Speaking Notes

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Lessons from the South Atlantic

Last week I arrived back from travelling to the island of St Helena on the last Royal Mail Ship in the world operating a regular service. It was a lesson in the value of modern communications; for the first time in 25 years I was unable to use a mobile phone.

For those who don't know of St Helena, it's one of the most isolated communities on the planet, primarily known for being the place where the British sent Napoleon into his final exile.

There's no airport, so the ship is the only lifeline for the local population, apart from the internet. Unfortunately, the internet doesn't help much on St Helena as it depends on a very slow satellite link that would not be acceptable in Australia.

It takes a long time to download anything and with one service-provider there's little incentive for keen pricing or consistent service. Links regularly go down and locals speak of customer complaints being ignored for days.

Thirty minutes of Wi-fi at any one of the handful of hot spots in Jamestown, the island's capital, will cost you back six St Helena Pounds; roughly eleven dollars. Two hours will set you back around five times that.

Last November, they introduced free unlimited downloads after midnight, but late-night download speeds make a snail look fast. It's been reported that it takes three days to download a single episode of *Game of Thrones*. Clearly, they have a solution that will deter the most determined peer-to-peer pirate!

Australia has done OK, but we can do better

As well as being a lesson in the value of effective communications, it was also a good reminder of the benefits competition and a large telco market have brought in Australia. We sometimes forget that, and we shouldn't.

In the 2014 financial year, Australians each used around 2GB of data per month. By 2019, we expect Australians will each use around 10GB per month. That's a five-fold increase in five years.

Today 38 per cent of Australian households have four or more internet-connected devices. That is predicted to double by 2020.

What does Optus think of Vertigan and Harper?

Now is a good time to reflect on that as we've just received the recommendations of the Harper Review into Competition and the Vertigan Review. We're also on the cusp of the implementation of a new multi-technology NBN strategy.

There was a fair bit of instant commentary in response to the publication of the Harper and Vertigan recommendations. We at Optus avoided much of this, but not because we don't think either Review is important. They are, but it's a question of juggling public policy objectives.

Optus is on record expressing concern that political debate over the technological direction of the NBN has had unfortunate effect of relegating longer term issues, such as effective industry competition and a well-functioning telco market, to second order priorities at times.

So what is Optus' perspective of the recent reviews?

Much of the stridency of commentary about Vertigan, in particular, has been misplaced.

The dispassionate observer would have to conclude there was little chance a Federal Government was going to embrace such a suite of policy changes with brio.

That's not to say the recommendations are unworthy or entirely impractical, but there's only so much a government can juggle when it's of the scale of the NBN, especially a first term government.

It would also be a bit of leap into the dark to embrace such fundamental policy objectives without being more certain of the NBN being delivered and more certain of what it will deliver within the current communications policy framework.

No matter what one thinks about how it will be delivered, it has to be recognised the NBN has cemented some bi-partisan consensus.

There is support for two very important instruments to deliver consumer choice and the potential for more effective service-level competition. These are structural separation and ubiquitous national broadband infrastructure that is not controlled by the dominant incumbent.

As St Augustine said, "Lord make me pure, but not just yet".

We at Optus think more can be done, but we do agree that it is important to get the NBN built first and ensure its initial promise is realised.

In the long-run, there may not be as much to fear in the Vertigan recommendations as some suggest. They are, after all, an attempt to recover the public policy ground ceded during the original Cabinet debate about corporatising Telstra.

The corporatisation of Telstra left it as the dominant infrastructure owner as well as service provider. We've never got over this, whereas others have been more successful.

Australia's concentrated telco market

Australia has the most concentrated telecommunications market among comparable nations. Telstra dominates Australia's fixed-line voice and broadband, mobile and subscription TV markets.

The company has 50 per cent of the nation's combined mobile and fixed-line market. That's almost double the market share of the industry leaders in the US and UK.

But this isn't just about market share, it's also about market <u>power</u>. And market power can be used in several ways to reduce competition.

It can be used:

- to set infrastructure prices at anti-competitive levels
- to increase the barriers to entry and limit new competition
- to bundle products in ways its rivals cannot readily match, and
- to leverage market power across related vertical and horizontal markets.

The NBN reforms alone are not enough

The NBN and accompanying industry reforms should improve competition among fixed-line broadband service providers, but it will take time and there are risks.

There is a real danger that Telstra will carry over its market dominance into NBN services to extend its market power in mobile and other segments. By one estimation, Telstra could receive up to $98 billion in total from NBN Co for infrastructure leases and other payments.

Vertigan -Worthy Ambitions

In essence, Vertigan seeks to shift Australia's communications market to something closer to the American reality, where competition between cable operators and incumbent telcos has produced more effective consumer outcomes than we have enjoyed.

The response of Minister Turnbull and the Federal Government has been pragmatic, albeit Augustinian.

Structuring the NBN as Vertigan recommends might be too big and too uncertain a diversion at the moment. Nevertheless, we do have enough facts before us to give serious thought to the regulatory issues that both Vertigan and Harper canvass.

Both reviews place strong emphasis on constraining regulation where possible, on changing regulatory culture and adopting greater cross-industry, or economy-wide, principles where possible.

There is much to said for an evolution in the ACCC's role and considering a dedicated infrastructure regulator, while eschewing an industry-specific economic regulator.

The merits of a "Whole of Economy" approach

What distinguishes an imperfect market like the telecommunications market does not necessarily make it unique or make a compelling case for entrenching industry-specific regulation long-term.

We can all benefit from applying principles common to other industries with network infrastructure policy challenges. We at Optus, for example, have been pleased to see the ACCC apply lessons learned from challenges in regulating the NSW electricity sector when evaluating the NBN SAU.

Highly industry specific regulation carries high risk of being process and technology oriented, rather than outcome oriented. These are things to be avoided wherever possible.

The aim should always be to adopt wider, "Whole of Economy" principles grounded in technological neutrality; providing time limits or directed regulatory discretion where this cannot be done.

A Reform Agenda

Optus proposes a three fold reform agenda, that commences with a industry-specific initiatives grounded in economy-wide principles, but structured in ways that can rapidly evolve to a cross-sectoral regime:

a. *Revisit the Telstra structural separation arrangements to take into account the NBN's switch to a multi-technology network*

b. *Draw on what appears informing the Harper Review's commentary about change the cultural approach of regulators to mergers, particularly in industries with dominant incumbents, to take greater account of the realities of effective competition, and*

c. *Future-proof the regulatory regime to take into account the industry's convergence.*

The current regime is only a start

Australia's current regulatory regime was a good start, but we have to move on.

The industry has its own sections of the *Competition and Consumer Act 2010* that provide for fair access to essential fixed-line infrastructure such as Telstra's copper network. These provisions were amended recently to accommodate the reforms needed for the NBN.

These include:

- the structural separation of Telstra's fixed-line infrastructure and service divisions, and
- open and fair access to NBN infrastructure for all service providers.

They are, however, tightly focused on the fixed-line market and, on their own, inadequate to deal with the changes to the NBN and to the industry as a whole.

In essence, they are classical illustrations of how industry-specific regulation can lead to technological or process-oriented determinism.

Given the magnitude of NBN Co's payments to Telstra, it's no longer sufficient to focus policy debates and regulatory regimes solely on network access issues.

Enhancing structural separation

This is why Optus is proposing further reform initiatives, starting with structural separation applying to all RSPs, who may be underlying suppliers to the NBN.

Much of this can be achieved contractually, so we don't need enormous regulatory fiat. We are happy to practice what we preach: what is good for the goose is good for the gander.

We believe the current separation rules need to be reassessed following the NBN's switch to a multi-technology solution.

While Telstra has agreed to hand over its copper and cable networks to NBN Co, questions remain, such as: who will maintain those networks and integrate them with the NBN's fibre network?

Telstra is currently involved in fibre-to-the-node pilots for NBN Co. Is this a precursor to a greater construction role?

If Telstra is to have a broader role for the NBN, will the Telstra staff involved be adequately separated from the company's retail arm?

How will Telstra be able to leverage its NBN role and payments for, say, deploying mobile equipment and extending its infrastructure advantage further ?

Structural separation was established for a reason – to ensure there's genuine competition for consumers – so it's critical we get this right.

Merger rules

For our second initiative, we are suggesting a more flexible approach to mergers.

When assessing whether or not to approve mergers at present, there is a tendency to focus on nominal market concentration; the number of competitors.

This is fine for many sectors, but when there's one dominant player in a market, this approach can prevent competitors gaining sufficient size to compete effectively against the leader.

As Harper has noted, other factors, including international markets, can come into play. This is especially true in infrastructure-based industries where scale provides a critical advantage.

In these instances, we suggest a more pragmatic approach –with greater focus on the effectiveness of competition, not just the number of competitors.

Future-proofing the regulatory regime

Our third ideal goes further. It involves future-proofing the regulatory regime by giving the ACCC broader powers to regulate any company with significant market power.

This might be seen as "courageous" because the doctrinaire assumption is that it will lead to over-regulation and meddling. Therefore, I am advocating this to sow an intellectual seed rather than have high hopes initially.

While the Harper Review has taken an understandable stance of focussing on Section 46 of the current regime, there is no reason why at least some elements of the European approach shouldn't be considered.

Optus commissioned an in-depth study into the EU's SMP framework, and it found that the regime had led to more targeted regulation and actually resulted in the roll-back of unnecessary regulation.

For example, the EU candidate markets for regulation have been reduced from 18 to seven, with a proposed further reduction to four markets.

In addition, the EU's regulatory responses are subject to both review by the European Commission and to a right of appeal.

We have noted the Vertigan Review's concerns about the EU regime, but our study finds those concerns are over-stated.

The ACCC's only current remedy to maintain telecommunications competition is to mandate access to infrastructure and services, and set prices for that access.

This cannot address issues where infrastructure forms only a part of a company's market power, something that is increasingly likely to be the case after the NBN roll-out.

The ACCC itself has acknowledged its limitations in being able to address convergence issues and anti-competitive bundling – and its recommended legislative changes have never been made.

There is merit in considering seriously Australia adopting a framework similar to the European Union's regime, which focuses on operators with significant market power, or SMP.

Under an SMP regime, the regulator can implement a broader range of measures to deal with specific issues that might arise from abuse of that power.

In particular, the EU's regime allows regulators to act on significant market power pre-emptively, rather than after anti-competitive practices have damaged the industry. Regulation can be applied at the wholesale or retail level to protect competition.

However, regulation should be applied in a proportionate manner and in response to a specific problem; we do not propose regulation for regulation's sake.

Conclusion

These initiatives are critical. We all know how telecommunications – particularly cloud, mobile and social technologies – can transform the global economy.

To be competitive in the new global economy, Australian business needs to embrace these technologies. That requires affordable, state-of-the-art communications services.

By taking the initiatives that I've discussed today, we can take the road to greater competitiveness and higher growth.

Thank you.