

Sent: Saturday, 21 June 2008 5:42 PM

To: Regulatory

Subject: Request for submissions on regulatory issues - National Broadband Network

Thankyou for the opportunity to comment on the regulatory issues regarding the National Broadband Network

The underlying problem with fixed line telecommunications in Australia is that the sector is dominated by the incumbent telco - Telstra. Since the privatization of the telecommunications industry we have failed to see the emergence of network competitors in fixed line telecommunications for the provision of voice and data services. The Optus HFC cable is the only example of a geographically diverse, alternative, independent, fixed line customer access network. The Optus HFC cable is only capable of servicing 1.4 million homes in Brisbane, Melbourne and Sydney (1). This covers only about 18% of the total number of homes, so only 18% of homes have alternative, independent networks to choose from. The remaining 78% have no other choice of network other than Telstra's copper or HFC networks. In contrast (and by way of comparison) 95% of Australians have access to a choice of three alternative and independent mobile networks: Telstra, Optus and Vodafone. Clearly there has been a failure in the development of alternative and independent fixed line networks. And yet we see very successful development of alternative and independent mobile networks.

So why has this failure of the development of competing fixed line networks occurred ?

Clearly the capital cost of building a competing fixed line network is a major factor, estimated at more than 10 times the cost of building a mobile network. Indeed we have to question whether building duplicate fixed line networks is an efficient use of capital ?

By way of comparison we dont have duplicate electricity networks, we dont have duplicate water/sewer networks and we dont have duplicate gas networks. So a fundamental question is whether we should have duplicate fixed line telecommunications networks ?

To compare with other countries, we see in the USA that consumers often have a choice of telecommunications networks, through either traditional telco copper networks (AT&T) or cable TV networks (Comcast) or new Fibre networks (Verizon FiOS). In the USA we have competing fixed line networks and therefore competitive tension between telecommunications providers which promotes efficient use of resources and encourages innovation and investment in new technologies. In Australia we just dont have the same competitive tension because only 18% of homes have access to a choice of competing fixed line telecommunications networks. The cable TV industry failed to develop in Australia in the successful way that it did in the USA because of the power and protection afforded to the Free To Air TV networks in Australia. As a direct consequence we dont have extensive, geographically diverse HFC cable networks as they do in the USA and with the advent of satellite to deliver pay TV we are

unlikely to see this development occur in the future either.

So where does this leave Australia in terms of competing fixed line networks ? Unfortunately it leaves Australia at the mercy of the dominant incumbent Telco - Telstra. Telstra is a vertically integrated telecommunications provider that has a monopoly on the copper fixed line network covering the 78% of Australian homes that have no other telecommunications network provider. As such Telstra has enormous market power and enormous control over that 78% of customers. To address the power and control of Telstra a decision was taken in 1999 by government to unbundle the Telstra local loop (2). This allowed competitors to access the Telstra copper network and to install their own telecommunications equipment in Telstra exchanges to create facilities based competition. Competitors provided their own equipment to provide voice and broadband services over Telstra's local copper loop through the declaration of Line Sharing Services and Unbundled Local Loop Services. This facilities based competition has been extremely successful in delivering faster broadband services and lower consumer prices. Since the introduction of facilities based competition we have seen competitors such as iiNet and Internode be the first to deploy faster ADSL2+ broadband services, and cheaper VoIP voice services. In fact Telstra was one of the last to offer ADSL2+ services and to this day does not offer a residential VoIP service. The innovative, faster, cheaper services that facilities based competition has brought to consumers has been extremely beneficial to those Australian households that have access to them. Clearly the unbundling of Telstra's local copper loop has been an outstanding success. It has allowed competitors to invest in their own infrastructure and has promoted investment in exchange backhaul fibre infrastructure by third party network providers.

So what happens now under the proposed National Broadband Network ? The key issue with the NBN is how to maintain and enhance a competitive market in fixed line telecommunications. One outcome could be the emergence of a competing bid by a consortium to build a new, independent fixed line telecommunications network in partnership with the federal government under a public private partnership. If this outcome was achieved then 98% of Australian homes would have access to two competing fixed line networks.

Another outcome could be that Telstra wins the NBN bid in which case there would not be a competing fixed line network. Under those circumstances it would be essential that the existing facilities based infrastructure be maintained to provide the competitive tension that has led to consumers having access to innovative, faster and better value services. The danger with Telstra winning the NBN bid is that their plans for a fibre to the node network could see the existing facilities based infrastructure of competitors stranded and rendered useless. Indeed it has to be recognized that Telstra has a commercial incentive to destroy the existing competitors infrastructure and such an outcome would see Telstra expand its monopoly from copper services such as LSS and ULL to include a monopoly on all DSL services as well. Clearly this is a most undesirable

outcome as all the benefits of facilities based competition such as faster, more innovative and cheaper services for consumers would be destroyed by a Telstra FTTN.

So how can facilities based infrastructure be maintained in a FTTN environment ? Its turns out that the solution is quite straightforward. The solution is to allow the existing competitor ADSL2+ services to be remain in the Telstra exchanges and to build VDSL2 infrastructure at the Nodes. This solution enables the government's requirement of 12Mbit/s to be achieved and allows the benefits of facilities based competition to be retained (3). Such a solution will preserve competition and the consumer benefits that flow from competition.

What regulatory reform is needed for the NBN?

While the introduction of facilities based competition has been highly successful it has not come about easily. Telstra as the dominant incumbent has a commercial interest in delaying, obfuscating and dragging out competitors access to Telstra local loop infrastructure and Telstra exchanges. In addition the process of determining the access pricing for ULL and LSS services is extremely cumbersome, drawn out and open to abuse by Telstra's delaying tactics. Telstra has a conflict of interest between its network, wholesale and retail operations.

At this point it is worth considering the similar situation faced by British Telecom in the UK and the process used by the British Regulator, Ofcom, in resolving these problems faced by competitors (4). Ofcom's concern was that as the dominant incumbent BT had substantial wholesale market power and was a vertically integrated provider with a presence in the directly related retail markets and this combination gives BT the ability and the incentive to discriminate against downstream competitors who are also wholesale customers. Simply put BT had a conflict of interest between its network / wholesale / retail operations and could abuse its market power to disadvantage competitors. The proposed by Ofcom and agreed to by BT was functional separation of its business units to separate the network / wholesale / retail operations. The result was the creation of BT Openreach as a functionally separate unit of BT charged with looking after BT's customer access network - the last mile copper network. BT agreed to a series of undertakings by Ofcom to ensure that all access seekers are treated equally.

The key elements of the undertakings by BT are:

Functional Separation

Equivalence of inputs

Transparency and separate accounting

Independent audit and oversight

All of the relevant information regarding Openreach's products, services and pricing are available to all access seekers at its website (5). Each access seeker is treated equally and there is no discrimination on services, support and pricing. The BT experience has been very positive and has grown the total

market for broadband services.

How is the BT experience relevant to Australia ?

The current situation at Telstra is a very weak form of operational separation. Telstra's retail arm BigPond does not buy access to Telstra's network on the same terms as its competitors. On numerous occasions BigPond has had access to new services from Telstra network operations before competitors have been given that same access. Telstra has been subject to a number of competition notices from the ACCC regarding their anti-competitive behaviour (6). Clearly the current weak operational separation does not work at Telstra as evidenced through recent testimony by the ACCC to the Senate Estimates Committee (7).

What is needed for the NBN ?

The solution to the problems of Telstra's conflict of interest between its Network / Wholesale / Retail units is to follow the path of the successful implementation of functional separation at BT. Functional separation of the NBN will ensure that access seekers achieve equivalence of access. Functional separation of the NBN will allow greater transparency and accountability which in turn will allow for accurate determination of network costs and proper auditing. In short it will ensure that all access seekers are treated equally. The call for separation of the NBN has recently also been made by the state and territory governments with a strong preference for: "genuine wholesale provider separate from any retail service provider"

In addition to Functional Separation an independent Governance Board will be required to preside over the future direction of the NBN in terms of new technology, new products and new services. Such a Governance Board should comprise representatives from industry and a number of independent directors, such that the makeup of the board must not be influenced by any particular industry group. The board must have the power and the authority to ensure that decisions taken over the future direction of the NBN benefits those that it was built for, all Australian telecommunications consumers.

Finally it is imperative that the role of the ACCC must be maintained as independent regulator. The ACCC must have the authority to set price and non-price terms of access to the NBN. The ACCC must act to ensure an equitable balance between fair and reasonable pricing for consumers, and a fair and reasonable return on investment for investors.

Conclusions and Recommendations:

Since the privatization of the telecommunications sector, there has been a market failure to deploy a geographically diverse, independent, alternative fixed line network due to the high capital costs of deploying such networks and the market power of the dominant incumbent Telstra.

Since the unbundling of the Telstra local copper loop, there has been significant investment in competitive facilities based infrastructure and competitive backhaul networks. The competitive facilities based infrastructure has led the way in developing new, innovative, high speed, low cost broadband services and this has directly led to an increase in the takeup of broadband services.

The NBN represents a threat to facilities based competitive infrastructure because of the loss of unbundled services. However, facilities based competitive infrastructure can co-exist with the correct FTTN design, being ADSL2+ at the exchange and VDSL2 at the node. This FTTN design can meet the government's requirement of 12Mbit/s dedicated download speed. This FTTN design can preserve competition and preserve the consumer benefits that flow from competition, not destroy it.

The NBN needs to be functionally separate network. The NBN should adopt the successful functional separation model that was implemented by BT Openreach in the UK. Functional separation will ensure equivalence of access to all access seekers and enable a higher degree of transparency and accountability.

The NBN needs an independent Governance Board to steer the future direction of the evolution of the NBN to encompass new technology, new products and new services. The Governance Board must act to ensure that decisions are taken to benefit all Australian telecommunications consumers.

The ACCC, as regulator, must continue to play a key role in determining the price and non-price terms of access to the NBN. The ACCC must have the power to direct the NBN operator to comply with the regulatory undertakings in a timely manner.

Thankyou and sincerely,

Tolmartyr

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