Private Submission from Geraldine Carter

Please find attached a submission from me in relation to the ACCC's Inquiry regarding Telstra's special access undertaking.

This is a submission from me as an extremely concerned private citizen as I am concerned that the current proposed agreements reached between NBN, Telstra and Optus will result in consumers (and in particular my four young children) having to pay a much higher price for telecommunications services in the near future as a result of its anti competitive anti-consumer nature.

I am concerned that the ACCC is even contemplating accepting the migration plans when they are so clearly anti-consumer and anti-competition.

Why the ACCC should block the anti-consumer and anti-competitive Telstra and Optus migration plans

Summary
At a broad level, the ACCC must consider the national interest in structural reform of the industry, and the effect of structural reform on competition and consumers.

The Telstra migration plan involves Telstra being paid a large sum of money, $5 billion in direct bribes and a further $7 billionn in other access fees, to shut down its fixed network and to not compete against NBN. Telstra is also required under the plan per force to shunt consumers onto NBN independent of whether consumers actually want or desire the service. Telstra will forcibly disconnect consumers from its own service, without choice, even if consumers want to stay on the Telstra service.

The Optus migration plan also involves the same anti-competitive agreement to shut down the HFC network and force consumers onto NBN independent of their own desires and preferences. In the Optus case, the bribe payments by NBN for not competing are 3 times greater per customer at $1,600 per head.

It is estimated that consumers will be at a minimum of between $10 billion to $25 billion worse off if the ACCC approves the Telstra and Optus migration plans as a result of:

- higher prices for telecommunications services;
- reduced competition at both the wholesale and retail level between fixed networks;
- reduced choice for consumers; and
- over-capitalisation of the fixed network.

Consumers may be up to $40 billion worse off from the ACCC allowing migration plans to proceed, depending on consumer demand for NBN services.

The migration plans violate all the statutory criteria the ACCC is required to consider: they are anti-structural reform, anti-consumer, and anti-competitive. The ACCC must therefore block the Telstra and Optus migration plans to promote the welfare of consumers and competition.

The Telstra and Optus migration plan is anti-structural reform:

Clearly, the Telstra and Optus migration plans are anti-structural reform. If the migration plans are blocked, there will be 3 competing wholesale fixed networks: The Telstra copper network, the Optus HFC cable, and NBN – a highly competitive outcome. If the migrations plans are allowed, there will only be 1 monopoly regulated network, the NBN — a very anti-competitive outcome.

A market structure with 3 competing networks is clearly preferable to a market structure with a single regulated monopoly network.

The outcome is even worse for consumers where that monopoly network is over-capitalised, as is likely the case with NBN. In that instance, consumers are charged up to $40 billion more for services than necessary. The only consumer antidote to this over-capitalisation, is allowing current in situ networks to vigorously compete against NBN.

Competition will be greater in both upstream and downstream markets if the Telstra and Optus migration plans are blocked:

Downstream competition will be greater if there are 3 competing networks. The networks will each need to compete for the business of resellers, so wholesale prices will be lower and quality will be better. Resellers will have the choice of 3 networks and can play them off against each other to get lower access charges, rather than being forced onto 1 regulated network and required to accept the regulated price set by the ACCC.

Consumers better off if migration plans are blocked:

Consumer prices will be lower if the migration plans are blocked. Under the NBN monopoly outcome, the price will be set by the ACCC at average cost, or possibly a bit lower, and this sets a price floor (absent demand-side constraints discussed below). Under the competitive outcome with 3 networks open and competing, the ACCC price for NBN access sets a price ceiling.

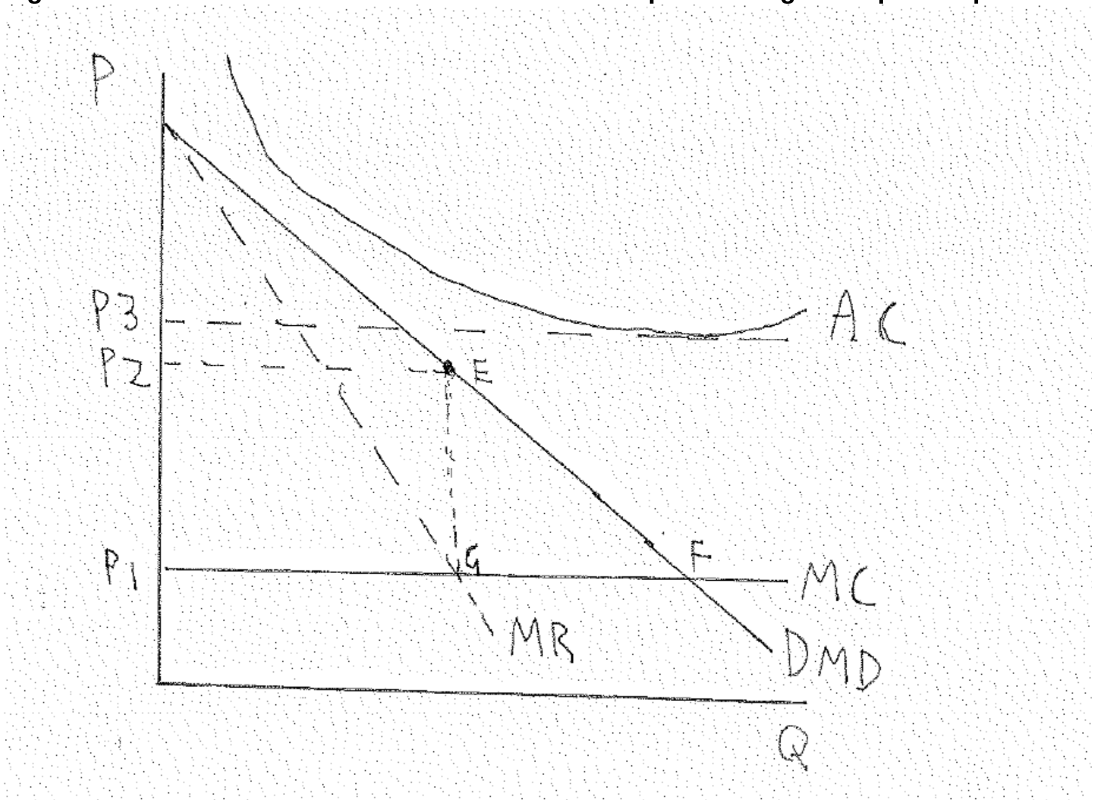
The networks will compete for customers and drop the price lower and lower, down to marginal cost, if price competition is vigorous *Bertrand competition*. As prices are driven down from average cost towards marginal cost by competition, consumer welfare is increased, and prices are more allocatively efficient: it is an efficient solution for a natural monopoly to have price set at marginal cost.

The situation is described and analysed in Figure 1. The average cost of the NBN network is shown by the curve AC. If the ACCC sets a TSLRIC price for the NBN wholesale network, which is the ACCC's current articulated price methodology, then, in the absence of a demand constraint, the market price would be set at P3. If the NBN costs $40 billion to rollout, then the area described by P3 to the AC curve and vertically down to the marginal cost curve (MC) collects $40 billion of revenue. Most of this $40 billion of revenue is inefficiency caused by the over-capitalisation of NBN and overcharging of consumers.

The NBN is unlikely to be commercial as no private sector operator has voluntarily decided to build an NBN. Therefore the Demand Curve for NBN services (DMD in Figure 1) is likely to lie anywhere below the average cost curve (AC).

Therefore, because NBN is demand constrained, to maximise profits, the NBN will likely voluntarily set prices at P2, which is slightly below the P3 regulated price.

Figure 1: Consumer welfare loss from the anti-competitive migration plan to proceed



Now consider the outcome with competition when the ACCC blocks the migration plans.

The marginal cost of serving subscribers on the Optus, Telstra and NBN networks is described by the curve MC. In practice, each network is likely to have similar marginal costs of servicing subscribers. It matters little for the analysis even if MC of serving subscribers differs somewhat between the networks.

In essence, with competition, price will be driven down from P2 to as low as P1. The welfare gain to consumers is area (P1,P2,E,F). Competition does its job increasing consumer welfare and protecting consumers from the over-capitalised NBN.

In summary, the ACCC regulated price P3 or the demand constrained profit maximising price P2, sets a <u>lower limit</u> on prices under the NBN monopoly outcome. However, if the migrations plans are blocked, these prices become an <u>upper bound limit</u>, with the MC price P1 being the lower bound price under competition. Prices must therefore necessarily be lower if the migration plans are blocked, and consumer welfare must be higher.

NBN losses from competition is good for consumers and society

NBN will suffer higher financial losses than under the anti-competitive monopoly outcome. **But** it can be shown it is far more efficient to fund such losses out of general tax revenue, than via a "narrow based" mark up on telecommunications services via regulated monopoly. The welfare loss increases by the square of the "mark-up". Suppose telecommunications services represent 5 per cent of the total production capacity of the Australian economy. Then a 1 point mark-up on all goods and services to fund the $40 billion NBN will cause 1/400th of the welfare loss of a 20 point mark-up on telecommunications services to fund NBN.

In other words, the welfare loss (E,G,F) is reduced to 1/400th or to 0.25 per cent of the size in Figure 1 by the ACCC blocking the anti-competitive migration plan. It is analogous to the economics underling the efficiency of having a lower rate broader based tax compared to a higher rate narrow based tax to raise a given level of revenue.

So lower profitability for the telcommunications networks via the outcome where the 3 networks compete and set price close to marginal cost is a good result for consumers and society.

Production costs will be no higher if the migration plan is blocked, and will, in fact, be lower

Two of the networks, Optus and Telstra, have already been sunk, and the 3rd network, NBN, is to be built regardless of the migration plans. So we will have 3 networks regardless. The question is whether we continue to use 2 of the 3 networks that have already been sunk; that is efficient use of existing infrastructure. We are **NOT** starting from a Greenfield with no networks and deciding whether to build 1 or 3 telecommunications networks, which is then a very different question.

The trench and duct sharing arrangement between Telstra and NBN can and will still occur, where it is efficient to do so, even if the ACCC blocks the migration plans. Where trench and duct sharing is the cheapest method for NBN to build its network, Telstra and NBN will have economically correct incentives to negotiate this sharing arrangement – to reduce total production costs, which is a win for everyone. In this respect, the ACCC decision on the migration plan should ultimately have no bearing on Telstra-NBN trench and duct sharing.

Production costs may, in fact, be considerably lower if the migration plan is blocked because NBN can save on building lead in devices and final drops to those customers who definitely **do not want and have no interest in NBN**. Thereby, there will be a saving in total costs by using existing infrastructure and not needlessly duplicating existing infrastructure in areas where there is no consumer benefit from NBN.

In addition, blocking the migration plans allows for greater dynamic efficiencies and competition efficiencies in reducing the marginal cost of serving subscribers.

For example, it may be the case that the marginal cost of maintaining the Optus HFC is lower than the higher capital intensive underground trenching solution of NBN – which over time will require considerable incurred expenses from repairing trenches. However, if the ACCC allows the migration plan, then the more efficient production method (or lower marginal cost solution) will be prevented from occurring and or being discovered.

Three networks competing to lower their marginal costs of serving consumers is a great benefit for consumers and for society. Having 1 network with no economic incentive to lower marginal costs is a bad outcome for consumers and for society by discouraging innovation.

Telstra's expert Grant Samuels has found consumers are at least $10 billion worse off. Consumers are between $10 billion to $25 billion worse off.
The Independent Expert's report by Grant Samuel calculates Telstra is $5 billion better off by not competing against NBN, and instead shutting down its network and taking a big payment from NBN to not compete. The report assumes NBN and Telstra would share customers evenly between them (50 per cent each) under a competitive scenario. Therefore NBN is likely to also be about $5 billion better off from not competing against Telstra — assuming an efficient and fair bargaining outcome between NBN and Telstra has occurred.

The $10 billion gain comes at the expense of consumers from the higher prices that occur from the non-compete scenario. So the Grant Samuel report directly shows the transfer of consumer surplus to producer surplus via the NBN –Telstra deal to establish a wholesale network monopoly, the rectangle and triangle of consumer loss from going from the competitive to the monopoly outcome. This transfer of surplus is described by the area (P1, P2,E,F) in Figure 1.

$10 billion is a likely to be a lower bound estimate of the welfare loss to consumers. To force Telstra to the negotiating table, because NBN competing against Telstra was such a ridiculous threat, the Government also had to threaten to ban Telstra from gaining access to future mobile spectrum and to divest its interest in Foxtel. The loss of access to future mobile spectrum would have cost Telstra upwards of $15 billion in present value, with no offsetting welfare gains to any consumers.

So Telstra, in negotiating the NBN outcome, would have also had to take into account the $15 billion loss from not gaining access to mobile spectrum.

Assuming equal bargaining power and an equal division of the spoils between Telstra versus NBN and the Government, the likely final outcome from anti-competitive migration plan was:

1. NBN $20 billion better off by not competing with Telstra and being able to charge P2 instead of a price approaching P1;

2. Telstra $20 bn better off, ($5 bn by not competing against NBN and instead getting a big payment, and $15 bn from gaining access to future mobile spectrum).

The loss of consumer surplus from the anti-competitive migration plans (P1,P2,E,F) is then greater than the gain of producer surplus of $25 billion (P1,P2,E,G) = $20 billion for NBN and $5 bn for Telstra.

Investment bankers the big winners if migration plan is allowed:
On Friday 2 September 2011 the Australian Financial Review StreetTalk say investment bankers stand to make $87 million in fees if the ACCC approves the anticompetitive migration plan.

The investment banks have generated the fees from constructing an anti-competitive outcome that gauges consumers with higher prices and does not provide them with any choice by having a single network and increasing the profitability of both Telstra and NBN versus the competitive outcome. $87 million is the investment banks' cut from constructing the higher profit, higher priced, anti consumer, anti competitive outcome.

Overcapitalisation: ACCC must protect consumers against it
NBN is an overcapitalised solution. The ACCC using TSLRIC will set prices at average cost, which will gauge consumers for up to $40 billion extra of money for something where there is no evidence they necessarily want or need. The ACCC regulated price, or demand, will set a price floor.

The major difference between NBN and the current Telstra network is NBN can supply 100 mbs data access, whereas the Telstra network generally supplies speeds of less than 20 mbs in most areas.

Optus offers high speed 100 mbs broadband access for consumers, with very low take-up. To date, it is estimated that less than 50,000 people have subscribed to the Optus high speed network that covers a population serving area of 3 million people. So take-up is less than 2 per cent of total available people who could subscribe, or 4 per cent of households.

When NBN was first rolled-out in Tasmania, less than 10 per cent of people decided to voluntarily connect to it. Similarly and startling low take-up rates have occurred in other NBN test areas, showing people in general do not want or have a need for the higher speeds offered by NBN. And, in particular, they are unlikely to want to pay much, if any, extra for it. For example, when NBN was rolled out in Brunswick to 2000 homes, only 7 people connected to the service.

The newly appointed Chairman of the ACCC, Rod Simms, says he wants consumers protected against gold plating in gas and electric utilities. The NBN raises exactly the same issue. The only way this protection can occur against the NBN is by forcing it to compete against the less capital intensive networks.

NBN is not a market efficient solution but a government mandated one; it is likely to be over-capitalised. The best constraint against over-capitalisation is competition, not regulation. For example, suppose NBN costs $40 billion and has been technically efficiently built. If NBN put in an undertaking recovering $30 billion of this or up to $40 billion it would mean very large price rises for consumers. It would be very difficult for the ACCC to reject such an undertaking if the undertaking did no more than recover NBN's direct costs of roll-out.

But it is very bad for telecommunications consumers because it forces them to pay $30 billion or $40 billion for something they may not want. In the extreme, if there was no demand for higher speed NBN services, and the ACCC allowed TSLRIC pricing for NBN, consumers would be $40 billion worse off by paying $40 billion extra for telecommunications services that they value at zero.

The current take-up of Optus high speed NBN, at 4 per cent, suggests, the welfare losses from NBN are likely to be up to $38 billion if the migrations plans are not blocked.

Again, the best protection against over-capitalisation and higher-regulated prices is having the Telstra and Optus networks as a choice, so people can take the less expensive, less capital intensive service if they want.

Vertical separation of Telstra is not an end goal. Consumer welfare is the end goal.

Vertical separation is a means to overcoming bottleneck power so downstream competition is on a level playing field.

Once NBN is rolled out in an area, the bottleneck is overcome, because competitors can re-sell over the NBN and no longer rely on the Telstra network for access. Therefore the vertical separation of Telstra is not relevant to downstream competition benefits once NBN is rolled out, because competitors will get access to the NBN on the same terms whether the Telstra network remains or not. Indeed, competitors are likely to get access to NBN on better terms if the Telstra and Optus network remains because NBN will be forced by competition to lower its wholesale prices below the regulated price in response to competition from Telstra as discussed above.

This example is already a reality. When NBN was rolled out in Tasmania, it started by giving wholesale customers free access to the network to get them to shift away from Telstra to NBN. These type of incentive plans would continue and flourish if the migrations plans are blocked.

Consumers necessarily better-off with more choice even if Telstra remains vertically integrated and competes against NBN

Consider 2 scenarios:

1. Where NBN is rolled out, and competitors all resell over it and there is no competition because the Optus and Telstra networks are shut down (NBN Prices are regulated by the ACCC); or
2. Where NBN is rolled out, competitors all resell over it, and Telstra remains a vertically integrated entity that competes against NBN.

Now if consumers choose Telstra in this scenario 2, they are, by definition better off because they are choosing something they prefer to NBN. In addition, NBN wholesale prices under scenario 1 and 2 would either be exactly the same (the regulated ACCC price), or lower under scenario 2 – because NBN is forced to compete against Telstra.

Therefore the NBN service is either the same or better under scenario 2 versus scenario 1. In summary, consumers are definitely better off under Scenario 2 because: if they choose the Telstra service they are getting a better service than under NBN, and NBN will be required to be at least as good or a better service to consumers under scenario 2 via ACCC regulation or as a response to Telstra competition.

In summary, a situation where there is only NBN must necessarily be worse for consumers than a situation where NBN competes against a vertically integrated Telstra and customers voluntarily choose the Telstra service.

NBN will be rolled out regardless of the migration plans

NBN will be rolled out at the same speed whether the ACCC allows or blocks the migration plans. NBN is being rolled out via Government mandate and decisions, not because of the commercial returns it makes. Therefore the NBN financial viability is irrelevant to the speed at which it will be rolled out which is determined by Government direction. So blocking the migration plan should in no way slow down the NBN roll-out plan or increase NBN roll-out costs.

Blocking the migration plan allows for deregulation
If the Telstra migration plan is blocked, the ACCC can potentially de-regulate significant areas of telecommunications. If NBN is rolled out in Melbourne, Sydney and Brisbane, you will then have 3 competing fixed networks: Telstra fixed, Optus HFC and NBN. The ACCC can then get out of the game of regulating fixed networks in these areas where you have 3 competing networks. If instead the ACCC allows Telstra and Optus to shut down their networks, then the ACCC will need regulate NBN wholesale prices for 20 years or more.

Optus network is included in the shutdown to maximise the anti-competitive outcome, the rent sharing between Telstra-NBN and Optus, and the consumer welfare loss
NBN is paying Telstra $5 billion to transfer 10 million subscribers per force onto the NBN network, or about $500 per subscriber. NBN is paying Optus $800 million to transfer 500,000 subscribers to the NBN, or $1,600 per subscriber. So NBN is paying over 3 times more per subscriber to shutdown the Optus network in addition to the Telstra network?

Why?

Because the anti-competitive gains to producers will only come from the complete suppression of competition. If the Optus network is still allowed to run, NBN will be constrained by competition and may have to set price close to P1 in Figure 1. Therefore, the producer surplus gains of up to (P1,P2,E,F) would not be available for NBN to then rent share with Optus and Telstra by paying $12 billion in total to Telstra, and $800 m to Optus.

The gains to NBN, Telstra and Optus exponentially grow from the suppression of competition from 3 to 2 and then to 1 network. So Optus would be able to demand 3 times more per subscriber, or a proportionally greater share of the producer rents, because suppressing its network is the key to monopolisation and maximising the anti-competitive, anti-consumer outcome. Without Optus on board, vigorous competition between Optus and NBN may have extinguished a substantial portion of the gains the insidious cartel agreement between Telstra and NBN.

In addition, fixed networks are competitive substitutes for mobile networks. So as NBN raises prices from P1 to P2 the demand curve for mobile services shifts outwards (an increase in demand) making all the mobile networks more profitable. So the anti-competitive, anti consumer outcome is good for NBN, Optus, Telstra and Vodafone.

So, diabolically for consumers, Telstra and NBN have made their anti-competitive agreement conditional on the ACCC also shutting down the Optus HFC network — to maximise the rent sharing for the fixed and mobile networks and correspondingly decrease the welfare of consumers.

No credible economist supports the migration plan

World leading economists have been asked about the welfare effects on consumers of the Telstra migration plan. Unanimously leading economists, such as Professor Jerry Hausman, have concluded the migration plan is anti-competitive and will cause large losses of consumer welfare and competition.

So far, no reputable economist anywhere in the world has publicly concluded the migration plan is good for consumers.

Rural consumers will be the big winners if the migration plans are blocked

If the migration plans are allowed, NBN will first focus on servicing the lower cost, most profitable urban areas, such as capital cities and CBD areas.

By contrast, if the migration plans are blocked, NBN will have much better incentives to service areas where Telstra and Optus may withdraw because of the higher cost of serving customers – rural areas. NBN would not roll-out first in Brisbane, Melbourne and Sydney if the migration plans are blocked because it will add very little over what the existing networks, including the Optus 100 mbs service, already provide. So NBN would better target higher cost rural areas first if the ACCC blocks the migration plans.

Furphy arguments about the migration plans

Arguments sometimes raised are: NBN will not be viable unless the Telstra network is shutdown.
Answer: NBN viability is irrelevant to consumer welfare, and indeed if it is non-viable then competition and choice is the best protection of consumer welfare. For example, if 50 per cent of people choose the Telstra network, so NBN only gets ½ the economies of scale and makes big losses, then clearly these 50 per cent of people choosing a non NBN network are better off than if they were denied the choice of the Telstra or Optus fixed networks.

Indeed, the more hopelessly NBN performs against Telstra and Optus, the higher the welfare gains to consumers from the ACCC blocking the migration plans, and allowing consumers the freedom to choose either the Telstra or Optus service.

The other argument supposedly in favour of the migration plan is the benefits from having a natural monopoly: it is better to have a single network than 3 networks.
Answer, Telstra and Optus networks are basically sunk, and NBN is being rolled out anyway. So you will have incurred 3 sets of production costs, 2 already incurred, no matter what the ACCC does. The more important question is what is the efficient use of existing infrastructure? It is not efficient to simply shut down the existing networks and waste the infrastructure rather than allow them to continuing providing competitive benefits to consumers.

Appendix 1:

In preparing this submission, the following criteria the ACCC must consider has been addressed:

(6) In deciding whether to accept an undertaking under this section, the ACCC must have regard to:

(a) the matters set out in an instrument in force under subsection (7); and

(aa) the national interest in structural reform of the telecommunications industry; and

(ab) the impact of that structural reform on:

(i) consumers; and

(ii) competition in telecommunications markets; and

(b) such other matters (if any) as the ACCC considers relevant.