

REGULATING IN TECHNOLOGY RICH ENVIRONMENTS



DIRECTIONS FOR REFORM OF
PART XIC OF THE TRADE PRACTICES ACT

TASK FORCE REPORT

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The Task Force on Regulating in
Technology Rich Environments
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on Regulatory Affairs 2008:
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BACKGROUND

The Task Force on Regulating in Technology Rich Environments is a group of senior business executives, government officials and academics, established by Global Access Partners (GAP) in 2008 to address issues and challenges in the current regulatory regime. The task force hopes to fill the policy vacuum which seems to exist at the moment in the area of telecommunications regulation.

Australia's telecommunications network suffers from a chronic lack of investment, leaving Australia disadvantaged in the modern information economy. An overbearing regulatory framework has deterred the necessary investment, focusing on the distribution of wealth in the current network, rather than fostering the creation of wealth and new assets. The regulatory framework requires fundamental reform. Evidence from other regulatory frameworks, such as energy, shows the benefits of separating powers between bodies tasked with setting policy, framing rules and implementing them in practice. Furthermore, the process should be subject to an independent system of review.

At their three meetings held in February, May and July 2008 in Sydney and Melbourne, the Task Force discussed the need to embrace reform, and a policy paper "*Directions for Reform of Part XIC of the Trade Practices Act 1997*" (see pages 4-21) was put forward as a possible framework for moving the process forward. It was agreed reform should encourage more and better competition and innovation, as well as much needed increased investment in the telecommunications sector. It was argued that good policy provision should be based on strong principles rather than horse trading between vested interests, the process which produced the poor policy outcomes currently bedeviling the sector.

The 'Second Track' process (see page 22) in general, and the work of this Task Force in particular, offer hope for a solution to the current impasse.

The findings of the Task Force were presented at the *GAP Congress on Regulatory Affairs: "Opportunities for Business"*, held in Parliament House of Victoria in Melbourne in September 2008.

It is understood that the success of the Task Force will be measured by the passing of regulatory reform.

GAP acknowledges the assistance of Telstra and Concept Economics in the drafting of this report. Sections of this report draw on a more extended discussion in Henry Ergas' book *Wrong Number* (Allen & Unwin, Sydney, 2008).

DISCLAIMER: This proposal represents a range of views and interests of the individuals and organisations participating in the Task Force. They are personal opinions that do not necessarily reflect those of the organisers and sponsors of the GAP Congress on Regulatory Affairs.

EXECUTIVE SUMMARY

Part XIC of the *Trade Practices Act* (third party access in telecommunications) is largely responsible for the lack of significant investment in fixed broadband infrastructure in Australia over the last decade.

- ▶ **It has remained static while the industry has been transformed since 1997. It has been subject to one review, which was largely ignored by government.**
- ▶ **It discourages capital investment in new infrastructure while encouraging those who wait for others to invest**
- ▶ **It fails to recognise the new LAMS regulatory paradigm – regulation is now set by a combination of laws; architecture; markets and societal norms.**

Telecommunications is a sector marked by rapid technological change. Australia has reached a tipping point where investment in next generation fixed networks must be the number one objective.

To encourage investment and innovation, regulation should be minimised and should deliver timely and efficient outcomes. Instead, business decisions in relation to telecommunications investment are being driven by their regulatory implications.

Part XIC vests excessive discretion in the regulator in terms of what is regulated and how it is regulated. It does not accord with the principles of regulatory best-practice.

There should be clear separation of the tasks of setting policy; converting policy into rules and implementing those rules – all currently done by the Australian Competition & Consumer Commission (ACCC). This reform has been done effectively in other sectors (e.g. energy) and should also occur in telecommunications.

There should be greater guidance on the scope of third party access, the criteria that must be met and improvements in the mechanisms for determining access:

- ▶ **Separate the task of recommending declaration from the task of determining the terms of declaration**
- ▶ **Merits review of declaration decisions**
- ▶ **Limit declarations to situations where services meet all of a range of hurdles**
- ▶ **Revocation where the hurdles are no longer met**

There should be pricing principles which the ACCC must consider in determining the terms and conditions of access. At very least, regulated prices should be sufficient to allow the access provider to recover efficiently incurred costs:

- ▶ **Plus an overarching duty to promote efficient investment and provide incentives for innovation and timely availability of services**

The Part XIC Undertakings regime has failed in its objective of providing industry certainty. The lack of clear principles puts the onus all on the submitter of the undertaking. The lack of any merits review of arbitrations provides an incentive to reject Undertakings:

- ▶ **Undertakings should be deemed reasonable and accepted if they are consistent with the pricing principles**
- ▶ **There should be merits review of arbitrations**
- ▶ **The flaws in the upfront Undertakings and Exemptions provisions need to be addressed**
- ▶ **The ACCC and the Australian Competition Tribunal (ACT) should provide guidance as to the reasons for their decisions what they would regard as “reasonable” and how any failings could be rectified**

These reforms will maintain a strong, fail-safe to prevent and clamp down on anti-competitive behaviour. They do not advocate the removal of the telecommunications specific Part XIB of the *Trade Practices Act*, which imposes stricter, additional safeguards against anti-competitive behaviour than the generic, economy-wide TPA provisions. Nor do they reduce the equivalence and transparency requirements in the operational separation regime. They simply seek to align a future telecommunications regime with evolutionary developments in the national access regime under Part IIIA of the *Trade Practices Act* and other linked regimes applying to similar key economic infrastructure.

These reasonable reforms would encourage capital investment, reduce unnecessary regulatory risk and intrusion and provide for more timely and efficient outcomes – but not undermine the ability to regulate third party access to bona fide bottleneck services.

DIRECTIONS FOR REFORM OF PART XIC OF THE TRADE PRACTICES ACT 1997

Introduction

1. It is widely accepted that the current telecommunications third party access regime has failed to deliver. That regime has resulted in competition largely based on the resale of Telstra's network and services, rather than the development of new networks and services, and hence has become ever more dependent on perpetuating access regulation rather than producing sustainable commercial outcomes. At the same time, potential investors – including Telstra and its competitors – have effectively refused to devote capital to any significant upgrading of the existing network for so long as the current regime remains in place. As a result, the transition to a National Broadband Network (NBN) – or more generally to genuine high speed broadband – has been delayed while the existing fixed network is showing ever-increasing signs of age and is not capable of meeting the needs of Australia's economy and society.

The high-speed broadband investment imperative

2. There is no doubt that we have reached a tipping point where investment in next generation networks that will enable high-speed broadband must be the critical objective of the telecommunications regulatory regime. This investment is central to Australia's future economic prosperity and social cohesion as it will:
 - a. Central in ensuring that Australia remains internationally competitive with other economies that are rolling out this productivity-boosting infrastructure
 - b. Help enable small businesses to compete on a technology level playing field with larger businesses
 - c. Overcome the distance disadvantage traditionally faced by businesses and other organisation based in or operating from regional Australia
 - d. Cut down on unnecessary travel and facilitate the effective monitoring and management of energy and scarce water resources to the overall betterment of the natural environment
 - e. Provide significantly more equitable access to educational materials and opportunities, particularly for people in regional areas
 - f. Facilitate the delivery of world-class health and aged care services.

3. We have reached this tipping point not only because of the transforming benefits of high-speed broadband infrastructure but also because of the fact that, without this infrastructure, Australia risks falling behind its major international competitors in Asia, Europe and North America who are already deploying and utilising this infrastructure. In the highly competitive globalised economy, developed nations are constantly striving to achieve a strategic “first mover” advantage and those that are left behind will find it increasingly difficult to regain lost-ground. Nowhere is this more the case than in relation to an enabling and transforming technology like high-speed broadband.

A massive capital investment is required

4. The capital expenditure required to deliver the benefits of truly ubiquitous high-speed broadband is massive and carries a significant level of investment risk. It will literally cost many billions of dollars to provide high-speed broadband nationally and the commercial success of this investment will depend upon convincing existing users, most of whom already have access to “best endeavours” broadband, of the benefits of upgrading to higher speeds. Additionally, any high-speed broadband network will need to compete head-to-head with other existing broadband solutions and also face the prospect that future technological innovations may render the network outdated, thereby requiring significant further additional capital outlay (or even stranding).
5. The imperative of this massive capital investment in high-speed broadband infrastructure comes at a time of increased economic uncertainty and a reduced willingness of the market to swallow capital risk. It also follows a decade during which there have been sub-standard levels of capital investment in major telecommunications infrastructure¹ (see Appendix), increasing the urgency of new investment and the hesitancy of the sector to make that investment. This paper argues strongly that the regulatory regime is largely responsible for this dearth of investment. Regardless of whether one agrees or not with this thesis, it is abundantly clear that it is now critical that the regulatory regime and its processes going forward must encourage and facilitate, rather than discourage and penalise, investment in critical telecommunications infrastructure. In particular, the regulatory regime must provide certainty and timely outcomes as well as realistically factoring in the risks entailed in making such massive investments.

¹ The ACCC and others have claimed there has been significant recent capital investment in telecommunications. It is clear that this investment has occurred overwhelmingly in the much less regulated mobiles sector and as a result of direct government funding subsidies. The lack of any investment in a National Broadband Network or upgrade of the Optus HFC network are clear demonstrators of the lack of significant investment in the regulated fixed network sector. Additionally, there is clear evidence that over the longer term, there have been sub-standard levels of Capital Expenditure in the Communications sector since 1997.

Infrastructure – a Government priority

6. The Australian Government has made investment in national infrastructure one of its highest policy priorities. The Government has demonstrated this commitment through the establishment of Infrastructure Australia and the unprecedented commitment of \$20billion to the Building Australia Fund. The Australian Government has also recognised the importance to business of reducing unnecessary regulation and red-tape. The reforms outlined in this paper are aligned with the Government's policy priorities. Critically, these reforms will actively encourage investment in critical high-speed broadband infrastructure and ongoing investment by the telecommunications sector. They will also facilitate more transparent, efficient and timely outcomes with a higher level of certainty for the telecommunications sector. Additionally, they will encourage innovation, risk-taking and an entrepreneurial culture, all of which are vital ingredients of a competitive, productive forward-looking modern economy.

Pro-investment regulation with a safety net

7. The reforms in this paper are not radical or unprecedented. They are unashamedly pro-investment, not only because investment is the number one priority for the sector but is the only sustainable means of delivering real long-term competition that is based on innovation and differentiation in customer products, services, offerings and prices in the market-place. As such, they will lead to more rather than less competition, driven by a combination of the new opportunities arising from an "open access" next generation network as well as the increased emphasis on encouraging and rewarding investment and innovation.
8. Other sectors of the economy, such as the energy sector, have benefited from similar reforms to their competition regimes as those being advocated in this paper. As has occurred in the energy sector, the proposed reforms would enhance accountability by introducing greater clarity in terms of policies and rules and who should have responsibility for setting, implementing and enforcing them. The separation of the functions of policy setting, rule-making, price setting and enforcement is in accordance with regulatory best practice outlined in the Hilmer Competition Reforms of the early 1990s.

9. The reforms will ensure that government policy makers, including those in the key economic portfolios, maintain primary responsibility for setting underlying competition policies for the sector with price-setting and enforcement appropriately being retained with the regulator. Finally, a primary objective of the reforms is to resolve the longstanding controversy, discontent and constant regulatory gaming that has been the hallmark of the telecommunications access regime over the last decade.
10. Importantly, the proposed reforms will maintain a strong, fail-safe to prevent and clamp down on anti-competitive behaviour. At a time when investment is the critical objective, it is vital to encourage and provide regulatory certainty to infrastructure investors. It is also important that infrastructure providers provide “open access” where bottlenecks exist and that there are rules in place to identify and punish anti-competitive behaviour. These reforms do not advocate the removal of the telecommunications specific Part XIB of the *Trade Practices Act*, which imposes stricter, additional safeguards against anti-competitive behaviour than the generic, economy-wide provisions. Nor do they reduce the equivalence and transparency requirements entailed in the current operational separation regime. Rather, they seek to align the telecommunications access regime with evolutionary developments in the national access regime and other linked access regimes applying to key economic infrastructure.

The problem

11. The current problems with Part XIC are not mere faults of implementation, but rather reflect underlying problems in the design of the regime. Part XIC was included in the *Trade Practices Act* in 1997, at a time when there were relatively few telecommunications infrastructure options; a small number of players in the market; high end-use prices and broadband did not exist. Over ten years later, there are a multiplicity of ways in which telecommunications services can be delivered over a wide range of networks; prices have been significantly reduced; there is a much larger number of players in the market; and the need to invest in infrastructure to provide high-speed broadband has become a first order priority.

A regime that is out-of-date

12. So while the market conditions and available technologies have all markedly changed, the accompanying regulatory regime has remained static. In more than a decade, the regime has only been subject to one serious review, which was conducted by the Productivity Commission in 2001. Its 700 page report and recommendations were largely ignored and in some cases contradicted in the then Government's response. Seven years later there has been a complete lack of data or analysis to assess the extent to which Part XIC conforms to world's-best practice by encouraging investment, promoting healthy industry outcomes and protecting consumers.
13. Even if Part XIC was relevant in 1997, it is indisputable that it is now totally outdated. It is totally unsuited to the telecommunications sector and the markets that it seeks to regulate. It certainly does not meet the test that has been set by the Minister for Finance and Deregulation of "continuous regulatory improvement and reform."
14. Telecommunications is a sector where rapid technological change necessitates high levels of infrastructure investment but Part XIC actively discourages investment both by incumbents and new entrants. The combination of technological change and the wider enabling benefits of telecommunications services make it highly desirable to have efficient regulatory processes and timely outcomes. Part XIC has proven itself incapable of delivering on either of these objectives. It is also widely accepted that industries which are characterised by high levels of innovation and rapid change are more likely to flourish under 'light touch' regulatory regimes with a bias toward market-based outcomes. However, Part XIC encourages regulated, price-based competition and, more and more, is seen by the regulator and market participants as a preferred substitute to the market. This bent away from market-based competition is directly attributable to the virtually unparalleled concentration of power and level of discretion that rests with the regulator under Part XIC.
15. Part XIC is also completely blind to the new-world regulatory paradigms. New-world regulatory paradigms and reform can be summarised as LAMS: Laws and formal regulation, which are imposed by the Government; Architecture, in the form of embedded code; Markets, which considers the consumer, capital and technology; and Societal norms, what people expect, demand and normative mindsets. Regulatory reform needs to account for the architecture, markets and social norms, not just the laws and the legacy regulations.

16. Major elements of the telecommunications regime have also remained relatively static since its inception compared to developments in other industry-specific access regimes. This increasingly means the regime is falling behind best-practice regulatory developments in access regimes covering infrastructure with lower levels of technological change and more predictable investment needs, such as gas and electricity networks. For example, electricity and gas infrastructure access regimes developed at the same time as Part XIC have undergone a number of extensive and detailed reviews, and already include features highlighted as essential throughout this report.
17. This separation between other access regimes and Part XIC is a fundamental problem with the telecommunications regime. It means Part XIC operates outside of the largely consistent and evolving access framework of the national access regime under Part IIIA of the *Trade Practices Act*, and closely linked industry specific regimes such as electricity and gas regimes designed to be approved under Part IIIA processes. This isolates the regime and means it has failed to develop in response to improvements implemented to regimes linked to Part IIIA.
18. The inherent flaws in Part XIC continue to result in a lack of investment, even where competing carriers have built their own alternative networks (e.g. Optus HFC, TransACT). In a sector which should be characterised by innovation and competition driven by investment in new technologies, there is a distinct lack of risk-taking and an entrenched reliance on regulatory outcomes. Business decisions are regularly decided on the basis of their regulatory benefits and impacts, rather than on normal commercial grounds. The regime is beset by conflict, long-running disputes, gaming and inefficiencies. All of these undesirable outcomes are the hallmarks of a regulatory regime that is over-reaching and stifling the market that it is attempting to regulate.

Excessive discretion

19. Central to these entrenched problems is the excessive discretion vested in the regulator both in terms of what is regulated and how it is regulated. That discretion arises from a system that centralises power in the regulator, while setting few boundaries on how that power is exercised. The effect is to encourage as wide as possible use of regulatory instruments thereby increasing regulatory risk, while inviting conflict between the regulator and the access provider, as well as between the access provider and access seekers. These effects constantly threaten to overload the regulatory institution and completely undermine the stated premise for the regime, which is to prioritise commercially negotiated outcomes.
20. There are two fundamental changes to the design of the regulatory regime that are required to better meet Australia's needs.

Best practice differentiation of roles

21. The first fundamental change is to more clearly differentiate the three tasks of setting policy; converting policy into rules; and implementing those rules on an ongoing basis – tasks which currently are conflated in the functions of the ACCC. The second fundamental change is to set clearer statutory guidance around the way in which each of those functions is undertaken, including the criteria that must be met and the mechanisms for ensuring accountability.
22. With respect to the first of these changes, the importance of having a “separation of powers” has been increasingly and widely recognised since the Hilmer report in the early 1990s and has been incorporated into other regulatory regimes, but not the telecommunications regime.

The energy sector is a guidepost

23. There is much to be learnt in this regard for the telecommunications regime from the process of reform in energy markets. In the late 1990s and early years of this decade, it became clear that the boundaries between the task of setting energy policy and that of regulating energy supply had become blurred, as regulators made policy by default and – in some instances – “on the run”. It also became clear that attracting the investment that the energy industries required would be difficult for so long as there was substantial regulatory risk. As a result, Commonwealth, State and Territory governments agreed to a process which resulted in a three-fold division of functions between the Ministerial Council on Energy (MCE), the Australian Energy Markets Commission (AEMC) and the Australian Energy Regulator (AER).
24. The MCE was established by the Council of Australian Governments (COAG) in 2001 to deliver the economic and environmental benefits for Australia from implementation of the COAG national energy policy framework. It comprises Ministers with responsibility for energy from the Federal Government and all States and Territories, and is the national policy and governance body for the Australian energy market, including for electricity and gas, as outlined in the COAG Australian Energy Market Agreement (AEMA) of 30 June 2004. It holds primary responsibility for setting policy for energy markets, and hence clearly removes that policy responsibility from the remit of regulators.

25. Having secured and clarified the location of the policy role, the MCE has continued to remove from the regulators the responsibility for setting the rules under which they regulate. Specifically, COAG, operating through the MCE, established the Australian Energy Market Commission (AEMC) in July 2005 to be the rule-maker for national energy markets under the Australian Energy Market Commission Establishment Act 2004 (South Australia).
26. The MCE also established the Australian Energy Regulator (AER) as a constituent part of the ACCC. It was established under Part IIIA of the TPA 1974 after an amendment through the *Trade Practices Amendment (Australian Energy Market) Act 2004* and operates as a separate legal entity. The AER implements the rules that are made by the AEMC, and its powers are intended to be limited to that "rule implementation" role.
27. In short, in the energy industries, the functions of policy-making, rule-setting and then regulatory implementation have been clearly differentiated by the reforms, with the regulator's role being confined to that of putting in practice the rules that are defined by the AEMC (itself acting within the policy framework established by the MCE).

The benefits for the telco sector

28. There are strong reasons for implementing a similar structure in telecommunications, although there is probably not a need to establish a completely new institution to develop access pricing rules as this role could be undertaken by an existing body such as the Productivity Commission. A clear differentiation between the various functions involved in the regulation of telecommunications would enhance transparency – as the policy settings and the rules would be more clearly spelt out – and predictability, thereby reducing regulatory risk. It would reduce the level of disputation and the opportunity for regulatory gaming and over-reliance on regulatory outcomes rather than market-based competition. It would also make the regulator more accountable, as the regulatory system would have to operate under clearly specified rules. If anything, it is even more important to secure such clarity, predictability and accountability in telecommunications – where rapidly changing technology creates great risks for investors, but also has the potential to enormously enrich our economic and social life – than in the relatively mature energy industries.

Clearer criteria and rules

29. The differentiation of functions and responsibilities needs to be accompanied by a greater guidance, within the statutory regime, on the scope of third party access and the obligations it involves, along with improvements in the mechanisms by which those issues are determined. Again, these enhancements which are recognised and utilised in other regimes, would reduce regulatory risk; increase the overall efficiency of the regime in producing timely outcomes; and reduce the opportunities for gaming the system – all of which are likely to help lead to increased investment and better outcomes for consumers.
30. Under the regime as it now stands, the decision to impose third party access on a service can be taken administratively by the regulator, and is not subject to rights of review on merits. The criteria guiding that decision are vague, and can be traded off against each other. There is a marked contrast between these arrangements and those in the national third party access regime (provided for in Part IIIA of the Trade Practices Act), which (a) separate the task of recommending declaration from that of determining it; (b) provide for review on the merits of declaration decisions; and (c) limit declaration to situations where a service meets all of a range of hurdles. It would be highly desirable to secure greater uniformity between the telecommunications arrangements and those in Part IIIA in terms of the mechanisms and criteria used for determining the scope and obligations of third party access.

Clear hurdles for declaration

31. This would involve specifying clear hurdles for declaration and making declaration decisions subject to full merits review. At the same time, the mechanism for revoking declarations should be strengthened. In particular, there should be a requirement that a declaration be revoked unless the decision-maker is affirmatively satisfied that all of the hurdles that would need to be met for original declaration continue to be met. This is in line with the Government's stated direction in terms of requiring accountability for the ongoing maintenance of regulation and removing unnecessary and outdated regulations. It requires a deregulatory mind-set and, hence, is best undertaken by a decision maker separate from the regulator and whose remit is not dependent on continuing declaration of services.

Clear price-setting rules

32. As regards the obligations that flow from declaration, the current regime is especially vague with respect to the manner in which access prices should be determined. While it lists a range of factors that must be taken into account in assessing whether proposed prices are 'reasonable', it does not prevent trade-offs from being made between those factors. At the same time, it provides no guidance as to the basis on which trade-offs should be made, nor does it limit their scope. Here too there is a marked contrast between the telecommunications regime and the regimes that apply to other industries, which again leads to uncertainty, risk, disputation, gaming and weakened investment incentives.
33. Part IIIA was amended in 2006 to include 'pricing principles' which the ACCC must consider in determining the terms and conditions of access. These principles require that the regulated price be set at a sufficient level to cover the efficient costs of providing access, including a return commensurate with regulatory and commercial risk. Additionally, the pricing principles allow for multi-part tariffs and price discrimination where such a pricing structure is efficient. There are no such principles in the telecommunications regime, nor is there an explicit requirement that regulated prices be sufficient to allow the access provider to recover efficiently incurred costs. The inclusion of such a requirement alone would send a very clear signal in terms of encouraging investment and reducing regulatory risk.
34. The regimes applied to the energy industries are even more specific, and prescribe the approach to be taken by the regulator in assessing costs. These prescriptions include the methods to be used to determine depreciation and the cost of capital, as well as the valuation of existing and new assets (all of which are issues that have beset the telecommunications regulatory regime over the last decade).
35. There is nothing in the structure or nature of telecommunications, or of telecommunications regulation, that would impede the development of clearly set out principles and methods for access pricing. Experience in the energy industries demonstrates that specifying such principles and methods in an appropriate mixture of legislation, codes and rules that cannot be changed by the access regulator reduces regulatory uncertainty and increases the overall efficiency of regulation.
36. Central among these principles must be a requirement that regulated prices be set in a manner consistent with full recovery of costs efficiently incurred. Additionally, methods of determining those costs must be specified, so that all market participants can confidently predict how costs will be assessed. Finally, as part of the wider exercise of cost determination, the cost of capital must be determined in a manner consistent with commercial and regulatory risk.

Explicit investment objective

37. Specifying principles and methods for setting the terms and conditions of access can help reduce, but will not eliminate, regulatory discretion and the resulting regulatory risk. So as to guide the regulator in the exercise of that discretion, there should be a clearly specified, over-arching duty for the regulator to act in a manner that will promote efficient investment and provide incentives for innovation and the efficient, timely and reliable availability of services. The widely recognised need for multi-billion investment in the telecommunications infrastructure that will underpin Australia's high-speed broadband future makes statutory recognition of these principles essential.
38. These improvements in the guidance provided to regulators need to be accompanied by changes aimed at improving the regulatory process.

Encourage industry-wide undertakings

39. An important part of the 'architecture' of the access regimes that came out of the Hilmer reforms was the scope for access providers to submit 'Undertakings' which, once accepted, would set the terms and conditions of third party access. This mechanism was intended to provide regulatory certainty to all market participants, and to reduce the burden on regulatory institutions by avoiding disputes, or simplifying their resolution. Although the terms used differ somewhat from regime to regime, all of the main Australian access regimes allow access providers to provide a commitment of this type.
40. There can be little doubt that the telecommunications Undertaking regime has failed in its objectives. Thus, very few Undertakings have been accepted under Part XIC. Moreover, of the five that have been accepted, one merely copied the indicative prices issued by the ACCC immediately prior to the Undertaking being lodged, another had very short duration (and was accepted on the basis of that fact) and two others subsequently failed on appeal. It is worth emphasising that it is not only Undertakings submitted by Telstra that have been rejected: so have those submitted by SingTel Optus and by Vodafone.
41. Two factors explain the failure of the Undertaking mechanism provided for in Part XIC.

Excessive discretion and a lack of clarity....again

42. First, Part XIC lacks any clear pricing principles and provides no guidance in any form as to how crucial elements of cost are to be determined. Rather, it sets out a range of very general factors the ACCC must consider, without specifying how those factors are to be weighted, and then requires the ACCC to be satisfied that certain broad tests are met before accepting an Undertaking.
43. This places the burden entirely on the submitter of the undertaking to satisfy the regulator (in the first instance the ACCC, and in the event of a subsequent appeal on the merits, the Australian Competition Tribunal) but there is very little, if anything, that constrains the regulator's determination as to whether or not it is satisfied. Moreover, if the regulator is not so satisfied, there is little that requires it to reach that view relying – as it would have to under, say, the Gas Code – on well-established principles and reasoning. Rather, it suffices that the regulator, in weighting the various factors, has decided that it has not been satisfied that the statutory tests have been met. As a result, the regulator has far more scope to reject Undertakings than would be the case under the energy regimes and has no obligation to say how a particular Undertaking would have to be varied in order for it to be accepted (unlike the Gas Code).

Misplaced incentives

44. Second, the structure of the regime provides incentives for the regulator to reject Undertakings. The telecommunications regime is unique in allowing merits review of decisions with respect to Undertakings but not allowing merits review of arbitration decisions taken by the regulator when an Undertaking is not in place. As a result, for so long as there is no valid Undertaking in place, the regulator's discretion in deciding arbitrations is effectively unlimited, at least as far as the substance of the decisions is concerned. In contrast, once an Undertaking is accepted, any access arbitration relating to the service covered by that Undertaking must be determined in a manner consistent with that Undertaking. This creates the potential for "moral hazard", as the regulator's powers are protected if not enhanced by rejecting proposed Undertakings.

Specificity to enable outcomes

45. Providing greater specificity as to the rules to be implemented in assessing access charges would in itself improve the efficacy of the Undertaking mechanism. This is because it would allow access providers to know the approach to be used in developing proposed access charges and would limit the ability of the regulator to successfully reject Undertakings consistent with the specified rules, methods and approaches. Importantly, it would recognise the desirability that an Undertaking regime provides certainty to the affected parties in a timely manner and provide clear direction to those who submit Undertakings about the commitments they could reasonably expect to make. For example, there is a strong argument that an Undertaking should be deemed as reasonable and must be accepted by the regulator if it is consistent with the pricing principles that have been laid down.

Pre-investment regulatory certainty

46. It is also clear that the provisions that were inserted in Part XIC of the TPA supposedly to provide upfront regulatory certainty to would-be investors have not been effective. There are a number of flaws in the Special Access Undertaking and Anticipatory Access Exemption provisions that make it very difficult to achieve the level of upfront regulatory certainty that is required by a commercial investor contemplating a very significant telecommunications infrastructure project. These flaws need to be addressed in any review of the current regulatory regime.

Effective merits review

47. At the same time, there is no reason of principle why telecommunications should be the only regulated industry without merits review of all regulated access pricing decisions. Indeed, the large economic and social gains that can come from investment and innovation in telecommunications suggest that it is an industry in which providing potential investors with protection from regulatory risk is especially important. Extending rights of full merits review to all telecommunications access pricing decisions – regardless of whether they are taken with or without an Undertaking in place – would ameliorate the moral hazard identified above.

48. Finally, it is important to make review of regulatory decisions, and more generally of regulatory conduct, more effective. While better, more specific, legislation will itself help, there is also scope to improve the Australian Competition Tribunal's review of ACCC decisions.
49. In particular, the Tribunal should be required to indicate, for each issue it considered about an Undertaking and in respect of which it rejected the approach adopted in the application, guidance as to what it would regard as "reasonable" and why. The Tribunal should not, in other words, confine itself to rejecting (say) a particular approach to depreciation; rather, it should set out guidance that can help all participants in future tackle that issue. To date, Tribunal decisions have not been satisfactory in this respect.
50. A similar obligation should of course bear on the ACCC. Thus, should the ACCC reject an Undertaking, it should provide clear guidance to the submitter and the wider industry not only about the reasons for the decision but also, within the limits of what is practical, as to how any failings could be rectified in a future Undertaking.
51. Additionally, when an Undertaking (or other application) raises multiple issues, it is not sensible for the Tribunal (or the ACCC) to only address one and reject the application on that basis, while leaving it entirely unclear whether even had that issue been addressed, it would have found the other elements in the Undertaking unacceptable. Such decisions merely reduce the efficacy of the merits review process in guiding decision-making. Rather, the Tribunal should be required to consider all issues that are likely to be material.

The end result

52. Taken as a whole, these changes would lead to a regime that is less intrusive – in terms of the scope of regulation – and where regulation would be more predictable. The differentiation of roles and functions between policy-making, rule-setting and regulation would further entrench the benefits this would bring. In turn, these changes would encourage investment, reduce regulatory risk and produce more timely and efficient outcomes, without in any way undermining the bona fide ability to declare and regulate third party access to bottleneck services.

A safety net against anti-competitive behaviour

53. It is also important to note that the existing telecommunication specific competition protections in Part XIB and operational separation would remain unchanged. These rules which elevate the regulatory protections available within the telecommunication sector above other industry sectors, will maintain a strong safety net against anti-competitive conduct. They are stricter than the generic anti-competitive behaviour provisions in the Trade Practices Act in that they carry a much reduced burden for the regulator in proving anti-competitive behaviour (i.e. the "effects" test). These reforms also do not advocate the removal of the existing operational separation regime that applies to the incumbent carrier.

Conclusion: a good result for consumers and the Government

54. Ultimately introducing a more certain investment environment through reform of Part XI C will be good for consumers because it will encourage operators to compete based on their own infrastructure, innovation and ingenuity rather than spending their time and resources in lengthy regulated access negotiations. The dramatic improvements in prices and innovative services in the wireless market where operators have been investing in competitive infrastructure is testament to the benefits of a "light-touch", more "hands-off" approach to regulation. Similar quantum improvements in the level of infrastructure investment and the development of innovative product and service offerings can be realised in the fixed network environment if the reforms suggested in this paper are implemented.
55. With \$20 billion of taxpayers' money committed to the Building Australia Fund, it is clear that the Labor Government recognises the importance of infrastructure investment to Australia's future economic growth and prosperity. The \$4.7 billion that the Labor Government has committed to the National Broadband Network is an express acknowledgement of the critical importance of investment in high-speed broadband infrastructure. It is clearly to the direct financial benefit of Australian taxpayers that the telecommunications access regime encourages and rewards maximum commercial investment in new infrastructure while maintaining the competition benefits of "open access" where bottlenecks exist. Otherwise, it will continue to fall to Governments to fill the void through taxpayer-funded subsidies and temporary patch-ups.

- 56.** Part XIC has clearly not delivered the necessary fixed network investment required for a world-class telecommunications infrastructure. By failing to achieve the right balance between “builders” and “buyers” at such a critical time, Part XIC has left Australia playing a dangerous game of “catch-up”. If Part XIC is not reformed, then the inevitable result will be sub-standard levels of investment; sub-standard high-speed broadband infrastructure; and sub-standard services for consumers and small businesses in the very area that is central to the nation’s future productivity and competitiveness. This is a high-priority and urgent reform. This group commends the reform direction contained in this paper to the Government and believes that it should be afforded urgent and high-level consideration.



GLOBAL ACCESS PARTNERS

The meetings of the Task Force were convened by **Global Access Partners (GAP)** – a proactive and influential network that promotes Australia's capability to find novel solutions to the issues facing the global community and translates these innovative solutions into business opportunities.

Through forums, conferences, missions, advisory boards and Open Forum (www.openforum.com.au), GAP facilitates real and lasting change for its stakeholders, by sharing knowledge, forging progress and creating input for Government policy.

The **'Second Track' process** is a new process through which previously ad hoc mechanisms for stakeholder engagement become the normal method of 'fast tracking' solutions to key issues. The process brings together experts from relevant sectors (including government, NGOs, business and consumer organisations) with a like-minded approach to resolving the issues positively and driving practical outcomes. Working collaboratively, these groups identify problems, initiate discussions, prepare white papers, develop solutions and oversee their implementation.

GAP has pioneered and effectively used the 'Second Track' process over the past five years in the areas of knowledge capital, deliberative democracy, social investment and health. The current projects include task forces in telecommunications regulation, urban water pricing, carbon economy, industrial environmental management, digital education, open media, innovation, security and risk, electronic health, evidence based surgery and genetic testing.

The success of GAP initiatives demonstrates that these new ways of interaction between government, business and the community can be further developed, tested and refined for the public benefit, without putting at risk the core, fundamental machinery of government.

Using the 'Second Track' process, GAP offers a path to developing real and lasting outcomes for its strategic partners and stakeholders

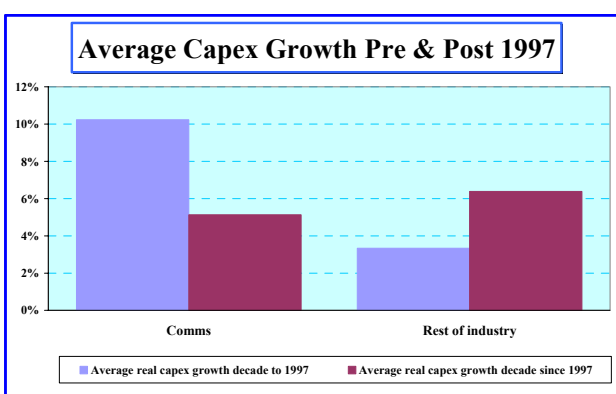
APPENDIX

Communication Sector Capex - long-term trends

ABS data indicates there has been strong Capex growth in the communication sector in recent years. This growth has been in the unregulated mobiles market and in government subsidised services.

In the regulated fixed network market, there has been little transforming Capex either to Telstra's copper network or the Optus HFC.

Historically, growth in the communication sector Capex (hereinafter - Comms Capex) has significantly out-performed other sectors.

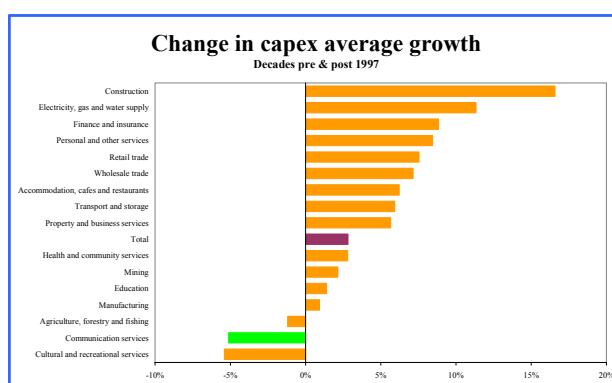


Since 1997 however, there have been significant periods of under-performance:

- ▶ Average annual growth in Comms Capex in the decade to 1997 averaged 10.2% (compared with non-Comms capex growth of 3.3%).
- ▶ Average annual growth in Comms Capex in the decade since 1997 has averaged 5.1% (compared with non-Comms Capex growth of 6.4%).

Since 1997, Comms Capex has nearly halved while non-Comms Capex growth has nearly doubled.

Communication is one of the few sectors where Capex growth in the decade since 1997 has been slower than in the decade prior to 1997.



Source: ABS, Catalogue 5204.0 Australian System of National Accounts 2006-07

Communication Sector Capex - a declining share

A longer term focus also reveals that prior to 1997 Comms Capex represented a steadily rising share of both total Capex (across all industries) and real GDP.

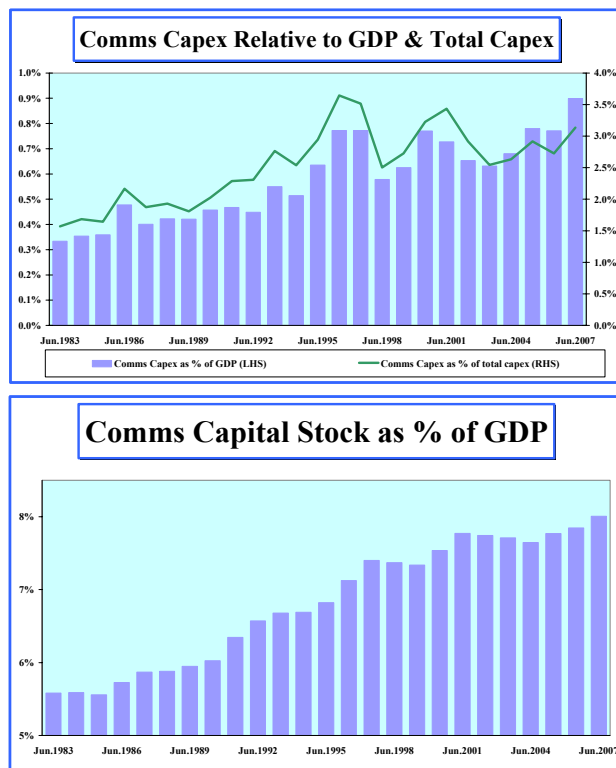
Since 1997 those trends have been significantly muted.

The net value of capital stock in the Comms sector steadily rose in the decade prior to 1997.

As a share of GDP, Comms capital stock rose from 5.9% in 1987 to 7.4% in 1997 (a gain in share of 1.5% points).

In the decade since 1997, Comms capital stock has increased from 7.4% of GDP in 1997 to 8.0% in 2007 (a gain in share of 0.6% points).

Comms capital stock as a share of GDP has slowed since 1997.



Source: ABS, Catalogue 5204.0 Australian System of National Accounts 2006-07

Conclusions

Analysis based on recent strong growth in Comms Capex cannot be used to claim that investment incentives for the Comms sector are appropriate.

Such short-term analysis is flawed because:

- ▶ investment incentives operate with a time lag;
- ▶ Capex in the Comms sector is lumpy and cyclical;
- ▶ technology advance is a key driver of recent growth;

Longer-term analysis reveals that:

- ▶ annual growth in Comms capex has slowed in the decade since 1997 (now 5.1% pa compared with 10.2% pre 1997). Capex growth in other sectors has accelerated over the same time period;
- ▶ over the same time period, Comms Capex has declined as a share of GDP and as a share of total Capex;
- ▶ gains in capital stock operated by the Comms sector relative to GDP have slowed since 1997 (increased share of GDP by 0.6% points over 1997 to 2007) compared with the decade immediately prior to 1997 (increased share by 1.5% points).

The recent surge in Capex partly reflects the following:

- ▶ a cyclical upsurge due to technology advance, especially in non-regulated assets;
- ▶ non-Telstra preference to buy rather than build fixed access infrastructure;
- ▶ non-Telstra investment in support infrastructure (eg DSLAM's) rather than basic fixed access infrastructure. Moreover, this access seeker DSLAM investment duplicates Telstra investment.

These are symptomatic of inadequate investment signals in fixed access infrastructure.

The analysis supports the conclusion that intensive access regulation of existing fixed networks significantly reduces investments in alternative infrastructure-based competition.