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Competition: Easy to talk about, Hard to deliver

Introduction

The National Broadband Network is critical to our industry, so that will be the focus of my speech today.

The Government is poised to carry out open heart surgery on the Australian broadband market.

That surgery can deliver huge benefits, but only if it establishes a strong competitive market.

Without strong competition, the new broadband network will fail to meet the high expectations that Australians have of it.

My message today can be summed up in a simple phrase:

Australia cannot take Competition in Broadband for granted.

As the leading competitive telco, Optus has clear views about how the broadband market structure must change to ensure

effective competition – regardless of who is chosen to build the new NBN network.

In saying Australia cannot take competition in Broadband for granted I have four key supporting points:

First, I will show that the right market structure is fundamental to delivering effective competition and the best outcomes for customers.

To illustrate this point, I will compare the highly competitive mobile sector against the Telstra-dominated broadband sector.

I will show that wherever the market structure means that competition is weak and Telstra is dominant, Telstra takes advantage of that market structure to charge eye-watering prices.

Throughout my talk I will also show you evidence that Telstra's statements about regulatory and policy issues are frequently misleading and self-serving and demonstrate a serious disregard for the national interest.

The second point I will make is that structural separation is the right solution for Australia – a fact supported by the experience of other countries and other industries in Australia.

Thirdly I will show that cancelling the OPEL network was a missed opportunity to correct Telstra's dominance in rural broadband and to set up an open access network that would have facilitated competitive bids for the NBN. The cancellation leaves Telstra with a huge monopoly infrastructure advantage in bidding for NBN – which must raise questions as to the reason for the cancellation.

Lastly, I will comment on the Government's NBN process.

I will highlight the safeguards Optus will require in order to lodge a bid.

But just as important, I will call for tough, clear measures to ensure any new network owner cannot exploit its dominance.

Optus is the largest competitive investor in Australian Telecommunications. Five billion dollars in five years – a billion dollars annually.

With the right ground rules for the process, and for the market that will emerge from the process, Optus stands ready to make a major investment to deliver NBN – and in turn help Australia create a sustainably competitive and innovative market.

A Tale of Two Markets

Let me start with the first point: that the right market structure is fundamental to delivering effective competition and the best outcomes for customers.

I will show this by comparing a competitive market – mobile – and a much less competitive market – broadband.

The fierce competition between mobile operators has delivered powerful benefits to consumers.

There has been sharp price competition, particularly in the form of mobile capped plans over the last few years.

In a recent report, the ACCC reported a ten year pattern of falling mobile prices, and stated that ‘competitive tension between the four mobile network operators generates a better competitive outcome than that in fixed services.’¹

Mobile competition has also delivered ferocious and continued innovation: from SMS and MMS messaging services, to third generation mobile networks, and now enhanced data services such as HSPA.

At Optus, we are spending \$500 million right now to increase our mobile broadband footprint: by the end of this year our entire 3G

¹ ACCC, ‘ACCC Telecommunications Reports 2005-2006, Report 1, Telecommunications Competitive Safeguards for 2005-2006’, p 11

network, will serve 96 per cent of the population and will carry HSPA.

In the early nineties the Government got the market structure right in mobile, allocating licences for the new GSM technology to three players at the same time.

Once that key decision was taken, the market powered ahead, and competition delivered substantial benefits to consumers. With the right market structure, there was little need for prescriptive regulation.

This is where I'll insert my first exhibit of evidence showing Telstra's lack of honesty on regulatory issues – and their disregard for the national interest.

In 2004 the ACCC took a decision to drive down mobile termination rates.

This forced Telstra's smaller and less profitable competitors, Optus and Vodafone, to hand money to Telstra – which is over \$450 million better off as a result!²

Telstra's leaders have systematically criticised the ACCC and called it one sided, yet they never mention how richly Telstra has benefited from this policy.

The ACCC's policy of forcing down mobile termination rates was supposed to deliver lower retail prices for fixed to mobile calls. Indeed Telstra supported that argument in its submissions to the ACCC arguing for these rates to be cut.

Let me quote from Telstra's August 2007 submission:

“Consumers benefit from reduced [mobile termination] rates in a variety of ways, including... reduced fixed-to-mobile prices...”³

But as the slide shows, Telstra has used its market power, over two thirds market share in residential fixed voice, to keep prices high - whilst pocketing the savings from the lower wholesale prices we have been forced to give it.

That is the first of several examples I will give of Telstra's behaviour when market structure favours it.

But returning to my overall theme; despite this anomaly the mobile market overall is a good example of a competitive market created by good Government policy that got the market structure right from day one.

Let's look at a very different market structure: Broadband.

² Optus internal estimate

³ 'Submission in response to the ACCC's Discussion Paper on the Draft MTAS Pricing Principles Determination for the period 1 July 2007 to 31 December 2008' Telstra Corporation, August 2007

Let's not pretend that Australia will ever be able to support multiple fixed line networks.

Telstra enjoyed an effective monopoly in consumer DSL for the first half of this decade, and exploited it.

It kept prices high – only dropping them in 2004 when Optus and competitors entered the market.⁴

Telstra imposed a 'one size fits all' approach, capping consumer DSL speeds at 1.5 Mbps.⁵

In a 2006 survey by respected industry consultants Spectrum, Telstra offered the lowest broadband speeds – but despite this, charged the third highest prices – in a sample of incumbent telcos in 15 countries.

This is again evidence that Telstra exploits the market structure and charges very high prices when it is not subject to effective competition.

When the next generation of ADSL2+ came along, Telstra again suppressed take-up. It delayed the introduction of ADSL2+ and

⁴ 'New Telstra Bigpond plans to stimulate greater demand for internet access', Telstra Media Release, 22 January 2002 and 'Bigpond Broadband at dial-up prices', Telstra Media Release, 15 February 2004

⁵ 'Bigpond Broadband at dial-up prices', Telstra Media Release, 15 February 2004

kept the majority of its exchanges on older, slower technology until early this year.⁶

Interestingly, this is the same Telstra whose senior executives routinely fulminate about the ‘broadband drought’ in Australia – a drought they were largely responsible for creating.

Another good example that what Telstra says about regulation is often inaccurate or incomplete.

Telstra’s DSL monopoly began to break down in 2006 when Optus and others entered the market, installing our own electronic equipment in exchanges, and leasing the copper wire from the exchange to customers’ homes. This is called ‘unbundling’ and we were able to do this because the ACCC mandated it.

Optus has made a substantial investment, installing equipment in 338 exchanges around the country so far, and in connecting our fibre to those exchanges. Today we have over 250,000 customers taking ‘unbundled’ services.⁷

This is because we have a highly attractive customer proposition. We offered ADSL2+ from start up in early 2006 – at a time when Telstra only offered first generation ADSL.

⁶ ‘More high-speed broadband after Government removes roadblock’, Telstra Media Release, 5 February 2008 and ‘Telstra keeps ADSL2+ under wraps’ Renai LeMay, ZDnet Australia, 25 August 2006

We have also offered breakthrough pricing, such as a flat \$79 for unlimited local and long distance calls plus broadband with 2 gig of download.⁸

Thanks in large part to unbundling, around 800,000 broadband services are now delivered over the infrastructure of Telstra's competitors, and the numbers are growing strongly. In selected areas competition is bringing more choices and lower prices – and broadband take up is jumping as a result.⁹

Of course, Telstra has fought bitterly at every step of the way. For example, just as competition started to bite, Telstra proposed an effective by pass strategy with its original FTTN plan.

I have listed on the slide some of the actions Telstra has taken.

In fact, the ACCC has recently noted that it is involved in 47 legal actions initiated by Telstra.¹⁰

This is part of a consistent pattern of behaviour by Telstra. Let me show another example of their actions to delay and frustrate competition in this market.

⁷ SingTel Optus Management Discussion & Analysis Q3 07/08 Financial Results ended 31 December 2007 p47

⁸ optus.com.au (broadband plan pricing)

⁹ 'Australian Broadband market in 2007' Asia Pacific Equity Research Document, Laurent Horrut, J.P Morgan Research, , 17 March 2008

¹⁰ 'ACCC piles on the pressure in forcing Telstra to keep broadband affordable', Matt O'Sullivan, The Age, 14 March 2008

The next slide shows something called a ‘main distribution frame’, or MDF, in an apartment block.

Telstra deliberately sought to frustrate the effects of unbundled competition for people who live in apartments.

It claimed it was only required to lease Optus a line from the exchange to the MDF – not to hand over the existing phone line to the customer’s apartment. So, before Optus could connect a customer, we had to install a new line from the MDF to the customer’s apartment.

As a result, when Optus notified Telstra of a customer switching to us, Telstra cut off the customer’s phone line very promptly on the appointed day. They committed to send a technician out to “tag” a line in the MDF; and then Optus had to send a technician out to make a connection from the tagged line – adding to our costs as well as inconveniencing the customer – who had to wait around all day.

Not surprisingly, many of the Telstra technicians failed to show up at the appointed time – indeed the appointed day. When they did turn up, eventually, the tagging often looked like what you see on the slide! In the meantime, the customer had no phone service

and promptly blamed us. As a result of this, Optus stopped selling services to apartment blocks.

Of course, when Telstra was connecting a new customer in the apartment block, it was allowed to use the existing phone line.

The ACCC, I am pleased to say, has ruled that Telstra is wrong, and it must provide us with the complete line. But sorting this out has taken about eighteen months – and produced enormous customer inconvenience and lost sales along the way.¹¹

Let me give you another example of Telstra's bitter resistance to competition. In March '08 they claimed that there was no room for competitors to install more DSL equipment at 76 exchanges nationally¹² – many of these exchanges are where demand is highest and competitor racks are full. On investigation, many competitor carriers have raised strong concerns about the truthfulness of this claim.

Now I am not here to criticise Telstra for the sake of it. But by now a pattern of behaviour should be becoming clear to you: a huge corporation with enormous market power and control of bottleneck infrastructure will inevitably exploit that power unless proactive steps are taken to change the market structure.

¹¹ 'ACCC Final Determination – Access Dispute between Optus Networks Pty Ltd and Telstra', ACCC Dispute Notice, 21 September 2006

And indeed the fixed telecoms market has an anti competitive market structure – the bottleneck infrastructure is owned by one player who uses that ownership to constrain competition.

Right now the Government is making policy for the new broadband world: it would be naïve to think it can expect Telstra to cooperate in encouraging competition if Telstra controls the new infrastructure. That is why the Government must build in structural features to limit Telstra's market power.

At the very least, whoever operates the new NBN network must be independent of any of the retail players competing in the market.

Structural Separation is the Right Solution

My third point is that the precedent for this action exists – and it has been successfully enacted.

In other countries – and other industries – there has been action to address the structural power of the incumbent.

In Britain, Ofcom recently mandated a tough separation regime for British Telecom –over fifteen years after BT was privatised.¹³

¹² TEBA: Capped sites for Telstra Equipment Building Access (TEBA) – March 2008

¹³ 'Ofcom accepts undertakings from Board of BT Group plc on operational separation', Ofcom Media Release, 22 September 2005

In New Zealand, the Government has imposed separation on Telecom New Zealand – recognising that its dominance was holding back the growth of a healthy broadband market.¹⁴

In Singapore, which is building a new national broadband network under a public-private process, the Government has insisted on different parties owning the physical network layer, the network control layer, and the retail layer.¹⁵

These are various forms of ‘structural separation’.

Governments have recognised that next generation broadband networks, by their very design, give the network operator even greater power than under today’s networks.

The same principle has been applied in other markets such as electricity. When the State Governments privatised their electricity operations, they first structurally separated them, by dividing them into different companies in generation, transmission and distribution.¹⁶

When the Labor opposition announced its broadband policy last year, Optus and the G9 welcomed the commitments Labor made to structural reform of the broadband market.

¹⁴ ‘Telecom split a credit to Minister’ Editorial, Dominion Post, 1 April 2008

¹⁵ Next Gen NBN presentation, IDA Singapore, 7 April 2008

We welcomed the commitment to a Government equity investment in a new national broadband network – thus ensuring it is a different legal entity to any reseller of services over the network.¹⁷

We welcomed the commitment to a genuinely competitive process to assess proposals from the private sector.

We welcomed the commitment to ensure open access.¹⁸

But recent developments are giving us increasing concern that the fine words of opposition are being lost under the heavy burden of Government and in the face of a seductive though anti-competitive pitch from Telstra.

The OPEL Decision

Let me highlight a major reason why we are concerned: the recent decision by the Government to cancel its contract with OPEL, the Optus-Elders joint venture to provide broadband services to rural and remote Australia.

This decision was wrong for many reasons.

¹⁶ “Review of National Competition Policy Reforms” Productivity Commission Inquiry Report, 28 February Report p22

¹⁷ Senator Conroy speech to National Press Club, 21 March 2007, page 29

¹⁸ Senator Conroy speech to National Press Club, 21 March 2007, page 28

Broadband Connect would have laid the foundation for real competition - in some of the most difficult parts of the country for competition to be delivered.

It was wrong for the Minister to cancel this contract after having stated in public on at least eight occasions, both as Minister and previously as Opposition Spokesman, that in Government he would honour the contract with OPEL.¹⁹

It increased investor perceptions of sovereign risk in Australia.

It was based on a fundamentally flawed database of premises which did not receive metropolitan-equivalent broadband services; a database which the Department of Communications refused to reconcile with OPEL's data even when we highlighted its flaws.

The Government has not formally responded to our call for a full public inquiry into how the Department assessed the coverage to be delivered under our contract.²⁰

But there will be other places to air these matters, and I am confident that Optus' position will be fully vindicated.

¹⁹ Various media references.

²⁰ 'Futuris-Optus contract scrapped Alliance hit for \$24m', Meredith Booth and Fleur Leyden, Adelaide Advertiser, 3 April 2004 and 'Press conference with Stephen Conroy, Minister for Broadband, Communications and the Digital Economy' Transcript, 2 April 2008 p4

For today - nobody should be in any doubt about what has happened here.

The Government made a political decision not to proceed with the OPEL contract. Optus again confirms publicly that it was ready to deliver the coverage we contracted to deliver.

Today, I want to concentrate on the consequence of that decision in policy terms.

The termination of the OPEL contract is a lost opportunity to boost broadband competition in Australia.

We responded to a Government program specifically designed to encourage private sector players to build new, competitive broadband infrastructure in rural and remote Australia.

OPEL committed to serve almost 900,000 premises which had not previously received metropolitan equivalent broadband services.

We committed to build thousands of kilometres of new, competitive fibre backhaul.²²

The entire network was an open access network. OPEL was required to sell wholesale services over its entire network to any

²² 'Optus and Elders to build rural and regional broadband network' Media release, 18 June 2007

interested operator, under a pricing structure determined by the Government in advance.

The OPEL network would have kick started the fibre-to-the-node process, because it could have been folded in to the national broadband network. Without it, Telstra has a huge cost advantage by being the bottleneck infrastructure provider in regional areas.

OPEL was chosen in an open, competitive process – in which Telstra participated and was beaten fair and square.

After Telstra lost, it mounted an aggressive campaign for the Government to terminate the OPEL contract – because it wanted to head off the threat of competitive entry in regional markets and to create a huge advantage for itself in FTTN.

The capitulation of Government, in the face of this pressure, does not augur well for the national broadband network process being genuinely contestable.

The Fibre to the Node Process

Which brings me, finally, to make some comments about that NBN process.

The Government is putting enormous faith in fibre to the node. Having cancelled OPEL, and with the new fibre rollout likely to

destroy unbundling, everything depends on how effective competition will be in the new world they create.

Telstra has changed its rhetoric: from lambasting the regulator and demanding that government had no place interfering in “free” markets: to now embracing the arms of Big Government and welcoming the Minister’s new process for NBN.

Am I the only person who sees cause to worry? Perhaps everybody else thinks we can trust Telstra to reach a sensible agreement with the Government and behave responsibly if it is allowed to build own and operate the new NBN?

Well I’ve shown you already several examples of how Telstra reacts to a market structure where it has infrastructure dominance.

And remember that Telstra’s stated objective is to sharply increase its profits by boosting its EBITDA margin to 50 percent - from current levels of around 42%.²³

Indeed a well known senior executive stated late last year that it aims to be ‘a premium provider charging premium prices.’²⁴

²³ ‘Transcript of Speech by John Stanhope, Telstra Corp’ New Zealand Exchange Company Announcements, 7 March 2006, p7

²⁴ ‘Stand-off in Rudd telco plan’, Michael Sainsbury and Andrew Colley, The Australian, 4 December 2007

Let's look at another recent example of Telstra's behaviour when it has market dominance: look at the extortionate prices of broadband over the NextG network. For over 12 months Telstra had the only infrastructure for high speed wireless until Optus and Vodafone launched in December 2007.

Yet more evidence that when Telstra is not subject to competitive discipline, it will charge sky high prices.

Recently, that same spokesman said that if Telstra were to build a new national broadband network, it would require a return on investment of 18 per cent.²⁵

Last year, he disclosed that the incumbent's planned **wholesale** price for line rental plus entry level 512K broadband would be \$59.²⁶

So if you look at the slide, this means that people will pay more tomorrow for the same broadband services as they get today.

Yet in the face of these statements of intent, the Government's policy process on the RFP does not even include a formal price setting role for competition watchdog the ACCC.²⁷

²⁵ 'Telstra wants network return 'north of 18pc', Jennifer Hewitt, The Australian, 22 March 2008

²⁶ 'Telstra tries a fast one with 14-year offer', Terry McCrann, Herald Sun, 8 June 2007 also 'Telstra warns of G9 broadband price slug', Garry Barker, The Age, 8 June 2007

²⁷ Request for proposals to roll-out and operate a national broadband network for Australia, Sch 10.4 'Role of ACCC', Department of Broadband, Communications and the Digital Economy, 11 April 2008

If the new national broadband network is a repeat of Telstra controlling bottleneck infrastructure it will be a comprehensive policy failure – and Australian consumers will literally pay for this mistake.

Let me highlight three specific concerns that Optus has with the current policy process.

Firstly, there is no requirement for structural separation. That is, there is no prohibition on a vertically integrated company building and operating the FTTN and being a retailer in the market.²⁸

The G9 has been happy to commit to build under a structurally separated model, in which no retail telco will have a controlling stake in the entity which owns and operates the network.

In our view, this is an absolutely non-negotiable minimum condition.

The Government must impose it on all bidders including Telstra.

²⁸ Request for proposals to roll-out and operate a national broadband network for Australia, Sch 1.5.16 Department of Broadband, Communications and the Digital Economy, 11 April 2008

Secondly, there is no rigour about how wholesale access prices will be set. That is why we are so concerned that the new network will lead to higher prices if the incumbent is chosen.²⁹

The Government must mandate that wholesale prices for access to this new network are set or approved by the ACCC. Any other mechanism is an invitation to massive price increases.

Thirdly, the requirement that the Government be a co-owner of the network, which was a key feature of Labor's policy announcement in March last year³⁰, has now been diluted.

The Government now says that it is willing to provide its investment as debt.

It looks very much like a way of accommodating Telstra's stated position that it will not build the network as a joint venture with Government.

These issues are of concern to all who want to see a strong, competitive market in telecommunications in Australia.

And there is a key additional issue of critical importance to Optus as a prospective bidder in the RFP process.

²⁹ Request for proposals to roll-out and operate a national broadband network for Australia, Sch 1.4.3 'Wholesale pricing and non-price terms and conditions' p14 Department of Broadband, Communications and the Digital Economy, 11 April 2008

³⁰ March 2007, ALP's New Directions for Communications, Chapter 5,

I do want to emphasise that Optus remains ready and willing to participate – if we can get the right assurances from Government.

We are part of a very large group with a very strong balance sheet.

Optus stands ready to work with others, particularly within the G9 but also other parties interested in joining us.

And we stand ready to provide a compelling proposal which will dramatically improve Australia's broadband services.

But we can only do this if we are given a fair and reasonable chance to put in a serious and compelling bid.

The ridiculously short time allowed for the preparation of proposals raises real doubts about whether the Government is looking for serious bids from any player other than Telstra.

The Minister says that rival bidders will have access to Telstra's network information. But bids are due on 25 July and the Act to mandate the disclosure of information is not yet passed.³¹ What use is network information delivered a few days before the deadline for lodging a bid?

³¹ "The Senate has referred the Telecommunications Legislation Amendment (National Broadband Network) Bill 2008 to the Committee for inquiry and report by 7 May 2008."
http://www.aph.gov.au/Senate/committee/eca_ctte/nat_broadband_network/index.htm

As the Australian Financial Review noted in its editorial on Tuesday 22 April,

“There is no justification for the rush, apart from politics,”
“Singapore consulted for two years before issuing a detailed request for tenders for a single, subsidised, national fibre to the premises network provider; a single, subsidised, national wholesale switching provider...and unlimited retail competition on top.”³²

Talk about competition is easy. Action requires leadership and taking a stand.

Conclusion

In this talk I have shown you that:

- Market structure is a critical determinant of competition in telecoms
- When it has market dominance – especially when it controls infrastructure, Telstra reacts with high prices and blocks the intended effect of regulation designed to improve competition

³² Australian Financial Review, Editorial, 22 April 2008

- Structural separation is a key ingredient to ensure sustainable competition and innovation in high speed broadband
- The NBN process announced by the government is deficient and will not deliver a competitive market unless it is changed
- Optus and the G9 are ready and willing to invest to deliver a structurally separated broadband network under a fair and pro-competitive tender process.

And above all, I have shown you that Australia cannot take competition in Broadband for granted.

Let me conclude as I began – with the observation that the Government is proposing open heart surgery on the broadband market – aided by its clinical experts – the Department of Communications.

As the patient is wheeled into the operating theatre, there are reasons to be troubled.

It is true that drastic treatment is called for.

But if the Government does not correct for the right diagnosis,
then getting the job done quickly is not going to benefit anybody
except perhaps the incumbent.

- ENDS -