

Chapter 3

Broadband uptake, impediments and competition

Introduction

3.1 This chapter examines the current level of competition in broadband services. Specifically it looks at impediments to both broadband uptake and competition. As the Australian Telecommunications Users Group (ATUG) told the Committee in overview:

The Australian market is not effectively competitive due to lack of robust infrastructure competition, and ineffective access to the infrastructure that does exist.¹

Uptake of broadband technology

3.2 The Australian Competition and Consumer Commission's Snapshot of Broadband Deployment, as at 31 December 2003, found that total broadband take-up was 698,700 and that:

Broadband take-up has increased by 335 200, or 92.2 per cent, from the December 2002 figure of 363 500.

3.3 However, the rate of broadband growth slowed over the last three quarters of 2003:

In Q4 2003, the growth rate was 14.4 per cent, compared to 18.2 per cent in Q3 2003 and 22 per cent in Q2 2003.

During this period, the quarterly growth rate decreased across each type of broadband technology.

3.4 The 14.4 per cent growth rate for the December 2003 quarter represents the lowest quarterly increase recorded in the period covered by the survey.

3.5 Within this context, 'other DSL' services continued to achieve the highest growth rate, increasing by 31.4 per cent in the December quarter.²

3.6 Of the report findings, ACCC Commissioner Mr Ed Willett said:

1 Australian Telecommunications Users Group Limited (ATUG), *Submission 33*, p.2.

2 Australian Competition and Consumer Commission, *Snapshot of Broadband Deployment as at December 2003*, URL: <http://www.accc.gov.au/content/item.phtml?itemId=512240&nodeId=file40bff0c3b3c39&fn=Broadband%20report%20December%202003.pdf>

The 14.4 per cent growth rate for the December 2003 quarter represents the lowest quarterly increase recorded in the period covered by the survey.

However it should also be noted that these growth figures pre-date the changes in pricing structures for broadband services that began in February 2004.... The impact of these changes will not become evident until take-up figures become available for the March 2004 and June 2004 quarters.³

3.7 Mr Bill Scales from Telstra told the Committee that the company has set ambitious targets for broadband uptake:

We aim to have one million broadband customers by the end of 2005 and \$1 billion in broadband revenue by the end of 2006. I am pleased to say that we are on track to reach both of these quite aggressive targets.⁴

3.8 Telstra has argued that Australia's level of ADSL penetration, in year three of its rollout (2003) exceeds the level of uptake at the same period in France, Canada and the United States and that international comparisons suggest that Australia's broadband progress is consistent with or better than other countries in the early stage of technology adoption.⁵

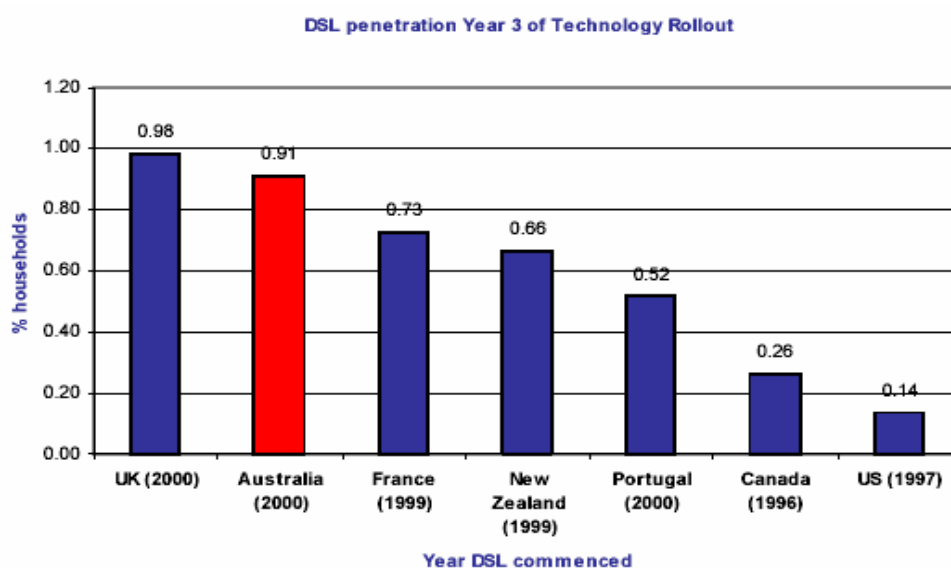


Figure 1: International comparisons of year three penetration rates⁶

3 Australian Competition and Consumer Commission, media release, 4 June 2004, URL: <http://www.accc.gov.au/content/index.phtml/itemId/512244/fromItemId/459302>

4 Mr Bill Scales, Telstra, *Committee Hansard*, Canberra, 12 November, 2003, p.63.

5 Telstra, *Submission 21*, p. 3.

6 *ibid*, p. 16.

3.9 Telstra's submission cited the Network Economics Consulting Group (NECG) study, which investigated the impact of regulatory and other economic factors on broadband take-up internationally, in support of its contention that there was no evidence to confirm that its ownership of an HFC network was leading to reduced broadband penetration:

NECG examined the full OECD broadband penetration database to see if there was any correlation between broadband penetration and participation by the incumbent telecommunications carrier in either the largest cable network operator, or any cable network operator. The analysis allows NECG to conclude that:

...cross-ownership of the largest cable and copper networks by the incumbent carrier ... does not have a statistically significant adverse impact on broadband penetration.

In addition, although the dummy variables for the ownership influence of incumbent carriers could not be considered statistically significant:

*[t]he direction of influence implies that divestiture or removal of the influence of the incumbent telecommunications carrier would lead to **lower**, not higher, penetration.⁷*

3.10 NECG found that broadband penetration could be explained by the age of the technology, real GDP per capita, and the penetration of subscription television:

Australian broadband penetration rates are not significantly lower than the average of the countries in the OECD data base, when due account is taken of basic economic factors explaining penetration rates ...[O]ne cannot conclude, based on a simple economic model and formal statistical criteria, that the Australian penetration rate is significantly lower than [the OECD] average.⁸

3.11 However, the ACCC has raised concerns over the statistical model developed in the report and the subsequent conclusions.⁹ It submitted that:

In particular, the Commission has identified a number of factors that may limit the explanatory power of the statistical model developed within this report, including that:

- as specified, it does not take account of 'price', 'quality', 'competition' or 'computer use/penetration' as factors explaining broadband penetration across countries;

7 Telstra,, *Submission 21*, p.29.

8 *ibid*, p.16.

9 Australian Competition and Consumer Commission, *Submission 52*, p. 4.

- it relied on some questionable assumptions regarding how the 'age of technology' variable is introduced into the analysis; and
- preliminary statistical testing suggests that it violates some of the fundamental assumptions of regression modelling.¹⁰

3.12 The ACCC engaged Associate Professor Ian Gordon of the Statistical Consulting Centre at the University of Melbourne to undertake an independent review on the NECG model and the conclusions drawn from that model. Associate Professor Gordon found:

There are significant problems with the model, even if the variables considered are assumed to be the only ones relevant.... I think that the intrinsic complexity of the situation makes a regression approach of limited value, for the goals of identifying whether countries are significantly behind other countries, and assessing whether cross-ownership affects broadband penetration. The other differences between countries with and without cross-ownership make a causal inference very difficult, based on observational data, and in my opinion such an inference cannot be drawn on the available data.¹¹

3.13 Overwhelmingly, the Committee heard that broadband take up rates in Australia were low and were falling in comparison to many international markets:

It is encouraging that the growth rate over the last quarter remained steady rather than continuing to decline. This is still of concern, however, as Australia is lagging behind many other developed nations in terms of broadband take-up...Broadband markets in Australia will need to develop much more quickly if Australia is to retain, let alone improve, its comparative international position.¹²

3.14 In September 2003, the OECD ranked Australia 21st in broadband uptake per head of population.¹³ Vertel argued that when contrasted with broadband penetration rates of other countries, Australia fares badly with only 5% of homes connected to broadband:

10 Australian Competition and Consumer Commission, *Submission 52*, p 4.

11 Australian Competition and Consumer Commission, *Submission 52a, Review of NECG report on broadband penetration in Australia*, Associate Professor Ian Gordon.

12 Optus, *Submission 36*, p.1.

13 Australian Industry Group, *Submission 34*, p. 6.

Hong Kong	52%
Singapore	25%
USA	19%
France	13%
Australia	5%

Figure 2: Percentage of homes connected with broadband internet.¹⁴

3.15 Mr Paul Budde told the Committee that:

Australia is already well behind comparable trading partners in broadbanding. In 2003 it features at the bottom end of the OECD rankings. A continuation of relatively slow growth will see the country lagging further behind in years to come.¹⁵

3.16 It has been suggested that broadband uptake is driven by a variety of factors including the ability of services to meet customer service demands. The Committee heard that in order to drive broadband take up, products and services need to be offered in a way that meets demand. Optus contended that to date the demand for broadband has been driven by the following factors:

- (a) convenience - customers wanting an always on connection and to be able to use the telephone and access the Internet at the same time;
- (b) value – the cost of the broadband service relative to the cost of dial-up (including accessing the Internet using a second dial-up line);
- (c) price certainty – being able to access broadband services using flat rate plans with no excess usage charges (so users do not face unexpected prices for exceeding usage limits);
- (d) performance – speed; and
- (e) content – the availability of video streamlining, downloading music and other multimedia content.¹⁶

Impediments to broadband uptake

3.17 Undoubtedly, the reasons for Australia's slow broadband growth and uptake in comparison to many other countries are complex. Evidence to the inquiry suggested that the key impediments to broadband uptake include availability of

14 Vertel, *Submission 37*, p.3.

15 Mr Budde, *Submission 6*, p.1.

16 Optus, *Submission 36*, p.12.

infrastructure, technical limitations, price and knowledge and perceptions about the value of upgrading to broadband technology.¹⁷

Network capability

3.18 The vast majority of the Customer Access Network (CAN), laid over decades, was designed to only deliver voice telephony. Twisted pair copper has been used since the 1880s as submarine cables and domestically from the 1930s and 1940s. After this period insulated copper pairs were used in the standard access network and almost all residential homes connect with it. Much of this cable has now been in the ground for 40 years and as the copper has aged it has crystallised and become brittle.¹⁸ The ageing network, coupled with the fact that the CAN was not engineered for the provision of data services is an impediment to the growth of broadband uptake. As Telstra explained:

The bulk of Australia's existing copper telephone network (and the networks in all other countries) was developed prior to the invention of the Internet, and was never designed to carry ADSL.¹⁹

3.19 A number of submissions similarly made the point that broadband services are not widely available because of the limited capacity of the existing infrastructure:

It should be profoundly obvious to all but the most inept, that the common technologies used for providing access for telephony are not suitable for Broadband distribution.... An entirely different customer access network infrastructure is an imperative that must be implemented as a priority, and this is the first and biggest impediment to be overcome: with or without competition.²⁰

3.20 Mr Charles Reed from Personal Broadband Australia Pty Ltd told the Committee:

The first point I would like to bring up is that our position and our opinion is that the low uptake of broadband is largely a supply issue, rather than a demand or pricing issue. Some of the supply reasons are quite evident.... They include issues around the existing copper network and the fact that it was not really designed for a high bandwidth data type service, with the limitations you heard about earlier on RIM block type areas leading to—to plagiarise your words, if I may—pair gain victims. There are issues with DSL of distance from the exchange, and there are difficulties and

17 The Institution of Engineers Australia, *Submission 25*, p.6.

18 Mr Malcolm Moore, *Submission 19*.

19 Telstra, *Submission 21*, p.8.

20 Mr Malcolm Moore, *Submission 19*, p.16.

complexities around things like multi-dwelling units in high-rise buildings. There is also the age of the actual copper. As the copper deteriorates, putting high bandwidth through it becomes harder.... Our position is that it is a supply issue, rather than a demand issue.²¹

3.21 Similarly, the Committee heard a significant amount of evidence on the technical constraints which restrict broadband access:

The supply side is the dominant impediment to the uptake of broadband technology. Whilst Telstra is an easy target in this debate, the existing copper network was only designed to carry voice and simply is not designed for the supply of broadband. The following problems with their network are well documented:

- Rim blocked areas;
- Pair gain impediments;
- Distance from the exchange (3.4 km or less);
- Not available to multi-dwelling apartments; and
- Age of the copper network affecting its quality.

As a result, broadband has a poor image in terms of both availability and service quality and we believe this is a contributing factor to broadband's low adoption rate.²²

3.22 Asymmetrical Digital Subscriber Line (ADSL) technology was developed in order to allow delivery of broadband technology over the copper twisted network. However, submitters advised the Committee that ADSL and other broadband services are simply not available to many regional institutions²³ and large numbers of individuals.²⁴

3.23 Telstra contends that there are three main reasons why some customers may not be able to access broadband via ADSL. These are:

- the serving Telstra exchange may not be ADSL-enabled;
- the customer's premises may be beyond the technical limits for ADSL transmission;

21 Mr Charles Reed, Personal Broadband Australia Pty Ltd, *Committee Hansard*, Sydney, 13 November, 2004, p.88.

22 Personal Broadband Australia Pty Ltd, *Submission 11*, p.4.

23 Townsville Catholic Education Office, *Submission 16*, p.1.

24 Mr Graham Leake, *Submission 2*, p.1.

- the telephone service may not be provided via a straight copper line but via some kind of electronic access line technology, commonly referred to as a pair gain system (PGS).²⁵

3.24 A number of submissions were received from private citizens unable to access broadband technologies due to either lack of infrastructure or unsuitable infrastructure.²⁶ Mr Kaon Li told the Committee that:

My current place of abode cannot get ADSL or cable.... When I apply for ADSL, I have received a notification that the exchange I'm on is a secondary exchange, and there is no plan to upgrade the exchange to support ADSL anytime soon according to Telstra. I believe there are a lot more people like myself in Australia who cannot get access to either ADSL or cable, and the greatest impediments to uptake of broadband technology may be that for many it simply isn't available.²⁷

3.25 Similarly, Mr Graham Leake told the Committee that:

There are a large number of people unable to connect to a physical (non-satellite) broadband connection in any older or outer suburbs of capital cities, including myself. Most CBDs are wired up with new cable or radio-WAN; country areas are being focussed on through issues with selling Telstra, but those of us in the middle are falling through the cracks.

I have tried for 3 years to get connected to ADSL or any other 512kbit or faster interface, and I am only 9km from the Perth GPO. We are the group of people "more than 3km from an exchange", usually on older exchanges.

I have spoken to many people over the last few years who are all in the same position - can't get ADSL, can't get cable, and radio WANs have not yet been set up to cover residential areas. I also notice a lot of similar complaints on the Whirlpool broadband internet forum.

In conclusion, the above problem of the outer and older suburbs is impeding the take-up of broadband services.²⁸

3.26 The inadequacy of telecommunications infrastructure also affects populations living in newer suburbs, such as in Gungahlin in the ACT. TransACT told the Committee that:

25 Telstra, *Submission 21*, p. 8.

26 Mr Michael Orford, *Submission 1*, p.1.

27 Mr Kaon Li, *Submission 17*, p.1.

28 Mr Graham Leake, *Submission 2*, p.1.

Gungahlin is one of the fastest growing areas not only of Canberra, but also across Australia. There were almost 20,000 persons living in Gungahlin in the year 2000 with projected estimate of 37,000 persons by 2010. This represents an annual population growth of 8.8%. Gungahlin is currently not well served by Broadband technology because of the inadequate Telecommunications infrastructure. All electricity cabling is underground. The costs of connecting services to underground cabling is high and as a result, TransACT has had to rate Gungahlin as a later priority for providing its Broadband Services. In the past, Telstra's ADSL service have been unavailable in Gungahlin resulting in significant negative impacts on residents, families and local business.²⁹

3.27 As discussed in Chapter 1 of this report and throughout this Committee's earlier report on the Australian telecommunications network, broadband services can be delivered by a range of technologies. The Committee notes that, in every circumstance where broadband cannot be obtained via DSL technology, it is available through satellite. However, this technology is troubled by issues of latency or propagation delay (for a more detailed discussion see the Committee's report into the Australian telecommunications network inquiry) and, as discussed below, is not an affordable method of broadband delivery for many customers.

Cost

3.28 Pricing is an important and frequently underestimated impediment to the uptake of broadband technology. The cost of broadband access in Australia is a significant factor in the low rate of broadband uptake, as is the relative low cost of dial-up 'narrowband' connections.³⁰ Mr James Nichols told the Committee:

I am considering getting broadband, on either cable or ADSL, but believe it is about \$80 per month which is too much for my budget. Considering I am single and in the top income bracket, I find it hard to see how the average consumer can afford broadband services.³¹

3.29 The cost of residential ADSL in Australia is high in comparison to a number of other countries, with Australia having the third highest one-off installation cost.³²

29 TransACT, ACT Government, *Submission 14*, p.3.

30 The Institution of Engineers Australia, *Submission 25*, p.7.

31 Mr James Nichols, *Submission 3*, p.1.

32 Townsville City Council, *Submission 15*, p.23

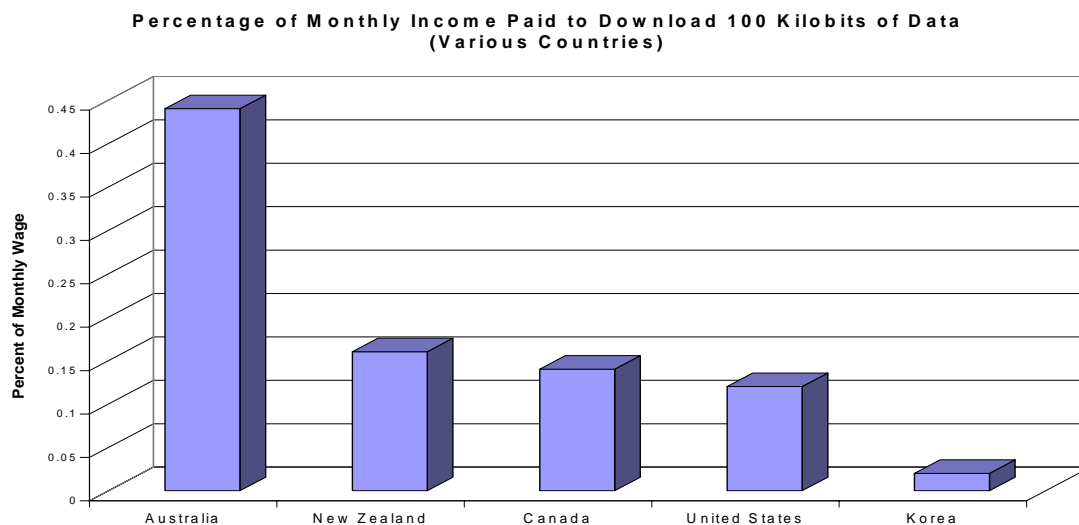


Figure 3: International comparison of broadband costs as a percentage of monthly wage.³³

3.30 A number of local governments emphasise cost as a major impediment to uptake of broadband in their regions. Blacktown City Council told the Committee that:

However, broadband from phone and cable companies can cost over \$60 a month. Many Web users will remain with dial-up due to cost. In Blacktown, most households earn less than \$50,000 a year, so many consumers simply can't afford broadband.³⁴

3.31 While the Townsville City Council argued that:

Pricing of broadband services remains unacceptably high and unattractive to many Townsville consumers. At present, the entry price level for domestic broadband services is around \$60 per month plus installation costs. For many residents and businesses, this price is simply prohibitive or at the very least unjustifiable.³⁵

3.32 The Australian Industry Group argued that cost prevented 29% of all firms not using advanced telecommunications from broadband uptake.³⁶ However, a

33 The Institution of Engineers Australia, *Submission 25*, p.7.

34 Blacktown City Council, *Submission 13*, p.5.

35 Townsville City Council, *Submission 15*, p.23.

36 Australian Industry Group, *Submission 34*, p.5.

number of submissions went further to claim that a pricing structure which includes limits on the volume of downloads per month was an impediment to broadband uptake and expansion.³⁷

Most broadband service agreements restrict the amount of data that can be downloaded in any month.... This severely restricts the way in which the service can be used.... In business terms, it equates to one reasonable sized database or one relatively small software application. The capabilities of broadband services currently on offer are more commercially aligned to premium narrowband services than to a true broadband service offering connection speeds measured in multiples of megabits with no download limits. This is because the current pricing arrangement effectively restricts the use of a broadband service so that while it may be fast and always connected, it is used sparingly due to the cost of exceeding the download limit.³⁸

3.33 The extensive use of download caps and 'throttles' by ISPs also deters broadband usage and modifies the end user's behaviour so that broadband services are used as a high-speed data service rather than as a true broadband.³⁹ Submitters were critical of this practice:

Price elasticity is further impacted in the Australian context by the prevalence of broadband caps. Australia is one of the few countries that has caps, which act as a strong deterrent to the use of broadband applications by end-users. It is ironic that telecommunications is one of the few industries in Australia that actively promotes a limitation of use! ... The price penalties for exceeding caps are also significant. Some ISP's 'throttle' services as users reach their caps; others allow users to continue using and charge very high surcharge penalties. Both of these responses have the effect of deterring usage of the broadband service, thereby reducing the public benefits of broadband service provision.⁴⁰

3.34 For regional and remote populations which rely on satellite services, cost of infrastructure installation is a significant inhibiting factor.⁴¹ The Committee was told that installation fees for satellite services are in excess of \$1000 for a single user in Alice Springs⁴² and significantly more in less populated regional towns. The Cabonne Council located in Molong, central NSW noted that two-way

37 Mr Duncan Raymont, *Submission 18*, p.7.

38 The Institute of Engineers Australia, *Submission 25*, p.8.

39 Mr Duncan Raymont, *Submission 18*, p. 7.

40 Townsville City Council, *Submission 15*, pp.26-27.

41 Gulf Savannah Development, *Submission 10*, p.1.

42 Alice Springs Film and Television Australia, *Submission 6*, p.1.

satellite costs approximately \$4000 to install and \$80 per month to access.⁴³ The Communications Expert Group told the Committee that:

Satellite Broadband is too expensive and is likely to remain beyond the reach of many businesses and individuals in remote areas.⁴⁴

3.35 Conversely, Telstra told the Committee that the extent to which the price of broadband influences the rate of broadband penetration is an open question. They cite the Western Australian Technology and Industry Advisory Council which found that:

There appears to be little correlation between affordability and take-up. For example, South Korea performs poorly in terms of affordability of both cable and ADSL services. This is despite the fact that they have the highest take-up of broadband services in the world. Similarly, France has a broadband take-up rate fractionally higher than Australia despite the fact that both ADSL and cable services are significantly more affordable in Australia (measured as a percentage of per capita GDP) than in France. Again this suggests that the impediment to broadband take-up is not ability to pay but willingness to pay.⁴⁵

3.36 However, in the United Kingdom rapid broadband uptake was achieved after regulatory intervention saw prices dropped significantly.⁴⁶ Similarly, Telstra itself saw a considerable influx of new broadband customers after it lowered its broadband price to \$29.95 per month in February 2004. In a media release dated 5 March 2004, Telstra claimed that its lower retail prices were having a significant impact on uptake of broadband services:

Consumers are voting with their feet and taking-up broadband in record numbers, following recent price reductions across the entire market.

The strong consumer response means the broadband market is expanding rapidly, with more than 10 per cent of Australian homes already connected,....

By offering broadband at prices equal to those prevailing elsewhere in the market, Telstra is helping expand the market and increase the nation's rate of broadband take-up....

Since Telstra announced discounted broadband prices in the middle of February, broadband applications have more than doubled, and the rate of

43 Cabonne Council, *Submission 27*, p.1.

44 Communications Expert Group, *Submission 30*, p.5.

45 Telstra, *Submission 21*, p.20.

46 Small Enterprise Telecommunications Centre Limited, *Submission 29*, p.4.

greatest growth was being experienced amongst wholesale ISP customers of Telstra.⁴⁷

3.37 In June 2004, Telstra issued a further media release detailing the large growth in customer numbers as a result of its February 2004 price reduction. Mr Bruce Akhurst, Group Managing Director, Telstra Wholesale, Broadband and Media said:

Telstra has signed its 750,000th broadband customer this week, following a 46 per cent surge in demand in just five months.... Telstra will beat its target of one million broadband customers by the end of next year. We are now on track to achieve that six months early, by the end of June 2005.

By dropping broadband prices, Telstra set off an avalanche of customer demand. We have been setting and then breaking records ever since.⁴⁸

3.38 The Committee concludes that cost is a factor in the uptake of broadband services. As Mr Steve Ireland told the Committee:

[The] key impediment to the broad uptake of broadband [is] price. I pay \$94.95 per month. It's too much and the price needs to be \$50.00. End of story! This issue by far outweighs the rest of the issues.⁴⁹

Customer knowledge

3.39 Many submitters point to a lack of customer understanding as an impediment to broadband uptake. This issue is compounded by the fact that available services and contract and terms of service are complex and confusing.⁵⁰ cBallarat argued that a lack of a general knowledge-base, service confusion and complexity, including lack of understanding of what broadband means and complex multi-tiered service contracts all impede broadband uptake.⁵¹

3.40 Additionally, Neighborhood Cable argued that the general population has no clear understanding of what broadband over fibre is or of the level of service that

47 Telstra, Media Releases 05 March 2004, *New broadband prices prompt market expansion*. URL <http://www.telstra.com.au/communications/media/mediareleasearticle.cfm?ObjectID=31205>

48 Telstra, Media Release 11 June 2004, *Cheaper prices send broadband numbers soaring*. URL: <http://www.telstra.com.au/communications/media/release.cfm?ObjectID=31894>

49 Mr Steve Ireland, *Submission 8*, p.1

50 Mr Stanley Tonkins, *Submission 9*, p.1.

51 cBallarat, *Submission 49*, p.1.

can be delivered over it. This may account to some degree why customers do not take up the superior technology.⁵²

3.41 The need for a public education program was raised with the Committee as was the fact that Telstra uses market power to 'dumb down' consumers in order to sell inferior telecommunications products:

There has been a lot of discussion this morning about defining broadband. I must admit I think that is a key function. There are a lot of statements in the marketplace at the moment and there is a lot of need for education. I believe that education falls upon Telstra. With its marketing dollars, the way it advertises and the way it spends, it should not dumb down the market.... That type of dumbing down of broadband is not doing anybody any real benefit.⁵³

Impediments to broadband competition

3.42 The Committee recognises that competition in broadband services occurs in the CBD areas of Australia.⁵⁴ However, in regional and rural Australia, where it is more difficult to establish a business case for broadband infrastructure deployment, competition is limited. Mr Moore told the Committee that:

Although Optical Fibre is connected to major businesses in the CBDs, virtually no optical fibre connects from the local exchanges to the homes and this will be the next big move.⁵⁵

3.43 Telstra submitted that there is strong competition in all broadband market sectors, evident by the 200 ISPs competing for the provision of one or more types of broadband services in Australia. It added that effective competition has delivered broadband services over ADSL and HFC cable at prices that are more affordable than in many other countries.⁵⁶

3.44 However, it is widely argued that Telstra's monopoly position limits effective competition in the broadband market. At a speech in November 2003 to the Australian Financial Review Telecom Summit, ACCC Chairman, Mr Graeme Samuel, claimed that:

52 Neighborhood Cable, *Submission 47*, p.7.

53 Mr Fred Grossman, Neighborhood Cable, *Committee Hansard*, Ballarat, 5 February 2004, p.25.

54 Small Enterprise Telecommunications Centre, *Committee Hansard*, Ballarat, 5 February 2004, p.21.

55 Mr Malcolm Moore, *Submission 19*, p. 25.

56 Telstra, *Submission 21*, p.27.

The existence of such extensive market power in a vertically integrated firm is a major risk to competitive outcomes. Telstra has both the ability and, importantly, the incentive to frustrate entry into complementary and substitute markets by other companies.⁵⁷

Broadband market

3.45 Telstra has 68% of the broadband market on its several fibre and copper networks and is strong in both metropolitan and regional markets. Optus has about 22%, predominantly in metropolitan markets, and the other competitive providers share the remaining 10%.⁵⁸ Bits on Light submitted the following comprehensive summary:

Both metropolitan and regional coverage

- Telstra HFC network - coverage is passing 2.5M homes - 40,000km of cable covering Melbourne, Sydney, Brisbane, Gold Coast, Adelaide & Perth. This required an investment of \$4B. There is currently no retail competition on this network.
- Telstra Fibre network – Telstra has deployed over 140,000 km of fibre in Australia. Significantly in the metropolitan, suburban, and regional network the breadth and depth of Telstra fibre coverage is without parallel.

Predominantly metropolitan coverage

- Optus HFC network - coverage available to 1.4M homes – 21,000km of cable covering Melbourne, Sydney, and Brisbane. Notably it is widely believed there is an 80% overlap with the Telstra HFC. This required an investment of \$3B. The total number of Broadband customers on the Optus HFC network is 110K and other Optus broadband networks is at most 9.5K. There is currently no retail competition on this network.
- Optus Fibre, LMDS and DSL network - Optus has deployed over 8,700 km of fibre (1/16th of that of Telstra), including inter-capital and CBD fibre rings in the capital cities. In addition over 100 exchanges have coverage with DSL. There is some retail competition on these networks.
- Other Competitive DSL providers include Request Broadband, NEC/Nextep, Primus, AAPT and Powertel. These have all focused on the business market & therefore collectively only currently have coverage in <110 largely overlapping exchanges. The non-Telstra DSL networks rely

57 Australian Competition and Consumer Commission, Commissioner Graeme Samuel, *A competitive telecommunications industry: Issues in competition and consumer law*, Speech to the Australian Financial Review Telecom Summit, 27 November 2003, Sydney, p.7.

58 Bits on Light Pty Ltd, *Submission 23*.

heavily on the declared services of Facilities Access to exchange building, ULL and spectrum sharing. In addition they rely on transmission services (bandwidth), which is not declared, to the exchange buildings. There is significant retail competition on and between these DSL networks, however the retail “floor” price for these business services is currently close to \$100, due to the high input costs of the declared services. The estimated number of Broadband customers on these DSL provider networks is < 20K.

- Uecomm Fibre network - Uecomm has fibre to over 650 buildings primarily in the CBD areas Brisbane, Sydney, Melbourne and the Gold Coast, with some metropolitan coverage. There is some retail competition on this network.
- Powertel Fibre network - Powertel has fibre to over 400 buildings primarily in the CBD areas Brisbane, Sydney, Melbourne and the Gold Coast, with some metropolitan coverage. There is some retail competition on this network.
- Other CBD Fibre networks include AAPT, Primus and MCI/Worldcom. These networks are often limited to the CBDs of the capital cities. There is some retail competition on these networks. The estimated number of Broadband customers on these fibre networks is < 5K.

Predominantly regional coverage

- TransACT Fibre/VDSL network (Canberra ACT). Coverage goal of 100K homes in the ACT, with currently around 60K homes and 5K businesses covered with an investment of approx. \$300M. TransACT has at least 20K customers on their network (incl. Pay TV, telephony & Broadband). There is retail competition on this network. The estimated number of Broadband customers on TransACT is 4.2K .
- Neighborhood Cable HFC network (Geelong, Ballarat, Mildura in Victoria). By the end of 2003, the coverage will extend to 90K homes with an investment of approx. \$60M. Neighborhood Cable has 5.4K customers on their network (incl. Pay TV, telephony & Broadband).The estimated number of Broadband customers on Neighborhood Cable is 1.1K.⁵⁹

3.46 The Committee consistently heard that Telstra's control over considerable sections of the telecommunications sector and its near monopoly control of the infrastructure in regional and rural Australia was a significant impediment to competition in broadband.⁶⁰ Key barriers include: the lack of facilities or

59 Bits on Light Pty Ltd, *Submission 23*, pp.3-4.

60 Neighborhood Cable, *Submission 49*, p.3.

infrastructure based competition, especially in outer suburban and rural and regional areas; Telstra's slow investment in alternative infrastructure technology; the power of the 1st tier carriers to peer; and the interconnection of both Telstra's wholesale and retail markets with Telstra's ability to bundle services and wall customers.

Investment in infrastructure and technology

3.47 The high cost to build infrastructure and Australia's small geographically dispersed population significantly restricts infrastructure-based competition in the telecommunications sector. The current level of infrastructure based broadband competition in Australia is minimal outside of CBDs. The Committee heard from Mr Fred Grossman from Neighborhood Cable who argued that:

Australia is a long way behind most developed countries. I think that is a fact that I do not need to talk about. One of the reasons for that is the lack of infrastructure based competition. One of the reasons the US has done well is the infrastructure based competition between telecommunications and cable TV networks.⁶¹

3.48 As noted in Chapter 1 the Committee heard that in late 2003 the ACCC allowed Telstra, under merger regulations, to purchase the IP1 fibre optic network which runs from Melbourne to Bunbury. The network was originally rolled out to provide direct competition to Telstra across Western Australia and that the recent acquisition of this network by Telstra is argued to have had a negative impact on broadband competition.

3.49 Of the decision to allow Telstra to purchase the IP1 network and the effect on wholesale prices of infrastructure competition, Mr Paul Budde said:

The reality, unfortunately, is that Telstra was the only one to do it. My heart bled, because when IP1 was announced—not installed; announced—prices went down 40 per cent; that is, wholesale prices for Telstra. In your state of Queensland, Chair, in Central Queensland, with a whole new backbone, prices dropped by 25 per cent instantly. That is what IP1, Next-Gen and all these new backbones are doing. In Tasmania, where there is no competition, prices are 40 to 60 per cent higher than on the mainland.... from a state development point of view that it really is a sad story.⁶²

3.50 Optus has HCF cable networks in certain parts of Sydney, Melbourne and Brisbane.⁶³ Nexium Telecommunications, Neighborhood Cable and TransACT have invested and rolled out limited cable infrastructure in Queensland, Victoria

61 Neighborhood Cable, *Committee Hansard*, Ballarat, 5 February 2004, p.25.

62 Mr Paul Budde, *Committee Hansard*, Sydney, 13 November, 2003, p. 68.

63 Optus, *Submission 36*, p.7.

and the ACT respectively. However, infrastructure roll-out costs continue to limit the number of competitors in this sector of the telecommunications market:

Neighborhood Cable as a publicly listed private company has invested private funds to build something for the community for the long term. Yesterday we launched a network in Geelong. There is \$17 million in Geelong. What was the last investment in Geelong of \$17 million? What was the last investment in Ballarat of \$15 million or \$16 million to put in infrastructure for the community?⁶⁴

3.51 Additionally, the lengthy delays to recoup these costs prevent infrastructure investment:

The problem was that after 1997 the industry ... made some bad decisions. The industry went a bridge too far in terms of its build. It built more capacity in the broadband space than the market could take. Therefore, the capital markets now are not seeing a return on the assets that have been invested. They will not return any true value probably for five to 10 years. We are talking about the big broadband builds that were built that are not going to give any return.⁶⁵

3.52 The Competitive Carriers Coalition told the Committee that:

I would simply suggest that the people at this table represent investment in telecommunications infrastructure in this country in the order of about \$4 billion.... I think Primus is proudly EBITDA positive. Nobody else at this table has seen any return on their investment.⁶⁶

3.53 Similarly, Optus contended:

Infrastructure investment is high cost and high risk. This is particularly the case in the residential and SME market. A bold move, such as that taken by Optus with its HFC network means large amounts can be spent and take a long time to earn a return. When faced with a strong and powerful incumbent, these risks are even higher.⁶⁷

3.54 It has been argued that Telstra will not develop any new CAN infrastructure before the end of this decade.⁶⁸ And a number of submitters claimed that Telstra

64 Mr Fred Grossman, Neighbourhood Cable, *Committee Hansard*, Ballarat, 5 February 2004, pp.28-29.

65 Mr John Stuckey, Comindico, *Committee Hansard*, Canberra, 12 November 2003, p.10.

66 Mr David Forman, Competitive Carriers Coalition, *Committee Hansard*, Canberra, 10 March 2004, p.22.

67 Optus, *Submission 36*, p.14.

68 Mr Paul Budde, *Submission 6*, p.3.

will not invest in new technology which will erode income from or cannibalise their existing infrastructure revenue. Mr Christopher Eckermann from TransACT Communications said:

If you are dominant in that revenue and with minimal expenditure you can capture the low end of the data market with ADSL, there is very little incentive to spend a lot of money refurbishing your network. You risk cannibalising existing products.⁶⁹

3.55 Additionally, the Committee was told that Telstra uses its powerful market position to limit infrastructure investment by its competitors,⁷⁰ and, that it uses its monopoly status to restrict the development of alternative infrastructure and future technologies which would challenge its market position:

Telstra has most effectively leveraged its incumbency and market power to deter investments in alternatives to the existing copper access network. Telstra's success in equating DSL with broadband is important in that it delays the emergence of market demand and investor support for alternative access technologies that are truly future-proof.⁷¹

3.56 Similarly the Committee heard:

Telstra has a large influence in the progress (or lack thereof) of this process by virtue of being the gatekeepers/owners of the copper loop network, and arguably can slow the process down until or unless they themselves have commercial plans to deploy the more advanced technology, as otherwise they have no incentive to assist in introducing any changes.⁷²

3.57 The Committee is concerned that there are limited incentives for Telstra to invest in new technologies and that current Commonwealth programs, such as HiBIS (as discussed in Chapter 1) continue to support Telstra's position of limited investment and the roll out of old technology. Mr Paul Budde told the Committee:

...countries around the world are now implementing, on a commercial basis, fibre to the home. In my discussions with Telstra, Telstra have clearly indicated that fibre to the home is not on their agenda; they do not see a need for that. They believe that the copper cable network can be upgraded

69 Mr Christopher Eckermann, TransACT Communications, *Committee Hansard*, Canberra, 12 November 2004, p. 48.

70 Optus, *Submission 36*, p.14.

71 Comindico, *Submission 31*, p. 8.

72 Australian Telecommunications Users Group, *Submission 33a*, p. 6.

and will be sufficient for a long time into the future. If that is the case, are those 30 or 40 countries absolutely stupid? I don't think so.⁷³

3.58 While a number of submitters argued the need for increased infrastructure investment and build as a means of increasing broadband competition, the Committee believes that Australia's vast size and low population density does not support a business case for multiple national infrastructure builds:

We do not have the population density to support lots of people rolling out infrastructure. I think the national challenge is to get the whole nation equipped with one good set of infrastructure. If you think about the pay TV roll-outs, there are 2.7 million homes passed but 2.2 million of those homes are passed by two companies offering very little differentiation in terms of technical capability. If, instead of 2.7 million homes passed with a high level of overlap, you put those figures end to end and we had Optus's 2.2 million and Telstra's 2.5 million, we would have 4.7 million homes passed and in a much better position than they are today.⁷⁴

Access to infrastructure

3.59 Telstra's copper network (the local loop) is the only ubiquitous telecommunications network reaching the majority of Australians and all ISPs and carriers are dependent on Telstra. The Communications Expert Group told the Committee that:

There is limited competition in the Broadband market because all ISPs and carriers are dependent on either Telstra wholesale broadband carrier products, or the purchase of Telstra backhaul capacity from points of aggregation.⁷⁵

3.60 Telstra is the owner of bottleneck infrastructure and affects operators both upstream and downstream of its infrastructure. It is widely recognised that this vertical integration is a key impediment to competition in broadband services. Despite the declaration of the local loop and attempts by the ACCC at regulation, Telstra maintains control over access to its network by competitors. The ACCC has argued that progress in achieving effective competition in telecommunications has slowed and the regulatory regime directed largely at the incumbent has failed to deliver the level of competition originally envisaged. Comindico submitted that:

Telstra presently is in a position to control and determine sectoral outcomes and overall industry structure to a greater degree than in most advanced

73 Mr Paul Budde, *Committee Hansard*, Sydney, 13 November 2003, p.63.

74 Mr Christopher Eckermann, TransACT Communications, *Committee Hansard*, Canberra, 12 November, 2004, pp.51-52.

75 Communications Expert Group Pty Ltd, *Submission 30*, p.4.

economies. This leads to systemic market distortions in the Australian telecommunications sector. Telstra is the owner of bottleneck infrastructure and acts both a supplier of retail and wholesale services utilising this infrastructure. Regulation seeks to employ purely behavioural remedies to force Telstra not to use this power to its advantage against direct competitors. Put simply, regulatory mechanisms to create competition rely almost exclusively on creating an obligation for one company (Telstra) to sell services it does not wish to sell.⁷⁶

3.61 Similarly, Primus told the Committee that:

Telstra's control over bottleneck facilities continues to frustrate Primus' ability to deliver broadband services to its customers.⁷⁷

3.62 Resellers without infrastructure are at the mercy of Telstra, which is in a position to use its monopoly over the infrastructure that carries services (backhaul) and of the infrastructure that delivers services to individual users (last-mile services) to 'tighten the collar' on regional competition, thus making network expansion difficult.⁷⁸ Mr Ian Slattery from Primus told the Committee that:

Primus's contention is that competition is far from effective in this area. That is largely due to Telstra's control over the network which all competing carriers require access to in order to supply broadband based services and drive the take-up and penetration of broadband services in this country.⁷⁹

3.63 However, not all submitters were critical of Telstra's behaviour in regard to network access. Mr Charles Reed from Personal Broadband Australia told the Committee that:

I would like to add that we are purchasing some transmission from Telstra, and in fact they have been terribly constructive to date. They have been very professional about their relationship with us and they have worked very closely with us.⁸⁰

3.64 The ACCC is sensitive to the fact that new entrants are unlikely to enter the market without first purchasing access services from the incumbent and gaining a

76 Comindico, *Submission 31*, p.10.

77 Primus, *Submission 32*, p.3.

78 Neighbourhood Cable Limited, *Submission 46*, pp.3-4.

79 Mr Ian Slattery, Primus, *Committee Hansard*, Ballarat, 5 February 2004, p.46.

80 Mr Charles Reed, Personal Broadband Australia, *Committee Hansard*, Sydney, 13 November, 2003, p.99.

customer base. Commissioner Ed Willett in a recent paper on challenges in telecommunication competition and regulation said:

The key challenge for a regulator, therefore, is to develop a framework that provides incentives for competitors to seek access to a fuller set of services over the shorter term while also providing incentives for these competitors to build their own infrastructure and rely less on the incumbent over the longer term.⁸¹

Access to information

3.65 Information asymmetry is argued to be a barrier to broadband competition as without appropriate geospatial information the telecommunications industry is unable to plan, analyse and invest in broadband infrastructure. The Committee was advised that:

Telstra's role in the provision of information to a successful broadband industry is critical and well understood. However, subtle differences in what Telstra chooses to provide industry can hinder its competitors, and therefore, the development of a broadband-empowered Australia.

Nowhere are these subtleties more apparent than in the different approaches between the provision of DSL-enabled telephone prefix lists and the provision of exchange boundaries in digital map form....

The impact to industry of not having ready access to comprehensive exchange/ RIM boundary information includes the following:

- uncertainties about market size (inc DSL deprived) in particular areas;
- reduced opportunity to employ precision-based tools such as Addressed-based DSL prequalification. Such tools have the ability to improve provisioning yields and reduce ordering frustration amongst customers;
- delayed resource allocation decisions (infrastructure planning, marketing, provisioning) by competitive providers; and
- frustration amongst State government bodies who have strategies to facilitate competition and reduce entry barriers. These bodies may have negotiated exchange boundaries for their own planning purposes – typically over lengthy timeframes. However, they can't necessarily promise that Telstra would provide competitive providers with the exchange/RIM boundary information critical to a successful commercial implementation.⁸²

81 Australian Competition and Consumer Commission, *Challenges in Telecommunications Competition and Regulation* Accessed on 30 June 2004, URL: <http://www.accc.gov.au/content/item.phtml?itemId=518743&nodeId=file40dbc06cdfb57 fn=20040625%20SPAN.pdf>

82 Australian Telecommunications Users Group, Callpoint, *Submission 33e*, pp.2-3.

3.66 Members of the Committee were informed that Telstra has four geospatial data sets, of which DCITA has access to two. Telstra's reluctance to make publicly available information which may be perceived as commercial in confidence significantly impinges on Telstra's competitors being able to offer a service or plan the deployment of infrastructure. Comindico told the Committee:

The problem of information asymmetry – where Telstra holds far more information about network conditions and costs, customer profiles, and competitors' product designs, than those it is competing against – undermines confidence further and makes risk profiles of new ventures almost impossible to quantify.⁸³

3.67 During estimates hearing questioning on 24 May 2004, Telstra told the Environment, Communications, Information Technology and the Arts Legislation Committee that it does not charge its competitors for technical information about the copper network for the purpose of accessing HiBIS subsidies to install ADSL or DSLAMs in exchanges. Mr Bill Scales, the Managing Director of Regulatory, Corporate and Human Relations said:

We do not sell that information....They would talk to our wholesale division and they would provide.⁸⁴

3.68 Despite these claims the Committee has taken evidence which is critical of Telstra withholding or selling, at high prices, geospatial information on its copper network. ATUG argued:

ATUG understands from industry that ... Telstra has elected to charge entities a fee between four and five digits, depending on the combination of geospatial datasets required. In ATUG's view this sizable fee further hinders the development of broadband, particularly for niche regional players who cannot justify these sums.⁸⁵

3.69 Similarly, PowerTel made a submission to the Committee in regard to Telstra's claims on information access raised at the estimates hearing. It stressed the detrimental effect of restricted information access on its ability to compete with Telstra in an effective manner, as was Telstra's intention to charge competitors for information access. PowerTel submitted that:

It has been PowerTel's experience that the obtaining of ESA [Exchange Service Areas] information from Telstra has been a long and arduous

83 Comindico, *Submission 31a*, p.5.

84 Mr Bill Scales, Telstra, Senate Environment, Communications, Information Technology and the Arts Legislative Committee, *Senate Budget Estimate Hearings*, Canberra, 24 May 2004, p.84.

85 Australian Telecommunications Users Group Limited, *Submission 33b*, p.2.

process. PowerTel has sought this information for a considerable period of time from Telstra and found it excessively difficult to obtain. Notwithstanding this, Telstra has recently provided PowerTel with ESA data however, in doing so, Telstra required an acknowledgement from PowerTel that the provision of future ESA data would be subject to new terms and conditions, including the imposition of charges.⁸⁶

Interconnection between wholesale and retail markets

3.70 The Committee has heard evidence which was critical of Telstra's wholesale and retail pricing activities. A number of submissions argued that the structural integration of Telstra is the primary point of failure of telecommunications competition. As ACIL Tasman has argued:

The market power of the incumbent owner of the local loop is significantly magnified if the owner, as in Telstra's case, is part of a vertically integrated company that also operates downstream from it. Being an essential facility owner and retailer at the one time places the vertically integrated firm in a kind of conflict of interest. The extra power enjoyed by the vertically integrated firm comes from its ability to monopolise areas of the downstream market by providing its own subsidiary with local loop access on favourable terms.⁸⁷

3.71 Comindico told the Committee that Telstra uses its monopoly control of infrastructure to deny wholesale services to competitors:

There have been many cases reported by wholesale acquirers of Telstra ADSL connection services where the application by a customer for a non-Telstra retail service has been refused on the grounds that Telstra wholesale cannot provide the service over the copper line available to that particular residence, only for that same customer offered an ADSL service by Telstra's BigPond retail arm.⁸⁸

3.72 Additionally, companies who do not own their own infrastructure are subject to Telstra's interconnection charges. The Committee heard that Telstra's wholesale prices are not sufficiently separated from Telstra retail prices. Optus argued that:

Telstra does not provide competitors with a wholesale local calling product (a local call resale service) at prices that permit effective competition — or that reflect costs Telstra avoids from not retailing local services. Hence Telstra's competitors, when adding their own retailing costs, are required to loss-lead in the provision of local calling via resale if they are to provide consumers with the one-stop shop or complete telephony service. This has

86 PowerTel, *Submission 55*, p.1.

87 ACIL Tasman, *Submission 7*, p.3.

88 Comindico, *Submission 31*, p.13.

decreased effective competition in both local and long-distance calling as well as the Internet services market.... If competitors are to match Telstra's retail price, they have little room if any to add in their retail and customer acquisition costs. This price squeeze which erodes access seekers' margins, is promoted by regulation and maximised by Telstra's regulatory gaming behaviour. The end result is that it constrains competition and harms end users. Resale competition is a vital stepping-stone to infrastructure competition.⁸⁹

3.73 Since regulatory intervention in late 2001, retail competition in ADSL has grown with over 200 residential broadband ISPs. The Committee heard that Bigpond Broadband (including ADSL, Cable and Satellite) retail grew by 12% (or 26K) to 240K end customers.⁹⁰ However, while the Committee is encouraged by the growth in broadband ISPs, evidence to the inquiry suggests that Telstra as both the supplier of wholesale and retail services uses this position to 'provide it with a seemingly impassable advantage over competitors'.⁹¹ Bond Wireless argued:

There seems to be a lack of a Chinese Wall between Telstra's wholesale and retail business as we have potential customers that have requested ADSL access for a very long time but upon learning of our solution, Telstra Countrywide suddenly is able to provide MiniMux solutions.⁹²

3.74 In mid February 2004 the media reported that Telstra lowered the cost of its ADSL broadband services by \$10 to \$29.95 per month for 200Mb of data. It also offered unlimited access for \$59.95 per month, which was \$20 less than the then equivalent Optus service.⁹³ It was argued that this pricing policy was to undermine long-term competition in the broadband market.

3.75 Telstra's cutting of retail broadband prices was of major concern to its competitors. The Committee was told that the cost of buying bandwidth from Telstra at wholesale had become higher than the retail price and this price was below the wholesale price being charged for its tails in non-metropolitan regions, and was an unsustainably small margin below its metropolitan wholesale price.⁹⁴ A detailed case study of this episode is included at page 73 of this chapter.

3.76 The Townsville City Council told the Committee that:

89 Optus, *Submission 36*, pp.17-18.

90 Bits on Light Pty Ltd, *Submission 23*, p.2.

91 Comindico, *Submission 24*, p. 8.

92 Bond Wireless, *Submission 44*, p.1.

93 The Australian, *Telstra in new internet price war*, 16 February 2004, URL: <http://www.theaustralian.news.com.au/printpage/0,5942,8696382,00.html>

94 Competitive Carriers Coalition, *Committee Hansard*, Canberra, 10 March 2004.

Predatory pricing can be anti-competitive if it leads to a vertical price squeeze. In this case, a carrier with significant market power or dominance sets prices below a particular measure of cost, thereby sacrificing short-term profits, with the effect of lessening competition by squeezing out equally efficient competitors and/or deterring future market entry.⁹⁵

3.77 Some broadband wholesalers felt that Telstra's entry-level plan was not uncompetitive - because of the low data limit set - but voiced concerns about Telstra's higher-priced unlimited plan.⁹⁶ However, the Committee believes that Telstra's current broadband prices, while appearing positive for the consumer, are anti-competitive in the long-term. By pricing wholesale only marginally below the retail price it is uneconomic and unprofitable for many ISPs to compete. Mr Ian Slattery from Primus said:

Primus believes it will potentially send smaller ISPs to the wall. That is to put it in simple terms. In a bizarre sort of way, there might be an upside for carriers like Primus whereby we can then acquire them, but I do not think that is necessarily the ideal outcome. It is just a possible outcome. But as I said before, a substantial percentage of Primus's dial-up customer base is at threat here. Bear in mind that the \$29.95 plan will lock in customers for 12 months. They will have a Telstra modem. They will then more than likely realise they are exceeding the 200 meg download limit and Telstra will quite happily push them up the price scale.⁹⁷

Accounting separation

3.78 The 2002 *Telecommunications Competition Act* made a number of amendments to the *Trade Practices Act 1974* to enable the ACCC to exercise its record keeping rule (RKP). Under these powers carriers can be required to keep records and supply reports to the ACCC and for those reports to be published.

3.79 In June 2003 the Minister issued a direction to the ACCC requiring it to implement an enhanced form of accounting separation intended to address competition concerns arising from the level of vertical integration of Telstra's wholesale and retail services. The Act requires accounting separation of Telstra's wholesale and retail operations, with Telstra to prepare current cost accounts to provide transparency to the ACCC about Telstra's ongoing and substantial

95 Townsville City Council, *Submission 15*, p.31.

96 ZDNet Australia, *More ISPs join broadband price war*, 23 February 2004, URL: <http://www.zdnet.com.au/news/communications/0,2000061791,39116261,00.htm>

97 Mr Ian Slattery, Competitive Carriers Coalition, *Committee Hansard*, Canberra, 10 March 2004, p.18.

wholesale and retail costs, and that Telstra publish financial statements in respect of core interconnection services.⁹⁸

3.80 Telstra summarises accounting separation as follows:

The Government requires Telstra to make information available showing whether Telstra (i) prices competitor access to its network fairly; (ii) sets its retail and wholesale prices at levels sufficient for competitors to generate satisfactory returns and (iii) does not favour its retail customers compared to its wholesale end-users.

The information can be classified into three limbs:

Limb 1 is the requirement for Telstra to update its regulatory accounting records from historic to current costs – being the costs that would be incurred if the network were to be built using today's up to date technology;

Limb 2 requires that Telstra provide data to the ACCC to show the margins available between Telstra's average retail prices for access/local, STD, IDD and fixed to mobile services and the costs that a competitor would incur in supplying these services if it were relying solely on Telstra's wholesale products for network inputs. The average available margin across the full set of these retail services (the margin of relevance to full service carriers) is also published; and

Limb 3 requires Telstra to publish a series of measurements that compare its performance in terms of new service connections and fault rectification for both wholesale and retail customers.⁹⁹

3.81 The ACCC received its first reports under the three RKPs in November 2003 and these were released publicly by the ACCC in December 2003. To a Question on Notice to the Senate Economics Legislation Committee the Regulator Affairs Division at the ACCC stated that:

On the basis of the first set of reports the ACCC did not identify any specific areas of concern pertaining to Telstra's treatment of its competitors in using its access services. However the ACCC noted that it was hard to draw firm conclusions from a single set of reports that were based on limited data, and further reports could produce different results. The highly aggregated nature of the reports could also serve to mask specific instances of conduct that may require investigation.¹⁰⁰

98 TransACT, Australian Capital Territory Government, *Submission 14*.

99 Telstra, URL: <http://www.telstra.com.au/communications/corp/accounting.cfm>

100 Australian Competition and Consumer Commission, Senate Economics Legislation Committee, Answers to Questions on Notice, Additional Estimates, 18 & 19 February 2004.

3.82 While there is community and industry support for the introduction of accounting separation of Telstra's wholesale and retail¹⁰¹, concerns over Telstra's ability to manipulate the reporting process were expressed to the Committee:

Without going into too much detail about the accounting separation, I am sure Telstra will come out with a lot of imputation test information to support the \$29.95 pricing. They will say that, if you look at the suite of broadband services, this pricing passes all the tests. One has to question whether you can actually use the current accounting separation testing regime to bring to them to task on these things. The first report that was run and released earlier this year was, in my view, an example of the system being manipulated in some fashion. The strict guidance of the process was not adhered to, so one would have to question whether you can actually use that information to benchmark the next report and how effective it is.¹⁰²

3.83 The Committee is concerned that the model used for imputation testing to assess whether Telstra is engaged in a margin squeeze is unreliable, as the ACCC has used highly aggregated data which is unlikely to reveal a vertical price squeeze.

Bundling

3.84 The Committee heard that Telstra's vertical integration allows it to implement pricing strategies, such as the 'bundling' of different services into a single offering.¹⁰³ Bundling allows discounts to be offered to buyers who acquire numerous services from one supplier. The strategy brings a number of customer benefits:

Bundling can generate a range of benefits in terms of efficiencies and pro-competitive outcomes. Economies of scope and scale may be achieved through bundling; and consumers may experience retail price reductions and service improvements.¹⁰⁴

3.85 Similarly, TransACT told the Committee:

Communications technology convergence has prompted Telecommunications providers to offer bundled services.... Bundling has the capacity to increase efficiencies and to encourage take up through the provision of consumer benefits such as lower prices and single bills. For example, ACTEW is now offering bundled services including ISP services.

101 Townsville City Council, *Submission 15*.

102 Mr Rajiv Jayawardena, Competitive Carriers Coalition, *Committee Hansard*, 10 March 2004, p. 17.

103 Comindico, *Submission 31*, p.13.

104 Townsville City Council, *Submission 15*, p.30.

Bundling also offers the potential for smaller Telecommunications providers to form partnerships to offer cheaper services at a price that is competitive with established Telecommunications providers.¹⁰⁵

3.86 Telecommunications operators benefit from bundling voice, video, and data services into a single offering by increasing average revenue per customer, reducing potential customer churn and attracting new customers by their range of services. Telstra's ownership of a wider range of businesses and services than any of its competitors allows it to offer unique bundles from their own resources. Telstra's competitors argue that some aspects of bundling are anti-competitive:

On the other hand bundling may have anti-competitive effects. Potentially bundling will make it more difficult for new and developing companies to break into the market as larger telecommunications providers, with the capacity to offer greater discounts, dominate the market.¹⁰⁶

3.87 Evidence to this inquiry suggests that by bundling services Telstra is able to offer customers retail prices which are below the wholesale price charged to competitors:

There are situations that appear unjustifiable, such as where elements of bundles are offered to retail customers at prices lower than the wholesale price for which competitors can acquire the same services from Telstra. Comindico understands anecdotally that there are corporate customers who pay less for fixed to mobile calls than the wholesale price other fixed networks pay Telstra to terminate a call from their network to a Telstra mobile phone user.¹⁰⁷

3.88 Similarly, the Competitive Carriers Coalition told the Committee:

It impacts on the business. I will mention one example of that to you. Bundling is the underlying methodology of delivering it. Fixed-to-mobile call prices are a very good example.... a recent initiative which allows a 50 per cent discount on a Telstra fixed line to a Telstra mobile service on call prices. That discount is not available anywhere else. No equivalent can be delivered. There is a terminating access wholesale price arrangement on mobile networks which, given that kind of discount off retail, would leave absolutely no margin to compete with. You could not possibly compete with that in offering a service in the retail market, as our colleagues are trying to do.¹⁰⁸

105 TransACT, Australian Capital Territory Government, *Submission 14*, p.5.

106 *ibid.*

107 Comindico, *Submission 31*, p.15.

108 Mr Steve Wright, Competitive Carriers Coalition, *Committee Hansard*, Canberra, 10 March 2004, p.19.

3.89 Neighborhood Cable told the Committee:

Neighborhood Cable objected to Telstra's notification to the ACCC of its third-line forcing conduct over the bundling of Austar's pay-TV product with Telstra's telecommunications services on the basis that this amounted to anti-competitive conduct. As Telstra pay TV would be simply reselling the standard Austar offering, the public would not benefit from any of the classic results of true competition.¹⁰⁹

3.90 The Committee heard that package deals involving the bundling of products are an attempt by Telstra to circumvent price regulations.¹¹⁰ It is concerned that bundling may be detrimental to competition in the longer term by enabling the leveraging of market power from one market to another to foreclose or discourage competition.

To be clear, I guess any carrier can match it. The point is for how long do you want to take a loss?¹¹¹

3.91 Additionally, the Committee heard assertions that the bundling of Foxtel with Telstra's broadband services was an inhibitor of market competition. Dr Walter Green, the Director of Communications Expert Group, told the Committee:

There is no doubt that the bundling of Foxtel with Internet and telephone services, where significant reductions are offered on Foxtel, is proving an inhibitor to competition, simply because the other carriers and Internet service providers do not have the same access to Foxtel that Telstra has.¹¹²

3.92 Telstra's ability to bundle services was argued to restrict Telstra's competitors from achieving adequate returns on their infrastructure investments. Mr Fred Grossman argued:

I think it is public knowledge that we at Neighborhood Cable opposed an issue that we thought was third-line forcing where Telstra applied to the ACCC to allow itself to bundle the Austar pay TV product and rebrand. We claimed in that submission ... that that was doing absolutely nothing for competition, in fact stifling competition. The ACCC in its wisdom saw fit to allow Telstra to bundle. We believe that adds absolutely no value. It is the same product to the same customers, just a little bit branded build, stifling our competition.

109 Neighbourhood Cable, *Submission 46*, p. 4.

110 ACIL Tasman, *Submission 7*, p. 51.

111 Mr Ian Slattery, Competitive Carriers Coalition, *Committee Hansard*, Canberra 10 March 2004, p.10.

112 Dr Walter Green, Communications Expert Group, *Committee Hansard*, Canberra, 12 November 2003, p.38.

Why does that bother us? It bothers us—going back to the opening statement—because we have invested \$60 million of private funds to build a true broadband network for 250,000 local loop customers. We need to make a commercial payback on that, as did railways and anybody else who did it a century ago.¹¹³

3.93 The Committee appreciates that consumers find it easier to receive bundled services with a single bill.¹¹⁴ However, the Committee is concerned that few competitors of Telstra can offer a similar service:

Telstra's ability to bundle wholesale access elements with a full suite of services and content, including Foxtel Pay TV and mobile voice services, is the most obvious manifestation of its ability to use its structural integration to curtail inroads into its market share by competitors. This is particularly evident in corporate and residential broadband markets.¹¹⁵

Peering and backhaul costs

3.94 The Department of Communications, Information Technology, and the Arts defines 'peering' as the exchange of traffic between two internet service providers (ISPs) on a settlement-free basis. In Australia there are currently four companies peered and accepted as Tier 1 providers for Internet backbone. These are Telstra Bigpond, Telecom NZ/AAPT, Ozemail/Worldcom, and OptusNet. Optus told the Committee:

The arrangements that we have for peering are effectively a more efficient version of the alternative approach, which would be paying the counterparty for data we download from their network and them paying us for data they download from our network.

Our approach has been consistent in that we have a set of objective criteria as to who we will enter into a peering arrangement with, which are based essentially on traffic volumes. The underlying economic factors that they relate to are the amount of investment that we need to be put into a network to have points of presence that are widely distributed and a capacity to physically carry and receive traffic. There is no particular magic about who it is that we peer with—it is just whoever has a volume of traffic that is broadly equivalent to the volume that we have.¹¹⁶

113 Mr Fred Grossman, Neighbourhood Cable, *Committee Hansard*, 5 February 2004, p.27.

114 Small Enterprise Telecommunications Centre Limited, *Submission 29*, p.6.

115 Comindico, *Submission 31*, p. 21.

116 Mr Paul Fletcher, Optus, *Committee Hansard*, Sydney, 13 November, 2003, p.123.

3.95 All other carriers and ISPs rely on these Tier 1 providers for transit arrangements. Non Tier 1 providers were critical of the current peering arrangements. Neighborhood Cable told the Committee that:

Because of Telstra's position in the marketplace and its peering arrangements it does not have the same backhaul costings or data costings that we do. Therefore, how does a competitor compete with an unlimited product when it is not able to purchase something that is unlimited?¹¹⁷

3.96 The Townsville City Council submitted that:

Council is concerned that existing peering arrangements that operate between the nation's 'top 4' Internet Service Providers are creating cost disadvantages for small regional providers. Such a situation has potential anticompetitive consequences and could either squeeze otherwise efficient competitors out of the market or deter future market entry.¹¹⁸

3.97 The Committee heard that Internet peering is an important factor in the cost of domestic bandwidth and that the lack of affordable peering arrangements makes international bandwidth cheaper than domestic bandwidth for smaller ISPs:¹¹⁹

Again, I will make it very simple: we need to connect our networks back to the Internet world and, in most cases, to use the backhaul capacity and the peering. To remain competitive you have to look at what pricing is out in the marketplace and how you price into that, and you have to be able to buy for less than you need to sell for. We find that difficult in certain circumstances.... There is not a large capacity to negotiate.¹²⁰

3.98 The costs associated with international peering arrangements was raised by ATUG's Ms Rosemary Sinclair:

The way we see it is that the current situation creates a negative impact for Australian users. The cost to Australian providers of getting traffic to and from the US is more expensive because the Internet peering arrangements do not apply to them. The reason people say that we have to charge users for downloads and that we have to have download caps and that prices have to be download limit related is that that is the way we buy the service. Within tier 1 carriers internationally, they swap traffic without these kinds of imposts and charges. We see an opportunity for this matter to be raised between Australia and the US—which is the main focus of our concern—as part of the free trade agreement. If we are interested in economic growth and

117 Mr Fred Grossman, Neighborhood Cable, *Committee Hansard*, Ballarat, 5 February 2004, p.28.

118 Townsville City Council, *Submission 15*, p.31.

119 Bits on Light Pty Ltd, *Submission 23*, p.7.

120 Mr Fred Grossman, Neighborhood Cable, *Committee Hansard*, Ballarat, 5 February 2004, p.30.

international cooperation, and in the knowledge society and the information economy that we all talk about then cost-oriented access is an important fundamental tool.¹²¹

3.99 Dr Paul Brooks when on to argue that:

Few people know that Telstra is part of that club of tier 1 peering carriers. By virtue of putting its equipment over in the US, it peers - with no data charges and no interconnect charges - with the United States and the international Internet backbone operators. But Telstra's argument is that it has to pay for the international circuit that links Australia to the US, to carry that traffic on. Part of that was built with shared funds from the American carriers, in terms of building the physical fibre infrastructure and rolling out the cable ships.

It is also not metered on a cents per megabyte rate. They connect into the Internet, the traffic gets exchanged at no charge and the link between Australia and the US - even though, essentially, the broadband service is paying itself for the transmission carriage - is the same amount per month or per year, regardless. That is true of other carriers which have capacity on the under-sea fibre cables as well. By putting equipment in the US, you can interconnect at no cost with all the other carriers and essentially become part of that tier 1 peering club. Some carriers in Australia are already part of that, but the recognition that they are no longer paying US carriers for content has not filtered through into their pricing models or, obviously, their arguments to various inquiries and commissions.¹²²

3.100 Mr Maha Krishnapillai from Macquarie Corporate Telecommunications also commented that:

Domestic peering is the gang of four I referred to earlier: Telstra, Optus, AAPT and OzEmail. They have a domestic peering arrangement that was entered into under the auspices of the ACCC in 1998. This has exactly the same impact on the Internet industry and, therefore, broadband in Australia, whereby those four carriers are able to swap traffic at no cost and either maintain a higher profit margin or gain a higher market share.¹²³

3.101 The Committee heard that backhaul costs are charged on a distance basis and therefore rural customers are financially disadvantaged. Mr Jonathan Withers from Personal Broadband Australia noted that government policy was

121 Ms Rosemary Sinclair, Australian Telecommunications Users Group, *Committee Hansard*, Sydney, 13 November 2003, p. 16.

122 Dr Paul Brooks, Australian Telecommunications Users Group, *Committee Hansard*, Sydney, 13 November 2003, p.17.

123 Mr Maha Krishnapillai, Macquarie Corporate Telecommunications, *Committee Hansard*, Sydney, 13 November, 2003, pp.19-20.

focused largely on supporting infrastructure roll-out in regional and rural areas with little regard for the cost of back-hauling traffic in these rural areas:

The thing that generally degrades the business case, if you like, for these rural areas, is the cost of back hauling the traffic.... While a lot of previous government policy has put money into the capital requirements of putting infrastructure into rural areas that does not address what we call the ongoing opex requirements of supporting that. One of the things we note is that the Internet is the first telecommunications space which has absolutely no distance based charging; you can access a site here in Sydney, over in the US or in the UK for exactly the same price—it is a characteristic of the Internet. What works against you in terms of wide-area deployment is that at the moment the back haul costs are not following the same model, so it is considerably more expensive to provide access in rural areas.¹²⁴

3.102 The issue of backhaul costs is complex and significant, as even modest bandwidths of two megabits per second for some rural locations can cost in the order of \$100,000 per year.¹²⁵

Universal Service Obligation

3.103 The Universal Service Obligation (USO) ensures that under the *Telecommunications (Consumer Protection and Service Standards) Act 1999* standard telephone services, payphones and prescribed carriage services are reasonably accessible to all Australians on an equitable basis, wherever they reside or carry on business. Telstra is currently the only designated Universal Service Provider and this has been identified as an impediment to broadband competition. Under the USO other carriers cross-subsidise Telstra by in excess of \$50 million per annum to provide services in non-metropolitan Australia. The Committee has been told that, where capital is already limited, the USO is another major impediment to smaller companies investing in infrastructure.¹²⁶

Smaller carriers operate on low profit margins, and the USO [that is based on income or revenue] significantly reduces their available capital for investment in broadband infrastructure. There is one case where a carrier gave up its licence because of the impact of the USO, and withdrew from providing broadband services in areas not serviced by Telstra. ISPs are further penalised by the USO, as their USO contribution is based on their

124 Mr Jonathan Withers, Personal Broadband Australia, *Committee Hansard*, Sydney, 13 November, 2003, p.90.

125 *ibid*, p.96.

126 Communications Expert Group, *Submission 30*.

total Internet and Telecommunication revenue. There appears to be an emerging market for small carriers servicing ISP needs.¹²⁷

3.104 Submitters were critical of the USO, and the policy position which supported it, as it did not encourage infrastructure investment. Dr Michael Bourk from the Small Enterprise Telecommunications Centre argued:

We lament the reduction in competition—and, in particular, facilities competition, which is really the engine, if you like, of competition in the long term. We regret that. We think that, to a degree, that is a problem with policy. Had the USO perhaps been able to naturally evolve as the network was evolving and as we moved to an ISDN network, we would not be facing a lot of these issues, because the bootstrap would have already naturally occurred. Then you already have an increased, advanced take-up, if you like, of broadband already occurring and making provision for the competitors. So we see that as a policy problem.¹²⁸

3.105 A number of submitters argued that the USO had reduced the growth in broadband infrastructure and consequently reduced the competitive pressures on Telstra. Optus submitted that the current USO funding arrangement that requires competitive carriers to fund the provision of Telstra's service in rural and regional Australia has a number of negative consequences for the promotion of competition:

- in an environment where competitive carriers are struggling to make inroads against the continuing massive dominance of the incumbent, the USO regime actually requires competitive carriers to cross-subsidise Telstra's activities, and thus strengthen Telstra's position;
- that the USO contribution acts as a significant disincentive for competitive carriers to provide their own regional and rural services. When a carrier is forced to pay another party to deliver standard services, there is no incentive to itself provide standard services, and a much more limited incentive to provide any additional services;
- that the contribution of other carriers to Telstra bolsters the significant value Telstra obtains from being the national carrier, and providing an ubiquitous service. These benefits are not considered when the USO is valued. Therefore, other carriers are paying Telstra to entrench its rural and regional dominance. Telstra makes much of its Australia-wide presence in its marketing – yet that presence in much of Australia is substantially cross-subsidised by Optus and other carriers; and

127 Communications Expert Group, *Submission 30*, p. 5.

128 Small Enterprise Telecommunication Centre, *Committee Hansard*, Canberra, 12 November 2003, p.29.

- that there is no understanding amongst rural and regional consumers of the USO regime, and that the industry as a whole contributes to the provision of their standard telecommunications services. This creates a perception amongst regional and rural consumers cementing their loyalty to the incumbent, and making change less likely.¹²⁹

3.106 Submitters to the inquiry argued that the USO could be modified in line with National Communications Fund or Networking the Nation type funding rather than being paid directly to Telstra. Carriers who are then interested in rolling out services to regional areas could access this funding on a dollar for dollar basis.¹³⁰

3.107 The Minister for Communications, Information Technology, and the Arts released the Review of the Universal Service Obligation and Customer Service Guarantee in June 2004. The review analysed the current arrangements for costing and funding of the USO and whether network extension and trenching costs are impeding access to USO services. The findings of this review are discussed in the Committee's recent report on the Australian telecommunications network.

Walled Garden

3.108 It has been argued that Telstra's large retail customer base and network infrastructure has allowed the organisation to develop a pricing regime which keeps customers tied to the Telstra network. Described as a 'walled garden' or 'castle', end users are charged for data they download above a monthly minimum. Telstra uses its telecommunications network to establish itself as a content aggregator, and Telstra retail broadband customers accessing data from a Telstra website receive an exemption from their download limit for that data. Describing the strategy last year, an article in *The Australian* reported that:

It involves Telstra's power as the owner of the bulk of Australia's telecommunications infrastructure and its ability to charge you more if you shop and surf anywhere else on the Internet other than a site of Telstra's choosing. Simply, Telstra is trying to herd the customer into its cyber castle ... Telstra will lure them then slam the drawbridge shut. If they travel outside the castle a heavy toll will be exacted as download charges zoom.¹³¹

3.109 The Committee heard that individuals find this facility useful. Mr Steve Ireland told the Committee:

129 Optus, *Submission 36*, p.22.

130 Dr Walter Green, Communications Experts Group, *Committee Hansard*, Canberra, 12 November 2003, p.40.

131 Comindico, *Submission 31*, p15.

I actually take advantage of Telstra's "Free Sites" in which they don't measure downloaded data.¹³²

Regulation

3.110 Industry regulation plays a significant role in the promotion or restriction of competition in the telecommunications sector (as outlined in Chapter 2). The Committee heard that the Australian Government is now reliant on the private sector as the primary driver for investment decisions, innovation and competition practices.¹³³ This strong reliance on the market has been seen as a key impediment to broadband growth:

SETEL contends that the slow rate of uptake of broadband and e-commerce is primarily due to Policy failure. The Commonwealth Government has generically promoted the importance of broadband services and their usage to the community in general but has failed to implement policies to ensure that all users have access to ubiquitous, affordable broadband services.¹³⁴

3.111 Neighborhood Cable was critical of the regulatory framework under which they and other carriers were given access to existing infrastructure:

Government also needs to review the legislative framework under which infrastructure builders can access and secure tenure on existing infrastructure. For example, a carrier is entirely dependant on the utility whose infrastructure it must rent in order to construct a network. There is generally only one utility company, which has the potential to create a significant imbalance of bargaining power. This can result in the unreasonable shifting of costs and liabilities and insecurity of tenure over the long term.¹³⁵

3.112 Within the current regulatory regime Telstra's continued market dominance is seen as a deterrent to many investors. Witnesses have told the Committee that they require a clearer indication from government on the management of Telstra's anti-competitive behaviour before they will commit to infrastructure investment:

Investors in the present market circumstances are particularly "shy" of investing in the disruptive, higher risk end of the technology spectrum. An important reason for this is that they lack confidence in the competitive environment. The evidence of Telstra's ability to use its size and market

132 Mr Ireland, *Submission 8*, p.1.

133 The Institution of Engineers, Australia, *Submission 25*, p.6.

134 Small Enterprise Telecommunications Centre Limited, *Submission 29*, p.5.

135 Neighborhood Cable, *Submission 49*, p.8.

power to curtail the entry of new technologies is powerful. The view that a new entrant will not get a “fair go” at leveraging its investment in new technologies is widespread, and supported by the ACCC’s own analysis.¹³⁶

3.113 Similarly, the Competitive Carriers Coalition told the Committee that:

I think any suggestion that in this environment anybody else would come in to put billions of dollars on the table to invest in another network, particularly in the light of the events we have seen in the last few weeks, is optimistic in the extreme. I think these events, as much as anything we have seen in the last two years, says very clearly to investors: ‘You would be insane to think that you can put money on the table and get a reasonable return on your investment. You are going to lose a lot of money for a long time.’¹³⁷

3.114 The Committee heard evidence which was critical of the current ‘light touch’ regulatory regime, under which it is claimed Telstra acts with impunity. SETEL claimed:

The application of ‘light touch’ regulation has resulted in the dominant carrier, Telstra, being able to increase prices of services to consumers with what appears to be a high degree of impunity.¹³⁸

3.115 Similarly, the Competitive Carriers Coalition argued:

From our observation, this means the regime itself is too weak, the administration of the regime is too weak or it is a combination of both of them. Ultimately, though, it shows that Telstra is unmanageable because it is structurally predisposed to manipulating wholesale and retail market power in ways to disadvantage other participants in the market.¹³⁹

3.116 Additionally, submitters commented on the high cost of an inefficient regulatory system. Mr Ian Slattery of Primus told the Committee:

The ACCC believes the current regulatory regime is ineffective. Its view is that the recent accounting separation legislation and the current access arrangements are unlikely to improve that. It also is of the view that, as opposed to what was intended in the 1997 Trade Practices Act amendments

136 Comindico, *Submission 31*, p.8.

137 Mr David Forman, Competitive Carriers Coalition, *Committee Hansard*, Canberra, 10 March 2004, p.22.

138 Small Enterprise Telecommunications Centre Limited, *Submission 29*, p.3.

139 Mr David Forman, Competitive Carriers Coalition, *Committee Hansard*, Canberra, 10 March 2004, p.10.

- when telecommunications was opened up to full competition - we now have more regulation and increased costs on the industry instead of less.¹⁴⁰

3.117 The Committee heard from a number of witnesses about the ineffectiveness of the current regulatory regime and cited the recent Telstra/ACCC dispute over Telstra's lowering of ADSL retail prices to below wholesale prices as an example of this. The Case Study below outlines the situation.

CASE STUDY: The effectiveness of the regulatory system

On 15 February 2004, Telstra Bigpond announced it would offer an ADSL 256Kbps retail service for \$29.95 per month. This price was claimed to be lower than the wholesale price which Telstra was offering to some of its competitors. Telstra defended its action by claiming that the reduction in price was to stimulate the retail broadband market - which had been declining - and competition more generally. In response to Telstra's new ADSL retail prices, Optus and a number of smaller ISPs announced cuts to their broadband plans to bring them into line with Telstra. However, smaller operators claimed that these prices were unsustainable and Telstra's 'pricing squeeze' was an attempt to manipulate the market.

In a submission to the Committee on 27 February, the Competitive Carriers Coalition wrote that:

*The CCC members believe that these price changes represent a wilful and calculated attack on the integrity of the wholesale ADSL market. It is clear that Telstra is engaged in manipulating the development of the ADSL market by forcing too-high wholesale prices on independent service providers and by favouring its own retail arm to the detriment of other providers.*¹⁴¹

Telstra's competitors went to the ACCC claiming that Telstra was engaged in anti-competitive behaviour. On 6 March the ACCC issued Telstra with a consultation notice. On 9 March the consultation notice was extended by two days when Telstra requested more time to respond to the case of anti-competitive behaviour asserted by the ACCC.

In line with requests from the ACCC to reduce its wholesale prices to levels which were competitive, Telstra lowered its wholesale price.

140 Mr Ian Slattery, Primus, *Committee Hansard*, Ballarat, 5 February 2004, p.47.

141 Competitive Carriers Coalition, *Submission 50*, p.3.

However, as Mr Simon Hackett, the Managing Director of Internode, argued:

It's a myth that \$29.75 is the wholesale access price compared to the Telstra \$29.95 retail price.... The \$29.75 charge is EX GST. When you remove the GST from \$29.95, it becomes \$27.23 – or \$2.52 BELOW the tail circuit charge. Also, that tail circuit charge is only one component of the full cost to mount a working ADSL service. When you add the other necessary costs in, you are up at more like \$35 as a minimum underlying cost.¹⁴²

On 19 March the ACCC issued a Part A Competition Notice to Telstra in relation to the pricing of Telstra's broadband internet services. The ACCC noted that it had reason to believe that Telstra had engaged and was engaging in at least one instant of anti-competitive conduct and was using its substantial market power to lessen and hinder competition.

Since at least 15 February 2004:

- a) Telstra has supplied, and continues to supply, wholesale Broadband Services to its Wholesale Customers at wholesale process set at a level whereby there was and is only a small positive or negative difference between those wholesale prices and the Retail Prices; and
- b) Telstra has refused, and continues to refuse, to supply wholesale Broadband Services to its Wholesale Customers at prices other than wholesale prices set at a level whereby there was and is only a small positive or negative difference between those wholesale prices and the Retail Prices.¹⁴³

The Part A Competition Notice against Telstra opened the way for a Part B Competition Notice to be issued with a possible fine of \$10 million - rising by \$1 million a day - and legal action from Telstra's competitors.

On 23 March Telstra's strategy was being commented on in the following terms:

At this stage it appears Telstra's strategy is to defuse the threat of the competition notice by commercially agreeing on deals on wholesale prices. Presumably it believes the potential volume gains,

142 Simon Hackett, Managing Director Internode, Opinion from Australian IT.com.au readers, *Broadband price squeeze*, 22 March 2004, URL: <http://australianit.news.com.au/common/print/0,7208,897342361542566nbv6,00.html>

143 Australian Competition and Consumer Commission, *ACCC issues competition notice to Telstra over broadband internet pricing*, 19 March 2004, URL: <http://www.accc.gov.au/content/item.phtml?itemId=490779&nodeId=file405a5f8237919&fn=Competition%20notice.pdf>

*and the potential to migrate entry-level customers to higher-capacity, higher-margins plans, will still offset the loss of wholesale margins.*¹⁴⁴

On 1 April Telstra announced two new wholesale access packages aimed primarily at addressing the ACCC's Competition Notice and the concerns of Telstra's wholesale customers. Telstra offered its wholesale customers the following options:

'Protected Rates' Option.

This option provides wholesale prices at a 40 per cent discount to retail access and connection prices across all plans. Wholesale prices will be tied directly to BigPond's pricing plans by taking BigPond's effective starting retail prices and deducting a 40 per cent discount for retail costs and further deductions to cover other wholesaling costs. This will suit customers who want certainty over wholesale/retail pricing relativity.

'Growth' Option.

*This package will assist broadband ISPs to drive profitable growth across the spectrum of retail pricing. It will offer attractive price reductions for higher speed plans, on the basis that sustainable industry outcomes can be achieved via migration of retail end-users from lower value plans. It will suit those ISPs who see the commercial opportunity to upgrade their customers to higher-speed plans; and who want full flexibility over their retail pricing options.*¹⁴⁵

It was reported that Telstra's price reductions appeased the ACCC's current concerns with ACCC Chairman, Mr Graeme Samuel, stating that Telstra's new offer 'appears to be a victory for commonsense'.¹⁴⁶ However, while the ACCC was apparently satisfied with the outcome, many of Telstra's competitors were critical, with a number of Telstra's largest wholesale customers claiming that Telstra had not consulted with them on the new pricing arrangements and that they had heard of the new pricing arrangements via the media. Additionally, it was claimed that the options available to Telstra's wholesale customers tied them into Telstra's retail structure. It was argued that the 'Protected Rates' Option introduced a third variable cost for ISPs and the 'Growth' Option had not dropped the cost of 256k port pricing despite the fact that this was the area in which the current price squeeze existed.¹⁴⁷

144 Stephen Bartholomeusz, Sydney Morning Herald, *Telstra strung up by its broadband plan*, URL: <http://www.smh.com.au/articles/2004/03/22/1079939582767.html>

145 Telstra, Media Release, 1 April 2004, *Low broadband prices preserved*, URL: http://www.telstra.com.au/communications/media/mediareleases_article.cfm?ObjectID=31526

146 Kate Mackenzie, The Australian, *Telstra BigPond Backflip*, 1 April 2004, URL: <http://australianit.news.com.au/common/print/0,7208,9146732^15318^^nbv^15306,00.html>.

147 Phil Sweeney, Whirlpool News, 6 April 2004, URL: <http://whirlpool.net.au/article.cfm/1257>

Commentators noted that the new pricing structure was largely an attempt to deflect ACCC intervention:

*Telstra appears to have attempted to move focus away from that by introducing bizarre wholesale offerings on the side, which appear to be ultimately unattractive to their customers.*¹⁴⁸

On 9 June it was reported that the Competition Notice was still alive and as of that date Telstra had accumulated \$91 million in possible fines. *The Australian* indicated a seeming hesitancy from Mr Samuel to act and Telstra's propensity to:

*Fight the case in court, but the fabulously paranoid telco never ever makes it past the courthouse steps, preferring always to let a large sack of shareholders' cash do the talking.*¹⁴⁹

Reported on 12 June, Mr Bruce Akhurst, Telstra's group managing director for wholesale defended Telstra's action as merely stimulating the market and providing broadband at affordable prices. The discounting had led, over a five-month period, to a 46% increase in broadband subscriptions. The action led Telstra to forecast that it would sign up its millionth broadband customer by July 2004, six months ahead of earlier forecasts.¹⁵⁰

On 25 June, the ACCC warned that the Competition Notice still remained in force and that a number of potential options were open to the Commission in relation to the notice.¹⁵¹

On 19 July 2004 the ACCC issued a further media release stating that it still had reason to believe that Telstra was engaged in anti-competitive conduct of a kind described in the Competition Notice. Consequently, the ACCC had decided to keep the notice in force.¹⁵²

This situation prevailed at the time of the Committee's finalisation of this report.

148 Phil Sweeney, Whirlpool News, 6 April 2004, URL: <http://whirlpool.net.au/article.cfm/1257>

149 Michael Sainsbury, *The Australian*, *Telstra taunts the watchdog*, 9 June, 2004.

150 Blair Speedy, *Weekend Australian*, *Broadband cuts 'altruistic'*, 12 June 2004, p.35.

151 Australian Competition and Consumer Commission, *Challenges in Telecommunications Competition and Regulation*, p. 3. At 30 June 2004, URL: <http://www.accc.gov.au/content/item.phtml?itemId=518743&nodeId=file40dbc06cdfb57&fn=20040625%20SPAN.pdf>

152 Australian Competition and Consumer Commission, *ACCC leaves competition notice in force*, 19 July 2004, URL: <http://www.accc.gov.au/content/index.phtml/itemId/524972/fromItemId/2332>

3.118 The Committee heard a substantial amount of evidence that claimed that the current regulatory framework which relies on sanctions by the ACCC was largely ineffectual against Telstra's considerable market dominance. The Competitive Carriers' Coalition argued that Telstra engaged in anti-competitive behaviour with little concern for sanctions that the ACCC may bring against it:

In other words, the ACCC has already used the most powerful and direct weapon in its regulatory armoury for dealing with anti-competitive activity in precisely this market. That Telstra has been willing to deliberately pursue a course of action that would result in the spectre of the same sanction being applied again shows that Telstra has no fear of competition notices.¹⁵³

3.119 The ACCC has recently argued there was not necessarily a contradiction between access or service-based competition on the one hand and facilities-based competition on the other. And there remained the need for a combination of wholesale, access-based and facilities-based competition under the current regulatory regime in recognition that full-based competition is not viable in all areas and, for more remote areas, may not be viable for some time to come. In seeking to obtain the right regulatory balance, Commissioner Ed Willett said:

The Commission has been cautious of regulating end-to-end wholesale broadband services under the telecommunications access regime contained in the Trade Practices Act.

We are mindful that doing so could result in long-term regulatory dependence that may stifle or delay the move towards more sustainable long-term competition. Rather, the Commission has relied on the competition provisions of the Act to address anti-competitive concerns in wholesale broadband markets as they have arisen. We will continue to monitor the effectiveness of this approach in light of any future industry developments in this area and cannot rule out the need for a more direct regulatory approach to this service.¹⁵⁴

Conclusions

3.120 The Committee has identified a number of impediments to the uptake of broadband services in this chapter. These include issues of network capability, cost and customer knowledge. The Committee also examined the current impediments to competition in broadband services. Significant amounts of evidence suggest that Telstra's monopoly position and control over the telecommunications infrastructure and its vertically integrated structure was a point at which broadband competition broke down. It is apparent that in light of the barriers to competition

153 Competitive Carriers Coalition, *Submission 50*, p.3.

154 Australian Competition and Consumer Commission, *Challenges in Telecommunications Competition and Regulation* At 30 June 2004, URL: <http://www.accc.gov.au/content/item.phtml?itemId=518743&nodeI=file40dbc06cdfb57&fn=20040625%20SPAN.pdf>

the current regulatory regime will need to be reviewed. As Dr Michael Bourk from SETEL told the Committee:

The problem remains the incredible incumbent strength of Telstra. That really does need to be addressed. It is a complex issue; we make no bones about that. But when you still have one carrier making over 90 per cent of the profits in the entire industry that is an issue that needs to be addressed.¹⁵⁵

3.121 The following chapter outlines a variety of proposals that may address the issues raised in the evidence.

155 Dr Michael Bourk, Small Enterprise Telecommunications Centre Limited, *Committee Hansard*, Canberra, 12 November 2004, p.29.