



ATUG submission

**A strategic review of the regulation of fixed
network services**

**ACCC Discussion Paper
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Background

Telecommunications is one of the most dynamic and important industries in our economy. OECD and other studies provide clear evidence of the link between advanced communications services, productivity, growth and prosperity.

There is no doubt that competition in telecommunications services thus far has delivered very significant benefits to the economy, the industry and end users since 1997 – estimated at \$12.4 billion in 2004-2005 by ACIL Tasman for the Australian Communications and Media Authority annual report to Parliament for 2004-2005.

The emphasis of regulation in the first 15 years of emerging competition the focus has been on price reduction and service level improvement. Going forward the issues of innovation and investment are firmly on the policy and regulatory agenda.

It is a truism to say that the industry is constantly changing – but this the reality that end users, industry, policy makers and regulators have to deal with. It is in this context that ATUG welcomes the ACCC discussion paper on regulation of fixed network services.

The discussion paper provides an opportunity to review the issues of the day and to determine whether they are adequately addressed in the interpretation of matters such as “long term interests of end users”, “encouraging investment” and relevant pricing principles.

The balance between innovation and investment, between competition and certainty, between metro and regional services are all in focus for end users and industry players – driven by significant changes in technology and suppliers and by changes in market demand for services.

Fixed network market regulation – next 5 years

The ACCC makes an important suggestion in ATUG’s view that a more holistic approach is needed in determining whether to declare fixed network access and services, and how to develop the pricing principles for such services which would be applied should commercial negotiation fail.

Services that should be included in this holistic approach include the same list of designated services described in the Operational Separation Plan Determination:

- Domestic PSTN Originating Access Service
- Domestic PSTN Terminating Access Service
- Local Carriage Service
- Unconditioned Local Loop Service
- Wholesale ADSL (Layer 2)
- Line Sharing Service
- Domestic Transmission Capacity Service

The inclusion of a Wholesale Line Rental product should be part of the Declaration Inquiry process now that re-balancing is completed.

ATUG thinks it is also timely to review the fragmented approach that exists to the implementation of regulation of fixed services. At present there are various roles which may overlap or lead to excessive regulation with little outcome for end users. Regulation should be focused, effective and provide speedy responses in the case of failure or abuse. ATUG would prefer to see better regulation rather than more regulation.

The list of regulatory interventions includes:

- both ACMA and the ACCC in monitoring competition,
- ACCC in anti-competitive conduct but with SPAN running an industry based ADR process,
- both ACIF and ACCC in consumer protection,
- ACIF developing the codes to support access arrangements
- ACMA in service quality,
- ACCC and Minister in Price Controls and Operational Separation,
- the Department in administering funding for accelerated broadband including DSL.

Apart from the duplication that this list implies, there is a significant gap in ATUG's view – that of monitoring effective implementation of access agreements without having to resort to anti-competitive conduct provisions of the Trade Practices Act. In ATUG's view the "lost key", "delayed technician" problem is likely to escalate over the next period and needs early and practical resolution. Whether the equivalence reporting approach of Operational Separation proves successful remains to be seen. End users consider after sales service (faults, switching, porting) as part of their supplier choice decision so ineffective implementation of regulatory decisions reduces the range of effective choices for end users.

In ATUG's view the market over the next 5 years will not exert sufficient competitive constraint on Telstra's activities in the fixed network area such that regulation is not longer needed. During the next five years, the impact of bundling strategies and the impact of social policy settings will also need monitoring for their competitive impact.

Beyond that period however there are prospects that mobiles and broadband will become the access paths of choice for end users – mobiles for convenience and broadband because of the potential to use to voice to (ironically) "add value" to the total package.

Competition thus far

This shift to mobiles and broadband, away from fixed line access is shown clearly in ACMA's Annual Telecommunications Performance Report for 2004-2005:

As at June 2005, Australia had:

- 18.4 million mobile services - up from 16.5 million in 2004
- 11.4 million fixed lines – down from 11.6 million in 2004
- 5.9 million internet customers – up from 5.2 million in 2004
- 2.2 million broadband customers – up from 1 million in 2004
- 1.6 million Pay TV customers – up from 1.5 million in 2004

In terms of usage and prices:

For fixed line services, access revenues increased but revenues (driven by decreases in call numbers and minutes) fell for local calls, long distance and fixed to mobile calls, the latter very slightly and not in line with ACCC mandated termination reductions.

For mobile services, total call minutes increased by 12%. The price per mobile minute in 2004-2004:

- Decreased by 1.4% for pre-paid residential services
- Increased by 7.2% for residential post-paid services
- Decreased by 8.8% for business services

This may mean that mobile pricing (beyond termination) becomes more of an issue for competitive assessment, or that the role of information in consumer protection increases. ATUG notes that OFCOM has very recently started a consultation on consumer switching and misselling practices.

For internet services, data volumes increased by more than 158%, narrowband by 22% and broadband by 230%. At the same time, prices declined by:

- 30% for ADSL customers
- 15% for cable customers
- 18% for satellite customers
- 3% for narrowband customers

The ACCC's Annual Report on Competitive safeguards identifies in the most recently available 2003-2004 report:

- continuing dominance of Telstra in the fixed line market,
- progress with ULL uptake,
- an oligopoly in mobiles with Telstra and Optus combined having 80% of the market, emerging but not substantial competitive pressure from Voice over IP and wireless broadband services.

ATUG's own study into the SME market conducted in 2003/2004 and 2004/2005 indicates developing competition in all sectors – fixed, mobile, internet. And a shift in emphasis by end users from fixed services to mobile services and internet based business. The report showed churn rates between 15% to 20% with the main driver being price, followed by service. SMEs are reasonably satisfied (40% -50%) that communications services were delivering value for money. After sales service is the key weakness for the industry. Perceptions of value included "being the biggest/oldest; having good products and services; having good customer service." In answer to who's the best, 84% of respondents indicated one of Telstra, Optus and AAPT. 3% or less nominated other carriers.

The OECD's Communications Outlook Report 2005 (data as at 2003) indicates that prices for Australian end users have not achieved the reductions seen by end users in similarly developed markets. In broadband services, speeds on offer in Australia do not compare favourably with speeds on offer in comparable countries.

Overseas Experience

Fixed Network Access and call services

The European Commission's recent analysis of the e-communications market in Europe, reports continuing dominance by incumbent telcos in retail access, emerging competition in retail calls markets and notes in particular little sustainable competition in wholesale markets:

http://europa.eu.int/information_society/policy/ecom/comm/doc/article_7/comm_pdf_com_2006_0028_f_en_acte.pdf, at page 7

5. MARKETS OVERVIEW

5.1 Fixed networks and services

In all Member States, the incumbent has continued to be dominant on the market for retail "access" – i.e. connection to a fixed telephony network enabling calls and related services to be made and received. However, competition is gradually emerging on both the domestic and international calls markets. This process has been facilitated by the application of appropriate remedies (notably carrier selection/pre-selection and wholesale line rental) and the introduction of competing technologies, in particular VOIP.

Wholesale markets, conversely, have shown few signs of sustainable competition save, in certain limited cases, for the market for transit services. The provision of call origination, which is needed by alternative operators to enable them to provide their own retail telephony and dial-up Internet services, is still an enduring bottleneck for competition. However, where effective remedies are applied at this level, they help to develop sustainable competition in the downstream retail (calls) markets, thereby enabling retail regulation to be phased out. As regards wholesale termination (services which operators buy from each other to enable their customers to make calls to different networks), all operators, irrespective of their size, have been found to be dominant, since, in line with the Recommendation, each operator's network constitutes a separate market on which it has a monopoly for terminating calls. Regulators have been able to reflect differences in the size of operators by imposing lighter remedies on smaller ones (i.e. by applying "asymmetric" remedies). The Commission has supported this approach where justified. In addition, the Commission has been keen to ensure that remedies in this market are effective: for example, an accounting separation obligation can render internal transfers visible and complement other obligations, while cost controls may provide the necessary transparency and legal certainty for market players, as well as helping to reduce termination rates.

Finally, as regards the "last mile" of the telephony network, connecting it to the end user (otherwise known as the "local loop"), the incumbent has invariably retained its near 100% market share. Effective access (by means of "local loop unbundling") and price regulation at wholesale level has been essential as a means of fostering the development of competition in the downstream markets, where alternative operators depend on local loop access to provide their services.

The EU reported on 7 February 2006 that:

“Regular economic analysis by EU Member States and the European Commission of competition in electronic communications markets and Commission scrutiny of draft national rules are paving the way to free markets, regulated solely by competition law, says a progress report published by the Commission today. Regulation in this sector applies only to operators whose significant market power could prevent the full benefits of telecoms liberalisation from getting through to consumers. Wherever a market analysis has found tangible signs of sustainable competition, regulation has been trimmed back or removed altogether. However, much remains to be done. As of 30 September 2005, sixteen EU Member States had found no effective competition on one or more of the 18 electronic communications markets defined by the EU and had taken steps to boost competition on the markets concerned. Five Member States had found only partial competition on one or more of these markets and had imposed remedies where it was lacking. But nine Member States had yet to notify the Commission of their analyses of any of the 18 markets. Of the analysed markets (152 out of 450), 123 were not competitive, 19 fully competitive, and 10 partially competitive.”

The analysis (by country, by market) indicated continuing concern over markets for fixed line access among others and is available at in the PDF document at:

<http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/06/125&format=HTML&aged=0&language=EN&guiLanguage=en>

ULL access

In regard to the specific issue of unbundling the local loop the most recent data is the OECD's Communications Outlook Report of 2005, based on data to 2003. The data (Table 2.11, page 59) shows increased uptake of LLU as a basis for accelerated competition in broadband in jurisdictions where LLU access and pricing has been considered in a holistic way with other forms of wholesale service and resale options: France has gone from 389 (including bitstream access) in 2001 to 273 255 unbundled lines in 2003; Netherlands from 5650 to 978 044 in 2003 and the UK from 13 474 to 300 000 in 2003.

Success in this competition policy area is further discussed in the EC's most recent implementation report, the COMMISSION STAFF WORKING PAPER, ANNEX TO THE EUROPEAN ELECTRONIC COMMUNICATIONS REGULATION AND MARKETS 2004 (10TH REPORT) {COM (2004) 759 final}:

“A good example is France, where the new entrants hold one of the highest shares of the DSL market, and consequently the overall broadband market. Broadband penetration has risen from 4.05% to 8.24% as at 1 July 2004, primarily driven by competition based on shared access and bitstream. France now has one of the lowest monthly rental prices in the EU for shared access and the French regulator (ART) has intervened strongly in relation to potential margin squeeze issues.”

UK Strategic Review

OFCOM initiated a Strategic Review of Telecommunications in 2004 based on concerns that, while benefits had been delivered to end users (price, quality and innovation), the current market structure for telecommunications is not sustainable and may start to stagnate or even go into reverse.

This was thought to come from a range of factors a number of which resonate in the current debate in Australia:

- technology change- IP networks, fibre to the home;
- margin erosion as the industry moves from traditionally high-margin PSTN business to lower margin broadband and data,
- users wanting further innovations -higher bandwidths, greater functionality, new applications, new content available across multiple platforms.
- effective and sustainable competition has been very difficult to achieve in practice

OFCOM's assessment reviewed the development of competition through various stages:

- managed duopoly competition,
- access based competition, and most recently,
- a period where infrastructure and services competition were seen to be of equivalent value and importance.

OFCOM determined in its review that there is no likelihood in the foreseeable future of cable networks being built out to the point where they are ubiquitous, and that regulatory policy for the next 5-10 year period cannot be based on emerging technologies such as fixed wireless access.

OFCOM's core conclusion has been that "to a significant extent, BT's access network will remain a natural monopoly - an 'enduring bottleneck' " - and will need to be regulated accordingly if competition is to thrive.

Given the existence of these enduring bottlenecks, OFCOM has said it will be necessary to ensure that access to these bottlenecks is available on genuinely fair terms to BT's competitors. Their concept is of 'real equality of access'. This has two elements - product level equivalence, and changes to behaviour and governance.

Beyond 2006

In 2006 there will be more developments on the technology front including 3G mobile services, wireless broadband services, IP communications in the corporate sector, Voice over IP in the small business and consumer sectors.

These will be accompanied by important developments in competition, flowing from adjustments to the regulatory framework put in place as part of the legislation to

support the further sale of Telstra. The key development in 2005 was the introduction of the Operational Separation framework that is designed to provide transparency and equivalence to ensure there is effective competition around copper network services. Operational Separation will be difficult to implement and administer in ATUG's view. However, it is absolutely essential given the bottleneck nature of the infrastructure to which the Operational Separation Plan will apply.

These developments in Australia are mirrored globally, where policy makers are taking on board the experience of the last decade and more in attempts to get competitive local access infrastructure in place. They are re-thinking the regulatory model – focusing on bottleneck services, areas of market power, clearer and simpler consumer protections, less regulation and more general competition regulation where possible.

Ahead of us are important questions:

How effective will wireless networks be in delivering high speed broadband to support voice and video applications? Will the industry facilitate interconnection of these services?

Can mobile networks now be seen as an effective substitute for fixed networks – offering voice, video and data at affordable prices?

Will the emergence of triple play broadband providers deliver effective competition across the range of services?

How will next generation networks be able to deliver anytime, anywhere, any content to any devices – with good quality of service?

Will the new infrastructure and information networks promote the “integrity” of the online environment and create confidence in the user community? How do we address spam, malware, spy ware, identity theft?

How will we support the development of a fibre network rollout? What are the implications of a fibre to the node strategy for competition?

The issue at the core of the discussion paper is how to find the right balance point for Australia between innovation and investment, competition and end user benefits as the next generation networks are built, given the continuing importance of the copper access network and the services it provides.

Summary

Technology and market demand are changing rapidly. Market power is shifting much more slowly. These factors need to be assessed in reviewing fixed network regulation. In ATUG's view continuing market power will be more significant to competition than technological change in the coming 5-year period.

A more robust, industry based approach to implementation of regulatory decisions needs to be established – industry based dispute resolution should play an increased role in securing certain and early outcomes in both pricing and practical matters.

The impact of government policy settings such as retail price parity, service quality assurance, local presence, operational separation, USO funding and broadband subsidies points to continued market failure in certain areas. Declaration decisions and associated pricing principles should support the direction of these interventions.

ATUG has a strong preference for explicit Government subsidy as the best tool for supporting end users in non-commercial markets. Cross subsidies assessed and administered by Telstra would not be a sufficiently transparent or certain mechanism in ATUG's view. Beyond the Connect Australia package, the Communications Fund provides possible sources of funds to achieve this outcome.

A holistic approach to regulatory settings for fixed network access and services is a better approach than a product-by-product approach. ATUG would point to both the UK and France where such an approach seems to have produced good results for end users, industry and the local incumbent according to all the participants.