



# Regulation Impact Analysis

## Telecommunications Amendment (Local Access Lines— Class Exemptions) Regulations 2022

January 2022

### Promoting competition for broadband users' benefit

Australia's telecommunications legislative framework aims to enable an industry that is efficient, competitive and responsive to the needs of the Australian community. The proposed regulation will incentivise smaller providers to compete with NBN Co at the infrastructure level. Other existing measures and ACCC powers will continue to protect consumers. The proposed measure is deregulatory.

### What is the policy problem you are trying to solve?

The wholesale residential superfast broadband telecommunications market is dominated by one large near-monopoly provider, NBN Co Limited (NBN Co), the large scale rollout of the NBN having recently finished. Large monopolies have a natural tendency to constrain supply and lift prices. Since the implementation of the Hilmer reforms in the 1990s, Australian Governments have accepted that active competition in the telecommunications market leads to better consumer outcomes in the form of higher quality services and lower prices. In addition, since the 2014 Vertigan Panel's *Independent Cost-Benefit Analysis and Review of Regulation* (Vertigan Review), the Australian Government has sought to promote infrastructure competition in the provision of telecommunications services. The legislation to implement the recommendations of the Vertigan Review and stimulate other entities to compete with NBN Co passed through Parliament in May 2020.

The deregulatory proposal covered by this Regulation Impact Statement aims to stimulate competition in the wholesale broadband infrastructure market by encouraging smaller providers to roll out their own networks to compete with NBN Co and other larger providers. The proposal will further enable smaller providers to earn retail and wholesale revenues from their networks, without the cost overheads associated with separating their businesses on either a structural or functional basis (as applies to larger providers, like NBN Co, that have significant advantages in terms of economy of scale and access to affordable capital).

Once those smaller providers have more than 12,000 customers they will be required to either structurally or functionally separate their wholesale and retail businesses. This will protect customers from the risks that could flow from the creation of a large vertically integrated telecommunications provider.

## Background

Prior to 2020, when the Parliament passed laws adjusting the structural separation requirements, all controllers of newly built Australian superfast fixed-line broadband networks built from 2011 supplying services to residential and small business customers were required to operate those networks on a wholesale-only basis. This meant that a company that controlled a network could not itself supply retail services over that network. Instead, that company was only able to offer wholesale services to providers willing to supply retail services to customers connected to the network.

These requirements were designed to prevent a network operator that is both a wholesaler and a retailer from advantaging itself over other retailers using the network operator's infrastructure. For example, an integrated business may have incentives to preference its own retail arm on price and non-price terms, such as prioritising its own repairs. Further, the retail arm may have greater access to information about network capabilities, scheduled maintenance and proposed upgrades. Together, these advantages can give the vertically integrated provider a sufficient edge over its competitors to the point that those competitors exit the market and potential new entrants are deterred, thereby narrowing the number of retailers that consumers can choose from. Prices may increase and choices may be more limited as a result.

However, in some cases, integration between the wholesaler and the retailer on a network can result in better outcomes for consumers. For example, if small network operators can provide both retail and wholesale services, they may be able to generate the revenue needed to gain a foothold in the market, increasing competition, particularly if a market already has a large incumbent infrastructure provider like NBN Co. Small providers that are vertically integrated can avoid double-marginalisation – where both the wholesale arm and retail arm need to make a relatively higher return on capital, leading to lower prices offered to customers, innovative deployment strategies and better network maintenance. In the longer term, this may help those providers challenge dominant infrastructure providers, thereby increasing competition at both the retail and wholesale level.

## Australian telecommunications regulatory framework

The Australian Government has a long history of opening up the telecommunications industry in order to promote competition in an effort to support better services and lower prices for telecommunications users, including Australian businesses and the general public. The telecommunications regulatory regime provides a framework within which entities can compete in the telecommunications market while providing affordable and reliable services. A detailed list of telecommunications regulation relevant to consideration of the proposed increase in the limit of the class exemption limit from the otherwise mandatory separation rules is at Annex A.

### **Telecommunications Act 1997 (Tel Act) – Part 8: Local access lines, Sections 143A and 142C**

Part 8 of the Tel Act regulates competition in the telecommunications market in relation to local access lines. While the default position is for superfast fixed-line broadband network owners to provide services to residential customers on a structurally separated basis, they can seek approval from the Australian Competition and Consumer Commission (ACCC) to operate on a functionally separated basis (i.e. operate both wholesale and retail businesses, but at arms-length from each other). For network operators to take advantage of this option, they need to voluntarily submit and have the ACCC accept a functional separation undertaking or elect to be bound by the ACCC's *Telecommunications (Deemed Functional Separation Undertaking) Determination 2020* (Deemed Functional Separation Undertaking).

The ACCC has the power under section 143A of the Tel Act to make determinations, by way of legislative instruments, to make class exemptions from the Part 8 wholesale only requirements for small network operators on a single basis or group basis. The relevant wholesale only provisions are:

- section 142C, in the case of local access lines that came into existence on or after the designated commencement date; and
- section 143, in the case of local access lines forming part of telecommunications networks that were in existence before the designated commencement date.

The designated commencement date was 25 August 2020.

The legislation provides that the class of persons eligible for exemptions is defined by the number of residential customers to whom a person or group of associated persons (as the case may be) is supplying fixed-line carriage services. The Act currently sets the default maximum threshold of 2,000 residential services in operation (SIOs) in all cases (refer to subparagraphs 143A(1)(d)(i) and (e)(i) and subparagraphs 143A(2)(d)(i) and (e)(i)). The SIO threshold can be increased to a higher number by regulations, but the maximum number that can be specified is 12,000 (refer to subparagraphs 143A(1)(d)(ii) and (e)(ii) and subparagraphs 143A(2)(d)(ii) and (e)(ii)).

### **Class Exemption Determination**

On 25 August 2020, the ACCC made the *Telecommunications (Superfast Broadband Network Class Exemption) Determination 2020* (Class Exemption Determination),<sup>1</sup> which exempts network operators supplying fixed-line carriage services to no more than 2,000 residential customers from the Part 8 separation requirements. The Class Exemption Determination includes a mechanism to allow the threshold to increase to a maximum of 12,000 residential customers if this is specified in any regulations.

### **Statutory Infrastructure Provider (SIP) scheme**

Once the NBN was declared built and fully operational in 2020, NBN Co became the default SIP for all of Australia. Other network providers can also be SIPs where appropriate, and on 20 August 2020, the Minister for Communications declared 17 new SIPs.

The SIP obligations are designed to ensure that all Australian premises are able to access superfast broadband services (25 Mbps download or better and 5 Mbps upload or better), and voice services over non-satellite networks. SIPs are required to connect premises and supply wholesale broadband services on reasonable request from a carriage service provider on behalf of a consumer. NBN Co is the SIP for areas where it has rolled out its network, and became the default SIP for all of Australia when the Minister for Communications declared the NBN to be built and fully operational on 11 December 2020. The Minister could also make standards, rules and benchmarks that could set out more detailed requirements, such as timeframes for providing access and rectifying faults. SIPs would be required to comply with any such standards, rules and benchmarks.

### **Regional Broadband Scheme (RBS)**

The Government established the RBS to provide for the transparent and sustainable funding of essential broadband services in regional, rural and remote Australia. NBN Co's fixed wireless and satellite networks provide broadband access to around one million homes and businesses across regional Australia. However, these networks are very expensive and are estimated to incur net losses of \$12.9 billion over 30 years<sup>2</sup>. Until the RBS was introduced, these losses were to be wholly funded by an opaque internal cross-subsidy from NBN Co's profitable fixed-line networks. The RBS makes this cross-subsidy transparent and requires other competing fixed-line networks providing high speed broadband services to contribute to the cost of funding broadband in regional Australia along with NBN Co.

The RBS does not impose a new cost on NBN users—the cost is already built into existing NBN pricing. Given NBN Co infrastructure is used to provide around 95 per cent of superfast fixed-line services, around 95 per cent of the cost of funding NBN Co's fixed wireless and satellite networks will continue to be paid for by NBN Co, whereas previously it was 100 per cent. The remaining five per cent will be paid for by operators of competing superfast fixed-line networks. This establishes a competitively-neutral funding mechanism for broadband services in regional and remote Australia. Consequently, the RBS is a long-term solution to support the delivery of essential broadband services in regional Australia well into the future, regardless of who owns the regional networks and who is the dominant fixed-line provider in profitable metropolitan areas.

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<sup>1</sup> ACCC [Telecommunications \(Superfast Broadband Network Class Exemption\) Determination 2020](#)

<sup>2</sup> ACCC's 2020 estimate, see [www.accc.gov.au/system/files/Report\\_on\\_modelling\\_of\\_the\\_Regional\\_Broadband\\_Scheme\\_Levy\\_initial\\_base\\_component\\_-\\_October\\_2020.pdf](http://www.accc.gov.au/system/files/Report_on_modelling_of_the_Regional_Broadband_Scheme_Levy_initial_base_component_-_October_2020.pdf)

## National Broadband Network policy

The Government outlined its NBN policy in its response to the Vertigan Review in December 2014.<sup>3</sup> The Government indicated that its approach to regulation in the telecommunications market would not unnecessarily restrict competition and, to this end, adopted the following policy framework:

1. Structural separation will remain the default requirement for new high-speed fixed-line broadband networks. But the ACCC will be given the power to authorise functional separation of such networks, and impose conditions as part of that authorisation, where it judges this to be in the long-term interests of consumers.
2. Competitively neutral arrangements will be put in place for the funding of the NBN's non-commercial fixed wireless and satellite services.
3. Legislation will be introduced requiring NBN Co to operate as the broadband infrastructure provider of last resort. The legislation will provide scope for non-NBN carriers to be so designated in circumstances where they take on or are better able to fulfil this role.

Each of the key measures to implement this policy framework have subsequently been put in place by the Government.

NBN Co has competitive advantages over smaller providers, in that, it has economies of scale and access to relatively affordable capital. The Government established a competitive regulatory framework along the lines of that outlined above during the rollout of the NBN to facilitate NBN Co being more 'competition ready'. The arrangements aim to provide clear and consistent rules for carriers looking to invest in new high-speed broadband access networks, and deliver a degree of competitive neutrality for NBN Co and other industry players.

## Changes to the separation requirements

The Tel Act was amended in May 2020 in a way that was designed to promote infrastructure competition in broadband services and to implement the Government's response to the Vertigan Review.

The default rule remains that networks must operate on a wholesale-only basis. However, the *Telecommunications Legislation Amendment (Competition and Consumer) Act 2020* (TLA Act) amended Part 8 of the Tel Act such that a network provider can supply both retail and wholesale services over lines built or upgraded from 1 January 2011 that are used to provide superfast broadband services to residences if the ACCC accepts an undertaking setting out how the owner will functionally separate its retail and wholesale activities or if the network provider elects to be bound by the Deemed Functional Separation Undertaking.

The new laws also allow the ACCC to exempt networks with up to 2,000 customers from the wholesale-only requirements altogether. Regulations can be made to increase the customer limit to which the exemption power applies to 12,000.

The TLA Act also amended the definition of 'local access lines'. From 25 August 2020, if a line in a multi-dwelling building is used to supply a superfast carriage service to a residential customer in the building then it is taken to be a local access line that forms a part of the infrastructure of that telecommunications network. As a result, networks that use lines within a building and wireless technologies to distribute superfast broadband to customers in multi-dwelling buildings are captured by the separation requirements. Consequently, the separation requirements are relevant to more businesses than they would have been under the previous laws.

## ACCC decision on a class exemption

The ACCC issued the Class Exemption Determination on 25 August 2020. The ACCC decided to exempt network controllers with up to the maximum allowable 2,000 residential services from the structural and functional separation requirements. The ACCC indicated in its Explanatory Statement for the instrument that it was satisfied an exemption from the separation requirements would reduce the disproportionate regulatory cost burden on smaller networks.<sup>4</sup> The ACCC

<sup>3</sup> See Australian Government [Telecommunications Regulatory and Structural Reform: December 2014](#)

<sup>4</sup> ACCC [Explanatory Statement for Telecommunications \(Superfast Broadband Network Class Exemption\) Determination 2020](#), p.2

also noted that the ongoing deployment of 5G mobile technology and high-speed fixed wireless broadband services will increasingly provide a competitive constraint on superfast fixed-line broadband networks.

The ACCC put forward the view that the exemption would have the effect of:

1. encouraging entry of smaller superfast network operators and promoting competition in retail and wholesale markets, and
2. reducing the disproportionate regulatory cost burden on operators of smaller networks of being structurally or functionally separated when participating in superfast broadband markets, enabling them to further invest in competitive infrastructure through increasing the reach of their networks and improving the quality of services provided to end-users.

The ACCC drafted the exemption instrument such that any decision by the Government to create regulations to increase the class exemption limit up to 12,000 residential services would automatically increase the class exemption limit if and when such a regulation is made. While the current 2,000 customer threshold allows for market entry, these operators are often aiming to grow their businesses. To illustrate, of the six small network operators supplying less than 2,000 residential services that provided submissions to the ACCC's consultation on the exemption proposal, the majority indicated they expected to exceed the specified threshold within a period of five years. In this context, the ACCC has informed the Department of Infrastructure, Transport, Regional Development and Communications (DITRDC) that it supports the proposed regulations that would increase the threshold to 12,000 customers.

## Addressing the policy problem

### The Benefits of Structural Separation

Access to affordable high-speed broadband is critical for Australians. However, deployment of superfast broadband networks is capital and labour intensive. This provides a natural incentive for network providers to vertically integrate their wholesale and retail functions to streamline costs and secure a local market monopoly. Vertically integrated providers can come to dominate the market, resulting in poor competition outcomes and substandard services. For example, in the 2000s, despite the pressing need, Telstra did not upgrade its residential broadband network. That led the Australian Government to create a structurally separated national provider, NBN Co. So as to not unfairly disadvantage NBN Co and to prevent the rise of another dominant vertically integrated provider, the Parliament passed the *Telecommunications Legislation Amendment (National Broadband Network Measures—Access Arrangements) Act 2011*, which required all owners of new networks capable of offering superfast services to operate on a structurally separated basis.

### Structural Separation Benefits Can Outweigh the Costs

While NBN Co has successfully facilitated successive governments' aims to improve residential broadband coverage and service quality, the residential fixed-line broadband market is now dominated by NBN Co. To balance against the lack of broadband infrastructure competition, the Government has taken steps to encourage new market entrants.

Following recommendations from the Vertigan Review, on 14 May 2020, the Australian Parliament passed the TLA Act. The legislation, allows providers, subject to approval by the ACCC, to functionally separate their telecommunications businesses, that is, to own and operate separate wholesale and retail arms. The legislation provided the ACCC a power under section 143A of the Tel Act to permit infrastructure providers to operate on a vertically integrated basis if they supply fixed-line carriage services to no more than 2,000 residential customers, or services in operation (SIOs). The TLA Act allows regulations to be made to increase the customer limit, so that the ACCC could exempt operators with up to 12,000 SIOs from the structural separation requirement.

The legislation recognised that by encouraging innovative market entrants to challenge NBN Co's market power, consumers may benefit. The Government considered that these benefits may outweigh the risk of new entrants abusing their market power through the establishment of local non-NBN Co monopolies. The potential for negative consumer impacts was mitigated by the simultaneous introduction of the SIP rules and the RBS. The SIP regime provides a regulatory safety net allowing all consumers to access broadband services of a minimum standard. The RBS allows NBN Co to be compensated for losing customers in profitable areas when it is required to serve its loss making customers.

In addition, the legislation allows the ACCC to set the upper customer limit for exemption from the structural separation requirement dynamically within the parameters set in the legislation. The proposed amendments to the regulations will increase the scope within which the ACCC can do that.

Allowing smaller operators to be vertically integrated is very unlikely to have a negative impact on retail competition. This is because there are significant costs for retail service providers to interface their business support systems (BSS) and operations support systems (OSS) with the systems of a wholesale access provider. In the telecommunications industry, BSS primarily consists of order capture, customer relationship management and billing, whereas OSS covers order management, network inventory management and network operations. DITRDC has seen little or no evidence that retailers are willing to engage with wholesale carriers with less than 12,000 customers. These small providers are unlikely to receive demand for wholesale services until they become large enough (i.e., at least 12,000 customers) for potential access seekers to attract enough customers to cover the overheads of interfacing with the network owners' systems.

The ACCC recognised the impediments to investment by smaller innovative infrastructure providers created by the functional separation requirements when it drafted the Class Exemption Determination such that those network operators with no more than 2,000 residential customers are now exempt from any separation requirements if they elect to be bound by the Class Exemption Determination. Further, the ACCC drafted the determination so any decision to create regulations to increase the class exemption limit up to 12,000 residential services would automatically increase the class exemption limit. The ACCC's analysis indicates that '12,000 services was the minimum level of services required to profitably offer a wholesale service and therefore represented a low risk upper bound for the exemption'.<sup>5</sup> While the ultimate aim of requiring structural and functional separation is to allow retail service providers to compete on an equal footing, without any demand for wholesale services supplied by smaller infrastructure providers, the default separation requirements impose an unnecessary burden on them. In turn, this provides a significant disincentive for otherwise innovative operators to enter the market and compete with NBN Co, and risks that those already competing, albeit at a small scale, will recognise there is no scope to grow their customer base and as a result may choose to exit the market.

Increasing the exemption threshold through the regulation power from 2,000 to 12,000 will also simplify the regulatory framework for both network providers and access seekers. Under the ACCC's July 2021 Superfast Broadband Access Service (SBAS) declaration<sup>6</sup>, providers operating superfast networks built or upgraded after 1 July 2011 must publish and offer a wholesale access service consistent with that specified in the ACCC's July 2021 Interim Access Determination (IAD) for the SBAS. Providers operating networks in existence before 1 January 2011 and not upgraded or expanded after that date are required to publish and offer a default wholesale access service consistent with that specified in the ACCC's SBAS IAD. Under the SBAS IAD, these providers that supply services to no more than 12,000 end-users are exempt under the small provider exemption because the ACCC concluded the compliance costs for these structurally separated operators would be very high relative to expected wholesale revenues, and that the aggregate benefits to end-users on these smaller networks associated with not making the exemption would not outweigh these costs, particularly when the structural separation requirements were in place, which removed the possibility of a network owner discriminating in favour of itself. However, following the consolidation of network ownership in the period since the ACCC's inclusion of the small provider exemption in the 2017 SBAS Final Access Determination (FAD), the ACCC is not aware of any SBAS providers that continue to benefit from the exemption. The ACCC is currently conducting an inquiry into re-making a single FAD to replace the SBAS and LBAS FADs. This follows the ACCC's decision to combine the SBAS and LBAS into a single declared service, the SBAS. Among other things, the ACCC is considering whether to retain, extend or remove the small provider exemption in the re-made FAD.

In making its Class Exemption Determination, the ACCC was required under the legislation to include a condition that those providers with no more than 2,000 customers (or no more than 12,000 should the Government make regulations), must provide wholesale access to a designated carriage service. The ACCC specified the SBAS and LBAS as designated carriage services on the basis that network operators were already required to offer wholesale access to these services by virtue of the declaration and the FADs. Raising the threshold to 12,000 residential customers will not affect network operators' obligation to offer the SBAS in any way. As a competitive safeguard, the ACCC also included a condition that a

<sup>5</sup> ACCC [Explanatory Memorandum for the Superfast Broadband Network Class Exemption Determination](#), p.2

<sup>6</sup> The ACCC's July 2021 SBAS declaration combines the previous SBAS and related Local Bitstream Access Service (LBAS) declarations under a single SBAS declaration instrument.



network operator who elects to be bound by the Class Exemption Determination must not discriminate between the person's wholesale customers or prospective wholesale customers and must not discriminate in favour of itself in relation to the supply of the LBAS and/or SBAS.

DITRDC estimates that at least 15 small broadband network providers have 2,000 or less residential SIOs, with an aggregate of between 5,000 and 7,000 SIOs, and at least a further four have 12,000 or less residential SIOs, with an aggregate of between 30,000 and 40,000 SIOs. DITRDC is aware of at least one provider with almost 2,000 SIOs that is currently monitoring any regulatory action to increase the exemption threshold from 2,000 to 12,000 SIOs. Decisions that providers in this position are contemplating, under current arrangements, include whether to either:

1. refrain from growing their new customers base, or
2. commence costly functional separation processes that will divert resources away from customer service.

The proposal to increase the exemption limit to 12,000 SIOs is aimed at increasing competition in the broadband infrastructure market. Under this arrangement, the Australian public would maintain access to high quality services, as mandated by the SBAS and SIP arrangements and the financial interests of NBN Co will not be harmed due to the RBS. In the longer term, the measure may provide consumers with access to better services and lower prices as a result of increased competition generated in the fixed-line broadband infrastructure market.

## Why is government action needed?

Since 2009, successive Australian Governments have invested in the design, build and operation of the NBN, an Australia-wide wholesale-only, open access superfast broadband network. NBN Co is a government business enterprise and is the dominant telecommunications provider of wholesale residential fixed-line superfast broadband network infrastructure. In most areas of Australia, NBN Co is the only wholesale superfast broadband provider. Consequently, NBN Co has a near monopoly in this market.

As the default supplier of around 95 per cent of superfast broadband services in Australia (now formalised through the SIP arrangements), NBN Co had been at a disadvantage to new competitors who do not need to cross subsidise loss making services. However, at the same time the Government reformed the separation arrangements and introduced the SIP regime, it also introduced the RBS, which places a levy of \$7.10 per superfast broadband service per month, through the *Telecommunications (Regional Broadband Scheme) Charge Act 2019*. This levy is then provided to NBN Co to subsidise its loss making services. The RBS is designed to neutralise the effect of alternative providers entering profitable markets while leaving NBN Co to service the unprofitable ones.

As noted in the Explanatory Statement of the RBS Bill, the Government's policy is to support infrastructure competition and this had been somewhat successful. However, as it was then structured:

*if competition intensifies, there is a risk that NBN Co will be less able to support its internal cross subsidy. While NBN Co is able to reduce its prices in commercially viable areas to respond to competition, if it does so, it will be less capable of funding cross subsidies to fixed wireless and satellite services.<sup>7</sup>*

With the RBS now commenced on 1 January 2021, NBN Co is no longer at risk of being subjected to unfair competition, particularly from smaller infrastructure providers.

The proposal to exempt smaller providers from the structural separation requirements is aimed at encouraging competition in a market dominated by a large stable government business enterprise. The telecommunications market is dynamic, in that new technologies can rapidly change an operating environment. Smaller companies can be more innovative because they have the ability to act quickly and decisively when implementing new ideas. This can have flow-on effects throughout the market when larger companies see new strategies being successfully implemented. Further, in the Explanatory Statement to its Class Exemption Determination, the ACCC noted that it was:

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<sup>7</sup> See p.8 of the [Revised Explanatory Memorandum for the Telecommunications \(Regional Broadband Scheme\) Charge Bill 2019](#)

*satisfied that the Instrument will reduce the disproportionate regulatory cost burden on operators of smaller networks of being structurally or functionally separated when participating in superfast broadband markets, enabling them to further invest in competitive infrastructure through increasing the reach of their networks and improving the quality of services provided to end-users.<sup>8</sup>*

## What policy options are you considering?

There are two options being actively considered:

1. Keep the status quo, that is, the 2,000 SIO threshold established by the ACCC, and
2. Increase the threshold to 12,000 SIOs (maximum allowed under the legislation).

### Option 1: Status quo

An option is to keep the status quo and do nothing, that is, to not make any regulatory changes. The threshold will remain at 2,000 residential customers.

Competition in the telecommunications infrastructure market is being stifled by regulations that discourage market entry by smaller innovative providers. Without intervention, there is a high risk that the market will continue to be dominated by a small number of larger infrastructure owners and operators that may lack the motive to offer more innovative telecommunications solutions and choice to end-users.

The existing regulatory arrangements prevent controllers of superfast (i.e., capable of providing broadband services with download speeds of more than 25 Megabits per second) fixed-line networks with more than 2,000 residential customers from operating unless they are either structurally or functionally separated. There are significant costs associated with separating a telecommunications business in this way, which are likely to be too high for smaller companies to bear. Whereas, larger companies such as NBN Co, TPG and Uniti benefit from significant economies of scale. The proposed regulations will lift the SIO threshold from 2,000 to 12,000 customers, and thereby remove the costly requirement for small infrastructure providers to structurally or functionally separate and enable them to expand their networks. Implementation of the proposal will also encourage new providers to enter the market.

Small superfast broadband network providers with more than 2,000 residential customers will continue to need to either structurally separate or lodge a voluntarily functional separation undertaking and notify the ACCC within 14 days of servicing over 2,000 residential customers, both of which would come at a very high regulatory cost for a small company.

DITRDC estimates that at least 15 small broadband network providers have 2,000 or less SIOs, with an estimated 5,000 to 7,000 SIOs in aggregate, and at least a further four have 12,000 or less SIOs, with an estimated 30,000 to 40,000 SIOs in aggregate. Submissions to the ACCC consultation process on establishing the 2,000 SIO threshold indicated that the majority of these smallest providers are intending to grow their businesses above 2,000 SIOs.

Should the Australian Government make a decision to do nothing, we are aware of at least one broadband network provider that will need to immediately decide between refraining from growing its new customer base, and commencing costly functional separation processes that will divert resources away from customer service.

### Option 2: Increase to 12,000 customers

We have also considered an option to increase the threshold through regulation to 12,000 SIOs, which is the highest allowable under the Tel Act.

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<sup>8</sup> See [Superfast Broadband Network Class Exemption Determination - Explanatory Statement \(acc.gov.au\)](https://www.accc.gov.au/publications/2018/superfast-broadband-network-class-exemption-determination-explanatory-statement)



As noted above, in making its Class Exemption Determination, the ACCC included a mechanism to allow the threshold to automatically increase to a maximum of 12,000 residential customers if this is specified in any regulations. The ACCC indicated in its Explanatory Statement to the Class Exemption Determination that it is satisfied that any extension of the thresholds mentioned in paragraphs 143A(1)(d) and 143A(2)(d) of the Tel Act to a maximum of 12,000 fixed-line residential customers would promote the long-term interests of end-users (LTIE) on a similar basis as for the application of the exemption for networks with up to 2,000 fixed-line residential customers.

In some areas, consumers being serviced by a smaller vertically integrated provider may only have access to one retailer. In such cases, consumers will be protected by the service obligations associated with the SIP arrangements. In other circumstances, the smaller vertically integrated providers may have overbuilt existing wholesale infrastructure providers or be overbuilt themselves. Again, consumers will be able to access a service consistent with that required by the SIP obligations, and will enjoy any further benefits associated with active infrastructure competition. Further, if a network owner decides to take advantage of the benefits associated with the class exemption then they must offer an SBAS service to other retailers on a non-discriminatory basis, that is, a wholesale Layer 2 bitstream service at a price benchmarked against that of the equivalent NBN Co service. Consequently, the costs to consumers associated with only having access to services from a vertically integrated provider are expected to be minimal given the strong consumer protection framework that applies.

Under Option 2, as small superfast broadband network providers grow their residential customer base to beyond 12,000, they would need to undertake functional or structural separation and notify the ACCC within 14 days of servicing over 12,000 residential customers. Prior to this option taking effect, providers that have above 2,000 but below 12,000 SIOs, should have already undertaken functional or structural separation.

## What is the likely net benefit of each option?

### Expected Costs

For each option there will be no cost to the Budget.

For each option there will be a negligible impact on NBN Co due to the scale difference between the networks. NBN Co had 8.4 million SIOs as of 30 June 2021. This is in contrast to:

1. an estimated range of 30,000 to 40,000 SIOs across at least four network providers with between 2,000 and 12,000 customers, and
2. an estimated range of 5,000 to 7,000 SIOs across at least 15 network providers with less than 2,000 SIOs.

In total, up to 47,000 SIOs are served by these smaller networks, which is around 0.5 per cent of NBN Co's market share. Further, these companies will be compensating NBN Co for its loss making services by paying it \$7.10 per service per month through the RBS levy.

There will be no additional costs to Australian superfast broadband users, with minimum broadband service levels guaranteed through the SIP arrangements.

For a small broadband network provider, project costs associated with implementing and maintaining functional separation is estimated between \$6.67 million and \$8.16 million over five years. This comprises \$1.65 million to \$2 million in once off costs and \$1 million to \$1.23 million in additional annual costs (\$5.03 million to 6.15 million over five years). These figures have been calculated based on discussions with a small broadband network provider that currently has approximately 2,000 SIOs and is aiming to increase these in the short term.

These costs are as a result of functional separation undertakings comprising (but not limited to):

1. maintaining, at arm's length, a single wholesale and single retail business unit
2. documenting, and publishing on its website, the terms and conditions, including price or a method of ascertaining price, on which the person's wholesale business unit supplies local access line services to its retail business unit – noting that in circumstances where the provider is a SIP, this activity will need to be undertaken regardless

3. requiring workers for the wholesale business unit that separate and different from the workers for the retail business unit
4. separating wholesale and retail:
  - a. operational support systems
  - b. business systems
  - c. communications systems, and
  - d. accounts, and
5. implementing the same customer interface for dealings between its wholesale business unit and customers as it does for dealings between its wholesale and retail business units.

Assuming the 19 known current providers with less than 12,000 residential customers took advantage of the class exemption, this would provide regulatory savings of \$126.73 million to \$155.04 million over five years.

## Option 1: Status quo

### Small providers

It is estimated a network provider with 2,000 SIOs earning Average Revenue Per User (ARPU) of approximately \$70 per subscriber would have approximately \$1.68 million in annual revenue, assuming no other income was available.

Keeping functional separation regulation at 2,000 customers, the project costs (outlined above) would likely exceed the annual revenue in the first year and after allowing for ongoing costs, the carrier would need to grow aggressively to regain profitability in three to four years after implementing functional separation.

The net cost of undertaking functional separation would likely be a deterrent for current small broadband network providers to increase their residential customer base beyond 2,000. These small network operators would need to divert finite resources towards functional separation regulatory arrangements and this would negatively impact the quality of customer service to the Australian community.

This would also act as a barrier for any potential new entrants to the market.

### Customers

Small network operators passing the 2,000 SIO threshold would need to divert finite resources towards functional or structural separation obligations, which would likely negatively impact the quality of service and pricing for their customers. Further, by deterring innovative infrastructure providers to compete with NBN Co, there will be less competitive pressure on NBN Co, as the incumbent, to innovate and cut its own costs, which would forgo a benefit to broadband consumers throughout Australia.

### NBN Co

Given the RBS levy, there will be no significant impact on the government business enterprise aside from a long-term increase in competitive pressure.

## Option 2: Increase class exemption limit to 12,000 customers

### Small providers

It is estimated a network provider with 12,000 SIOs earning ARPU of approximately \$70 per subscriber would have approximately \$10.08 million in annual revenue, assuming no other income was available.

Regulating for functional separation at 12,000 customers, the project costs (outlined above) and additional annual costs would likely be approximately a quarter of the annual revenue in the first year. While these costs would still be significant, they would be much more manageable compared to those incurred for smaller providers.

Consultation with industry indicated that the costs and processes of functional separation would be more manageable at 12,000, 20,000 or 50,000 customers. Consequently, there is a very high degree of confidence that this option is the best option available within the existing legislative framework, which caps the class exemption to 12,000 SIOs.

This would provide considerably more time for small and new providers to plan for functional separation and have the absolute minimum amount of revenue considered by industry as being viable to offset the significant financial regulatory and compliance burden.

### **Customers**

Increasing competition in this market, would be in the public interest. Customers would continue to experience similar service quality from small providers. Broadly, they may be offered better services or lower prices as a result of increased competition generated in the market.

If either the ACCC or the Government were concerned that a small vertically integrated provider was delivering poor outcomes for consumers, both would have avenues to respond available. First, SIP standards, rules and benchmarks in legislation could be made by the Minister for Communications and enforced by the ACMA. Second, the ACCC has the option to lower the customer threshold for the class exemption (within the higher ambit set by regulation) using existing powers. Third, a failure to comply with the conditions of the Class Exemption Determination is subject to civil penalties and the ACCC may apply to the Federal Court for judicial enforcement.

Further, there is a market imperative for smaller providers to offer high quality and affordable services. Given the NBN rollout is now complete, smaller providers taking advantage of the proposed class exemption will be competing with NBN Co to deploy infrastructure in new estates and multi-dwelling units, and have an incentive to protect their reputation when bidding to be to provider of choice. Also, the increased service speeds and quality associated with the deployment of 5G mobile networks will provide another competitive pressure on smaller infrastructure providers.

### **NBN Co**

For NBN Co, with over 8.4 million SIOs and an increasing presence in the enterprise market, the impact on its revenue will be very minimal, particularly given the funds the company would receive through the RBS levy. NBN Co is able to build and provide infrastructure to provide wholesale services in the same areas of the small broadband network providers.

If there was significant pressure from new entrants then NBN Co may be forced to improve its network deployment cost structures in order to compete, which could potentially benefit the Government business enterprise by decreasing its overall cost structure. It would also align with the Government's objectives to increase competition in the superfast broadband market.

### **Monitoring**

Should the Government decide to implement this option, we recommend targeted stakeholder consultation occur within two years to gauge whether a further increase is warranted (subject to legislative change) or any positive or negative issues are identified.

## **Who did you consult and how did you incorporate their feedback?**

The ACCC undertook a formal public and industry consultation commencing in June 2020 . DITRDC undertook one in early 2021. These are both directly relevant to this regulatory policy proposal. The DITRDC also consulted with the ACCC in the preparation of this RIS.

### **DITRDC Consultation**

From 15 January to 5 February 2021, DITRDC conducted a public consultation process with the telecommunications industry and other interested stakeholders. The purpose of this was to gauge industry support for whether the Minister for Communications should make a recommendation to the Governor-General for the *Telecommunications Regulations 2021* to be amended to provide the ACCC with the power to increase the class exemption limit to 12,000 residential customers.

Six submissions were received, from NBN Co, the Australian Communications Consumer Action Network (ACCAN), Aussie Broadband, Lynham Networks/Lightning Broadband, Telair/MyOwn Tel and Interphone. The latter four smaller infrastructure providers supported an increase to the threshold. Aussie Broadband and Interphone indicated higher thresholds were more suitable, 50,000 and 20,000 respectively, to reach necessary benefits of scale to structurally separate. Interphone described functional separation requirements as an administrative impost that do not add benefit to the end consumer.

Telair and Lightning Broadband both indicated that the SIP regime and the ACCC's SBAS declarations would address any potential concerns around service quality. Interphone, Telair and Lightning Broadband are designated SIPs under the Telecommunications (Designated Service Area and Statutory Infrastructure Provider) Declaration (No. 1) 2020.<sup>9</sup>

NBN Co does not support the proposed regulation. It raised concerns that it may create small vertically integrated monopolies, with the potential for the operator to discriminate in favour of their own retail business, undermine competition and reduce incentives for investment. It argued there is high uncertainty whether this will promote competition, efficient investment, or promote new entry to the market.

ACCAN indicated that the class exemption limit should only be increased to 12,000 SIOs once the Minister for Communications has set appropriate rules, standards and benchmarks for SIPs, and there is guaranteed price regulation on all newly built networks, regardless of size. ACCAN also identified a risk of localised fixed-line infrastructure monopolies emerging.

DITRDC has consulted the ACCC, given it is responsible for the administration of the Class Exemption Determination on the proposed regulations to change the exemption threshold to 12,000 customers through regulation. The ACCC supported the proposed amendment to the Telecommunications Regulations, for similar reasons expressed in the Explanatory Statement for the Class Exemption Determination. Specifically, because the ACCC considered that:

- competition will continue to be safeguarded by: Part 8 of the Tel Act; the Minister's SIP powers; and the ongoing deployment of 5G that will provide a competitive constraint on fixed-line network operators
- increasing the threshold to 12,000 residential customers will promote the LTIE on a similar basis as the exemption granted by the ACCC for networks with up to 2,000 customers, and
- 12,000 customers is the minimum level of services required to profitably offer a wholesale service and therefore represents a low risk upper bound for the exemption.<sup>10</sup>

## ACCC Consultation

On 5 June 2020, the ACCC initiated consultations on a proposal for it to grant a class exemption for carriers with no more than 2,000 residential customers. The ACCC also consulted on whether to include a mechanism to allow the threshold to automatically increase to a maximum of 12,000 customers if this is specified in any regulations.

The ACCC observed that the higher threshold of 12,000 was consistent with the ACCC's previous decision to exempt smaller providers from the SBAS declaration. Under the ACCC's 2017 SBAS FAD<sup>11</sup>, SBAS providers supplying up to 12,000 SIOs were not required to offer regulated wholesale access to their networks. This is because the ACCC found that compliance costs for these operators were expected to be high relative to expected wholesale revenues, and therefore the aggregate benefits to end-users from retail competition on these smaller networks were not considered to outweigh the compliance costs.

In preparation for the commencement of the TLA Act, on 5 June 2020, the ACCC consulted publicly on a draft instrument for the class exemption of small networks of up to 2,000 customers. The ACCC sought feedback on the class of persons, if

<sup>9</sup> See [Telecommunications \(Designated Service Area and Statutory Infrastructure Provider\) Declaration \(No. 1\) 2020 \(legislation.gov.au\)](https://www.legislation.gov.au/ulidx/2020-06-01/australian-communications-consumer-action-network-act-2001/2020-06-01/australian-communications-consumer-action-network-act-2001-section-100)

<sup>10</sup> ACCC [Explanatory Statement for Telecommunications \(Superfast Broadband Network Class Exemption\) Determination 2020](#), p.2

<sup>11</sup> Details of the ACCC process and decisions for the 2017 SBAS FAD are available at [www.accc.gov.au/regulated-infrastructure/communications/sbas-final-access-determination-inquiry-2016](http://www.accc.gov.au/regulated-infrastructure/communications/sbas-final-access-determination-inquiry-2016). The ACCC is currently conducting an ongoing inquiry into remaking the SBAS FAD, see [www.accc.gov.au/regulated-infrastructure/communications/fixed-line-services/sbas-final-access-determination-inquiry-2021/discussion-paper-and-submissions](http://www.accc.gov.au/regulated-infrastructure/communications/fixed-line-services/sbas-final-access-determination-inquiry-2021/discussion-paper-and-submissions) for details.

any, to whom the exemption should apply and queried whether any other conditions and limitations should be included. The discussion paper also sought input on a draft Deemed Functional Separation Undertaking that outlined the requirements that providers would need to meet to avoid having to structurally separate.

During its consultation process, the ACCC received submissions from NBN Co; ACCAN, Aussie Broadband and several smaller infrastructure providers (Connected Australia, Countrytell, Frontier Networks, Lynham Networks, Real World Networks, Swoop, and VostroNet), Telstra, TPG Telecom, and Uniti.

NBN Co argued that a level playing field requires a uniform regulatory approach, that is, all telecommunications infrastructure providers should be fully structurally separated. NBN Co therefore opposed the introduction of any exemption that would potentially establish a three-tiered approach to the separation requirements (i.e. fully structurally separated carriers, functionally separated carriers and, for those subject to the class exemption, vertically integrated carriers). NBN Co argued that such a situation would neither support efficient investment nor promote infrastructure-based competition for consumers.

ACCAN argued that exemptions from structural separation requirements can lead to poor outcomes for consumers. ACCAN's preference was for providers with 2,000 or more customers to be subject to either functional or structural separation.

Smaller telecommunications providers argued that functional separation would impose substantial costs on their businesses (both in terms of initially separating business operations and then maintaining separate business arms). Smaller providers argued they were already competing in a low-margin market. Aussie Broadband, Lynham Networks, Countrytell, Connected Australia, Real World Networks, Vostronet and Swoop all submitted that it would not be viable for an operator with less than 2,000 connections to separate, and that strictly enforcing the requirements would not promote meaningful competition. There was some consensus from this stakeholder group that providers would need to have around 50,000 customers before functional separation would be financially viable.

Larger providers, including Telstra and TPG tended to concur with the positions outlined by smaller providers. Telstra argued that functional separation would impose overly onerous requirements on smaller providers, which would result in material costs to their businesses. TPG argued that the ACCC should keep the goal of infrastructure-based competition front-of-mind and argued that applying the same separation requirements that apply to NBN Co to smaller providers would make the mistake of treating market entrants as if they had equal market power and access to low cost capital as NBN Co.

## Stakeholder views considered in policy options

We considered stakeholders' views raised in the consultations in developing the two options outlined in this regulatory policy proposal.

### **Increase SIOs to 12,000 and more**

In the mid-2020 consultation process, there were strong views provided by industry stakeholders, for both small and large superfast broadband network providers, that it would not be viable for an operator with less than 2,000 connections to separate, and would need around 50,000 customers before functional separation would be financially viable.

In the early 2021 consultation process, all four small superfast broadband network providers that responded, supported an increase to at least 12,000 SIOs. Two providers, Aussie Broadband and Interphone, indicated higher thresholds were more suitable: 50,000 and 20,000, respectively. In response we have included a recommendation in Option 2 to undertake targeted consultation with industry within two years, to gauge whether a further increase is warranted.

### **Uncertain competition, investment and new market entry**

NBN Co argued there is a high uncertainty around whether establishing a threshold will promote competition, efficient investment, or promote new entry to the market. In response, we have included a recommendation in Option 2 to undertake targeted consultation with industry within two years, to gauge whether any positive or negative issues are identified.

### **Rules, standards and benchmarks**

ACCAN argued that the ACCC should only increase the class exemption limit to 12,000 SIOs once the Minister for Communications has set appropriate rules, standards and benchmarks for SIPs, and there is guarantee price regulation on all newly built networks, regardless of size. We are satisfied that, with the SIP obligations and RBS Scheme now in place it is suitable to proceed with this regulatory policy.

DITRDC conducted public consultation from 29 January 2021 to 15 March 2021 on draft rules standards and benchmarks for SIPs and the process for making a determination, subject to the Minister for Communications' approval, is well advanced.<sup>12</sup> Further, should any issues arise, the Minister is empowered to establish rules, standards and benchmarks as required. In this context and as noted above, we have included a recommendation in Option 2 to undertake targeted consultation with industry within two years, to gauge whether any positive or negative issues are identified.

### **Localised small monopolies**

NBN Co and ACCAN also identified a risk of localised fixed-line infrastructure monopolies emerging. While there is potential for this happen, the likelihood is diminished given the need for these growing businesses to retain a good reputation to continue to grow, and because these providers will increasingly be competing with 5G mobile operators. However, as noted above, we have included a recommendation in Option 2 to undertake targeted consultation with industry within one and two years, to gauge whether any positive or negative issues are identified.

### **Why now?**

Industry stakeholders have also expressed an expectation that this regulation be finalised before the end of 2021. One provider, in particular, has expressed a need for this to occur prior to this timeframe. In response, we seek to finalise this process to have the regulation in place by early 2022.

## **What is the best option from those you have considered?**

With the SIP obligations and RBS scheme in place, we consider it is suitable to proceed with the proposed regulation.

We consider the proposed threshold increase to 12,000 SIOs is an appropriate level to increase competition with NBN Co at the infrastructure level, and that it will likely result in lower prices and/or result in better services for Australian residential superfast broadband users. This is the maximum threshold outlined in the Tel Act and, as provided for in the ACCC's Class Exemption Determination, could take effect immediately.

Existing legislation contains other mechanisms (SIP standards, rules and benchmarks and ACCC powers to declare services and adjust down the class exemption customer threshold) that can be used to control any risks associated with the creation of small vertically integrated monopolies. Given NBN Co has now completed the rollout of its network the new arrangements will be used primarily by entities looking to compete with NBN Co at the infrastructure level. Competition is good for consumers. It will incentivise NBN Co and innovative competitors to provide quality services to consumers and keep prices low.

Enacting this legislative instrument will give effect to increasing, from 2,000 to 12,000, the amount of residential superfast broadband services that small telecommunications providers are able to supply before needing to undertake costly functional or structural separation, as set out in the Class Exemption Determination.

Industry stakeholders have expressed an expectation that this regulation be finalised as soon as practicable and before the end of 2021.

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<sup>12</sup> See [DITRDC public consultation on draft standards, rules and benchmarks for SIPs](#)



# How will the Chosen Option be Implemented and Evaluated?

## Measures of success

As noted above, a condition of the class exemption is that when telecommunications service providers elect to take advantage of avoiding the separation requirements, they must agree to offer an SBAS service to prospective wholesale customers. Consequently, a key measure of success of the proposal will be whether the majority of smaller telecommunications infrastructure providers elect to take advantage of the class exemption. This will demonstrate that infrastructure providers have determined that the benefits of the proposed regulations outweigh any costs.

Being required to offer the SBAS is viewed a minor regulatory burden because access seekers are not expected to be attracted to reselling services over smaller networks due to the relatively high costs of establishing a systems interface. We would therefore expect the majority of smaller providers to elect to take advantage of the class exemption, and consider this to represent a key benchmark of success.

## Implementation risks

After the regulations are made, there is a risk that smaller providers will be unaware of their ability to elect to take advantage of the class exemption. To mitigate against this risk, DITRDC will publicise the regulations once made and contact industry peak bodies and the expected small telecommunications businesses that will be eligible, both directly and through the Communications Sector Group of the Trusted Information Sharing Network for Critical Infrastructure Resilience.

There is also an ongoing risk that telecommunications infrastructure providers do not comply with their obligations under Part 8, perhaps due to being unaware of them. Consequently, the DITRDC's awareness raising of the proposed regulations also provides an opportunity to remind smaller providers of their obligation to comply with the broader Part 8 requirements.

## Compliance

The ACCC sets out the principles adopted to achieve compliance with the law in its *Annual Compliance and Enforcement Policy*.<sup>13</sup> In 2021, these include competition and consumer issues in telecommunications.

Contraventions of the wholesale-only rules and non-discrimination obligations in Part 8 are civil penalty provisions with penalties up to \$10 million for each contravention. Under the Tel Act, the ACCC is responsible for monitoring compliance and enforcing the relevant Part 8 provisions. The ACCC may seek to enforce compliance with these provisions by issuing formal warnings, infringement notices or seeking Federal Court orders.

In the event that a network operator that has elected to be bound by the Class Exemption supplies fixed-line carriage services to more than 12,000 residential customers, the network operator must notify the ACCC, in writing, of that event within 14 days of that event occurring. In such circumstances, the ACCC would expect the network operator to commence discussions about lodgement of a functional separation undertaking or an election to be bound by the ACCC's *Telecommunications (Deemed Functional Separation Undertaking) Determination 2020*.<sup>14</sup>

Importantly, in the interim the network operator with more than 12,000 SIOs must continue to ensure that:

1. it makes the SBAS available for supply to wholesale customers, or prospective wholesale customers
2. it does not discriminate between its wholesale customers or prospective wholesale customers in relation to the supply of the SBAS, and
3. it does not discriminate in favour of itself in relation to the supply of the SBAS.

## Major decision points

The following major decision points were made in the proposal's development.

1. an in-principle decision to consider the deregulatory proposal was made by DITRDC through the provision of advice to the Minister for Communications, Urban Infrastructure, Cities and the Arts on 6 August 2020
2. agreement for DITRDC to consult on the deregulatory proposal provided by the Minister on 13 August 2020
3. DITRDC announced on 13 January 2021 that consideration was being given to increasing the class exemption customer limit when it published a consultation paper on its website, and
4. the Minister provided policy approval on 9 August 2021 for the DITRDC and Office of Parliamentary Counsel to draft regulations to increase class exemption customer limit to 12,000 customers.

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<sup>13</sup> See ACCC *Annual Compliance and Enforcement Policy* at [www.accc.gov.au/publications/compliance-and-enforcement-policy](http://www.accc.gov.au/publications/compliance-and-enforcement-policy).

<sup>14</sup> See ACCC *Telecommunications (Deemed Functional Separation Undertaking) Determination 2020* at [www.legislation.gov.au/Details/F2021C00342](http://www.legislation.gov.au/Details/F2021C00342).

## Annex A: The Telecommunications Regulatory Framework

The parts of the Australian telecommunications regulatory framework most relevant to the consideration of the proposal to increase the class exemption from the structural and functional separation requirements include but are not limited to the following:

1. [Telecommunications Act 1997](#), including recent changes via the [Telecommunications Legislation Amendment \(Competition and Consumer\) Act 2020](#) (TLA Act) to:
  - a. Part 8, allowing limited functional and structural separation
  - b. Part 19, introducing SIP rules
2. [Telecommunications \(Regional Broadband Scheme\) Charge Act 2020](#), also introduced via TLA Act
3. [Telecommunications Regulations 2021](#)
4. [Competition and Consumer Act 2010](#):
  - a. Part XIB
  - b. Part XIC
5. NBN Co's regulatory framework comprising:
  - a. the [National Broadband Network Companies Act 2011](#)
  - b. NBN Co's [Statement of Expectations](#)
  - c. NBN Co's [Special Access Undertaking](#)
  - d. NBN Co's [Wholesale Broadband Agreement](#)
6. ACCC determinations, particularly the [Telecommunications \(Superfast Broadband Network Class Exemption\) Determination 2020](#) and [Telecommunications \(Deemed Functional Separation Undertaking\) Determination 2020](#), and
7. ACCC service Declarations, particularly the [Superfast Broadband Access Service](#) (SBAS).

The most relevant regulations that directly relate to this proposal are:

1. Part 8 of the Tel Act, specifically Sections 143A and 142C
2. The SIP scheme
3. The [Regional Broadband Scheme](#) (RBS), and
4. The ACCC Class Exemption Determination.