AlixPartners

PUBLIC VERSION

Response to the third expert reports of Mr Feasey and Dr Padilla

Third expert economic report of Matt Hunt

Prepared at the request of Optus

4 December 2022

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Appendices

1 Introduction

1.1 My instructions

1. I have been instructed to prepare this report by Herbert Smith Freehills ("**HSF**"), solicitors (together with MinterEllison) for Singtel Optus Pty Ltd ("**Optus**"), in connection with the Australian Competition and Consumer Commission's ("**ACCC**") review of the proposed infrastructure and spectrum sharing arrangements between TPG Telecom Limited ("**TPG**") and Telstra Corporation Limited ("**Telstra**") (the "**Proposed Transaction**").

2. Given the considerations raised in my First and Second Reports relevant to assess the likely effect, if any, of the Proposed Transaction on competition and efficiency, I have been asked to provide my views on relevant matters raised by the public versions of:

   (a) The third expert report of Richard Feasey dated 10 November 2022 (**Feasey 3**");

   (b) The third expert report of Dr Jeorge Padilla dated 17 November 2022 ("**Padilla 3**").

3. I have attached HSF's letter of instructions at Appendix A1.

1.2 Credentials

4. My name is Matthew (Matt) Hunt. I am an economist and a Managing Director in the Investigations, Disputes and Risk practice in the London office at AlixPartners UK LLP. I lead AlixPartners' EMEA economics practice and the economics work in the telecommunications (hereafter, telecoms), media and technology sectors.

5. I am the same Matt Hunt who prepared an expert report on behalf of Optus dated 25 October 2022 ("**my First Report**") and a second expert report on behalf of Optus dated 16 November 2022 ("**my Second Report**"), (together, "**my First and Second Reports**"). My qualifications and experience are outlined in section 1.3 of my First Report and my CV is attached at Appendix A4 of that report. Unless indicated otherwise, I adopt in this report the defined terms used in my First Report.

1.3 Documents relied upon

6. Where I rely on a material fact in order to reach an opinion expressed in this report, the material fact has been drawn from the documents referred to in Appendix .

1.4 Preparation of this report and acknowledgement of my duty as an expert

7. I confirm that I have read the Federal Court's Expert Evidence Note and the Harmonised Expert Witness Code of Conduct and agree to be bound by them. I attached the Expert Evidence Note at Appendix A2 of my First and Second Reports.

8. In preparing this report, I have been assisted by colleagues at AlixPartners, including Mat Hughes and Federica Grilli.

9. I confirm that all the opinions expressed in this report are my own opinions. My opinions are based wholly or substantially on specialised knowledge arising from my training and study as an economist and my professional experience.

1.5 Report structure

10. The remainder of this report is structured as follows:

(a) **Section 2** summarises the key points in this report.

(b) **Section 3** provides my responses to the key points raised in Feasey 3.

(c) **Section 4** provides my responses to the key points raised in Padilla 3**.**

(d) **Section 5** sets out my overall conclusions and my declaration.

2 Executive Summary

11. I have reviewed Feasey 3 and Padilla 3. In those reports, Mr Feasey and Dr Padilla have misunderstood or mischaracterised the views that I set out in my First Report. Consequently, in this report I address the key points raised in Feasey 3 and Padilla 3, clarifying my position by reference to my First and Second Reports and explaining where I agree or disagree with Mr Feasey and Dr Padilla.

12. As set out in the conclusions of my First and Second Reports, in my view the key concern as regards the Proposed Transaction is that, through significantly reducing Optus' incentive to invest in the RCZ, there will be a resulting significant weakening of dynamic competition at the network level in the RCZ, and, over time, this will result in a materially less competitive outcomes in retail and wholesale mobile telecoms markets.[1]

13. This is particularly the case relative to what I consider the most likely counterfactual of 5G network sharing between Optus and TPG in the RCZ, which would enable Optus to achieve economies of scale and compete more effectively with Telstra, which has a very high share of subscribers in the RCZ. Accordingly, I consider that the Proposed Transaction would lead to customer foreclosure by precluding such a network sharing agreement.

14. If the Proposed Transaction proceeds:

    (a) Optus will be a weaker competitor in retail and wholesale mobile markets, with such markets being closely vertically related to network infrastructure; and

    (b) all operators will have lower quality networks due to the weakening of dynamic competition. As the competition from Optus as regards RAN investment in the RCZ will be substantially weakened, this will materially reduce the competitive imperative on Telstra to maintain and improve its network. Adverse effects will start to arise immediately post-Transaction [redacted], which will in turn reduce the competitive imperative for Telstra to make costly investments in the RCZ.

15. My views are grounded in the evidence that is available to me: my understanding of the facts as regards the Australian mobile telecoms sector set out in section 3 of my First Report; Optus' internal documents, both prior to and following the announcement of the Proposed Transaction; and witness statements submitted to the ACCC by Optus. I note that key elements of Mr Feasey's and Dr Padilla's analyses are based on abstract and conceptual reasoning or on their instructions. As I emphasise in my First and Second Reports, this causes me concern.

16. In particular:

    (a) The counterfactual Dr Padilla has been instructed to adopt involves less effective cooperation between TPG and Optus compared to the agreement between TPG and Telstra under the Proposed Transaction.

    (b) Dr Padilla asserts that variable charges to TPG are lower than those he has been instructed to adopt in the counterfactual, albeit he accepts that the Proposed Transaction is unlikely

[1] See, for example, §§18-20 of my First Report and §§14-19 of my Second Report.

to impact national prices through costs as 80% of the population live in urban and suburban areas.[2]

(c) Dr Padilla's analysis of Optus' investment incentives is at odds with the facts [redacted], including as regards various of his assumed or instructed modelling assumptions (see sections 4.3 and 4.4 of my Second Report).

17. The points raised by Mr Feasey or Dr Padilla have not led to me to alter my conclusions.

18. In the sections below I provide my response to specific points raised in Feasey 3 and Padilla 3. Where I do not directly respond to particular points raised by Mr Feasey or Dr Padilla it should not be taken to mean that I agree with those points.

[2] See §289 of my First Report, and Padilla 1, §6.3-6.9.

3 My response to Feasey 3

3.1 Optus' investment incentives

19. In my First Report I analysed Optus' investment incentives based on the facts available to me: Optus' internal documents, both prior to and following the announcement of the Proposed Transaction, and witness statements submitted to the ACCC by Optus. In that analysis I considered the importance of economies of scale, including by reference to Analysys Mason's work on the costs of networks in the RCZ that is based on Optus' actual network costs.[3] I note that Mr Feasey's analysis is largely abstract and conceptual, and I refer to examples of this below, such as §31 of Feasey 3 where, in contrast, my analysis is based on the facts. I note that Mr Feasey does not consider substantively the importance of achieving economies of scale to a firm's incentives to make investments.

Paragraph	Mr Feasey's statement	My response
31	*"The management of Optus are therefore likely to face greater risks when making network investments as a result of the transaction but will also face greater risks of losing customers from not doing so. It is quite reasonable for the management of Optus to wish to reduce these risks. But it does not follow that the consequence of a higher risk environment in which to make investment decisions is that Optus will undertake less investment. If the costs or risk of not investing have become much higher, and the cost or risk of investing only somewhat higher, then Optus will continue to have strong incentives to invest in its network and these incentives may in fact be stronger than before. Indeed, in my view, this is a reasonable characterisation of the effect of the transaction upon Optus' investment incentives."*	This is an entirely conceptual argument, which is not based on the facts. My analysis in my First Report and my Second Report is based on the evidence as regards Optus' assessments of network investments based on Optus' internal documents, both prior to and following the announcement of the Proposed Transaction, and witness statements submitted by Optus (see section 7 of my First Report and section 4.3 of my Second Report).
Footnote 41	*"Note that in a counterfactual which involved network sharing between TPG and Optus (as adopted by AlixPartners) I would expect Optus' incentives to invest to be lower because any benefits from the investment will be shared with TPG. I noted earlier that Houston Kemp accept that the incentive to invest in the counterfactual is uncertain, which I interpret to mean they also accept it could be weaker as well as stronger."*	I do not see how Mr Feasey is able to make this statement in the abstract without considering the form of the agreement between Optus and TPG. There are clear benefits of economies of scale and spectrum sharing (if that were to be included) that would result from an agreement between Optus and TPG. And Optus and TPG can agree a form of contract that provides Optus with sufficient incentives to invest (see my First Report, §265). As regards Optus' incentives to enter into such an agreement, its witness evidence was that [redacted]

3 See sections 6 and 7 of my First Report.

		[redacted]
33	*"I do not agree. This is because, as I explained earlier in this report, I do not consider that the additional advantages in relation to the RCZ that Telstra derives from the MOCN arrangement to be particularly significant in the context of the advantages which Telstra already holds. The transaction specific effect is small. AlixPartners assert that there are advantages but do not offer any evidence as to their significance. The additional revenues and contribution to profits from payments received from TPG are, in my view, relatively insignificant within the overall."*	The effect of the Proposed Transaction is not small in the RCZ. As I observe in my First Report (§246), Mr Feasey states that the revenues that Telstra expects to generate from the Proposed Transaction are $1.6-$1.8bn over the first 10 years of the agreement [redacted] My First Report shows the advantages of scale based upon the Analysys Mason modelling. As I note at §170(a) and §170(b) of my First Report, Telstra's [redacted] existing advantage in terms of unit costs will increase significantly as a result of the Proposed Transaction (although Telstra having lower unit costs is not procompetitive because the constraint from Optus is weakened). [redacted]
Footnote 46	*"I note that AlixPartners seek to argue that Telstra obtains significant advantages from the transaction which will deter Optus from investing, on the one hand, but at the same time argues that any efficiency benefits Telstra derives from sharing spectrum are 'overstated'."*	This statement appears to reflect a misunderstanding on Mr Feasey's part. Optus' loss of market share in the RCZ due to the Proposed Transaction affects its investment incentives, particularly relative to the counterfactual of a network sharing agreement between Optus and TPG (see above). As regards the spectrum efficiencies, I largely do not consider these to be merger specific (as TPG would have incentives to lease spectrum to Telstra or otherwise monetise its spectrum, for example through a deal with Optus) and Optus and Analysys Mason consider that there would be benefits to spectrum sharing with TPG. Dr Padilla assumes that the additional capacity available to Telstra through using TPG's spectrum would be equivalent to it increasing its number of sites in the RCZ by 39%; as stated at §306 of my First Report, Dr Padilla has overstated these benefits as Telstra would only need to address congestion at specific sites (without additional spectrum) and there may be lower cost solutions than adding sites. In addition, absent the Proposed Transaction, any such congestion could be addressed through Optus investing to win market share off Telstra where it faces congestion, which will in turn prompt dynamic network competition (see §§306-307 of my First Report).

35	*"AlixPartners' and Optus' position appears to be that the effect of the transaction on these comparative advantages will be so significant that Optus will give up any thought of being able to acquire customers from Telstra (or TPG) and will no longer contemplate investments which it would otherwise have made."*	I believe that Optus will follow profit-maximising behaviour, based on my review of its documents and witness statements. Optus will continue to invest where it expects it to be profitable to do so. [redacted]
36	*"The revenues and profits which Optus will earn from variable wholesale fees paid by TPG in such a counterfactual will take time to accrue in exactly the same way as for Telstra in the factual, and I expect these fees to be lower than those Telstra will obtain in the factual."*	I agree that the fees from TPG will take time to accrue. I do not believe that the fees that Optus would obtain from TPG (in the counterfactual) relative to those Telstra would obtain under the Proposed Transaction is a determinative factor. In my view, the impact on competition (and consumer outcomes) is what is most important and a deal between Optus and TPG will strengthen infrastructure competition in the RCZ, resulting in enhanced competition and better services for consumers.
38a.	*"Analysys Mason's model computes the impact of sharing on the unit cost of conveying traffic over the RCZ network (but not, it appears, the effect this will have on the average costs of conveying traffic on the network nationally which is what will inform retail prices)."*	Mr Feasey's statement misses the point; the issue is not total MNO costs across all of Australia, but the extent of economies of scale in the RCZ and how this affects Optus' investment incentives in the RCZ. Analysys Mason's modelling, which considers forward-looking average unit costs, is highly relevant for considering investment incentives in the RCZ (see Section 6.3 of my First Report).

3.2 Overall significance of the transaction

20. I address the specific points raised by Mr Feasey as regards the overall significance of the Proposed Transaction in the table below.

Paragraph	Mr Feasey's statement	My response
8	*"Third, to the extent that the transaction enables TPG to compete more effectively with Telstra and Optus, TPG will be starting from a position in which it has historically been by far the weakest and least attractive of the three operators for those who value services in the RCZ. The idea that TPG would immediately or even quickly acquire a very significant share of customers from Optus as a result of the transaction is, in my view, highly implausible."*	I agree that TPG will start from a weak competitive position. I do not consider TPG will immediately acquire significant shares from Optus (and have not said so). TPG will build share in the RCZ over time and will take share from Optus (see my First Report, §§273-274). I do not understand why both Mr Feasey (in Feasey 3) and Dr Padilla (in Padilla 2) consider that TPG will only acquire limited share of customers in the RCZ, when it is able to benefit from access to Telstra's network (and in a situation where Optus will be at a significant disadvantage in any realistic investment scenario). I believe it is more likely that TPG will take considerable share – it will be a much more credible competitor with an attractive

		offering to consumers as regards network coverage and quality in the RCZ (see my First Report, §§203-204). My view appears to align with the Applicants' own views – they specifically argue that TPG will "*compete aggressively to build its market share*".[4] In my view, what is most relevant is that Telstra's network share will increase, and Optus' share will fall, [redacted] [redacted]
10	"*Fourth, to the extent that a counterfactual involved TPG and Optus sharing a network and spectrum, and this enables Optus to compete more effectively with Telstra and TPG for customers who value coverage and service in the RCZ, the effects will be similarly limited. Telstra would continue to have access to 50% more sites in the RCZ and will have almost three times more customers who reside in the zone and more customers who value coverage outside of it than Optus and TPG combined. TPG's capacity to add traffic to Optus' network in such a counterfactual by acquiring customers from Telstra will be less than its capacity to generate wholesale revenues for Telstra by acquiring customers from Optus in the factual. Moreover, as I discuss further below, access to TPG spectrum in such a counterfactual would have little, if any, impact upon Optus' ability to compete for customers who value services in the RCZ under any reasonable assumption about traffic growth or TPG customer acquisitions because Optus will already be able to accommodate any additional demand using its existing spectrum resources.*"	Mr Feasey emphasises that TPG will have a considerable capacity to acquire customers from Optus under the Proposed Transaction. I agree strongly with this. It is for that reason that I believe that the Proposed Transaction will undermine Optus' investment incentives. In effect, here Mr Feasey says that the Proposed Transaction will strengthen Telstra's already considerable advantages of scale (and provides it with additional spectrum efficiency advantages). In contrast, in the counterfactual, TPG will bolster Optus' investment incentives and enable both operators to win greater share from Telstra (collectively) (see my First Report, §240 and §241(a)).

3.3 Price effects

21. I address the specific points raised by Mr Feasey as regards price effects in the table below.

Paragraph	Mr Feasey's statement	My response
17	"*Like HoustonKemp, AlixPartners also appear uncertain about the short-term effect of the transaction on prices and seem reluctant to rely upon it when arguing that competition will be*	In my view it would be a mistake to focus on short-term price effects. That is a distraction from the key issue raised by the Proposed Transaction which is the negative impact on infrastructure investment, both by Optus and

[4] TPG counterfactual submission, 8 November 2022, §89.

	substantially lessened."	Telstra, the latter due to weakened infrastructure competition between Optus and Telstra (see my First Report, §42). This is the case primarily in the RCZ, but also outside the RCZ as a consequence. A reduction in infrastructure competition will affect competition, including on prices. I expect that in the short-to-medium term competition to be more effective under the counterfactual and prices will be lower (see my First Report, §§290-292).
17(a)	*"Like HoustonKemp, AlixPartners ignore the significant differences between the networks of Telstra and Optus in the RCZ and so assume TPG would be similarly positioned as a competitor to Telstra in the factual and in a network sharing counterfactual. I do not agree and consider that TPG will represent a significantly more effective pricing constraint upon Telstra in the factual than in such a counterfactual."*	These references don't show that my First Report ignores the difference between Optus and Telstra – indeed I recognise there is a difference throughout the report. Rather, I note big differences between TPG's position in the factual and the counterfactual (see my First Report, §§296-300).
17(b)	*"I do not accept that Optus, as the larger operator relative to TPG, will necessarily provide the main pricing constraint on Telstra in the factual or a network sharing counterfactual. I explained in my Second Report why smaller operators are often price leaders and larger operators tend to be price followers."*	The evidence clearly shows that TPG is currently a less close competitor to Telstra. Telstra is not a price follower, as suggested by Mr Feasey. My First Report, §94, references Ben White's witness statement *"Telstra currently prices its mobile services at a premium to its nearest competitor (Optus)"*. If Optus were not the main pricing constraint to Telstra and TPG were its main constraint, why would Telstra's prices have such a high premium compared to TPG's and a smaller premium over Optus'?
18	*"When assessing prices in the longer term AlixPartners ignore that TPG will also be a less effective competitor and weaker pricing constraint on Telstra in such a counterfactual."*	It is not clear to me why Mr Feasey considers that it is unequivocal that TPG will be a less effective competitor and weaker pricing constraint on Telstra in such a counterfactual. In my view, that is not the case. The evidence shows that there will be greater investments by Optus and greater infrastructure competition with Telstra in the counterfactual. TPG will benefit from that investment through a network sharing arrangement with Optus. In the counterfactual, as there will be three MNOs that have competitive offerings (specifically as regards network coverage and quality in the RCZ), there will be greater competition (see my First Report, §40).

4 My response to Padilla 3

22. Padilla 3 purports to address my First Report, but it does so partially, at most. In the sections below I highlight the key economic theory and factual (or assumption) differences so that the ACCC can understand why we arrive at different conclusions.

23. In line with the reasoning set out at §28 of my Second Report, I consider Dr Padilla's views on investment effects first and then consider his views on price effects and spectrum efficiencies.

4.1 Investment effects

21. I address the specific points raised by Dr Padilla as regards longer-terms effects on investment in the table below.

Paragraph	Padilla's statement	My response
3.17a	*"Telstra already has a much higher regional market share (and presumably greater scale economies) than Optus and this has not deterred Optus from investing".*	I note in my First Report that Optus' business case for 5G investment [redacted]
3.17b	*"Telstra does not price aggressively in the hope of forcing Optus out of the market".*	I have not stated that Telstra prices aggressively to force Optus out of the market. In my First Report I consider that if the Proposed Transaction proceeds, it is highly likely that TPG will win share from Optus in the RCZ and that, consequently, Telstra's share of subscribers at the network level in the RCZ will increase (due to TPG's closure/transfer of its RCZ sites and due to its share of subscribers growing), with Optus losing economies of scale. This loss of economies of scale [redacted]
3.19	*"A key part of the calculation is how many customers who value regional coverage Optus would retain if it continued to invest under the Proposed Transaction. I am unable to view Mr Hunt's estimates, but I have reason to believe that if it continued to invest, Optus would retain a significant customer base in the RCZ".*	Optus' modelling of its own investment incentives considers [redacted] Optus' analysis following the announcement of the Proposed Transaction showed [redacted]

		[redacted] As set out in sections 4.3 and 4.4 of my Second Report I have concerns as regards the factual basis for Dr Padilla's modelling of Optus' investment incentives and believe, on the basis of the limited information available to me, that it is likely to be flawed.
3.24a	*"Under Mr Hunt's view of the counterfactual, the competitive pressure that Optus would face would be reduced as (i) Optus would not face competition from TPG and (ii) Telstra's regional network would be capacity constrained due to lack of spectrum. This would reduce the competitive pressure on Optus to improve its network quality".*	Dr Padilla misunderstands my views. In the counterfactual, I consider that Optus would have strong incentives to invest to improve its network quality and to compete against Telstra (which would retain a material competitive advantage over Optus). I also consider that Optus would compete against TPG at the retail and wholesale level – TPG would have improved network coverage by access to Optus' RAN network in the RCZ. Telstra congestion would be a signal to Optus that it would be likely to win customers from Telstra, which would incentivise investment by Optus. This would be particularly the case in the counterfactual as Optus would benefit from economies of scale. I would expect Telstra to dynamically respond. In that regard, it is important to recognise that spectrum is not a hard capacity constraint in mobile networks and there are numerous methods that mobile operators can increase capacity without additional spectrum (see §68 of my First Report). In short, competition from Optus would provide Telstra with a competitive incentive to invest to improve its network to address congestion.[5] In contrast to the Proposed Transaction, in the counterfactual there would be three MNOs offering retail and wholesale access to a competitive 5G RAN in the RCZ (on two competitive infrastructures) [redacted] (see my First Report, §40).
3.25	*I also do not share Mr Hunt's view that Telstra would invest less under the Proposed Transaction than in his view of the counterfactual. I expect Telstra would invest more because:* *a. Telstra would face the need to compete with TPG's higher coverage (a higher*	I disagree with Dr Padilla. I note that Dr Padilla appears to be referring to various types and/or locations of investment. This is evident because TPG will not compete with Telstra as regards RAN in the RCZ so there would not be any increased incentive for Telstra to invest in RAN in the RCZ because of TPG's

[5] And, as noted at §308 of my First Report the fact that Telstra has congestion in regional areas may be symptomatic of a lack of network competition in those areas, which means that Telstra does not have the same competitive imperative to improve its network in regional areas as it does in metro areas.

	coverage level than what TPG could offer in a network sharing counterfactual); b. *Optus can be expected to continue to upgrade its regional network to better compete with Telstra and, post-transaction, TPG; and* c. *wholesale payments from TPG would improve Telstra's economics of additional investment in the MOCN at the margin.*	higher coverage (in fact, as Dr Padilla recognises in his first report, this might disincentive such investments). Thus, Dr Padilla appears to be referring to other types of investments (i.e. not RAN in the RCZ). In my view, the primary focus should be on investment in the RAN in the RCZ, with impacts on investment in other areas or in core networks being secondary. In that regard, as I set out in section 7.3 of my First Report, Telstra's incentives to invest in its network in the RCZ in large part depend on the competitive benefits of such investment, including the extent to which it faces active infrastructure competition from Optus so as maintain its market share and the pricing premium associated with its network leadership. This has been a central feature of infrastructure competition in the RCZ in recent years. If Optus' incentives to invest are significantly reduced in the RCZ (as I find they would be), the competitive pressure on Telstra resulting from investments by Optus will be reduced. In that context, the benefits of additional payments from TPG will be unlikely to have any material impact on Telstra's investment incentives.

4.2 Direct impact on quality and price competition

22. I address the specific points raised by Dr Padilla as regards the direct impact of the Proposed Transaction on quality and price competition in the table below.

Paragraph	Padilla's statement	My response
3.6	*"My view is that if the Proposed Transaction is blocked, then any agreement between TPG and Optus would be on worse terms for TPG than the Proposed Transaction and would not compensate for Optus' inability to offer TPG as good coverage as TPG would receive under the Proposed Transaction".*	Dr Padilla's first report ("**Padilla 1**") states that he has been instructed as to the terms of any Optus-TPG cooperation agreement, including as regards both prices and whether it extends to network sharing in the RCZ. These instructions appear to directly affect Dr Padilla's conclusion. I have not been instructed to make any assumptions as regards the nature of the counterfactual and have instead based my evidence on my review of the key documents in the case and my understanding of the facts. In my First Report (section 8.4), I consider instead the underlying incentives of Optus and TPG absent the Proposed Transaction (including pre-Transaction documents and witness statements, and the commercial context [redacted]), and their poor outside options if
3.8	*"Mr Hunt does not appear to have considered the effect of the ACCC blocking the Proposed Transaction although he argues that TPG's bargaining power will be limited if its outside options are poor. He makes this point with respect to TPG renegotiating future access terms with Telstra. In my Second Report, I set out why I consider that, if the Proposed Transaction proceeds, TPG's future*	

	bargaining position will be at least as good as its current bargaining position".	they do not reach such an agreement (due to the challenges they both face in competing with Telstra nationally and particularly as regards network infrastructure in the RCZ as they cannot individually achieve economies of scale). [redacted] In section 8.5 of my First Report, I address the specific form such a network sharing agreement would take, [redacted] I have not concluded that any network sharing agreement between Optus and TPG would lead to worse terms for TPG, but merely that this was a possibility but not determinative to the assessment of competitive effects (see §264 of my First Report). In practice, as I do not know the terms that Telstra has agreed with TPG, it would not be possible to reach any such conclusion [redacted] I also caution that TPG's contractual protections in its contract with Telstra are likely to be imperfect. This is important because TPG will be very largely dependent on Telstra as regards access to RAN infrastructure in the RCZ (see §§298-300 of my First Report). In my First Report, I consider that even if TPG were to pay higher variable charges to Optus in the counterfactual, the impact on this effect on competition cannot be judged in isolation and needs to account for the fact that access charges would further fund network investment by Optus, which in turn will improve the quality of network available to both Optus and TPG (see §295 of my First Report).
3.7	*"An ACCC decision to block the Proposed Transaction would instead turn Optus into the effective monopoly potential supplier of access to TPG. Optus would then have both competitive and financial reasons to require TPG to pay relatively high access charges and limit its coverage which would stymie TPG's ability to provide competitive offers to win customers from Optus".*	I believe Dr Padilla's analysis is incomplete because, as I note at §35 of my Second Report, Dr Padilla does not consider the significant impact that a deal with TPG will have on Optus' ability to achieve economies of scale in the counterfactual. In my view, this is an important omission. With greater economies of scale Optus will have lower unit costs (see section 6.4 and, in particular, §176(b) of my First Report) and will be able to invest in additional network infrastructure in the RCZ, enabling Optus to compete more effectively with Telstra. As both Optus and TPG would benefit from this, increasing their joint surplus, this provides Optus with an incentive to offer sufficiently attractive terms to TPG that would enable TPG to be competitive, ensuring that it would make significant payments to Optus to contribute to

		the cost of the 5G investment in the RCZ (and increasing Optus' profits compared to a scenario of no network sharing arrangement between Optus and TPG).
3.11	*"Mr Hunt also argues that even if TPG's competitiveness improves under the Proposed Transaction, it is less important for price competition because it is a smaller rival nationally than Optus. I have the opposite view to Mr Hunt. The Proposed Transaction would enable TPG to offer competitive coverage and, precisely because of TPG's small current market share, it would have the incentive to price aggressively to seek to grow its share. Mr Hunt observes that smaller firms have natural incentives to set lower prices to steal business from rivals, but Mr Hunt fails to apply this to his analysis of TPG's likely competitive impact. When TPG offers coverage better than Optus and much closer to Telstra's coverage than TPG's current coverage, I consider that Telstra and Optus will be forced to reduce their prices to seek to limit the loss of their customers to TPG".*	Under the Proposed Transaction, I agree that TPG will win market share from Telstra and Optus, including specifically in the RCZ. And, in general, I agree with Dr Padilla that all, other things equal, smaller firms have incentives to set lower prices to steal business from their rivals. However, all other things are not equal, and TPG will be hampered in competing with Telstra (compared to Optus) due to TPG's branding issues and lower market share in all geographical areas (see §75(c) of my Second Report). I also note that my comment regarding the price setting incentives of smaller firms was made in the context of considering Telstra's and Optus' incentives in relation to the terms that they may offer to TPG under a network sharing agreement. As the additional scale and volumes resulting from an agreement with TPG are more valuable to Optus than Telstra, because Optus is a smaller operator, this factor would provide Optus with an incentive to offer TPG keener wholesale prices than Telstra. Dr Padilla has not addressed this issue and I note that he has been instructed that TPG would secure superior terms from Telstra than Optus in the counterfactual. As regards the impact on price competition, I do not consider that this can be assessed absent a consideration of the competitive effects of the Proposed Transaction on Optus and an appropriate consideration of the counterfactual. As I set out in section 5 of my Second Report, Dr Padilla's analysis of price effects is flawed and should be disregarded because: (i) it assumes that Optus will remain a strong competitor; (ii) it relies upon what I believe is an unlikely counterfactual; and (iii) it uses numerous broad-brush assumptions and conjectures that do not relate to this specific matter and appear in some instances to be inconsistent with the available evidence.
3.12	*"I also consider that price competition will be greater under the Proposed Transaction because the three operators will be closer competitors than in the SOPV Counterfactual".*	I do not agree with Dr Padilla that the three MNOs would be closer competitors under the Proposed Transaction than in the counterfactual. Under the Proposed Transaction, [redacted] TPG will be reliant upon Telstra's

		network in that area. This means that in the medium term there would be significantly reduced retail and wholesale competition, including on price (see §291 of my First Report).
3.13	*"I note Mr Hunt's view that the ACCC should place weight on the potential effect on infrastructure investments by Optus rather than what he describes as short-term price effects. I consider that there is no sound basis for such a view."*	As the ACCC recognises, competition in the supply of both wholesale and retail mobile services is enabled by the underlying infrastructure of the mobile networks (see §105 of My First Report). On this basis, I consider that the impact of the Proposed Transaction on competition at the level of mobile network infrastructure is critical to assess any impact on competition. The Proposed Transaction undermines the process of dynamic network competition in the RCZ, which in turn leads to substantial lessening of competition in the retail and wholesale mobile markets (see §107 of My First Report). Dr Padilla's short-term pricing analysis does not take such effects into account.
4.10	*"Moreover, to the extent that Analysys Mason appears to claim that Telstra's marginal costs would fall with the Proposed Transaction, I expect such a change to increase competition and benefit consumers. Economic theory shows that a substantial part of a firm-specific reduction in marginal costs can be expected to be passed through into lower prices. Even a monopolist (with linear demand) can be expected to pass-through 50% of a marginal cost saving and the rate of pass-through of firm-specific marginal cost reductions generally increases with competition."*	Dr Padilla's observation that a monopolist can be expected to pass-through 50% of marginal cost savings has very limited, if any, relevance to the impact of the Proposed Transaction on prices. The primary impact on competition of the Proposed Transaction is a weakening of Optus' incentives to invest in 5G in the RCZ. In the medium term this will lead to significantly reduced retail and wholesale competition (see §291 of my First Report). In such a situation, where Telstra's closest competitor will be weakened, any possible reduction in marginal costs for Telstra would not be likely to lead to lower prices. In any case, I note that Analysys Mason's analysis considered average forward-looking unit costs in the RCZ and not marginal costs.

4.3 Spectrum efficiencies

23. I address the specific points raised by Dr Padilla on spectrum efficiencies in the table below.

Paragraph	Padilla's statement	My response
3.37a	*"I understand that Telstra's need for additional spectrum is integral to Telstra agreeing to enter into the Proposed Transaction with TPG on competitive terms. If TPG were instead simply to lease the spectrum to Telstra, then TPG would not gain the additional coverage resulting*	The benefits of additional spectrum are modest according to the Applicants' own expert, and cannot explain why Telstra entered into the Proposed Transaction (see §73 of my Second Report).

	from the Proposed Transaction and mobile customers would not gain the benefit of more effective competition in the mobile market".	In any case, I consider that leasing spectrum in the counterfactual would be an option which would enable efficiency benefits while ensuring increased competition (see §262 of my First Report).
3.37b	*"Sharing TPG's spectrum with Optus would not deliver the productive efficiency benefits of the Proposed Transaction (i.e. of spectrum being allocated to where it is of most use) and nor would Optus be as willing to offer as good terms to TPG so as to access the spectrum".*	I understand that Optus would gain significantly from sharing spectrum with TPG (see my First Report, §305(a)). As regards terms offered to TPG, as set out in my First Report and Second Report, I do not consider this to be a determinative question when considering authorisation of the Proposed Transaction. TPG's interests are a separate question to whether the Proposed Transaction is also in consumers' interests. In my view, there is good reason to consider that under the counterfactual TPG would be able to compete and Optus would have greater incentives to invest in the RCZ in competition with Telstra (see §68(c) of my Second Report and §264 of my First Report).
3.37	*"Mr Hunt argues that the Proposed Transaction will have a negative impact on dynamic network competition and that this will mean that spectrum may not be efficiently utilised over time. However, Mr Hunt's reasoning is circular and fails to consider how spectrum sharing under the Proposed Transaction can promote competition."*	Dr Padilla misunderstands my point. In the face of strong network competition, operators have an incentive to utilise efficiently the spectrum they have available. Accordingly, if network competition in the RCZ between Optus and Telstra is significantly reduced in future, this is likely to weaken Telstra's incentives to use spectrum efficiently.
3.41	*"Mr Hunt states that Optus could also enjoy cost savings in a network sharing counterfactual. I agree but given that Optus already has much more spectrum per SIO in the RCZ, I would expect that there would be greater savings in marginal costs from Telstra gaining access to additional spectrum and hence a greater impact on mobile service prices".*	The Proposed Transaction will in effect strengthen Telstra's already considerable competitive advantage by providing it with additional spectrum efficiency benefits. As I expect competition from Optus to be considerably weakened (in particular as regards 5G networks in the RCZ) following the Proposed Transaction, there is no reason to believe that the spectrum efficiency benefits will be passed on to consumers. In fact, to the contrary, additional spectrum reduces the cost to Telstra of responding to any investment by Optus, and the expectation of such responses will further deter investment by Optus (see §§185-186 and §207 of my First Report). In the counterfactual, on the other hand, Optus will retain its incentives to invest, and both Optus and TPG will compete against Telstra. The resulting efficiencies from spectrum sharing in the counterfactual are, consequently, more likely to be passed on to consumers.
3.42	*"Mr Hunt comments that "congestion sends the right signals to operators to compete with each other." I do not understand Mr Hunt's reasoning. If Telstra is congested, then it will have not capacity*	As I explain at §107 of my First Report, in my view, congestion provides Optus with an incentive to win share from Telstra where Telstra's network is congested and, at the same time, provides Telstra with an incentive to

	in that area to take additional customers from rivals. This would reduce its incentive to set low prices and it would give Telstra's rivals the ability to price higher without risking the loss of customers in that area to Telstra. As such, I consider that congestion acts to limit competition".	improve its network to provide increased capacity. This is how I see congestion being part of the dynamic competitive process. Moreover, the existence of congestion may be evidence of inadequate competition already in network infrastructure in the RCZ, which the Proposed Transaction (if authorised) will then only further weaken.

5 Overall conclusions

24. In my view, as I concluded in my First Report, the Proposed Transaction will lead to a substantial lessening of competition. This results from the significant weakening of dynamic competition at the network level in the RCZ, and, over time, will result in materially less competitive outcomes in retail and wholesale mobile telecoms markets. Feasey 3 and Padilla 3 do not raise any additional facts or arguments that lead me to alter my conclusions.

Declaration

25. I have made all the inquiries which are desirable and appropriate (save for any matters identified explicitly in this report) and no matters of significance that I regard as relevant have, to my knowledge, been withheld in preparing this report.

[redacted]

Signature of Matt Hunt

4 December 2022

A1 HSF Letter of instructions to AlixPartners

HERBERT
SMITH
FREEHILLS

Matt Hunt
Managing Director
AlixPartners UK LLP
6 New Street Square
London EC4A 3BF
United Kingdom

1 December 2022
Matter 82737584
By email

Dear Mr Hunt

Letter of instructions - Further expert economic report in respect of application for merger authorisation by Telstra and TPG
Our client: Singtel Optus Pty Ltd (Optus)

1 Introduction

We refer to your engagement in this matter and our letters of instruction dated 24 October 2022 and 16 November 2022 in respect of your first and second expert reports.

The purpose of this letter is to confirm your instructions to prepare a further expert report in this matter and the questions that your report is to address.

2 Request for a further expert report

Based on your expertise as an economist, and given the considerations raised in your first and second reports relevant to assessing the likely effect, if any, of the Proposed Transaction on competition and efficiency, please consider and provide your views as appropriate on relevant matters raised by the public versions of:

(1) the third expert report of Richard Feasey dated 10 November 2022;

(2) the third expert report of Dr Jorge Padilla dated 17 November 2022.

3 Materials you are to rely on

In preparing your report, please have regard as necessary to the materials referred to in Schedule 1 to our letters of instruction dated 24 October 2022 and 16 November 2022 and the materials referred to above. Please specifically identify in your report these and any additional materials on which you have relied.

4 Your duties and responsibilities as an independent expert

Please prepare your report in accordance with the requirements of the Federal Court of Australia Expert Evidence Practice Note (GPN-EXPT) (Practice Note), which accompanied our letter dated 24 October 2022 and includes the Harmonised Expert Witness Code of Conduct that you must comply with.

HERBERT
SMITH
FREEHILLS

We look forward to receiving your report.

Yours sincerely

[redacted]

Linda Evans
Partner
Herbert Smith Freehills

Patrick Clark
Partner
Herbert Smith Freehills

A2 Glossary

ACCC	Australian Competition and Consumer Commission
CMA	Competition and Markets Authority
HSF	Herbert Smith Freehills
MNO	Mobile Network Operator
MOCN	Multi-Operator Core Network
Optus	Singtel Optus Pty Ltd
Proposed Transaction	Proposed commercial arrangements between TPG Telecom Limited and Telstra Corporation Limited
RAN	RAN
RCZ	Regional Coverage Zone
Telstra	Telstra Corporation Limited
TPG	TPG Telecom Limited

A3 Documents relied upon

A3.1.1 In addition to the documents referred to in my First and Second Reports, I have relied on the following documents for the purposes of producing this report.

(a) Third expert report of Richard Feasey (Public version), 10 November 2022.

(b) Third expert report of Dr Jorge Padilla (Compass Lexecon), 17 November 2022("Padilla 3").