

14 November 2014

The Hon Malcolm Turnbull MP  
Minister for Communications

**By email to:** infrastructureandaccess@communications.gov.au

Dear Minister

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

The purpose of this letter is to provide the iiNet Group's response to the draft *Carrier Licence Conditions (Networks supplying Superfast Carriage Services to Residential Customers) Declaration 2014 Instrument* that was released for consultation on 14 October 2014 (**the Draft Conditions**). The Draft Conditions are accompanied by a draft regulatory impact statement for early assessment (**Draft Regulatory Impact Statement**).

The iiNet Group consists of a number of carriers (including Adam Internet Pty Ltd, Agile Pty Ltd, Chime Communications Pty Ltd, and Transact Capital Communications Pty Limited) as well as a number of carriage service providers providing services through different brands such as the iiNet, Internode, Adam Internet, Westnet and TransACT brands (for convenience referred to collectively in this letter as 'iiNet'). iiNet is Australia's second largest DSL Internet Service Provider. iiNet provides over 1.8 million broadband, telephone and IPTV services nationwide. The Draft Conditions, and the circumstances that have led to their creation, obviously have direct relevance to iiNet and its business. Accordingly, iiNet welcomes the opportunity to comment on the Draft Conditions.

iiNet strongly supports the rationale behind the Draft Conditions. In particular, iiNet agrees with the following views expressed in the Draft Regulatory Impact Statement:

- The policy objective of Parts 7 and 8 of the *Telecommunications Act 1997* (**the Anti-Cherry Picking Rules**) was to apply NBN consistent disciplines to new superfast networks (i.e. that, like the NBN, these networks should be wholesale only and open access).
- Without the level playing field that the Anti-Cherry Picking Rules is intended to create, there is likely to be harmful effects to competition.
- The Australian Competition and Consumer Commission's conclusion that TPG's FTTB network rollout is not captured by the Anti-Cherry Picking Rules gives rise to concerns that the competition objectives that the Anti-Cherry Picking Rules are intended to deliver will not be realised.

- In order to avoid potential harmful and long lasting detrimental effects on competition, action must be taken now to address the loophole in the Anti-Cherry Picking Rules that has been identified by TPG's FTTB rollout.

While iiNet supports the rationale behind the Draft Conditions, iiNet believes that the Draft Conditions do not go far enough and there is a disconnect between the competitive 'playing field' that the Anti-Cherry Picking Rules is intended to achieve and the competitive playing field that the Draft Conditions will achieve. In iiNet's view, this disconnect gives rise to serious concerns about the effectiveness of the Draft Conditions in their current form. iiNet believes that in order to ensure that the Draft Conditions will be effective, it is necessary for the Draft Conditions to deliver a competitive playing field based on wholesale only open access.

The remainder of this letter is in three parts as follows:

- Part 1 – identifies the scope of the 'mischief' that the Draft Conditions must address.
- Part 2 – explains why wholesale only open access is the most appropriate approach.
- Part 3 - provides suggested enhancements to the functional separation approach in the Draft Conditions in the event that iiNet's views in Part 2 are not accepted.

#### **Part 1 - the scope of the 'mischief' that the Draft Conditions must address**

It appears clear to iiNet that the mischief that the Draft Conditions are intended to address is opportunistic cherry picking that takes advantage of the 1km extension loophole in the Anti-Cherry Picking Rules. This cherry picking involves the re-deployment of a network to provide superfast services to residential and small business customers in circumstances where that network was previously used to provide transmission services and/or services to business and/or government customers. In light of this, it is important to ensure that the Draft Conditions do not capture 'business as usual' superfast networks.

The need to avoid capturing 'business as usual' superfast networks is clearly reflected in the Draft Conditions by the carve outs to the definition of 'designated telecommunications network' in paragraph (c) of that definition. While these carve outs do appear to capture the majority of scenarios that relate to business as usual networks, iiNet has identified one potential scenario that may not be captured as follows:

*A superfast network that was used to provide superfast services principally to residential customers was in existence prior to 1 January 2011. This network is not an HFC network.*

In this scenario, this network would not be captured by the Anti-Cherry Picking Rules. Nor would it be necessary for this network to be subject to a Ministerial Exemption. As this network would not come within any of the other carve outs in paragraph (c) of the definition of 'designated

telecommunications network', this network would be captured by the Draft Conditions. Given that this network was being used to provide superfast services principally to residential customers prior to 1 January 2011, it does not come within the mischief that the Draft Conditions are intended to address. In light of this, it appears to iiNet that, for completeness, and in order to avoid any potential unintended consequences, the Draft Conditions should contain a carve out that deals with the above scenario. iiNet believes that this issue can be easily dealt with by adding the following paragraph (c)(iii)(F) to the definition of 'designated telecommunications network':

*any fixed-line network in existence immediately before 1 January 2011 which was before that date used to supply superfast carriage services wholly or principally to residential customers.*

## **Part 2 – why wholesale only open access is the most appropriate approach**

The creation of a wholesale only NBN (with Anti-Cherry Picking Rules that were intended to deliver NBN consistent disciplines to other new superfast networks) was intended to address telecommunications market structural issues that have existed for many years.<sup>1</sup> The need to address these market structural issues arose from the chilling effect of Telstra's vertical integration on the achievement of effectively competitive retail markets in the telecommunications sector.

When consideration was given at the turn of this decade to structural reform of the telecommunications industry in order to address Telstra's vertical integration, the relative benefits of structural separation verses functional separation were explored.<sup>2</sup> In this regard, the following views of the Australian Competition and Consumer Commission are pertinent and neatly summarise the fundamental problem with functional separation (emphasis added):

*without a retail arm to which it may seek to provide an advantage, a wholesale-only operator would gain little from favouring one access seeker over another, thereby ensuring true equivalence. On the other hand, **vertical integration of any form** into downstream markets, **even when subject to regulatory measures**, will not ensure equivalence.*

The competitive playing field that the Anti-Cherry Picking Rules are intended to achieve is one based on wholesale only open access not only for NBN Co but for all *new* superfast networks.<sup>3</sup> The notion of wholesale only open access is consistent with the notion of structural separation rather than functional separation. As the Draft Regulatory Impact Statement points out, any rollout by a carrier

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<sup>1</sup> Explanatory Memorandum to the Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010, at p.2.

<sup>2</sup> By structural separation, iiNet means the legal separation of assets and activities into separate corporate entities with separate unrelated owners/shareholders – see for example Australian Competition and Consumer Commission, Submission to the Department of Broadband, Communications and the Digital Economy “National Broadband Network: Regulatory Reform for 21st Century Broadband”, June 2009, p.31.

<sup>3</sup> The emphasis has been put on the word 'new' because there has never been any suggestion that 'business as usual' networks should be subject to this requirement.

of a new vectored VDSL 2 network re-opens the competition concerns that the NBN and the structural separation of Telstra were intended to address.<sup>4</sup> Given that:

- the intention of the Draft Conditions is to close the gaps in the Anti-Cherry Picking Rules that allow the rollout of such a network; and
- the Anti-Cherry Picking Rules are based on a structural separation model,

it is difficult to understand why a model based on functional separation is seen as an appropriate outcome, even in the short term.

iiNet notes that the Draft Regulatory Impact Statement does consider making changes that would lead to the Anti-Cherry Picking Rules being applied as intended (i.e. there would be a wholesale only requirement rather than a requirement for functional separation).<sup>5</sup> However, the Draft Regulatory Impact Statement sets out a number of perceived disadvantages arising from this approach. iiNet respectfully submits that these disadvantages are more apparent than real and they do not provide a justification for an inconsistent approach between the requirements of the Anti-Cherry Picking Rules and the requirements of the Draft Conditions. The reasons for this conclusion are set out in the table below.

Disadvantage as stated in Draft Regulatory Impact Statement	iiNet response
<p><i>"If carriers do not currently operate on a wholesale-only basis, option 3 would mean that they would have to structurally separate their operations in order to supply superfast carriage services to residential and small business customers. Carriers could face significant costs in divesting assets or business units, especially if the market were to take the view that any divestment was forced and therefore had the character of a fire sale. That said, the option provides a suitably long lead time (1 January 2017) for companies to adjust their operations."</i></p>	<p>At the outset it is important to note that the Draft Conditions only apply to 'designated telecommunications networks' that are used to supply services to residential customers.<sup>6</sup> The Draft Conditions do not impose any obligations in respect of:</p> <ul style="list-style-type: none"> <li>- any other networks that a specified carrier may own or operate that are not 'designated telecommunications networks'; or</li> <li>- any designated telecommunications networks that are not used to supply services to residential customers.</li> </ul>
<p><i>"Separation costs could be significant. These would include establishing separate business, operational and IT systems, separating staff members and assets between the different businesses, negotiating supply contracts between the two businesses, establishing a new compliance regime to ensure that functions remain separate and establishing a new reporting framework."</i></p>	<p>This means that it may not be necessary for the specified carrier to structurally separate at all – i.e. subject to making some minor drafting changes to the Draft Conditions, the specified carrier could continue to provide retail services in respect of large business and government customers and provide wholesale services which allow other, non-related, carriage service providers to provide services to residential</p>

<sup>4</sup> Draft Regulatory Impact Statement, at p.5.

<sup>5</sup> Ibid, at p.14 (considered as 'option 3').

<sup>6</sup> Draft Conditions, clause 5.

Disadvantage as stated in Draft Regulatory Impact Statement	iiNet response
	and small business customers.
<p><i>"To the extent that a requirement to operate on wholesale-only and non-discriminatory basis encourages carriers not to roll out networks in competition with NBN Co, this would deter carriers from seeking to roll out vectored VDSL2 networks before NBN Co (or as an alternative to NBN Co, for example in new developments). As a result, some end-users may not receive the benefits of high-speed broadband as quickly as otherwise (for example, because their premises are further down NBN Co's schedule)."</i></p>	<p>This disadvantage has broader relevance than to just the Draft Conditions. This disadvantage also applies to the Anti-Cherry Picking Rules themselves. Given that the Government has identified an immediate need to close the gaps in the Anti-Cherry Picking Rules, this disadvantage should not prevent an approach based on structural separation.</p>
<p><i>"Legislation can take a long time to pass through the Parliament and there can be no certainty for industry about future regulatory arrangements until it sees the final form of the legislation. The option therefore does not provide short-term certainty for industry."</i></p>	<p>An amendment to the legislation is not required. A carrier licencing condition can achieve the same outcome.</p>
<p><i>"The option does not address coordination problems caused by wholesale-only operators being cut off from end-users' needs, though as noted above this issue can be addressed through consultation and contractual mechanisms."</i></p>	<p>iiNet notes that there is a suggested solution to this disadvantage stated as part of its articulation. Furthermore, there would be similar issues raised by an NBN Co rollout. Therefore, this issue is clearly not insurmountable.</p>

Given that:

- a wholesale only NBN is intended to address long standing structural issues that have detrimental impacts on competition in the telecommunications sector;
- the policy objective of the Anti-Cherry Picking Rules is to apply NBN consistent disciplines to new superfast networks (i.e. that, like the NBN, these networks should be wholesale only and open access);
- any rollout by a carrier of a new vectored VDSL 2 network re-opens the competition concerns that the NBN and the structural separation of Telstra were intended to address;
- the intention of the Draft Conditions is to close the gaps in the Anti-Cherry Picking Rules that allow the rollout of such a network referred to in the previous bullet point; and
- as demonstrated in the table above, the perceived dis-advantages of adopting a structural separation model in the Draft Conditions (so as to be consistent with the intended outcomes from the Anti-Cherry Picking Rules) are more apparent than real,

iiNet believes that there is a compelling case to base the Draft Conditions on a structural separation model. However, as pointed out in the table above, this need not require actual structural separation provided that the specified carrier is willing to forego retail supply to residential and small business customers (crucially, this requirement must also apply to associates<sup>7</sup> of the specified carrier). This can be achieved relatively simply by replacing clause 6 of the Draft Conditions with the following:

*(1) The specified carrier must not use, or permit any of its associates to use, any local access line forming part of the designated telecommunications network to supply a carriage service except to:*

- (a) a carrier or carriage service provider;*
- (b) a large business retail customer; or*
- (c) a public body.*

*(2) If the Specified carrier supplies a ['specified wholesale service'<sup>8</sup>] the specified carrier must at all times during which the specified carrier supplies a specified wholesale service:*

- (a) offer to supply, upon reasonable request by another carrier or carriage service provider, a Layer 2 Wholesale Service using the designated telecommunications network at a price of not be more than \$27 on a per port per month basis;*
- (b) not discriminate between carriers and carriage service providers in relation to:*
  - (i) the supply of a specified wholesale service including without limitation in respect of:*
    - (A) applicable price terms and non-price terms;*
    - (B) applicable systems, processes and procedures; and*
    - (C) carrying out any activity that relates to the supply of the service, including without limitation, activities that relate to service provisioning and fault rectification; or*
  - (ii) carrying on any of the following activities:*
    - (A) enhancing a specified wholesale service;*
    - (B) an activity that is preparatory to the supply of a specified wholesale service;*
    - (C) an activity that is incidental to the supply of a specified wholesale service; and*
    - (D) giving information to carriers and carriage service providers about any of the above activities.*

### **Part 3 - Enhancements to the Draft Conditions**

As stated in part 2 above, iiNet believes that there is a compelling case to base the Draft Conditions on a structural separation model. However, if, notwithstanding the arguments made in part 2 above, the Minister decides to adopt an approach based on functional separation, iiNet would suggest the changes outlined below.

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<sup>7</sup> As defined in section 152 of the Telecommunications Act 1997.

<sup>8</sup> iiNet suggests the following definition: *a wholesale carriage service that is used by a carrier or carriage service provider to supply carriage services to residential or small business customers.*

Functional separation is not an end in itself and it only has utility to the extent that it ensures that the network owner does not favour its own retail operations. Although the Draft Conditions include all of the basic aspects of functional separation, iiNet believes that some enhancements are required in order to ensure that the Draft Conditions have the intended effect. iiNet suggests the following enhancements:<sup>9</sup>

- The requirement not to discriminate is crucial to the efficacy of the Draft Conditions. The obligation not to discriminate has two aspects. The first aspect is to ensure that there is no discrimination as regards applicable terms and processes. The second aspect of non-discrimination is to ensure that the relevant terms and processes are implemented in a non-discriminatory manner. For example, the wholesale company could adopt a process that involves connecting a service in no more than five business days. This process could be stated to apply to both the retail company and wholesale customers. However, the wholesale company could, in practice, connect retail company services faster than wholesale customer services (e.g. connect retail company services within two business days). Although it is arguable that paragraph 6(2)(i)(A) of the Draft Conditions is broad enough to deal with both of these aspect of discrimination, iiNet believes that this should be made explicit. iiNet suggests that paragraph 6(2)(i)(A) be replaced with the following:

*'in favour of the retail company in relation to the supply of an eligible service including without limitation in respect of:*  
*(i) applicable price terms and non-price terms;*  
*(ii) applicable systems, processes and procedures; and*  
*(iii) carrying out any activity that relates to the supply of the service, including without limitation, activities that relate to service provisioning and fault rectification.'*

- The wholesale company should have an obligation to monitor and report on its compliance with the Draft Conditions. Such a requirement will encourage compliance.
- The wholesale company should be required to develop and publish complaint handling processes for dealing with complaints by wholesale customers that allege discrimination by the wholesale Company. Again, this will encourage compliance.
- The Draft Conditions should not have an expiry date. iiNet believes it is safer to revoke the Draft Conditions when they are clearly no longer required rather than set a date for expiry in circumstances where future long term arrangements are currently very unclear. In this regard it is worth noting that not only must the ACCC conduct a public inquiry into whether a superfast broadband access service should be declared, but, in addition, if the ACCC decides

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<sup>9</sup> Please note that the requirements specified in the second to fourth dot points in this list are intended to also apply to a wholesale only structural separation model if one is adopted (see part 2 of this letter as regards the justification for a wholesale only structural separation model).

that such a service should be declared, it must then conduct another public inquiry into the terms of a final access determination for that service.

Although not something to be included in the Draft Conditions instrument, iiNet believes that there should be a commitment by the Department of Communications to review the Draft Conditions after six months with a view to ascertaining whether they are meeting their objectives.

In addition to the above points of substance, iiNet has identified the following minor drafting issue:

- Clause 6(4) of the Draft Conditions requires that the price offered for the supply of the Layer 2 Wholesale Service must not be more than \$27 on a per port basis. This should specify that this is a monthly charge.

iiNet is happy to discuss the issues raised in this letter further, or the Draft Conditions more generally, with you and/or the Department of Communications if required.

Yours faithfully



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