Response to Consultation Paper on Telecommunications Regulatory Arrangements

April 2014

The CCC welcomes the opportunity to comment on the latest paper from the NBN cost benefit analysis panel. The CCC and its members have been deeply involved in the regulatory processes for many years, and were active in the discussions that led to the regulatory changes in 2009/10. The effectiveness of the regime remains a central concern to the ability of the access seekers to compete effectively.

The CCC believes it is crucial that the history of the regime, and the weaknesses that bedevilled past arrangements are kept sight of when the present arrangements are considered.

The Evolution of the Regulatory Regime and Regulatory Practice

The present regulatory regime has evolved in response to experience over years since 1997 reforms. The changes made have been responses to deficiencies that emerged as it became apparent that the policy outcomes in communications markets have failed to reach expectations in terms of price, service and competition improvements, or international competitiveness.

The regulatory arrangements put in place in 1997 were predicated on the expectation that, over time, commercial relationships would develop between access seekers and the incumbent access provider, Telstra, and that investment in competitive infrastructure would allow competitors to bypass Telstra's ubiquitous network, and in so doing reduce its market power. These expectations proved optimistic. They failed to take account of the incentives to which different industry participants responded.

These incentives reflected the structure of the market – particularly the vertical and horizontal integration of Telstra, its incumbent market share, and its subsequent market power – and the nature of the technologies deployed, specifically, that the network has bottleneck characteristics at the customer access/last mile level.

Changes to the regime over the years responded to the reality that elements put in place to facilitate and support commercial negotiations were in practice gamed to effect delays and create uncertainty for market entrants because the controller of the access network remained fundamentally an unwilling, or at best conflicted, seller.

The policy reform package legislated through 2009/10 was an attempt to comprehensively respond to what had been learnt through this period.

The simultaneous creation of the NBN was a long term solution to the problems caused by the monopoly fixed line access owner having a business incentive to deny equivalent access to the network to its competitors through progressively structurally separating the monopoly access network.

The market is likely to be in a state of transition from one where Telstra is the dominant fixed line access provider to one where NBN Co is the dominant supplier for many years. The regime therefore needs to straddle circumstances where the dominant supplier is vertically integrated, and therefore has the incentive and ability to discriminate against competitors, to one where there is a national monopoly fixed line wholesale access provider, with the incentive to maximise its returns by charging excessive access charges.

Structural separation remains, in the CCC's submission, the main game for policy and regulation. Effecting equivalence of access in the meantime is crucially important.

The regime in place today therefore recognises that the communications market is defined by:

- The existence of bottleneck characteristics at the access network
- Unequal bargaining power between access network owners and access seekers
- A history marked by regulatory gaming by participates with incentives to delay resolution of regulatory matters

The elements of the regulatory framework now provide the Commission with the ability to determine regulated services, prices, terms and conditions in a timely way. The high level of disputation that created a near paralysis in regulatory processes to resolve pricing matters under what was often referred to as the negotiate/arbitrate/litigate regulatory model has been addressed through the additional pricing determination powers granted the Commission.

These changes have created a degree of certainty in regulated pricing. They also better align regulatory tools to the incentives of market participants, particularly the bottleneck access network owners, Telstra and NBN Co.

However, it remains unequivocally the case that the Australian communications markets remain among the most distorted and unbalanced in the developed world. Telstra's dominance of industry revenue and profit is indicative of a profound and persistent lack of competition. This is reflected in too-high prices and constrained innovation.

The CCC is of the view that some the regulatory processes in the initial years of the present regime have not resulted in the decisive action warranted by this situation.

For example, the regulation of the domestic transmission service has left access seekers disappointed and at times confused for more than a decade. This service is a crucial input to all downstream services, yet the process of establishing regulated prices has repeatedly failed to establish prices at a level that replicates the prices achieved in competitive markets. Access seekers regard the prices struck under the first determination process as being well above cost and inconsistent.

Similarly, the regulation of the mobile terminating access service in the early 2000s was a welcome initiative by the Commission, however the absence of action to ensure that the reduction in wholesale prices flowed through to retail prices had the effect of allowing Telstra to enjoy windfall gains for many years. This disadvantaged end users but also seriously distorted competition due to service bundling at retail levels allowing profit and cost shifting to occur.

Disappointment with these decisions notwithstanding, the CCC does not at this point advocate wholesale changes to the regulatory arrangements to reintroduce processes to review the Commission's decisions. The present regulatory arrangements were introduced only in 2010-11.

The CCC therefore does not support fundamental changes to Part XIC, although there are diverse views in the competitive carrier community about the need for change.

There are some elements of the policy and regulatory environment that are problematic and need reconsideration because they are inconsistent with the principles and assumptions underlying the policy and regulatory regime. Below are the CCC's views on some of the elements of the regime that the framing paper draws attention to, and some elements the CCC believes should be examined as they are not consistent with the underlying premise of the policy approach.

Regular Independent Review of Industry Performance

The CCC submits that it would be helpful to the industry, regulators and policy makers for there to be a regular assessment of Australia's progress toward a market that is internationally competitive and delivering improving consumer outcomes relative to those experienced in other markets. Such a review could examine the regulatory and market developments that had occurred in the review period, and assess how they had contributed to market outcomes.

These reviews could be modelled on the Regional Telecommunications Inquiry reviews, headed by an independent panel supported by the Department of Communications. As well as undertaking a generalised assessment of the state of the telecommunications market, the review should offer an assessment of any Part XIC decisions made by the ACCC. This would allow for a more holistic assessment of the impact of the specific decisions of the ACCC.

Instituting regular benchmarking and analysis of progress against other nations would help keep all industry participants focused on the main game of improving services and provide some basis against which to assess the effectiveness of the regulatory processes.

Information Asymmetry

As discussed above, the CCC and its members were disappointed with the outcome of the first the determination process to establish a price for transmission services, believing the regulated prices settled on were substantially above Telstra's internal costs, and substantially above where prices would be in a competitive market.

One of the problems that emerged in this process was the information asymmetry between Telstra and access seekers into the claimed costs and prices for providing these services upon which the Commission based its decisions. This meant access seekers had limited scope to test the quality of the data on which the Commission was basing its proposed prices.

The Commission has sought to redress this imbalance in the early stages of its present transmission pricing inquiry, using it Record Keeping Rules powers to make more data available for analysis and comment by other parties.

However, the CCC is concerned that the RKR mechanisms themselves could result in delays as they provide generous timelines for access providers to respond. The CCC believes there is scope for these processes to be streamlined.

Appeals Processes

The removal of merits review rights on Commission decisions, other than on administrative grounds, was a consequence of a pattern of gaming by Telstra. The incentives that gave rise to this conduct remain and there is every reason to believe that this conduct would resume should the merits appeal process be restored. Having said this, the ACCC should be open to some form of qualitative review. The Independent Review suggested above would prove a useful discipline on the regime.

Non discrimination

The CCC believes it is crucial for the health of downstream retail markets that NBN Co is precluded from discriminating against downstream customers. There is the potential for some RSPs, in particular Telstra, to negotiate a different and superior set of prices, terms and conditions for access services because it has other services that it NBN Co might wish to acquire, such as transmission. While this might be commercially attractive to NBN Co, such a situation would entrench Telstra advantage in retail markets. This would be inconsistent with policy goals.

Regulatory Hierarchy

One fundamental problem relates to the hierarchy of regulatory instruments and commercial agreements. The present situation – where commercial agreements have primacy over regulatory tools and determinations – does not reflect the imbalance of market power facing access seekers acquiring services from either Telstra of NBN Co.

The CCC believes policy makers have relied too heavily on NBN Co's wholesale only, structurally separated status and not recognised that its position as a monopoly supplier of access services infers on it great market power in negotiations with RSPs. The imbalance of power in negotiations for the supply of services has already been evident in the degree of dissatisfaction RSPs have expressed in relation to NBN Co's unwillingness to compromise on several issues that its customers have raised as areas of concern in its draft supply agreements.

The CCC submits that the current hierarchy of instruments is inconsistent with the principles underlying the NBN policy. That is, the policy recognises that the national access network has bottleneck characteristics and needs to be regulated as a monopoly. This contrasts with the hierarchy, which is effectively a throw back to the negotiate/arbitrate model.

The CCC believes commercial agreements should not supplant regulatory remedies in the context of bottleneck services. Providing access seekers with the security of knowing they can seek regulatory redress encourages commercial resolutions because the party suffering a disadvantage in terms of market power knows it can seek intervention in the event that it believes it has been dealt with

unfairly. The absence of regulatory redress forces an access seeker to be extremely conservative in its approach to negotiations and would be reticent to enter into an agreement unless it had a very high level of comfort with the terms of the deal.

Consistent with the imbalance of power in the commercial negotiations between access seeker and the owners of bottleneck network owners, the CCC believes the legislative hierarchy should be:

- BROCs
- Special Access Undertakings
- Determinations
- Agreements

This preserves BROCs as a tool for the Commission to use in cases requiring urgent intervention, and preserves the ability of access seekers to seek regulatory redress in recognition of the unequal bargaining power between the parties.

Binding rules of conduct

The introduction of binding rules of conduct as an instrument into the Commission's tool kit was welcomed by the CCC. The CCC continues to be of the view that binding rules of conduct remain an important and relevant instrument that recognises the inherent power NBN Co will have as the sole ubiquitous national supplier of access services. That the tool has not to date been used – in the short time since it was introduced –should not be considered to be evidence that the instrument is not necessary as a deterrent to anti-competitive conduct, or a necessary instrument for the Commission to be able to intervene to protect competition in the event of anti-competitive conduct.

Making BROCs subject to appeal or review would be a retrograde step. BROCs are intended to be used in cases where there is a need for a swift and decisive intervention to prevent harm in a market. Part XIB competition notices were similarly intended to be used in such circumstances, but, over time, the Commission became increasingly "gun shy" about responding to Telstra's conduct by implementing Competition Notices in the face of legal disputes with Telstra about what constituted sufficient change in conduct to resolve the issue, debates that dragged on for many months.

BROCs are designed to be able to resolve matters immediately by empowering the Commission to specify unacceptable and corrective conduct. Diluting this clarity would be a retrograde step.

Ordinary Undertakings

Undertakings were intended to provide a mechanism to provide industry-wide certainty over terms of access to regulated services under the negotiate-arbitrate model which otherwise anticipated access terms would be negotiated bilaterally.

In practice, the many undertakings presented to the Commission by Telstra were almost all rejected, often included terms that the Commission had previously rejected as unreasonable.

A number of CCC members believe that the introduction of access determinations as a replacement for the negotiate/arbitrate model means the intended role of undertakings in providing industry-wide pricing is no longer required.

Access Determinations

The access determinations regime was introduced in recognition of the inability of access seekers or the regulator to resolve pricing disputes with Telstra in a timely manner. Undertakings, which had been designed as a means by which access providers could resolve pricing arrangements for declared services in a more efficient way, had proved ineffective. Rather, successive undertakings had been presented by Telstra in terms that the Commission had made clear it would not accept, having the effect of delaying the resolution of prices.

It is difficult to see how the proposal in the framing paper for reference offers as an alternative to determinations could be designed in such a way as to avoid the process becoming bogged down by gaming as occurred in the past.

Interim determinations were also designed in response to the problems of the past. They provide a mechanism whereby the Commission can provide a level of certainty for both access seekers and access providers while it reaches a final determination of prices. The CCC does not believe it is appropriate or necessary for these to be subject to procedural fairness. This would be contrary to the reasons for introducing interim determinations in the first place.

Again, the CCC detects no clamour from the industry for the introduction of a procedural fairness test on interim determinations, despite its belief that the outcome of some recent determinations processes have fallen short of the bold measures necessary to correct the gross distortions in Australian communications markets.

Retail Performance Guarantees and the Incidence of Responsibility

While the CCC believes the policy framework now recognises the reality of the market by being predicated on the access network being a bottleneck, there are some policy and regulatory elements that continue to reflect the assumption that services will be supplied to end users by integrated providers. This misalignment between the policy regarding industry structure and the regulatory tools and safeguard in place is creating difficulties for access seekers in their access terms negotiations with NBN Co.

For example, the Customer Service Guarantee is an obligation on retailers to meet certain conditions in supplying services to end users such as connection and repair times. However, RSPs are often completely reliant on NBN Co's performance to meet connection and repair deadlines before they can perform their own retail customer services functions.

NBN Co has been unwilling to provide RSPs with back-to-back performance agreements to compensate them for a failure to meet CSG deadlines. The responsibility for meeting these customer service standards should therefore be at least shared between the network owner and the retailer.

The CCC welcomes the recognition in the most recent Statement of Expectations from the Government to NBN Co that this should be a shared responsibility.

Ministerial Pricing Determinations

The CCC believes the provision for Ministerial pricing determinations is anachronistic and inconsistent with the industry's need for a consistently and independently regulated market. It is unclear when or how a Ministerial pricing decision would be needed and appropriate. The CCC would therefore support the repeal of the power.

Facilities Access and Part XIC

The CCC believes the retention of the "negotiate-arbitrate" model of price setting for access to lower functional level services listed under the Telecommunications Act is not optimal and more direct pricing through determinations would be preferable. Instances where disputes about the terms of access to facilities arise should be able to be resolved through the declaration of these facilities by the ACCC. However, this is proving an unwieldy, or at least slow, process.

Nevertheless, the difficulty does not seem to arise because the Commission does not believe it has sufficient discretion to regulator these lower level functional services under Part XIC.

The CCC would support a change in the regulatory arrangements to provide the Commission with the power to directly determine prices, terms and conditions for those facilities for which direct access is provided under Schedule 1 of the Telecommunications Act.

Application of Part XIC and Significant Market Power

A number of CCC members believe that The CCC believes the addition of an SMP test to declaration processes risks unnecessarily adding confusion to a process that is understood and about which there is no strong lobby for change. Requiring the Commission to apply a market definition in circumstance where it has accepted that there is a case for declaration would not seem to provide any obvious benefit while creating a risk that circumstances where access seekers might not have the opportunity to provide services to some end users but the resolution if this situation becomes bogged down in arguments about market definitions.