Document 44

TREASURY EXECUTIVE MINUTE

Minute No.

18 October 2010

Deputy Prime Minister and Treasurer

MEETING WITH TELSTRA CEO, MR DAVID THODEY (BR10/289)

Timing: You are scheduled to meet with Mr David Thodey, CEO of Telstra, on 19 October 2010 at 11.30am.

Recommendation/Issue:

- There are four primary issues which Mr Thodey may wish to discuss with you:
  - the introduction of the Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010 (CCS Bill);
  - the ongoing Telstra and NBN Co negotiations concerning the Definitive Agreement;
  - NBN network design, including points of interconnection to the NBN; and
  - the Review of Access Pricing Principles for Fixed Line Services, currently being undertaken by the ACCC.

Noted Signature: .... …../…../2010

KEY POINTS

- Talking points for your meeting are provided at **Attachment E**.
- The CCS Bill is primarily intended to introduce structural change into the telecommunications industry, by requiring the functional separation of Telstra if it does not voluntarily undertake structural separation
- The Minister for Broadband, Communications and the Digital Economy, Senator the Hon Stephen Conroy, is seeking to reintroduce the CCS Bill into Parliament this week (further information at **Attachment A**).
  - You have been already been provided with a briefing on this issue, see Executive Minute 20102587.
  - Passage of the Bill in February 2011 is essential to enable Telstra to sign the Definitive Agreements.
- A non-binding Financial Heads of Agreement was entered into between NBN Co and Telstra in June 2010 (further information at **Attachment B**). The agreement provides:
  - NBN Co access to Telstra's infrastructure to avoid unnecessary duplication; and
  - for the progressive migration of customers from Telstra's copper and cable networks to NBN.

- Telstra, NBN Co and the Commonwealth agencies are in the process of negotiating detailed Definitive Agreements, which is expected to take a few months. Treasury understands that negotiations are ongoing.
- A key NBN network design issue that is yet to be resolved is the number and location of Points of Interconnect, and the extent to which NBN Co bundles its access and backhaul products.
  - Points of interconnect (POI) are the locations where retail service providers (RSPs) will be able to connect to the NBN in order to offer their products to consumers.
  - The location and number of POIs is a sensitive issue, in particular for those companies (including Telstra) with existing backhaul infrastructure that may be at risk of being 'stranded'.

[s.34(3)]

  - The ACCC is expected to release a draft of the discussion paper on the NBN Points of Interconnect (POI) issue sometime this week *(information not to be disclosed to Mr Thodey*).
- On 17 September 2010, the ACCC released a draft report setting out its proposed approach to access pricing that will apply to the fixed line services declared under Part XIC from January 2011. The draft indicative prices that the ACCC are proposing are specific to the six declared fixed line services supplied over Telstra's (copper and fibre) access networks.
  - The ACCC's draft report proposes indicative prices based on a significant change in the method of pricing (further information at **Attachment D**). This method results in a lower indicative price for wholesale line rental (from $25.57 for a home to $20.00) an local carriage services (from 17 cents to 7 cents per call).

Contact Officer:

Manager
Communications and Infrastructure Access Unit

ATTACHMENT A

TELECOMMUNICATIONS LEGISLATION AMENDMENT (COMPETITION AND CONSUMER SAFEGUARDS) BILL 2010

- The Minister for Broadband, Communications and the Digital Economy, Senator the Hon Stephen Conroy, is seeking to reintroduce the Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010 (CCS Bill) into Parliament on 19 October 2010.
  - You were provided with a briefing on 15 October 2010 on the CCS Bill (Executive Minute 20102587). In order for the Bill to be introduced you need to provide your policy approval to provisions in the Bill which relate to the *Trade Practices Act 1974* (TPA).
- The CCS Bill is primarily intended to introduce structural change into the telecommunications industry, by requiring the functional separation of Telstra if it does not voluntarily undertake structural separation. It also aims to streamline the operation of the telecommunications parts of the TPA, and introduced further 'consumer safeguards'.
- The Department of Broadband, Communications and the Digital Economy (DBCDE) has had extensive discussions with Telstra over the last 12 months on the drafting of amendments to the CCS Bill.
  - The purpose of those discussions was to ensure that the Bill would establish a practicable approach to completing structural reform and would facilitate all parties giving effect to the commitments made in the Financial Heads of Agreement signed between Telstra and NBN Co in June 2010.
  - Telstra retains some concerns about a small number of provisions (most notably in relation to the absence of merits review for access determinations under Part XIC), but DBCDE is confident that Telstra supports the overall Bill.

Outline of the CCS Bill

Separation of Telstra

- Telstra's high level of vertical and horizontal integration, as well as its incumbent status, have allowed it to maintain a high degree of dominance in the telecommunications sector, hindering the development of competition in the sector.
  - The introduction of the NBN as a wholesale-only, open access network will transform the structure of the sector. However, the Government indicated it would legislate to improve competitive outcomes during the rollout of the NBN, rather than wait for the new sectoral structure to eventuate.
  - The CCS Bill provides a number of incentives to structurally separate, including denying Telstra the opportunity to acquire specified valuable bands of telecommunications spectrum.
    - : If Telstra does not structurally separate, the Bill provides for the imposition of functional separation. However, the deal with Telstra, if finalised, is likely to

result in Telstra submitting of a structural separation undertaking (SSU) to the ACCC.

Streamlining Parts XIB and XIC.

- The telecommunications-related anti-competitive conduct and access provisions of the TPA have been seen as ineffective and open to 'gaming' by parties to delay or damage new entrants.
- The CCS Bill streamlines these provisions by replacing the 'negotiate-arbitrate' model with new arrangements where regulators set up-front terms and conditions of access, and improves the ACCC's enforcement process.

Consumer safeguards

- The CCS Bill aims to enhance the standard of services under the Universal Service Obligation and the Customer Service Guarantee. It would allow the Minister to set certain minimum standards of service.

ATTACHMENT B

TELSTRA AND NBN CO AGREEMENT

- Telstra, NBN Co and the Commonwealth agencies are in the process of negotiating detailed Definitive Agreements, which is expected to take a few months. Treasury understands that negotiations are ongoing.

Overview of the agreement

- A non-binding Financial Heads of Agreement was entered into between NBN Co and Telstra in June 2010. The agreement provides:
  - NBN Co access to Telstra's infrastructure to avoid unnecessary duplication; and
  - for the progressive migration of customers from Telstra's copper and cable networks to NBN.
- Before any agreement is finalised it must first be approved by Telstra shareholders. The ACCC will also review the competition aspects of the agreement.
- It has been estimated that the agreement will deliver Telstra a post-tax net present value of approximately $11 billion. This includes payment for the decommissioning of Telstra's copper network and cable broadband service, use of Telstra's infrastructure, and the value to Telstra of avoiding costs, including certain Universal Service Obligation (USO) costs.
- The Agreement between NBN Co and Telstra provides for:
  - The reuse of suitable Telstra infrastructure, including pits, ducts and backhaul fibre, by NBN Co as it starts to rollout its new network avoiding unnecessary infrastructure duplication; and
  - The progressive migration of customers from Telstra's copper and pay-TV cable networks to the new wholesale-only fibre network to be built and operated by NBN Co.
    - : The migration of Telstra customers to the wholesale-only open access NBN is expected to help deliver structural separation of Telstra.
- The Australian Government will require NBN Co to be the wholesale supplier of last resort for fibre connections in greenfield developments from 1 January 2011.

Regulatory and budget commitments

- The Government will progress public policy reforms to support the transition to NBN to which Telstra attributes a value of approximately $2 billion.
- The Government will establish a new entity, USO Co with Commonwealth funding of $50 million in 2012-13 and 2013-14, increasing to $100 million per annum thereafter.
  - The remaining funding that USO Co requires will be contributed by industry, as it is now, with final arrangements subject to industry and stakeholder consultation.

- USO Co will assume responsibility for most of Telstra's Universal Service Obligations for the delivery of standard telephone services, payphones and emergency call handling from 1 July 2012.
- The Government will provide $100 million to Telstra to assist in the retraining and redeployment of Telstra staff that will be affected by this very significant reform to the structure of the telecommunications industry.
- The Government has also committed to providing to Telstra, in conjunction with the Definitive Agreements, a guarantee for the financial obligations of NBN Co until NBN Co is fully capitalised.

ATTACHMENT C

POINTS OF INTERCONNECT

[s.34(3)]

- The ACCC is expected to release a draft of the discussion paper on the NBN Points of Interconnect (POI) issue sometime this week *(information not to be disclosed to Mr Thodey*).

- POI are the locations where RSPs will be able to connect to the NBN so as to be able to offer their products to consumers.

- The number and location of POIs will have significant short, medium and long term implications for the structure of and competition in the fixed line telecommunications market.

NBN Co's preferred approach

- NBN Co is proposing to provide a small number of POIs (14 aggregation POIs at five capital city locations, with limited options for interconnection at 195 locations for specific applications or technical reasons). NBN Co also proposes to bundle its access and backhaul products for sale as a single product.

- NBN Co strongly links its POI location policy with achieving uniform national wholesale pricing.

Telstra

- Telstra is likely to oppose NBN Co's proposal for a limited number of POIs.

- Telstra has previously argued (in its response to a NBN Co consultation paper in December 2009) that it should be able to interconnect with NBN Co at each fibre exchange (implying around 800 POIs).
  - However, such an approach would be detrimental to retail competition, because of Telstra's dominance in the backhaul market.

ATTACHMENT D

ACCC REVIEW OF ACCESS PRICING PRINCIPLES FOR FIXED LINE SERVICES

- On 17 September 2010, the ACCC released a draft report setting out its proposed approach to access pricing that will apply to the declared fixed line services from January 2011 to 31 December 2014.
  - The draft indicative prices are specific to the six declared fixed line services supplied over Telstra's (copper and fibre) access networks.
  - These legacy services make up the key wholesale and access services delivered over Telstra's copper network and include the: unconditioned local loop service (ULLS); wholesale line rental (WLR); line sharing service (LSS); public switched telephone network originating access (PSTN OA); public switched telephone network terminating access (PSTN TA); and local carriage service (LCS).
  - Submissions to the draft report are due by 22 October 2010. Telstra has not yet made a submission.
- This draft report proposes indicative prices based on a significant change in the method of pricing.
  - The ACCC is proposing to move to a building block pricing model (also known as a regulated asset base, or "RAB" model), which calculates prices based on the assets and costs associated with providing the regulated services. Previously the ACCC has used the hypothetical replacement cost model.
  - The ACCC states that this change in its approach to access pricing for fixed line services is consistent with its approach in other regulated industries.
- The ACCC estimates that prices for these resale services are estimated to fall as a result of this change, while prices for other services will remained fairly stable. The table below sets out the proposed prices. The 'bands' relate to different geographical areas.

Summary—Current indicative prices compared with proposed draft indicative prices to apply from 1 January 2011 to 31 December 2014

	Current indicative prices	**Draft indicative prices**
ULLS access prices with geographically de-averaged prices		
Band 1	$6.60	$6.50
Band 2	$16.00	$16.00
Band 3	$31.30	$31.00
Band 4 (notional price)		*$100*
WLR (per line per month)	$25.57 (Homeline) $26.93 (Businessline)	$20.00 (nationally averaged)
LSS (per line per month)	$2.50	$2.50
PSTN OA and TA (per minute)	1c (headline rate)	1.1c (headline rate)
LCS (per call)	17c	7c

ATTACHMENT E

TALKING POINTS

Introduction of CCS Bill

- I understand that there have been constructive discussions between Telstra and the Government on the details of the Competition and Consumer Safeguards Bill.
- The Competition and Consumer Safeguards Bill 2010 is set to be introduced in this sitting of Parliament.
- The Bill sets up a procedural framework that enables a transformation of the structure of the telecommunications sector.
- The early passage of this Bill is critical to enable all parties to give effect to the commitments they made in the Financial Heads of Agreement.
- I strongly urge Telstra to give this Bill its clear and unambiguous public support.

Regulatory certainty

- The Government has taken significant steps to provide the regulatory certainty needed in order for the successful implementation of the National Broadband Network.
  - The Government continues to work on its response to the NBN Implementation Study, which it will release in due course.
- I understand that there are issues relating to the NBN and Telstra raised in the Implementation Study which the Government has yet to consider.
  - The Government is cognisant of the need for certainty in the area and is considering these issues closely.

NBN Co Agreement

- I understand that Telstra and NBN Co are in the process of negotiating detailed Definitive Agreements, following the Financial Heads of Agreement entered into in June 2010.
  - The Government is committed to the successful implementation of the NBN, and has taken a number of steps in order to provide the regulatory certainty needed in order for the Definitive Agreements to be finalised.

Points of Interconnect

- The Government understands that this is a key concern for the future development of the communications industry in Australia.
- I can assure you that the Government is considering this issue closely.

Review of Access Pricing Principles for Fixed Line Services

- I understand that the ACCC is currently consulting on a proposed approach to Access Pricing Principles for Fixed Line Services which it proposes to apply to declared fixed line services from 1 January 2011.
- I understand that Telstra has been involved in the consultation which the ACCC has undertaken to date, and I strongly encourage Telstra to continue to work with the ACCC on this important issue.