Regulation Impact Statement

for the

Telecommunications Industry Regulatory Accounting Framework made under section 151BU of the *Trade Practices Act 1974*

May 2001

Background

The Commission assumed the primary role for competition and economic regulation in the Australian telecommunications sector when it was opened up to competition in July 1997. Its co-regulator the Australian Communications Authority (ACA) was established at the same time and is responsible for technical regulation and some telecommunications consumer protection matters.

In March 2001, there were sixty-nine licensed carriers operating in the Australian telecommunications sector.[1] As at June 2000, the annual turnover of this sector was approximately 30 billion dollars. Telstra accounts for about 65 per cent of this sector, while Cable & Wireless Optus, Vodafone, AAPT and Primus together account for approximately another 25 per cent of the sector.[2]

The Commission currently administers the telecommunications industry Chart of Accounts (COA) and Cost Allocation Manual (CAM) developed by AUSTEL under the 1991 telecommunications regulation regime. COA/CAM is a horizontal accounting separation model (i.e. it requires reporting on major retail services) under which Telstra, Cable & Wireless Optus and Vodafone report quarterly on financial information.

The Commission's responsibilities in the telecommunications market include access provisions under Part XIC of the *Trade Practices Act 1974* (the Act) and enhanced competitive safeguards under Part XIB of the Act.

The main provisions under Part XIB of the Act are:

- telecommunications specific anti-competitive conduct provisions (the competition rule);
- issuing competition notices where the Commission has reason to believe there is a contravention of the competition rule;
- issuing tariff filing directions; and
- record-keeping rules.

The Commission's main powers under Part XIC of the Act include:

- declaration of telecommunications services (and revocation or variation of a declaration);
- consideration of applications for exemption from the standard access obligations applying to declared telecommunications services;
- approval of an access code;
- approval of access undertakings; and

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[1] Australian Communications Authority, list of licensed carriers as at 27 March 2001, obtained from http//www.aca.gov.au.

[2] ACCC estimates using published and unpublished data.

- arbitration of access disputes.

The Commission is also required to administer certain provisions under other telecommunications legislation, including the retail price controls on Telstra.

Section 151BU of the Act provides that the Commission may, by written instrument, make record-keeping rules requiring one or more specified carriers or carriage service providers to keep records and prepare reports using information from those records. The Commission also has powers to provide or require public access to the reports, which it is not using at this time. The ACA can also make record-keeping rules in accordance with section 529 of the *Telecommunications Act 1997*.[3]

1. Problem and issue identification

The problem being addressed is the inadequacy of financial and usage information obtained under the COA/CAM reporting regime to properly assist with the fulfilment of the Commission's regulatory responsibilities.

The main limitations of the COA/CAM regulatory reporting regime are:

- it only covers major retail services;
- inadequate vertical separation;
- internal costs at the access level are not explicitly defined;
- some service definitions have become obsolete; and
- no service usage information, making it difficult to determine relevant unit costs and revenues (and therefore prices) for services.

These limitations have restricted the ability of the Commission to use the COA/CAM records for access arbitrations, for anti-competitive investigations, and for other purposes.

2. Specification of objectives

The primary objective of the RAF is to provide for accounting separation for major vertically integrated carriers. That is, carriers are required to report separately on the retail and wholesale businesses. This information will assist the Commission with investigations of possible anti-competitive conduct, in arbitrations on the terms and conditions of access to declared telecommunications services and in assessing any undertakings offered by an access provider on the terms and conditions of access to a declared service.

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[3] The ACA released a discussion paper in October 2000 on the purpose and issues related to the development of record-keeping rules under section 529 of the Telecommunications Act. Those rules are likely to require reports on key performance indicators, to ensure consistent and comparable reporting of key measures of the quality of service provided by fixed and mobile network carriers.

Another objective is to provide the Commission with a base of regular and audited financial information that will assist it in performing other regulatory functions, particularly for inquiries into the possible declaration of services (or revocation or variations of existing declarations) and potentially in reports on competition and telecommunications prices under Part XIB of the Act. The information should be relevant to the Commission's activities under the following specific provisions:

Part XIB

- **Division 2:** Anti-competitive conduct
- **Division 3:** Competition notices and exemption orders
- **Division 11:** Reports on competitive safeguards
- **Division 12:** Monitoring charges paid by consumers
- **Division 12A:** Reports about competition to government

Part XIC

- **Division 2:** Declaration inquiries
- **Division 3:** Exemption applications from standard access obligations
- **Division 5:** Access undertakings
- **Division 8:** Resolution of disputes about access

The Commission also has the objective to balance these information requirements against the administrative and implementation costs to the industry of complying with the rules. This will include only applying the rules to specific carriers or carriage service providers to the extent necessary.

3. Identification of options

This Regulation Impact Statement assesses a number of broad policy approaches to possibly achieving the objectives. The options are listed below in order of their relative compliance costs and, inversely, on their ability to assist the Commission:

Option 1: use the Commission's *ad hoc* information gathering powers to obtain internal records as required for particular investigations and arbitrations;

Option 2: require record-keeping, on a historical cost basis, on the costs and revenues of declared access services supplied by some or all providers of such services;

Option 3: require record-keeping for full accounting separation from some or all providers of declared services, based on historical costs; or

Option 4: require record-keeping of forward-looking economic costs for declared services supplied by some or all providers of declared services.

4. Impact analysis

Impact group identification

Telstra, Cable & Wireless Optus, Vodafone, Primus and AAPT will be most affected as the carriers the Commission intends to initially notify under the rules. Telstra, Cable & Wireless Optus and Vodafone currently report under the COA/CAM regime.

These carriers will be required to amend and/or develop reporting systems to comply with the new rules. Partly balancing the costs for Telstra, Cable & Wireless Optus and Vodafone will be a decrease in the frequency of reporting, from each quarter to each half-year.

Primus and AAPT will be required to provide regulatory accounts for the first time.

Carriers and carriage service providers who are not required to report will be affected by the new rules indirectly in that it will improve the information available to the Commission to assess anti-competitive conduct and access disputes, and for the other purposes identified above.

The new rules will affect consumers to the extent that this group could be expected to benefit from a competitive and efficient telecommunications market. If, in the future, some of the information obtained from the reporting regime is publicly released, other groups such as the industry, government departments and research organisations may benefit through increased access to information on the telecommunications industry.

The Commission has invested resources in the development of the new rules and will continue to devote resources through its ongoing role in the administration, implementation and oversight of the reporting regime.

Assessment of benefits and costs of alternative options

Option 1 – *ad hoc* information gathering

This option does not involve the development of record-keeping rules and relies on the Commission's *ad hoc* information gathering powers under section 155 of the Act and those associated with arbitrating access disputes under section 152DC of the Act. This option does not require the provision of information to the Commission until the Commission makes a specific request for financial or other information.

The benefit of this option is that it avoids any general costs of compliance with a regulatory financial reporting regime for carriers who would otherwise be required to report. This option will also impose costs on carriers and carriage service providers as they will need to spend time searching, extracting or re-constructing the information required every time the Commission requires information to fulfil its statutory responsibilities.

The Commission will incur costs formulating specific information requests each time it attempts to obtain information from a carrier or carriage service provider. Depending on the complexity of the request this may take anywhere from under one week to several weeks. The quality and usefulness of the information received may also not be as great as under other options. The Commission would need to rely on existing recording processes, which may not adequately provide for allocation of common costs. Further, the information may not be provided in the context of comprehensive reports, and therefore subject to potential bias. Importantly, this option is unlikely to meet either the primary or secondary objectives, unless specific requests are frequent.

Option 2 – reporting on declared services only

This option requires that carriers and carriage service providers keep records and report to the Commission on retail services being supplied by declared (ie. regulated) services only. Its is therefore likely to have lower compliance costs for carriers who would be required to report to the Commission compared to options 3 and 4.

This option does not overcome a number of the key limitations of the current reporting regime because it only covers a limited number of services and there is no vertical separation between activities. The costs of downstream services may still need to be estimated for particular investigations or arbitrations either implicitly as the difference between prices or tariffs and the costs of access services or explicitly using the specific information gathering powers to acquire records ordinarily kept by a carrier or carriage service provider of downstream service costs.

Under the second approach, as well as the cost for developing reporting systems to provide information on upstream activities, reporting carriers and the Commission would therefore also incur costs in order to obtain sufficient information on downstream activities. Such information will not be subject to the same allocation methods or audit requirements as upstream services and may affect the Commission's ability to effectively undertake its functions and may adversely affect competition in the market.

Finally, records that are kept for compliance under this option will be kept in an information vacuum with no linkage to consolidated accounts and may provide an opportunity for reporting carriers and carriage service providers to distort these costs.

Option 3 – horizontal and vertical accounting separation

This option implements a full horizontal and vertical reporting regime. It therefore introduces accounting separation between the wholesale and retail businesses of major vertically integrated carriers. This means costs can be clearly allocated to specific services with direct, attributable and unattributable elements separately identified across the retail and wholesale components of a carrier's business. The benefits of this approach are:

- for the Commission, it will minimise opportunities for cost manipulation and provide a basis for comparing costs across different carriers and carriage service providers and the market;

- it will provide regular and audited financial and other information;

- it avoids overly prescriptive architecture, for example by defining a hierarchy of network elements and services; making it easier to add new or amend existing service descriptions.

The costs of this option mainly relate to the cost of complying with the framework for reporting carriers and carriage service providers. These costs will vary depending on a range of factors including their size, the number of services they provide and if they are required to report for accounting separation or on a more limited basis. As discussed below, the Commission considers that a sliding scale of reporting should apply for

Vodafone, AAPT and Primus, having regard to the relative benefits to the Commission of requiring these carriers to submit all reports against the compliance costs to the carriers. In all cases, the Commission will work closely with these carriers during the implementation phase to ensure compliance costs are minimised.

Option 3 is broadly based on the existing COA/CAM line item categories and allocation approaches. It therefore reduces the extent to which financial systems and procedures need to be changed for Telstra, Cable & Wireless Optus and Vodafone. Also partly balancing the costs for Telstra, Cable & Wireless Optus and Vodafone will be a decrease in the frequency of reporting, from each quarter to each half year.

The RAF will impose costs on the Commission in terms of the ongoing administration of the RAF and costs associated with reviewing and amending the rules to ensure they remain relevant. Future costs should be limited to approximately one to three staff months per year to administer the rules in addition to staff time spent using and analysing the information provided by the RAF to assist with Commission functions. These costs should be offset to some extent by a reduced need for the Commission to seek alternate information when arbitrating access disputes or investigating anti-competitive conduct.

Option 4 – forward-looking cost model

This option would involve development and implementation of a full accounting separation model with all costs calculated using forward-looking economic modelling. Forward-looking costs are reported on a current rather than historical basis. As noted by the Commission in its general access pricing principles, forward-looking costs are consistent with those that would prevail for an efficient firm in a market with effective competition.

The advantage of this option is that it will provide the most complete information to the Commission to assist, particularly, in disputes over the terms and conditions of access. Historical costs would still need to be reported to the Commission, as this information would be needed for many of the purposes listed above.

This option involves the highest compliance cost burden for both the Commission and reporting carriers and carriage service providers. The development of forward-looking costs would require the resolution of various practical and methodological issues of considerable complexity and require very high investment of resources for the Commission and carriers and carriage service providers required to report on this basis. Modelling of forward-looking costs was undertaken by the Commission for the Public Switched Telephone Network – only one of many services to be reported on in the RAF – and took over 18 months and required the employment of a consultant as well as significant contributions from Telstra.

Carriers to be notified under the Regulatory Accounting Framework

A further issue relevant to the compliance costs of the various options is the number of carriers the Commission notifies to report. The Commission has decided the two major vertically integrated carriers, Telstra and Cable & Wireless Optus, should be required to report, because of their relative size and the variety of different services provided by them. AAPT, Primus and Vodafone, however, will be required to supply information

only on revenue and service usage at the retail and external wholesale level, and total assets and costs (disaggregated into the RAF line items, but not allocated to the different services).[4] This will decrease the costly process of cost and asset allocation across services for these carriers, while still providing the key information for reporting and inquiry purposes (revenue and service usage) allocated to the various service groups.

The Commission has considered whether it would be preferable to seek this information in a separate record-keeping framework. However, the Commission believes these modifications to the RAF for AAPT, Primus and Vodafone will enable it to obtain information earlier (ie. because it will not need to develop the new record-keeping framework) and minimises the number of regimes under which carriers are required to provide information.[5]

5. Consultation

The Commission has engaged in a significant consultation process related to the development and implementation of new record-keeping rules. An industry Working Group was initially established and chaired by the Commission. The Working Group comprised representatives from Telstra, Cable & Wireless Optus, Vodafone, AAPT, BT and Primus, which were nominated under the auspices of the Telecommunications Access Forum.[6]

The Working Group developed and agreed on a broad conceptual model that separated a carrier's or carriage service provider's activities between its wholesale and retail components and provided relevant financial information on these aspects. In August 1997, the Commission provided a discussion paper to the Telecommunications Access Forum seeking comments on this model and other options for new record-keeping rules.

The Commission then engaged the services of Arthur Andersen to develop the conceptual model to a point where it could be practically applied to the appropriate carriers and carriage services providers. A draft report by Arthur Andersen was released for comment in June 1999 and finalised in December 1999. After considering comments on this report, the Commission released a draft of the RAF in November 2000.

The Commission received eight submissions on the draft RAF. The submissions generally supported the reporting regime specified in the RAF. No submissions were

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[4] In the Information Paper released with the draft RAF in November 2000, the Commission indicated that it would consider developing criteria to select which carriers and carriage service providers should report under the new Rules. The Commission now favours an approach where carriers and carriage service providers are selected to report by directly considering each carrier and carriage service provider against the objectives of the RAF.

[5] These carriers will be notified to partially report under the RAF, to implement this approach.

[6] The Telecommunications Access Forum is the industry's self-regulation body for access issues, representing both access providers and access seekers.

received opposing the Commission's proposed accounting separation model. The major issue raised in most submissions was how broadly the RAF should be applied and potential cost of compliance for smaller carriers and carriage service providers.

Telstra submitted that the RAF provides a reasonable balance between the Commission's requirement for information while ensuring the regime is not unduly burdensome. Telstra argued that all carriers and carriage service providers who supply a declared service should report. Cable & Wireless Optus commented that the RAF should only apply to Telstra because Telstra is the only carrier with substantial market power and applying to any other carrier would be inefficient. Vodafone commented that compliance costs will exceed those currently incurred under COA/CAM and noted that it was important for the Commission to ensure the RAF did not become an end in itself, but rather a tool to assist in Commission investigations.

PowerTel, AAPT, Primus, One.Tel and iiNet commented that the implementation of the RAF would be unduly onerous and a significant cost burden for them if they were required to report in full.

Since November 2001, the Commission has been engaging in on-going discussion with Telstra, Cable & Wireless Optus, Vodafone, AAPT and Primus regarding the introduction of the RAF.

6. Conclusion and preferred option

Options were assessed against the objectives noted earlier: ability to assist the Commission with its telecommunications functions listed above; and relative compliance and administrative costs. The option that is most likely to meet these objectives is option 3, the RAF.

Option 1 is not suitable because it relies on the Commission's *ad hoc* information gathering powers which cannot guarantee that information required by the Commission from carriers will be available when requested and does not facilitate accounting separation. Option 2 does not meet the Commission's objectives because it is unable to provide sufficiently detailed information from large vertically integrated carriers and would still require the Commission to make additional information requests to those carriers. Option 4 would impose significant compliance costs for large vertically integrated carriers and the Commission because of the complex methodological issues that would require resolution before this option could be implemented.

Option 3 provides comprehensive information – by service at the retail and wholesale level – of high integrity to assist the Commission in its regulatory responsibilities without engaging in the lengthy process of implementation required if option 4 is followed. Therefore, as well as achieving the primary objective of accounting separation, the RAF can also be used to provide information relevant to the Commission's functions generally, which will assist in reducing the number of information requests made to carriers and carriage services providers each year as well as enhancing the consistency and usefulness of information provided to the Commission.

7. Implementation and review

The RAF is not a disallowable instrument. It will come into effect on the date the Rules are issued by the Commission. The Commission will issue the Rules by making a public announcement, placing the Rules on its website the same day and providing a copy of the Rules to the carriers and carriage service providers who are notified by the Commission that the RAF applies to them, as required by section 151BU of the Act.

Reporting carriers and carriage service providers will be required to report from the financial year 2001/2002 and on. Primus, who reports on a calendar year basis, will report the second half of 2001 before providing full reports for 2002 and following years.

The Commission intends to work closely with reporting carriers and carriage service providers particularly over the first six months of implementation. The Commission may need to amend certain provisions in the RAF over this period in order to resolve any practical problems that emerge over the implementation phase. Reporting carriers will be provided with details of any amendments and are likely to be given an opportunity to comment on any such amendments prior to their introduction.

The changing regulatory environment and the rapid changes that characterise the telecommunications sector are likely to require regular reviews of the RAF. The Commission's current expectation is that it will conduct a review of the RAF and its application in 2003.