

## After the Dust Settles – What Does the Telstra Separation Legislation Really Mean?

Shane Barber, Kathryn Edghill, Graham Maher and Mitch Kelly review the content and implications of recently proposed amendments to Australian telecommunications legislation.

On 15 September 2009, the Minister for Broadband, Communications and the Digital Economy, Senator Stephen Conroy, announced fundamental reforms to Australia's telecommunications regulations by way of the Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2009 (**Bill**).

As speculation continues about who will be the likely winners and losers from the rollout of the National Broadband Network (**NBN**), it is useful to examine if and how this opening regulatory salvo will achieve the Government's stated aims of 'enhancing' competitive outcomes within the telecommunications industry and strengthening consumer safeguards.

The Government's targeting of specific industry sections and participants to achieve its broader policy aims, in this case the structural or functional separation of Telstra, contrasts with the approach adopted by its predecessor government, which generally reflected a technology and participant neutral approach to regulation.

If the initial industry response is anything to go by, there is much to commend this new, more targeted approach, but closer inspection of the reforms indicates some lurking problems. For instance, there is a real concern that there is much scope for the Australian Competition and Consumer Commission (**ACCC**) to increase its influence in the telecommunications industry in a manner which is, in fact, not conducive to long term competition.

### Objectives and structure of the Bill

The Bill is stated to have three primary objectives:

- (a) addressing Telstra's vertical and horizontal integration;
- (b) streamlining the access and anti-competitive conduct regimes provided for under Parts XIB and XIC of the *Trade Practices Act 1974* (Cth) (**TPA**); and
- (c) strengthening consumer safeguard measures and reducing unnecessary red tape.

The Bill contains amendments to the following pieces of legislation:

- (a) the *Telecommunications Act 1997* (Cth);
- (b) the *Radiocommunications Act 1992* (Cth);
- (c) the *Trade Practices Act 1974* (Cth);
- (d) the *Telecommunications (Consumer Protection and Service Standards) Act 1999* (Cth); and
- (e) consequential amendments to the *National Transmission Network Sale Act 1998* (Cth).

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## *The Bill will allow Telstra to voluntarily undertake structural separation and to voluntarily offer to divest control over its hybrid coaxial networks and subscription television broadcasting licences (Foxtel).*

### Addressing Telstra's vertical and horizontal integration

Telstra's integrated position across all telecommunications platforms has long led to concerns that the existing telecommunications structure is failing consumers, businesses and the economy in general. The Bill proposes fundamental reforms aimed at addressing Telstra's vertical and horizontal integration and the power imbalance which flows from Telstra's dominance in the provision of fixed line carriage services.

The Bill will allow Telstra to voluntarily undertake structural separation and to voluntarily offer to divest control over its hybrid coaxial networks and subscription television broadcasting licences (Foxtel). Strong incentives are included in the Bill for Telstra to provide such voluntary undertakings, in the form of denial of access to designated parts of the spectrum if it does not do so. If structural separation is not offered, the Government will impose a strong functional separation framework on Telstra by requiring it to:

- (a) conduct its network operations and wholesale functions at arm's length from the rest of Telstra;

- (b) provide equivalent price and non-price terms to its retail business and non-Telstra wholesale customers; and
- (c) be transparent to the regulator and competitors via strong internal governance structures.

### Changes to Parts XIB and XIC of the TPA

In order to address concerns that the access provisions of Part XIC of the TPA have failed to adequately provide access to telecommunications infrastructure in a timely fashion and that the provisions of Part XIB of the TPA have not adequately addressed possible breaches of competition law within telecommunications markets, the Bill proposes certain amendments to both Parts.

Surprisingly, the amendments to Part XIB are relatively minor. They remove the procedural fairness requirements which previously obliged the ACCC to consult with a party before issuing a Part A competition notice (a process which the Government believes was previously prone to delay and obstruction).

The amendments to Part XIC are more substantial and give the ACCC a greater role in determining the terms and conditions on which access is to be granted to telecommunications infrastructure by allowing the ACCC to:

- (a) determine up-front terms and conditions for a 3-5 year period (following industry consultation);
- (b) determine principles to apply for longer periods;
- (c) make binding rules of conduct to immediately address problems with the supply of regulated wholesale services; and
- (d) reject 'serial' undertakings offered by access providers as a means of delaying the grant of access.

## Strengthening consumer safeguard measures

The Bill identifies the following two objectives:

- (a) strengthening consumer safeguard measures in the transition to the NBN;
- (b) reducing red tape by addressing the requirement for carriers to pay the universal service obligation (USO) levy, carrier licence fees, the costs of the National Relay Service and funding for the Australian Communications and Media Authority (ACMA); and

The Bill introduces a number of measures to affect these objectives, some of which include:

- (a) requiring Telstra to meet new minimum performance benchmarks in their management of the USO (including civil penalties of up to \$10 million for failures to do so);
- (b) providing new minimum performance benchmarks on the Customer Service Guarantee provided by telephone companies to meet or exceed CSG time periods;
- (c) requiring telephone companies to either offer priority assistance services or inform them of their availability to be purchased;
- (d) providing the ACMA with increased powers to issue infringement notices instead of commencing court proceedings; and
- (e) exempting carriers with revenue less than \$25 million per annum from paying an annual carrier licence fee.

## *If structural separation is not offered, the Government will impose a strong functional separation framework on Telstra*

### What is the impact for Telstra?

The Bill creates a dilemma for Telstra. It must either:

- (a) agree to divest its copper line network and, potentially, control of its hybrid fibre – coaxial network and control of Foxtel in return for access to the communications spectrum it will require to compete in the market for the next generation of wireless broadband services; or
- (b) retain these networks and control of Foxtel in circumstances where it will be excluded from access to the relevant spectrum, at the same time facing increasing regulation of its business with the ACCC seeking to achieve 'functional separation'.

The first 'structural separation' option, which is the Government's preferred option, may well result in Telstra having to divest assets at a substantial discount to their current book value, either to a competitor or more likely to the Government's NBN Co, which may very well cherry pick which of these assets it chooses to acquire.

The second 'functional separation' option will result in Telstra holding on to a copper line network, which Senator Conroy was quick to note requires extensive maintenance and which may very well be redundant in the next ten years once the NBN is established. Further, Telstra may be shutting itself out of developing markets for provision of content through wireless broadband services, which is clearly a key to the future of telecommunication services in Australia.

In seeking to nudge Telstra in the direction of structural separation, the Government is hoping that it has achieved the right balance in its carrot and stick approach, but that does not mean that there are not risks which may stymie the Bill.

The Australian Constitution permits the Government to acquire property but only if such acquisition is on just terms. The critical

issue here is whether the Government, despite its insistence that Telstra has the flexibility to choose the future direction of its business, has effectively made Telstra an offer it can't refuse and which, if accepted by Telstra, is likely to result in the Government's NBN Co or Telstra's current or potential competitors, acquiring Telstra assets at steeply discounted prices in what amounts to a forced sale scenario.

No doubt Telstra will be keenly considering this issue in the coming weeks. If the Bill does come into effect, a legal challenge is at least a possibility. Alternatively, Telstra may seek to use this legal uncertainty as a bargaining chip to achieve more favourable terms should it look to agree a voluntary undertaking.

### What is the impact on competition and the role of the ACCC?

Based on the wording of the Bill, the role that the ACCC is to play in achieving the Government's aims, although generally applauded by consumers and the industry itself, is deserving of some scrutiny.

When Part XIB (which deals with anti-competitive conduct) and Part XIC (which deals with access to telecommunications infrastructure) were introduced into the TPA in 1997 the intention was that such industry specific competition regulation would ultimately be repealed and that the industry would eventually be subject only to those provisions of the TPA which apply to all industries. Some 12 years later, those Parts remain in force and with some of the most significant structural changes the industry has seen about to occur, we are further than ever away from reverting to non-industry specific competition regulation and closer than ever to a more interventionist ACCC.

The outcome of the proposed reforms is that the ACCC will be able to more readily and directly influence the terms on which access is provided both in the transition period to the NBN and thereafter, with reduced scope for challenge (and regulatory gaming) by the relevant participants.

## *the ACCC will be able to more readily and directly influence the terms on which access is provided both in the transition period to the NBN and thereafter*

The ACCC has long recognised the important part that controlling access to infrastructure, including access pricing, plays in regulating competition in the industry, telling the Productivity Commission in 2000 that "if the preferred outcome is a 'positive act' then Part XIC may be the preferable 'regulatory tool'". It would seem that it will now have the preferable regulatory tool.

### Senate

The Bill has received a mixed response from parties in the Senate. While the Government appears to have obtained the support of the Greens, the Coalition was not as responsive, even levelling the accusation that the Government was "holding a gun" at Telstra's head.

While requesting that the Government prioritise access for rural, regional and disabled citizens due to past access concerns, the Greens were prepared to support the Bill within the Senate. Greens communications spokesman Scott Ludlam commented that the Bill was in line with demands made by the industry for many years, and stressed that not only Telstra, but the NBN Co or any other telecommunications provider, should "never be allowed to own public infrastructure and simultaneously compete with retail providers" as competition and national telecommunications growth would be unacceptably affected.

The Coalition however was not so enthused. Shadow communications minister Senator Nick Minchin chastised the Government for what he believed was insufficient analysis of the impact the Bill would have on employees of Telstra, shareholders and customers. Senator Minchin believed that, given the apparent more conciliatory stance and attitude of current Telstra management, the Government should take a more considered and cooperative approach. He believed that if the government was focused on building the NBN and was committed to achieving the stated objectives, the Government should instead take an approach which would not lead to serious risks within the telecommunications sector following any break-up of Telstra.

### Consumer and lobby groups

One of the key issues which garnered significant attention in the first days following the Bill's announcement was the potential effect it would have on the shareholders of Telstra. The Australian Shareholders' Association chief executive, Stuart Wilson, believed it represented a "giant kick in the teeth for Telstra shareholders" and that there was "not one good thing for shareholders to come out of the [Bill]". These vehement comments were centred on the belief that those individuals, who had previously purchased shares from the Government, were highly susceptible to the effects of "draconian selective rules" now sought to be imposed by the Government.

### *The Bill has received a mixed response from parties in the Senate*

However, consumer bodies were generally positive towards the introduction of the Bill, with sentiments that the proposal was overdue. Australian Communications Consumer Action Network CEO Allan Asher stated that the new provisions for minimum performance benchmarks and new ACMA powers were overdue as the "past assumption that retail competition will guarantee high levels of customer service has proved false". Additionally, Choice Director of Policy and Campaigns, Gordon Renouf, emphasised that consumers would be the winners from improved productivity where retailers compete on a fair basis.

### Access seekers

The reaction amongst access seekers appears unequivocal, with all praising the Bill as a positive step to remedying what was perceived to be a significant deficiency within the industry. Macquarie Telecom was enthusiastic about the Bill's approach, provided "the government and the ACCC, who will play a key role here, do stick to the path that's been set". iiNet regulatory director Steve Dalby echoed these comments and believed that while the Bill was positive, he hoped to see objective criteria set that would measure the outcomes of any proposed separation.

AAPT CEO, Paul Broad, believed the Bill went further than expected, though highlighted that the ultimate focus should remain on ensuring customers can move freely between providers and there was more transparency around access and pricing.

Optus regulatory director Andrew Sheridan believed that the Bill was "done in a way which clearly reaches out to Telstra". Internode carrier relations manager John Lindsay believed that the government was "greenmailing" Telstra into cooperating on the implementation of the NBN.

### An initial impression

The Bill represents a vital first step in establishing the regulatory framework in which the NBN will operate. However, it may not deliver the outcomes it seeks to achieve as:

- (a) there remains significant uncertainty surrounding the possible structural separation of Telstra. Not only does this uncertainty arise because Telstra is only required to 'voluntarily' submit a

structural separation undertaking, but the effects of a failure to do so, in terms of denial of access to parts of the spectrum, may lead to challenges by Telstra to the constitutional validity of the scheme proposed in the Bill; and

- (b) much of the detail surrounding the terms on which structural separation and functional separation undertakings will be approved remains unstated. In the case of the former the role of the ACCC and the Minister in terms of determining the factors which will be taken into account are not specified. In the case of the latter, while the requirements of functional separation are more clearly outlined, the final decision to accept or reject lies with the Minister who must seek the ACCC's advice.

The Government appears to be applying commercial pressure to force Telstra to sell its assets to the NBN without making it do so. In what could be a flag for its true intentions, in its outline of the Explanatory Memorandum, the Government says structural separation:

*...may involve Telstra progressively migrating its fixed-line traffic to the NBN over an agreed period of time and under set regulatory arrangements, and sell or cease to use its fixed-line assets on an agreed basis. This approach will ultimately lead to a national outcome where there is a wholesale-only network not controlled by any retail company—in other words, full structural separation in time. Such a negotiated outcome would be consistent with the wholesale-only, open access market structure to be delivered through the NBN.*

Telstra will have a difficult decision to make and must make it fairly quickly. The longer it delays deciding to 'roll' its assets in (if that what it ultimately decides), the greater the risk that those assets will have less value to NBN Co as it builds its own network. Historically Telstra has seized every avenue to protect its position. It is arguable that this time the Government has applied some significant pressure to avoid that.

It seems that the Government has chosen to regulate competition in the market in the important transition period to the NBN through means of incentives for Telstra to structurally separate and by giving the ACCC broader powers to determine access terms and conditions. Whether these will be successful in controlling the current 'gorilla' in the industry, Telstra, or preventing the emergence of another dominant market player, or whether they will simply result in the ACCC becoming a de facto industry participant remain to be seen.

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