	<p>ATUG Annual Conference 2007</p> <p><i>Communications issues: noise and bluster or just plain facts</i></p> <p>7 March 2007</p> <p>Graeme Samuel, Chairman</p>
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Introduction

There is a lot of noise and bluster about telecommunications competition and access regulation at the moment.

There are ongoing claims from some carriers that the Australian Competition and Consumer Commission (the ACCC) is setting access prices below cost, despite the fact that the law actually prohibits this and the judicial review body, the Australian Competition Tribunal, has repeatedly found in the last year that some prices proposed by carriers are unreasonable and above cost.

Telstra has initiated a High Court case between it and the Commonwealth on the telecommunications access regime under the *Trade Practices Act 1974* (the Act). Telstra is arguing that Part XIC of the Act is beyond the legislative power of the Commonwealth Parliament and that the ACCC has no jurisdiction to arbitrate access disputes for the Unconditioned Local Loop Service (ULLS) and the Line Sharing Service (LSS).

The ACCC has rejected Telstra's request to suspend further arbitration in ULLS and LSS matters. We will proceed on the basis that an Act of Parliament is valid and binding unless we are told otherwise by the courts.

Suspending arbitration in access disputes for key broadband-enablers such as ULLS and LSS would also have a significant negative impact on end-users and on broadband rollout in this country.

Another example of the bluster is the spruiking about the ACCC's Competition Notice that was issued to Telstra because it increased its wholesale line rental price in December 2005. Our Notice indicated we had reason to believe Telstra was engaged in a price squeeze over low spend customers – this is a very specific allegation.

Our decision to revoke the Competition Notice has been described as a 'black day for consumers' by the Competitive Carriers Coalition, which has argued that the law is ineffective. Meanwhile, Telstra has argued the decision is proof that the ACCC is abusing its powers and that the telecommunications-specific parts of the Act should be removed.

In fact, our actions are an example of the complementary nature of competition law and access regulation. Issuing a Competition Notice provides

rights to third parties to take damages actions. It also allows the ACCC to consider the option of penalty proceedings (although these have a significantly higher evidentiary burden than is required for the issue of a Competition Notice) and gives the party that is issued the Notice the option to change its behaviour, an option that has been taken up after the issue of each previous Competition Notice.

In this case, Telstra chose not to amend its conduct.

In these circumstances, the ACCC has a number of options under the telecommunications regime. We considered the range of tools available, including penalty proceedings under Part XIB as well as the Part XIC access regime. In this case, we decided to institute access regulation through the declaration of a wholesale line rental service. As part of this, we now have the ability to set reasonable wholesale prices through arbitration where the parties are not able to achieve reasonable outcomes themselves and have made one interim determination to date.

In revoking the Notice, we also took account of other changes to market circumstances that occurred while the Notice was in force.

Then there is the ongoing debate about the availability and speed of broadband in Australia and whether broadband rollouts are meeting the demands of Australian consumers and business.

Some claim that regulation is stifling investment and are calling for high access prices and regulatory holidays. Others argue that it is ADSL2+ competition, driven by the unbundling of the local loop, that has encouraged broadband rollouts in many of the leading countries and, indeed, is beginning to do so in Australia.

In the midst of all this noise and rhetoric, the Commission is getting on with business.

Today, however, I'm going to talk a bit about some of these issues, including access prices, discussions with carriers about new investment and broadband availability and demand in Australia.

The ACCC's approach to access costs

It is clear that carriers are coming to the ACCC with proposals that are not always justified by sound analysis of costs on any approach and are, or are likely to be found to be, unreasonable by both the ACCC and the Tribunal.

Legislative criteria

The object of the telecommunications access regime is to promote the long term interests of end users. The Act sets out a list of factors to which the

ACCC must have regard in assessing this, including the economically efficient use of, and investment in, present and future infrastructure.

Furthermore, the ACCC must have regard to a number of matters, including:

- the legitimate business interests of the provider, and its investment in facilities used to supply the declared service; and
- the direct costs of providing access to the declared service.

Complaints that the ACCC prices access services below cost are therefore nonsense – the ACCC allows carriers to fully recover legitimate costs. If the ACCC prevented carriers from doing so, Telstra could successfully challenge it in the Tribunal or the Federal Court. I think the fact this hasn't happened speaks for itself.

Cost models

The debate about access pricing today is heavily focused on Telstra's fixed legacy copper network, built up across the 20th century. So let's take a closer look at how Telstra has proposed that the ACCC should price this network over the last decade.

Since the Part XIC access regime commenced in 1997, the ACCC has consistently accepted Telstra's proposals to set prices based on its hypothetical, 'forward looking' cost models (known as TSLRIC). It is only recently that Telstra has started to publicly argue that prices should be based on its 'actual costs'.

Just think about that for a moment – the implication of the existing forward-looking approach is that each time a new undertaking is lodged, the ACCC accepts that the network be valued as if it were brand new (with a commercial return calculated on that network), ignoring the age and past depreciation of Telstra's *actual* network. That doesn't sound much like 'actual costs'.

We have accepted TSLRIC because it provides one way of dealing with some of the issues involved with technologically dynamic industries such as telecommunications. But the ACCC has recognised – as the Tribunal has pointed out – that there is more than one approach to setting prices that can be reasonable.

In saying that, the ACCC has objected to attempts by Telstra to 'mix and match'. That is, the ACCC expects Telstra to be consistent in its pricing approaches across different services – for example, in the way it recovers line costs between voice and broadband services. Telstra cannot 'double dip' by recovering the same costs from both services.

In making decisions about undertakings, the ACCC can only assess what parties put before it – indeed, recent Tribunal judgements have emphasised this point. As such, if Telstra was prepared to put all its 'actual costs' before the ACCC, including the actual written-down value of its copper network, the

ACCC would clearly give it serious consideration. Again, this has not happened.

Line Sharing Services (LSS)

I would now like to briefly discuss pricing of the Line Sharing Service (LSS). Telstra has recently made public statements about how a \$3.20 interim LSS determination allows Telstra's competitors to get wholesale broadband access for the price of a cup of coffee, then sell a retail broadband service for the cost of a restaurant meal.

Telstra's complaints that LSS charges are too low conveniently ignore two important factors.

First, the LSS is only one input in a retail broadband service. An access seeker also requires DSLAM equipment, building services, transmission, marketing and customer support to provide a retail broadband service. This means the total cost of providing a retail broadband service is likely to be up to ten times the cost of the LSS alone. That adds up to quite a lot of coffees – maybe even a decent meal.

Second, Telstra complains that the LSS charge does not allow it to recover the cost of the line itself. However it is important to note that Telstra's network is capable of producing a variety of services. Historically, Telstra has chosen to recover *all* of its network costs from voice line rental charges, and *none* from broadband charges. Pricing for the LSS simply reflects the choices Telstra has made for its own services.

Allowing a contribution to line costs in LSS charges as well as voice would allow Telstra to double-dip. The ACCC has consistently stated that it is open to Telstra putting forward proposals which rebalance the distribution of costs between its voice and broadband services, including the LSS.

Telstra proposed the pricing methodology which applies to the LSS. It was an inevitable consequence of Telstra's preferred approach that as the volume of demand by access seekers for the LSS (and ULLS) grew, prices for these services would decline.

I've discussed the pricing of Telstra's legacy copper network. When it comes to new networks, such as an FTTN network, the ACCC has frequently expressed the view that if it was required to set prices for that network it would be likely to accept actual costs as being efficient, subject to a reasonable level of scrutiny that costs have not been inflated to the detriment of end-users.

For example, where an undertaking was able to show that the costs of a new network were established through a genuine, arms length tender process with third party contractors to build the infrastructure, the ACCC would be highly likely to accept those costs as being efficient.

Unfortunately, the failure of a number of carriers to propose reasonable undertakings with access prices that would apply across-the-board has meant

we are now arbitrating around 30 individual disputes between parties. We are working hard to move towards finalising these disputes.

Rather than having to arbitrate these disputes individually, the ACCC would prefer voluntary access undertakings that provide across-the-board access prices based on demonstrated efficient costs; and that include reasonable terms and conditions that balance the interests of consumers with those of industry. Such undertakings would give everybody regulatory certainty.

Broadband availability and take-up in Australia

I now want to turn to the issue of broadband availability and demand in Australia.

It has been quite instructive to look behind the rhetoric coming from all sides, to see the actual global situation, and to look at the actual drivers of advanced network rollouts in leading countries.

Much has been made of the fact that the OECD ranks Australia 17th out of 30 developed countries in terms of broadband take-up. This statistic is sometimes quoted as evidence that the regulatory regime is stifling broadband investment.

However, this confuses the availability of broadband infrastructure with its take-up by subscribers. In fact, following recent investment by telecommunications companies, the availability of broadband in Australia has increased significantly.

Over the past 18 months or so, providers such as iiNet, Internode and Adam Internet have taken advantage of the ULLS and the LSS to be the first to launch ADSL2+ services and to give themselves a distinct speed advantage over competitors.

Since then they have been joined by others such as Optus, Powertel, Nextep and Agile.

Increased competition has spurred other carriers, and recently Telstra, to also roll out ADSL2+ services. Following upgrades to its network late last year, Telstra launched ADSL2+ services that currently enables 46 per cent of households to access broadband speeds of up to 20 Mbps – At this juncture I must point out that I am talking about maximum peak speeds to give an idea of what is technically feasible. However, the actual speeds of these services may vary between customers depending on a range of factors, including distance from the exchange and electrical noise. This should not be seen as an endorsement of providers making false representations to consumers about what average speeds will be available over their broadband connection.

Mobile services are also making considerable progress. With Telstra's 'Next G' network launched in October 2006, terrestrial mobile broadband is

now available to 98 per cent of the population. In late January, Optus announced its intention to build a 3G HSDPA network that will cover 96 per cent of the population. Hutchison and Vodafone have also commenced 3G network upgrades.

Telstra likes to say that this investment has occurred only because the ACCC does not regulate access in the mobile sector.

While there are differences in the nature of the bottlenecks in the delivery of mobile compared with fixed line services, in both cases there is regulated access to the physical infrastructure. In the case of the mobile sector, key physical bottlenecks such as sites, towers and backhaul infrastructure, as well as mobile termination, are regulated. All of these inputs are relied on by the competing networks.

In fact, I note that the empirical data suggest investment in telecommunications infrastructure is *increasing* over time. The latest Australian Bureau of Statistics figures show that over the three years to June 2006, average annual investment in telecommunications increased by 8 per cent per annum. This is comparable to growth experienced in all other sectors and the economy as a whole.

Of course, consumer take-up of all that new investment in broadband may be constrained by other factors – such as retail prices. But before anyone runs off and accuses the carriers of charging too much for access to the network, to be fair, the take-up of broadband from carriers in Australia also continues to grow rapidly. In fact, the rate of growth in subscriber numbers in Australia is faster than all but one other country in the OECD's ranking table (i.e. Denmark). This suggests Australia is well on the way to catching up to the broadband leaders.

The ACCC's most recent *Broadband Snapshot* estimates that as at September 2006, broadband take-up across business and household users is now over 3.6 million. This is an increase of over 1.2 million services, or 51 per cent, from the September 2005 figure.

The ABS's *Internet Activity Survey* report released earlier this year points to a similar trend. I should note that the ABS's report adopts a different methodology to our own *Broadband Snapshot*. The main difference is that the *Broadband Snapshot* is based on a smaller sample. Therefore, it is likely to understate total subscriber numbers, particularly in relation to wireless broadband.

The ABS report shows that, as at September 2006, 3.91 million Australians are subscribing to broadband, which represents an increase of 1.8 million broadband subscribers between March 2005 and September 2006.

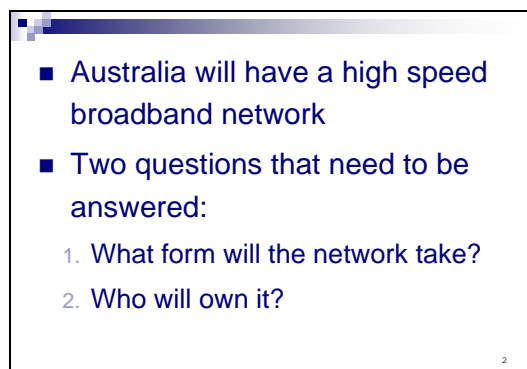
Based on ABS figures, household broadband penetration has now reached 42 per cent, which equates to an increase of around 130 per cent over the last 18 months. This suggests broadband is booming.

Even Telstra acknowledged in its results for the end of the half financial year that its retail broadband business was performing well – according to its statements, its retail broadband revenue grew \$166 million to \$497 million during the reporting period, which it claimed represented market-leading growth of 50.2 per cent.

Options for high speed broadband networks

Of course, Australia's take-up rate is only one side of the debate. The other question is whether broadband speeds are fast enough to ensure Australians are not being 'left behind'.

Slide 2

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- A slide with a blue header bar and a white background. It contains a bulleted list with two main items. The first is a blue square bullet followed by the text 'Australia will have a high speed broadband network'. The second is a blue square bullet followed by 'Two questions that need to be answered:'. Below this, there is a numbered list with two items: '1. What form will the network take?' and '2. Who will own it?'. A small number '2' is in the bottom right corner of the slide frame.
- Australia will have a high speed broadband network
 - Two questions that need to be answered:
 1. What form will the network take?
 2. Who will own it?

As I said last year, I am absolutely confident that Australia will have a high speed broadband network.

There are two questions that need to be answered in relation to this: What form will the network take and who will own it?

I'm going to talk about possible answers to these questions in some detail.

In answering these questions, we need to look at three geographic 'footprints'. The first footprint covers Australia's densely populated areas – the state capitals. The second footprint covers less densely populated areas, such as outer suburban areas and regional centres. The final footprint covers remote areas, which accounts for a very small proportion of Australia's population.

It is important to note that nearly all Australian consumers can access higher speed broadband.

Slide 3

Footprint 1

- **Copper network:** ADSL & ADSL2+; 91% of the population connected via copper network; speeds up to 8 Mbps to 20 Mbps
- **Cable:** available to around 2.7 million premises; speeds up to 10 Mbps to 17 Mbps
- **Wireless:** deployed in metropolitan and regional areas; some fibre also available

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Footprint 1

In the first footprint, ADSL, ADSL2+ and cable provide the bulk of broadband services.

Around 91 per cent of the population is connected via the copper network to local exchanges offering ADSL or ADSL2+ broadband, with speeds ranging from up to 8 Mbps to 20 Mbps. (Again, when I use the term “up to” I am referring to the maximum peak speeds that could be available, not the average speeds customers may experience.) Just under half of the population have a choice of ADSL2+ providers.

Around 2.7 million premises can access cable broadband, with potential maximum speeds of 10 Mbps or 17 Mbps through Optus and Telstra’s HFC cable networks respectively.

In addition, there are a range of wireless broadband networks deployed in both metropolitan and regional areas. Some fibre is also available in this footprint.

Several state governments have pledged support for commercial trials of Fibre-to-the-Premises (FTTP) technology. For example, last year the Victorian government announced support for a request for tender to roll out FTTP in the Aurora housing estate in Melbourne’s north. The network is expected to reach approximately 8 000 residential homes.

Slide 4

Footprint 2

- ADSL and ADSL2+
- Wireless and satellite increasingly popular further out from urban hubs
- Cable also available in some areas
 - Eg. HFC network servicing 90,000 households in Mildura, Ballarat and Geelong
 - Speeds up to 8 Mbps

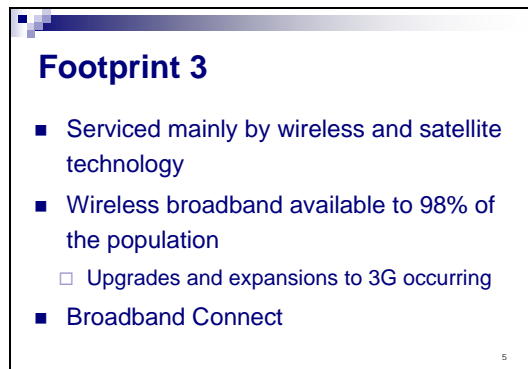
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Footprint 2

The second footprint is served by similar technology, although wireless, and sometimes satellite, is increasingly popular further out from urban hubs.

Cable services are also available in some areas. For example, one provider has rolled out an HFC network servicing over 90 000 households in Mildura, Ballarat and Geelong, which offers speeds up to 8 Mbps.

Slide 5



Footprint 3

- Serviced mainly by wireless and satellite technology
- Wireless broadband available to 98% of the population
 - Upgrades and expansions to 3G occurring
- Broadband Connect

5

Footprint 3

Broadband services in footprint three are mainly delivered using wireless and satellite technology.

As I've already noted, mobile broadband is available to 98 per cent of the population, and several providers are upgrading and expanding their 3G services. Almost every Australian can access broadband via satellite.

Federal Government subsidies such as through the Broadband Connect program are increasing the availability of high speed broadband services. I note the Department of Communications, Information Technology and the Arts (DCITA) estimates that well over one million additional broadband services have already been made available to consumers through the Broadband Connect program.¹ Given the existence of Broadband Connect in this third footprint, let's go back and focus on the first two footprints a little more.

Despite all the evidence that both telecommunications investment in Australia is growing and broadband take-up by subscribers in Australia is outstripping the norm, Telstra argues we are in a broadband drought. Well, if that's so, there is a relatively easy way for Telstra to increase the availability of high speed broadband to Australians.

After two years of ADSL2+ roll out by competitors, Telstra finally launched its own ADSL2+ services in 364 exchanges, reaching 46 per cent of households, in late 2006.

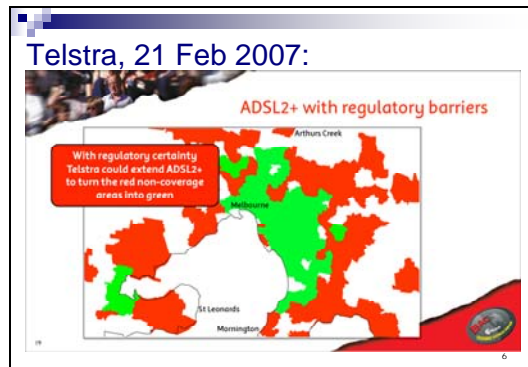
¹ Communications Day16 Feb 07

Why didn't Telstra switch on the service in all exchanges?

We now know from Telstra's recent market briefing that it would not take that much for Telstra to 'flick the switch', as I've been calling on them to do, and extend ADSL2+ coverage.

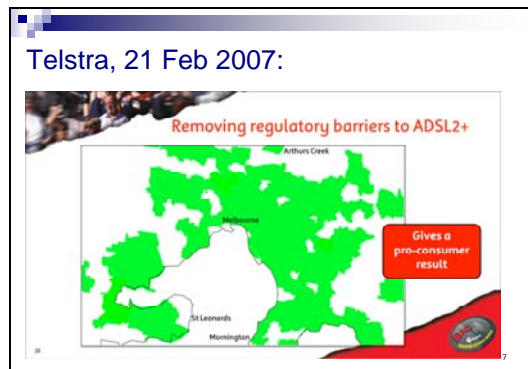
To put into context how easy it would be for Telstra to do this, I'd like to refer to some slides used at Telstra's launch of its "Back Telstra" campaign, in February this year.

Slide 6



This slide shows Melbourne and its surrounding suburbs. I understand that the green areas are ADSL2+ coverage areas and the red areas are non-coverage areas. Telstra claims it could extend ADSL2+ coverage into these red areas if it had "regulatory certainty".

Slide 7



So with "regulatory certainty", this is what ADSL2+ coverage would look like.

This is good news for consumers – on an Australia-wide basis, the 'green area' covers around 90 per cent of the Australian population. That would mean around another 45 per cent of households could have access to ADSL2+ if only Telstra would flick the switch.

Slide 8

Dr Phil Burgess, 21 Feb 2007:

"We can turn tomorrow, or the next day - in 48 hours, turn ADSL2+ on in every one of these red areas. Every one of those ADSL enabled [areas] can be turned on with ADSL2+ with 20 Mbps to all those homes.....if we could simply get an assurance from the ACCC and from DCITA that they would not appropriate our property if we turn it on..."

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Not only that, Telstra has indicated it can turn on ADSL2+ in these areas in as little as 48 hours.

However, Telstra argues that regulatory barriers are preventing it from rolling out ADSL2+ to more exchanges. According to Telstra, without regulatory certainty, it cannot offer ADSL2+ in exchanges where its competitors do not already offer this service for fear that the ACCC would decide to regulate access to a wholesale ADSL2+ service.

As I have already said, the ACCC has clearly stated that a compelling case has not been made for regulating a wholesale DSL service.

Let me say it again. In our Fixed Services Review position paper in June 2006 we said, and I quote:

"the Commission...considers that a compelling case for declaration of a wholesale DSL service at this time has not been made."

Slide 9

Dr Phil Burgess, 21 Feb 2007:

"...So none of those [red areas] will go on unless we can get a letter. All we need is Graeme Samuel and Helen Coonan to send us a letter saying we will not, you know, appropriate your property..."

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If Telstra is not satisfied with the statements that the ACCC has already made, there is a very easy way for Telstra to receive absolute regulatory certainty about the treatment of new ADSL2+ services.

As we have discussed with Telstra, if Telstra wants a letter from the ACCC guaranteeing regulatory certainty, all it needs to do is write one to the ACCC first asking for regulatory certainty.

² Last said by GS at the Broadband Australia Conference 30 November 2006

Telstra can ask for an exemption from regulation for ADSL2+ services under the Act. This would give Telstra a formal, legal guarantee that competitors will not be given access to its ADSL2+ services under Part XIC. An exemption can be sought for a service even when it does not currently exist.

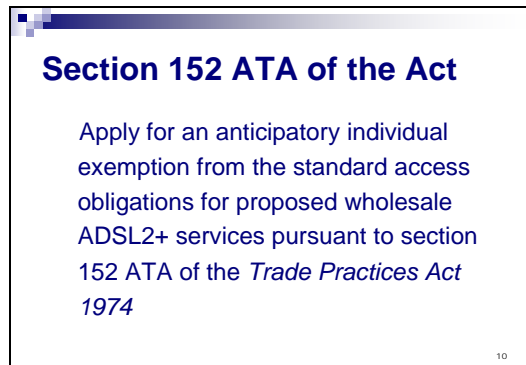
Under section 152ATA of the Act, if the ACCC is satisfied that it would be in the end-users' long term interests, we may determine that if a proposed service becomes a declared service, the provider is exempt from the standard access obligations.

Let me be perfectly clear: this means that if the ACCC is satisfied that an exemption should be granted it would not force Telstra to give access to its competitors to this particular service. You can't get much more certainty than that.

Telstra knows about access exemptions. Following its request, the ACCC gave Telstra an exemption in 2002 from providing access for wholesale local calls in CBD areas.

To date, Telstra has not been willing to make an application for an exemption for wholesale ADSL2+ services. To assist Telstra we have taken the liberty of drafting a letter to initiate the statutory process.

Slide 10



Section 152 ATA of the Act

Apply for an anticipatory individual exemption from the standard access obligations for proposed wholesale ADSL2+ services pursuant to section 152 ATA of the *Trade Practices Act 1974*

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If Telstra sends the ACCC such a letter, we undertake to assess the request rigorously and quickly under the Trade Practices Act.

In the meantime, we have said before and I say again that we see no compelling case for declaration.

But it's not just about ADSL2+. Some are now claiming that even faster broadband speeds are required. There are a few ways we could get faster speeds.

One is to roll out VDSL services, which can provide higher speed broadband over copper, essentially by taking fibre closer to the home. For example, a VDSL service can provide up to 50 Mbps within half a kilometre of an exchange. VDSL services have already been rolled out in Canberra.

Another possibility is upgrading the existing cable network, which are available to around 2.7 million premises. With current available upgrades,

cable could technically provide speeds of up to 30 Mbps. In the future this could increase to 100 Mbps.

Of course, fibre networks also offer significantly higher speeds than those currently available.

Telstra discussed a fibre-to-the-node rollout proposal with the ACCC last year. After extensive discussions, the ACCC considered that Telstra should put the proposal forward for examination by stakeholders. Regrettably, Telstra instead suspended discussions.

As you will be aware, the G9 group of carriers also has a fibre-to-the-node proposal which it is discussing with the ACCC.

I think it's fair to say the G9 appear to have a more developed proposal than we ever saw from Telstra. The G9 members have been providing information to the ACCC on their infrastructure model, financing and proposed access arrangements. They have stated an intention to lodge a special access undertaking in the second quarter of 2007.

The ACCC is happy to discuss undertaking proposals with all industry parties – with a view ultimately to public consultation. It was on this basis that the ACCC engaged in talks with Telstra about its FTTN proposal and is now having similar talks with the G9.

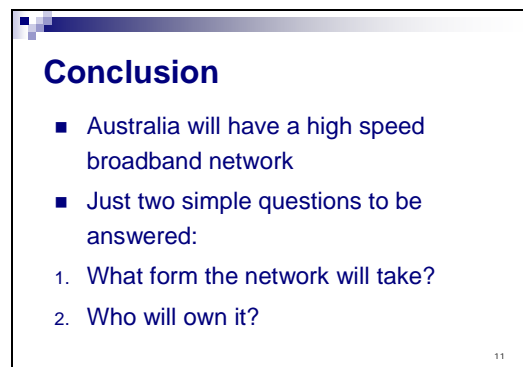
The ACCC would always welcome a resumption of talks with Telstra. It is certainly in the interests of all Australians to have some competitive tension between the parties looking at rolling out FTTN.

Finally, direct fibre-to-the-premises (FTTP) offers superior broadband speeds to FTTN. Such FTTP rollouts are occurring in fibre-leading countries such as Japan and Korea, bypassing FTTN altogether. I certainly don't rule out increased investment in FTTP in Australia as well. As I said, several state governments have pledged support for commercial trials of FTTP technology.

However, let me clearly state a few fundamental principles that will apply to discussions with the ACCC about proposed fibre rollouts:

- Transparency is crucial. No deals will be done with any carrier behind closed doors. All proposals must be put forward for public consultation at the appropriate time.
- As required by the TPA, there is the need to strike a balance between the interests of potential access seekers and investors' need for a rate of return commensurate with risk.
- The ACCC must preserve the confidentiality of discussions with parties prior to a proposal being put out publicly. This will maximise the competitive tension between parties, leading to the best outcome for end users.

Slide 10



The slide is titled "Conclusion" and contains a bulleted list of two main points. The first point is "Australia will have a high speed broadband network". The second point is "Just two simple questions to be answered:", followed by a numbered list of two questions: "1. What form the network will take?" and "2. Who will own it?". The slide number "11" is visible in the bottom right corner.

Conclusion

- Australia will have a high speed broadband network
- Just two simple questions to be answered:
 1. What form the network will take?
 2. Who will own it?

11

As I have stated, I truly believe Australia will have a high speed broadband network. There are two questions to be answered and we hope to answer these questions in the coming months.

Conclusion

To conclude, the ACCC is getting on with business, despite the usual distractions of litigation and chest-beating by some parties.

The ACCC is pressing on with its statutory responsibilities of maximising the opportunities for vigorous competition and efficient investment in Australian telecommunications, by all parties, impartially and without fear or favour. Ultimately this will be to the benefit of all 20 million Australians.