

	<p><b>Broadband Australia 2009</b></p> <p><b><i>Competition regulation in a changing environment</i></b></p> <p><b>Ed Willett, Commissioner</b>  <b>11 June 2009, Sydney</b></p>
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## Introduction

It is an understatement to say that there have been a few developments in the communications sector recently. The Australian Government's announcement in April of its proposed National Broadband Network, or NBN, puts Australia on the cusp of a new era in communications.

On top of this, the Government has also raised the prospect of significant reform to the existing telecommunications competition regime and changes to the structure of Telstra, which is itself adjusting to a new leadership team. The Government's regulatory reform process may lead to a number of real improvements in competition in the industry.

The ongoing backdrop to these high level developments is one of the more dynamic industries in the Australian economy, where evolving technologies drive the design and uptake of new devices and applications for consumers and business.

All of this is more than enough to keep the ACCC well and truly occupied. However, it is important not to focus solely on daily distractions and lose sight of the bigger picture; in particular, how to ensure that when the NBN infrastructure is rolled out, Australia has competitive communications markets to make best use of it.

In this period of change, the ACCC is working hard to protect and promote competition and provide the highest level of regulatory certainty for all industry participants – both access providers and access seekers – as well as ensuring the interests of consumers are protected.

## Implications of the NBN announcement

I want to note, at the outset, the clear parameters that define the ACCC's consideration of investments in the telecommunications sector and, indeed, many other sectors of the Australian economy. The ACCC has a clear interest in the types of access arrangements that apply to existing and potential bottleneck infrastructure, whether Telstra's copper access network or a future network that has been proposed but is yet to be rolled out. The Commission also needs to communicate its understanding of trends in industry technology and structure and the roles it sees for itself.

However, it is not the ACCC's role to express a preference for, or promote, one network proposal or technology over another. It is for the parties making the investments to choose the technologies in which they invest. The ACCC's role has always involved applying the provisions of the *Trade Practices Act*, where

this is necessary, to ensure effective access to these network elements in order to promote competition and efficient investment for the benefit of end users. This has been and, as the Government has indicated, will continue to be, the ACCC's approach to considering potential new investments.

Without doubt, the Government's proposed National Broadband Network will have a significant impact on the Australian communications industry. The NBN announcement raises a number of regulatory issues as well as opportunities. Principal among these is that the NBN could lead to significant structural change in the industry.

The Government has announced a number of underlying principles that will shape the future industry structure in an NBN environment. In particular, the Government has indicated that the NBN company will only provide wholesale services and will offer these services on an open access basis.

The Government has also confirmed that no retail company will be able to control the network in its own interests. Clearly, this represents a substantial shift from the current industry structure.

The vertical integration of Telstra has long been recognised as one of the most significant ongoing concerns for the industry. Telstra is both vertically and horizontally integrated in the network, access, wholesale and retail levels of the industry, covering both fixed line and mobile sectors, across voice, broadband and pay TV markets.

Such levels of integration are unprecedented anywhere else in the world, and have significantly constrained competition in the communications sector in Australia.

There have been attempts in recent years to address these issues by imposing accounting and operational separation regimes. However, these measures have been ineffective in constraining Telstra's incentives and ability to discriminate against access seekers.

In moving to a new industry structure, it is critical to ensure the right framework is in place to promote robust competition in communications markets for the benefit of industry and consumers into the future.

With the rollout of the NBN to begin soon, a number of technological and network design matters will require detailed consideration in the short term.

The Government has announced that an FTTP rollout will begin in Tasmania later this year and on the mainland in 2010. In addition, from July next year, fibre connections will be mandatory in all greenfields developments.

Of critical importance to the industry, as well as to the ACCC, will be types of services that the NBN operator will be required to offer. As the ACCC has said before, it will be important that the NBN company offers an access service that is sufficiently technologically neutral and flexible to support a wide range of existing and future applications and services.

In its assessment of the FANOC special access undertaking for a fibre to the node network two years ago, the ACCC considered the definition of a bitstream access service. In its decision, the ACCC set out what it regarded as the minimum requirements for access services supplied via a fibre network. The

ACCC considered it was important that the access service be defined as close as possible to the basic physical infrastructure to maximise the ability of access seekers to control their own costs and supply chain, differentiate service offerings, innovate and improve service quality.

The ACCC is not alone in this view – Ofcom, the UK regulator, has similarly emphasised the importance of high levels of flexibility and configurability of access services, allowing downstream operators as much control as possible.

While issues relating to the design of the NBN and the appropriate regulatory settings require our close attention now, the pay-offs remain some years away. However, the Government's regulatory reform discussion paper suggests a number of options to improve competition today, in the transition to an NBN environment.

Among these options is a requirement for Telstra to functionally separate to improve incentives to treat access seekers and its own retail business units on equivalent terms.

The key feature of functional separation models is that the network provider operates at arms length from downstream service providers. This usually requires operations and management separation and for decisions to be made independently by the separated division and the rest of the company.

As the ACCC has said before, functional separation may go some way to addressing concerns regarding the promotion of equivalence in the treatment of access seekers, if it is successfully implemented. However, vertical integration of any form into downstream markets, even when subject to functional separation, will not ensure equivalence.

The ACCC has given careful consideration to this option as well as the other options put forward by Government, as I know have many other parties. The ACCC has provided a submission to Government in response to the discussion paper and we expect government will publish submissions shortly.

### **The current broadband environment**

In the meantime, the ACCC's day-to-day core business remains important.

The ACCC monitors developments in the competitive environment across broadband markets and, more broadly, across the communications industry on an ongoing basis.

We continue to see investment in the industry as well as lower prices for consumers. At the same time, however, the industry is still characterised by a high degree of concentration.

According to ABS estimates, the demand for broadband services grew by around 30 per cent in 2008, with the number of broadband subscribers reaching 6.7 million by December last year.<sup>1</sup>

Access seekers have continued to invest in their own infrastructure, primarily by installing digital subscriber line access multiplexers (DSLAMs) in Telstra's

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<sup>1</sup> Australian Bureau of Statistics report: *8153.0 - Internet Activity, Australia, December 2008*  
<http://www.abs.gov.au/ausstats/abs@.nsf/mf/8153.0?OpenDocument>

exchanges (although, for a number of reasons, this may be coming to an end). Investment to date has enabled access seekers to compete more vigorously in the broadband markets and across more elements of the supply chain.

Meanwhile, investment in alternative networks has also continued. For example, both Telstra and Optus have upgraded the peak speeds on their cable networks. At the same time, in the mobile sector, 3G carriers have continued to improve the coverage and data capability of their networks.

Despite this, it would be fair to say that competition across the industry has not developed as quickly as was anticipated in 1997, and it is clear that competition is emerging unevenly. In some market segments, and indeed in some geographic areas, competition appears to be developing quite well. In others, the state of competition is much less encouraging.

The market for fixed broadband services is a good case in point.

Competition in this area is underpinned by ongoing regulated access to the unconditioned local loop service (ULLS) and the line sharing service (LSS). Over 20 ISPs have installed their own equipment in Telstra's exchanges to provide broadband DSL services directly to consumers and businesses.

As at the end of last year, there were 537 exchanges across Australia in which Telstra faced direct competition from at least one ISP with its own infrastructure.

However, the level of competition varies significantly from area to area. Where barriers to entry are lower, investment in access based competitive infrastructure, and thus competition, is emerging more quickly.

But barriers to entry remain high in many geographic areas. This is demonstrated by the fact that the number of exchanges with competitor DSLAMs accounting for only 20 per cent of total number of Telstra DSL enabled exchanges.

As a result, while there are some encouraging signs of competition, the underlying structural issues in the industry have meant that competition across the board remains constrained.

Telstra still controls the infrastructure by which the overwhelming majority of fixed line voice and broadband services are provided. The impact of this control on retail markets is clear. In the fixed line voice sector, for example, Telstra controlled 72 per cent of all fixed line retail voice subscriptions in 2007/08. Meanwhile, its nearest rival Optus held an 11 per cent share. Similarly, Telstra's share of the retail fixed broadband market, as determined by the number of subscribers, increased from 47 per cent in 2005-06 to 58 per cent in 2007-08.

The ACCC has not, and never has had, a particular view on the 'right' structure for the telecommunications industry in Australia. But there is no doubt that the current industry structure is problematic, to say the least. The ACCC is committed to delivering regulatory outcomes that will promote competition in broadband markets. But the success of competition regulation will depend on the extent to which the incumbent access provider has market power and the degree to which it is vertically integrated into downstream markets.

If an access provider has market power as well as a strong incentive to deny access to competitors, an access regime based on the negotiate/arbitrate model may have difficulties delivering timely access on reasonable terms and conditions for the industry.

A few statistics on the operation of the current regime would appear to demonstrate this. Since 1997, the ACCC has been notified of a total of 157 telecommunications access disputes. This is in stark contrast to the three access disputes that have been notified to the ACCC under Part IIIA of the TPA across all other sectors of the economy.

Over the past 24 months, judicial review has also been sought in respect of almost all final arbitration determinations made by the ACCC. There are currently 14 final determinations before the Federal Court – all relating to ULLS and LLS.

The ability of access providers to propose access terms and conditions in undertakings has likewise failed to provide greater certainty under the regime.

In total, 34 access undertakings have been submitted under Part XIC of the TPA for 10 different telecommunications services. The ACCC found that only five of these were in the long term interest of end users, and therefore acceptable, after applying the criteria in the TPA.

Four of the ACCC's decisions to reject undertakings have been appealed unsuccessfully to the Australian Competition Tribunal. I note the ACCC's recent decision to reject Telstra's latest ULLS undertaking has also been appealed to the Tribunal. The matter will be heard over the coming months.

These examples clearly demonstrate that improvements to the current regulatory regime could be made to facilitate faster and better outcomes for all parties. Much thought has been given to appropriate reforms by both the ACCC and other parties in the context of the Government's regulatory review process.

### **Recent developments**

Turning to recent developments in regulation, there are a number of recent matters that I want to draw your attention to today.

First, I want to note that the ACCC works to ensure that all market participants have the greatest degree of certainty about regulatory settings under the TPA that can reasonably be provided given market conditions. The ACCC considers that this principle is particularly important in a time of significant transition in the industry, as the Government moves to implement its NBN announcement.

We expect the eight year transition period to be a time of major structural and competitive change as the communications industry moves to an environment where an NBN operates alongside or, potentially, instead of, Telstra's Customer Access Network.

In this regard, the ACCC recently issued a final decision extending the declaration of the mobile terminating access service for another five years, which is the maximum period available under the TPA. Regardless of their size, mobile network operators have exclusive control of access to customers on their own network. As a result, mobile operators are subject to weak competitive constraints when setting prices for the service. Therefore,

extending the declaration will promote continued competition and certainty in the market for retail mobile services.

A week ago, the ACCC also released a draft decision proposing to extend the declaration of the principal access services used for the provision of fixed voice and broadband services over Telstra's copper network for the full five years available under the TPA. This will ensure competitors have sufficient access to the essential inputs needed to promote competition and efficient investment in the fixed voice and broadband markets. This is particularly important in a time where significant changes to the delivery of fixed services are likely to occur.

Of course, while regulatory certainty is important, it is also necessary for regulation to remain well targeted and to ensure that the regulator remains responsive to market developments.

In this regard, the ACCC is satisfied that sufficient statutory mechanisms exist to review the regulation of fixed-line services or, for that matter, any declared services, if required at any time to take account of changes in market conditions.

The ACCC recognises the dynamic nature of the industry and takes every effort to understand and respond appropriately to market changes as they occur. This was evidenced by ACCC's recent decision on the Vodafone/Hutchison merger. In not opposing the merger, the ACCC was cognisant of the need for mobile network operators to have sufficient scale to make significant investments in their network capabilities, particularly in light of the increased customer demand for bandwidth-hungry data services.

Only a few years ago there was little appreciation for such network capabilities. But the large increase in mobile broadband and data services demanded by consumers has meant that operators need to maintain investment in their mobile networks in order to sustain competitive provision of such services.

### **Consumer matters**

As well as delivering effective regulatory outcomes for industry, the ACCC has been actively working on consumer issues in the communications sector. The ability of consumers to make informed decisions about products or services in the market depends in a very basic way on not being misled. Misleading conduct is not only bad for consumer choice, it's a form of anti-competitive behaviour as well – it is essentially a form of unfair competition.

In recent years there has been a disturbing increase in consumer complaints for the industry. Three months ago, the ACCC put the communications industry on notice that standards must improve. Since then, I am pleased to note that there have been two very welcome developments that will go a long way to ensuring consumers are accurately informed when making purchasing decisions.

One of the matters at the forefront of the ACCC's consumer efforts has been mobile premium services. About 50 per cent of mobile premium service complaints are from consumers who received such services but they did not ask for them. Around 20 consumers a month complain to the ACCC that they feel they have been duped into accepting a service that, in some instances, costs them a considerable amount of money.

We welcome the package of consumer protection measures, including the Mobile Premium Services Code recently announced by ACMA. I note that several of the ACCC's recommendations were included in the final package. We hope industry participants will respond positively to the package. And we have no doubt the ACMA will vigorously enforce compliance.

Another practice that has troubled the ACCC, as well as a great number of consumers, is the confusing pricing of service packages. We welcome recent amendments to the TPA that require companies to take greater care to clearly inform consumers of the full price of a service.

In relation to communications services, providers should ensure that a single whole-of-contract price, including for ADSL and wireless/mobile broadband plans, is disclosed prominently to potential purchasers. It is not acceptable for prices to be buried in fine print or after viewing a number of webpages.

### **Regulatory challenges going forward – control of content**

My comments so far indicate a fairly full agenda for the ACCC going forward. However, there is one other area I want to touch on before I conclude.

The Australian Government's regulatory reform discussion paper raised a number of concerns about the integration of network owners into content markets. Specifically, it noted concerns arising from vertical integration between content distribution and communications networks and horizontal integration across networks. The discussion paper noted Telstra's ownership of the ubiquitous fixed line copper network as well as the largest HFC cable network in Australia, in conjunction with its 50 per cent stake in Australia's principal pay TV content provider, Foxtel.

The ACCC recognises that access to content is becoming increasingly important to communications providers, with technological advances allowing communications networks to deliver content that previously was only provided by traditional media companies in print, radio and television.

Mobile network operators and fixed line broadband providers have become increasingly active in purchasing content, such as the rights to popular sporting competitions and new release movies.

Of course, exclusive arrangements for the supply of content are not necessarily anti-competitive. Indeed, such arrangements have been a feature of free-to-air broadcast business models for some time, without necessarily raising competition concerns.

However, concerns could arise if a communications network operator is able to acquire sufficient compelling content on an exclusive basis such that this limits the ability of alternative network operators to offer attractive packages to consumers.

Control of both the communications network as well as a large volume of compelling content could confer on a company significant market power in both the communications and content sectors.

## **Conclusion**

Despite the ACCC's ongoing work to promote competition, ensure regulatory certainty for investment and promote the long term interests of consumers, there will continue to be regulatory challenges for some time to come.

The ACCC welcomes the opportunity created by the Australian Government's National Broadband Network policy to address the underlying structural issues in the industry. The ACCC also welcomes the Government's review of the regulatory framework and industry structure in the transition period.

A review of the current broadband environment suggests that competition is emerging unevenly. While competition in some segments of the market is encouraging, on the whole competition has not developed as quickly as would have been anticipated with the telecommunications reform in 1997. Addressing the current underlying structural issues of the industry will assist in improving competition, with subsequent flow on benefits to consumers and business.

As we enter the transition period to a NBN, the ACCC will continue performing its functions in a vigorous and robust manner to ensure regulatory certainty for industry and to promote the long term interests of all Australians.