STATUTORY AMENDMENTS

TO FACILITATE

COMPETITIVE PROPOSALS FOR THE CONSTRUCTION OF AN AUSTRALIAN NEXT GENERATION BROADBAND NETWORK

SUBMISSION TO THE FEDERAL GOVERNMENT BY

THE G9 CONSORTIUM

DATED 30 MAY 2007

1. Executive Summary

1.1 The Federal Government must create an environment in which there is competitive tension in the construction of a hybrid fibre twisted pair network (**HFTP Network**) in Australia. The HFTP Network is the specific fibre to the node (**FTTN**) architecture that utilises the copper local loop. Only a competitive process will yield an efficient level of investment at the "right" price to end users.

1.2 The technical constraint to achieving such a competitive process is that an investor in an HFTP Network architecture must have access to *all* of Telstra's copper wire from each node to the end customer premises (through a process that may be described as "pillar migration").

1.3 However, under Part XIC of the *Trade Practices* Act (**TPA**) Telstra is not required to give such access and can in effect obstruct competitive proposals for the construction of the HFTP Network. This situation arises due to technological and economic features of the HFTP Network that were not anticipated at the time when Part XIC was drafted. The legislative amendments proposed in this submission are aimed at addressing this issue and are entirely consistent with the objectives of Part XIC.

1.4 For so long as Telstra is able to obstruct alternative HFTP Networks, it can refuse to build a network itself unless it is guaranteed a price that allows it to extract monopoly profit from users of broadband services in Australia. This strategy holds to ransom the potential benefits to Australian consumers and the Australian economy of the HFTP Network. In doing so it destroys part of that potential value of the HFTP Network (in the form of a delay in the construction of an HFTP Network and by pricing at levels that discourage use).

1.5 Telstra benefits from any such delay because the uncertainty surrounding the HFTP Network build makes it impossible for its competitors to commit major ADSL2+ investments using the current unconditioned local loop service (**ULLS**), as such investments are likely to be stranded under the Telstra HFTP Network proposal.

1.6 The magnitude of monopoly profits that Telstra is attempting to extract can be determined from its stated desired cost of capital. For major infrastructure projects such as the HFTP Network, the required return on investment represents by far the largest cost element in determining prices for consumers.

1.7 Telstra has stated that it had negotiated a return on investment with the ACCC of 10.32%. This (10.32%) is materially above the return on investment other monopoly owners receive. Under the standard approach by Australian regulators a return of around 8.5% is warranted under prevailing interest rates. Importantly, the HFTP Network revenues provided in the context of a special access undertaking (**SAU**) will be less risky than most other regulated monopolies, precisely because the HFTP Network owner gets to set the terms of the SAU. In doing so, the HFTP Network owner can largely eliminate regulatory risks.

1.8 The ability to create competitive tension for the construction of the HFTP Network, a new and nationally significant piece of infrastructure, provides the Government with a unique opportunity to hold a competitive auction for a major piece of infrastructure before it is put "in the ground". This process will:

- reveal the true cost of capital of the HFTP Network, which is likely to be much lower than that being offered by Telstra;
- encourage investors to offer to build an HFTP without delay;
- offer prices that include an "order of magnitude" of saving to consumers;
- encourage new and innovative services;

- include terms that do not discriminate in favour of a vertically integrated provider; and

- secure competition in broadband services for Australians long into the future.

2. Background to pillar migration

2.1 In an HFTP Network environment, the most efficient way to configure the nodes and pillars is to take all of the copper wires currently coming into the pillar on the exchange side, and connect them to a single node located near that pillar. The node would contain broadband equipment, including digital subscriber line access multiplexers, and it would be connected by fibre to the exchange or other point of interconnection.

2.2 Under this network structure it is not technically or economically feasible for competitors to build a separate node and fibre connection back to the exchange and interconnect at the pillar. This is because the pillar typically serves 200 homes (or business premises) and many of those homes or premises are using more then one copper wire. In short, there is not room to connect multiples of hundreds of copper wires from more than one node to the pillar. All the "space" is taken up with active connections. Therefore, even if a competitor builds a node next to the existing node and pillar, there will be no space in the pillar to which the competitor node can connect and allow cross connect to customers.

2.3 It is true that theoretically every time a customer requests a connection to the competitor's network, there could be a "jumpering" of an individual twisted copper pair. That is, a technician could go out to the pillar and take a copper wire which previously went from the pillar to Telstra's node and swap it over so that it now connected to the competitor's node. However, this would be an extremely expensive and inefficient method of provisioning the HFTP Network. It would destroy much of the economic benefit which is achieved from moving to an HFTP Network, namely, that there is one migration of ULLs to the node when it is built and thereafter most customer switching is done remotely.

2.4 As a result, for a competing HFTP Network to proceed the Telstra pillar would need to be connected to the competitor's node, such that *all* of the ULL lines from that particular pillar would be connected across to the competitor's node at one time. This "jumpering" of all the ULL lines from a pillar to the node may be described as "pillar migration".

3. Access to an essential input

3.1 The twisted copper pair local loop is an enormously important piece of national infrastructure. It exhibits very strong economies of scale. In private hands, the owner of the local loop infrastructure has the ability and incentive to price above cost. Regulation is therefore critical in controlling monopoly pricing and to create an access regime which is the basis of competition in fixed line telephony and broadband services.

3.2 Part XIC of the TPA provides for the terms of access to services to be regulated if they promote competition and the efficient use of infrastructure in telecommunications markets. The ULLS was declared under these provisions in 1999 and was declared again in 2006. The ACCC has arbitrated the price and non-price terms of access to the ULLS.

3.3 The ULLS is critical to competition in telephony and broadband services. Competing carriers have rolled out substantial infrastructure that use the ULLS to provide services to consumers. This competitive investment has resulted in new services for end users including broadband speeds of up to 20Mbps. This compares to the broadband speeds of less than 1.5Mbps which are offered by Telstra in areas that are not in the footprint of competitive ULLS based infrastructure investments.

3.4 Similarly strong economies of scale and natural monopoly characteristics exist in the operation of an HFTP Network. The essential technical and economic features of an HFTP Network mean that there can only be one HFTP Network based on the twisted copper pair local loop in a particular geographic area.

4. Creating competitive tension in the SAU process

4.1 The SAU provisions were introduced in 2002. The intent of the provisions was to resolve uncertainty in relation to regulated access terms for potential investors in infrastructure.

> *The purpose of the proposed amendments is to provide certainty for potential investors in telecommunications infrastructure and services in relation to access to that infrastructure or service in the future by allowing the ACCC to rule on whether the terms of a proposed undertaking are acceptable prior to the investment being made.*[1]

4.2 The intent of the provisions was to allow the investor and the pricing regulator to enter into a type of "regulatory pact".

> *Under the current provisions of Part XIC, a potential investor in a telecommunications service is unable to receive an exemption from the obligation to provide access to a declared service or to lodge an access undertaking until they supply an active declared service, as declaration can only occur for a service that is being supplied. This can provide a disincentive for investment because it means potential access providers cannot obtain regulatory certainty as to whether or not their service will be declared, and if so, on what terms they will be required to provide access. In particular, where "risky investments" are subject to potential declaration, the investment may be rendered uneconomic as a result of* ***this*** *uncertainty*. [emphasis added]

4.3 Importantly the risk mitigated by the SAU provisions is the risk of the regulator setting the future terms of access, not the other risks associated with the nature of the investment. Such non-diversifiable risks would be captured in the pricing of the service (potentially via the WACC) regardless of whether it is a new investment subject to the SAU provisions or whether it is an existing investment subject to the ordinary access regime. This is "made out" by the fact the regulator applies the same *reasonableness* criterion when considering whether to accept either a SAU or an ordinary access undertaking.

4.4 The SAU provisions are not designed to allow an investor to "extract" more favourable terms of access than would otherwise be achieved if it were a sunk investment. Rather the purpose of the provisions is to simply provide certainty regarding access terms to allow investment to occur.

4.5 It is arguable that for new investments to proceed a higher expected return on capital would be necessary (compared to the return needed to maintain a sunk investment). This is based on uncertainty about the true WACC and the risk of regulatory error.

4.6 Telstra has indicated that it has achieved a higher return as a result of negotiations with the ACCC and also that it is seeking from the Federal Government favourable policy changes and access terms (including a higher WACC). However, there remains considerable uncertainty as to the importance of the terms of access in the decision of whether or not it is commercially sensible for the investment to proceed. That is, it is uncertain whether Telstra is seeking to extort rents via its negotiations or whether it truly requires the terms it proposes in order to raise the necessary capital from investors.

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[1] Explanatory Memorandum, Telecommunications Competition Bill 2002, The Parliament of the Commonwealth of Australia, House of Representatives. Page 72.

4.7 In such an environment the SAU provisions cannot operate effectively because the proposed investment can only be made by Telstra, as it controls access to an essential input or essential service (in this case, pillar migration) and there is significant information asymmetry regarding the necessary conditions (including the terms of access) for the investment to be economic. In this respect there is likely to be a clear dichotomy between the necessary conditions for the investment to be socially efficient (economic) and the conditions that Telstra, as an incumbent vertically integrated monopolist, would require in order for the investment to be commercially sensible.[2]

4.8 The objective of the policy should be to create an environment in which those necessary terms can be "revealed" to the market. To the extent that pillar migration and other legislative changes remove barriers for competing infrastructure proposals to develop they will reduce information asymmetry and provide a credible alternative to Telstra's proposal.

4.9 It is therefore critical that the Government create competitive tension in the current debate over the construction of the HFTP Network. The cost to consumers (and competition) of not doing so is too great.

4.10 By way of example, the Singapore Government has created a competitive environment for the construction of a national broadband network by calling for collaborative interest from the incumbent, and other potential infrastructure providers, for the construction and operation of the network. This project began, in part, from perceived delays by the incumbent in investing in high speed broadband infrastructure and also a desire on the part of the Singapore Government to lead other countries in investing in broadband infrastructure. To achieve this, the Singapore Government has created a competitive tender process and structure for the separation of network construction, operation and management of a national broadband network. This has created a credible threat of entry in the customer access network that will provide very strong incentives for the incumbent to offer reasonable terms of access and to proceed with broadband infrastructure investments.

5. Overview of proposed amendments

5.1 The regulatory changes necessary to facilitate a competitive HFTP Network deployment are:

- an access regime that facilitates pillar migration; and
- a regime that prevent HFTP Network overbuild, for a limited period, to enable a competitive allocation process to be conducted and the successful tenderer for each area to complete its initial build.

5.2 Pillar migration is not feasible within Part XIC because of the manner in which certain restrictions operate under that access regime. However, an amendment could be made to allow specific modifications to these restrictions for broadband services provided over an HFTP Network. This could be done by Ministerial determination without financial risk to the Commonwealth.

5.3 While pillar migration facilitates a competitive HFTP Network build it does not prevent overbuild or a "race to the node". Accordingly, for a limited period of time the Federal

[2] We would contend that Telstra's strategy is to delay investment because it currently earns a substantial surplus on existing infrastructure. New investment must return it incremental gains in addition to those surpluses. Competition via ULLS (in its current form) is eroding those surpluses. HFTP would kill ULLS competition in its current form and would seem to be the part motivation for Telstra to propose the investment. There is a clear tension within Telstra as it needs to respond to ULLS competition by rolling out DSLAMs in areas where competitors have invested infrastructure. This is a typical incumbent strategy.

Government should implement a special licensing system for HFTP Network construction and operation that allows it to formulate and conduct a competitive allocation process. That allocation process will ensure that end users are able to achieve the best outcome in terms of both price and non-price attributes of competing HFTP Network proposals whether the successful tenderer is Telstra, the G9 or any other interested consortium.

5.4 Whilst important and significant the types of amendments proposed by the G9:

- are relatively minor in scope (although a significant contribution to the national interest);
- allow the Minister, possibly following a recommendation of the NCC, to modify the regulatory regime in limited respects in recognition of the bottleneck characteristics of the ULL and its importance to the specific economics of an HFTP Network build;
- address the risk of overbuild by allowing the Minister or ACMA to exclude an HFTP Network build from the existing carrier licences (for a limited period) to allow time to conduct a process for issuing licences and to deploy the HFTP Network; and
- do not seek to establish any preferred position for any specific carrier or group of carriers but rather to level the playing field for any carrier or consortium to be the HFTP Network provider in any particular region of Australia.

5.5 In summary, the amendments proposed by the G9 would be entirely consistent with Australia's existing telecommunications policy and its longstanding commitment to delivering benefits to consumers through competition. The amendments would facilitate that competitive environment by establishing a process, possibly a competitive tender, for the initial HFTP Network build, given the adverse economics of overbuild and the entrenched monopoly that would be created by an uncontested Telstra build.

5.6 Set out below are the G9's proposals for statutory amendments that could achieve these policy objectives. These proposals are not the only means of achieving the necessary policy objectives and the G9 has not sought to be prescriptive. In many cases alternative options have been proposed for consideration. The G9's intention is to convey the nature of the amendments that would achieve the necessary policy outcomes.

6. Current limitations of the access regime

6.1 Part XIC could, with some minor variations, allow the ACCC to arbitrate in respect of pillar migration. This would allow the ACCC to consider whether declaring pillar migration was in the long term interests of end users as well as the additional reasonableness criterion set out in section 152CR of the TPA.

6.2 The ULLS is currently a declared service. However, merely declaring the ULLS is not sufficient to facilitate pillar migration under the access regime as a result of:

- the obligation to supply a declared service being subject to certain limitations, as set out in section 152AR(4); and
- the power of the ACCC in respect of arbitral determinations being subject to certain limitations in section 152CQ.

6.3 As a result of these limitations Telstra would be able to frustrate the ACCC facilitating pillar migration to an alternate HFTP Network provider. This is predominantly because pillar

migration involves an access seeker being provided with the use of certain ULL lines that Telstra is currently using to provide services to its own customers.

6.4 In this respect:

- section 152AR(4)(b) of the TPA provides that paragraph (3)(a) does not impose an obligation to the extent (if any) to which the imposition of the obligation would have the effect of preventing the access provider from obtaining a sufficient amount of the service to be able to meet the access provider's reasonably anticipated requirements, measured at the time when the request was made; and

- section 152CQ (1) (b) of the TPA, which deals with restrictions on the determinations that the ACCC may make in relation to arbitrated access disputes, stipulates that the ACCC must not make any determination that would prevent an access provider from attaining an adequate amount of the services to be able to meet the access provider's reasonably anticipated requirements, measured at the time when the access seeker made a request in relation to the service.

6.5 In addition, there may be further impediments to the cut-over of all lines being required under the Part XIC access regime in other provisions of section 152AR(4) and section 152CQ :

- Section 152AR(4)(a) and (c) of the TPA provides that paragraph (3)(a) does not impose an obligation to the extent (if any) to which the imposition of the obligation would have the effect of preventing a service provider from obtaining a sufficient amount of the service to be able to meet the service provider's reasonably anticipated requirements measured at the time when the request was made. It would also not have the effect of preventing any person from obtaining (by the exercise of a pre-request right[3]) a sufficient level of access to the declared service to be able to meet the person's actual requirements. Section 152CQ(1)(a) and (1)(c) of the TPA contains restrictions in similar terms to the restrictions on the determinations that the ACCC may make in relation to arbitrated access disputes.

- Section 152AR(4)(d) of the TPA provides that paragraph (3)(a) does not impose an obligation to the extent it would deprive any person of a protected contractual right. Section 152CQ provides that the ACCC must not make a determination that would have the effect of depriving any person of a protected contractual right (section 152CQ(1)(d)). "Protected contractual right" is defined in the TPA as a right under a contract that was in force at the beginning of 13 September 1996. Telstra may have contracts in place with some retail or wholesale customers that date prior to 1996 which involve the provision of services in a manner that utilises the local loop. Such contracts may constitute protected contractual rights.

6.6 The G9 does not believe that the amendments it is proposing are inconsistent with the policy underlying these provisions. Rather, the G9's concern is that the manner in which these provisions are currently drafted allow them to be used to obstruct a competitive HFTP Network deployment in an unintended manner.

7. Potential solutions to these constraints

7.1 To facilitate pillar migration under the current provisions of the Part XIC access regime the Federal Government could simply delete or significantly vary section 152AR(4) and section 152CQ. However, it is our view that such an approach would be unnecessarily broad. In the

[3] A pre-request right is defined in section 152AR(12) as a right under a contract or under a determination (within the meaning of Division 8) that was in force at the time the request for access under paragraph (3)(a) was made.

majority of circumstances the requirements of section 152AR(4) and section 152CQ(1) operate as reasonable limitations and do not hinder the ability of the access regime to meet the objectives of Part XIC.

7.2 The G9 considers a reasonable approach is to include within the access regime an express provision for the Minister, possibly following a recommendation of the NCC, to modify the operation of those limitations in respect of a particular access service. In effect a modification power would be created that would allow these access regime constraints to be adjusted where it was considered that this furthered important national policy objectives.

7.3 The ULLS provides the best example of a scenario where such a modification is warranted. The ULLS is a true bottleneck feature of an HFTP Network which without the possibility of alternative providers being in a position to access currently used lines prevents carriers other than Telstra from being in a position to economically build HFTP Network infrastructure. For these reasons there are strong arguments that the existing limitations in section 152AR(4) and section 152CQ(1) should be able to be modified in respect of the ULLS. This would give alternative HFTP Network providers a fair and equal opportunity to deploy an HFTP Network.

7.4 Such an amendment could be expressed to be a power for the Minister to make a determination, such that it would be a disallowable instrument, in similar terms to the current section 152CH power to implement Ministerial pricing determinations. Alternatively, the determination could be made as an administrative decision by the Minister possibly following a recommendation by the NCC.

7.5 It may be appropriate that the relevant amendment specify matters such as the criterion to be taken into account in making such a determination or the process to be undertaken before such a determination could be made.

7.6 Similar requirements to the NCC's recommendations for declaration under Part IIIA could be prescribed. This would reflect the national interest policy objective of ensuring Australians are served by next generation high speed broadband networks. For example the criterion applied to NCC declaration recommendations under Part IIIA of the TPA include the following:

- the access (or increased access) to the service would promote competition;
- it would be uneconomical for anyone to develop another facility to provide the service;
- the facility is of national significance having regard to:
    - the size of the facility;
    - the importance of the facility to constitutional trade or commerce; or
    - the importance of the facility to the national economy; and
- the access (or increased access) to the service would not be contrary to the public interest.

7.7 The G9 is not suggesting that the Part IIIA concepts should replace the objectives of Part XIC. However it is of the view that if the bottleneck characteristics of the ULLS are assessed in the context of an HFTP Network build and the significance of pillar migration is recognised it is clear that the national interest is best served by facilitating such access.

7.8 Some examples of the form of amendment to the legislation that could be made to empower the Minister to make such a determination and the NCC to make such a recommendation are set out in section 1 of Schedule 1.

8. **Maximum period of a declaration**

8.1 An HFTP Network would be a significant investment that would be dependent on the continued availability of the ULLS on reasonable terms. Therefore, in order for it to be feasible for an entity other than Telstra to obtain finance to construct an HFTP Network on reasonable terms it is preferable to have the certainty that the ULLS will remain a declared service for a longer period.

8.2 Section 152ALA currently provides a maximum period for which a service can be declared of 5 years. One alternative would be to amend section 152ALA to provide for a longer period as the maximum declaration period (for example up to 15 years). Taking into account that the usage of ULLS in an HFTP Network is a special case, and that 5 years is not an inappropriate period for many other declared services, it may be preferable to establish a power to extend the maximum period in respect of a particular declared service. This would not commit the ACCC to any particular period. Rather it would give it more flexibility to set a longer period where it determined that such a longer period was required to meet the objectives of Part XIC.

9. **Constitutional acquisitions of property and compensation under section 152EB**

9.1 Telstra has recently commenced proceedings in the High Court seeking orders that ULLS access under the current Part XIC access regime is an acquisition of property other than on just terms.

9.2 Section 152EB of the TPA provides that if a determination would result in an acquisition of property and would not be valid because a particular person has not been afforded just terms, then the Commonwealth must pay that person a reasonable amount of compensation (to be agreed between the Commonwealth and the person or determined by a court of competent jurisdiction).

9.3 It is the view of the G9 that the existing provisions that allow for ULLS access, or those proposed for pillar migration, would not constitute laws relating to the acquisition of property under the Constitution that require terms other than those set under Part XIC of the TPA. This is in part because it is and always has been a condition of Telstra's licence to be a telecommunications carrier that its services are subject to the declaration, arbitration and other provisions under Part XIC as amended from time to time. These provisions are an essential feature of operating in the telecommunications market in Australia.

9.4 The G9 does not believe that it is appropriate for Telstra's claim to affect the policy decisions that would otherwise be taken by the Federal Government. Indeed to the extent that such proceedings have the effect of delaying or constraining such policy decisions this would deliver to Telstra a strategic benefit that would be sufficient to justify it commencing and maintaining those proceedings, regardless of the merits of its arguments.

9.5 Notwithstanding this, the G9 understands that to the extent there is any risk of a claim by Telstra against the Commonwealth under section 152EB of the TPA, no matter how remote, the Commonwealth may wish to take steps to ensure that such financial exposure is removed.

9.6 If a claim for compensation arose as a result of the ACCC setting a ULLS access charge at less than the amount that would be required under the Constitution then the ACCC could be directed to set a higher amount that is consistent with the requirements of the Constitution and thereby remove the claim for compensation. For example the Minister could set a Ministerial pricing principle under section 152CH of the TPA that would have this effect.

9.7 Alternatively, the Commonwealth could make a limited legislative amendment to section 152EB to provide that an access seeker that acquired property as a result of any declaration was directly responsible for meeting any claim for compensation as a result of that acquisition, rather than the Commonwealth. If such an amendment were pursued it could ensure that it

only made each access seeker responsible for property acquired directly by that access seeker and not the acquisitions of others. An example of such a proposed legislative amendment is set out in section 2 of Schedule 1.

9.8 In summary, there are a range of methods by which the outcome of Telstra's proceedings could be made financially irrelevant to the Commonwealth and a matter to be contested directly between Telstra and access seekers.

10. Scope of the amendments regarding pillar migration

10.1 The provisions implementing pillar migration are the minimum necessary to facilitate a competitive tension in investment in an HFTP Network in Australia. In this sense the amendments would be regarded as minor in scope, but recognise the economic and technical realities of next generation fixed line broadband infrastructure and its national significance.

- The national significance of broadband infrastructure is well recognised in terms of its impact on the productivity of businesses. In terms of households, the impact of broadband is defined in terms of its significant enhancement of the community's access to innovative services, advanced communications and interactive applications, and the feedback this has on businesses and other users.

- The technical reality of a fibre broadband network is that an HFTP Network will entrench and "extend" the incumbent's monopoly. The existing monopoly is confined to the network element which constitutes the local loop, but an HFTP Network means that the investor will provide services rather than network elements to end users and the cost base over which competition occurs (and leads to lower costs) will be significantly reduced.

10.2 The proposed amendments implementing pillar migration are targeted and are narrow in scope. They are confined to Part XIC of the TPA and therefore would only capture telecommunications infrastructure and services. It would also be possible to include significant thresholds for them to be implemented if that were deemed necessary, and those thresholds could include national interest criterion.

10.3 The provisions implementing pillar migration are significantly short of structural separation, a policy that has been implemented in overseas jurisdictions. Pillar migration will not prevent joint ownership of the local loop and downstream businesses. However, it will mean that the ability of the vertically integrated incumbent to harm competitors will be significantly reduced.

10.4 Pillar migration is a natural extension of the existing access regime for ULLS. In essence the access seeker is seeking access to the same piece of infrastructure with the intention of upgrading one element of that infrastructure. The difference is that current technologies allow that migration to be made on an individual end user basis. However, in an HFTP Network environment that migration will need to be made on a node by node basis.

10.5 In a policy sense then, the effect of pillar migration in an HFTP Network environment is to extend the benefits of existing ULLS based competition to all end user customers. In this context it also does no greater harm to the interests of the incumbent than do existing forms of access and continues to allow Telstra to earn a regulated return on its historic investment in the local loop at the same time as operating in downstream markets (albeit on a more equal footing with competitors).

10.6 There are a number of precedents existing in energy markets that demonstrate that other access regimes contemplate that infrastructure owners can be required to engage in activities with respect to their infrastructure for the benefit of access seekers, including physical changes to that infrastructure such as expansions, extensions or upgrades to access provider facilities:

- It is not uncommon for access seekers to engage in upgrades of an access provider's network. For example, the Gas Code provides express provisions for access seekers (including foundation customers) to pay the upfront cost of increasing the carrying capacity of pipelines (see section 3.16 of the Gas Code).

- In 1999 the Office of the Regulator General (ORG, now the Essential Services Commission) held a competitive tender to supply electricity infrastructure to new developments in the Docklands precinct of Melbourne. Prior to this tender, Citipower had an exclusive licence for the provision of infrastructure and retail services in this precinct. However, the Victorian Government decided to open up the provision of infrastructure services to competitive tender. Powercor won this tender despite Citipower retaining the exclusive retail franchise for all non-contestable retail customers (ie, those with annual consumption below 160Mwhpa). Further, CitiPower was also the licensed distributor for that precinct. This ORG decision gave rise to a situation where, despite having the right to exclusively provide retail supply to medium to small customers in this area, CitiPower would be forced to purchase network services from Powercor in order to reach those customers.

- Moreover, it is not uncommon for customers to pay for upgrades to access a provider's network to provide greater quality of service. For example, through the construction of transformers located near the customer's premise.

11. Managing the risks of overbuild

11.1 In order to prevent overbuild (or a race to the node) and to ensure that an HFTP Network roll out occurs efficiently and expeditiously the G9 recommends that the Telecommunications Act (**TA**) is amended to either specify an allocation system in respect of "HFTP Network licences", or to provide the Minister (ACMA or the ACCC or another body) with the power to determine such an allocation system.

11.2 Currently, any entity with a carrier licence (or nominated carrier declaration) could commence building an HFTP Network. Therefore as part of the licence allocation system it will be necessary to amend the TA or impose an additional licence condition to ensure that an HFTP Network cannot be built without the specified "HFTP Network licence".

11.3 The TA could be amended to include an express provision requiring a licence for an HFTP Network or by adding an additional licence condition to the carrier licence conditions in Schedule 1 of the TA. The Minister also currently has power under section 63(1) of the TA to determine that each carrier licence is subject to such conditions as are specified in the instrument. Therefore, without any amendment to the TA, the Minister could utilise the power under section 63(1) to determine an additional carrier licence condition for all carrier licences. The licence condition or provision would need to specify that a carrier would not be permitted to own, or act as nominated carrier in respect of, an "HFTP Network" unless the carrier held an HFTP Network licence.

11.4 To ensure that the impact of this amendment (or Ministerial licence condition determination) was no more than what is reasonably required to prevent anti-competitive overbuild the requirement to obtain an HFTP Network licence could be expressed to only apply for a specified period such as five years. This would have an added benefit of providing an incentive for the holder of the HFTP Network licence to roll-out their network to as large an area as possible within the relevant period; to ensure the licence holder achieved the maximum benefit from the period of overbuild protection.

11.5 Five years from the commencement of the service would be appropriate to allow for construction of the network, which is likely to take a minimum of three years, and then two years of operations to establish stable operating conditions.

11.6 An HFTP Network could be narrowly defined in the legislation to ensure that the service for which a specific HFTP Network licence would be required did not capture services that do not utilise the ULLS. This would be appropriate given that it is the bottleneck of the ULLS that creates the need to have a regime under which the potential for overbuild is addressed.

11.7 Such a definition would ensure that services that could potentially compete with an HFTP Network (such as wireless services, HFC networks or the delivery of broadband over powerlines) that would not utilise the bottleneck ULLS in the same manner, would not be prevented from developing during the period of overbuild protection.

11.8 An allocation system for HFTP Network licences could be specified in an amendment to the TA or alternatively the TA could be amended to provide the Minister (or ACMA or the ACCC) with a broad power to determine an appropriate allocation methodology. It may be appropriate to specify that a review must be conducted by the Minister prior to the determination of the allocation methodology for the HFTP Network licence. However it would be in the interests of the telecommunications industry and of consumers for such a review to be conducted within a tight timeframe.

11.9 Some suggested drafting in respect of the amendments to the TA to establish an appropriate allocation system are set out in Schedule 2.

12. Process for allocating the HFTP Network licence

12.1 The G9 contemplates that the allocation process would include a strong competitive element. For example this could involve an open bidding arrangement or a closed tender process.[4] The assessment of bids could involve an assessment of elements including the following:

- The features, attributes and scalability of the HFTP Network.
- The speed and geographic scope of the HFTP Network.
- The wholesale access price of the broadband access services provided over the HFTP Network (including elements of that access price such as the WACC).
- The wholesale access non-price terms offered to all access seekers using the HFTP Network.
- Management and structural benefits of the proposal, including ownership separation and incentives for behaviour that will improve competition in markets for carriage services.

12.2 For example, in October 2005, the comparable return on investment provided by the Victorian regulator of electricity businesses was 8.6% (1.7% lower). It must also be recognised that the standard approach has been estimated to already incorporate significant elements of monopoly returns. The Allen Consulting Group has attributed this excessive cost of capital to the fact

[4] It is important to note that a necessary component of any competitive process will be the provision of network information in order for parties to offer a complete bid. Whilst parties such as the G9 have detailed information on the Telstra network and access to the same technical solutions from vendors, an open tender process would likely require the provision on detailed network design information and service numbers to bidders on a confidential basis.

that market capitalisation of regulated businesses is between 40% to 60% higher than the value of regulated assets - suggesting the allowed regulated return is well in excess of the true cost of capital. The Allen Consulting Group (2003), Review of the Gas Code: Commentary on Economic Issues, report to BHP Billiton, August.

12.3 A competitive process would provide the Federal Government with a unique opportunity to reveal the true cost of capital for an HFTP Network which on the basis of the analysis in section 1 of this submission can be expected to be well below Telstra's ambit claim of 10.32%. To put this in perspective, a 4.0 percentage point reduction in the cost of capital from 10.32% to 6.3% represents a 39% (4/10.3=0.39) reduction in the annual revenues required to finance the HFTP Network investment. If the Allen Consulting Group analysis is even remotely accurate, this is the order of magnitude of savings to consumers that the Government can expect from a competitive bid.

30 May 2007

Amendments to the TPA to Facilitate Pillar Migration

1. To enable the Minister to exempt some services from the limitations in sections 152AR(4) and 152CQ(1)

DIVISION 6 - MINISTERIAL ~~PRICING~~ DETERMINATIONS

152CH. Ministerial ~~pricing~~ determinations

(1) The Minister may make a written determination setting out principles dealing with price-related terms and conditions relating to the standard access obligations. The determination is to be known as a "Ministerial pricing determination".

(2) The Minister may make a written determination that sections 152AR(4) and 152CQ(1) will not apply, in whole or in part or in specified circumstances, in relation to one or more declared services.

(3) A determination under subsection (1) or (2) is a disallowable instrument for the purpose of section 46A of the Acts Interpretation Act 1901.

(4) In this section:

"price-related terms and conditions" means terms and conditions relating to price or a method of ascertaining price.

Section 152CHA - Recommendation of the Council

(1) The Minister or any other person may make a written application to the Council asking the Council to recommend whether the Minister should make a determination under section 152CH(2) in relation to one or more declared services.

(2) After receiving the application the Council must recommend to the Minister that:

(a) a determination under section 152CH(2) should be made, and the recommended form of the determination; or

(b) a determination under section 152CH(2) should not be made.

(3) In deciding what recommendation to make the Council must take into account:

(a) that access (or increased access) to the declared service would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the service;

(b) that the facility is of national significance, having regard to:

(i) the size of the facility; or

(ii) the importance of the facility to constitutional trade or commerce; or

(iii) the importance of the facility to the national economy; and

(c) that access (or increased access) to the declared service would not be contrary to the public interest.

(4) On receiving a recommendation from the Council the Minister must either make a declaration or decide not to make a declaration.

(5) The Minister must publish, by electronic or other means, his or her decision on in respect of a determination recommendation under subsection 152CHA(4) and his or her reasons for the decision.

(6) The Minister must give a copy of the publication to:

(a) the applicant under section 152CHA(1); and

(b) the provider of the declared service.

(7) Before publishing under subsection (6), the Minister may give any one or more of the following persons:

(a) the applicant under section 152CHA(1);

(b) the provider of the declared service; and

(c) any other person the Minister considers appropriate;

a notice in writing:

(d) specifying what the Minister is proposing to publish; and

(e) inviting the person to make a written submission to the Minister within 14 days after the notice is given identifying any information the person considers should not be published because of its confidential commercial nature.

(8) The Minister must have regard to any submission so made in deciding what to publish. He or she may have regard to any other matter he or she considers relevant.

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2. To require that access seekers bear any risk in respect of claims for compensation

152EB. Compensation for acquisition of property

(1) If:

(a) any obligation, a determination or any other decision or instrument issued under Part XIC would result in an acquisition of property; and

(b) the obligation determination or any other decision or instrument issued would not be valid, apart from this section, because a particular person has not been sufficiently compensated;

~~the Commonwealth~~any access seeker that has acquired property as a result of the obligation, determination or decision or issue of the instrument must pay that person:

(c) a reasonable amount of compensation in respect of the property acquired by that access seeker as agreed on between the person and that access seeker ~~the Commonwealth~~; or

(d) failing agreement - a reasonable amount of compensation in respect of the property acquired by that access seeker as determined by a court of competent jurisdiction.

Schedule 2

Amendments to the Telecommunications Act to prevent HFTP overbuild

7. ***Definitions***

HFTP licence *means a licence to build, own and operate an HFTP network.*

HFTP network *means a telecommunications network that supplies carriage services over a hybrid fibre twisted pair network-using a copper (or aluminium) wire from an end user to a node co-located with the copper access pillar and the use of fibre optic cable between the node and a point of interconnection.*

57A HFTP Licence

A carrier must not own, or act as nominated carrier in respect of, an HFTP network unless the carrier holds an HFTP licence

57B Procedures for allocating HFTP licences

(1) Prior to [insert date] the Minister must determine, in writing, the procedures to be applied in allocating and issuing HFTP licences:

(a) by auction; or

(b) by tender; or

(c) by allocation for a pre-determined price or a negotiated price; or

(d) by any other method.

(2) Without limiting subsection (1), the system so determined may:

(a) apply generally or in respect of a particular geographic area;

(b) require payment of an application fee, but not a fee that would be such as to amount to taxation;

(c) impose limits on the number of licences that may be issued to, or controlled by, any one person or group of persons;

(d) impose limits on the geographic coverage (by area or population reach) that may be obtained under licences issued to or controlled by any one person or group of persons;

(e) limit the persons eligible to apply for such a licence.

(3) Before determining the allocation system under subsection (1) the Minister must:

(a) consult with the ACCC in respect of:

(i) whether the procedures should include and of the limitations referred to in subsection (2) and if so the nature of those limitations.

(ii) the allocation process and criteria that will promote the objectives of Part XIC of the Trade Practices Act.

(b) conduct a review in respect of the proposed allocation process and criteria which includes public consultation and consultation with carriers.

(4) The Minister must cause to be prepared a report of a review under subclause (3)(b).

(5) The Minister must cause copies of the report to be laid before each House of Parliament within 15 sitting days of that House after the completion of the preparation of the report.

(6) The Minister may give the ACMA a written direction requiring the ACMA to allocate a licence or licences under section 57C within a specified period.

57C Issue of HFTP licences

The ACMA may allocate HFTP licences in accordance with the procedures determined under section 57B, but not otherwise.