



Regulation impact statement

Extending the Carrier Licence Conditions (Networks supplying Superfast Carriage Services to Residential Customers) Declaration 2014

Context

Introduction

On 31 December 2014, the Minister for Communications ('the Minister') made the *Carrier Licence Conditions (Networks Supplying Superfast Carriage Services to Residential Customers) Declaration 2014* (CLCs). The CLCs impose functional separation¹ and wholesale supply obligations on carriers who extend existing networks to supply superfast carriage services² to residential customers, but who were not otherwise subject to similar obligations in the *Telecommunications Act 1997* (the Act). The CLCs addressed concerns that vertically integrated networks could create local access bottlenecks that impede effective retail competition and that such operations would be at a competitive advantage relative to other networks already subject to similar rules.

The Minister is now considering whether to extend the CLCs, which expire on 31 December 2016. The CLCs were originally intended to be transitional measures pending the passage of new legislation announced in the Government's December 2014 *Telecommunications Structural and Regulatory Reform* policy statement.³ That statement set out a number of proposed changes to the separation arrangements in Part 8 of the Act, which include retaining the default requirement for structural separation but allowing for functional separation subject to authorisation by the ACCC to facilitate commercial flexibility. However, the passage of legislation has been delayed.

This regulatory impact statement examines extending the licence condition by a short period to ensure there are appropriate separation rules to address the competition issues above and there is no regulatory gap before the Act can be amended. It also considers whether additional measures should be put in place to improve transparency that regulatory objectives are being achieved.

The original RIS for the CLCs ('the 2014 RIS') identified a number of competition concerns arising from vertically integrated networks. The key concern is that in situations where there is an infrastructure

¹ 'Structural separation', which requires market entrants to operate as either wholesale or retail businesses, but not as both, is required under Part 8 of the Act for 'superfast' networks. The CLCs put in place 'functional separation' for some networks that were exempt from Part 8. Functional separation requires a single corporate entity to separate its wholesale and retail operations into separate companies or business units, while allowing it to retain ultimate control of both.

² 'Superfast carriage services' are defined in the Act and are essentially carriage services supplied over fixed-line networks that allow end-users to download communications with a download transmission speed of 25 Mbps or more.

³<https://www.communications.gov.au/sites/g/files/net301/f/Telecommunications%20Regulatory%20and%20Structural%20Reform%20Paper.pdf>

access bottleneck, the firm controlling the network has the incentive and ability to deny access to would-be competitors and potentially favour its downstream operations over those of its competitors. These concerns can be addressed by separation rules in relation to network and retail operations. However, such rules can have efficiency impacts for the regulated firms, for example, in terms of reduced co-ordination between retail and network operations, increased transaction costs, regulatory compliance costs and reduced economies of scope. A key issue, therefore, is the trade-off between the benefits of separation rules for competition and the potential impacts on efficiency.

The superfast network rules

In March 2011, the Parliament enacted legislation (Parts 7 and 8 of the Act) to require new networks that were able to provide download speeds of more than 25 Mbps ('superfast networks') to residential and small business customers to operate on an open access, wholesale-only and non-discriminatory basis. The networks were also required to offer a Layer 2 [bitstream] wholesale service.⁴

These requirements were very similar to those applying to NBN Co and were intended to ensure that new networks that are built provide consumers with a choice of competing retail service providers and the benefits of competition, in terms of service innovations and lower retail prices. As such they sought to provide consumers with the same types of outcomes that they should enjoy on the NBN. The rules were also intended to create a more level regulatory playing field for NBN Co, enabling it to compete more effectively in the provision of infrastructure. As a result of this, NBN Co would also be better able to cross-subsidise loss-making services, as required by the previous Government's operational model for the NBN. The current Government now intends that these loss-making services be funded by a transparent, competitively neutral industry subsidy scheme, pending new legislation announced by the Government's December 2014 policy statement.

The superfast network rules involve a number of exemptions. One exemption applies to network operators who extend superfast networks that existed before 1 January 2011 by less than 1km (the statutory 1km exemption). This was intended to permit existing networks to be extended on a limited basis. The intention was that new networks, and any substantial extensions of existing networks, targeting residential or small business customers should be subject to the new rules.

Following the implementation of the superfast network rules, TPG announced it would use its existing business networks to supply superfast services to residential customers on a vertically integrated basis using the 1km statutory exemption. The Government noted that a number of carriers could similarly use the exemption to roll out large scale networks that were not subject to Parts 7 and 8 of the Act. This raised competition concerns that the carriers would have the incentive and ability to deny access to would-be competitors and potentially favour their own downstream operations over those of their competitors. This was contrary to the intent of Parts 7 and 8. Consequently, the CLCs were made in December 2014 to address these concerns, pending the enactment of new legislation.

The Government is developing legislative reforms to Parts 7 and 8 of the Act that will retain the default requirement for structural separation of new superfast networks, but allow network operators to operate on a functionally separated basis if authorised by the ACCC. This will provide commercial and competitive flexibility while continuing to address the competition concerns arising from vertical integration.

⁴ 'Layer 2' is a commonly-used term in the industry and refers to a particular layer in the network. A Layer 2 service will not have the characteristics of a retail service but forms a 'raw' foundation on which a wholesale customer can build retail services such as telephony or Internet access.

The Carrier Licence Conditions

The CLCs subject carriers operating a 'designated telecommunications network' to a number of new wholesale supply and separation obligations if they do not operate those networks on a wholesale-only basis. A designated telecommunications network is defined as that part of a fixed-line telecommunications network made up of local access lines, or parts of local access lines, that are used, or are technically capable of being used, to supply superfast carriage services to residential customers.

Key to the CLCs' new obligations is subsection 6(6), which sets out the conditions relating to functional separation. The overarching principle of subsection 6(6) is that a specified carrier's retail company cannot supply eligible services it receives from the wholesale company unless those services are also offered by the specified carrier's wholesale company to other carriers and carriage service providers on the same terms and conditions. This requires carriers not operating designated telecommunications network on a wholesale-only basis to separate their business into a retail company and a wholesale company. The CLCs allow for functional separation instead of structural separation (as with Part 8) to afford carriers greater flexibility while still addressing the fundamental competition concerns.

Subsection 6(7) and 6(8) of the CLCs set out conditions relating to access obligations. Subsection 6(7) provides that where a Layer 2 Wholesale Service is not a declared service, a specified carrier must offer to supply, upon reasonable request by another carrier or carriage service provider, a Layer 2 Wholesale Service using the designated telecommunications network. This is based on the basic service that must be offered under Part 7 of the Act. Subsection 6(8) sets the maximum price of \$27 per month (exclusive of GST) for the supply of the Layer 2 Wholesale Service. The price is based on the price that the ACCC set under its declaration of the Local Bitstream Access Service in respect of networks subject to Parts 7 and 8 of the Act.

Carriers subject to the CLCs were required to register with the ACCC. To date, no carrier has registered, meaning that all designated networks must now be operating on a wholesale-only (structurally separated) basis or are operating in breach of the CLCs. TPG advised, early in 2015, that it had disposed of its retail business, meaning it was operating on a wholesale-only basis and did not need to comply with the functional separation obligations under the CLCs. It has since created a functionally separate wholesale company to supply wholesale Layer 2 services.⁵

This suggests that the CLCs have been successful in supporting competition by regulating vertical integration. However, there have been calls for the level of compliance to be made clearer through new transparency requirements.

Superfast Broadband Access Service Declaration

Part XIC of the *Competition and Consumer Act 2010* (CCA) sets out the telecommunications access regime. Under Part XIC, the ACCC can 'declare' access to telecommunications carriage services if it is in the long term interest of end-users. Declaring a carriage service has the effect of obliging carriers to supply wholesale services if they operate a network that is capable of supplying that service. Declaring superfast carriage services would address the supply concerns covered by the CLCs in the long term.

On 11 September 2014, the ACCC commenced a declaration inquiry into whether a superfast broadband access service (SBAS) should be regulated under the CCA. On 29 July 2016, the ACCC declared SBAS and made an interim access determination (IAD). This requires carriers operating certain superfast networks to supply SBAS over their networks, including networks that would be subject to the CLCs. As a result,

⁵ *Communications Day*, 'TPG's new functionally separated wholesale arm releases FTTB services: with \$4 CVC charge,' Issue 5195, pp.1-2.

subsections 6(7) and 6(8) now operate subject to the SBAS declaration, although networks with fewer than 2,000 services in operation are exempted from the declaration.

As noted in the 2014 RIS, ACCC declarations can establish wholesale supply obligations, but cannot impose separation or non-discrimination requirements on carriers. As a result, the declaration of SBAS does not fully address the competition concerns identified in 2014.

Defining the problem

The CLCs were intended as a short term measure, having been originally planned to remain in place for two years and expire by 31 December 2016, while legislation was developed and passed by the Parliament. However the Government's proposed long-term reforms to introduce functional separation obligations, which were planned to take effect on 1 January 2017, have been delayed and are yet to be introduced into the Parliament. It is unlikely that they can be considered by the Parliament before 1 January 2017. This means that the CLCs may expire before the new legislation can take effect. If the licence conditions are allowed to lapse, there is a risk that carriers could extend superfast networks on a vertically integrated basis and re-open the competition issues relating to vertical integration that the CLCs were put in place to address.

This regulatory impact statement addresses the question of whether to extend the CLCs by a short period to ensure there are appropriate separation rules to promote competition and there is no regulatory gap before the Act can be amended. It also considers whether additional measures should be put in place to improve transparency that regulatory objectives are being achieved. Such measures would aim to clarify how carriers who are subject to the CLCs, but have adopted wholesale-only models, are operating, promoting certainty for the sector.

Overview of options

Four options are examined in relation to the problems identified.

Option 1. Do nothing. The existing CLCs would expire and carriers would no longer be required to implement functional separation of networks subject to the CLCs. Any long term solutions would depend on the passage of legislation, which is discussed under Option 4.

Option 2. The Minister could extend the CLCs for 18 months (i.e. to expire on 30 June 2018) until legislative changes are passed. Some minor changes could be made to remove spent provisions. The CLCs would continue to require those carriers not subject to Parts 7 and 8 of the Act that supply superfast carriage services to residential customers to establish functionally-separated retail and wholesale units, with the wholesale unit required to offer the services to the retail unit, other carriers and service providers on the same terms and conditions.

Option 3. The Minister could extend the CLCs for 18 months as proposed in option 2, and amend the CLCs to:

- remove spent provisions, and
- include additional transparency obligations covering carriers who own or control designated telecommunications networks.

The additional provisions would ensure that such carriers provide the Minister and the ACCC with a declaration that they are not supplying wholesale services to associated service providers and also require them to provide information on their network coverage, wholesale services on offer and service terms and conditions.

Option 4. Implement legislative changes in line with the Government's December 2014 policy statement before the CLCs expire. This would involve repealing Part 7 and amending the wholesale-only rules in Part 8 to reset the basic requirement of structural separation and allow the ACCC to authorise functional separation. Access to high-speed broadband networks would be dealt with by Part XIC of the CCA through the ACCC's SBAS declaration.

Regulatory impacts of options

The four options have been assessed against the following criteria:

- Does the option promote investment in, and consumer access to, superfast broadband?
- Does the option allow operators to achieve efficiency gains through integrated operation?
- Does the option address competition concerns in relation to vertically integrated networks?
- Does the option promote a level regulatory playing field between market players?
- Does the option impose ongoing or one-off compliance costs on a carrier?

The assessment considers the impacts on different stakeholders, including consumers and industry (including NBN Co).

Option 1—Do nothing—allow the CLCs to expire

Option 1 has the following advantages:

- A limited number of carriers might extend networks by less than 1km on a vertically integrated basis. This could promote some additional investment in new superfast broadband infrastructure and provide some end-users with earlier access to superfast carriage services than may otherwise have been the case.
- Option 1 would enable any efficiency gains achievable through more integrated operations to be captured by those with networks that were otherwise caught by the CLCs.
- As the CLCs would automatically lapse, the option could be implemented quickly and with no administrative costs and would provide industry with some legal certainty.

The option has the following disadvantages:

- Vertically integrated operators could favour their downstream operations over those of competitors seeking access to the network. This could limit the degree to which competition provides benefits to consumers.
- Incumbent carriers with pre-2011 infrastructure could extend their networks by less than 1km on a vertically integrated basis, giving them an advantage over new market participants that would not have this option and who have to invest on a structurally separated basis.
- NBN Co may face greater competition in some areas, and if this reduces its revenues, this could place pressure on its ability to cross-subsidise service provision for regional end-users.
- Given that the Government has indicated that it will seek to introduce legislation along the lines set out in the CLCs, industry would face the uncertainty of another potential short term regulatory change.

The extent to which Option 1 would promote investment is unclear. Only a limited number of carriers with pre-2011 infrastructure would be able to take advantage of the change. Moreover, under the CLCs, TPG has continued to expand its fibre-to-the-basement network in major capital cities. In December 2014, the network was present in a small number of buildings. In early 2015 it was present in over 600 buildings. By August 2016, the network had reached over 1,500 buildings with further expansion planned.⁶

Data from other countries—the United Kingdom, New Zealand and Singapore - that have introduced functional separation of major telecommunications networks also show that network investment has continued after separation.⁷

Similarly, it is unclear that greater vertical integration would lead to significant efficiency gains. For Singapore, data provided to the Department of Communications and the Arts by the Infocomm Development Authority show that retail prices on the separated next generation national broadband network have fallen on an annual basis since it was completed in 2010. In the United Kingdom, the average price of a broadband package decreased by 48 per cent between 2004 (when functional separation was introduced) and 2012, facilitated by greater non-discriminatory access to unbundled local loops.⁸ In Australia, broadband prices on TPG's fibre-to-the-basement network have been stable since the CLCs were introduced.⁹

The regulatory burden measurement for this option is at Annex A.

Option 2—Extend the Carrier Licence Condition

Option 2 has the following advantages:

- The option addresses the concerns about the competitive impact of vertical integration by ensuring that access seekers will have access, on a non-discriminatory basis, to services.
- Incumbent carriers with pre-2011 infrastructure would not be advantaged over new market participants that can only enter the market on a structurally separated basis.
- There would be scope for affected operators to capture some efficiency gains, for example, through greater co-ordination of retail and network operations, which might result from more integrated operation. These efficiencies would be shared with other retail access seekers who need to be treated on a non-discriminatory basis.
- NBN Co would operate on a more level regulatory playing field, reducing pressure on its revenues and its ability to cross-subsidise service delivery for regional end-users.

⁶ See *Communications Day*, 'TPG's new functionally separated wholesale arm releases FTTB services: with \$4 CVC charge,' Issue 5195, 17 August 2016, p.1

⁷ For New Zealand, see Ministry of Business, Innovation and Employment (2016), *Telecommunications Act Review: Options Paper*, p.5. For the United Kingdom, see Department for Culture, Media and Sport (2016), *A New Broadband Universal Service Obligation: Consultation*, pp.5-7 (increases in the deployment of superfast broadband infrastructure by the functionally separated network provider, Openreach). For Singapore, see <http://www.netlinktrust.com/press/netlink-trust-completes-integration-of-singapores-fibre-assets/>.

⁸ Ofcom (2015), *Cost and value of communications services in the UK*, pp.4-5.

⁹ In December 2014 TPG charged \$69.99 per month for an unlimited broadband service (bundled with a telephone) on its network. Currently, the retail provider to whom TPG sold its retail business on the network, Wondercom, charges \$69.99 per month for the same bundle (<https://www.wondercom.com.au/fttb>). Other retail providers on TPG's network offer similar prices for an unlimited broadband and home phone bundle; for example, ello charges \$69.99 per month (<http://ello.com.au/>), AusBBS charges \$64.95 per month (<https://ausbbs.com.au/residential/fttb/>), nbnSP charges \$55 per month (<https://nbnsp.com.au/fttb/>) and Boom Broadband charges \$65 per month (<http://boombroadband.com.au/nbn-products/fibre-to-the-building/>).

- Network operators and retail service providers who have planned on the basis of the CLCs and replacement legislation could continue to operate as planned.
- No carriers would have to take action if the CLCs were extended because they would effectively be carrying on under their current business models.

Option 2 has the following disadvantages:

- To the extent the rules discourage investment, there may be a limited impact on investment and earlier access to superfast broadband for some consumers. However, as discussed under Option 1, the impact on investment may be minor.
- To the extent that functional separation has an impact on business efficiency, there may be additional transaction costs for the separate entities and these would continue to be passed on to end-users. Again, however, as discussed under Option 1, the extent of such potential efficiency losses appears to be limited.

The regulatory burden measurement for this option is at Annex A.

Option 3—Extend the Carrier Licence Condition with added transparency measures

Option 3 has similar advantages to option 2, given it is a variation of that option:

- The option addresses the concerns about the competitive impact of vertical integration by ensuring that access seekers will have access, on a non-discriminatory basis, to services.
- Incumbent carriers with pre-2011 infrastructure would not be advantaged over new market participants that can only enter the market on a structurally separated basis.
- There would be scope for affected operators to capture some efficiency gains, for example, through greater co-ordination of retail and network operations, which might result from more integrated operation. These efficiencies would be shared with other retail access seekers who need to be treated on a non-discriminatory basis.
- NBN Co would operate on a more level regulatory playing field, reducing pressure on its revenues and its ability to cross-subsidise service delivery for regional end-users.
- Network operators and retail service providers who have planned on the basis of the CLCs and replacement legislation could continue to operate as planned.
- No carriers would have to take substantive action if the CLCs were extended because they would effectively be carrying on under their current business models.
- The proposed transparency obligations would provide new visibility and confidence that the rules were working to support fairer competition.

Option 3 has similar disadvantages to option 2, with the additional implications of the proposed new transparency rules.

- To the extent the rules discourage investment, there may be a limited impact on investment and earlier access to superfast broadband for some consumers. However, as discussed under Option 1, the impact on investment may be minor.
- To the extent that functional separation has an impact on business efficiency, there may be additional transaction costs for the separate entities and these would continue to be passed on to end-users. Again, however, as discussed under Option 1, the extent of such potential efficiency losses appears to be limited.

- The new transparency obligations involve a new regulatory burden, however the associated costs are likely to be negligible because carriers would only have to sign a declaration and provide information which should already be collected in the ordinary course of business. The Department estimates that this work will take about 15 hours a year to complete for each carrier that is affected. This equates to a regulatory burden of about \$980 per year per affected carrier. We estimate that there are at most four carriers that are likely to need to provide additional information.

The regulatory burden measurement for this option is at Annex A.

Option 4—Legislation to address the issue

Option 4 has similar advantages and disadvantages to options 2 and 3. The key difference is that under option 4, legislation would need to be passed by the Parliament before the CLCs expire. There is no certainty that this can be achieved, given the few months remaining before the CLCs expire and competing legislative priorities. Consequently, in the short term, this option presents the same outcomes as option 1. In the longer term it presents the same outcomes as option 2. The new regulatory approach would also address the transparency issues targeted under option 3.

The regulatory burden measurement for this option is at Annex A.

Selecting the best option

The preferred approach is option 3. Extending the CLCs in the short term will address the fundamental policy issue that carriers rolling out substantial extensions of pre-2011 networks can operate on a vertically integrated basis, leading to poor competitive outcomes. It will minimise any impact on NBN Co's ability to compete on a level playing field and to cross-subsidise its rural and remote networks, pending the enactment of broader legislation to address these issues. It will provide policy and regulatory continuity for market participants, while requiring minimal regulatory adjustments. While there could be potential impacts on network investment and efficiency, these are seen as limited given the number of providers affected, evidence that separation has had limited effects in these areas, and the scope to capture some efficiency gains through functional separation.

The CLCs would apply for an additional 18 month period, subject to the timing of legislative change. Once legislation is in place the Government would adopt, in effect, option 4. As stated in the December 2014 policy statement, the Government will put forward new legislation. This will require new high-speed broadband networks targeting residential customers to be structurally separated as a default. However, carriers would be able to submit undertakings to the ACCC containing functional separation and non-discrimination commitments. The ACCC could then authorise functional separation. This would enable some of the efficiency benefits from vertical integration to be captured while also providing benefits for consumers from more effective retail competition.

Amending the CLCs to include additional transparency obligations covering carriers who own or control designated telecommunications networks would improve transparency and public confidence that competition objectives are being achieved. As stated earlier, compliance with the new provisions is estimated to involve a minor regulatory burden of about \$980 per year per affected carrier. This reflects the amount of time estimated to fill in forms and gather information (about 15 hours), multiplied by the wage for work-related labour costs, which is \$65.45 per hour.

Consultation

Under section 64 of the Tel Act, before the Minister makes CLCs the Minister must provide a draft of the CLCs to an affected carrier and invite the carrier to make a submission on the draft. The timeframe for the submission is 30 calendar days from the date the Minister provides the draft to the carrier. As CLCs on superfast carriage services could affect a number of carriers, the Department, on behalf of the Minister, will write to all licensed carriers in Australia, inviting submissions on the draft CLCs. The Department of Communications and the Arts will also place a copy of the draft CLCs and the early assessment draft of the RIS on the Department's website.

Implementation and evaluation

Option 3 would be implemented by the Minister extending the CLCs with the proposed amendments. The CLCs would take effect from the day after they are registered on the Federal Register of Legislative Instruments. The CLCs would be a disallowable instrument.

The Government would continue to evaluate the effectiveness of the CLCs, including the nature of any impacts on carriers and on end-users, through its regular monitoring of industry circumstances and liaison with carriers and regulators.

In the long term, the CLCs will eventually be superseded by the legislative amendments detailed in option 4.

Annex A—Regulatory burden measurement

The regulatory burden measurement of the different options is set out in the table below.

Option	Preferred	Regulatory burden measurement
1: Status quo—CLCs lapse	No	Nil. There are no compliance costs or additional costs on industry.
2: Extend the Carrier Licence Condition. This will require functional separation of wholesale and retail business units.	No	Nil. Carriers would continue their current business models, so there would be no compliance costs or additional costs on industry.
3: Extend the Carrier Licence Condition, but also amend it to incorporate amendments to provide greater transparency.	Yes	Limited. Extending the CLCs would see carriers continue their current business models, so there would be no compliance costs or additional costs on industry. However, the additional obligations would have a limited regulatory burden (about \$980 a year per affected carrier). All carriers have been planning for the future legislative changes.
4: Apply Part 7 and 8 as intended by removing exemptions.	No	Nil, in this context. A separate RIS has been developed for the legislation.

Assumptions (Option 1)

This option would mean carriers subject to the CLCs would no longer need to comply with the separation rules under the CLCs. These carriers could extend networks on a vertically integrated basis. To the extent that they choose to do so, this could involve some costs, however these would be taken on voluntarily and not imposed by option 1.

Other industry players that have planned on the basis of the CLCs and legislation being enacted may choose to re-assess their future plans. However, any change in plans would be a voluntary decision by the firms involved, noting the Government has indicated it intends to legislate similar rules.

Given these considerations, there is no regulatory burden imposed by this option.

Average annual regulatory costs (from business as usual)

Change in costs (\$ million)	Business	Community organisation	Individuals	Total change in cost
Total by sector	(\$0)	\$0	\$0	(\$0)

Assumptions (Option 2)

Extending the CLCs would not require carriers to change their current business models. They would be able to carry on 'as usual'. Consequently, this option would not produce any new compliance costs for industry. As such there is no regulatory burden imposed by this option.

Average annual regulatory costs (from business as usual)

Change in costs (\$ million)	Business	Community organisation	Individuals	Total change in cost
Total by sector	(\$0)	\$0	\$0	(\$0)

Assumptions (Option 3)

- Extending the CLCs would not require carriers to change their current business models.
- The inclusion of new transparency obligations in the CLCs will impose a minor regulatory burden on 1–4 businesses, that is, those with pre-2011 infrastructure that may be able to take advantage of any relaxation of the rules. Given the approximate cost of compliance is estimated at 15 hours a year per business, this equates to a regulatory burden of about \$980 a year per affected carrier. This figure is based on an estimate of the amount of time required to fill in the necessary forms and gather information (estimated at 15 hours), multiplied by the wage figure for work-related labour costs, which is \$65.45 per hour.

Average annual regulatory costs (from business as usual)

Change in costs (\$ million)	Business	Community organisation	Individuals	Total change in cost
Total by sector	(\$0.004)	\$0	\$0	(\$0.004)

Assumptions (Option 4)

- The cost to industry of amending legislation to repeal Part 7 and amend the wholesale-only rules in Part 8 will be negligible in this context. The rules have been in effect since 2011, so carriers are already subject to existing structural separation requirements.
- Introducing greater flexibility through allowing functional separation is expected to promote investment by carriers on the basis they have greater commercial and competitive flexibility.

Average annual regulatory costs (from business as usual)

Change in costs (\$ million)	Business	Community organisation	Individuals	Total change in cost
Total by sector	(\$0)	\$0	\$0	(\$0)