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NBN Co: Optus HFC Agreement authorisation

Draft response to ACCC questions in letter dated 7 October 2011

1. NBN Co's view of the likely future absent authorisation of the Optus HFC Agreement

1.1 Question 1

In commenting upon the Applications and the Optus HFC Agreement entered into by NBN Co, Telstra Corporation Limited (**Telstra**) recently publicly stated:

There is a risk that the ACCC may not approve this agreement. The implementation of the agreement between NBN Co and Optus is not a Condition Precedent to the Proposed Transaction. If it is not approved (or does not come into effect for some other reason), Optus may continue to service customers on its HFC network within the NBN Fibre Footprint. In these circumstances, the Proposed Transaction would still proceed (subject to the Conditions Precedent being satisfied or waived) and Telstra would be required to disconnect Copper Services and HFC Broadband Services provided to premises in the NBN Fibre Footprint at the relevant Disconnection Date. If this occurred, and Optus was successful in developing and marketing its HFC broadband services in competition with services provided using other existing networks and/or the NBN, there is a risk that there could be a material adverse effect on the value of the Proposed Transaction to Telstra, Telstra's earnings and its financial position and performance.¹

The ACCC seeks NBN Co's response and/or comments to the above statement, in particular, does NBN Co agree with the above statement by Telstra? If not, please provide reasons.

1. The statement quoted by the ACCC sets out Telstra's views about the potential impact on Telstra if the Optus HFC Agreement does not come into effect.
2. NBN Co's views about the likely future absent authorisation of the Optus HFC Agreement are set out in Confidential Annexure 1 to its submission dated 29 August 2011.

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¹ Explanatory Memorandum for the resolution under item 2 at the annual General Meeting on 18 October 2011: Telstra's participation in the rollout of the National Broadband Network, Telstra Corporation Limited, 1 September 2011, at pp 22 – 23.

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1.2 Question 2

At paragraph 91 of NBN Co's submission dated 29 August 2011, accompanying its Applications (**NBN Co's submission**), NBN Co stated that *'the ACCC should assess the public benefits against any anti-competitive detriments arising from the Optus HFC Agreement, compared with the current state of competition in the relevant markets'*.

Please explain why NBN Co considers that current market conditions provide a suitable point of comparison for identifying the likely consequences of the Optus HFC Agreement coming into effect.

3. In weighing public benefits and detriments, the ACCC must compare the position which would or would be likely to exist in the future if authorisation were to be granted and the position that would be likely to exist in the future if authorisation were not to be granted².
4. The assessment of the position that would be likely to exist in the future without authorisation cannot involve speculative or possible effects. Rather, the relevant effects must be probable commercial and economic likelihoods³.
5. The telecommunications industry is undergoing significant change and Optus HFC Agreement has been negotiated and entered into in a unique policy and regulatory environment that has been developed to deliver that industry change. The Optus HFC Agreement forms part of the development of those regulatory and policy settings and industry change. The regulatory and policy settings that apply to NBN Co and the telecommunications industry also generally assume the entry into and implementation of the DAs between NBN Co and Telstra.

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² ACCC Guide to Authorisation, p 31.

³ NBN Co also notes the Federal Court's decision in *Australian Competition and Consumer Commission v Metcash Trading Ltd* [2011] FCA 1079, in which the Federal Court found that the counterfactual situation must be assessed on the balance of probabilities, as to what the future state of the market will be, both with and without the relevant conduct; that is, the counterfactual must be more probable than any competing hypothesis advanced. NBN Co considers that any view of the future without authorisation other than the status quo cannot satisfy this test.

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6. If the Optus HFC Agreement does not come into effect, NBN Co submits that the position that would be likely to exist in the future is a matter of mere speculation. The only position that can be identified as a probable commercial and economic outcome, at least for the foreseeable future, is the status quo.

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1.3 Question 3

Further to question 2, what would the effect on NBN Co's investment in the NBN be if the Optus HFC Agreement were not to come into effect? In particular what would the effect be on the timing and scale of NBN Co's investment?

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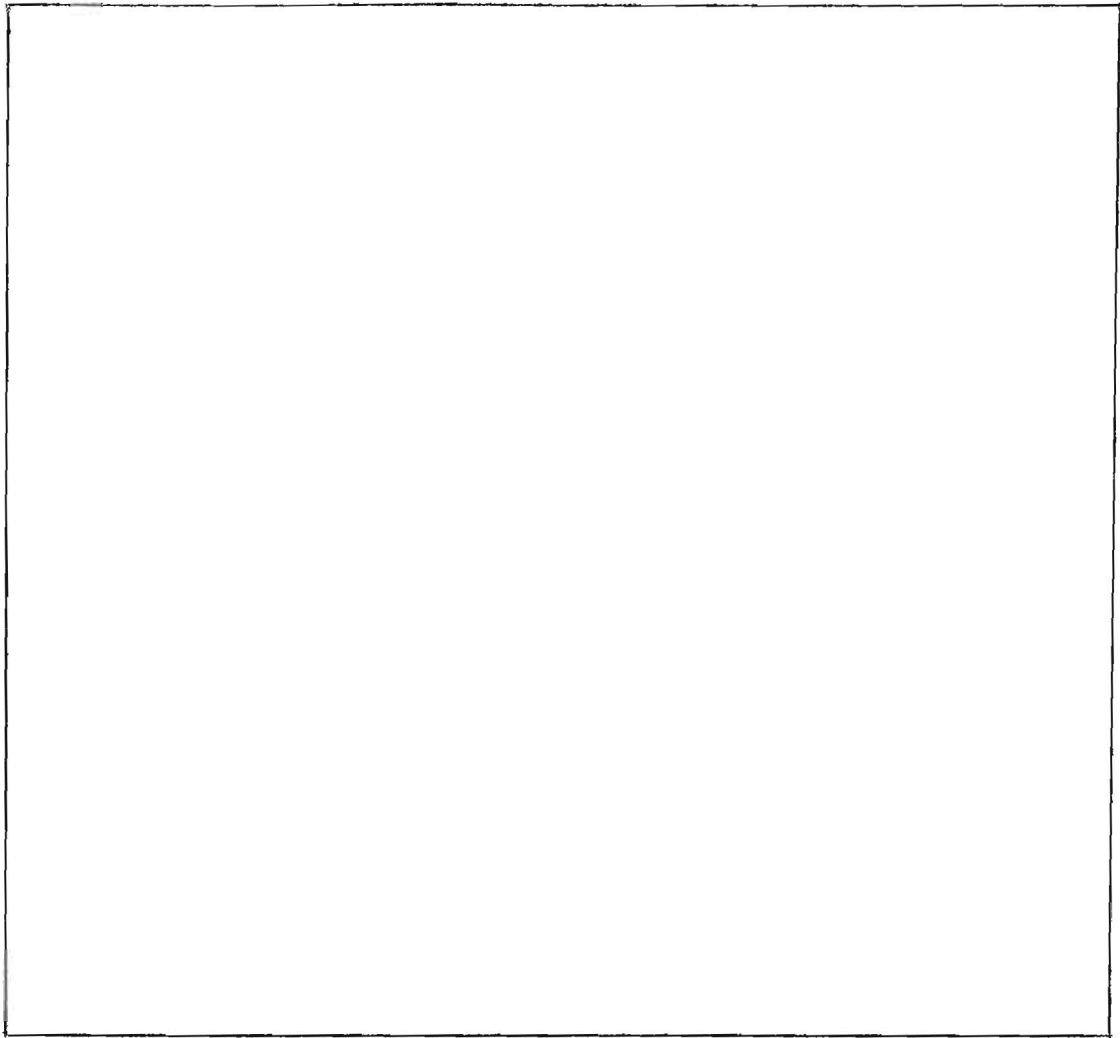
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2. Take up rates and subscriber projections

2.1 Question 4

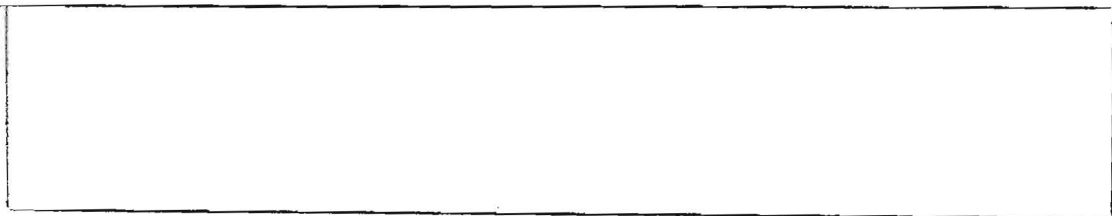
At paragraph 101 of NBN Co's submission it is noted that the progressive migration of customers from the Optus HFC network to the NBN is expected to enhance the take up rates of the NBN.

Please provide details of the expected rate of migration by Optus HFC subscribers to the NBN with the following assumptions:

- a. authorisation is granted to the Optus HFC Agreement (migration with the agreement); and
- b. authorisation is not granted to the Optus HFC Agreement (migration without the agreement).

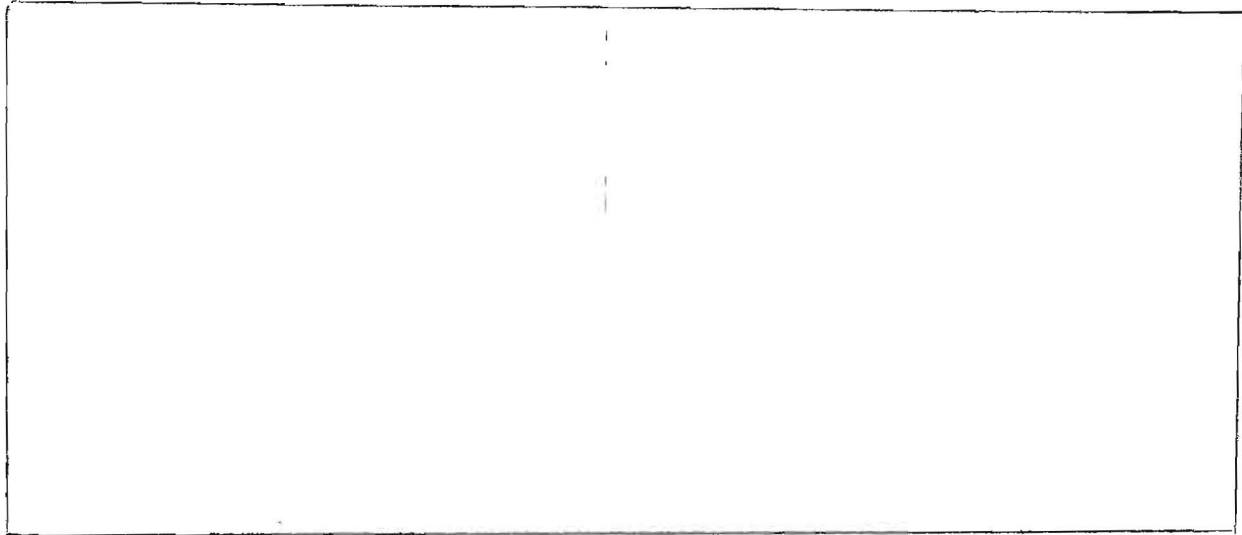
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2.2 Question 5

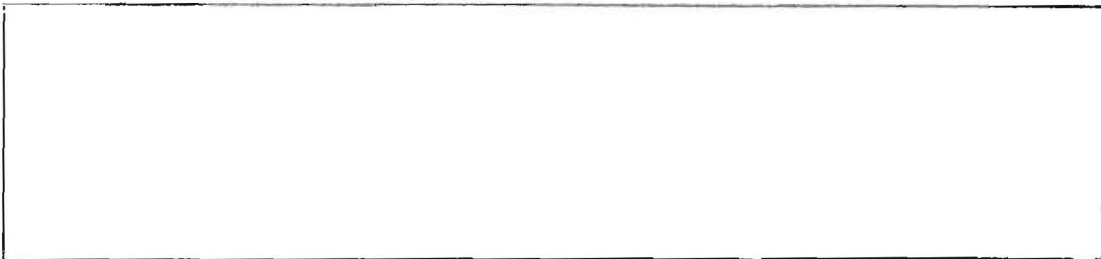
At paragraph 133 and 134 of NBN Co's submission it is noted that the Optus HFC network currently offers data download speeds of up to 20Mbps/1Mbps with a technical ability to provide a maximum download speed of 100Mbps/1Mbps.

For each financial year up to and including financial year 2028, please provide NBN Co's projections regarding subscriber numbers for different speed tiers, for example:

- a. download speeds of 12Mbps, 25Mbps, 50Mbps, 100Mbps, 250Mbps, 300Mbps, 500Mbps, 1000Mbps;
- b. upload speeds of 1Mbps, 5Mbps, 10 Mbps, 12Mbps, 20Mbps, 40 Mbps, 50Mbps, 100Mbps, 200Mbps, 400Mbps.

(see Exhibit 9.24 of NBN Co's Corporate Plan). Please provide the basis for these projections and any assumptions made.

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2.3 Question 6

Paragraphs 97 and 107 of the NBN Co submission state:

[The Optus HFC Agreement] ... improves NBN Co's ability to achieve its targeted take up of services and projected financial returns.

Optus HFC customers are located in metropolitan areas. NBN Co anticipates that those customers are higher margin customers. ... The impact of demand and ARPU on NBN Co's expected Internal Rate of Return is illustrated in Exhibit 1.10 to NBN Co's Corporate Plan.

In assessing the likely effect of the Optus HFC Agreement on NBN Co's projected financial returns/internal rate of return, please identify the assumptions made by NBN Co, in order of importance,

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regarding the number of subscribers who would elect to use the Optus HFC network in preference to the NBN (i.e. if the Optus HFC Agreement did not proceed but the Telstra/NBN Co deal did).

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3. Policy and regulatory change

3.1 Question 7

Paragraph 90 of the NBN Co submission states:

that there can be no commercial certainty as to the likely future state of competition without the Optus HFC Agreement. Without the Optus HFC Agreement, the Government's NBN expectations, policy settings and regulatory framework are likely to require revision, including the semi-distributed POI structure and the implementation of uniform national wholesale pricing. However, the nature and extent of that revision is a matter for speculation. See also section 6.2 of the NBN Co submission.

- a. Please provide reasons why NBN Co considers the Federal Government's NBN expectations, policy settings and regulatory framework including the semi-distributed POI structure and the implementation of uniform national wholesale pricing are likely to be revised in the absence of the Optus HFC Agreement. Please provide any supporting documentation.
- b. Does NBN Co expect that it would be unable to meet the uniform national wholesale pricing commitment or semi-distributed POI structure at all without the Optus FC Agreement? If so, please provide the basis for this view.

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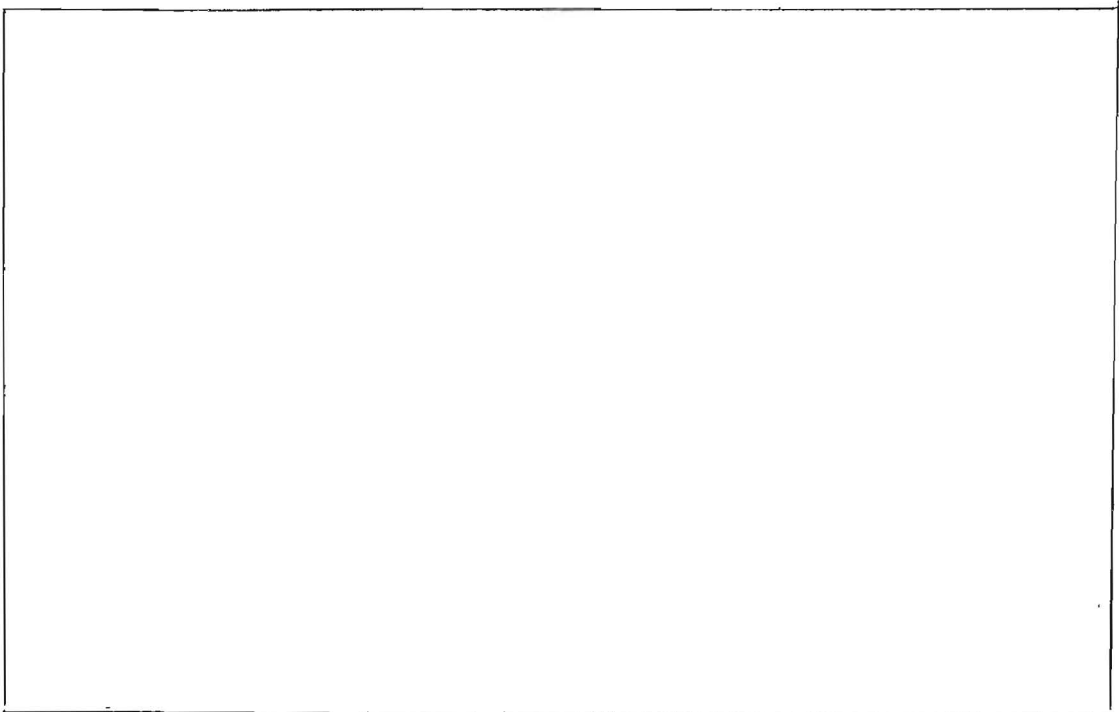
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4. Competition from competing platforms

4.1 Question 8

The ACCC notes that at page 49 of NBN Co's Corporate Plan, a prediction is made that in financial year 2025 there will be circa 16 per cent of residential premises that are 'wireless-only' and that there are no 'wireless-only' businesses. Further on page 85 of its Corporate Plan, NBN Co states that '*...even in a situation where Definitive Agreements are entered into with Telstra, NBN Co will face competition from competing platforms (notably wireless)*'.

Would NBN Co's prediction that approximately 16 per cent of residential premises will be 'wireless-only' and that there will be no 'wireless-only' businesses change depending on whether the Optus HFC Agreement is authorised? If so, please provide details of how these changes would affect NBN Co's financial performance. Please provide substantiation for this view.

22. Page 49 of the Corporate Plan states:

The Plan assumes 13% of total residential occupied premises being wireless-only today, increasing to 16.3% by FY2025 and 16.4% by FY2040. In terms of total occupied premises (residential plus business), this implies 13% of total premises are wireless-only by FY2025.

23. The NBN Corporate Plan did not assume the existence of the Optus HFC Agreement.

24. NBN Co assumes that this question relates to the anti-disparagement clause in the Optus HFC Agreement. However, the anti-disparagement clause is not relevant to the predicted number of wireless only homes or the extent to which Optus' wireless data services might compete with the fixed broadband services offered by the NBN. The prediction in the Corporate Plan

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assumed that the retail service providers (**RSPs**) offering wireless services continue to market those services as they are currently marketed. The anti-disparagement clause does not prevent Optus from marketing its wireless services, as set out in answer to question 10 below. In addition, the prediction applied to wireless voice and data services, the breakdown of which is set out in page 32 of the Corporate Plan (11% and 4% respectively). The anti-disparagement clause applies only to wireless data services only and only where the marketing of those services directly targets the HFC serving areas.

5. The 'anti-disparagement' provision

5.1 Question 9

Paragraph 35 of the NBN Co submission provides that the Optus HFC Agreement prevents Optus from conducting a marketing campaign targeted at retail customers within the HFC serving area in respect of wireless data services which is disparaging of the performance or functionality of the NBN, being a marketing campaign that is expressly critical of or makes any expressly adverse statement about the performance or functionality of the NBN.

Please provide examples of statements or types of marketing campaigns that NBN Co considers would be likely to contravene this provision.

25. NBN Co considers that any express statement in Optus advertising for its wireless data services in HFC serving areas which brings discredit upon, lowers the estimation of, denigrates or belittles the performance or functionality of the NBN would be likely to contravene this provision. It is not possible for NBN Co to provide definitive examples of such statements or marketing campaigns, however, indicative examples would be:
- (a) where Optus makes express statements in advertising for its wireless data services in HFC serving areas that, by reason of NBN Co being Government-owned, it could not be expected to be innovative or offer up to date services.
 - (b) Optus makes statements in advertising for its wireless data services in HFC serving areas expressly disparaging the reliability of the NBN as relatively new and untested.

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5.2 Question 10

Paragraph 119 of the NBN Co submission provides (in part) that the anti-disparagement provision will have no effect on competition for wireless broadband services. It is further noted that Optus does not currently promote its wireless services with reference to either its HFC network or Telstra's copper network.

If the anti-disparagement provision will not have an effect on wireless competition or Optus' ordinary marketing approach, please explain why the anti-disparagement provision is necessary or integral to the Optus HFC Agreement. Please provide any supporting documentation.

26. As provided for in paragraph C of the Background to the Optus HFC Agreement, the purpose of the Optus HFC Agreement is to reward Optus for migrating HFC Customers to the NBN. It is to NBN Co's commercial benefit, and is in the national benefit, to do so for the reason articulated in NBN Co's submission accompanying the section 88 application. Thus NBN Co wishes to encourage all current Optus HFC customers to migrate, and to migrate as early as possible for its benefit and for the national benefit.
27. Because the NBN-based services are new, NBN Co wishes to foster the demand to migrate customers from other fixed line networks, and thus increase the demand for the take up of NBN based services.
28. NBN Co considers that it is important to ensure that any Optus wireless data services marketing campaign running at the time migration is being encouraged by NBN Co and other RSPs does not, by denigrating the performance of functionality of the NBN, make migration less attractive. In essence, the anti-disparagement clause is a safeguard to ensure that the purpose for entering into the Optus HFC Agreement, and the benefit to the nation thereby resulting, is achieved to the greatest extent possible without being adversely affected by negative sentiment derived from disparaging comments about the NBN. Having agreed to pay Optus for migration (which is in NBN Co's interests and the purpose of the Optus HFC Agreement), NBN Co does not wish to be deprived of the benefit of the Optus HFC Agreement, and nor should the full benefit to the nation be reduced, in part, by reason of a campaign by Optus that could thwart its objective by disparaging the performance of functionality of the NBN.
29. NBN Co and Optus were acutely conscious of the need to ensure that vigorous and effective marketing of wireless data services by Optus marketing was not dampened or discouraged by clause 5.2(c) of the Optus HFC Agreement. The parties agreed on the precise wording, including the clarifying exceptions, after a substantial and lengthy negotiation. Optus, in particular, as an important supplier of wireless data services now and into the future was acutely protective of its ability to carry out its currently intended and possible future promotional activities for wireless data services unimpeded. NBN Co and Optus believe that

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the clause, as drafted, does not impede Optus' ability do so. It follows that the clause does not have the purpose nor could it have the effect of preventing, restricting or limiting the supply of any wireless data service by Optus to any person in any material way.

Permissible marketing

30. While Optus does not currently promote its wireless services by express comparison with fixed line services, it is possible it could do so in the future. The clause does not prevent this from occurring, if Optus wished to do so at some point.
31. Should Optus wish to do so, it can make a fair comparison between the benefits of its wireless products based on objective facts (including its performance characteristics such as download speeds and network coverage) compared to fixed line services, including fixed line services using the NBN. If Optus wished to promote the benefits to customers of the mobility of its wireless broadband services using its cellular network compared to the fixed location of services over the NBN, that would be permissible (clause 5.2(e)). If Optus wished to make what is commonly regarded as a powerful form of comparative advertising, on price, provided it did so in an accurate like-for-like comparison, that would also be permissible.
32. Indeed, the clause allows promotion of wireless data services in any way Optus chooses without limitation:
 - (a) in any location nationally where there is no comparison made with fixed line services on the NBN;
 - (b) in any location nationally where there is a comparison with fixed line NBN-based services that is not expressly disparaging of the performance of functionality or the NBN;
 - (c) in any location nationally where there is a comparison with fixed line NBN based services that is expressly disparaging of the NBN other than on its performance of functionality (such as, for example, on the prices of services over the NBN);
 - (d) outside Optus HFC Areas (which are in parts of Brisbane, Sydney and Melbourne) where there is a comparison with NBN based fixed line services that is expressly disparaging of the performance or functionality of the NBN;
 - (e) in any location nationally by comparison, which may be disparaging, with copper and HFC based fixed line services and wireless services.

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33. The clause allows unfettered promotion of wireless voice services throughout Australia in any way Optus chooses, whether or not it is disparaging of the NBN.

6. Ability to achieve take up targets and projected financial returns

6.1 Question 11

NBN Co has submitted that the Optus HFC Agreement improves NBN Co's ability to achieve its targeted take-up of services and projected financial returns by both residential and business customers, see for example paragraphs 97, 101-2, 107-8 of NBN Co's submission.

- a. Please provide a description of the assumptions and any sensitivity analysis that has been undertaken to support this view. Please also provide any supporting documentation.
- b. Please detail the risk analysis undertaken in respect of the effect of the Optus HFC Agreement on NBN Co's anticipated revenues and/or payments to be made to Optus under the Optus HFC Agreement. Please also provide any supporting documentation relevant to this analysis.

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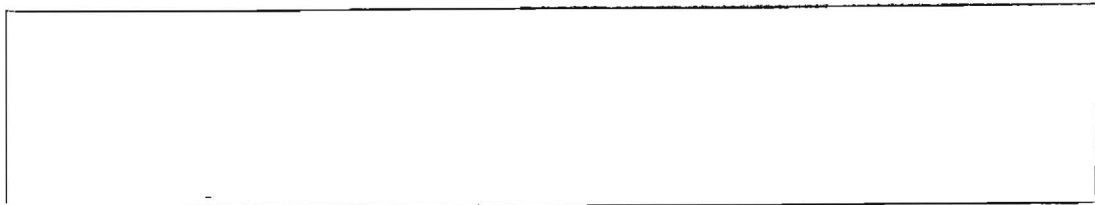
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7. Energy efficiency**7.1 Question 12**

Paragraph 151 of the NBN Co submission suggests that the NBN may be more energy efficient than existing HFC networks.

- a. Please provide an estimate of the average energy requirement to support a subscriber on Optus' HFC network for a given period. For example, 'xx kW/h per annum per subscriber'. Please provide any supporting documentation and data.
- b. Please provide any further details supporting this claimed public benefit.

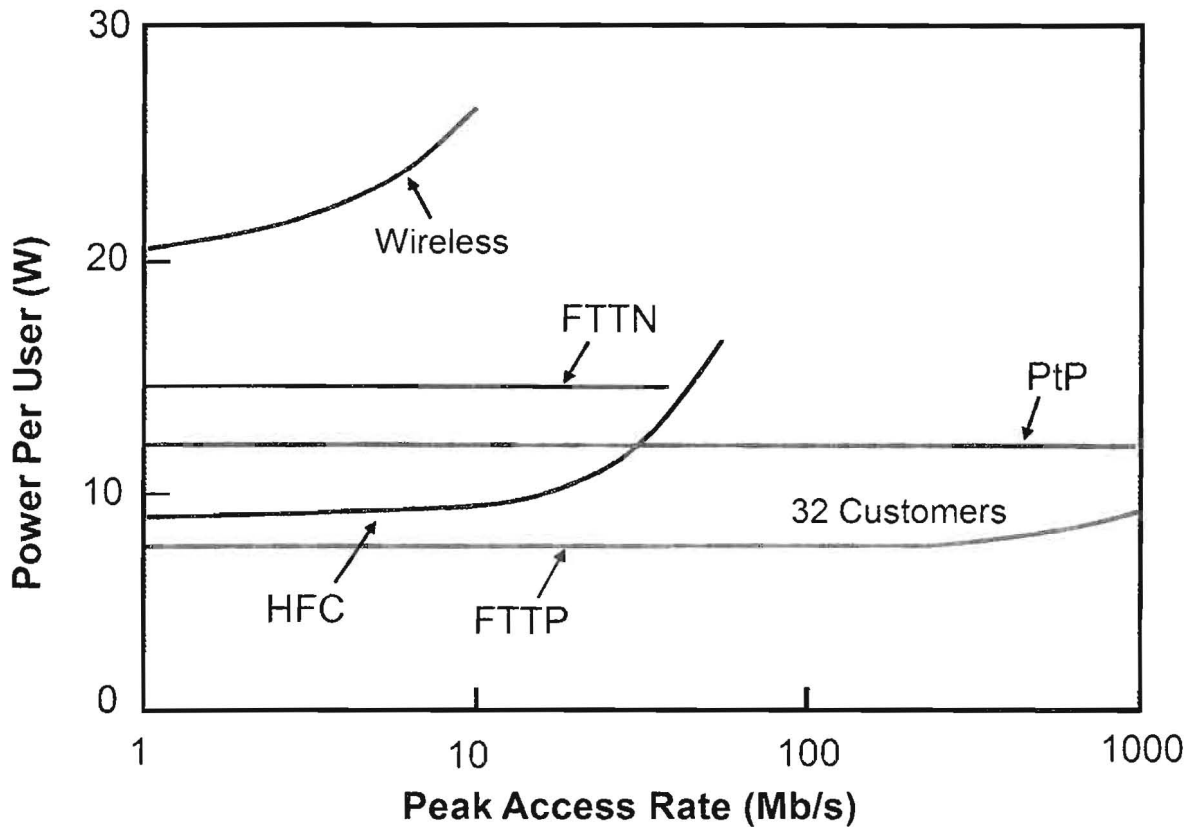
38. The statement contained in paragraph 151 of NBN Co's submission is based on published academic research regarding the relative energy consumption of alternative telecommunication access technology. In particular, a paper by Tucker, published in the Telecommunications Journal of Australia, titled *Broadband Facts, Fictions and Urban Myths* states:

For almost all bit rates, a FTTP network consumes around 7 watts per user. The alternative technologies all consume more power, with wireless access networks consuming between 20 and 30 watts per user, depending on the access rate. For an access rate of 10 Mb/s, wireless network would consume approximately four times more energy than a FTTP network. If we consider a national network with 5 million users, the 10-Mb/s wireless network would consume approximately 100 megawatts more than a 100-Mb/s FTTP network. Depending on what kind of power station is built to provide the extra power needed to run the wireless network, it would result in a greenhouse impact of up to 2 million tonnes of CO₂⁴.

39. Tucker's paper contains the following figure illustrating that for all peak access rates up to 100 Mb/s FTTP networks user lower power per user than HFC networks:

⁴ Rod Tucker (2010), "Broadband Facts, Fictions and Urban Myths" in *Telecommunications Journal of Australia*, vol 60, no 3, 2010, Monash University Press, pp 43.8-43.9.

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- 40. NBN Co has attached a copy of Rod Tucker’s paper, which was published in the *Telecommunications Journal of Australia* in 2010.
- 41. The efficiency differences between an HFC network and FTTP network arise because an HFC network has a distance related limit that ends up resulting in a greater number of power supplies being deployed than may otherwise be the case on an FTTP network. This is because the number of subscribers on an HFC network is not directly related to the power supply capacity, but is instead dependent upon a mixture of the radiofrequency loss (requiring a new line amplifier) and the direct current (DC) loss in the cable (which results in the supply voltage being too low to power the amplifier).
- 42. NBN Co understands that when Telstra considered re-powering its Melbourne HFC footprint (in support of its 100MB broadband offer), the average hub serving area required 2.5 power supplies, with each hub serving area servicing approximately 700 subscribers.
- 43. Assuming that each power supply was a 900VA unit that had a best case efficiency of 80% (and potentially as low as 50%), this equates to an alternating current (AC) mains demand of 1125VA.

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44. Using these estimates as a rough guide, each HFC subscriber service required 4 watts (being $1125 \times 2.5 / 700$), in addition to the power required to run the NTD and the power required to aggregate / signal process and distribute the data to the hub.
45. Conversely, the NBN Co GPON product requires 1560Watts to support a maximum of 4096 subscribers. This equates to 0.38Watts per subscriber, in addition to the power required to run the NTD and the power required for the transit & aggregation equipment.
46. NBN Co also notes that Optus in its submission to the ACCC identifies environmental benefits arising from the Optus HFC Agreement. Specifically, paragraphs 6.32 and 6.33 of the Optus submission states:

Another benefit of the HFC Agreement is that the decommissioning of the HFC network will lead to lower carbon dioxide emissions.

Optus notes that FTTP networks such as the NBN are likely to have lower power requirements and will therefore have lower carbon dioxide emissions than the present HFC network. This is because the HFC network has active elements which translate from the fibre portion of the network to the coaxial portion of the network (this is at each node). The FTTP network does not have any such requirements being passive between the exchange and the end user premises....

8. Wholesale market development

8.1 Question 13

Paragraphs 136-139 of the NBN Co submission put forward the position that the Optus HFC Agreement supports the development of a 'vibrant wholesale market'.

- a. Please explain in detail what is meant by a vibrant wholesale market.
- b. Please explain in detail how the Optus HFC Agreement supports the development of a vibrant wholesale market.
- c. In the absence of the Optus HFC Agreement, please explain why the development of a vibrant wholesale market would be impeded. Please include whether NBN Co considers it likely that Optus would participate in a wholesale market without the Optus HFC Agreement.
- d. Please provide any supporting documentation for your responses to this question.

47. As noted in the Statement of Expectations, the Government has committed to structural reform of the telecommunications industry to ensure that the NBN facilitates a competitive and vibrant telecommunications sector. By "vibrant wholesale market", NBN Co means that the services offered by NBN Co will enable vigorous downstream competition.

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48. As noted by DBCDE in the Explanatory Memorandum to the *Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010*:

The Government's plan will dramatically improve the availability of superfast broadband across Australia and fundamentally change the competitive dynamics of the Australian telecommunications sector. This new network will be wholesale-only and open access to maximise competition, and ensure improved consumer outcomes. (p 9)

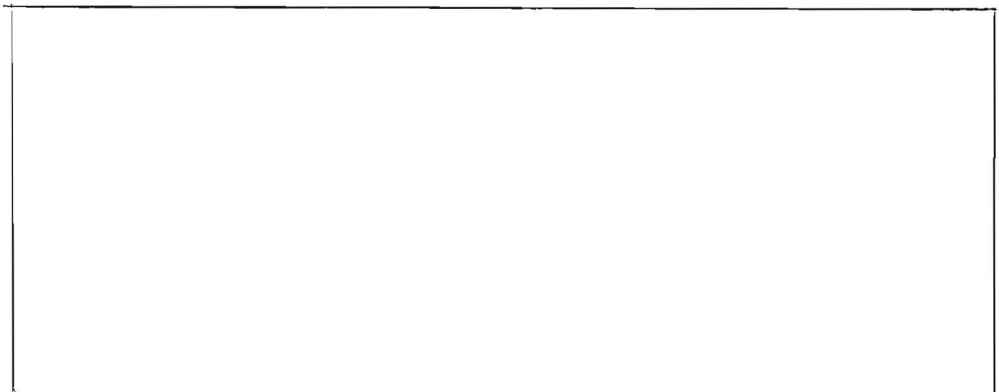
49. The ACCC's Advice to Government National Broadband Network Points of Interconnect dated November 2010 stated:

The network design for the NBN may impact the way in which markets for the provision of wholesale services develop during the transition from the copper network to the fibre network. Even though NBN Co will be a provider of wholesale services, these services are expected to be at a sufficiently low enough layer in the supply chain to allow other service providers to offer 'value-added' wholesale services to RSPs. These wholesale services could include the supply of services for use or resale by those RSPs which could range from a small addition to the service which is provided by NBN to a complete product which is readily able to be resold with minimal intervention by the RSP.

50. The Advice also stated "The ACCC believes that vibrant wholesale markets are an important input for ensuring vigorous competition in the downstream retail markets " and "A healthy wholesale market is expected to be required following the roll-out of the NBN in order to support vibrant competition and innovation at the retail level."

51. NBN Co notes that Optus' confidential submission in support of the authorisation applications states:

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9. Preventing cherry-picking

9.1 Question 14

Paragraph 186 of the NBN Co submission provides that the Optus HFC Agreement, by preventing the use of the Optus HFC network for cherry picking, will increase the number of customers using the NBN. NBN Co submits that this will, in turn, maximise the economies of scale and scope that are inherent in the NBN.

The ACCC is interested in assessing the potential consequences for economies of scale and scope available to NBN Co as a consequence of the Optus HFC Agreement coming into effect. Please provide the following:

- a. Economies of scale:
 - (i) the ongoing 'fixed costs' – capital expenditure and fixed operating expenditure – as a percentage of the total cost to operate the NBN; and
 - (ii) the change in the average cost per subscriber assuming
 - i. no shutdown of the Optus HFC network (and thus no migration of Optus HFC customers onto the NBN), and
 - ii. shutdown of the Optus HFC network and migration onto the NBN.
- b. Economies of scope:
 - (i) an estimate of the fixed common costs – the capital and fixed operating expenditure shared between broadband, voice, pay TV and other services on the NBN;
 - (ii) an estimate of the incremental capital and fixed operating expenditure (if these services were provided on separate networks) – for broadband, for voice, for pay TV and for other services on the NBN; and
 - (iii) the change in average cost per subscriber assuming
 - i. no shutdown of the Optus HFC network (and thus no migration of Optus HFC customers onto the NBN), and
 - ii. shutdown of the Optus HFC network and migration onto the NBN.
- c. The nature of this cherry picking (including the number of subscribers and spend per subscriber).
- d. The likely effects of this cherry picking on NBN Co's revenues and costs.
- e. The likely effects of this cherry picking on NBN Co's profitability.

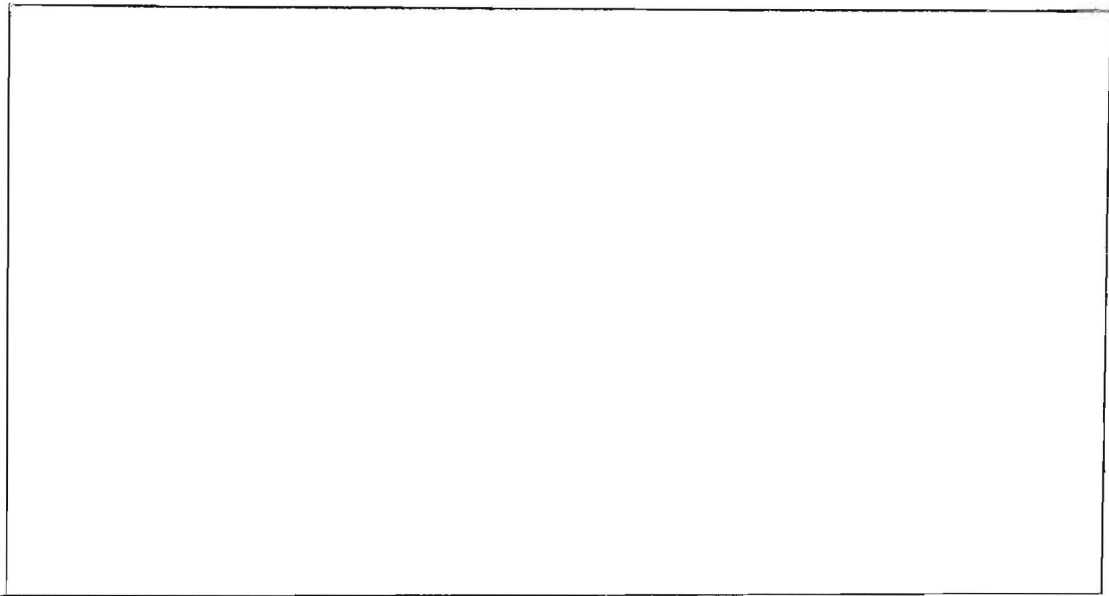
Please provide any supporting documentation.

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10. Provisions integral to Optus HFC Agreement

10.1 Question 15

With respect to each provision of the Optus HFC Agreement sought to be authorised, to the extent not already provided to the ACCC, please provide:

- a. detail on whether the provision is integral and/or necessary to the Optus HFC Agreement;
- b. a description of the public benefits and public detriments NBN Co considers are likely to arise; and
- c. the basis for this view including any supporting documentation.

54. As set out in NBN Co's submission dated 29 August 2011, the objective of the Optus HFC Agreement is to set out the terms on which NBN Co will reward Optus for HFC subscribers who migrate to network services provided on the NBN.

55. Table 1 below identifies each of the provisions of the Optus HFC Agreement for which Authorisation is being sought. These provisions are described in more detail in section 4.2 of NBN Co's submission dated 29 August 2011.

56. Each of the provisions for which Authorisation is being sought is integral to the Optus HFC Agreement as a whole and supports the progressive migration of HFC subscribers to the NBN. If authorisation of the relevant provisions is not granted, the significant operative provisions will not come into force and the Optus HFC Agreement will terminate.

57. The public benefits that will arise as a result of the operation of these provisions will therefore arise as a result of the operation of the Optus HFC Agreement as a whole. Each of the

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provisions for which Authorisation is being sought is integral to the capacity for these overall public benefits to arise.

Table 1: Public benefits and detriments arising from the relevant provisions

Provision for which Authorisation is being sought	Public detriments	Public benefits
Clause 4.3(a): Conduct of HFC Service business by Optus	NBN Co does not consider that any detriments to the public will result from the Optus HFC Agreement.	Sections 6 and 7 of NBN Co's submission dated 29 August 2011 identifies the public benefits arising from the Optus HFC Agreement (to which each of the provisions for which Authorisation is being sought is integral).
Clause 5.2(a): Fixed line network preference in favour of the NBN	Section 7 of NBN Co's submission dated 29 August 2011 addresses public criticism of aspects of the Optus HFC Agreement, as well as criticism of aspects of the Definitive Agreements between NBN Co and Telstra that could also potentially be levelled against similar aspects of the Optus HFC Agreement.	
Clause 5.2(c): Anti-disparagement provision		
Clause 9.2: Migration of eligible Optus subscribers		
Clauses 10.1, 10.2, 10.3: Deactivation in HFC Serving Areas, decommission of HFC Network and limitations on deactivation and decommission		
Clauses 10.2(b); (c); (d): No further extension or use of HFC Network after deactivation.		
Clause 10.4: Limitations on the disposal of the HFC Network.		
Clause 11.1(a): Payment of migration fee by NBN Co to Optus.		

58. In addition to the public benefits of the Optus HFC Agreement as a whole (as identified in NBN Co's submission dated 29 August 2011) and the benefits arising from the anti-disparagement clause set out in NBN Co's answer to question 10 above, the public benefits set out below will arise specifically from the anti-disparagement provision.

The anti-disparagement provision will protect consumers

59. Most consumers seek to maximise their value for money from their telecommunications spend by purchasing a bundle of wireless and fixed services that provide a combination of service

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characteristics, including, but not limited to, service quality, speed, download limits, mobility and device functionality.

60. The anti-disparagement provision will help ensure that Optus markets fixed and wireless products based on their relative service characteristics, functionality and value for money. This will enable consumers to make informed decisions regarding voice and broadband services and to maximise their value for money. This outcome is also consistent with the Government's policy objective of maximising the availability of affordable high-speed broadband services.

The anti-disparagement provision will not restrict the ability of Optus to compete in relevant markets for voice and broadband services

61. Paragraphs 26 to 33 explain why the anti-disparagement clause will not fetter Optus' ability to market wireless services.

62. The anti-disparagement provision will not prevent or restrict Optus from:

- (a) competing vigorously for wireless customers;
- (b) marketing wireless voice services;
- (c) marketing wireless broadband services with reference to their functionality and value proposition;
- (d) offering wireless voice and broadband services to customers; and
- (e) investing in its mobile network or undertaking product development. This is confirmed by Optus' recent announcement to rollout a 4G, Long Term Evolution (LTE) network⁵.

63. As noted in paragraphs 29 to 33 above, NBN Co understands that Optus considers that the anti-disparagement clause will not restrict Optus from engaging in marketing activities for wireless services.

⁵ Optus, Optus announces a more interactive mobile future with 4G rollout, Media Release date 15 September 2011, see <http://www.optus.com.au/aboutoptus/About+Optus/Media+Centre/Media+Releases/2011/Optus+announces+a+more+interactive+mobile+future+with+4G+rollout>.

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64. In addition to the responses to the potential criticisms of the anti-disparagement provision set out in section 7 of NBN Co's submission dated 29 August 2011 identified, NBN Co further submits:
- (a) The anti-disparagement provision aligns with Optus' commercial incentives; and
 - (b) The anti-disparagement provision will not lessen competition in any relevant markets; and
 - (c) The anti-disparagement provision ensures fair competition and informed consumers.

Alignment with Optus' commercial incentives

65. As a profit maximising business, Optus has strong commercial incentives to generate margins from the supply of both fixed line services and wireless services. For example, an integrated telecommunications provider has the opportunity to earn margins from both the retail supply of fixed line services in addition to earning a margin from the supply of wireless services. If, however, Optus was to become a wireless-only provider of services it would not only forego retail margins from the supply of fixed services but it would also most likely earn lower margins from its wireless services.
66. Wireless voice and broadband services are generally more expensive than fixed line services because wireless services attract a "mobility premium". If, however, Optus were to seek to compete directly with the NBN this premium would likely be competed away.
67. These factors suggest that it is commercially rational for Optus to supply both fixed and wireless voice and broadband services. In this regard, the anti-disparagement provision is consistent with the commercial incentives faced by Optus.

No lessening of competition

68. As noted above, the anti-disparagement clause will not prevent Optus from competing in relevant markets. It follows that the anti-disparagement clause is not likely to have the effect of substantially lessening competition in relevant markets.
69. The criticisms of the anti-disparagement clause assume that it operates to prevent Optus from marketing wireless services as a substitute for fixed. The clause does not operate in that way, as set out in NBN Co's answer to question 10 above.
70. However, even if the clause operated in that way:

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- (a) NBN Co does not consider that wireless data services (to which the clause applies) are an effective substitute for fixed broadband services.
- (b) NBN Co considers that the anti-disparagement provision ensures fair competition and informed consumers.

Wireless and fixed line services are complementary

71. Economic theory defines complementary goods as two goods which have a negative cross elasticity of demand⁶. This means a good's demand is increased when the price of another good is decreased.
72. Using data sourced from the ACCC's *Telecommunications Reports 2009-10* it is clear that fixed and mobile services are complementary. Specifically, according to the ACCC in the 2009-10 period:
- (a) Average real prices for PSTN fixed line services decreased by 5.8 per cent. In the same period, despite average real prices for mobile services increasing, the demand for mobile subscriptions rose by 7 per cent.
 - (b) Despite an average reduction in the real price of mobile broadband services of 18.5 per cent (compared to a price reduction of only 2 per cent for DSL services) the take-up of DSL subscription services increased by 4 per cent.
73. This data clearly suggests that both fixed and wireless services (voice and data) meet the textbook definition of complementary goods. Furthermore the ACCC's recent press release alludes to the complementary nature of the fixed and wireless services by noting that⁷:
- Subscription numbers for both fixed and mobile services suggests that while mobile take-up continues to grow, this is not necessarily at the cost of fixed line services. Convenience is prompting the growth of mobile services, though these remain primarily voice services. Fixed broadband remains the dominant technology for downloading data, accounting for 91 per cent of data volumes.*
74. In a number of regulatory processes the ACCC has consistently stated that wireless services are not an effective substitute for fixed line services. Those statements are set out in Annexure

⁶ Sullivan, Arthur; Steven M. Sheffrin, 2003. *Economics: Principles in action*, p 88.

⁷ ACCC, *Wireless increasing popular, but fixed lines dominate downloads* Media Release dated 23 September 2011.

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1. Criticisms of the anti-disparagement clause on the basis that wireless services are a substitute for fixed services appear to be directly contradictory of positions taken by the ACCC in other contexts.

Anti-disparagement provision ensures fair competition and informed consumers

75. It is clear from the ACCC's consideration of the extent of substitutability between wireless and fixed services (as noted in Annexure 1) that there is significant uncertainty as to whether, and to what extent, those services could be said to be substitutes.
76. Given the lack of clarity as to the extent to which wireless and fixed services might be substitutable for lower speed broadband services (the anti-disparagement provision does not apply to voice), if the anti-disparagement clause were to operate to prevent a marketing campaign that inaccurately represented the extent of substitutability, the anti-disparagement clause will help ensure that Optus markets fixed and wireless products based on their relative service characteristics, functionality and value for money and avoid the risk of consumer detriment that would arise from an inaccurate marketing campaign.

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Annexure 1

Examples of ACCC statements considering substitutability between wireless and fixed services

- In its Final Decision on the *Local Services Review* (July 2006) the ACCC considered that wireless services were not an effective substitute to wholesale fixed line services outside the CBD areas⁸:

The ACCC also found that there is considerable uncertainty about the development of competitive infrastructure platforms and services, such as wireless access, fixed-to-mobile substitution, VoIP and the ULLS, that could act as supply substitutes to the LCS and WLR services. Currently these services cannot be considered to be effective substitutes outside of the CBD areas. However, given the speed of technological change and uncertainty regarding take-up of alternatives to Telstra's wholesale services, it is difficult to be definitive about substitution trends beyond a two year period.

- As part of its *Fixed Services Review Declaration Inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR* (July 2009) the ACCC “closely considered the substitutability of fixed and mobile voice at the retail level”. To do this the ACCC applied a SSNIP test using data from ACMA’s *Communications Report* for the period 1999-00 to 2007-08⁹. This analysis led the ACCC to conclude that fixed and mobile services were complementary¹⁰:

The ACCC notes that, taken together, the previous declines in fixed voice services subscriptions and increase in mobile services subscriptions suggests that there is some degree of fixed-to-mobile substitution occurring. However, the ACCC is of the view that the increase in mobile phone subscriptions has not been fully ‘offset’ by an equivalent decrease in fixed services. Accordingly, from a demand perspective, the ACCC is of the view that mobile use may be viewed by the majority of consumers as a complement to their traditional fixed-line rather than as a substitute.

...

⁸ ACCC, *Local Services Review: Final Decision*, July 2006, p.7

⁹ A SSNIP Test is established the smallest ‘product’ or ‘geographic’ space over which a hypothetical monopolist could impose a ‘small but significant non-transitory increase in price’ (SSNIP) without reducing its profits. A SSNIP in the context of the hypothetical monopolist usually consists of a price rise for the foreseeable future of 5 to 10 per cent above the price level that would prevail without competition.

¹⁰ ACCC, *Fixed Services Review Declaration Inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR: Final Decision*, July 2009, p.21.

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..., the ACCC continues to take the view that mobile services are only an effective substitute for fixed-line voice services in a small percentage of cases. For most consumers, the two platforms are seen as complements rather than substitutes. This is due to a range of factors, including costs associated with mobile services, the inconsistency of call quality and consumer practice.

- In its June 2009 public submission to the DBCDE public consultation on the *National Broadband Network: Regulatory Reform for 21st Century Broadband*, the ACCC also voiced concerns about the extent to which wireless services are effective substitutes to fixed line services. The ACCC notes the shared nature of wireless platforms and that in densely populated areas (i.e. metropolitan areas) wireless networks may not be a close substitute to fixed networks¹¹:

Wireless/mobile networks are increasingly capable of providing competitive voice and lower bandwidth data services, and there are expectations that shared cell bandwidth capacities will continue to increase over time. However, these technologies usually involve the sharing of capacity between users, and consequently require significantly increased network capacity as the number of users and the amount of traffic they generate grows. This is particularly an issue in densely populated areas. Future technological improvements such as the so-called Long-Term Evolution (LTE) of 3G services can provide alternative ways of improving service quality, but the expected timeframes suggest they will continue to lag the offerings available via fixed-line networks. Consequently, there are continuing concerns that wireless networks may not be close substitutes, particularly in densely populated regions, for higher bandwidth fixed networks.

In addition to above statements by the ACCC, independent research by a Senior Policy Advisor to the ACCC concluded that the dominant relationship between fixed and wireless services was one of complementarity. Specifically in a 2006 research paper authored by, Dr Rod Albon¹², titled Fixed- to-Mobile Substitution, Complementarity and Convergence concluded that¹³:

The more dominant characteristic between fixed-line and mobile networks appears to be one of complementarity, relating to calls between fixed-line and mobile networks — fixed-to-mobile

¹¹ ACCC, *Submission to the Department of Broadband, Communications and the Digital Economy National Broadband Network: Regulatory Reform for 21st Century Broadband*, June 2009, p.53

¹² Rob Albon is Senior Economic Adviser, Regulatory Development, with the ACCC.

¹³ Rob Albon, 2006, "Fixed- to-Mobile Substitution, Complementarity and Convergence", *Agenda*, Volume 13, Number 4, 2006, pages 309-322

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(FTM) and mobile-to-fixed (MTF). In the immature phase of mobile telecommunications the value of mobile subscription is heavily dependent on the ability to receive calls from, and make calls to, the dominant fixed-line network. There are simply not enough mobiles to call and receive calls from. This relative dependence on the fixedline network gradually lessens as mobile penetration increases, but calls from and to mobiles remain a major driver of willingness to pay for mobile subscription.