

## **Internet Industry Association**

### **Submission on Request for Proposals for a National Broadband Network**

National Broadband Network Panel of Experts  
Department of Broadband, Communications and the Digital Economy  
GPO Box 2154  
CANBERRA ACT 2601

By email: [regulatory@dbcde.gov.au](mailto:regulatory@dbcde.gov.au)

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The Internet Industry Association (IIA) appreciates the opportunity to comment on the issues relevant in the Panel of Experts' Request for Proposals (RFP) for a National Broadband Network (NBN).

#### **About the IIA**

Founded in 1995, the Internet Industry Association (IIA) is Australia's national Internet industry organisation. Members include telecommunications carriers, content creators and publishers, web developers, e-commerce traders and solutions providers, hardware vendors, systems integrators, banks, insurance underwriters, technology law firms, ISPs, educational institutions, research analysts, and those providing professional and technical support services. Increasingly, our members also include businesses hoping to establish an effective online presence for the purposes of e-commerce.

On behalf of its members, the IIA provides policy input to government and advocacy on a range of business and regulatory issues, to promote laws and initiatives which enhance access, equity, reliability and growth of the medium within Australia.

In preparation for the drafting of this submission, the IIA asked all its members<sup>1</sup> to comment on the regulatory aspects of the RFP. We received a diversity of views. We have assessed those comments and provide the following statement of principles and recommendations, together with analysis on why this is the preferred position of the IIA.

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<sup>1</sup> A list of members is available at [www.ii.net.au](http://www.ii.net.au)

## **1 Executive Summary**

The IIA calls for structural separation between the NBN operator and service providers who would access the network.

Having regard to the lessons of the past, regulation alone (under the current provisions of the Trade Practices Act) cannot prevent future potential anticompetitive conduct.

Therefore, whoever operates the NBN must not have a retail operation.

Where structural separation is not feasible, the minimum requirement would be absolute and enforceable functional separation.

There should be parity in backhaul prices between regional and urban Australia on the basis that the regions are disadvantaged and taxpayers funds are being provided for the NBN.

If wholesale access prices are regulated under the NBN (as they must be), then vertical separation is all the more important. The operator would otherwise have a compelling motive to act in other (non price) anticompetitive ways.

The rate of return must reflect the commercial risk. Since unprecedented public funds are being provided, the rate of return should be reduced accordingly. An artificially high rate of return will inflate access prices and deter uptake. This is long term infrastructure and can justify a long term payback period.

ADSL2+ infrastructure based competition has driven recent diversification of services. A transition period for ADSL2+ in existing exchanges should apply to preserve these benefits until fibre is fully deployed.

Consideration should be given for the NBN to be built from poorly served areas first, then back to highly serviced areas to protect these ADSL2+ services and the competitive pressure they provide.

## **2 Statement of Principles**

The regulation of the NBN should ensure that:

1. Fair, regulated access pricing will apply to the NBN
2. The successful NBN operator must not have a retail business nor, in any way, be structured so that it may benefit its own operations in preference to competitors'
3. A level playing field must apply for all access seekers
4. Regional parity should be achieved to the greatest extent possible
5. Transitional arrangements are in place to protect competitive services

6. An ability to differentiate products is guaranteed
7. Investment in new and innovative products and services is encouraged.

### **3 The National Broadband Network Commitment**

In July 2006, the IIA released its National Broadband Targets 2010.<sup>2</sup> This aimed to develop aspirational targets for both fixed and mobile broadband. These indicate where Australia needs to be by 2010 to remain internationally competitive with other leading information economies.

We were pleased that these targets were endorsed by the Rudd Labor Opposition in its election commitments prior to the last Federal election.

In our analysis, we pointed out that patterns of consumption of what are now disparate communications, information and entertainment services will change as convergence proceeds. These services have become standard fare for many ISPs internationally as they move to capitalise on revenue-building opportunities that come with convergence.

Users benefit from better value offerings and more choice. More importantly, it is the potential new uses that will accelerate our transformation into a digital economy. This has major implications for the demand for bandwidth by Australian homes and businesses.

Our analysis assumed the following uses will become mainstream in other advanced information economies by 2010, or not far beyond, including:

- internet telephony with high function advanced features
- high definition videophones
- effective telecommuting
- remote diagnosis and telehealth services
- interactive remote education
- rich multimedia entertainment
- digitally-controlled home appliances
- broadband-enabled motor vehicles

We observed that:

- Fixed and mobile services will provide citizens with ubiquitous access to unprecedented quantities of content, as well as empowering them with high quality communications capabilities. The promise of a connectivity cloud approaches as we become

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<sup>2</sup> 2010 National Broadband Targets: Maintaining Australia's Global Competitiveness, Internet Industry Association, July 2006 at [www.iaa.net.au](http://www.iaa.net.au)

more accustomed to and indeed dependent upon always-on services.

- Private investment may not be enough to realise our broadband goals. Public expenditure will be necessary to future proof the Australian economy by investing in high capacity information infrastructure, particularly in areas of market failure, that is, areas that are uneconomic or cannot support competition.
- Beyond our economic future, broadband will also underpin continual levels of government services, health care, education and entertainment commensurate with a successful 21<sup>st</sup> century economy.

Our report concluded that for Australia to have equivalent services, we must have the broadband infrastructure and capacity to deliver and that a **nation building approach** to the problem be adopted.

The 2007 election commitments were a very welcome development which gave us confidence that the Rudd Government both understood the need for a national approach to broadband, and was committed to delivering it.

However, the regulatory constraints through which a project of this kind will be governed will have a major bearing on the extent to which Australians are best able to maximise the benefits of the new utility.

The key attributes of a successful telecommunications market include:

- Maintaining a competitive landscape
- Offering choice to users
- Providing value for money
- Achieving internationally competitive performance levels
- Responsive to the changing needs of society
- Supporting the creation of new products and services
- Supporting new entrants and the expansion of existing services
- Providing a reasonable long term return on investments.

Delivering on these objectives will allow us to regain lost momentum relative to other leading internet-enabled nations. Otherwise we will repeat the mistakes of the past by entrenching bottlenecks – with a concomitant effect on competition, innovation, pricing and uptake.

#### **4 The Regulatory Experience**

In a deregulated market such as telecommunications, remaining regulatory processes must be fair, fast and decisive.

The IIA's 2001 policy manifesto<sup>3</sup> analysed a number of important national policy documents. Its recurrent theme: Competition is the fundamental driver of efficiency. While highly developed in parts of the industry, competition is distorted both by market dominance and unworkable regulation.

So while Australians are innovative and competitive, our competitors are raising hurdles higher and more rapidly than we can jump them.

The 1997 Part XIC amendments to the Trade Practices Act, the culmination of the Hilmer reform program, heralded a new era of telecommunications competition.

Access to essential infrastructure promised greater efficiencies in their use, more choice for consumers, better pricing and innovation in products and services.

Many argue that in hindsight, the competitive outcomes have arisen in spite of the regime, not because of it.

The majority of submissions the IIA received from its members argued strongly that the access regime has failed to cope with tactical, procedural 'log jamming' by established interests. The current regulatory regime is therefore flawed in its susceptibility to delay, gaming and resultant uncertainty.

From the viewpoint of access seekers, the following characterisation of the existing regulatory arrangements is typical of their experience:

1. The incumbent has little interest in negotiating access arrangements with competitors. Negotiations are half hearted and designed to delay outcomes.
2. Arbitration doesn't work (in a market sense) when the process takes two and a half years to get an answer and the so-called Final Determination is only valid for six months.
3. There is no price-setting mechanism available to the regulator (an arbitration expires and only applies to the party involved).
4. Operational blockages are as damaging as pricing. There is no equivalence in operational process with the incumbent's retail operation.
  - a. The incumbent insists on access seekers using systems and processes it doesn't use itself;
  - b. It refuses to implement customer transfer processes;
  - c. It refuses to participate in industry arrangements for customer transfer;
  - d. When wholesale ordering systems fail, there is no priority as they do not use the systems themselves;

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<sup>3</sup> *Manifesto for the Information Economy*, Internet Industry Association, July 2001.

- e. Restrictive work practices for exchange work, truck roll and fault repair are institutionalised;
  - f. The incumbent's network design discriminates against competitors (FTTN or RIMs, CMUXs, PGS etc).
5. Commercial practices are one-sided, take-it-or-leave-it offers
- a. Many 'wholesale' products are resold retail services with added restrictions.
  - b. Forcing is common. (If you want this, you have to buy that).

It is these kinds of practices which have given rise to delay and uncertainty. In a rapidly evolving market such as telecommunications, delay is death to innovation and death to competitive products and services.

The structural attributes of the market are such that key infrastructure is concentrated in the hands of an operator which is vertically integrated and has every reason to resist competition. There is no suggestion of moral turpitude here – they are acting rationally and in the best interests of their shareholders, as they are bound to do.

However, the market structure and the conflicts of interest that accompany it make this state of affairs difficult to regulate.

As the Productivity Commission recognised in its 2005 review of National Competition Policy Reforms:

*[[I]t is important to recognise that the task of regulating monopoly infrastructure is challenging due to, among other things:*

- *the large information asymmetries between regulators and service providers;*
- *the incentive effects created by regulations that may encourage gaming or*
- *discourage cost minimisation;*
- *uncertainty about technology and future demand;*
- *the risk of regulatory capture; and*
- *interactions between different regulations.*

*Consequently, regulations designed to reduce the adverse effects of market power can themselves produce economic distortions and incentive problems. These include the risk that errors in pricing and access determinations may deter or distort investment in major infrastructure facilities.<sup>4</sup>*

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<sup>4</sup> Review of National Competition Policy Reforms, Productivity Commission Inquiry Report, No 33, 28 February 2005

Perhaps the single biggest contributor to the renewed competition in broadband which undoubtedly does exist today in Australia, has come from local loop unbundling. The declaration of the local loop under Part XIC has given competitors access to exchanges in which to install their equipment. But they have been able to deploy not only data, but also voice services. As the above comments indicate, it has not been an easy process, and we have lost out due to inefficiencies. But it has delivered some competitive outcomes.

However, a national fibre network will not readily lend itself to unbundling. Not only will existing competitive infrastructure assets be stranded, but the scope for sustainable competitive services would be in doubt.

The reticence of the Productivity Commission to recommend full structural separation in its 2005 review (though they did consider it worthy of examination even then), was predicated on a belief that competition could be made to work via regulation. This was partly because the existing network was capable of supporting competitive infrastructure at bottleneck points.

In 2008, with significant public funds on offer to defray the investment cost (and accordingly lower the risk) coupled with the diminishing scope for unbundling, we doubt the Commission need reach the same conclusion.

With such little confidence in the *status quo*, the majority of submissions received by the IIA called for **structural separation** as the only way to avoid the mistakes of the past.

Not only are competing nations embracing structural separation, the internet has become an essential part of our lives. Business depends on it. The internet has become a major productivity tool for many. Social, cultural and ultimately democratic engagement are all benefited by it. Social programs are made more efficient because of it. Its transformative power is untapped even now. In the future it will leverage many more of the strengths of this nation, as we evolve towards a more innovative and environmentally sustainable digital economy. This power of the internet, however is only truly unleashed under broadband - fast, affordable broadband.

The substantial investment of \$4.7bn of public funds into the NBN compels the Government to commit to a framework that weighs the interests of specific shareholders in favour of advancing the interests of the nation as a whole.

Experiences from elsewhere now show that vertical separation can deliver best on this objective. We need not recite here the experiences of elsewhere except to point to the UK, Italy and New Zealand of examples where separation has severed the Gordian Knot of the incumbent's enduring conflict of interest. Others in their submissions will no doubt expand on these experiences. We recognise that the tensions we have referred to are not unique to Australia. Nor need the solutions be.

If the past 10 years since deregulation tells us anything, it is that effective competition cannot be guaranteed by government fiat or regulation alone. Structural changes that remove the temptation to engage anticompetitive behaviour are warranted.

This is particularly the case where access prices will remain regulated. In a regulated wholesale price environment and in the absence of vertical separation, the propensity to engage in competition-damaging practices could increase.

Where full structural separation is not achievable, then functional separation could be considered. However, in order to be effective, it must have:

- i) strict, independent statutory oversight
- ii) transparency
- iii) separate reporting
- iv) management incentives that are based on the performance of the infrastructure entity alone
- v) service equivalence on all terms and conditions, including price; and
- vi) such other measures as necessary to prohibit differential benefits flowing to the parent company (where the NBN is operated by a subsidiary).

## **5 Determination of Access Prices and Acceptable Rate of Return**

The policy intent of the NBN stated it would:

“Ensure competition in the sector through an open access network that provides equivalence of access charges and scope for access seekers to differentiate their product offerings”<sup>5</sup>

We support that intent.

The policy also made clear the following stipulations for bidders:

“A pre-requisite for all proposals made under this process is that they submit to providing genuine open access to bottleneck fibre to the node infrastructure. Genuine open access would require:

- Equivalence of access charges; and
- Full scope for access seekers to differentiate their product offerings by allowing the customisation of access speeds, quality of services and contention ratios.”<sup>6</sup>

In addition it stated:

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<sup>5</sup> *New Directions for Communications A Broadband Future for Australia – Building a National Broadband Network*, ALP Policy Statement, March 2007

<sup>6</sup> *Ibid*, p 19

“Regulated access prices would be set at a level that ensures a commercial return can be made on such an investment.”<sup>7</sup>

The rate of return on investments must reflect the level of risk attaching to the venture. As this investment is being part funded by Government, the level of commercial risk to investors is reduced. An artificially high rate of return from a long term asset with an operational life probably exceeding all other forms of broadband, deters uptake and the economic benefits which we expect to accrue to the nation as a result of this investment.

Access prices should be regulated to balance the level of risk with the broader public policy goals of encouraging uptake and usage upon which the entire exercise is predicated.

Regional backhaul should be regulated to ensure as far as possible price parity with metropolitan services. Since this scheme will involve a substantial investment of public funds, backhaul charges between city and bush on the NBN should be comparable as a matter of social equity.

## 6 Transitional Arrangements for ADSL2+

As stated above, access to exchanges and the unbundling of the local loop have been key drivers in the rapid development of competitive broadband plans available to Australian consumers today.

This fact is borne out by the quarterly IIA/Spectrum Value Partners national Broadband Index.<sup>8</sup> The latest report shows a decline in costs for users of high speed services (17Mbps+) in early 2007 caused by the launch of standalone 24Mbps ADSL2+ plans by competitive access providers.

This report shows that competition brought about by ADSL2+ deployments extended the number of Australians now accessing higher speed broadband (from 23% to 41% in 15 months).

Access seekers have invested considerable sums in competitive infrastructure. These investments are potentially rendered redundant in a fully fibre network.

So that the NBN implementation does not itself undermine hard won competitive outcomes, we urge **transitional arrangements** be put in place to preserve alternative forms of broadband competition until the fibre network is fully deployed.

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<sup>7</sup> Ibid, p 19

<sup>8</sup> [www.iaa.net.au/images/spectrum-iaa-broadband-index-08q1.pdf](http://www.iaa.net.au/images/spectrum-iaa-broadband-index-08q1.pdf)

We propose the following steps:

1. As with analog television, there should be a defined transition period (say five years) during which time existing ADSL2+ and the existing access regime at exchanges is preserved.
2. After this time, its preservation is no longer mandated.
3. This can be done by using mid-span injection to allow existing exchange-based ADSL2+ to stay active when a node is built. Customers would be cut over or back under software control at the appropriate time.
4. In the meantime, consideration should be given to building the network 'outside in'. That is, that in the first instance it is built where broadband is not currently available, rather than overbuilding areas like major metropolitan areas where there is competition choice and acceptable performance today. An example would include connections downstream of RIM and pairgain units and too far from the exchanges - the people who don't have broadband at all today - and grow the market, and THEN as late as possible, re-work the infrastructure that already delivers the Government's stated target speeds.

We are happy to provide the Expert Group with further information in relation to the matters canvassed in this submission and once again appreciate the opportunity to provide our views.

Peter Coroneos  
Chief Executive, IIA  
On behalf of the Board