

  <p data-bbox="616 360 751 434">Australian Competition & Consumer Commission</p>	<p data-bbox="831 197 1355 275">AFR Broadband Australia 2007 Conference</p> <p data-bbox="887 324 1355 403">The regulation of Australia's broadband market</p> <p data-bbox="946 454 1355 577">Michael Cosgrave, Group General Manager Communications Group</p> <p data-bbox="943 624 1355 660">21 August 2007, Sydney</p>
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The pace at which broadband technology has become a standard service, both for business and home-users, is quite remarkable.

Ten years ago, the ACCC made only scant mention of internet services in its Annual Report on the state of competition in the industry. Today, that would be an unacceptable omission.

Just like industry, the ACCC embraces an ongoing process of reassessment and adjustment, to take account of these rapid developments. It is impossible, not to mention undesirable, to rely on historic assessments of market structure and competition to establish 'set and forget' regulatory arrangements.

Indeed, was it not for the flexibility of the tools available under the telecommunications competition regime, regulation could well be an almost impossible task. Instead, the regime has demonstrated it can provide effective competitive safeguards, while allowing investment and innovation to flourish.

Today, I am going to say a few words about the current state of play in the broadband sector and consider some of the potential developments on the horizon. I will then comment on what these mean for the ACCC and for effective and well-targeted access regulation. I will also comment on the ACCC's recent work on access dispute arbitrations. I will conclude with a few words on consumer protection issues that are relevant to this group.

Overview of competition in the broadband sector

Debate about the state of broadband has occupied a lot of space in Australia for some time. Clearly, there is a strong feeling in some quarters that 'something must be done' to improve broadband availability and speeds.

It is not for the ACCC to comment one way or the other on whether any proposal is 'best' – determining whether any particular investment should go ahead is a matter for individual firms.

I want to emphasise that the ACCC's objective in regulating competition in the industry is to foster the integrity of the competitive process and the long term interests of end users, or the LTIE. This objective is quite different to that of individual firms, which is to maximise their profits. It is also only a subset of

the broader policy objectives of importance to government, including equity between urban and rural users and the affordability of services.

Through the declaration of the unconditioned local loop service (ULLS) and the line sharing service (LSS), the ACCC has created a regulatory environment that fosters substantial investment in competing infrastructure.

The strategy of opening up access to the ubiquitous copper network is consistent with the mainstream approach of overseas regulators, in countries where telecommunications is *not* characterised by vibrant inter-modal competition between access networks (particularly fixed cable and copper) owned by different entities.

At last count, 19 broadband providers were using mandated access to these bottleneck services to install their own DSLAM equipment in local exchanges. This investment conferred a distinct speed advantage on these providers, who were the first to offer ADSL2+ to end-users. The incumbent has reacted to increased competition by increasing the quality of its own services.

Consumers have been the winners from this process. Just over 50 per cent of Australian homes can now access ADSL2+ broadband. We know this number could increase dramatically (to almost 90 per cent) within just 48 hours if Telstra 'flicked the switch', as the ACCC's Chairman has called on it to do.

The ACCC recognises that it is common for regulators in the European Union, for example, to regulate a wholesale DSL service. However, given the success of quasi-infrastructure competition on the back of the ULLS and LSS declarations, the ACCC sees no compelling case for adopting this approach in Australia. Despite the ACCC repeatedly stating this point, Telstra still seems uninterested in offering ADSL2+ services across the board, except where competitors already provide these services or are looking to do so.

Opportunities for non-DSL broadband services have also grown as innovation and competition increase. Wireless technology already accounts for the majority of regional broadband networks and OPEL has announced a likely role for wireless in its Broadband Connect network.

In addition, the potential upgrade paths touted by Australia's four 3G network operators raise the possibility of these networks becoming a viable alternative broadband platform in the future.

There is an ongoing debate over whether wireless broadband will be an effective substitute or complement for fixed line access networks. Measuring fixed to mobile substitution is a difficult 'art', replete with the usual methodological debates. Time will tell, but this is likely to depend on a number of factors including realistic technology up-grade paths as well as the availability and performance of fixed line services in rural and remote areas.

Until recently, the role of HFC cable broadband was probably understated in Australia. Despite a limited geographic footprint, HFC is actually our second most utilised access network, accounting for 17 per cent of all connections. But it is significantly under-represented when compared to the OECD average of 29 per cent. In the United States it is the principal platform. Vibrant HFC competition also exists in other countries, such as South Korea, the United Kingdom and the Netherlands.

While the growth in Telstra's cable broadband subscribers was only 1.2 per cent last financial year, this could pick up following Telstra's proposed HFC upgrade, which it claims will provide 30 Mbit/s shared speeds to 1.7 million homes. We will be interested to see whether other HFC providers follow suit.

Of course, unless there is some significant expansion in the HFC footprint, this will only affect competition in the major cities and a few regional centres.

Finally, there is the option of increasing the amount of fibre in the network. Aside from the national fibre-to-the-node plans flagged by Telstra and the G9 carriers, fibre-to-the-premise networks are already being rolled out in greenfield sites. Some state governments have also supported fibre proposals.

I would note the draft guidelines set out by the government's broadband Expert Taskforce make it clear that a range of technologies other than FTTN may meet the Expert Taskforce's criteria.

Competition regulation in a dynamic industry

Recognising and responding to changes in the industry

Ongoing developments in the sector underline the industry's dynamism. Future change is also a certainty, given the Expert Taskforce process, Broadband Connect and, of course, the inevitable transition to a full IP world. The competitive environment itself will also promote continued innovation and investment in broadband services. The guarantee of ongoing change underlines the need for a dynamic approach to competition regulation.

At this point in the process, it is not easy to predict the impact of change on the competitive landscape with any certainty.

On the one hand, we could see a shift to established inter-modal competition between different broadband access networks controlled by different players, as in the United States. Inter-modal competition may encompass copper and fibre networks, HFC cable and even wireless platforms. Currently, of course, there is not much indication of this happening in Australia, where a single player controls both the copper network as well as the largest HFC network. It is also the largest mobile operator and has a 50 per cent share in the principal Pay TV provider.

On the other hand, it is possible that a single, dominant end-to-end fibre network may emerge, which replaces the existing copper access network, replicating or even strengthening its enduring bottleneck characteristics.

Obviously, the implications for access regulation will differ greatly in each scenario. In the first, the existence of multiple competing forms of stand-alone infrastructure may give rise to a compelling case to wind back access regulation quite significantly.

A winding back in the second scenario may also be justified, indeed necessary if the transition renders existing declared services technologically or commercially redundant. However, regulated network access, possibly at the level of an IP 'bitstream service' if a fibre access network is rolled out, is

likely to be even more important in this scenario, if alternative forms of fixed access become unfeasible.

Hypothesising about possible 'end of history' scenarios is not particularly helpful in a practical sense. However, it demonstrates the diversity of potential developments in the competitive landscape that may emerge over time.

This underlines the importance of the ACCC remaining responsive to change to ensure regulation is well-targeted, effective and minimally distortionary, given the regulatory objectives of the Trade Practices Act.

At the same time, the ACCC cannot simply stop regulating existing bottleneck services just because there are arguments that these services are likely to be superseded at some time in the future.

For example, there is little doubt that Australia will transition to a full IP world. But this transition is likely to occur over several years. Revoking the declaration of the public switched telephone network (PSTN) termination service, for example, during the period of this transition, is unlikely to promote the LTIE, even though this service will very likely be superseded.

While all *future* voice services will be IP based, *currently* the PSTN termination service is widely used by competitive providers. Revoking the declaration prematurely could allow certain carriers to strengthen their market power and harm existing competitors for analogue voice services. This could make it more difficult for competitors to re-enter the market once the NGN transition is complete.

The ACCC set out its views on the broad analytical approach to access regulation in the telecommunications industry in its second position paper on the Fixed Services Review, released earlier this year.

A number of implications flow from the paper. First, regulation should focus on enduring bottlenecks. Second, regulation should be wound back where it is no longer required to promote the LTIE. Third, the ACCC should resist calls for new regulation unless that regulation is required to promote the LTIE.

Our long standing view is that the best way to promote the LTIE is to foster facilities-based competition, where this is feasible and does not lead to inefficient duplication of infrastructure.

Competing forms of standalone infrastructure allow different providers to have greater control over their costs and supply chain as well as a greater ability to improve services and differentiate service offerings. In turn, this is more likely to lead to sustainable competition and improved services over time.

However, if different access networks are controlled by the same provider there may only be a minimal improvement in competition. A single provider will have less incentive to improve services on one network where this is likely to cannibalise its revenues on its other networks. It was with this in mind that the ACCC some time ago called for a cost benefit analysis of the divestiture of Telstra's HFC network.

In some cases, vigorous, full facilities based competition between different network providers will not be economically efficient or feasible. All the loud debate about fibre proceeded on the basis that there would be only one

network as duplication would be inefficient. Commentators expressed similar views about the dual HFC rollout in the 1990s. In these instances, access regulation can enable competitors to combine third party infrastructure with their own network infrastructure.

In the past, the ACCC has generally, but not always, assessed competition for the purposes of access regulation on the basis of national markets for telecommunications services. There have been compelling reasons for taking such an approach, including the fact that prices have generally been set on a national basis and many networks have national or near-national coverage.

However, given evidence of varying degrees of infrastructure competition in certain geographic areas, the ACCC now considers it may be appropriate for detailed empirical analysis to take place at the local exchange level.

This would make the ACCC's holistic review of fixed line service declarations in 2008 and 2009 more responsive to the uneven geographic pattern of infrastructure competition. The competition analysis will require solid information on substitution possibilities, including in relation to diversity of ownership, or the lack thereof.

The ACCC has indicated it is open to receiving exemption applications for declared services in areas where there is competing infrastructure. Telstra has taken up that invitation and has lodged exemption applications for the local carriage service and the wholesale line rental service in 371 exchanges across metropolitan and regional Australia, where competitors have rolled out their own DSLAM equipment. The onus will be on Telstra to establish that such exemptions would promote the LTIE. The ACCC will consult publicly on the applications before deciding whether to grant the exemptions.

Regulation and investment in telecommunications

While access regulation has clearly fostered broadband investment by new entrants, the incumbent has argued regulation stifles or delays its own investment in telecommunications services.

This is surprising, given ABS figures that show that average annual growth in public investment in the communications sector was actually 22 per cent for the three years to June 2006. This figure includes investment made by the incumbent, which was a public company at the time.

Let me be clear – firms do not need ACCC approval to invest in telecommunications infrastructure. It is up to firms to make their own investment decisions in this regard, taking account of relevant government processes, such as the Broadband Connect programme or the process being managed by the Expert Taskforce.

However, a firm may lodge a voluntary special access undertaking, or SAU, with the ACCC that sets out proposed terms and conditions of access to new services. The purpose of the SAU provisions is to provide certainty for firms regarding the access arrangements that will apply *before* firms commit to the investment. This will be attractive where firms believe a 'service' may potentially be subject to access regulation. Given the FTTN rollout

fundamentally involves an upgrade to the copper access network, Telstra unsurprisingly accepted the need for access regulation.

The ACCC can only accept an SAU if, following a public consultation process, it considers the proposed terms and conditions of access are reasonable. The ACCC has already accepted one SAU, which was submitted by Foxtel for its digital set-top unit service.

One of the complaints levelled at the ACCC is that it stifles investment by setting arbitrary access prices that are below cost. This is simply not true.

In administering the telecommunications access regime, the ACCC must take account of a number of factors set out in the Act. These include:

- the economically efficient use of, and investment in, present and future infrastructure,
- the legitimate business interests of the provider and its investment in facilities used to supply the service, and
- the direct costs of providing access to the declared service.

If the ACCC prevented a carrier from recovering the legitimate costs of providing a service, the carrier could successfully challenge the ACCC's access prices in the Competition Tribunal or the Federal Court.

That this has not happened speaks for itself. In fact, in four out of four decisions on access prices since June 2006, the Competition Tribunal has affirmed the ACCC's approach.

Telstra also blames the ACCC for Telstra's delay in investing \$4 billion in its proposed fibre-to-the-node network. Telstra argues it has been held back for almost two years now as a result of out-of-date regulations.

Again, this argument does not acknowledge what Telstra itself has openly recognised time and time again since it first floated the FTTN proposal in November 2005 – that is, that access to an FTTN network would be regulated under the Trade Practices Act.

Telstra has never disputed this fact – indeed, even at the launch of its BACK Telstra campaign in February, Telstra acknowledged it had always seen the FTTN network as a network that every competitor could access.

Telstra's CEO made it clear just over a week ago that he appreciates the importance of competitors' access to enduring bottlenecks when he partly attributed Telstra's disappointing results in New Zealand to the country's regulatory environment, 'where they haven't opened up access like they have in Australia and the rest of the world'.

However, Telstra's offer to share its proposed FTTN network with competitors is almost meaningless if the price charged effectively stymies competition.

In any event, neither the ACCC nor the public were ever given the opportunity to assess whether Telstra's proposed access prices were reasonable. Close to two years after the proposal was first floated, the ACCC and the public are still left to ask what price Telstra proposes to charge for broadband access.

Only a rogue regulator, with no regard for the legal constraints imposed by a democratically elected government, could have agreed to access terms and conditions without a formal SAU before it, without public consultation and without an indication of access prices.

Telstra could have put forward an SAU, including pricing information, 12 months ago. Instead it refused, delaying the roll out of an FTTN network.

Resolving access disputes

I would now like to say a few words about the ACCC's work in determining the terms and conditions for services used to provide broadband, particularly DSL services.

As at 20 August, the ACCC was arbitrating 30 telecommunications access disputes. This figure represents a welcome decline in the number of outstanding disputes in recent weeks.

The conditions of access to declared telecommunication services are determined through a negotiate/arbitrate model under the Act. The starting point, of course, is that the parties should seek to resolve disputes privately. However, negotiations may not, and unfortunately frequently have not, led to a satisfactory outcome for the parties, particularly where one enjoys market dominance and is vertically integrated.

Where negotiations fail, the ACCC can make binding determinations with regards to the access arrangements that will apply between the parties. Arbitral determinations are the *only* mechanism under the Act by which the ACCC can itself determine the terms and conditions of access.

There is no obligation on access providers to submit reasonable access undertakings to the ACCC. Similarly, an ACCC decision to reject an access undertaking has no impact on the price an access provider may charge for its services. Furthermore, the ACCC has no power to set an industry-wide price for a particular service.

The ACCC is currently arbitrating disputes across seven declared services under the Trade Practices Act. The large majority of these relate to the ULLS, LSS and the Mobile Terminating Access Service.

The ACCC has recently made three final determinations for disputes over the LSS. The LSS allows carriers to provide separate voice and data services over a single copper line. The history of determining terms and conditions for the LSS are instructive.

Telstra lodged an access undertaking for the LSS in December 2004, which included a \$9 monthly LSS charge. The ACCC rejected the undertaking as it was not satisfied that this charge was reasonable. The Australian Competition Tribunal confirmed the ACCC's decision last year. Despite the comprehensive rejection of its LSS access price, Telstra continued to charge access seekers \$9 a month.

Nine LSS access disputes have been notified to the ACCC since Telstra's 2004 undertaking. So far, only the final determination for the dispute brought by Chime Communications (a subsidiary of iiNet) has been made public. The ACCC is moving towards finalising the other LSS disputes.

The final determination sets a monthly LSS access price of \$2.50, which fully reflects the Tribunal's reasoning. The access price is backdated to June 2004. Two weeks ago, Telstra asked the Federal Court to review the ACCC's process on administrative law grounds, after almost two years arbitrating the dispute.

Reasonable terms of access for the LSS will bring significant long term benefits to consumers of broadband services, including a greater diversity of service providers, a greater range of higher quality services and more reasonable prices.

The effectiveness of the ACCC's arbitral powers is strengthened by the ability to backdate access price determinations to around the time that the companies began negotiating the terms of access. Backdating allows the ACCC to minimise incentives to delay the arbitration process, which is important given dispute resolution can take over two years.

One of Telstra's criticisms of the ACCC's approach to setting LSS access prices is that the ACCC decided against including a contribution to the costs of the copper line over which the LSS is supplied.

The ACCC recognises there could be economic efficiency benefits if an appropriate contribution towards lines costs was included in LSS access prices. However, given the ACCC's view that Telstra already fully recovers its line costs, a contribution cannot be included until Telstra changes its pricing for other services that also rely on the copper line, to prevent it from 'double dipping' and over-recovering its network costs from access seekers.

The current access prices across the board mean that customers who pay the full cost of renting a line for voice services can access broadband services for just the extra costs of providing that service on the same line.

These extra costs, such as IT systems and product management, are independent of the length of the copper connecting the customer to the local exchange. Therefore, Australia's low population density is simply not relevant to comparing LSS charges in Australia and overseas, as has been suggested.

The ACCC cannot *itself* rebalance the proportion of line costs Telstra recovers across the various services that use the copper loop. However, the ACCC is open to Telstra putting forward a proposal that rebalances the distribution of line costs between its voice and broadband services.

The ACCC has had over fifty disputes before it over the last year. Rather than arbitrating these disputes individually, the ACCC would prefer carriers to submit access undertakings with access prices based on demonstrated efficient costs. The undertakings should include reasonable terms and conditions that balance the interests of consumers with those of industry.

Protecting consumers

Before I conclude, I want to make a few comments about the ACCC's commitment to consumer protection.

Firms *should* emphasise the benefits of their product over those of competitors – it is competition between firms that drives innovation and lowers prices if investment leads to greater coverage or speed.

However, while vigorous competition clearly benefits consumers, the process falls down where consumers are subject to misleading or deceptive representations. The Trade Practices Act recognises this across the economy.

Earlier this year, the ACCC worked with industry to resolve concerns about potential misleading representations on available broadband internet speeds. We were pleased that following our work with ISPs, the conduct of concern was rectified without the need to resort to legal action.

Currently, the ACCC is looking at the use of traffic prioritisation tools by ISPs. The ACCC recognises that peer-to-peer downloads can place a heavy burden on available bandwidth and that some ISPs are using traffic prioritisation tools to de-prioritise such traffic during times of peak use.

There may be valid commercial and technical reasons to discriminate between different types of traffic. These could include, for example, a desire to protect the performance of time-sensitive applications such as VoIP. While ISPs are free to decide whether to de-prioritise certain traffic, the ACCC is concerned that a failure to disclose such a policy could mislead or deceive consumers as to the standard or quality of the internet service provided.

The ACCC considers that all limitations on data speeds imposed by ISPs, including traffic prioritisation, should be disclosed to consumers.

Conclusion

The evolution of internet services from niche to mainstream over the last ten years underlines the tremendous rate of change in the industry.

Keeping across developments is a key challenge for the ACCC and, no doubt, the industry as whole.

The ACCC is working hard to ensure that despite these changes, regulation remains targeted and effective and promotes the long term interests of end users.