CHECK AGAINST DELIVERY

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Securing Major Competitive Investment: How to Repeat the Success of the Early Nineties

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Introduction

It is a great pleasure to join you at today's Communications Day breakfast.

How can you fill a daily newsletter with the events of just one industry?

As the pages of Communications Day reveal, the secret is to find an industry with strong differences of opinion on just about every issue.

It's a journalist's idea of heaven.

I've got good news for the publishers of CommsDay – there is no chance of peace breaking out any time soon.

The daily news flow, from CommsDay and others, is important.

But today I want to step back and take a longer perspective – particularly as our industry faces one of the biggest transformations since competition began in 1992.

I will start by pointing out the contribution which Optus has made to Australia – not just the telecommunications sector but our broader economy and society.

Second, I will show that what has been achieved is a consequence of good public policy in the early nineties.

The reforms of those times were designed to unleash competition. In Australia's case they succeeded spectacularly in mobile – but they failed in the fixed line sector.

Thirdly, I will show you that, as we move to a next generation broadband network, it is our last chance for another generation to get competition working in fixed line.

Next, I will highlight the real issue here and one that many (even in this room) have been distracted from: not "who builds the NBN network" but "how the network is owned and operated" and why that matters to you and to all Australians.

Finally, I will update you on the Terria bid to build the network – and update you on some of the other things we are working on at Optus.

Optus is a major contributor to Australia

Let me turn first to Optus' contribution to Australia’s economy and society over the past sixteen years.

This is not always well understood, partly because Optus is not listed in its own right.

Yet as this chart shows, Optus has been one of the most extraordinary “start up” stories in Australian corporate history.

Today, Optus would be one of the top twenty five companies by revenue if we were listed separately on the Australian Stock Exchange.

We are a very large employer, with over 10,500 employees[1].

We are also a very large investor. Our cash capital expenditure in our last financial year was $1.13 billion. This puts us in a similar league as Qantas ($1.4 billion) and Wesfarmers ($1.2 billion), and ahead of such icons as Brambles ($870 m) and Toll ($380 m).

In fact, we have been investing large amounts in Australia from the day we started.

Since our inception we have invested more than $15 billion in telco infrastructure.

In a recent report, the ACCC highlighted the importance of investment by competitors in driving competition.

> 2006–07 saw the highest level of investment in telecommunications in the 10 years since the sector opened to competition in 1997...Increased investment has enabled access seekers to differentiate their downstream product offerings to compete more vigorously for retail customers[2].

If investment by competitors is key, then investment by Optus is by far the most important part of that.

We are bigger than the rest of the non-incumbent telecoms carriers put together, as the chart on the left shows.

And take a look at the chart on the right, which shows investment by Optus and other Australian telcos over the past four years. As you will see, Optus makes up the lion's share of non-incumbent investment.

Since the time we entered the market Optus has been continuously building networks, as this slide shows.

Today, Optus operates a mobile network with over 4,000 base stations; a fibre transmission network with over 10,000 kilometres of fibre; four satellites; an HFC network extending over 26,000 kilometres; a direct fibre network serving business customers with

[1] Optus Q1 Financial Results 2008/2009 Management Discussion and Analysis

over 17,000 connections; and a ULL network with 360 exchanges around the country[3].

All of this has been built up since Optus entered the market in 1992. By any measure Optus has made a substantial contribution to Australia's economy and society.

Today, we have over 7 million mobile customers and around 1 million fixed line and broadband customers[4].

Only a few of Australia's very largest companies can match this number of direct customer relationships.

The competition we have led has brought enormous benefits to Australians.

According to a recent ACCC report, average real prices for telecommunications services have fallen by 33 per cent in the ten years to 2007, with local call prices dropping over 50 per cent, and international call prices dropping over 70 per cent.[5]

Time after time Optus has led the competitive charge.

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[2] ACCC telecommunications reports 2006–07, Report 1 Telecommunications competitive safeguards for 2006–07, covering letter, pp 1-2
[3] Optus Q1 Financial Results 2008/2009 Management Discussion and Analysis
[4] Optus Q1 Financial Results 2008/2009 Management Discussion and Analysis
5 ACCC telecommunications reports 2006–07 | REPORT 2, Changes in prices paid for telecommunications services in Australia, 2006–07, p 71

Early this decade Optus built the Reef network, a competitive fibre optic cable running from Brisbane to Cairns. Wholesale prices for transmission to and from towns all the way up the Queensland coast dropped sharply.

From 2005, Optus introduced ADSL2+ services around Australia. While Telstra was keeping its customers on the older, slower ADSL for as long as it could, Optus was delivering the latest technology[6].

And today, Optus is delivering customers much better value in mobile broadband – following substantial and continuing investment in data capacity on our 3G network.

We are keeping up the competitive pressure. We have launched the first home cap across fixed and broadband; the first unlimited mobile plan; market leading iPhone internet browsing plans … I could go on…

As one good example of how we are bringing choice and changing the boundaries, let me show you how we are communicating the benefits of our new mobile offer.

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[6] 'Optus steps up competition with DSL rollout' Optus media release, 22 September 2005

There is a consistent theme here. Through our substantial network investments, Optus has been able to deliver our customers three key attributes which our brand stands for.

We give our customers new levels of value for money; we make technology more accessible; and we offer high levels of service.

These are the very things the Government's 1992 reforms were designed to bring to Australian telecommunications.

Policy Success in Mobile; Policy Failure in Fixed Line

So those reforms have delivered a big pay-off – and Optus has played a big part.

In the mobile sector, the policy worked.

By handing out three GSM licences, not two, the sector was intensely competitive from the outset.

And the Government kept up the competitive pressure by releasing spectrum for new entrants like One.Tel and subsequently Hutchison.

The intense competition in mobile has generated enormous benefits for consumers in price, service and innovation.

According to the ACCC, over the last ten years average prices for GSM mobile services have fallen 42 per cent.[7]

But look too at how competition has driven innovation. Australians have enjoyed the rapid arrival of the latest mobile technology, from GSM in the mid nineties, CDMA in 2000, third generation mobile around 2004, and more recently high speed data services such as HSDPA being provided over the mobile networks of all of the major operators.

Each operator has been scrambling to get ahead of the others – and consumers have benefited.

But while the mobile sector has very much delivered on the expectations of 1992, the fixed sector has been a huge disappointment.

Don't get me wrong – I am proud of the work that Optus has done to bring competition in fixed line.

But we are fighting with one hand tied behind our back.

Where we can make investments and build network, we have had great success.

[7] ACCC telecommunications reports 2006–07 | REPORT 2, Changes in prices paid for telecommunications services in Australia, 2006–07, p 71

But in too many areas of the fixed line market, Telstra is massively dominant – and the rules are too weak to correct it.

The 1992 and 1997 reforms have failed to deliver the intended competition in mass market fixed line telecommunications.

The reason is clear: nothing was done to solve the structural imbalances in the fixed line sector.

The Government made a poor decision on fixed line because it listened to vested interests.

This created a monster company, which owned a ubiquitous network, was vertically integrated, and had scale advantages very difficult for any competitor to overcome.

In particular, in a country with only one communications line to most homes the Government allowed one company to both own that network and to operate in the market in a way that prevented anyone else from building an alternative access point to that home or from getting equal access to their lines.

In observing Telstra's behaviour since then – it is clear that they are reflecting market incentive.

Look at the facts of recent history in our industry:

In the late 1990s Optus Vision started building an independent access link to Australian homes. Telstra followed this cable down 80% of the streets it rolled out and then carpet bombed those areas with marketing programs, discounts and sales.

The Optus Vision rollout stopped as the operators found themselves unable to make any money: Telstra subsequently wrote off half a billion dollars on their cable investment. But as most analysts agree: this was a shrewd investment: they protected far greater profits in their local loop.

And similarly today – Telstra's behaviour is to aggressively frustrate competitors as they seek to access the last mile to the home under the ULL regime.

In the case of apartment dwellers, Telstra has flouted its legal requirements.

This slide shows something called a 'main distribution frame', or MDF, in an apartment block.

Telstra claims that it is only required to rent Optus a line from the exchange to the MDF – not to hand over the existing phone line to the customer's apartment.

And even if Optus agrees to work within this Telstra created approach, they have further obstructed the customer handover by creating a process that is unworkable and creates days of delays. It has taken us almost two years to work through the ACCC to get this resolved – even then Telstra appealed against their findings and that is delaying things for another year or more. So for some time- Optus has withdrawn from selling broadband to apartments.

And there are many similar stories in the industry about how Telstra has blocked and slowed competitor access to exchanges with ridiculous and unbelievable excuses about lack of space.

Our current market structure and regulation inherently gives Telstra the incentive and the means to suppress competition in fixed.

Sure, Australia is better off than the monopoly days before 1992; but fixed line competition has fallen far short of its potential.

There are four main consequences of the profoundly unsatisfactory fixed line market structure.

First, unlike in mobile, the market structure does not drive the rapid introduction of new technologies. On the contrary, Telstra used its dominance of broadband to delay the introduction of high speed ADSL2+, and to cap consumer speeds at 1.5 Mbps for many years[8]. And that's just for those customers who can get a Broadband service.

Indeed, secondly, the market structure has resulted in large numbers of Australians being left unserved. In sharp contrast to the wide coverage of mobile broadband, when it comes to fixed broadband, millions of Australians still receive only slower speed DSL – or in too many cases, no DSL at all.

For example, the South Australian Government recently estimated that 50,000 premises in metropolitan Adelaide cannot receive DSL at all[9].

Third, the market settings in fixed line have been much less successful in attracting significant investment than in the mobile sector.

Investors simply do not have sufficient confidence of getting a payback to be prepared to allocate their capital into fixed line services.

Fourthly, the fixed sector is bedevilled by the fundamental conflict of interest between Telstra's position as a retail carrier and its position as the owner of the dominant fixed line network.

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[8] 'Telstra keeps ADSL2+ under wraps' Renai LeMay, ZDnet, 25 August 2006
[9] 'Broadband black holes hit 55,000', Cameron England, Adelaide Advertiser, 27 September 2008

Time after time, the story in fixed line is the same. Telstra blocks competitor access to the bottleneck, the single line connection to most of Australia's homes and small businesses – because it can, and because in its rational self-interest, it does.

Customers are frustrated, competition is impeded – and the sector fails to live up to its potential.

What is at Stake in 2009

In consequence, as Australia turns towards the construction of a national broadband network, the stakes are very high.

Clearly the efforts of 1992 and 1997 did not succeed. In 2009 we have our third and last chance for another generation to achieve real competition in fixed line telecommunications

But the stakes are higher now: fixed line now represents a far more critical factor in our economic performance. In 1992 and 1997 this was a debate largely about voice telephone. In 2008 it's about access to Voice and High Speed Broadband!

Out of this process, the Government must choose an outcome which advances the national interest. Though they need only look to governments in nearby markets such as Singapore and New Zealand to see good precedents on how to reform and establish competition in the fixed line market.

But if you are Telstra; if you have generated monopoly returns for your shareholders for many decades; and if the market and regulatory structure incents you to do so, then naturally you advocate self interest and not national interest.

Don’t just take my word for it: look at Telstra’s actions:

Today Telstra’s fixed line business is incredibly profitable. Telstra fixed retail revenue represents over $12 billion out of their total $24 billion in annual sales, but over $7 billion out of their $10 billion of annual profits. It generates astonishing EBITDA margins - monopoly type rates of return. It is where Telstra makes the majority of its money.[10]

Accordingly, its CFO made it clear last week: Telstra will not build the NBN unless it can maintain or increase its rate of return[11].

So, to protect its shareholders, Telstra only wants to build the NBN if the new network can be as profitable as its existing network.

That is why Telstra has delayed the NBN for over three years now – it has not yet got the terms it is demanding. And it has a strong

[10] Based on industry estimates
[11] ‘The future of broadband networks’ John Stanhope, Telstra presentation to the BBY Conference, 14 October 2008

incentive to continue delaying and obstructing high speed broadband if it threatens their huge profits margins in the fixed market.

One of Telstra's major arguments in delaying competition is that the local loop is owned by them: that allowing anyone else to access or use their infrastructure in a way that damages their profits is unfair and damages their property rights. This evokes some sympathy from average Australians: all of us fear having our homes or businesses confiscated by Big Government.

But, as so often with Telstra's recent public arguments; this is a major distortion of the facts.

Telstra recently, in a blaze of publicity took a case to the High Court of Australia arguing that the ULL regime was such an example of property rights being abused.

The High Court thought very differently. It comprehensively backed the access rules – and handed Telstra a 7-nil drubbing.

But it also included in its judgement, handed down in March, several statements which are very important and relevant to allowing another operator such as Terria to build the NBN whilst accessing Telstra's infrastructure :

> "Although it is right to say that Telstra bought and paid for the PSTN and thus owns it, it has never had the rights in respect of the assets of PSTN of the nature or amplitude which its arguments assumed"[12]

Indeed in describing the 1991 Act that transferred the PSTN from the Government to Telstra the court notes that a core objective was to foster competition in the industry and hence says:

> "Telstra's ownership of the assets of the PSTN vested in 1992 was subject to the statutory rights of access and to the use of those assets by other carriers" [13]

Indeed, these facts beg an important question in the light of Telstra's threats to block or delay any competitor seeking to roll out the NBN using access to its infrastructure: just who does run Australia?

A large corporation like Telstra threatening to hold up the NBN by tying it up in the courts; or the elected representatives of the people? Should any large Corporation be tolerated if it chooses to use its massive financial and legal resources to delay inroads on its monopoly profits in a manner clearly against the Public interest and clearly against the intent of the law that created them?

Let me suggest to you that the public debate needs to change.

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[12] 'Telstra Corporation Limited v The Commonwealth [2008]', High Court of Australia, 6 March 2008
[13] 'Telstra Corporation Limited v The Commonwealth [2008]', High Court of Australia, 6 March 2008

We need to hear less about issues which are irrelevant to the national policy objective and Public interest.

We need to hear less about phoney distinctions between Telstra and other bidders - such as technology. We all buy from the same vendors. Telstra will not win the NBN bid on technology.

As for claims that only Telstra can manage a large, complex network build:

The fact is, Optus has vast experience in building and operating new networks. We are eager to deploy that experience to build the NBN.

The Issues We Need to Get Right

The truth is that the coverage of the debate has been distracted from the real issues that serve Public interest. It doesn't really matter who builds this network – though I sincerely hope that Terria does – but regardless we will all probably offer Australia the same technology and features.

What really matters are three issues we need to hear a lot more about: price; separation and innovation.

First, when this new network comes along - what is the price that Australians will pay to use it?

Last year, Telstra said that if it built the NBN, its wholesale price for line rental plus entry level 512K broadband would be $59.[14]

As the slide shows, this would mean that Australians would pay more tomorrow for the same broadband services as they get today.

Higher speed services will be even more expensive.

The national broadband network will not be a success if it offers great technology at high prices; it will be a success if it offers great technology at prices that all Australians can afford thanks to the power of competition.

The Government must drive a tough bargain on the access price that whoever operates the new network will be permitted to charge.

By far the best way to do that is to give the ACCC power to set the price. That is what Terria has proposed.

The second fundamental issue is the separation regime that will apply to the new network.

[14] 'Telstra tries a fast one with 14-year offer', Terry McCrann, Herald Sun, 8 June 2007

Let’s be clear on one thing – whoever builds and owns the NBN, it will be a monopoly network – most Australian homes will only ever have one communications connection point.

No rational party or government could justify building a second such network.

That means regulation of the monopoly NBN will be critical.

The entity which owns and operates the new network must be structurally separated. You cannot have any one retail Telco controlling the NBN or you have a conflict of interest in dealing with competitors.

The Terria bid delivers structural separation as an inherent feature of our design.

‘Open access’ won’t just be rhetoric for Terria; it will be the core business.

In recent months Telstra has taking to claiming that its model is open access too.

Do not believe it. As Paul Keating once said, you should always back the horse marked ‘self interest.’

Telstra’s self interest is not served by an open access model; Terria’s is, and that is the difference.

In its Request for Proposal, the Government says it is ‘determined to ensure that appropriate open access arrangements are in place to promote competition and ensure efficient investment.’[15] It specifically requires that access is provided on equivalent terms.

Yet here is what Kate McKenzie, Telstra’s head of wholesale, said recently.

> Whether we would sell exactly the same products in the wholesale division as the sort of things that retail would be seeking for their end customers, not necessarily. Just like it is now, we sell a lot of things in wholesale that retail don’t directly buy an equivalent of and I expect that would continue to be the case.”[16]

Let me decode that for you. In Telstra’s so called open access network, it would keep giving its retail business preferential treatment over its wholesale customers.

Or you could look at what Sol Trujillo said a few weeks ago.

> Telstra's National Broadband Network will be an open access network ... But like any investor, Telstra needs to be confident that the returns on invested capital justify the risks.[17]

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[15] Request for proposals to roll-out and operate a national broadband network for Australia, Sch 1.5.14 ‘Competition and Open access’ , Department of Broadband, Communications and the Digital Economy, 11 April 2008
[16] ‘Interview with Kate McKenzie’ Alan Kohler, Business Spectator, 17 July 2008
[17] ‘Australia at the Crossroads’, Sol Trujillo, Speech to FINSIA Executive Luncheon, Park Hyatt Melbourne, 8 October 2008 p14

Let me decode that one too. If Telstra gives access to third parties, it will charge a very high price for doing so.

Telstra recently made a submission on the regulatory system that should apply to the NBN.

Telstra says it does not want the new network regulated under the existing telecoms specific provisions of the Trade Practices Act.

It does not want the ACCC involved in price setting.

It does not want to be under any obligation to sell the same services to its retail competitors as it provides to itself.

Telstra's so-called 'open access model' is a sham – and all Australians, will pay a higher price for broadband under it.

Dr Chris Doyle, an international expert on telecoms regulation, has observed:

> In my view there is every reason to be concerned that the NBN operator, particularly if it were Telstra, would not operate in a way that would meet the Government's objective of "open access" and "equivalence of access prices and non-price terms and conditions".[18]

Let me use this chart to set out, with absolute clarity, what Terria means when we commit to provide open access over our network.

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[18] 'Comments on the Telstra Submission on Vertical Integration and Separation' Dr Chris Doyle, September 2008 p32

I challenge Telstra to match our commitment.

The third major issue is innovation.

As I have shown, while Australia's mobile sector has a highly competitive market structure, the fixed sector has been relatively stagnant.

If Telstra is allowed to build the NBN on its stated terms, it will be even worse than today's fixed line sector.

As I have shown you in a market where one of the retail providers is massively dominant and controls the infrastructure: rather than innovation, you get stagnation.

We need a strong focus on building a competitive market structure – with the right economic incentives to attract investment.

I mentioned that the competitive mobile environment has led to Optus making substantial investments.

Optus and the SingTel group stand ready to make similar large investments in fixed line – if the incentives are right.

But if the Government simply does a cosy deal with Telstra, and fixed line competition suffers in the process, then we will look for more attractive places to put our capital. So, no doubt, will many other potential investors.

That would be a bad outcome – but it is not one we expect.

What Optus is working on – the Terria Bid and otherwise

Indeed, Optus is hard at work, with our Terria partners, to give the Government an easy decision. Our bid will offer Australia a new broadband network – and a competitive broadband sector.

Let me assure you of two things.

First, Terria is going full steam ahead.

Our commitment to lodge a compelling bid is unaffected by TCNZ's decision to focus their investments on New Zealand.

There are close to 60 people working on the Terria bid and we are bidding to win. We can match Telstra on technology, we can match it on project management, we can match it on the resources and capabilities of the consortium – and we will beat Telstra on price and open access.

Second, our commitment will not be affected by these uncertain economic times.

We have a compelling proposition, and with the limited, defined regulatory changes we have sought, it is clear that the proposition is financeable.

These interesting times may mean a little more creative thinking is required, but we are certainly more than ready to meet that challenge.

While Optus is devoting substantial energy to the NBN, we are working on plenty of other things besides.

In mobile, we are well advanced on the largest network expansion in the company's history – rolling out our 3G network to serve 98 per cent of the population. We are adding over 700 new base stations to our network and extending Optus' mobile network coverage by 400,000 square kilometres.

In satellite, we are about to launch the D3 satellite.

Our Optus Business Division is delivering services over its IP-based network to an ever growing number of businesses.

If we get the opportunity to participate in the build of the NBN, we will be delighted to invest our capital there.

If another builder is chosen, but the network operates on the structurally separated, open access basis that we have recommended, then Optus will certainly be a vigorous wholesale customer of the network – and you will see a strong, continuing allocation of Optus capital to consumer broadband.

On the other hand, if the Government gets the policy settings wrong and stifles competition, then inevitably the SingTel Group will need to revisit its capital allocation decisions and focus on those markets that have delivered a proper competitive regulatory environment.

Conclusion

Let me conclude with the guiding principle which should apply to the national broadband network.

Government should choose the bid – and the regulatory structure – which maximizes competition.

That is the principle which the Government successfully applied in 1992 when it introduced competition in the mobile network.

But it was not sufficiently vigorous in applying this principle to the fixed line network – and as a result it has left serious unfinished business.

The NBN offers the chance to correct that error.

The decisions taken in 1992 – imperfect as they were on the fixed line side – unleashed a company called Optus which has made a major contribution to our nation.

The Government should have no less substantial a goal in mind as it determines its way forward on the national broadband network in 2008.

Thank you.