

Competitive
Carriers'
Coalition Inc

Response to DCITA Connect Australia Discussion Paper

December 2005

Executive Summary

- Competition must be the primary policy means to ensure regional citizens keep pace with metropolitan areas.
- HiBIS has provided a massive subsidy to Telstra's planned ADSL rollout, but the services it subsidized are already obsolete
- International analysis shows that it is perilous for policy makers to intervene with subsidies for incumbents in regional areas on the assumption that competition cannot be sustained because
- Internationally and domestically, there are increasing examples of the subsidy of the rollout of fibre infrastructure on an open access (dark fibre) basis in regional areas where telecommunications competition has failed
- Broadband Connect and Clever Networks presented an unprecedented opportunity for competitive, future-proof infrastructure to be deployed in regional areas. This is an opportunity for a "big bang" response to the infrastructure and competition weaknesses in regional areas that might never be repeated.
- Conversely, if these programs subsidise Telstra to entrench itself in regional areas, they could be used to build an irreversible barrier to competition and condemn regional Australia to second class status for a generation

Background – the Lessons of International and Australian Experience

Main Point: The Connect Australia programs Broadband Connect and Clever Networks represent examples of both demand side and supply side subsidy programs that have been evolving in Australia and overseas for a decade. However, these latest programs are to be funded to unprecedented levels. The CCC submits that it is not only crucial that the lessons of the past are learnt and reflected in the new programs, but also that the historic opportunity to continue to evolve toward the most effective approach to subsidizing non-metropolitan Australia is not missed.

Federal Government programs can broadly be described as having fallen into two categories: supply side and demand side. Supply side program provided funding for the deployment of particular network elements in regional areas but were criticized for creating technology islands that did not deliver real benefits to end users. This led to the development of HiBIS, which was designed to deliver end user service on a par with metropolitan areas.

But HiBIS has not deliver parity because it has not emulated in regional areas the incentives to invest that Telstra faces in areas where competitive entry is occurring.

International experience has also shown beyond doubt that incumbents have no incentive to be the first to invest in disruptive technology, such as true broadband infrastructure. Therefore, subsidies to Telstra to deliver improve regional services, where competition has not been strong enough to force it to invest anyway, has not stimulated Telstra to deliver anything more than the minimum standard required to meet the program requirements. HiBIS money has been spent by Telstra installing ADSL equipment in selected regional exchanges where it might have been expected to install such equipment anyway if competitive entry was stimulated, or even if it did not believe it could hold out investing in order to attract a subsidy.

The CCC has in the past raised concerns that the HiBIS program was not designed to be future proof. In fact, its design guaranteed it was not. That is, it was funding the rollout of broadband services to non-metropolitan areas against a benchmark that was established by reference to the standard products that Telstra chose to make available in cities as at 2004. The failure to make future-proof investments has two manifestations: the failure to deploy technologies that overcome the acknowledge limits of DSL in regional areas, and the failure of the scheme to bring regional areas onto Telstra up-grade roadmap, as announced in November this year.

The equipment installed does not overcome the technical geographic limits of DSL services that have long raised questions about the appropriateness of the technology in regional areas. It is likely that DSL technologies will be suitable for many businesses at the centre of regional towns, but HiBIS was targeted at residential users. Most regional

towns have large populations at the fringes of the town, and are at the hub of farming communities, beyond the reach of DSL.

Reaching these consumers would require more substantial investment than simply installing DSLAMs in exchanges, possibly even the use of alternative technologies. But Telstra has not deployed HiBIS in significant new terrestrial fibre rollouts, for example. By contrast, most micro-carriers accessing HiBIS have deployed wireless technologies with greater geographic reach.

There is no reason to believe that simply increasing the total available funding will make any difference whatever to the incentives that bear on Telstra.

The HiBIS base speed of 256 kbps reflected Telstra's base ADSL product. It took no account of the increasing availability of much higher speed services that were becoming available in metropolitan areas where infrastructure based competition was beginning to become established, through either ULL take-up or, in a handful of cases, alternative network rollouts.

It was clear that these services running at 256 kbps fell far short of true broadband and were already far slower than the basic services being offered in leading broadband countries such as Canada, Korea, Japan and much of Europe. The HiBIS program does not seem capable of stimulating a deployment of higher speed technologies.

This inherent weakness in the HiBIS program is now apparent in both the increasing availability of true broadband services from alternative suppliers in the cities and the announcements by Telstra about its intended network upgrades. Telstra has announced upgrades in the form of Fibre to the Node or Fibre to the Home only in the capital cities. That is, Telstra's proposed network upgrades are confined to areas where infrastructure competition based on ULL access has been concentrated to date. Clearly, this is a response to competition.

However, it is becoming increasingly clear that infrastructure-based competition and competitive entrants face greater barriers in rural Australia than in metropolitan Australia. This is neither surprising, nor unique to this country. Around the world, two trends can be observed. Firstly, it has been observed by the OECD that the most effective way of ensuring regional and rural consumers enjoy the benefits of advancing telecommunications technology that is enjoyed by city consumers is to establish effective competition in the industry generally. The Government has in 2005 acknowledged the weaknesses in the telecommunications competition policy and regulatory framework and made some amendments to it.

Secondly, there is an emerging model of deploying next generation fibre-based networks in regional centres on an open access basis, sometimes with the financial support of the public sector.

Ireland provides an example of a country where competition has not been delivered through effective national policy. Eircom continues to dominate the Irish telecommunications market. The number of access lines in Ireland that have been unbundled is about 2%, at the bottom end of the EU. The corollary of this is Ireland's position at the bottom rungs of the EU broadband penetration tables.

As in Australia, it appears that competition is weakest in regional areas.

As a result, the Irish Government has implemented the MAN (Metropolitan Access Network) Program to deploy fibre access networks in many regional towns in Ireland. These are to be deployed as open access networks available to any carrier. *The Irish Government has recognized that it must not only subsidise that deployment of infrastructure where competition failed to be effectively established, but also must use this investment in infrastructure to stimulate competition by making it open access.*

There is also emerging support in Australia for a similar approach from political parties. The National Party's Page Research Centre called in March 2005 for the consideration of a publicly funded rollout of a national fibre, wireless or hybrid fibre/wireless access to the home network. The Opposition proposed in November a publicly supported open access, fibre to the home rollout.

In Queensland, the Government-owned Ergon Energy has deployed fibre rings in several regional towns. Its rationale for doing this is to support the development of these regional economies to support growth in its core energy business. In effect, this is an example of a corporate sector subsidy for broadband infrastructure not dissimilar to the ideas floated by both the National Party and the Opposition.

The Ergon investment also demonstrates the very different incentives that a pure infrastructure wholesale company will respond to even in those regional areas that were ignored in Telstra's recently announced fibre to the node proposal.

However, there are market constraints that suggest such initiatives are unlikely to emerge nationally unless the Connect Australia package is designed to be supportive of them.

Market Constraints – Competitive Entry in Regional Markets

Potential competitors to Telstra in regional areas come from both new, locally based entrants, and from those carriers that have established first in metropolitan markets and then seek out opportunities to enter smaller markets, often as they follow customers.

The travails of locally owned and operated regional access network new entrants have been well documented in the media. Telstra, for all its complaints about the cost of providing regional services, has displayed a pattern of swift and aggressive reaction to the emergence in regional areas of potential competitors deploying access networks using technologies such as wireless that bypass the Telstra last mile bottleneck. The compliance

requirements of the HiBIS scheme has further tilted the playing field against these small entrants because Telstra has such a huge advantage in being able to meet the scheme requirements while smaller operators without experience in dealing with bureaucratic processes complain of a lack of support and interest from the department.

Any action that provides Telstra with even further competitive advantage in regional areas will have the direct effect of slowing the improvement of services to regional Australian communities. The OECD has reported that the emergence of regional Wireless ISPs has driven incumbents to move to respond by making xDSL services more widely available. Also, it reports that incumbents in France and Austria are deploying wireless solutions themselves in regional areas that are not suited to fixed line broadband technologies.¹

HiBIS has massively subsidized Telstra and there have been numerous reports of wireless local ISPs being disadvantaged as a result. The CCC is aware that the DCITA has had brought to its attention even more examples than have been publicly reported.

Other features of the HiBIS scheme have been disgracefully mismanaged by the Department, to the detriment of smaller operators. For example, Telstra was allowed to manage the database describing those areas eligible for subsidy at different level. Smaller operators seeking to use the database have been advised that Telstra did not freeze the database at the start of the scheme, and then told to direct customers' queries about service eligibility to Telstra for resolution.

The other threat to Telstra's position in regional areas comes from its most important and effective competitors in metropolitan areas seeking to exploit market opportunities that take them to regional areas. This is the type of competitive evolution that might be expected in an effectively competitive market, and typically it would be led by corporate market opportunities. For example, competitors providing services to corporate customers with regional offices would in this way establish a "beach head" outside of the capitals, which could in turn allow them to build critical mass of business in regional areas to support infrastructure investment.

The investment stepping stones philosophy that underpins telecommunications competition policy and regulation in Australia anticipates that through the acquisition of wholesale access products, competitors will enter new markets and develop their businesses to the point where they invest in their own infrastructure where it can be supported.

It is critical that the appropriate market signals are communicated in regional areas because the lower teledensity in those areas means it is unclear how far effective and sustainable infrastructure-based competition can reach. In some markets, it may emerge that infrastructure competition will never be sustainable. In those cases, judgments will need to be made about appropriate access arrangements and perhaps about continuing subsidies.

¹ The Development of Broadband in Rural and Remote Areas. OECD Working Paper 10 May 2004

However, Telstra has acted in ways that confuse these signals, particularly in the crucial corporate market. Telstra, for example, first resisted making available wholesale versions of products such as its business grade DSL product, for which there is no effective substitute for carriers wishing to service corporate customers in regional markets, and then has presented prices for the service that are clearly high.

HiBIS is designed to promote residential services and does not lend itself to stimulating investment by carriers to build around these barriers to entry.

A Proposed Approach

The magnitude of the total funding available under the Connect Australia package means that it could make a huge positive or negative impact on the competitive environment. If the programs are badly designed, they could set back competition outside of the cities for years.

To this end, the CCC believes it is important that the Clever Networks and Broadband Connect programs are explicitly linked where possible to leverage the maximum benefit to communities. One program can provide the transmission infrastructure, the other the end user access. Further, open access arrangements should be a strict condition of the Clever Networks program.

The CCC submits that the Clever Networks program should concentrate on two infrastructure types: developing open access, preferably dark fibre, networks or rings in regional towns, and, where required and justified by a supporting business case, alternative transmission or backhaul to and from these locations.

In other words, it should be focused on the points of infrastructure bottleneck that have demonstrably held back the delivery of services to regional Australia, and be designed to directly stimulate competitive entry to dilute Telstra continuing market power in regional areas.

The Broadband Connect program should subsidise the connection of customers of all types and sizes to these networks, not only residential customers. The Broadband Connect subsidies should differ from the HiBIS approach in that it should be possible to apply for one-off capital grants to support the deployment of access network infrastructure, such as wireless or fibre tails, and of customer premises equipment.

Specifically excluded should be Telstra xDSL services delivered through upgrades to existing Telstra networks. These upgrades can be expected to occur anyway as Telstra responds to competitive entry. In those locations where Telstra does not respond, it can be assumed that it has determined there is not the capacity for competing infrastructure. Because the Clever Networks subsidy would specify open access arrangements, there would be scope for Telstra to deliver services on that infrastructure if it wished. At the

same time, there would be a competitive level playing field and the basic infrastructure available to the community would have been substantially improved.

Priority should be given to Broadband Connect proposals that would provide alternative access networks capable of delivering service to multiple customers. For example, applicants should be able to apply for funding to deploy a wireless access transceiver to deliver services to a single corporate customer that was not able to access an appropriate fixed line service. However, the applicant should be encouraged to utilize access technology that could also serve other customers, such as residential consumers. This capacity could be wholesaled to other service providers if the applicant did not want to provide those services themselves. Proposals that suggest making such wholesale capacity available should be favored.

Proposals should also be required to provide a explanation of a future technology upgrade path, and a description of the conditions that would need to be met for such additional investment to be made.

The magnitude of the funds on offer under these programs demands a boldness that has been lacking in past program designs. It is potentially a once in a generation opportunity to deploy in regional areas open access, future proof infrastructure that will at once overcome both the network weaknesses and the infrastructure bottleneck barriers to competition that might otherwise never be overcome in regional Australia.

This is a “big bang” opportunity that demands the political and policy courage necessary to identify and pursue an outcome that would require the co-ordination of design and operation of the Connect Australia and Clever Network programs toward a clear goal. It is highly unlikely that the same outcome would result from the piecemeal methods of distributing funds that have been a feature of past programs.

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