Limited v National Rugby League Investments Pty Limited* (No. 2) [2012] FCA 34, para.60

⁷⁸ *Singtel Optus Pty Limited v National Rugby League Investments Pty Limited* (No. 2) [2012] FCA 34, para.67

⁷⁹ *Singtel Optus Pty Limited v National Rugby League Investments Pty Limited* (No. 2) [2012] FCA 34 para.89

⁸⁰ *Singtel Optus Pty Limited v National Rugby League Investments Pty Limited* (No. 2) [2012] FCA 34 para.95

parties to record, the Court has effectively made both remote and traditional PVR technologies legally doubtful.⁸¹

- 7.11 By characterising Optus as the maker because it designed and supplied the service is akin to describing the manufacturers of PVRs such as the FOXTEL IQ or TIVO as the makers of the copies created using those systems as in those instances the equipment is also pre-configured to record programs in response to a person pressing the “record” button and sometimes records even when that step is not taken by the end-user (for example FOXTEL’s Series Link function and TIVO’s Season Pass Manager).

Australian law is inconsistent with international approach

- 7.12 The consequence of the Full Court decision is that time shifting technologies which have been held to be lawful in other jurisdictions such as the US and Singapore (with its very similar *Copyright Act*) are now unlawful in Australia. As a result not only was the Optus TV Now product withdrawn from the market but similar products offered in Australia such as MyTVR and BeemTV were also withdrawn.
- 7.13 This contrasts starkly with other jurisdictions where these types of services are being introduced at a rapid rate. In Singapore the failure of the legal challenge to RecordTV⁸² means that in Singapore consumers are able to record free to air TV shows to the cloud and watch them back on devices such as mobile phones, PCs or iPads.⁸³ It has been reported that in Europe there has been a “spate of recent deployments”.⁸⁴
- 7.14 If Australia does not address the shortcomings in the copying for private use exception we will be left behind the rest of the world.

Optus’ recommendations

- 7.15 As such, Optus recommended three core principles that should be adopted:
- (a) **Copyright law should focus on the end-user** and their ability to access copyright material. Copyright law should not be used to unreasonably restrict the ability of end-users to view or use material that they otherwise have a legitimate right to view or use. In addition, liability for copyright infringement should not extend to electronic transmission networks; in the same way that liability was never extended to the physical postal networks.
 - (b) **Copyright law should be technologically neutral** and should not disadvantage new and innovative technologies. A focus on the physical act of copying limits society from utilising efficiencies available from new technologies, such as cloud computing.

⁸¹ See Giblin, Rebecca, Stranded in the Technological Dark Ages: Implications of the Full Federal Court’s Decision in *NRL v. Optus* (June 18, 2012). *European Intellectual Property Review*, 34(9), 2012 (Forthcoming). Available at SSRN: <http://ssrn.com/abstract=2086396>.

⁸² *RecordTV Pte Ltd v MediaCorp TV Singapore Pte Ltd* [2010] SGCA 43

⁸³ see <http://www.recordtv.com/>

⁸⁴ Cloud PVR Spreads Over Europe by Philip Hunter, *Broadcast Engineering* (9 July 2012). Available at <http://broadcastengineering.com/news/cloud-PVR-europe>.

- (c) **Copyright law should be consistent with international jurisdictions.** The digital economy is increasingly international, with data being able to travel the cloud instantly. The global digital economy is producing new and innovative services. Australian copyright law would impose significant cost on Australian end-users if it is not developed consistently with other jurisdictions and prevents services from being delivered in Australia.

7.16 The ALRC in its final report also advocated for the introduction of a flexible fair use exception. The case it postulates for fair use is based on several arguments, with the primal feature being that it should explicitly recognise the need to protect rights holders' markets.

*The ALRC recognises the importance of having copyright exceptions that are certain in scope. This is important for rights holders, as confidence in exploiting their rights underlies incentives to creation. It is also important for users, who should also be confident that they can make new and productive use of copyright material without a licence where this is appropriate.*⁸⁵

7.17 Put simply,

*By appropriately limiting the ambit of copyright, exceptions can increase competition and stimulate innovation more generally, including in technologies and services that make productive use of copyright material. **The ALRC considers that fair use finds the right balance.** It protects the interests of rights holders, so that they are rewarded and motivated to create, in part by discouraging unfair uses that harm their traditional markets. It can also stimulate innovation, particularly in markets that rights holders may not traditionally exploit.*⁸⁶ **[emphasis added]**

Principles for copyright reform

7.18 In summary, the ALRC's fair use arguments can be summed up as:⁸⁷

- (a) *Fair use also facilitates the public interest in accessing material, encouraging new productive uses, and stimulating competition and innovation.*
- (b) *Fair use is technology neutral, and it is not confined to particular types of copyright material, nor to particular rights.*
- (c) *Fair use promotes what have been called 'transformative' uses—using copyright material for a different purpose than the use for which the material was created.*
- (d) *Fair use also better aligns with reasonable consumer expectations. It will mean that ordinary Australians are not infringing copyright when they use copyright material in ways that do not damage—and may even benefit—rights holders' markets.*

7.19 The imposition of a simple and transparent fair use exception would therefore address much of the uncertainty that surrounds the ability of end-users to access/use the copyrighted material in multiple locations and devices. This uncertainty no doubt stems from the shift

⁸⁵ ALRC, 2013, Copyright and the Digital Economy, Final Report, November, p.22

⁸⁶ ALRC, 2013, Copyright and the Digital Economy, Final Report, November, p.23

⁸⁷ ALRC, 2013, Copyright and the Digital Economy, Final Report, November, pp.22-4

from content accessed via physical means (through physical formats such as books and CDs) to access to content delivered in a digital environment. In this latter scenario, the contention lies with respect to the focus on the physical act of copying precludes society from utilising efficiencies available from new technologies, such as cloud computing.

- 7.20 This begs the simple question that: if the end-user has a right to access the material, then why should it matter over which technology the material is delivered, or through which technology/device the end-user chooses to view it.
- 7.21 In addition to the introduction of a fair use exception, the ALRC proposed that this should contain three elements (ALRC Recommendation 5-1):
- (a) *An express statement that a fair use of another's copyright material does not infringe copyright;*
 - (b) *A non-exhaustive list of four fairness factors to be considered in determining whether use of that copyright material is fair; and*
 - (c) *A non-exhaustive list of illustrative uses or purposes.⁸⁸*
- 7.22 The 'fairness factors' was generally supported by respondents, including Optus, to the inquiry. The proposed non-exhaustive list of fairness factors include (ALRC Recommendation 5-2):
- (a) *The purpose and character of the use;*
 - (b) *The nature of the copyright material;*
 - (c) *The amount and substantiality of the part used; and*
 - (d) *The effect of the use upon the potential market for, or value of, the copyright material.⁸⁹*
- 7.23 Importantly, the broad and principles-based factors should be considered and viewed on balance rather than in the form of a thresholds test. Optus reiterates that the interpretation of the four factors should be from the perspective of the end-user: that is, the actual user of the copyright material. So for example, where the ALRC asks whether the use was commercial under the 'purpose and character of the use' test, the focus should be whether use of material by the end-user was for a commercial purpose.

Regulatory restrictions on land use

Question 10 – Are there planning, zoning or other land development regulatory restrictions that exert an adverse impact on competition? Can the objectives of these restrictions be achieved in a manner more conducive to competition?

- 7.24 Telecommunications carriers are affected by the ad hoc nature of planning, zoning and land development regulation across Australia. Mobile operators in particular are impacted as land

⁸⁸ ALRC, 2013, Copyright and the Digital Economy, Final Report, November, p.124

⁸⁹ ALRC, 2013, Copyright and the Digital Economy, Final Report, November, p.144

use laws greatly impact on the ability to install base stations at the location which is optimal for network performance. The industry is facing a period of significant growth in demand for data, and growing expectations from end-users for wider and better coverage. This cannot be achieved without investments in additional base stations. Inefficient land use laws directly impact on the costs and time it take to deploy sites.

7.25 Optus has experienced the following impacts:

- (a) State bodies (e.g. Crown Lands) and Local Governments routinely discriminate against telecommunications carriers for the cost of accessing suitable sites for infrastructure build or restrict access to sites. And although telecommunications carriers have the ability to appeal overcharging and access restrictions through the Courts, the process for obtaining resolution is long, costly and ultimately causes network coverage to be negatively affected. For example, in April 2012, Telstra commenced proceedings in the Federal Court against the State of Queensland to Federal Court over the issue of the Department of Environment and Resource Management (DERM) charging telecommunications carriers for land used for communications sites at a rate that is significantly higher than rent charged to other Crown land users for other comparable sites. The matter is still unresolved; and
- (b) The practice of zoning is unduly arbitrary in nature. There are many examples of inefficient and discriminatory outcomes and once again causes frustration, delay and additional cost in developing much needed infrastructure.

7.26 In light of the above, it would be beneficial if the redress available for telecommunications carriers for issues arising from telecommunications infrastructure development proposals were to be standardised across Australia. Standardisation would improve competition, lower costs to deploy towers, and decrease the time required. There is merit making this consistent with other telecommunications laws that apply on a national basis.