



Broadband Australia 2006 Conference
***Critical regulatory issues for
a competitive broadband market***

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Introduction

It's now becoming a bit of a cliché to begin these speeches with a comment about the exciting changes taking place in broadband, but this is hard to avoid.

Change has arrived, and has already brought with it many potential advances in services for consumers, and opportunities for new and existing players to expand their offerings, and stake a claim in the market. The challenge for the ACCC as regulator is to stay abreast of changes in the industry, and keep our eye on competition and choice as our main goal. In this way, we can help to ensure that the Australian public is best positioned to benefit from the developments that occur.

It is quickly evident following a glance over the topics to be addressed during this conference that there are still so many aspects of the broadband market that are yet to be established to any high degree of certainty:

- What should Australia aim for in terms of broadband infrastructure?
- To what extent will broadband infrastructure in rural areas differ from that in cities?
- What position does wireless technology have in the emerging broadband market?

...To name but a few. And this does not even venture to the demand side of the market.

We all have a role to play in addressing questions such as these and shaping Australia's broadband future. This is all the more challenging in the face of the constant speculation, opinion, and in some cases – plain misinformation that surrounds the regulation of the telco industry. And there has been no shortage of this in the past 12 months. So as 2006 draws to a close, I think that now is a good a time as any to sort the wheat from the chaff on a few things.

Broadband market is taking off

I'm probably stating the obvious when I say that Australians' appetite for broadband has really taken off in the past couple of years. There was initially a large surge in broadband take-up, particularly in 2004-05, when we witnessed very strong growth. As we would expect though, the percentage

growth of broadband take-up has declined as the total subscriber base has increased in absolute terms.

The ACCC's latest figures have broadband take-up in Australia at around 3.5 million connections. According to a recent report by Market Clarity, this puts Australia's broadband penetration at 17.5 per cent, which is equal to or better than many other OECD countries with large areas of sparsely populated land.

Market Clarity estimates that Australia is only slightly behind Britain and the US, which had penetration rates near 20 per cent. And although broadband speeds were initially low, these have also improved.

It is also encouraging to see that a large proportion of broadband take-up has occurred in regional areas. Data recently published by the Australian Communications and Media Authority (ACMA) show that although regional areas have a lower overall proportion of broadband take-up, regional households have taken up broadband subscriptions at a faster rate (80 per cent growth) than metropolitan households (39 per cent growth) in the last year.¹

And while 17.5% is hardly a saturated market, it seems that increasingly, Australian broadband consumers can now consider not just *whether* to get broadband, but *what kind* of broadband service they want.

Telecommunications companies can now use a range of new and advanced technologies to provide a wider range of services to the end user. Obviously, DSL technologies accessed using the traditional copper wires are the best known.

But there are other options, including HFC (Hybrid Fibre Coaxial) cable, satellite broadband, and a range of wireless technologies that have come onto the scene, including iBurst, WIMAX, 3G mobile telephones, and most recently, Telstra's Next G service. I don't intend to talk about throughput speeds of these technologies – what's important is that there is a range of options and they're all getting better.

But of course, DSL is still the key. ADSL – delivered over Telstra's copper network - is by far the most widely used broadband technology nationally.

ADSL2+ rollouts

Industry activity in the past year or so has really shown the importance of having an unbundled local loop for DSL competition. And even though this may have been subdued for a period due to uncertainty around Telstra's fibre-to-the-node plans, the number of providers using either the ULL or the line sharing service (LSS) to install their own DSLAMs increased to 19 by June 2006, up from 9 the year before².

This approach has allowed these competitors to differentiate their service from Telstra's wholesale resale product. The ability of competitors to

¹ ACMA (2006), Communications Services Availability in Australia 2005-06, p.12

² Australian Communications and Media Authority (ACMA), *Communications Services Availability 2005-06*, November 2006.

differentiate their service should not be underestimated. After all, that's essentially what competition is about.

By investing in their own DSLAMs and using the ULL to supply ADSL2+, competitors can differentiate their products from Telstra's wholesale product in a range of ways.

Generally speaking — and while this depends on a range of factors, such as the quality of the copper and the presence of interference — these competitors will be able to provide a customer living within 3km of their exchange with speeds of between 3 and 16Mbps through ADSL2+.³ This is significantly higher than speeds of between 2 and 8Mbps if that customer were on a standard ADSL service. The potential for differentiation is even more significant when one considers that the alternative was to resell Telstra's wholesale product, which until recently had speeds capped at 1.5Mbps.

Over the past 18 months or so, pioneers such as iiNet, Internode and Adam Internet took advantage of the unbundled local loop to be the first to launch ADSL2+ services and to give themselves a distinct speed advantage over their competitors. Since then they have been joined by others such as Optus, Powertel, Nextep and Agile.

Even more encouraging for the development of what I call quasi-facilities based competition has been that a number of these operators installing DSLAMs are now looking to provide wholesale access to their ADSL2+ infrastructure to other retailers.

Under competitive pressure, it was only a matter of time before Telstra was forced to respond. Telstra's announcement that it would remove the shackles on ADSL speeds is good news, given the geographic reach of its network is so extensive.

Telstra now claims that ADSL speeds of up to a maximum 8Mbps (with the normal caveats of distance from the exchange, etc) are available from exchanges covering 91 per cent of Australians, and speeds of up to a maximum 20Mbps are available in exchanges covering almost half the population. Far from being a disgrace, these numbers compare well with countries like the UK and the US, which enjoy far more inter-modal competition, mainly from extensive cable networks. And that is before we consider the speeds which Telstra claims will be available to 98 per cent of the population through its NextG network.

Telstra's announcement of its ADSL upgrade contained the following sentence — *“Because of regulatory constraints, the up to 20Mbps service would be limited to exchanges where competitors are also offering those higher speeds”*.

³ Source: The Commerce Commission of New Zealand, *“Local Loop Spectrum Management”* 26th July 2006

Telstra's announcement raises several significant questions:

- Firstly, why did it take Telstra so long to launch ADSL2+ when its competitors have been making this technology available to consumers for the past two years?
- Secondly, we are informed that Telstra has ADSL technology in exchanges covering 91% of the population, and we understand that all of these DSLAMs could be readily upgraded to provide ADSL2+. Why then has Telstra limited this upgrade to just 364 exchanges covering 46% of the population, being only those exchanges where Telstra's competitors are already offering high speed broadband to its customers?
- Thirdly, how can Telstra blame the regulator for limiting the extent of its ADSL2+ rollout, when wholesale broadband is not even a regulated service? We have said that a case has not been made for regulating a wholesale DSL service, and Telstra has not even come to us to ask for it to be exempt from regulation.

I'm known for being a bit of a media junkie, and I nearly choked on my cornflakes when I read a quote in last week's Kalgoorlie Miner, where Telstra claimed that Kalgoorlie residents will not receive ADSL2+ because the ACCC might decide to give it away to competitors below cost.

Forget about this idea of wholesale broadband being given away "below cost". – it's not even a regulated service.

Wholesale broadband service

At the risk of sounding like a broken record, the Commission has already stated its own view that a compelling case has not been made for declaring a wholesale DSL service supplied by Telstra or any other carrier. We think it's a dynamic, early-stage market and it should be allowed to run full-steam.

Let me reiterate - in our fixed services review position paper in June, we said this:

The Commission... considers that a compelling case for declaration of a wholesale DSL service at this time has not been made. In the face of potentially significant growth in the ULLS, wholesale declaration could encourage greater reliance on the resale of DSL services in place of greater take-up of the ULLS, which could drive lower wholesale DSL prices and innovation by Telstra or a ULLS based competitor.

The Commission will continue to monitor the supply of wholesale xDSL services and may re-examine whether to declare the service, if significant concerns about access to the service are apparent.

The summation of that is we prefer to see facilities based competition; that is, we prefer to see competitors installing their own infrastructure, their own switching devices, in a manner that will ensure that they can provide a more enduring form of competition than simple re-sale of others' services.

Interestingly, just last week in the UK, where wholesale broadband is a regulated service, the regulator Ofcom announced that it is reviewing where DSL regulation can be pared back. Ofcom has indicated its belief that ULL-based competition is crucial to the UK's broadband progress, rather than retail competition based on wholesale broadband products.

It should also be recognised that the Broadband Connect model articulated by the Minister essentially mandates a quasi-access regime for Government-funded wholesale broadband services. These should by definition apply in those areas which are uneconomic for multiple providers to enter the market. As such, they could go a considerable way towards addressing any residual competition concerns around areas where it is less feasible for competitors to take up the ULLS.

Exemption available to Telstra if required

If Telstra is not satisfied with the signals it is getting from the ACCC and wants a formal, legal guarantee that its ADSL2+ services will not be regulated under Part XIC, it can seek an exemption under the Act.

The Act allows carriers to seek to have a service exempt from regulation under Part XIC even if the carrier has yet to make the investment. In my view, the exemption provisions in the Act are a very effective way for a carrier to get certainty if it is offering services that should not be regulated.

But Telstra claims that following the Australian Competition Tribunal's decision on Foxtel in 2003, it will not be granted an exemption for ADSL2+ because the infrastructure has already been built.

This sounds like a legal technicality that I just don't accept.

The Foxtel case arose out of a pretty unique set of facts. At the time, Foxtel argued that an exemption from Part XIC would be in the long term interests of end-users because the ACCC had already accepted an undertaking under section 87B of the Trade Practices Act, which in itself, locked in an access regime.

The Tribunal then compared the access regime under the 87B undertaking with what it could have been under Part XIC, and decided that it liked the XIC scenario better. Therefore, the Tribunal decided that it would not be in the long term interests of end-users to grant the exemption.

But whether or not the network has been built is a different issue. You can't base your case on the argument that you won't build the facility if you have already done it.

The exemption provisions **can** be used for a network that has been built or will be built. The key is to establish that an exemption is in the long term interests of end-users.

But in any event, the ACCC doesn't speak for the Tribunal, and lawyers can debate hypothetical rulings endlessly. If Telstra doesn't intend to offer ADSL2+ in other areas unless and until it gets an exemption, then it doesn't seem to have much to lose by seeking one and finding out for sure.

And so my first challenge to Telstra today is “throw the switch”. Activate ADSL2+ in those DSLAMs you have already installed and offer high speed broadband to the vast majority of Australians, as you can. Don’t wait for your competitors to move first, thus forcing you into action.

And stop using the now overplayed excuse of “regulatory constraints” as a subterfuge, in the hope that you might be able to persuade our politicians to remove regulations designed to foster and promote competition in the communications sector for the benefit of 20 million Australians.

I note that our major media moguls have joined the chorus in saying that broadband speeds in Australia are inadequate. And frankly when the major provider of broadband in this country caps its broadband offerings at 1.5mbps, as was the case just a few weeks ago, I’d be inclined to agree. Fortunately, it seems that the threat of competition has finally forced Telstra to take the brakes off its broadband offerings, and improved broadband speeds are becoming more widespread in Australia.

But as for the criticism from our media moguls directed at the regulatory environment, in some cases their comments reflect a lack of understanding of the relevant issues. And it has not gone unnoticed that it might well be in their own private interests to argue for Government intervention on broadband. The ACCC will, however remain focussed on regulating for the broader public interest – not just selected companies.

ACCC actions in relation to the ULLS

Hopefully by now I have convinced you that we at the ACCC have not been plotting to declare a wholesale DSL service, at the very least not unless a clear and compelling case has been made and subjected to full public scrutiny. It is particularly difficult to see how this would arise in relation to urban areas, and I note that Ofcom’s review of wholesale broadband access is also looking at how regulation can be pared back on the basis of geography.

Instead, we have been clear about our belief in facilities-based competition as the best path to sustainable competition. In 2006, most of our efforts towards this goal have been focused on the ULL.

The ACCC’s views on Telstra’s proposed undertaking with a geographically averaged monthly charge of \$30 are well known, with Telstra asking the Australian Competition Tribunal to do a merits-review of our decision to reject the undertaking.

Final submissions are due to be tendered to the Tribunal today, and the hearing is set down to begin on 4 December.

Also moving towards conclusion in the first half of the new year are the 11 ULLS and 6 Line Sharing Service access arbitrations currently before the ACCC.

In separate announcements in September and October, the ACCC revealed that it had provided interim determinations in a number of access disputes

over the ULLS monthly charge. This was done to inform the debate on the ULLS and encourage reasonable ULLS prices to apply across the market.

But we are consistently hearing Telstra's mantra about how the ACCC is requiring it to provide access below cost. When the ULLS interim determinations were released earlier this year we heard Telstra ask how the ACCC could be providing interim determinations that reduce access prices, when inputs such as copper and petrol are rising.

Believe me, I am all-too-aware of movements in petrol prices, and it seems that some people are so impressed with the price of copper at the moment that they are willing to rip out Melbourne's public transport copper cabling to make a quick buck!

But in all seriousness, costs matter and the ACCC takes them seriously. In general, regulating access prices for telco services is done using a TSLRIC method. For those in the audience who are not aware, TSLRIC is the primary cost methodology used by the ACCC in regulating telecommunications prices – one consistently adopted by Telstra in putting forward its PIE II model, and one also previously accepted by the Australian Competition Tribunal.

TSLRIC is a complicated concept and I won't go into the details of it here today. Suffice to say, however, there are different ways of estimating costs within TSLRIC, but in any case, the methodology allows changes in projected costs such as labour, copper and petrol to be taken into account.

The ACCC is always open to discussion about costing methodology. But if Telstra wants to propose an alternative approach then it has to make the case. In that respect, the ACCC is actively reviewing its approach to see how we can improve things. For instance, we have circulated a discussion paper to key industry parties about the possibility of developing a new costing model.

To date, access prices have been the main issue in access disputes. Lately we have managed to bed down some access prices which will hopefully help us to carry out our arbitration responsibilities more swiftly. Lately though, we're finding that non-price issues are emerging more and more.

Obviously in an environment where more carriers want to transition away from resale-based competition to facilities investment using the ULL, it is important that they can migrate customers without delay. If competing providers with plans for a high profile launch of ADSL2+ services can only migrate their customers in a trickle rather than en masse, then there can be adverse consequences for competition.

The ACCC will continue to meet any challenges that emerge, which can be made more difficult by the fact that the issues can be unique to each dispute.

Fibre-to-the-node

The ACCC certainly has focussed much of its efforts on the ULL but that is not the result of some irrational fixation. The fact is that presently, the ULL is a major bottleneck service. But who knows - this might not always be the case.

The ACCC is ready and willing to keep regulation evolving to reflect market developments. I think we demonstrated this through the FTTN discussions

with Telstra, where we considered the competition issues that might arise if the market were to transition away from current copper-based competition toward competition based on access to a wholesale bitstream service. This would be a fairly fundamental change, but one the ACCC was prepared to consider in a public inquiry.

Amongst the media fever pitch around Telstra's fibre-to-the-node proposal and its decision to call off discussions with the ACCC, it is understandable if many have forgotten that an alternative proposal was put forward by the G9 group.

Any party can come and talk to us about a new infrastructure proposal. We will give serious thought to what this might mean for access and competition. For example, does the new network create a bottleneck service which it would be economically inefficient to replicate? If so, how should access be provided, and at what prices?

We can also advise parties about the requirements of the Trade Practices Act, which, of course, governs the terms and conditions of access that would apply if a new service were considered to be a bottleneck, as well the availability of other arrangements like special access undertakings and regulatory exemptions.

Now, it is understandable that infrastructure owners would want quick and simple answers to these questions, but, just like the Commission's processes in other industries, we can't come to these views without testing ideas in the market, which is what the Act requires.

For example, one way of getting certainty is through a special access undertaking. But the law requires that ACCC cannot accept a special access undertaking and allow parties to proceed with building a network until it has gone through a public consultation process.

I want to emphasise this point, because it was a fundamental issue in the context of the FTTN proposals put to us this year.

The ACCC had emphasised to Telstra and the G9 throughout the course of discussions, that regulatory decisions could not be made without full public scrutiny of the proposed arrangements. You might recall that the ACCC called on Telstra in late July to finalise its FTTN proposal, and put it out for public discussion. This was in recognition of the fact that ongoing discussion of Telstra's FTTN proposal had created considerable uncertainty for competitors who had already made or planned significant investments based on the ULLS.

It was shortly after this that Telstra withdrew its proposal. It would have been preferable for Telstra to place details of its proposal on the table for public examination, but Telstra appeared unwilling to do so.

The ACCC has not discussed the G9's FTTN proposal at the same level of detail as Telstra, but has advised the group of some of the issues that it believes would need to be resolved prior to any network build. Clearly, despite the ACCC applying its statutory processes equally to Telstra and the G9, the parties have gone down separate paths, with the G9 proposing to release another document for public consultation.

And so here is my second challenge to Telstra. Put your FTTN proposal on the table for public examination - to the extent that it was developed, prior to Telstra withdrawing from discussions on the proposal. This is a matter of significant national importance and public interest. Telstra has publicly accused the regulator of attempting to impose "below cost" and economically unrealistic regulatory constraints on its FTTN proposals. The most recent of these was Telstra's assertion in last week's Canberra Times that the ACCC's "rejection" of Telstra's FTTN proposal was the reason why some Canberra residents are on waiting lists for broadband.

The ACCC categorically rejects these assertions. Telstra should put its FTTN proposal on the table for public examination and release the ACCC from the confidentiality obligations that Telstra has imposed upon it, so that these issues can be placed in the public domain.

This will enable Telstra's FTTN proposals - and the ACCC's response - to be subjected to a rigorous examination by our legislators, the investing public and the Australian community each of who have a deep vested interest in understanding the relevant issues.

The ACCC firmly believes in the principle of transparency and the resultant discipline of accountability – it challenges Telstra to do likewise.

Conclusion

Much of what the ACCC does is a balancing act. In these rapidly changing times, the challenge for regulators is to ensure that the Australian public is best positioned to benefit from any developments that occur. Right now, a large part of the policy and regulatory focus is on getting the regulatory settings right to allow competition to drive broadband take-up.

We strive to get the regulatory mix right, so that carriers are provided with sufficient incentives for expanding their networks, and consumers still receive the benefits of competition in the presence of bottleneck infrastructure.

Regulation is typically based on maximising the opportunities for efficient competition while ensuring incentives for ongoing investment in the underlying bottlenecks.

It is my hope that we can move the telecommunications industry into a position where effective wholesale competition allows end-users to face a range of choices, and become more informed about the services on offer.

There is still have a lot of work to do to get markets into this position, but it is worth striving for, not only so that consumers can enjoy the benefits of competition, but also so that markets can operate as free from the encumbrance of regulation as possible.

Of course, it's not realistic to expect an industry like telecommunications to be subject to the minimal regulation that characterises most competitive industries. However, I look forward to reaching a situation where wholesale markets are sufficiently competitive so that additional regulatory safeguards like retail price controls become superfluous to requirements.

Through the activities I've discussed today, the ACCC is trying to achieve that mix of sustainable competition and efficient investment, ultimately to allow the industry to flourish and enable as many people as possible to benefit from technological advances.