Submission to the Australian Competition and Consumer Commission on its Draft Communications Sector Market Study Report

Department of Communications and the Arts

21 December 2017

The Department of Communications and the Arts (the Department) welcomes the draft Communications Sector Market Study report by the Australian Competition and Consumer Commission (ACCC) and the opportunity to comment on it.

The Department has supported the ACCC market study in light of the ACCC's objective of ensuring it is better informed of market developments in the exercise of its statutory regulatory functions. The Department has also seen the market study as an efficient way to improve understanding of the sector within the Department, public service, industry and community generally. The draft report contains much valuable information to this end.

As the ACCC has made clear in the draft report, the sector is undergoing significant change, and has been in flux for many years. Ongoing structural and regulatory reform, including the rollout of the National Broadband Network (NBN), as well as other technological developments and commercial activities, mean the Australian communications sector is in transition. In such an economically significant industry, which is fundamentally driven by the commercial activities of private sector players, it is incumbent on government and regulators to well understand the players' incentives, risks and other drivers.

As a key regulator in the sector, and the broader economy, the observations and opinions of the ACCC are highly influential and carry real weight with parties making significant investments. It is important, therefore, that the ACCC's work is evidence-based, objective, well-considered and avoids unwarranted speculation. A document like the market study needs to be careful that it does not cause market participants to misconstrue the direction of Government policy or the ACCC's own regulatory intentions.

In this submission the Department is focussing on two main areas:

- the regulatory posture for the sector going forward; and
- specific matters discussed in the report where the Department considers it important to confirm or clarify the Government's or the ACCC's position — the valuation of the NBN and its impact on pricing is a particular case in point.

<u>Regulatory posture</u>

The Department's view is that priority must be given to commercial forces and regulation should play a secondary role.

Clearly the ACCC must operate within the legislative framework set by the Parliament and with due regard to the policy framework set by the Government. The ACCC's primary role is to regulate in accordance with these frameworks. In the case of the communications sector, the ACCC is the lead regulator in relation to matters of competition and generic consumer issues. The Australian Communications and Media Authority (ACMA) is the lead regulator in relation to matters such as radiocommunications and content and clearly has special responsibilities for consumer issues in telecommunications. The Government expects both regulators to work together closely, in a co-ordinated fashion, to produce the best possible outcomes for consumers and industry participants. This is reflected, for example, in the Government's decision in response to recommendation 10 of the ACMA Review that cross-membership between the ACCC and ACMA should be revitalised.

While the NBN is an obvious and significant public sector intervention in the market, the Government's clear preference is that investment in the telecommunications sector be led by the private sector, be commercially-based and commercially sustainable, and face the least regulation possible. This is a view we have previously put to the ACCC in our submission to the ACCC's mobile roaming inquiry. The Department therefore welcomes the ACCC's comments in the draft report in line with these objectives and considers the ACCC's regulatory posture going forward should give priority to these objectives. This includes the ACCC's preference to keeping a watching brief on the emerging Internet of Things and over-the-top services sectors as opposed to intervening in these sectors.

Given the sector is in a significant period of transition, there should be strong evidence that additional regulation will produce a net benefit and not create distortions, particularly distortions of an enduring nature. In this context, the ACCC's disposition should be to remove barriers to investment and competition where it is within its remit, and avoid regulation unless there is a demonstrable case for it. For example, in relation to the draft report's proposal that the ACCC will consider a potential email portability regime, in the Department's experience this is not an issue of major concern to stakeholders and would appear amenable to a range of practical solutions. The Department is particularly concerned about regulatory interventions to promote competition, including from small players, which create dependencies that are inefficient and unsustainable in the long term.

The draft report puts considerable emphasis on ongoing industry monitoring. It is important for the ACCC to have robust data on which to base its decisions. The Department is also interested in access to such data. However, we both need to be mindful of creating unnecessary data collection and reporting burdens for industry. This is particularly so given that the majority of the costs of the communications functions of the ACCC and the ACMA are funded by industry through licence charges on carriers. There is a need to focus on priority issues, for example, the impact of nbn's recent pricing changes on high speed broadband affordability.

Where a clear problem is evident and regulatory intervention is undoubtedly justified, any ACCC action should be based on consultation with stakeholders, be targeted, effective, proportionate and designed to minimise negative consequences.

Given the importance of the communications sector in enabling infrastructure for the wider economy, particularly as more economic interaction occurs online, the Department and the Government expect the ACCC to keep them informed in advance of its thinking and proposed course of action to the extent feasible given the constraints on it. Such an approach is vital to all parts of Government working together to deliver optimal outcomes for the community as a whole.

Key issues

Consumer experience on the NBN

As the draft report indicates, an immediate issue for industry, Government, and the regulators, is optimising the consumer experience on the NBN.

It is important to recognise that the majority of consumers are satisfied with their NBN service and that connection to the network has provided large numbers of Australians with vastly improved access to high speed broadband. To put this in context, in 2013 there were up to 1.6 million premises throughout Australia that had either no access to fixed broadband or very poor broadband connectivity, with peak median download speeds of less than 4.8 megabits per second (Mbps). Now over 6.5 million premises can connect to high-speed broadband, including over 2.9 million premises in rural and regional Australia, and by 2020 11.6 million premises will be able to access the NBN.

The NBN rollout is a significant step-change for consumers and industry. As the number of households and businesses migrating to the NBN continues to grow, it is to be expected that the number of consumer complaints will also rise. It is important, however, to keep this in perspective. The TIO's 2016-17 report shows that the proportion of complaints about services delivered over the NBN compared to the number of activated services remained at a similar level to 2015-16 (around 1 per cent), despite the network more than doubling in size. For example, in 2016-17 there were just over 11,000 NBN connection complaints to the TIO out of 1.3 million activations during the period – that is about 0.8 per cent of activations. Similarly, just over 16,000 fault complaints were made to the TIO, for around 2.4 million active services – about 0.6 per cent.

Within this context, and recognising that a large proportion of current customer concerns are specific to the migration process, the Department is of the view that regulatory action needs to be targeted and supported by strong evidence of consumer harm. That is why the Minister for Communications announced on 21 December 2017 a targeted suite of new protections to ensure broadband customers get the level of service they expect from their internet service provider and to address some transitional problems associated with migration to the NBN. These measures have been informed by ACMA-commissioned research into consumers' experiences before, during and after migration to the NBN. The ACMA has also used its formal powers under the *Telecommunications Act 1997* to collect information from businesses across the NBN supply chain to help guide industry improvements.

The Government will provide $8.7 million over three years from 2017-18 to the ACMA to enhance important consumer protections, including:

- clarity of information – consumers will be provided with easy to understand information about their NBN plans and the broadband speed they have selected.
- complaints handling standards – to address the current 'handballing' of complaints, a new complaints handling standard will enable the ACMA to move quickly to address deficient complaint handling. Additionally, retail providers will be required to report to the ACMA on customer complaints, with the results to be published to help consumers differentiate between retailers based on the quality of their customer service.

- service continuity – consumers will be able to re-activate a service on a legacy network within a certain timeframe if an erroneous disconnection has occurred and the NBN cannot be connected.
- service quality – consumers will be assured of a functioning and quality NBN connection as retail service providers will be required to complete line testing at the time of installation.

The Government's consumer experience improvement package builds on a substantial body of actions already being undertaken by industry, NBN Co Limited (nbn) and regulators to ensure the NBN rollout is in line with consumers' and taxpayers' expectations. This also includes action taken by the ACCC to ensure NBN consumers have access to accurate speed information and are protected by the Australian Consumer Law.

We note that on 2 November 2017, the ACCC also announced an inquiry into wholesale service standards. The ACCC's power to regulate wholesale service levels is a significant one and the Government will monitor progress of the ACCC's inquiry closely. The ACCC's public inquiry into NBN service level standards will be a useful input to the Government's broader agenda for the delivery of the NBN and wider market reforms.

The Government is committed to ensuring consumer protections remain relevant in the evolving telecommunications market. In this regard, the Government has indicated its intention to conduct a review of the existing telecommunications consumer safeguards framework. The Government's clear objective is to ensure a fit-for-purpose regulatory framework that provides effective protections for consumers in the NBN environment and into the future, while fostering commercial and competitive investment and activity to the greatest extent possible. The review will necessarily intersect with several other initiatives underway such as the Government's proposed statutory infrastructure provider legislation and review of the universal service obligation.

nbn valuation and pricing

In the draft report the ACCC has recommended that in the medium term, and depending on future developments, the Government consider whether nbn should continue to be obliged to recover its full cost of investment through its prices. The draft report indicates that further work could be done to examine possible options that may provide nbn with greater flexibility for example, direct budget funding arrangements for non-commercial services, debt relief measures or an asset revaluation (p.133). This is inconsistent with Government policy. Notwithstanding nbn's series of pricing discounts which have responded to market requirements, we note that the ACCC agreed to the existing pricing and cost recovery model at the outset of the NBN project[1].

Concerning matters of asset valuation, the valuation of the Government's investment in nbn, as recorded in the Department's Annual Financial Statements, is determined according to accounting standards. The investment must be recorded at fair value and this is currently assessed to be $16 billion based on the value of nbn's net assets (i.e. total assets minus total liabilities). Its value is less than the $29.5 billion in equity invested in the company because a

[1] ACCC decisions and access undertakings in relation to the NBN, 2011 to current
https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn

portion of the equity has been used to fund operating costs during the start-up phase while nbn's revenues are less than its operating costs.

Accounting standards require nbn to assess the value of its assets annually, including an assessment of whether any of its assets need to be impaired. A write-down or impairment can only be triggered by nbn. The valuation of nbn in the Department's financial statements is approved by the Australian National Audit Office (ANAO). As a result it is not possible for the Government to initiate a revaluation of nbn's assets.

As a Government Business Enterprise, nbn is expected to operate commercially and efficiently within the legislative and policy framework provided, including the *Competition and Consumer Act 2010* and the *National Broadband Network Companies Act 2011*. The Government has not set a rate of return requirement for nbn. Each year the company prepares an annual Corporate Plan that balances outcomes for consumers, retail services providers and Government and proposes a set of prices which have an associated return to Government (this is known as the Commonwealth's Internal Rate of Return (IRR)) and is consistent with nbn's regulatory commitments. The Government reviews the Corporate Plan prior to publication.

Some commentators have asserted that an asset write down would allow nbn to reduce its prices and maintain its current IRR. However, the Commonwealth's IRR used to classify the NBN as an investment is calculated based on the whole-of-project gross cash outflows (equity payments) and inflows (dividends and sale of the investment in future) between nbn and the Commonwealth. Accordingly, for Commonwealth accounting purposes, a write down or impairment (a non-cash transaction) on nbn's assets would not affect the relevant rate of return for the Commonwealth. As there is no effect on the IRR, it would not affect nbn's prices.

nbn has conducted regular industry consultations and sought feedback on pricing construct options over a long period of time. Earlier this month, nbn responded to calls for further pricing variations by announcing major changes to its wholesale pricing structure to provide more affordable options designed to improve the broadband experience of Australians connected to the NBN. These changes provide significant discounts on the current wholesale prices nbn charges retailers for the higher speed tiers, and are significantly below the pricing caps approved by the ACCC. The ACCC should see how these changes play out in the marketplace before deciding whether further regulatory intervention may be warranted. In this context, however, it will be important for the ACCC to monitor how retail providers respond to this initiative by nbn, as the Minister has recently raised with the ACCC.

Funding nbn's non-commercial services

In the draft report the ACCC has indicated that its preference is for nbn's loss-making services to be funded directly from the Budget (p.189). The Government does not agree with this view.

nbn's fixed wireless and satellite networks, which provide broadband services predominantly to regional Australia, will incur losses of around $9.8 billion in net present value (NPV) terms over 30 years. nbn currently funds these losses through an opaque internal cross-subsidy from its profitable fixed line networks in metropolitan areas.

Funding nbn's loss-making fixed wireless and satellite networks from the Budget would be very expensive, costing up to $1 billion per year. There can be no guarantee that future governments would continue to make this amount of Budget funding available.

On 22 June 2017, the Government introduced Bills into the Parliament to establish the Regional Broadband Scheme (RBS), which will secure regional broadband funding into the future regardless of the Budget priorities of the day. The funding will be collected through a monthly charge of $7.10 per premises on all nbn-comparable high speed fixed line broadband network providers. The RBS is designed to maintain incentives on nbn to contain the costs of its satellite and fixed wireless networks because nbn will continue to pay around 95 per cent of the costs. These incentives would be lost if nbn's loss-making networks were funded from the Budget. During the public consultation on the approach for funding nbn's loss-making services, the ACCC clearly expressed support for the introduction of a levy on nbn and nbn-comparable services[2].

The RBS puts nbn on a level playing field with other comparable carriers with respect to its fixed wireless and satellite networks. It targets services that are substitutable for an nbn service, consistent with the general economic principle that all providers of substitutable services should be treated in the same way, and requires nbn-comparable providers to contribute proportionate to the size of their networks. The Government is confident it is the most efficient, equitable and transparent way to fund nbn's loss-making fixed wireless and satellite networks over the long term.

nbn privatisation

The draft report contains a brief discussion of privatisation in the telecommunications sector, with particular reference to the NBN (p.130).

Since the NBN was established, the stated policy of all Australian Governments has been to privatise the network once it has been built and is fully operational, subject to appropriate public policy safeguards. This is foreshadowed by the *National Broadband Network Companies Act 2011*, which sets out a clear and methodical process for privatisation of the company. The process for privatisation requires independent review by the Productivity Commission of, amongst other things, the appropriate regulatory settings going forward for the NBN. It also requires privatisation itself to be confirmed by the Parliament.

The Department is fully aware of the significant market power nbn is likely to exercise at the wholesale level in the telecommunications market. This is reflected in its establishment under law as a wholesale-only, open access platform, which operates at a low level in the service stack, with price and non-price terms and conditions of supply subject to ACCC oversight.

Mobile Black Spot Program (MBSP)

In the draft report, the ACCC considers that implementing open access requirements for government subsidy programs, like the MBSP, will deliver greater benefits to competition and consumers (p.189).

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[2] ACCC submission to the NBN non-commercial services funding options consultation paper, 5 June 2015, p.3. ACCC submission to the NBN non-commercial services funding options - final consultation paper, November 2015, p.2

Under the MBSP, the Commonwealth is funding around 28 per cent of the capital costs of base stations with the remaining cost being met by the mobile network operators (MNOs) and state governments. Many of these base stations are in locations that are not economically viable for MNOs to invest in without Government support, due to very small markets with low economic returns. Different types of access provisions, such as roaming between MNOs or the sharing of infrastructure, influence the economic return available from these base stations and therefore ultimately the funding contribution sought from the Commonwealth.

The MBSP to date has therefore sought to effectively balance the programs competing objectives of coverage and competition. This has been done through robust and measurable coverage criteria, and by providing incentives for co-location.

The current co-location incentives include technical specifications for MNOs when co-locating on base stations at incremental cost, mechanisms for the co-design of base station, discounted backhaul to the nearest exchange and an independent dispute resolution process. The program recognises that MNOs make commercial decisions whether and where to co-locate on mobile towers. Co-location appears to currently be working effectively under the program, with co-location currently occurring or being planned at around 87 base stations.

Spectrum management

The Government is currently developing a spectrum reform package that will simplify licensing and allocation processes, establish a more flexible and efficient regime, and create the conditions to promote secondary trading of spectrum. This follows from the recommendations of the Department's 2015 Spectrum Review.

In designing a new legislative and regulatory framework for spectrum management, the Government intends to create a framework which supports the effective management of a valuable and scarce national asset, fosters competition in the communications sector, drives productivity and encourages innovation. To achieve this, a balance in the regulatory settings needs to be struck between (a) certainty for potential and current spectrum holders and (b) flexibility for industry and the regulators to respond to emerging spectrum needs. The exposure draft of the new Radiocommunications Bill requires the spectrum regulator to consult the ACCC where appropriate and practicable. The Government respects the important role the ACCC holds as Australia's economic regulator and welcomes continued engagement with the ACCC on the design of the new spectrum management framework.

Support for smaller players

The draft report contains several proposals targeted at strengthening competition from small providers with a view to maintaining competitive discipline on larger providers (pp.143-144, for example). This includes the proposals concerning the supply of wholesale inputs in the aggregation market, including access to nbn's 121 points of interconnection (POIs). The number of nbn POIs was determined by nbn and the ACCC in 2010-11 with reference to competition criteria developed by the ACCC.

While the Department recognises that the majority of services on the NBN are provided by the top four players, it is also mindful that more than 100 providers are offering services, either through direct relationships with nbn, or using intermediaries. Private sector providers have made significant investments in the aggregation market based on the structural decision to have 121 POIs and new small providers have entered the market in full knowledge of the prevailing structure.

The Department appreciates the merits of fostering competition, especially from new entrants, to provide a competitive discipline on larger players. Strong retail competition is a fundamental element of the NBN design. However, care needs to be taken that regulatory interventions that support small players do not create artificial competitive outcomes in the market which are ultimately unsustainable and do not promote economically efficient outcomes.

Dense cell networks

The draft report proposes that the ACCC will consider stakeholder views on whether it should assess the merits of open access for small cell infrastructure (p.179). Such networks are at a relatively early stage of development and the potential issues are only briefly discussed in the report. The Department considers intervention of this kind premature. It is not clear that the kinds of problems the ACCC anticipates will emerge. On the other hand, such regulation (and speculation about it) could discourage investment. It is important to ensure that there are incentives for private businesses to invest in infrastructure.

Future scenarios

In the context of discussion about competition between access technologies, the draft report outlines four future scenarios for the communications industry (pp. 171-173). The Department is concerned that the scenarios' discussion of future nbn action in response to 5G technology and the availability of spectrum bands is speculative and potentially misleading for industry and the wider community. Regardless of the caveats placed on the discussion, given the ACCC's relationship to government and its role in the sector, readers could mistakenly believe that there is some interest in Government in the scenarios described. Alternatively, the discussion could be seen as an attempt by the ACCC to shape Government thinking in a particular way. While neither of these conclusions would be correct, there is a risk that readers could interpret the text in this way. The Department does not consider such scenarios are an appropriate inclusion in the final report.

Market concentration and vertical integration

The draft report finds that competition is present across communications sector markets, albeit to varying degrees. However, the draft report also notes in several instances the presence of concentration and vertical integration, particularly in the aggregation (p.80) and mobile markets (p.74). It is not clear whether the ACCC, in making these observations, is suggesting there are particular issues in these areas that need closer attention or action. Our conclusion is that given the overall assessment of competition, it is not. This is particularly so, given that the ACCC has a key role in assessing and approving major mergers and acquisitions that can contribute to concentration and integration in the sector.

However, these are significant observations by the ACCC and could give rise to concern on the part of market players. Given this, it may be useful for the final report to clarify these observations. This may require deeper analysis of the issues than is currently the case.

The observation that market concentration is a feature of the sector may suggest that economies of scale and scope are important, given the capital intensive nature of the sector. Equally, this may have implications for opportunities for small players and the potential for sustainable interventions for small players.

Similar questions about economies arise in relation to concentration and integration in the aggregation market given the significant investments required to provide transmission to nbn's 121 points of interconnection. The situation is further complicated here by the ACCC's past views on the development of competition in this segment, including the determination of the number of nbn's POIs, and the relatively early stage of development of this market.

Adequacy of the current regulatory framework

The draft report notes that the economic regulatory framework for the communications sector has proven to be capable of accommodating major changes to the sector and that it is fit for purpose (p.184, for example). While this may be a reasonable conclusion, we need to be wary of complacency and keep the framework under ongoing review in terms of its effectiveness and efficient operation. The Department is particularly mindful that a framework that provides too much discretion to regulate can discourage investment and competition. Conversely, a framework that is too inflexible can lead to the same consequences. It is important to ensure the right balance is struck.

For its part, the Government is concerned that the current separation rules in Parts 7 and 8 of the *Telecommunications Act 1997* that apply to new fixed line broadband networks are problematic. To this end, the Telecommunications Reform Package it has introduced aims to improve commercial and competitive opportunities by allowing such networks to operate on a functionally separated basis. The ACCC will play an important role in administering these laws.

That package also includes the RBS.

In the draft report, the ACCC queries whether the RBS should be extended to fixed wireless services should they become substitutable for fixed line broadband services.

In relation to the RBS, the Government has ruled out applying the RBS to mobile and fixed wireless networks at this time as these networks are not currently substitutable for a high speed fixed line service, due to the higher charges for data use. The Government has committed to reviewing the RBS on a regular basis, and the legislation includes a requirement to conduct a review within the first four years of the RBS' operation. During that review, the Government could consider the scope of the RBS in light of technological changes in the market.

Implicit in this point is also the question of whether separation rules should be extended to fixed wireless services if such services are considered substitutable for fixed line broadband services. The regulatory position to date has been not to extend separation rules to wireless platforms because they are not currently considered substitutable and the preference is to minimise regulation. However, there is an issue here, if only in terms of regulatory symmetry, that the Government may need to consider if fixed wireless services are found to be, or are marketed as, substitutable for fixed line high speed broadband. The alternative approach would, of course, be to wind back separation rules, if effective alternative mechanisms to achieve the policy objectives they are directed at could be identified.

As discussed above, outside the core economic regulation framework the Government is proposing significant new legislation in relation to radiocommunications, telecommunications service delivery and, potentially, consumer safeguards, depending on the outcomes of that review process.

Conclusion

The Department considers the ACCC's communications sector market study has been useful in raising awareness of issues affecting an industry in flux and the ACCC's efforts are appreciated. Going forward, it will, as always, be vital to strike the right balance between commercial initiative and activity, and necessary regulation. Clear preference should also be given to the former, and this is a strong theme in the draft report. The Department endorses this approach.

In relation to particular issues, the Department submits that the ACCC should consider more fully the following matters in finalising its report:

- Government actions in train to improve consumer experience in the NBN migration;
- the ACCC's comments on the valuation of the NBN and its potential impact on pricing;
- the difficulties in funding nbn's non-commercial services from the Budget;
- the policy commitment to NBN privatisation and the right regulatory settings for it;
- the practical impact of open access requirements on the MBSP;
- the approach being taken with the new radiocommunications framework;
- whether interventions for smaller players are necessary and sustainable;
- concerns about access regulation for dense cell networks at this early stage;
- excluding scenarios on future technology competition with reference to nbn;
- the ACCC's comments on market concentration and vertical integration; and
- proposed Government reforms to the legislative framework for the sector.