Policy Derailed – A Brief History of Telstra's Inconsistent Claims and the Consequences for Telecommunications Policy Development

A Submission to the Senate Select Committee on the NBN

September 2008

Introduction and Summary

The CCC welcomes the opportunity to contribute to the Senate Select Committee inquiry into the national broadband network.

The CCC represents the interests of non-dominant telecommunications carriers in Australia. It has been an active participant in policy discussions in Australia since it was formed as a loose alliance in 2001, and especially since it was incorporated in 2004.

Telstra has recently appealed to policy makers and regulators to "have faith"[1] and abandon the basic precepts of regulation in Australia. It says this is necessary if Telstra is to build a next generation access network capable of delivering higher broadband speeds.

That is, Telstra is in effect saying "trust us to be left with the most minimal regulation and the investments we have refused to make will be made, the competition we have systematically tried to suffocate will flourish and the prices that consumers have watched sit stubbornly at the peak of the world comparison tables will come down."

The CCC submits that trust must be earned. Certainly, to accept the proposition presently being put forward by Telstra, a very high level of trust would be required.

Telstra has a history that demonstrates that it can be trusted only to enrich itself by promoting regulatory changes that favor itself against the interests of a more competitive industry. It has a history of statements and assurances that have so often been proved false by the passage of time, or from which Telstra itself has resiled sometimes within months, that can lead only to the conclusion that Telstra cannot be relied upon.

Below are just a few examples of occasions on which Telstra has earned the right to be mistrusted by the Australian people in general, and the Parliament and Government in particular, as a source of information and advice on important public policy.

Further, this list shows that many of the instances of acknowledged failures of policy in Australia in the past 10 years are directly attributable to policy makers accepting at face value and acting upon Telstra's self-interested advice.

This alone should be enough to ensure that Telstra is not trusted to dictate the terms of the NBN.

Pair Gains: "Whatever You Do, Don't Tell the Customer"

In 2002, Telstra admitted in a Senate Estimates hearing that it was the usual practice, when a customer ordered a second line, for Telstra to install what is called a "pair gain".

[1] Dr Tony Warren: Informa Broadband conference presentation July 2008.

A pair gain means that, instead of installing a second full copper line into a home, the existing twisted pair of copper wires is separated, and different dial tone and phone numbers are provided on each single piece of copper.

However, once a pair gain was installed, the householder could not access ADSL. Further, the peak capacity (speed) of the new half-line for dial-up Internet was also halved.

Given that in the early 2000's many Australians ordered second lines precisely so they could access dial-up Internet, this might have seemed relevant information to provide to those customers about to have a pair gain installed.

However, not only did Telstra charge the full price of a separate line for this half-capacity service, it also admitted in the Senate hearings that it did not tell customers that they were buying a service that would provide them with half speed dial-up Internet, nor that splitting their line into two in this way would mean that they would be unable to receive an ADSL broadband in the future.

The Australian Government later set aside $50 million of taxpayers' money for a program to start to fix these custom-made faults in Telstra's network so these customers stuck in broadband black spots could receive ADSL.

Limits of ADSL Broadband: Telstra Re-writes the Laws of Physics to Suit Itself

Laurence Paratz, at the time a senior manager in Telstra CountryWide, told a Senate hearing in December 2002:

> "For example, ADSL has a limit of about 3½ to four kilometres from the exchange. This was well understood by both the Besley and Estens inquiries — where they focused on outcomes rather than inputs."

It was notable that there was an implied criticism of the Senate inquiry in this statement, suggesting that the regional telecommunications inquiries had accepted Telstra's arguments and that the Senate should too.

This was at a time when Telstra was facing complaints that regional customers were not being left behind as broadband gained popularity in the cities, were competitors to Telstra were aggressively entering the market. Telstra was not investing to provide ADSL in areas which had not yet benefited from this competition. It was this issue of regional customers missing out on broadband that the Senate committee was concerned about.

In 2006, to overcome the reluctance by Telstra to invest in providing ADSL to regional Australia, the Federal Government proposed a large subsidy to allow competitors to deliver broadband.

Lawrence Paratz said in a speech in July 2006:

> "The laws of physics and properties of cable do impose a limit on the distance at which ADSL can deliver broadband. It's *often misquoted and misrepresented as being 3 ½ or four kilometres*. That only applies on the thin copper wires used in urban situations.
>
> "In rural situations, we have historically used much heavier copper – this was done so that the voice signal could travel further without excessive loss – and this also applies to ADSL on the same cables. So ADSL also goes further in regional and rural networks than in city networks. How much further?
>
> "Well, just last week I checked on some customers near Mildura. I would have found the same picture anywhere, so it's a representative example. I found customers operating, within all technical limits at 6 km, at 7 km, and at up to almost 8km from the exchange." (Italics added)

Mr Paratz, in identifying that there had been made in the past misrepresentations about ADSL capabilities in regional areas, did not choose to identify himself and Telstra as the source of those misrepresentations.

Adequacy of Speed: ADSL is Too Fast One Day, Internationally Disgraceful the Next

In 2002, the rest of the world was moving rapidly to embrace broadband as competitors to incumbents began offering ADSL based services.

In Australia, Telstra was defending its slowness in investing to make the service available at an affordable price, just as competitors were showing that there was strong demand for the service in those places where they had managed to force their way into the market.

Tony Warren, Telstra's head of regulatory, said to a Senate hearing December 2002:

> "There is an ADSL fetish that ADSL equals broadband. We do not believe that. We sell broadband services, and so we will try ISDN for those customers. That may be all they need, particularly if they are downloading stuff from the US, because ISDN is the maximum speed you will need to get stuff from the US."

ISDN is a technology that was rapidly being superseded by faster ADSL even in 2002.

Tony Warren in a speech in July 2008 advocating the need for Telstra's demanded regulatory terms to be accepted so that it could make an immediate investment in a Fibre To The Node network to deliver fast broadband claimed:

> "We (Australia) are stuck in the slow lane."

Broadband Penetration I: On Track One Day, In Crisis the Next

In July 2003, Telstra commissioned an economics consultancy firm, NECG, headed by Henry Ergas, to prepare a paper for a Senate inquiry that challenged concerns that Australia was falling behind the rest of the developed world in broadband penetration.

This study declared, in part:

> "When the influence of relevant basic economic variables is taken into account, Australia's broadband penetration rate is not significantly lower than the OECD average in a formal statistical sense"

Tony Warren told a Senate hearing that this paper showed:

> "Australia certainly do very well. We are mid-rank; we are not Lichtenstein, Japan or wherever, but we do pretty well."[2]

Almost exactly two years later, Telstra began a political campaign promoting the idea that Australian broadband was an international disgrace. Tony Warren has been one of the leading Telstra voices claiming Australia is a broadband disgrace, and said in July 2008:

> 'Australia is falling behind. We are not even on the fibre radar.'[3]

Broadband Penetration II: "No one wants it" One Day, "We are being denied by the Government" the Next

In 2002, Telstra CEO Ziggy Switkowski said low broadband penetration in Australia was because Australians did not see any use for it. It had nothing to do with Telstra's lack of investment in infrastructure. He said:

> "Our experience from the Launceston project ... is that the availability of broadband, even when priced below cost, is absolutely no indication of people's willingness to use it at this time."
>
> "We believe that the current phase of growth of the Australian broadband market is nearing completion. To move to the next growth phase we believe there must be attractive applications, content and devices for more consumers to take up this service. Telstra's local experience suggests ... price and ubiquitous infrastructure availability alone will not stimulate sufficient levels of demand to create the next phase of growth for the broadband industry among residential consumers."

[2] http://www.aph.gov.au/Hansard/senate/commttee/S7167.pdf
[3] Dr Tony Warren Informa Broadband conference presentation July 2008.

Telstra argued that Government policy should be focused on encouraging content development, and Telstra itself said it would direct investment toward this, rather accelerating infrastructure rollout.

Less than three years later, in August 2005, Telstra was demanding that the Government subsidise Telstra with reduced regulation and grants so it could build a new broadband network. It admitted that Telstra had underinvested for years in modernizing its network. It said the network had to be built, and then customers would begin to use it.

Regulated Price Methodologies: Heads we win, tails you lose

Telstra has constantly claimed that it is forced to provide access to its monopoly network below cost. It has called the ACCC a "rogue regulator" and "maggots" for applying the cost-plus pricing methodology used in most of the rest of the developed world, known as TSLRIC+ (total service long run incremental cost plus margin).

Recently, Telstra has claimed this pricing approach by the Commission to existing services is stopping Telstra from investing in FTTN, because it means it does not trust the ACCC.

However, in New Zealand, Telstra's wholly owned subsidiary argued **for** the methodology the ACCC uses in Australia.

In fact, Telstra argued in 2005 that the regulator there should go further.[4]

In a submission to the New Zealand regulator, it argued that the regulator should always opt for LOWER regulated prices because this would lead to:

- Lower **consumer prices**
- Stronger **competition**
- More **innovation**
- Greater **investment**
- Less **wasteful duplication**

Telstra even employed expert consultants in New Zealand to prove that lower access prices encouraged greater investment.

In Australia, Telstra has argued exactly the opposite on every point**.**

4 http://www.comcom.govt.nz//IndustryRegulation/Telecommunications/InterconnectionDeterminations/InterconnectionPricingReviews/ContentFiles/Documents/TCL%20submission%20on%20TSLRIC%20260505%20final%20%20PUBLIC.pdf

In August 2005, Telstra told the Federal Government that these same regulatory approaches in Australia *weakened* competition, *prevented* lower prices and *stopped* investment.

Telstra showed no compunction about telling two national governments completely opposite stories within months of each other.

Network Models: Telstra Keeps the Truth to Itself (Again)

Over the past several years, Telstra has presented to the ACCC three models that purport to show the cost of operating its network. The first two, called PIE and PIE II, were shown after detailed investigation to be fundamentally flawed and unfit to be relied upon.

Late in 2007, Telstra released another model, called TEA.

When it did so, Telstra finally admitted that its previous models were unreliable. But it claimed its new model was the best it could produce and that it would co-operate fully with the ACCC and the industry to ensure that everyone could have confidence in the model.

In the past two months, Telstra has been caught playing the same old tricky game of trying to hide the truth.

The following extract from a letter from ACCC General Manager, Communications, Michael Cosgrave to Tony Warren of Telstra in July 2008 describes this conduct by Telstra.

> "Telstra made continuous representations during TEA model development and contemporaneously with the public release of the TEA model, that the TEA model would be a new, accurate and more transparent approach to modelling, and represent a clear shift away from the lack of transparency issues that bedevilled its previous cost model. Telstra conceded that it did not have 'clean hands' on the issue of cost model transparency with its previous model, but asserted that TEA model would be designed to be more transparent to allow for the ACCC and industry to understand and have confidence in the model.
>
> "However, it is now apparent that Telstra has not been fully transparent about TEA model developments and issues in the current process. In particular, Telstra states that it has adopted a practice over some months of accumulating a list of issues with the TEA model until it deems that the issues have reached a level of materiality to warrant the release of a new version of the TEA model. It has only been in response to the ACCC alerting Telstra of errors found in the TEA model, and requesting Telstra to confirm that it was not aware of further errors, that Telstra has chosen to disclose further errors within the TEA model.

Telstra's thus far unilateral assessment of the materiality of the errors in the TEA model may or may not ultimately be accurate. This is beside the point. The issue here is that after repeated claims of increased transparency, Telstra has reserved to itself the ability to release information at a time of its own choosing. That does little to inspire confidence in Telstra's commitment to a transparent process." (Emphasis added.)

Infrastructure and Competition

In the Telstra Annual Review 2004, Donald McGauchie and Ziggy Switkowski wrote that:

> "The infrastructure sharing partnership with Hutchison …avoids costly duplication of facilities while permitting Telstra to enter the 3G market on an expediated timescale. More importantly, it results in competition where it should be – at the customer level"

That is, that it supported the idea that basic networks should be separately owned and operated, and that retailers should share infrastructure so that they could instead invest money more efficiently in competing more effectively with different services at the retail level.

By August 2005, Telstra had begun to demand that it should not have to provide any competitive access to a new broadband network.

Telstra's position now that competitors should be forced to build their own network if the want equal access to that which Telstra provides to itself. Telstra chairman Donald McGauchie said in July 2008 that competition should be based on competition between fully vertically and horizontally integrated rivals. [5]

On CDMA and regional mobile networks

In its 2004 Annual Review Telstra said of its regional CDMA mobile voice and data network:

> "The CDMA network continues to grow across regional Australia, bringing voice coverage to more rural communities and highways and putting rural and regional customers on the path to future technology improvements. Telstra CountryWide committed more than $30 million to complete the rollout of Australia national next generation voice, data and wireless Internet network by upgrading the CDMA network to One Times Radio Transmission Technology (1xRR). Users

[5] http://www.businessspectator.com.au/bs.nsf/Article/Donald-McGauchies-speech-FVSM7?OpenDocument

> can send and receive emails, access the Internet at high speeds and use telemetry services, all from a compatible mobile phone, laptop or desktop computer fitted wit a 1xRR PC card of modem, wherever there is CDMA coverage."

The Federal Government subsidized the regional rollout of the CDMA network to areas Telstra said were uncommercial to an estimated total of $110 million.

Within a year of the above statement assuring Australians that it was investing in a future upgrade path for the CDMA network, Telstra announced that the entire network would be scrapped and replaced by one using a different technology. All customer handsets and other equipment were made worthless overnight. Telstra did not offer to sell the network to another operator, despite reports that others were willing to consider making an offer.

The Cost of the NBN

From August 2005 until August 2007, Telstra repeatedly claimed publicly that the cost of building an national broadband network using fibre to the node technology would be $9.6 billion.

In May 2008, Telstra managing director Sol Trujillo said it would now cost $15 billion, an increase of 50% in cost. The next month Telstra managing director Donald McGauchie said the cost was not up to $25 billion.

At this time Telstra was arguing publicly that the Government should not consider other proposals to build a similar network because only Telstra could afford to build it.

On October 8 2008, Mr Trujillo told a media conference that: "We're talking about a build that's probably going to exceed $10 billion and could be as high as $15 billion in total costs to build, if all objectives were to be met."

This reduced cost estimate was made on the same day that the rival Terria bid representatives told the Senate Committee that its estimates were that the cost would be $10 billion or less.

Conclusion

The CCC provides the above examples because it is aware that some members of the committee were not participants in the processes and hearings in the term of the previous Parliaments at which Telstra made various representations that have since been reversed.

The CCC believes that it is important that Telstra's track record is taken into account when policy makers consider the risky policy prescription that Telstra is now proposing.

If Telstra has reversed or walked away from so many of its past assertions or positions such a short time after so fiercely advocating them, the CCC submits that policy makers can not have confidence that the positions Telstra is promoting today will prove any more robust in the face of Telstra's changing self-interest.

What has proved enduring over the past decade in jurisdictions around the world has been the wisdom of promoting competition in telecommunications as the best lever to reduce prices and improve services.

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