

Submission in Response to the Minister's Invitation for Comments on Telecommunications Regulation

June 2008

Primus Telecom is a full service provider offering local, domestic and international telephony, data, ADSL, ADSL2+, web hosting, VPN's and mobile services. The company operates a five-city switched network with over 100 points of presence. Over the past 10 years Primus invested considerably in establishing itself as a sustainable and competitive participant in the Australian communications industry, having also installed its own DSLAM network across more than 260 service exchange areas.

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Introduction

Until now the story of telecommunications competition in Australia has been blighted by the failure of successive governments to take the necessary steps to ensure a truly open and competitive telecommunications industry. This failing has left Telstra with the ability to leverage its control over the customer access network to favour its own retail interests, at the expense of fostering a truly competitive industry.

Telstra has been able to perpetuate a position of dominance across all retail markets, despite the fact that other industry competitors are more innovative, more credible and generally offer better value propositions. How has Telstra managed to maintain this position? It is simply a consequence of being able to leverage ownership of the customer access network to impede and hamper the efforts of competitors. Competing service providers are critically dependent on fair and reasonable access to the customer access network, but Telstra has no incentive to encourage or foster competition, and has not committed to providing fair, reasonable or timely access to that network. It is a simple case of profit incentives urging Telstra to favour its retail arm at the expense of its wholesale arm.

Some of the conduct engaged in by Telstra has been quite explicit, for example defying access obligations and refusing industry participants access to exchanges so they cannot install their own broadband equipment. Other conduct has been a little more strategic, such as refusing to implement efficient migration processes, and the practice of routinely disputing ACCC pricing decisions to delay competitor rollout and unsettle competitive telecommunications investment.

The advent of a monopoly fibre optic customer access network will present a greater opportunity for the network operator to influence, or if it chooses, impede, the development of competition. The obvious and only solution is to remove the incentives for the network operator to engage in anticompetitive conduct. That solution is a structurally separated network operator. In the view of Primus, the consumer and national interest will only be served if the network operator has no incentives to favour a particular retail participant. Structural separation must accordingly be the first condition of deployment of the NBN.

Through the appointment of this Expert Panel the Government has demonstrated a desire for a well-informed, independent and robust recommendation that delivers the best outcome for the national interest. The decisions around the NBN could have lasting effects for 30, or even 50, years. This is clearly a once in a generation opportunity to put in place a framework that can deliver the real and perpetual benefits of competition to consumers throughout Australia. It can also serve to enable Australian entrepreneurs and businesses to genuinely compete in the global arena. For too long now Telstra has regulated the pace of competition and technological advances in Australia. In taking the industry forward Primus takes this opportunity to comment on the regulatory structure that must accompany the NBN. We trust the Expert Panel is willing to make the

independent and robust recommendations worthy of its stature, recommendations that will lead to NBN decisions that will stand the test of time, and unlock the real future benefits of competition for all Australians.

One chance to “Get it Right”

Much of the call for structural separation to date has centred around commercial decision-making in relation to the operation of the NBN. While that is appropriate, the Expert Panel must also remain cognisant that the initial design and architecture of the network is also critical to the potential for service competition. The network must be designed and constructed in a way that will facilitate future competition. Such an imperative will be absent from the mind of a network builder that has its own retail agenda. However this consideration must be paramount. Much of the technical explanation illuminating the design and construction strategies that could serve to ultimately hamper open competition is beyond the scope of this submission, however the clear way to counter these risks is to ensure structural separation as a condition of awarding the right to construct and deploy the network. This will ensure the network architecture is not closed to a truly competitive outcome.

It is a great tragedy of competition in the industry today that one of the major impediments to innovation is that industry participants are often dependent on Telstra making services or processes available to them before they can offer the type of services they want to make available to their retail customers. Unfortunately, Telstra has proved to have little appetite to engineer or make available new services or processes if they have the potential to challenge its retail market position. It's clear that high speed broadband and naked DSL would have arrived on the market much earlier if someone other than Telstra was in control of the network. The sad reality is that Telstra's control of the network and its specific retail profit agenda counter the incentives that should typically operate to drive the introduction of new and innovative wholesale and retail services. A network operator that had no retail profits to protect, and accordingly was indifferent to retail market shares, would naturally be more open to working with industry participants in developing new and innovative services. The Expert Panel should not overlook the impact the ownership structure could have on the evolution of communications products and services in the future. As stated above, for too long now Telstra has regulated the pace of competition and innovation.

It is clear to all industry participants that the current industry structure and regulatory framework will not be appropriate for a fibre optic customer access network, which of its nature can lend itself to greater risks of monopoly abuse than the current architecture. Relevantly, the current operational separation rules have proved a failure, with Senator Conroy even publicly condemning them as such. The Expert Panel must not overlook the non-price considerations which are key to fostering efficient competition and a workable interface between the network operator and the competitive industry. Non-price considerations that impede competitive activity have historically emerged on a regular basis, however to date Telstra has demonstrated a lack of genuine interest in improving the conditions for competition. This is understandable given its conflicting interest in

preserving retail market share and profits. The clear failing is however the inability of the current operational separation rules to address the inequalities and non-price considerations that have emerged. Unlike Telstra, a structurally separated operator of the customer access network will be indifferent as to which retail competitor has the relationship with the customer, and would not have any incentives to oppose fostering, for example, more efficient and relevant services, migration processes and provisioning rules.

In the view of Primus the Expert Panel must ensure that any NBN proposals received for consideration are based on a structurally separated foundation. This is the only way to ensure that decisions around the design and construction of the NBN, as well as its ongoing operation, are made to protect and advance the competitive outlook. This framework has been successfully introduced in the gas and electricity industries in Australia, and has also been implemented in relation to telecommunications infrastructure in overseas jurisdictions. Primus sees this current process as the one chance to get the structure right in the communications and broadband industry in Australia. Primus urges the Expert Panel to take this decision, for the good of competition, and for the good of consumer interests in Australia.

Evidence of Failure in the absence of structural separation

Experience to date has demonstrated many failings of the current industry structure. Primus takes this opportunity to briefly comment on some of these failings. In considering these examples in the wider context of regulatory improvements, Primus also suggests the Expert Panel consider whether these matters would necessarily present as issues if the network operator to date had been structurally separated. The view of Primus is that the industry would not have encountered many of these concerns if the customer access network had been operated under a structurally separated framework.

- **Access to exchanges**

Telstra's obstruction of access to public telephone exchanges has been well documented. Telstra has specifically set about impeding broadband competition through delaying and obstructing access seekers from installing broadband equipment (DSLAMS) in public exchanges.

The access regime mandates Telstra to give competitors access to public exchanges. It should be fairly straight forward and quick to install the necessary equipment, essentially a cabinet that contains electronics connected by cable to the MDF. However Telstra has imposed a cynical and convoluted access process that can mean delays of more than 2 years before an ISP such as Primus can install its own DSLAM equipment, and offer its own broadband service in an exchange service area.

More recently Telstra has also brazenly denied access to many exchanges stating that these were capped – purporting (as it turned out falsely) that there was no room for installing cabinets or for connecting broadband or voice equipment to the MDF. After some years of complaint and subsequent pressure from the ACCC, Telstra was recently forced to review that position and has now made access available to many previously “capped” exchanges. In reality ISP’s should have been able to install their own broadband equipment in some of these exchanges many years ago. This is a clear case where Telstra’s agenda in maintaining the status quo and obstructing competition has succeeded in delaying genuine broadband competition. In our view a structurally separated operator would have sought to encourage and expedite wholesale business, as it would not have had its own retail market considerations to take into account.

- **Obtaining access pricing**

The mechanism for obtaining access prices is lengthy and expensive, and subject to gaming by Telstra. The current arbitration regime involves each industry participant lodging an access dispute and waiting for the ACCC to process each of these disputes. The ACCC can have more than 40 access disputes on its books at any one time, which leads to a lengthy backlog and delay. As an example, to the knowledge of Primus no access seeker has ever reached genuine agreement with Telstra in relation to ULL pricing, a key wholesale service that Primus first acquired in 1999. In the last couple of months the ACCC has issued pricing determinations for access to the ULLS, however these are largely retrospective and expire in the coming week. This has effectively meant the whole industry is currently lodging another set of individual access disputes for pricing for coming years. This is only a short time after the ACCC had managed to conclude the previous disputes, which in some cases were notified 2 to 3 years ago. These are very legal and drawn out processes, each potentially costing in excess of a hundred thousand dollars. Each industry participant that requests fair and reasonable access to the ULL is forced by Telstra to fund its own dispute proceeding. This is naturally very wasteful for the industry in terms of financial cost and staff hours. The nature of these proceedings, and the fact that Telstra routinely rejects the authority of the ACCC and challenges many decisions in court as well, means the industry never has any certainty as to any price cycle until it is of historical significance only. This seriously complicates forward planning, and makes investment decisions very difficult and risky.

Objectionable and unconscionable dealings

It is fairly routine for Telstra to issue directions in respect to changes to processes or access practices without consultation, or in some cases, without sufficient advance notice. It is also standard practice for Telstra to impose terms in service contracts that would often be considered unconscionable or uncommercial.

These edicts can, more often than not, detrimentally impact on Primus customers, or the ability of Primus to win further customers. For example, one of the more recent notifications received by Primus concerned Telstra's intention to increase the length of time it takes to migrate certain new broadband customers, increasing it from 10 days, to 20 days. Clearly it is difficult to win customers if they could be without a service for up to 20 days in migrating to Primus. Another recent example involves threats that Telstra would limit the ability of Primus to conduct service qualification testing. This is an essential step to ensuring Primus is able to successfully migrate customers onto our own network. Further to this, despite industry demand for such a process over many years, Telstra, as yet, has not introduced an efficient LSS to ULLS migration process.

In the view of Primus a structurally separated network operator would have interests in working with industry on these matters. More specifically, Primus considers a structurally separated network operator would have incentives to work cooperatively with industry participants to improve operational procedures and churn processes.

Price squeezes and high speed broadband

Historically Telstra has been reluctant to make access available to wholesale broadband services. And when it has made access available it is generally on unjustifiable, and in some cases uncommercial, terms. This is counter to the incentives that would normally drive a wholesale business to profit maximise through expanding utilisation of its wholesale services.

As the Expert panel is no doubt aware, the ACCC has issued competition notices against Telstra in respect to price squeeze conduct concerning both broadband and line rental services. These competition notices identified anticompetitive conduct on the part of Telstra in offering its wholesale products at inflated charges, charges that would not permit ISP's such as Primus to compete in the market against Telstra's own retail offerings. It is very clear that such anticompetitive conduct would not occur if the network operator was structurally separated, and therefore had no competing retail market revenue to protect.

Recently Telstra has rolled out ADSL2+ services in more than 900 new exchanges as a consequence of Government concession, but Telstra refused to permit wholesale access to this high speed broadband service. Telstra has the largest ADSL2+ footprint in Australia. A structurally separated network owner in a similar position would clearly look to maximise revenue from the network and would offer that service to wholesale customers. Competition would be much stronger, and consumers would be significantly better off, if that ADSL2+ network was not in the hands of Telstra. Once again Telstra chose not to make a high speed broadband service available because it would impact detrimentally on its retail profitability. More recently there have been reports that Telstra will

make ADSL2+ available, but most industry commentators are agreed it will not be at commercially attractive, or even remotely reasonable, access pricing.

- **Information asymmetry**

Many industry participants are concerned that Telstra has an advantageous position in the retail market because of the competitor information available to its wholesale arm. The failure of operational separation gives no comfort to industry competitors that this information is appropriately protected from disclosure to Telstra's retail arm. It should be noted that this information would be very useful in targeting marketing activities. These concerns and risks would clearly not arise with an industry structure where the network operator did not have its own retail agenda, and therefore no conflicting interests.

The Key Regulatory Requirements for an NBN

In considering the failings of the current industry structure and regulatory framework, and in looking to how best capture the potential competition benefits from the deployment of a NBN, Primus considers the following key regulatory proposals must be put in place in connection with the deployment of the NBN.

- Rules enforcing the right structure in the industry - "structural separation"

Operational separation has failed. Under operational separation the people who run both wholesale and retail arms are appointed and are responsible to the same overarching management and board. In making decisions they know what is in the interests of their company and what is required of them to protect its interests, even at the expense of other competitors and consumers.

Structural separation, on the other hand, eliminates the incentives to engage in anticompetitive conduct. The interests of a structurally separated company are not aligned with the interests of any particular retailer, but with retailers and consumers generally. An independent network has a commercial interest in maximizing traffic on the network and therefore encouraging innovation in services.

- Rules mandating equivalent access terms, and prohibiting discrimination

To ensure a level playing field it should be mandated that the network operator must offer equivalent rights of access to all wholesale customers. While this is less of a concern with a structurally separated operator, there still remains potential for large retailers to unduly negotiate better terms. While these may at times be justified by efficiency arguments, in the absence of such justification they distort the efficiency of the retail offerings, perpetuating discrimination against smaller industry participants and new entrants.

- New processes for determining published reference tariffs and non-price terms and conditions for all network services

As noted above, the current process for obtaining access pricing is wasteful and inefficient, taking many years to resolve and requiring each access seeker to fund its own litigious and lengthy dispute. The process has also largely led to mainly retrospective pricing. Primus is of the view that as with the gas and electricity industries in Australia, the ACCC should be empowered to determine price and non-price terms of access before the relevant regulatory period commences, in the context of a single and open industry inquiry. This would provide access certainty and permit the industry to plan ahead, while negating the need for industry participants to each dispute and litigate their respective terms of access. Regulatory periods could be set as 2 to 3 years, with a right to reopen the access terms (prospective application only) in the event of unforeseen and material events arising.

Access tariffs should be based on efficiently incurred cost and should seek to promote the long-term interests of end-users. The returns allowed on any investment in the NBN need to be reasonable having regard to the desire to promote affordability. The permitted return should not overstate the level of risk associated with the investment.

- Specification of minimum available cornerstone services.

The initial regulatory inquiry should also define a set of minimum services that must be offered by the network operator. Primus would anticipate a suite of broadband access services being made available, and in addition a standard telephony service, a linear broadcast service and point to point (and multipoint) services. There must be specific consultation around these services with industry participants (wholesale customers) having a right to inform the process.

- Oversight and arbitration processes

In the event of dispute with the network operator in respect to network operational decisions, or decisions impacting on services, or disagreement around the nature of the services offered, a wholesale customer should be entitled to lodge a complaint with an oversight group or arbiter. That arbiter could be charged with determining a fair and reasonable outcome in the event of such dispute. The ACCC broadly exercises similar arbitration powers, and Primus sees no reason why the ACCC should not exercise this function in the NBN context.

- Commitment to review parts XIB and XIC

In addition to making decisions about specific regulatory tools (as specified above and below) the Expert Panel should initiate a more rigorous assessment of Parts XIB and XIC of the Trade Practices Act 1974. Such an assessment is beyond this scope of this review, and would best be initiated once the NBN contract had been awarded, and the ownership structure, network architecture and nature of services had been published. Such an inquiry should also consider the impact of “access to content” as applicable to the evolution of competition on the NBN. A further review of the competition and regulatory regime should be commenced 2 to 3 years from services first becoming available. At that time it would be hoped that stake holders would have had an opportunity to form some views about how the regime can be finetuned.

- “Outside in” deployment and compensation for stranded assets

Suitable regulatory rules should be introduced in recognition that many consumers already obtain competitive offerings of the minimum 12Mbps downlink transmission speed sought by the Government. In light of this, any deployment should initially be mandated to target areas that do not achieve these speeds, largely rural and regional areas in Telstra designated zones 3 and 4.

Importantly, there is a need to undertake a national audit of services currently available to prioritize urgent provisioning of services to underserved areas. In other words, broadband poor areas should be rectified ahead of everything else, and this must be one of the key objectives and considerations of NBN.

Primus also notes that the deployment of services onto the NBN will cause some disruption to service provider supply arrangements. Primus considers it should be mandated as part of the rollout that compensation be made available to industry participants that find capital investments (such as DSLAMS or current transmission networks) underutilized or stranded as a consequence of the deployment of the NBN. Similarly, where service providers are locked-in to long term contracts for the use of equipment or transmission, in the event that equipment or transmission was to become redundant as a consequence of the NBN then an appropriate compensation mechanism should be in place to compensate for out of pocket expenses in terminating those contracts.

Primus notes these compensation claims could be minimised if deployment was initially mandated in underserved areas, with sufficient advance notice of potential disruption to services in CBD and metro areas. Primus suggests advance notice of at least 5 years, and considers that such a notice period would also lessen the likelihood of litigation by detrimentally affected service providers, who have generally incurred significant expense and risk to establish themselves as genuine competitors to industry incumbents.

- Protecting Consumers from disadvantage

Consumers should not be disadvantaged in any way in relation to the deployment of the NBN. For example, consumers should not be forced to pay more for a service on the NBN that is equivalent to what they presently acquire on the current network. In this respect the best consumer safeguard available would be to let customers elect whether their current service continues, or whether they choose to be provided a service on the NBN.