Bramex Pty Ltd
ABN 25 008 547 877

Telephone 02 6161 9898
Facsimile 02 6161 9292
Mobile 0412 623 519
Email ramsay@bramex.com.au

Please address mail to:
Bramex Pty Ltd
147 Hawkesbury Crescent
Farrer ACT 2607
Australia

Consultants in
telecommunications radiocommunications and broadcasting
Australian Government Registered Lobbyist

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PARLIAMENT OF AUSTRALIA – SENATE ENVIRONMENT, COMMUNICATIONS AND THE ARTS LEGISLATION COMMITTEE

SUBMISSION BY BRAMEX PTY LTD

TELECOMMUNICATIONS LEGISLATION AMENDMENT (COMPETITION AND CONSUMER SAFEGUARDS) BILL 2009

(A summary is included at the end of this submission on Page 7)

Introduction

Bramex supports the concept of an NBN as a visionary goal for provision of Australian telecommunications. The government is to be commended for deciding that a long run strategy is needed for this aspect of national infrastructure development.

The purpose of this submission is to examine how it became necessary to set this goal and whether this Bill for potential legislation is an appropriate method of achieving it.

We thank the Senate for this opportunity to present views on the Bill.

Current Telecommunications Legislative Policy and Outcomes

Current legislative policy is to a large extent bi-partisan in its origins. Succinctly, it relies fundamentally on competition in the provision of infrastructure as well as services.

The policy had its genesis in the reforms initiated by the Labor Government in the Telecommunications Act 1989, with competition in the provision of services mainly using the combined monopoly infrastructure of Telecom Australia, OTC and Aussat. With the Telecommunications Act 1991 the Labor government created a duopoly of fixed infrastructure on the basis that the existing monopoly could initially be broken down by a single strong competitor. Optus won a hybrid financial bid and beauty contest. Included

in its prize was the former government national satellite monopoly, Aussat, thought at the time to be the ugly duckling but now a valuable part of the Optus business.

The Government provided for a triopoly in mobile telephony infrastructure, mainly because the new GSM technology was eminently suited to having a three to five competing players and the significance of mobile telecommunications generally was underestimated, even in the early 90s. Vodafone became that third mobile operator.

As initially planned, the duopoly gave way to full and open competition in infrastructure and services under the Telecommunications Act 1997, this time introduced by a Coalition government continuing the Labor-initiated policy. The Coalition took policy one major step further in privatising Telstra as a listed company, so that there now exists a large body of shareholders, with holdings ranging from the mammoth amount held by the Future Fund down to parcels each of a few shares held by a multitude of small investors.

In the subsequent 12 years to 2009, there has been a revolution in the industry, with services hardly imagined at the start of the period in relation to their higher quality, greater functionality and lower prices in real terms. The key players have remained Telstra, Optus and Vodafone, all with first mover advantages over the other operators holding carrier licences, around 160, entitling them to provide whatever infrastructure and services they are financially and technically able to produce. Many of these services are provided partly or wholly on the infrastructure of these three first-movers. Broadly, the carriers and service providers have made profits and the customers have had "a good deal".

But all in the garden is not lovely. The 12 years have been characterised by disputes between the carriers, notably between Telstra and Optus, but also involving many other "access seekers", with complaints that Telstra wants too high a price for access and frustrates access by other means. Telstra complains that access prices are kept unrealistically low by the ACCC, in turn frustrating its investment plans and encouraging others to take a subsidised ride on its network, rather than to invest in infrastructure themselves. Telstra claims that the principal reason that there is not wider provision now of fibre-to-the-node or fibre-to-the-home is that potential access prices are too uncertain, courtesy of the ACCC, to risk such a large investment.

It is hard to assess objectively the degrees of truth in these claims. Absurd arguments comparing retail pricing in Australia with those in highly populated, small geography countries only serve to muddy the picture.

Perhaps deeds speak louder than words. For example Telstra and Optus started off in 1993 with a level playing field in GSM mobile services, each with the same amount of new spectrum and both with the ability to move their existing AMPS customers, served on the former Telstra AMPS infrastructure, to GSM. Vodafone was hobbled and not permitted to start until over a year later, so any comparison with it is not valid.

In a few years Telstra had invested in double the number of base stations built by Optus, while Optus invested more heavily in marketing. Arguably the Optus marketing was significantly superior but customers soon found out that Telstra provided better geographical coverage and therefore more reliable service. Consequently Telstra has always stayed ahead of Optus in mobile customer numbers. Telstra also had the vision to bid, at great investment cost, for the disused AMPS spectrum, when AMPS was compulsorily closed down by the Government. This laid the foundations for its costly but successful investment in mobile CDMA and later Next G services.

One cannot label this less optimal investment by Optus as inability to find the funds or expertise. Its various shareholders have included major world telecommunications companies, BellSouth, Cable & Wireless and Singtel. BellSouth was particularly expert in all aspects of mobile communications and provided Optus with key staff. It is reasonable to say that this Optus degree of investment in all infrastructure, fixed and mobile, was a matter of choice, namely to limit investment and use the infrastructure of Telstra where possible, especially where regulated access pricing enabled better returns.

Others such as AAPT followed a similar policy, though the smaller players were much lower down the scale of capacity to invest and had to rely more on Telstra.

Unfortunately this outcome was the antithesis of the policies intended under the 1991 and 1997 Acts. It discouraged investment by Telstra (though it still invested up to $4 billion per annum). Possibly worse, it gave the many minor players more limited choice of access provider, simply because no one had anywhere near the same capacity to provide access as Telstra. Yet somehow Telstra gets the blame for this!

Is the Bill Addressing the Right Problem?

The Bill is clearly "aimed at enhancing competitive outcomes in the Australian telecommunications industry and strengthening consumer safeguards". The Explanatory Memorandum (EM) then talks about Telstra and its integrated structure, noting that it is "one of the most integrated telecommunications companies in the world owning the only copper network connecting almost every house, the largest cable and mobile networks, and a 50 per cent stake in Foxtel, Australia's largest subscription television provider"

It does not point out that Optus owns an extensive HFC network in several major capital cities, which can provide all the functionality of the Telstra copper network. It does not mention that Transact has an extensive fibre-to-the-node network in Canberra-Queanbeyan, providing telephony, Internet and Cable TV, with tens of thousands of customers. It fails to mention the Optus dominance of the national satellite market.

It does not point out that any other organisation could have obtained a carrier licence and rolled out a Foxtel network totally independent of Telstra or Optus, with no regulatory barriers not faced by the other two, or the current availability of ample satellite capacity for anyone wanting to enter this subscription TV business.

The simple fact is that no one but Telstra, with its two media partners, has stepped up to the large capital investments in the same way as Telstra. Yet the EM implies that somehow the lack of foresight and entrepreneurial failure by others is the fault of Telstra.

In short, there is a culture in Australia of under-investment in fixed telecommunications infrastructure, with the notable exception of Telstra and possibly Transact. Yet the Bill is aimed not at this deficiency but at breaking up Telstra!

The Structure of the Bill

There is little doubt that this Bill is drafted with the best intentions of fixing the perceived problem. As covered above, it may be trying to fix the wrong problem. Who is to say that the examples of the UK and NZ, mentioned in the EM, are appropriate for Australia? The UK is a geographically small, densely settled country. NZ is small, sparsely settled, with nowhere near the telecommunications financial strength or the environmental challenges of the Australian telecommunications sector. These references are minimally relevant distractions from the real issues.

More importantly, the government, in its desire to do what perceives as "the right thing", urged on by the ACCC and competitors, especially Optus, infringes its own principles of good governance, fairness and justice. These principles have been widely and properly proclaimed by other Ministers of the current government about other activities such as company governance and financial market behaviour.

Good Governance

The Bill is replete with unfettered discretions exercisable by the Minister and the ACCC, examples being Sections 577 (1) (b), 577 (2) (b), 577B (5). These give draconian unspecified powers to persons with no stake in the operational and financial performance of Telstra, with potential major effects on customers and shareholders. They introduce major regulatory uncertainty and therefore inefficiencies into a vibrant industry. They will undoubtedly increase spending on the regulatory function and therefore cost consumers more.

Fairness

The Bill is coercive as shown in Section 577 and later sections on the alternatives to break up of Telstra. The coercion is particularly inappropriate regarding subscription television broadcasting licences, a penalty for entrepreneurial risk-taking, which any other party could have undertaken at the same time. It appears that one media company, which did not take the commercial risk earlier, is now circling in the hope that there will be a forced divestiture of Foxtel. This would indeed be a perverse outcome by reinforcing an existing television oligopoly at the expense of Telstra and its shareholders. Worse, Foxtel customers are likely to receive a less competitive, inferior service.

It is also inappropriate to force separation through coercion, potentially devaluing Telstra assets sold by the Commonwealth to Telstra shareholders. It proclaims that Australia is a country of significant sovereign risk for investors, who incidentally will be wary of any future privatisation on the NBN Co.

In coercing separation through the threat of preventing Telstra from bidding for valuable spectrum, particularly below 1000 MHz, the Government is potentially:

- Denying spectrum to the company which has proved to be the most efficient over an extended period in the use of this scarce resource,
- Therefore potentially denying Australian customers the opportunity to use the best mobile services,
- Penalising the many Telstra shareholders by shutting off market opportunities,
- Denying itself the best auction price by diminishing the number of bidders for the spectrum, whose value would be measured in billions of dollars.

The government may be aiming at Telstra but collaterally shooting itself in the foot.

Justice

The orders enforceable by the Federal Court, for example in Section 577G (2) are also draconian. Again those in sub-section (h) "any other order that the Court considers appropriate" are completely open ended orders. They could mean that Telstra must take action to the severe detriment of its operational or financial performance, with far-reaching effects across the community. No doubt the judges would take advice of the ACCC as to the effects but again the ACCC in the past, in order to impose solutions in the name of competition, has contributed to the overall distortion of the market.

Both Fairness and Justice

Telstra may give undertakings about structural separation, hybrid fibre-coaxial (HFC) networks and subscription television broadcasting in order to avoid other onerous structural matters. The question arises as to why this applies only to Telstra. Is not Optus also vertically integrated, an owner and operator of HFC and a subscription television broadcaster? Is it not strongly dominant in the national satellite market? The only possible answer is that Optus is smaller than Telstra. However it is equally capable of the same motives which are seen by the Government to be anti-competitive.

The Bill is silent on existing fibre networks not owned by Telstra. Optus and others have long-standing long distance fibre networks and also intra city networks. Are only Telstra's networks to be regulated by this Bill with others free to do as they choose, including competing with the NBN? A lumbering government NBN Co would have to be nimble to fend off these "by-passers", a term to be resurrected from the dustbin of the long-gone monopoly infrastructure days.

Fundamental Change to Existing Policy

The concept of a government-owned monopoly NBN is an exact reversal of the current legislative policy of completely open competition in provision of infrastructure. Labor introduced the policy of infrastructure competition as part of the wider micro-economic reform of the 80s and 90s and the benefits are now patently clear. It was fundamentally concerned with market efficiency.

Economic theory and past experience points to the fact that monopolies will always tend to abuse their power in the market, usually more so when they are government-owned entities. Further, they lose the incentive to innovate and operate at the leading edge of technology. One has only to look at the remaining government monopolies such as water-providers to see the current evidence. The government is proposing to re-create a monopoly in a single telecommunications backbone, a sure recipe for long term inefficiency and lethargic innovation. It is the wrong method of achieving the right aims.

A Better Way to Go

Market efficiency leading to better outcomes for consumers should be a fundamental aim, not hobbling large players to prop up the small. Large and small players in all markets contribute in different ways, often the smaller being more nimble, innovative and niche-oriented. An effective competition regulator, operating under appropriate legislation, will pursue this fundamental aim and control market behaviour only when it fails the efficiency and consumer-benefit tests. Neither the ACCC as it currently interprets its telecommunications role, nor the proposed legislation encourages this focus. In fact they are heading in the wrong direction.

To achieve an effective NBN, there is a better method than the proposed monopoly. City-based telecommunications are usually profitable because of the dense population. Given regulation which mandates higher speeds over time, perhaps over the eight year period now envisaged, and which does not mandate uneconomic access charges, competition will create one or more NBNs in each city and connecting the cities. Competition by Transact has already produced in Canberra one fully-fledged “NBN” (using FTN technology) in competition with Telstra’s copper.

The converse applies to telecommunications in the bush. These have to be subsidised to achieve a similar grade of service to those in the city. The Government needs to bite on this bullet and pay for this subsidy in order to achieve its NBN policy goal in the bush. In those uneconomic areas there will naturally be only the subsidised provider because infrastructure will be uneconomic for other providers.

This is not to say that the government should lightly encourage use of scarce capital on ventures which will not produce a direct economic return. The regulation needed in the cities is that of general competition, including reasonable access rules, not telecommunications-specific provisions. These might be coupled with mandated

performance standards to be implemented over time, leading to the replacement of copper with fibre by whoever moves first. In the bush, it is a matter for policy decision how much scarce capital funded by taxpayers should be used to build a network which cannot produce economic returns but can yield other worthwhile policy outcomes.

Summary

The NBN is a visionary policy goal worthy of implementation through government encouragement, not coercion.

Policy development and implementation 1989 to 2009 shows that the competitive infrastructure policy was generally correct but the outcome has been one skewed by under-investment by most of the players, with the exception of Telstra and some small players.

The Bill has not recognised this fact, blaming Telstra for current market deficiencies, and therefore addresses the wrong problem.

It is draconian in addressing the perceived problem, infringing the Government's own principles and credentials in governance, fairness and justice, creating the spectre of sovereign risk in Australian investment and specifically penalising large numbers of large and small investors.

Market efficiency leading to better outcomes for consumers should be a fundamental aim, not hobbling large players to prop up the small.

Its outcomes on subscription TV and allocation of mobile spectrum may have particularly perverse outcomes for customers, shareholders and the Government itself.

The Bill represents a major reversal of bipartisan policy of full and open competition in the provision of telecommunications infrastructure.

There is a better way of achieving the NBN goal, relying on competition in the profitable cities and subsidised construction in the bush. While the ACCC is pivotal in this scenario, its decisions can also cause major distortions and cause government telecommunications policy to fail.

Ross Ramsay
Bramex Pty Ltd

Declaration of interests (see next page)

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Ross Ramsay is the Managing Director of Bramex Pty Ltd, which consults principally in telecommunications and radiocommunications. He has 5 decades of experience in government and industry on these activities.

For eight years in the 1980s he headed the spectrum management function of the Commonwealth and advised Ministers on mobile spectrum matters. Later, working for Bellsouth, he was closely involved in developing and implementing the policy and strategy of the winning 1991 bid by the consortium eventually named Optus. He worked for and consulted to Optus for several years in the 90s.

Neither he nor Bramex holds Telstra or Singtel shares. Neither has ever worked for Telstra. A related superannuation fund holds Telstra shares as a very small percentage of its assets but no other shares in telecommunications companies.