

 	<p><b>Australian Telecommunications Users Group</b></p> <p><b><i>2008 Annual Conference</i></b></p> <p><b>Graeme Samuel, Chairman</b></p> <p><b>13 March 2008, Sydney</b></p>
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## **Introduction**

The telecommunications sector is moving inexorably towards the next major challenges of what has already been a substantial evolution.

This week has already been marked by Minister Conroy's announcement of the Panel of Experts to assess proposals to build a National Broadband Network. This is the next step in what promises to be an eventful and challenging process, and the ACCC obviously has a key role to play, providing advice on pricing and competition issues, and delivering a report to the Panel.

But as the new Government prepares its plans for a National Broadband Network, the industry continues to go about its business, albeit with each player in the market keeping at least one eye to what the policy means to them. Likewise, the Australian Competition and Consumer Commission (the ACCC) is continuing to go about its business.

Competition continues to drive investment, either through the upgrade of existing wireless networks to 3G – where infrastructure competition exists – or in the continuing installation of DSLAMS in exchanges, where over the past year the number of unbundled loops has roughly doubled, despite the overhang of a change in technology that could strand these investments.

The dynamics of competition will continue to play a key role in the delivery of services to consumers and businesses over the next five years, as a national broadband network is gradually built out.

The global debate on next generation access (or NGA) is underway right now. Almost every month sees new discourse and developments in Australia and overseas. Regulators everywhere are working towards clarity on pricing, service specification and migration processes, all critical issues in the move to NGA. These regulatory debates are also clearly focussed on how to maintain competition during and after this transition.

## **Benefits of competition in Australian telecommunications**

It's not hard to find indicators of the benefits of competition in our telecommunications industry. In terms of the variety of products, choice of providers and prices, consumers are better off now than they have ever been. Clear examples of how competition is delivering tangible benefits to consumers may be seen in relation to:

- the mobiles sector
- the availability of high speed broadband; and even
- proposals for a next generation access network.

### ***Developments in 3G networks***

Despite claims by some parties that reductions in termination prices threaten infrastructure investment, there has been significant, ongoing investment in the mobiles sector over the last few years.

It was Hutchison who initially applied competitive pressure to other mobile network operators by being the first to construct a 3G network in Australia. Telstra, Optus and Vodafone then followed suit and established their own 3G networks. Now all four mobile network operators are actively investing in 3G mobile broadband technology.

With Telstra's 'Next G' rollout, Telstra claims terrestrial mobile broadband is now available to 99 per cent of the population. Telstra CEO, Sol Trujillo, also recently announced further investment to increase Next G network speeds – that's network speeds, not handsets - to up to 21 Mbps this year and 42 Mbps in 2009.

Optus and Vodafone are also investing to extend both the speed and the reach of their respective 3G networks, which they each claim will reach around 95 per cent of the population by the end of the year. Hutchison is also further investing to improve available speeds on its network, which is confined to the capital cities.

It is no coincidence that these developments have taken place within a market structure comprising four competing mobile carriers, supported by access regulation for bottlenecks such as sites, towers, transmission and terminating access, that allows these carriers to enter the market and compete.

### ***Availability of high speed broadband services***

The continued expansion of broadband services is another good case in point.

Increased competition in the provision of broadband services has seen progressively lower broadband prices, increased data caps, better speeds and new innovation and products (such as naked DSL). This increased competition in broadband by other ISPs and carriers owes a significant debt to being able to obtain access to Telstra's copper loop.

Competitors have this access through the declaration of the unconditioned local loop service (ULLS) and the line sharing service (LSS). In this regard, the ACCC's approach to access is firmly in line with that of most overseas regulators. Services such as the ULLS and LSS are regulated in most countries. Indeed the ACCC is even more light-handed in its approach. Many of these countries also regulate wholesale DSL services, whereas the ACCC has never done so. The main exception to this standard is the USA, where, according to the OECD, independent cable networks have about 52 percent

of broadband subscribers – obviously this provides vigorous inter-modal competition.

Nonetheless, in Australia, access to Telstra's copper via the ULLS and LSS has fostered substantial investment in competing infrastructure. At last count, there were 19 broadband providers using their own DSLAM equipment in local exchanges to access the copper lines and provide broadband services. It is these competitors who were the first to offer significantly faster broadband services – ADSL2+ – and Telstra has reacted to this competitive pressure by increasing the quality of its own services.

In February this year, Telstra finally announced it would be flicking the switch on its ADSL2+ network. A full 20 months after I first called on them to do so.

The ACCC welcomes Telstra's decision to expand ADSL2+ to a further 2.4 million homes. Telstra has blamed the delay in rolling out services beyond the footprint of its competitors on a lack of regulatory certainty regarding the ACCC's likely approach to regulating DSL services. However, as Minister Conroy observed at the time of Telstra's announcement, the ACCC had made a number of consistent public statements relating to the regulation of wholesale access to ADSL services.

He concluded that there is a high degree of regulatory certainty in relation to the ACCC's approach to wholesale ADSL2+ services, and advised Telstra accordingly.

### ***ACCC approach to access pricing***

On the subject of blame, I should point out that the ACCC also rejects the tired and erroneous claims by Telstra that the ACCC somehow sets prices "below cost". After its latest loss in the courts of appeal, this time to the highest court in the land, Telstra managed to find – somewhere in the High Court's 18 page, 7-0 judgement against it - evidence that the ACCC was setting prices "below cost".

The Trade Practices Act basically prohibits this – in setting prices the ACCC must always have regard to the direct costs of providing access, and the legitimate business interests of the access provider.

Furthermore, the ACCC has been conservative in its approach to pricing. The actual prices the ACCC has set for the ULLS in Band 2 areas started at \$12.30 in 2005-06, and have risen to \$14.30 in 2007-08 – a rise of over 16 percent, reflecting both an increase in Telstra's network costs over that period and a recovery of the service-specific IT costs.

We have allowed the use of Telstra's own cost model, even one criticised by the Australian Competition Tribunal. Telstra itself has conceded its PIEII model was 'excessively flawed' and that Telstra 'does not have clean hands' on the issue of model transparency. The ACCC's approach has been vindicated by the courts.

Yet even as Telstra complains that it cannot recover its 'actual costs', it has itself consistently proposed prices based on 'forward-looking' cost models. Perhaps the best evidence that this forward-looking approach suits Telstra is

that its latest cost model, the so-called TEA model' – is based on this principle.

Since Telstra announced this new model on December 21, the ACCC has already received three versions from Telstra, and the undertaking which it supports has already been withdrawn once, and re-submitted on a virtually unchanged basis.

The key point is that the ACCC has long recognised the more enduring benefits of efficient investment, whether that be in conjunction with unbundling or via continued technological evolution of the PSTN. As I mentioned earlier, it was the DSLAM investments by Telstra's competitors which instigated the step up in broadband services to ADSL2+.

One of the areas we are currently focussed on is ensuring there are minimal impediments to firms being able to make investments in broadband infrastructure. To do that we need to get a good handle on the issues. For example, the cost of backhaul has been flagged as a possible impediment to access seekers providing competitive DSL services in rural areas. Furthermore, it seems effective access to this service will only become more important as next generation access networks are rolled out. Given backhaul is already regulated, the ACCC is currently developing a domestic transmission cost model, on which industry comment was sought last year, and which we hope to release shortly.

Other issues are also on the radar. For example, there may be real physical impediments that mean competitors cannot be provided access to an exchange or group of exchanges, such that they cannot install DSLAMs to access the ULLS or LSS. If so, perhaps there is little the regulator can do.

Alternatively, there may be what I call 'artificial' constraints – where there are claimed impediments to competitors accessing the ULLS and LSS, but this isn't actually the case. In these cases, there may be regulatory remedies that could be pursued.

The ACCC is well aware of industry concerns and is currently working with parties to try and obtain the relevant facts to determine if impediments are real or artificial. If the ACCC has the appropriate evidence to establish that there may be competition issues, the ACCC will consider what action to take and what are the best tools to deal with these impediments.

In this context I should observe that, contrary to the impression created in some recent reports, the ACCC is not shelving the use of competition notices. Competition notices remain a valuable enforcement tool for the ACCC. But there are a couple of points I should make. A competition notice investigation is similar to a complex investigation under section 46 of the Trade Practices Act, but is also made public. A competition notice exposes the recipient of the notice to potential penalties and damages action from third parties. It gives them an opportunity to change their conduct. .

However, the Competition notice process can be complex – and we should never forget that the process depends on the ACCC being able to adduce

sufficient evidence to demonstrate to the Federal Court that there has been a breach of the Competition Rule by the recipient.

The ACCC has a number of regulatory options available to it. These include enforcing compliance with either the anti-competitive conduct provisions of Part XIB, or access obligations under Part XIC, as well as measures such as record-keeping rules, which can increase transparency and thereby increase investment certainty.

The ACCC also sees real benefits in industry processes both aiding this transparency, and addressing some other issues that might arise. Ensuring seamless processes behind the scenes – for example, in interconnection, or allowing customers to switch providers with ease - is an important element to ensuring end-users receive the level of service one would expect in a modern, technology driven sector.

### ***Improvements in next generation network proposals***

A final hint of the benefits of competitive tension is the improved specifications of next generation access network proposals since 2005.

In 2005, Telstra first mooted a proposal for an ADSL2+ fibre-to-the-node (FTTN) network. The initial proposal promised 'super-fast broadband speeds' of 12 Mbps on the back of an ADSL2+ FTTN network upgrade. Subsequently, the 'G9' developed a proposal which also offered an ADSL2+ network but with greater speeds of up to 24 Mbps.

Telstra argued against the G9 proposal, in part on the grounds that 'ADSL2+ is barely today's technology, let alone tomorrow's'. At this point, Telstra said it intended to roll out a VDSL2 network, which could potentially offer broadband speeds to households of up to 50 Mbps - and the G9 has since indicated it will follow suit.

Perhaps competition has pushed both groups to continually improve their proposals. I look forward to seeing the next stage of this process as the Government progresses towards a decision on a National Broadband Network.

This dynamic is also playing out in France, where competition from newer entrants providing fibre to the home is spurring the incumbent France Telecom towards planning fibre all the way to the home.

### **Future competition**

As in the examples I've just discussed, competition will be essential to delivering benefits to telecommunications users in the future.

There are a variety of government processes that may impact substantially on the suite of regulated services currently available. The ACCC does not have views on what the "best" broadband network would be – that is a matter for industry and Government. Clearly there will be challenges in relation to implementing any upgrades to the existing network, and just as clearly, industry players, regulators and Governments are wrestling with this all over

the world, not just here in Australia. Access, service specification, appropriate pricing and ensuring a smooth migration from current ULLS and LSS services are key issues.

The Government has clearly stated, and Telstra and the G9 have both acknowledged, that a new network must be open access. Parties are going into this with eyes wide open, and know that other carriers will access their network to provide competing broadband services. As such, pricing for access will be of critical importance. There is no point having a super fast network at inflated prices, particularly where consumers already have a range of competing services and various pricing options available to them.

The ACCC's views on pricing are pretty well known. Most recently, we have published how pricing on a new network might be approached in our draft decision on the special access undertaking provided by the G9.

The ACCC has always said that the party willing to undertake the risk of significant, new investment should be appropriately rewarded, and that the costs of efficient new investments should be recognised.

However, the technical specification of the future access service (or services) is also important. The ACCC believes an access service should be specified at as low a layer in the network as possible. That is, the closer the service is specified to the actual physical infrastructure, the greater the ability of carriers to control their own costs and supply chain, differentiate service offerings, innovate and improve service quality. All these factors mean more scope for effective competition in the final provision of high speed broadband services to consumers.

The actual migration of voice and broadband services to an upgraded network presents technical and operational challenges. The rollout of fibre will be a staggered process. There may be a need for the ULLS and LSS to be available for an appropriate period of time following the initial rollout to ensure the transition can be as smooth as possible.

A smooth migration will require the cooperation of access seekers, the successful network provider and Telstra. These matters would be the subject of separate public consultation. In this time of flux, it's important all parties contribute actively to the debate about reasonable standards and conditions.

The Government's Panel of Experts will also no doubt be confronted by issues around the underlying industry structure. In that context, I'd like to take a moment to speak briefly about operational or functional separation.

Increasingly, vertically integrated telecommunications firms around the world are showing a willingness to implement substantive functional separation. This is perhaps in recognition of concerns regarding the incentives for anti-competitive discrimination against their downstream competitors.

The UK started down this road in 2005, but in more recent times there have been major steps taken elsewhere in Europe, as well as across the Tasman. In Italy, Telecom Italia announced about a month ago the separation of its access network from the remainder of the business. In New Zealand the Government, with Telecom New Zealand's co-operation, has introduced laws requiring TNZ to go down a similar path. More broadly, the European

Commission last year formally recommended that regulators consider requiring operators with significant market power to consider functional separation as a remedy. That said, the EC's comments came with the important caveat that functional separation was most relevant "particularly where non-discrimination behaviour cannot be ensured by other remedies".

Here, we have more recently heard calls from some parties that the new Government should open up structural issues for debate. And the new Government has already expressed a desire to review the operational separation regime currently applying to Telstra.

The ACCC's views on these matters are already on the record. I should clarify that the ACCC has not said that "only a structurally separated ownership arrangement would represent a sustainable public policy outcome" as some have suggested. We have said that "a vertically separated ownership model could reduce incentives for the access provider to discriminate between downstream users of the access service and, therefore, facilitate strong and effective competition between access seekers in retail markets."

But we have also previously recognised that mandated structural separation would come with some costs. Such considerations have informed the development of functional separation models around the world.

When the Australian regime was being established, I gave evidence to the Senate regarding what the ACCC believed a successful operational separation regime should encompass. This included 5 key principles:

- (1) there should be precise details and obligations of the operational separation plan;
- (2) the scope of the services to be covered should be clear;
- (3) there should be an enforcement regime to ensure effective compliance;
- (4) there should be a clear explanation of the ACCC's powers to investigate compliance; and
- (5) internal wholesale pricing should be developed.

The issue of structural or operational separation is a matter of policy for Government. But so long as policy is directed towards an operational separation model, these principles are not a bad start to an effective operational separation regime. The ACCC will provide to Government, at an appropriate point in time, its views on the current operational separation regime based on its experience to date.

## **Other issues**

In the meantime at the ACCC, it's business as usual.

The ACCC is progressing the arbitration of a large number of access disputes, and as of last week has a new ULLS undertaking from Telstra before it, which again submits a \$30 access price for the ULLS in Band 2.

The ACCC is also currently assessing 12 applications lodged by Telstra seeking to exempt various services from the standard access obligations, and has just received a significant amount of data from carriers as part of the infrastructure audit.

Unfortunately, the current work program is subject to a litigious overlay. Taking into account the recent High Court matter, the ACCC is currently involved in 47 legal actions initiated by Telstra. This impressive list includes:

- 1 appeal to the Full Federal court;
- 12 ADJR actions in the Federal court on ULLS and LSS arbitration determinations;
- 1 Federal court ADJR action regarding administration of retail price controls; and
- 33 applications to the Administrative Appeals Tribunal for review of ACCC decisions on Freedom of Information requests.

The ACCC fully respects the rights of parties to seek review of ACCC decisions; however, this level of activity does make one wonder what is motivating it all.

Before finishing, there is one further issue I would like to raise, particularly relevant when addressing the national telecommunications users group. The issue of which the ACCC has become aware is the inclusion of certain 'right of last refusal' clauses in telecommunications supply contracts with large corporate customers.

There are several variants of these kinds of clauses, but broadly they forbid corporate customers from taking services from anyone other than their current or recent telecommunications supplier, unless that supplier's offer is less advantageous than any other offer made.

Although these types of clauses may seem attractive to large corporate customers, and beneficial in the short term, such clauses – if widely used – are not necessarily in their long term interests. For example, they may deter other service providers from bidding for large corporate contracts. This may then affect the price and quality of service customers can obtain over the longer term.

Consequently, there are cases of these types of clauses being deemed illegal in overseas jurisdictions, including the EU.

I therefore recommend that large firms carefully consider their position before signing contracts containing such clauses.

## **Conclusion**

This promises to be another fascinating year for the telecommunications sector. A major new policy, along with flourishing investment in 3G, DSLAMs and other broadband technologies, suggest little slowing down in what has already been a rapidly changing environment.



The ACCC itself has many challenges ahead. In meeting these, we will continue to exercise the utmost rigour in our declaration and exemption decisions, in assessing undertakings, arbitrating disputes, and investigating allegations of anti-competitive conduct.

In all this activity, the ACCC's interest is not to protect individual competitors or outdated technologies, but to promote the competitive process for the long-term interests of end-users. And I hope that the benefits for those end-users continue to improve.

Thank you.