

# Submission to the ACCC on “Telstra – Structural Separation Undertaking and Draft Migration Plan”

Joshua Gans and Jerry Hausman

13<sup>th</sup> September 2011

This is a submission to the ACCC’s investigation of Telstra’s Structural Separation Undertaking (SSU) and draft migration plan. While we both reside outside of Australia, we were motivated to provide a submission because of our long history and experience of working on telecommunications and competition policy issues there. At present, and in recent years, we have not consulted or acted on behalf of any telecommunications provider in Australia.

We examine two aspects of the SSU noting that we believe it is within the scope of competition policy for firms to engage in vertical and other separation activities as the usual presumption is that these will not have adverse anti-competitive effects. Thus, we do not oppose the principle of Telstra restructuring itself to meet new competitive challenges and to ensure continued access to government access rights.

The aspects we examine are the additional elements to the SSU regarding Telstra’s repositioning of its HFC network and its competitive position in wireless broadband. In each case, we believe that the proposals are both wholly anticompetitive in this context and, if accepted, would set an extraordinarily poor precedent for the operation of competition policy and efforts to subvert anticompetitive behaviour in Australia.

## **HFC Broadband Network**

The structural separation undertaking requires Telstra to disconnect its copper network and to remove the broadband capability of its HFC network. It will also be prohibited from supplying some fixed line services. Optus have reached a similar agreement with NBN Co. with regard to their HFC network.

The stated goal of this provision is to make NBN Co. (a government-owned entity operating as a business) the monopoly wholesale provider of fixed line services in Australia; at least with respect to existing incumbents in that industry. Specifically, they are designed to prevent the two largest incumbents from competing upstream against NBN Co in the future.

The consequence of this provision will be strongly anti-competitive. First, competition from independent cable providers has been a critical source of investment in broadband in the US and elsewhere; resulting in improved quality, higher penetration and lower prices for consumers.<sup>1</sup> The proposed agreement

---

<sup>1</sup> See Jan Bouckaert, Theon van Dijk and Frank Verboven (2008). [Regulation and broadband penetration – What is required to regain speed in Belgium?](#)

would eliminate that source of competition as it would prevent Telstra's HFC cable being used for broadband services.<sup>2</sup> In order for such competition to re-emerge, another independent HFC network would have to be constructed. However, it is safe to say, that experience and economic common sense rule that out as a possibility.

Second, on its face, this is an agreement to restrict competition. Two potential competitors in broadband services are agreeing for one of them to exit the wholesale broadband market. Not only that, the exit is coming from the company that is currently the largest and most experienced provider of such services. There is no evidence to suggest it is a failing firm or similar justifications for early coordinated exit. Instead, it is viable and experience elsewhere demonstrates that cable providers are significant competitors against fibre providers of broadband.

These anti-competitive consequences are not accompanied by any mitigating circumstances that may make this provision in the public interest. This requirement is not necessary for Telstra to achieve or want to pursue structural separation. Indeed, for Telstra, acting unilaterally, this agreement reduces its ongoing profits and would require compensation today. Put simply, there is no advantage to Telstra from being restricted in its competitive actions aside from conditional transfer payments (that are themselves welfare neutral).

In addition, there are claims that if Telstra were a strong competitor, NBN Co would not invest in its own network to the same extent. Again, there is no supporting evidence for this. The presumption and evidence thus far is that competition spurs investment in these industries – even when characterised by a natural monopoly. It can be that such a situation does not arise when only a few investors have access to funds necessary for large infrastructure capital expenditures but, in this case, Telstra has such funds (and its network is already deployed and its costs sunk) while NBN Co has committed public capital. So the conditions for strong infrastructure-based competition are in place. This is the logic the ACCC has applied in competition matters for almost two decades.

It may also be claimed that strong competition would only emerge in areas of denser population and so the NBN Co's hopes of subsidising rural roll-outs through urban margins would be threatened. However, we must point out that a cross-subsidy does not equate to a free subsidy. Urban consumers will pay regardless. It is not the role of competition policy to facilitate cross subsidies. Competition policy should promote competition and if governments wish to promote another goal (say, economic provision of broadband services in rural areas) they should finance that policy in another and more transparent manner. Microeconomic reform had moved us away from this type of inefficient financing of government objectives. This proposal would move Australia back. In any case,

---

Denni, M. and H. Gruber, 2005, [The diffusion of broadband telecommunications: the role of competition](#), working paper

Wallsten, S., 2006, [Broadband and unbundling regulations in OECD countries](#), AEI Brookings Joint Center for Regulatory Studies, Working Paper 06-16.

<sup>2</sup> Telstra does not use its HFC for fixed line telephony and we expect this will continue.

our point here is that enforcing competition policy principles will not preclude government policy from being enacted and financed.

Finally, NBN Co may be concerned that its wholesale customers have a conflict in dealing with it when they have a separate broadband business. In this case, we note that the appropriate, competitive solution would be for Telstra to divest itself for its HFC network to an independent firm (perhaps FOXTEL) and for that firm to independently use the network to supply broadband services and fixed line telephone services.<sup>3</sup> This would solve any conflict issues NBN Co may have given Telstra's retail power while allowing wholesale provision to remain competitive, perhaps more so than if Telstra is a retailer across both networks.<sup>4</sup>

One final remark. We note that the agreement between NBN Co and Telstra is contingent on the agreement between NBN Co and Optus regarding Optus's HFC cable. In other words, one bilateral agreement is requiring another agreement with Telstra's closest competitor to exit a market. This is as close to as anticompetitive a clause as one could imagine.

### **Wireless services**

For 20 years, Telstra will not promote wireless services as a substitute for fibre. Telstra has a penalty (no disconnection fee) if a consumer chooses to use a wireless service. The mobile industry is beginning to adopt the next 4G technology, LTE (Long Term Evolution). Telstra has announced they began selling LTE modems at the end of August 2011. Verizon has been providing LTE service in the US for the past ten months and current data speeds are reported to be 17.2 Mbps which is approximately 14 times faster than AT&T's HSPA+ network. However, LTE networks are expected to improve greatly in the future. A recent report for Ofcom, the UK telecommunications regulator, states that by 2017 LTE is expected to have a peak speed of 328 Mbps and by 2020 a peak speed of 2940 Mbps.<sup>5</sup>

Note that within the next 5 years, LTE speeds will surpass the current highest speed download rate of 50Mbps offered by Verizon's FTTP FIOS network in the US.<sup>6</sup> Within 10 years the speeds on LTE will be another factor of 10 higher.

Given these download speeds, LTE will likely provide significant competition to fixed broadband, even for the more speed intensive consumer applications such as streaming of sports events. As tablets become more prevalent, we expect many consumers to prefer to watch broadband content on tablets or other devices which permit mobility both within a residence, e.g. in the back yard, and within Australia.

---

<sup>3</sup> Cable companies now provide approximate 1/3 of fixed line telephone service in the US. In some section of the US, e.g. Long Island, the cable company now provides more fixed telephone service than the Bell Operating Company (Verizon). See FCC "Trends in Telephone Service", September 2010.

<sup>4</sup> We proposed this type of separation in 2006, "[T3 must ring in rule changes](#)," *Australian Financial Review*, 8th August, 2006, p.55.

<sup>5</sup> Report for Ofcom, "4G Capacity Gains", 27 January 2011, p. 25.

<sup>6</sup> Current maximum cable download speeds in the US are less than 50 Mbps.

Competition in telecommunications has arisen largely by the introduction of new technologies, e.g. mobile telephone and cable fixed line telephone. Regulation has a much smaller effect on creating competition. Here, however, permitting this agreement will be anti-competitive because it will not allow Telstra, the largest mobile provider in Australia now and likely into the future, to compete with the NBN. We understand that an agreement imposing similar restrictions on Optus is in place. NBN Co argue that both are reasonable because wired and wireless broadband are complementary. There is, however, no evidence for that and, indeed, an effective wireless service allows consumers to substitute away from wired services; putting pressures on those providers to keep prices low and quality high.<sup>7</sup> We can conceive of no greater anti-competitive action than the largest mobile service provider agreeing not to compete against the monopoly fixed line provider. The result will be less innovation, higher prices, and less choice for Australian consumers.

In addition, some dispute that wireless technologies can compete effectively with a full fibre network and that this set of agreements will 'future proof' Australia. Consumer preferences regarding portability suggest otherwise. Instead, the likely consequence of these proposed agreements is to future proof NBN Co against competition.

Our conclusion is that the "Telstra – Structural Separation Undertaking and Draft Migration Plan" is likely to be massively anti-competitive. While it may suit the needs of the Government, Telstra, and others, it will lead to significant consumer harm lasting for 20 years or more. No one at the bargaining table appears to have represented consumer interests. We ask the ACCC to step in, in its role as the independent regulator on competition, to protect consumer (and national efficiency) interests against a return to monopoly network provision in telecommunications in Australia.

---

<sup>7</sup> A recent US government survey found that 29.7% of US households no longer subscribe to wired service, but instead they depend entirely on wireless service. Given that a disproportionate number of wireless only respondents are young, people, we expect this percentage to grow in the future. See S. Blumberg and J. Luke, "Wireless Substitution: Early Release of Estimates from the National Interview Health Survey, July-December 2010", CDC, June 8, 2011

## About the authors

Professor **Joshua Gans** holds the Skoll Chair in Innovation and Entrepreneurship at the Rotman School of Management at the University of Toronto. Previously, he was a professor at the University of Melbourne. In 2007, Professor Gans was awarded the Economic Society of Australia's Young Economist Award for the best economist under the age of 40. Professor Gans has conducted extensive research into competition policy and regulation including a chapter on Wireless Communications in the recent volume, *Handbook of Telecommunication Economics* and ongoing analysis of broadband developments in Australia. He founded and manages the economic consultancy, Core Research.

Professor **Jerry Hausman** is the John and Jennie S. MacDonald Professor at MIT, where he has been on the faculty since 1973. He has been Director of the MIT Telecommunications Economics Research Program since 1988 where he teaches a course, "Competition in Telecommunications" each year. Professor Hausman has received the John Bates Clark Medal from the American Economic Association as the best economist under the age of 40 and the Frisch Medal from the Econometric Society. He also received the Biennial Medal of the Modeling and Simulation Society of Australia and New Zealand. Professor Hausman has done research in econometrics, public finance, applied microeconomics and regulation. He wrote the chapter on Mobile Telecommunications in the volume, *Handbook of Telecommunication Economics (2002)*. He also wrote the chapter on Regulation for the *International Handbook of Telecommunications (2003)*. Professor Hausman has recently published papers on broadband economics issues, the effects of unbundling in the US and other countries, use of broadband in mobile, and the future direction of telecommunications regulation. He has written numerous other academic papers on topics in telecommunications economics and regulation.