

# The ACCC's communications market study

## ANTICIPATIONS AND SPECULATIONS

### The market study announcement

On 4 August 2016, the Australian Competition and Consumer Commission Chairman Rod Sims announced that the ACCC's next market study will focus on the Australian communications sector.<sup>1</sup>

The proposed market study is wide ranging, and, unlike the recent East Coast Gas Inquiry, which was precipitated by a spike in prices due to gas shortages, there appears to be no single catalyst for the market study.

The ACCC describes the purpose of the study is to “ensure that the implications of developments in the communication sector are well understood, to identify issues that prevent relevant markets from delivering economically efficient and competitive outcomes in the interests of consumers, and to identify options, if required, to address these issues.”

The study description emphasises the broad nature of the review, with coverage of fixed and mobile networks, core and aggregation network services and over-the-top (OTT) services.

A further focus appears to be the consolidation and “structural change” that has occurred in the sector, and the impact of these on competition and efficiency.

A final area of focus is retail competition, and whether the transparency and comparability of consumer product information and costs of switching service provider may be impeding competitive outcomes.

### Comments

The market study comes at a time when the early returns from the Australian NBN experiment are in – and they are not entirely positive. Now is an opportune time to take stock, with consolidation of the fixed sector seemingly finished<sup>2</sup>, and the impact of various decisions on how retail competition will emerge on the NBN becoming clearer. Equally, while the NBN is an important part of the future communications sector, consumers' appetite for mobile services continues unabated and its impact can no longer be marginalised in regulatory decisions.

---

<sup>1</sup> <http://www.accc.gov.au/about-us/market-studies/communications-sector-market-study>

<sup>2</sup> As per Mr Sims comments: <http://www.smh.com.au/business/m2-group-merger-with-vocus-could-be-the-end-of-big-telco-mergers-20151105-gkrscd.html>

Based on the ACCC Chairman's commentary, we expect some or all of the following issues to be covered:

- **Increasing concentration in the fixed retail market:** Recent acquisitions have produced four larger-scale retail suppliers of NBN services, with Telstra still retaining the pre-eminent market position.<sup>3</sup> This raises two issues.

The first is whether the fixed market consolidation is consistent with competitive markets and economic efficiency. A particularly interesting aspect here will be how the ACCC assesses the *drivers* of consolidation. Both NBN Co and the ACCC seem to have had a role in this. NBN Co's decisions about the structure of charges, and the balance between access and capacity (or CVC) charges, seemed to favour larger suppliers. But the ACCC will also need to assess its own decisions on recent mergers and on the 121 points of interconnection (PoI) model used by NBN Co that it developed. NBN Co's initial preference was to have far fewer PoIs to lower retail barriers to entry and encourage a more vibrant retail market. The ACCC preferred a model which featured more competition in backhaul services, but which entrenched economies of scale and higher barriers to entry for retailers. Has the ACCC struck the right balance here?

The second issue is working out the *cause* of Telstra's ongoing strength in NBN retail markets: is it better offerings, or customer stickiness, inertia, or a lack of trust in the offerings of competitors? Does the NBN model advantage Telstra over its competitors? And to what extent can better consumer information and lower switching costs help consumers make the best choices?

- **Competition between NBN Co and other wholesale suppliers of broadband services:** The ACCC's recent decision to "declare" a superfast broadband access service has put NBN Co on more of a level footing with competitors and prospective competitors. The playing field could become more level still following a forthcoming Government decision to tax competitors to NBN Co in lower-cost areas to allow NBN Co to subsidise fixed wireless and satellite services (which was the subject of a study by the Bureau of Communications Research).<sup>4</sup>

However, NBN Co's business model seems far from secure. Fixed line competitors are untroubled by national coverage obligations and the vagaries of government ownership. Nascent competition from mobile broadband is likely to ramp up further with faster variants of 4G and ultimately a switch to 5G on the horizon.

---

<sup>3</sup> <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-wholesale-market-indicators-report/reports>

<sup>4</sup> <https://www.communications.gov.au/what-we-do/bureau-communications-research/our-work/commissioned-projects/nbn-non-commercial-services-project>

Ultimately, these trends will place a sharp focus on how NBN Co competes. NBN's total revenues of less than \$300 million a year and accumulation of regulatory losses ("ICRA") already reaching \$6.2 billion by July 2015<sup>5</sup> mean it is operating in territory which no private supplier would contemplate. It has been found in breach of Government competitive neutrality policy and without the revised funding mechanisms appears to remain so.<sup>6</sup> How then can the ACCC use its powers to ensure that the marginal investment dollar gets distributed between NBN Co, fixed competitors and mobile competitors in a way that maximises benefit to consumers?

- **The conflict between competition and NBN Co's business case:** As Mr Sims has been fond of saying in relation to ports privatisations, governments often seem willing to sacrifice competition and efficiency in the name of a better sale price. How then might the ACCC feel about giving NBN Co a role in promoting other kinds of competition that could increase efficiency, but potentially threaten NBN Co's business case? An obvious example is access to dark fibre owned by NBN Co. Such services could be used to promote backhaul competition within NBN Co's service areas – in New Zealand, obligations exist on local fibre companies to offer unbundled fibre services by 2019.<sup>7</sup> A further example might be competition between mobile service providers: the efficiencies available from sharing not only towers but also other forms of network infrastructure could dramatically decrease the costs of mobile operators extending their networks to regional and rural Australia. However, in both cases services could end up cannibalising NBN Co's wholesale supply of fibre bitstream services to retailers and reduce returns to the Commonwealth Government.
- **Mobile competition and mobile roaming:** Moving to mobile communications, there is ongoing debate about how to increase competition in regional and more remote areas of Australia. This has been a recent focus of the Productivity Commission's review of USO arrangements, where both Vodafone and Optus have argued that Government policies towards fixed markets – particularly the scope benefits accruing to Telstra via the fixed line USO – have accentuated Telstra's advantages in mobile markets and allowed Telstra to become a *de facto* monopolist in many areas. Roaming and other forms of regulated network sharing can lower rollout costs but can reduce the returns from rolling out first, so maximising investment requires a careful regulatory balancing act.

---

<sup>5</sup> ACCC, *NBN Co Special Access Undertaking Long Term Revenue Constraint Methodology 2014–15: Draft Determination and Price compliance reporting 2014–15*, March 2016

<sup>6</sup> <http://www.pc.gov.au/inquiries/completed/nbnco>

<sup>7</sup> <http://www.crownfibre.govt.nz/ufb-initiative/frequently-asked-questions/>

- **Fixed to mobile substitution (FMS):** FMS is another issue that continues to arise because all signs are that the trend is here to stay. By December 2014, 12% of the adult population were exclusively mobile, but this rose to 29% when just voice calling was considered.<sup>8</sup> This is a material increase from 2010 when only 13% of adults were mobile-only and provides a strong indication that mobile and fixed calls are more substitutable than ever. This trend has profound implications for how the ACCC regulates call termination and origination services (including wholesale services like line rental and local calls).
- **Peering:** Peering arrangements refer to how internet service providers connect their networks and pass traffic to one another. Peering is the practice of allowing reciprocal traffic flows between providers at no charge. Australia's arrangements are unusual in that while peering is commonplace among smaller service providers, the so-called "gang of four" which includes both Telstra and Optus<sup>9</sup> require other providers to purchase connectivity to and from their networks at commercial (transit) IP carriage rates. The existing arrangements were strongly influenced by a 1998 ACCC decision; massive increases in data usage may well place further pressure on these arrangements, which seem to lack a sensible economic basis in an NBN world.
- **Net neutrality and OTT players:** Network (Net) neutrality refers to how retail broadband service providers treat content which runs over their networks. The rise of Netflix and other OTT streaming services are massively changing the costs of delivery and the value proposition for retail broadband services, which raises a debate about whether and how OTT services should pay for this. Net Neutrality has been a major policy (and political) debate in the United States, with the FCC's "Open Internet" rules which prohibit certain forms of blocking, throttling or paid network prioritisation recently being upheld in the Supreme Court. Net neutrality has also received considerable attention from regulators in Europe. Yet, up until now, policy makers and regulators in Australia have largely been content to watch the emerging trends. In our view, the behaviour of certain retailers in Australia would be against the rules (or spirit of the rules!) in the United States, and the ACCC will undoubtedly be considering the implications of this for content markets.<sup>10</sup>
- **Consumer issues, including switching costs and product information:** The ACCC has long been active in the consumer space on misleading advertising of mobile and broadband services. Service providers now know that the word "unlimited" is not just advertising puffery! However, the deeper

---

<sup>8</sup> <http://www.acma.gov.au/theACMA/engage-blogs/engage-blogs/Research-snapshots/Australians-get-mobile>

<sup>9</sup> <http://blog.internode.on.net/2011/05/16/peering-policy-gaps-nbn/>

<sup>10</sup> See our comments on Net Neutrality given to the ACCC's regulatory conference in 2015: <http://tinyurl.com/zomnc44>

concerns here relate to how well consumers are able to receive and interpret information to inform their decisions. Product differentiation can produce benefits for consumers with different preferences, but at some point the differentiation can start to look like deliberate confusion. We expect that the ACCC may be willing to explore some of the insights from behavioural economics to better arm consumers in their battles for a better mobile plan.

Switching costs that lock consumers into certain contracts and suppliers may be a further concern of the ACCC, as these seem to undermine normal competitive processes. The economic literature is more ambivalent about switching costs, because while switching costs reduce competitive switching, the costs also increase the returns to winning customers and so can intensify competition! A careful study of the facts is therefore required.

The outcomes of the market study are to identify options that would better place the ACCC to address material issues, including in relation to whether the ACCC's current regulatory focus is appropriate to meet the requirements of the changing communications landscape.

In our view, the ACCC would do well to address even a small number of these thorny regulatory policy questions! An issues paper will be released later in 2016 and the ACCC will report some time in 2017.

<b>CONTACT</b>	<b>Warwick Davis</b> <a href="mailto:warwick.davis@frontier-economics.com.au">warwick.davis@frontier-economics.com.au</a>
	Frontier Economics Pty Ltd
	<b>FRONTIER ECONOMICS ASIA-PACIFIC</b> BRISBANE   MELBOURNE   SINGAPORE   SYDNEY
	<a href="http://www.frontier-economics.com.au">www.frontier-economics.com.au</a>