7 August 2006

The Manager

Company Announcements Office
Australian Stock Exchange
4th Floor, 20 Bridge Street
SYDNEY NSW 2000

Office of the Company Secretary

Level 41
242 Exhibition Street
MELBOURNE VIC 3000
AUSTRALIA

Telephone 03 9634 6400
Facsimile 03 9632 3215

ELECTRONIC LODGEMENT

Dear Sir or Madam

Transcript from Telstra Fibre to the Node Briefing – Teleconference

Attached is a copy of the transcript from today's Telstra Analyst Briefing on fibre to the node, for release to the market. The Q&A transcript will also be released to the market when available.

Yours sincerely

Douglas Gration
Company Secretary

TELSTRA FIBRE TO THE NODE BRIEFING

TELECONFERENCE 7 AUGUST 2006

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ANDREW MAIDEN: Good morning everyone and thank you for joining today's briefing. We apologise for the short notice. The reasons for that short notice will be apparent to you in a minute or two. Phil Burgess will speak. Phil is the group managing director for public policy and communications. When Phil is finished, you will be able to ask questions in the format described in the invitation and at the conclusion this call Phil's comments and your questions and his answers will be transcribed and later this afternoon they will be posted with the ASX and following that Telstra's consumer web site www.nowwearetalking.com.au. So I will now hand over to Phil Burgess.

PHIL BURGESS: Thank you, Andrew. I have a brief statement, after which I would like to answer any questions that you may have. For the question and answer part, I will be joined by two of my colleagues; Tony Warren, who heads the Telstra regulatory affairs, and Frank Hatzenbuehler who led our team in developing the high speed access service that I am going talk about a bit more later and who leads our cost studies program.

I talked with ACCC chairman Graeme Samuel last Friday and again this morning. We discussed the progress we are making in the FTTN talks, that is the talks between Telstra and ACCC around the $4 billion high speed broadband fibre to the node network that we want to build to provide high speed broadband connectivity to four million households over the next 40 months.

Both these conversations were substantive, frank and civil.

Both focused clearly on issues, critical issues that continue to divide us. These issues are related primarily to two things: Actual cost and the way those costs would be recovered. I called the chairman on Friday because I wanted to alert him as to how we were thinking about these things and especially the cost issues. I also wanted to know the thinking behind his public comments for us to go public with our FTTN proposal.

When we were talking again this morning the chairman and I agreed that we have reached an impasse in our FTTN deliberations and it is only fair for us to inform stakeholders, including Telstra shareholders, that this round of ACCC Telstra FTTN talks have failed. We have also agreed that the FTTN and the ULL agendas that we are discussing include important issues for Telstra, the industry and the nation and that we will continue to address these issues in a variety of forums including, when it is appropriate, direct negotiations with the ACCC.

Let me talk a little bit about the chairman's public comments last week that we should go public. He has urged us to go public with the FTTN proposal, in his words to see how the public, the competition, the commentators react. I told him Friday that doesn't make any sense for us, for several reasons: First of all, we agreed with him and the ACCC to go public once we had some, what we called green lights and perhaps some amber lights from the ACCC, but no red lights. As things now stand we have some green lights, a lot of them and I will talk about those in a second, and amber lights but we also have some very bright red lights, so the conditions for going public have not been met.

There is a second reason and that is the competition, going to the competition doesn't make a lot of sense because the competition have already stated their opposition. For example, SingTel Optus CEO, Paul O'Sullivan, the leader of the opposition to a Telstra FTTN investment in Australia was quoted in The Australian on 11 August as saying: "Telstra's fibre to the node network should not be allowed to proceed. We will do everything necessary to stop it."

I think it is unfortunate that these views exist in an industry that is so key to Australia's future. In fact, there is no need to stop Telstra's FTTN project. The fact is the FTTN project has been on hold since last year, last December, pending regulatory reforms that could safeguard the investment of our shareholders. As we reported in our year end summary last month, all aspects of Telstra's transformation strategy are proceeding on or ahead of schedule and on budget, except for regulatory reform to achieve the FTTN deployment safeguard that will protect our shareholder investment. We initiated these talks with the ACCC in the hope that we could resurrect the FTTN project which has been on hold since December.

The third issue the chairman raised about our going public was that the decision to make the investment could be informed by what the commentators think. The fact is that the FTTN investment will not be affected by what commentators think. The FTTN investment will be made if we are permitted by the ACCC to price the service at commercial rates, rates that reflect all of our costs and under regulatory conditions that protect our shareholders' $4 billion investment from being pillaged by competitors. So the only thing that makes a difference in the short term is what the ACCC thinks. The ACCC holds 100 per cent of the decision-making power over the short term and can, with the stroke of a pen, set prices and make commitments that will advance the FTTN investment by Telstra.

We have got a lot of tight time constraints on our side that are driven primarily by the Telstra transformation investment schedule. We did not want to submit a FTTN undertaking to the ACCC that would not be in the ballpark. Instead, we wanted an FTTN undertaking that avoided issues that could kill us from the outset. An undertaking that is dead on arrival helps no-one. These why we entered into these discussions in the first place.

As matters turned out, the ACCC was unable to give us the green light we need to proceed. As a result, we will not be submitting an undertaking to build the FTTN. Because we will not be submitting an undertaking, no purpose is served by submitting a discussion draft of our proposal for review by the industry, though a detailed technical overview of our proposal will be available on "now we are talking" web site later this afternoon.

I regret this outcome because households, businesses, government and non-profit enterprises are headed for a digital future that will be characterised by new band width-hungry applications. The need for advanced network technologies to cover the long distances, low densities and difficult terrain found in Australia will become increasingly apparent. The Telstra FTTN plan, however, has now been removed from the table, despite the best efforts of Telstra and a lot of hard work by the ACCC. The discussions we had with them were affable, they were professional, they involved a lot of hard work and I think both sides gave it a shot.

But instead of success, the failure of the ACCC and Telstra to find a way to advance our FTTN plan is in my view a casualty not so much of the relationship that we had, but a casualty of confused, inconsistent and ultimately counterproductive telecommunications policies and regulations that discourage investment, including investment in new digital infrastructure. The failure of the FTTN talks is only the latest example. We tried to get across the goal line and I believe the chairman and his ACCC colleagues also gave it a go, but we didn't make it.

Let me just go into one other point before I turn it over to questions. Despite all the stumbling blocks that we had, and cost was the primary one, it is important to note the areas where we seemed to make progress and in some cases substantial progress and to reach provisional agreement. I say "seemed to" and "provisional" because at the outset we agreed that nothing would be agreed to until everything is agreed to. But I think it will be instructive for people to know the extent to which we really did find a lot of agreement on a whole range of issues. Let me just give you a sense for those.

These talks were not scuttled by disagreement over access. Even though early on we were opposed to competitive access for all kinds of reasons - our shareholders after all are building this facility and, as the Group of Nine is already showing, anybody can build it - the ACCC had a different view. They thought access should be part of a new regime, so early on we made a major concession to keep the talks moving. That concession was our agreement to decide to design an FTTN access regime that would provide competitive access on commercial terms that could be approved by the ACCC. We also agreed to design that service so that it provided competitors with access on terms equivalent to those available to Telstra's own retail unit. The result is our proposal for a high speed access service, we call it HAS, a summary of which will, as I said, be available later this afternoon on Now we are talking.

Another point is talks were not scuttled over network management issues; that is, for example ULL would be shut down on an exchange-by-exchange basis as the FTTN was turned on. That could have been a stumbling block but they understood the logic and the wisdom of not having these two things simultaneously.

Number three is talks were not scuttled by disagreements over transition management issues. For example, we agreed that competitors could have access to our build-out plans, including timetables, on an exchange-by-exchange basis to facilitate their transition, management and capital spending plans.

Fourth, the talks were not scuttled by disagreements over the cost of the FTTN build-out. We essentially agreed on those costs. Number five, talks were not scuttled by disagreements over the cost of capital. We even reached agreement on that issue, which is often a stumbling block in these kinds of things.

Number six, the costs were not scuttled by disagreements over the takeup rate used in the calculation of prices. Number seven, the talks were not scuttled by disagreement over FTTN service description, the bit stream service we call the high speed access service.

The talks were not scuttled by disagreements over the cost of providing the high speed access service to access seekers, but we were in the process of working through differences related to the costs of the elements, both copper and fibre, used in providing bit stream. Those differences, in our view, and I think in the view of the

ACCC, could have been resolved. The talks were not scuttled by disagreement over the principle that the burden of paying for service in high cost areas could be shared by all 10 million, should be shared by all 10 million (fixed line) telecommunications users in Australia.

Finally, the talks were not scuttled by disagreement over the principle that a bit stream surcharge or subsidy would be the most competitively and technologically neutral way to ensure that Telstra could underwrite the shortfall we incur and will continue to incur in providing service delivery into high cost areas that we are obligated by law to do.

In short, we reached provisional agreement, and I emphasise it is provisional agreement, on a wide range of very difficult issues that need to be resolved to create a new paradigm for regulating the IP space. We almost got there. The last few yards are always the toughest and we didn't make it.

So why did the talks fail? They failed because in our view we faced clashing world views on the issue of costs. We ran into trouble not on the principles related to funding high cost areas, but on the levels of funding required to deliver services to households and other premises outside the FTTN footprint, including people and communities in regional, rural and remote Australia as well as suburban areas outside the footprint.

These differences centred on our view of costs and the ACCC's view of costs. This is a fundamental point: When you can't agree on costs, it is impossible to agree on prices and we are here today because our different view of cost led to irreconcilable differences on price.

Let me just say a few words about funding high cost areas.

Funding the high cost areas in rural and regional Australia was an issue from the outset because the high speed access service would have to generate revenues to fund cost not covered by the universal service obligation fund. We have been discussing this issue with the ACCC since late 2005.

It is a long-standing policy of the Australian Government to protect the interests of telecommunications users in regional and rural Australia. In its current form that policy involves imposing on Telstra a range of obligations to supply services to those users to regulate quality standards at prices that are no higher than those we charge to consumers in the metropolitan area. We agree with that policy and we agree with the social compact that includes a national, uniform price.

It is a policy that seems to have the support of most Australians who believe that people in the bush should have the same access as people in the cities when it comes to telecommunications and that access should be at roughly the same price, but we also require that our shareholders be compensated for the costs that policy imposes on us.

These costs are simple to understand. When you are building or maintaining a network of any kind, an electric power grid, a gas pipeline, highways, railroads or a telecommunications network, there is what I call the DDT factor. DDT refers to distance, the longer the distance the higher the cost; density, the lower the population density the higher the cost, for example the low population density from sprawling suburbs to rural areas compared to a down-town central business district are huge, the differences; and terrain, the more difficult the terrain the higher the cost, for example providing telecommunication services to mountain areas or islands or swamps is enormous.

I was recently up at Tiwi Island where we saw first hand the enormous cost of servicing a pay phone. We provide services in non-metropolitan areas at prices that are a fraction of the costs involved. Just this month we spent $63,000 to provide a single service to a customer in Mount Macedon by boring under an environmentally sensitive area to provide a line. There is a project currently ongoing in Kirup in south-western Western Australia where it is costing $107,000 to plough several kilometres of cable, some of it through rock, to provide a single service.

So even though these costs are higher for telecom services in non-metropolitan areas, the government's policy of national uniform price means the price is the same as a low cost central business district and that's a policy that we agree with. The result is that revenues from the high cost areas do not cover the costs which in some cases are more than $50,000 just to connect the phone line to the network.

The result of the shortfall between the low nationally average price and the cost, which exceeds the price in high cost areas, this shortfall has to be recovered from somewhere. As matters now stand, there are two sources for that recovery: One is the universal service obligation which most people know about and we can talk about more in detail. The other is through cost subsidies and both of those are part of the way that we maintain a national uniform price in this country.

The bottom line is that the ACCC can't keep cutting wholesale prices in cities where the surplus comes from to pay for the bush and expect Telstra to continue to fund the bush. The money just won't be there, and those kinds of issues were discussed repeatedly during our conversation.

The ACCC accepted the principle of a surcharge or a subsidy, but there was no meeting of the minds on the amount required. What the ACCC was willing to contemplate in terms of an amount would not have come close to covering the costs involved. In fact, in our discussions we centred in on costs that were as low as $1.77 a month to costs that were as high as $13.63 a month. Those are very difficult gaps to fill.

The bottom line is that two world views are clashing; one, the policy world view of the government, established in law for a national uniform pricing or price averaging for retail consumers to generate funds to subsidise the bush, which is also the world view of Telstra, and the world view of the ACCC, which has priced the averaging for wholesale providers that, with increasing competition and lower ULL prices, will destroy the financial foundation of the government's policy of urban/rural parity and the government's choice of funding mechanisms, the cross subsidy model.

So, when all is said and done, the problem you see is really not between Telstra and the ACCC; it is a conflict within the government between the policy making arms, the ministries and Parliament and the regulatory arm, the ACCC. The government needs to get its own policy house in order before there will be progress for all Australia on the FTTN talks. Until that happens, Telstra shareholders will be caught in the crossfire of conflicting policies and approaches inside the government, with the government and the ACCC wanting our shareholders to pay the costs of confused, conflicted and counterproductive telecommunications policies and regulations that discourage investment in new digital intra-structure. Because we will not let that happen, because we are going to protect our shareholders' investment, we have had an impasse. That, in a nutshell, is why we hit the wall on FTTN.

If there are any questions, I will be happy to take them and Tony Warren and Frank Hatzenbuehler are also here to do that.

(Q and A follows.)

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