Bureau of Communications Research - Consultation Paper on **nbn** non-commercial services

nbn's response

9 November 2015

Contents

1 Introduction

nbn welcomes the opportunity to comment on the Bureau of Communications Research's (BCR) Final Consultation Paper: **nbn** non-commercial services funding options (Consultation Paper).

nbn agrees with the BCR's principles-based approach for considering economically sound ways to fund the rollout of **nbn**'s fixed wireless and satellite networks in regional Australia. In particular the BCR has assessed the relative merits of alternative funding arrangements against a set of overarching principles that are supported by key industry stakeholders. These principles are transparency, contestability, competitive neutrality, sustainability, economic efficiency and equity. Unfortunately, the BCR has not weighed the relative importance of each of these principles against the key issues which somewhat undermines the rigour of the BCR's analytical approach. Accordingly the result is that the BCR's assessment of the overall merits of alternative arrangements could be perceived as somewhat subjective. For example, when considering the merits of alternative cost allocation methodologies, the BCR have given considerable weight to the principle of competitive neutrality and less weight to the principle of sustainability which encompasses the principle of administrative burden and complexity. By contrast, when considering the issue of whether networks that serve government, medium and large business customers should be included in the eligibility arrangements, the BCR seems to give greater weight to the principle of sustainability and considerably less weight to the principle of competitive neutrality.

Despite the shortcomings of the BCR's analytical framework, **nbn** agrees with many of the BCR's recommendations. In particular, **nbn** agrees that:

- the BCR should assess the commerciality of the fixed wireless and satellite networks on an aggregated basis and not on a granular basis;
- it is appropriate to quantify the losses to FY2040; and
- the use of the discounted cash flow (DCF) model is appropriate.

However, there are two recommendations where analysis is lacking and where further consideration is warranted. The two recommendations relate to:

- **The choice of methodology for allocating common costs**: In seeking to achieve competitive neutrality the BCR has assumed that an avoidable cost approach is superior to a fully allocated approach. However, it doesn't appear that the BCR has given due consideration to the particular circumstances of **nbn**'s operating environment and as a result there is a risk that an avoidable cost approach will result in under recovery of **nbn**'s true cost of providing fixed wireless and satellite services. To the extent that this will place an unfair and costly burden on **nbn** it is inconsistent with the principle of competitive neutrality. For these reasons **nbn** supports a fully allocated cost approach.
- **The scope of the levy**:
    - The BCR needs to specifically recommend that mobile networks that directly compete with **nbn** for high speed data services to the premises (such as 5G networks) should be included in the levy at a set point in the future. Highlighting these future levy contributions is not only essential to inform future mobile investments but will also avoid adverse industry impacts in the future. Broadening the scope of the levy will also further economic efficiency and competitive neutrality.
    - Additionally, **nbn** is concerned about the exclusion of medium and large business and government enterprises. Excluding these premises is inconsistent with the principle of competitive neutrality and achieving a level regulatory playing field. Furthermore, these premises are not treated any differently in the Statement of Expectations and so excluding

them from the levy is inappropriate and inconsistent policy. As a result **nbn** submits that the scope of the levy should be broadened to include these medium and large business and government enterprises.

In this submission **nbn** focusses on the shortcomings of the BCR's analysis underpinning these two recommendations. We also highlight the potential risks that may arise if the BCR does not address these shortcomings and make consequential revisions to its recommendations.

2 Cost allocation

Since its initial consultation paper, the BCR has moved from a fully distributed cost approach to an avoidable cost approach when determining the commerciality of the network. We understand that the BCR's shift in respect of the cost allocation methodology has been guided by two main factors: competitive neutrality and approaches used in other industries. The BCR has also considered concerns raised by **nbn** regarding the potential administrative burden that an avoidable cost approach may impose on it.

In relation to the issue of competitive neutrality we note that the BCR has been guided by relevant literature including documents and guidelines authored by reputable Australian Government agencies and advisory committees. However, the BCR's reliance on this literature, and its findings, is both narrow and selective. Furthermore little consideration seems to have been given to the how the BCR should apply the lessons from the selected literature to its assessment of the options for funding **nbn**'s non-commercial services given the unique features of Australia's telecommunications industry, including the complex policy and regulatory framework within which **nbn** operates.

In relation to the approaches used in other industries **nbn** notes that the BCR's views on this issue directly contradict those of the ACCC.

Finally, in relation to the potential administrative burden that an avoidable cost approach may impose on **nbn**, we note the BCR has failed to weigh this tangible detriment against the potential hypothetical benefits that may or may not arise from an avoidable cost allocation approach.

These points are elaborated in the following subsections.

2.1 Competitive neutrality

The BCR's preference for an avoidable cost approach is driven by the argument that it may support competitive activity. In arriving at this conclusion the BCR has had regard to stakeholder submissions as well as the following literature:

- A 1994 paper prepared by Steering Committee on National Performance Monitoring of Government Trading Enterprises (SCNPMGTE) titled "Community Service Obligations: Some Definitional, Costing and Funding Issues"; and
- The Australian Government Competitive Neutrality Guidelines for Manager which was released in 2004.

We note that both of these papers focus specifically on achieving competitive neutrality between government enterprises and the private sector in the wider context of a reform agenda of deregulation and market liberalisation. However, despite this specific focus neither paper advocates that an avoidable cost methodology is appropriate in all circumstances. Indeed, we note that the SCNPMGTE examines the choice of methodology in industries that exhibit decreasing cost structures and suggests the use of avoidable costs plus a mark-up.[1] Furthermore an Industry Commission paper released in 1997 which reviewed the progress of various Australian Government's in implementing competition reforms in respect of costing and funding Community Service Obligations (CSOs) noted that many Australian State and Territory Governments have departed from the use of an avoidable cost methodology:

[1] 1994 paper prepared by Steering Committee on National Performance Monitoring of Government Trading Enterprises (SCNPMGTE) titled "Community Service Obligations: Some Definitional, Costing and Funding Issues", Pp 45-46.

Several governments have recognised that the avoidable cost method may not be appropriate in all circumstances. For example, the NSW, ACT and NT Governments have adopted the fully distributed cost method for price concession CSOs and the policies of the Victorian and Queensland Governments allow for departures from avoidable cost where CSO provision is large in relation to the overall activity. The common basis for these exceptions is that an avoidable cost method may underestimate the cost of CSOs in the presence of significant joint or common costs. This is a particular issue in conditions of declining costs, a feature of several industries in which GBEs operate.[2]

In more recent times an increasing number of studies have emerged which criticise the avoidable cost approach for failure to account for the scope and dynamics of market liberalisation and its simplistic approach to the counterfactual of no universal service obligation. A separate but important contribution from the access pricing literature develops an approach to a universal service that seeks to ensure efficient entry decisions. In order to ensure efficient entry, the universal service levy on entrants must include the contribution to the incumbent's fixed and common costs that such entry displaces.[3]

Furthermore, we note that the BCR has not examined whether the avoidable cost methodology is the most appropriate approach given the unique circumstances, of **nbn**'s obligation to provide fixed wireless and satellite services in addition to fixed line services (which involves the provision of services to both profitable and loss making areas). Indeed, we note that **nbn**'s circumstances are considerably different to those of many "textbook" examples of CSO arrangements. In particular, there are four important aspects which warrant consideration by the BCR:

- Despite the BCR proceeding on the basis that the **nbn** fixed line network is profitable at an aggregate level, this network covers both profitable and loss making areas. Importantly, **nbn** is obligated to serve the entire fixed line coverage area using fixed line technologies regardless of whether doing so is commercial. This is in contrast with many textbook examples of CSO arrangements where the firm is considered as comprising of two separate and distinct functions: a function which undertakes non-commercial activities in fulfilment of its CSO and a function which undertakes only commercial activities.[4]
- Many textbook examples of CSO arrangements give little consideration to how the firm is regulated.[5] In most cases it is acknowledged that the CSO function of the firm may be subject to regulation but often it is assumed that commercial activities of the firm are constrained by market forces and therefore unregulated. This is in stark contrast to **nbn**. Not only are **nbn**'s fixed wireless and satellite networks subject to coverage and supply obligations but **nbn**'s commercial activities - supply of fixed line services - are subject to minimum coverage obligations, access regulation, supply and non-discrimination obligations, price and revenue constraints (as per **nbn**'s special access undertaking (SAU)) and lines of business restrictions.[6]
- **nbn**'s coverage obligations in respect of its fixed line network drives the magnitude of common costs. Again this differs from most other Australian firms with a CSO. For example, **nbn** understands that much of Australia Posts common and joints costs are driven by its CSO activities.

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[2] Industry Commission, "Community Service Obligations: Policies and Practices of Australian Governments", Information Paper February 1997, p.23.

[3] See for example Armstrong, M (2008) "Access Pricing, Bypass and Universal Service in Post" Review of Network Economics, 7(2): 172-187.

[4] See for example VHA submission Pp 7-8 which includes a simple example of the cost allocation problem. This example assumes nbn has two parts reflecting the high cost and low cost areas ("loss making" and "profitable" areas).

[5] See for example Appendix B of Commonwealth Competitive Neutrality Complaints Office, "Cost Allocation and Pricing: CCNCO Research Paper", October 1998.

[6] See Independent cost-benefit analysis of broadband and review of regulation, "Statutory review under section 152EOA of the Competition and Consumer Act 2010" June 2014.

- It is unlikely that a profit maximising firm would ever seek to duplicate **nbn**'s fixed line footprint. Hence, competitors who seek to cherrypick the most profitable areas of **nbn**'s footprint would have an enduring cost advantage over **nbn** as they would have no obligation to serve high cost to serve areas. Accordingly, claims that an FDC approach will place other network providers at a competitive disadvantage to **nbn** are overstated.
- **nbn**'s fixed wireless and satellite services face a number of competitive constraints, most notably from Telstra's ongoing operation of its PSTN network outside **nbn**'s fixed line footprint and from mobile wireless services (which offer both voice and broadband functionality). This is in contrast to many textbook and real world examples of CSO arrangements in which the provider of the CSO service is the monopoly provider of that service and in many cases enjoys enduring protections from competition in respects of those services. For example, Australia Post has the exclusive right to issue postage stamps and collect, carry and deliver letters within Australia that (subject to exceptions) weigh not more than 250 grams. Australia Post was given this statutory monopoly so that revenue from its reserved services could fund the cost of meeting its CSOs.[7] **nbn** is not a monopoly provider of voice and broadband services in its fixed wireless and satellite footprints nor does it enjoy any protections from future market entry or competition.

2.2 Approaches used in other industries

The BCR also justifies its preference for an avoidable cost approach on the basis that it is consistent with approaches used in other industries and companies that the BCR considers are similar to **nbn**. In particular, the BCR uses Australia Post as an example.

nbn notes that the BCR's views seem to directly contradict with those of the ACCC. In its public submission to the BCR the ACCC supported the use of a fully allocated cost approach on the basis that:

> *This approach is a well accepted method for allocating costs, has been adopted in a variety of regulatory settings, including for Australia Post and in the electricity and gas industries. This approach has also been recently adopted in the ACCC's draft decision in relation to Telstra's fixed line services. The ACCC considers that a fully allocated approach is an appropriate way of allocating costs for the purpose of measuring losses from non-commercial services.* [8]

In respect of Australia Post's use of an avoidable cost approach, **nbn** submits that the BCR misunderstands the purpose for which Australia Post maintains and uses an avoidable cost approach. This purpose has little relevance to the choice of an appropriate cost allocation method for estimating the losses arising from **nbn**'s fixed wireless and satellite services.

The Australian Postal Corporation Act 1989 (APCA) requires the ACCC to assess whether Australia Post is cross-subsidising its commercial services (referred to as non-reserve services) with revenues from its statutory monopoly services (referred to as reserved services). To undertake its cross-subsidy assessment the ACCC seeks to identify whether the revenue from any commercial service is less than the avoidable cost of providing that service group and whether the revenue generated by CSO services is greater than the stand-alone cost of providing them. This requires Australia Post to provide the ACCC with information about the avoidable and stand-alone costs associated with its commercial and CSO services.

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[7] See ACCC, Australia Post's draft price notification, Issues paper September 2015 p.16.

[8] ACCC, "ACCC submission to the NBN non-commercial services funding options consultation paper, June 2015, p.6.

In practice, the ACCC's cross-subsidy assessment is a theoretical check to ensure that Australia Post is not gaining a competitive advantage from being the statutory monopoly service provider for the collection and delivery of letters within Australia. The ACCC's cross-subsidy assessment does not determine the extent to which Australia Post is able to recover its costs or how it prices any of its products and services.[9] In fact, as noted by the ACCC in its public submission to the BCR, Australia Post uses a fully allocated cost approach for pricing CSO services (i. e. its monopoly letter services).[10]

2.3 Sustainability and administrative burden

The BCR has noted **nbn**'s concerns about the significant administrative burden that is likely to arise as a consequence of having to maintain two sets of costs allocations:

> *The BCR's acknowledges NBN Co's concerns around the administrative burden of implementing an avoidable cost approach, recognising that this would require allocating costs and assembling accounts solely for this purpose.*[11]

In response to these concerns the BCR simply asserts that the benefits of using an avoidable cost approach will outweigh the costs and administrative complexity that this approach will impose on **nbn**.

The BCR also justifies its recommendation by highlighting that a fully allocated cost approach risks an over allocation of common costs which may impact adversely on competition. However, an avoidable cost approach runs the risk of under allocation of costs which may adversely impact the wider sustainability of **nbn**'s service provision. This risk is in addition to the costs and administrative burden that would be imposed on **nbn** as a result of having to maintain two sets of cost allocations.

Rigorous policy analysis would involve the BCR attempting to identify the likely costs of the administrative burden and weigh them against the benefits that are likely to be realised from an avoidable cost approach. Consideration would also be given to whether any potential benefits to competition that may arise from a fully allocated cost approach outweighs the future adverse impacts to **nbn**'s longer term commercial sustainability. In undertaking this analysis, it should be acknowledged that potential benefits to competition will most likely be limited to infrastructure based competition while adverse impacts to **nbn**'s commercial sustainability will adversely impact the provision of an open access network that facilitates retail competition and reduces the costly and potentially wasteful duplication of infrastructure characterised by pervasive and enduring economies of scale and scope.

[9] Another way of saying this is that Australia Post does not use an avoidable cost approach to allocate common costs between its CSO services and its commercial services.

[10] See ACCC, "Australia Post's draft price notification, Issues paper", September 2015 p.16.

[11] Bureau of Communications Research – Final Consultation Paper, NBN non-commercial services funding options, page 33.

3 Scope of levy

The BCR has recommended that the scope of the levy is defined very narrowly and be limited to industry participants that resemble **nbn**. As part of this limitation, the BCR has recommended that mobile operators and fixed line networks that service Government, medium and large business customers should not be required to contribute to the levy.

nbn considers that the scope of the levy is a fundamental issue that will have long lasting impacts on the industry and the extent to which there is efficient future investment and market entry across the industry. As a result, this is a fundamental issue and needs to be properly analysed from all angles to ensure that the right approach is adopted from the outset.

We have detailed **nbn**'s concerns with the BCR's recommendation and its supporting analysis below.

3.1 Limited assessment of the available options

nbn notes that the BCR has only considered two alternative eligibility arrangements: an **nbn** equivalent approach and a telecommunications industry levy (TIL) style industry wide approach. The BCR's assessment of a limited set of eligibility arrangements is despite the fact that industry responses to the initial consultation paper identified a wide range of different options, including, for example, a proposed funding approach which is broad based and determines contributions according to profits earned.[12] Another approach that was proposed is the inclusion of content providers on the basis that they are likely to be a direct beneficiary from the rollout of the **nbn**.[13] Based on the BCR's Consultation Paper it not clear the extent to which the BCR considered the merits of these alternative arrangements.

Additionally **nbn** notes that the BCR's recommendation of a narrow base of contributors to the levy gives little weight to the fact that submissions were divided on whether eligibility should be broad enough to include mobile network operators.

3.2 Competitive neutrality and equity

nbn notes the shortcomings of the BCR's analysis in respect of how the alternative arrangements perform against its six principles:

- When assessing the alternative funding approaches against the criteria of competitive neutrality the BCR implicitly assumes that mobile and fixed line networks are not substitute services and as a result does not give any consideration to whether a narrow base of contributors places eligible fixed line operators (including **nbn**) at a competitive disadvantage to mobile operators. Furthermore, the BCR does not appear to have considered whether the alternative funding approaches places **nbn** and other eligible fixed line networks that serve both residential and business customers at a competitive disadvantage to non-eligible fixed lines networks that are exempted on the basis that they serve only medium and large business customers.
- When assessing the alternative funding approaches against the criteria of equity the BCR analysis amounts to little more than referencing the given characteristics of the mobile industry in 2012-2013. In particular the BCR makes reference to the number of low income households that subscribe to mobile-only broadband services. However, there is no consideration of how the alternative approaches would

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[12] VHA submission, p.19.

[13] iiNet submission , p.7.

impact those households that subscribe to a fixed line voice-only service, many of which are likely to be vulnerable or disadvantaged customers.[14] Furthermore, the BCR has not considered how the alternative arrangements spread the costs of the losses from **nbn**'s fixed wireless and satellite networks across the beneficiaries of those networks. **nbn** submits that when considering the equity impacts of the alternative eligibility arrangements the BCR needs to consider how the costs and benefits of the arrangements will be spread across society as whole. The BCR's analysis fails to do this.

3.3 Economic efficiency

The BCR's recommendation of a narrow base of contributors to the levy relies heavily on its analysis of how the two alternative funding options perform against the principle of economic efficiency. In Table 11 of its Consultation Paper the BCR describes the principle of economic efficiency as follows:

> *Non-commercial funding models should be assessed by whether they support or constrain productive, allocative or dynamic efficiency. Allocative efficiency includes consideration of the distortionary impact of taxes and levies on demand for goods and services.* [15]

Curiously, when considering how the alternative eligibility approaches perform against the criteria of economic efficiency the BCR has focused almost exclusively on **nbn**'s incentives to minimise fixed wireless and satellite losses. Specifically, the BCR argues that a narrow eligibility arrangement will provide strong incentives for **nbn** to minimise its fixed wireless and satellite losses because "limiting eligibility to NBN equivalent services means that NBN Co remains strongly accountable for fixed wireless and satellite losses, as it must fund nearly all of these losses from its own fixed line customers."[16] The BCR also argues that productive and dynamic efficiency will be higher under a narrow industry arrangement.[17]

For the following reasons **nbn** strongly disagrees with the BCR's analysis regarding the extent to which economic efficiency will be impacted by the eligibility arrangements:

- The BCR's analysis implies that firms that incur higher losses are more likely to minimise costs and innovate which will in turn maximise productive and dynamic efficiency. **nbn** submits that such logic is counterintuitive to economic theory.
- **nbn** faces strong efficiency incentives independent of the proposed industry levy. **nbn** as a government business enterprise is required to act in accordance with its Statement of Expectations which requires **nbn** to minimise peak funding, optimise economic returns and enhance the company's viability.[18] This requirement applies regardless of the level of risk faced by **nbn** regarding revenue sufficiency and irrespective of which industry participants are required to contribute to the proposed levy.
- **nbn**'s SAU includes a number of provisions to ensure the efficiency of expenditures by **nbn**. These include provisions for the ACCC to determine that expenditure meets the prudency criteria set out in the SAU. Furthermore, constraints on **nbn**'s prices to not increase by more than CPI less 1. 5% each year means that **nbn** has an incentive to both minimise costs and maximise the take-up of services. These

[14] Telecommunications Industry Ombudsman, "Submission on the Universal Service Obligation Legislative Reform for transition to the National Broadband Network", August 2011, p.9.

[15] BCR, "NBN non-commercial services funding options: Final Consultation Paper", October 2015, p.45.

[16] BCR, "NBN non-commercial services funding options: Final Consultation Paper", October 2015, p.54.

[17] BCR, "NBN non-commercial services funding options: Final Consultation Paper", October 2015, p.54.

[18] See Statement of Expectations http://www.nbnco.com.au/content/dam/nbnco2/documents/soe-shareholder-minister-letter.pdf

aspects of the SAU will remain unchanged irrespective of which industry participants are required to contribute to the proposed levy.

In respect of the BCR's analysis regarding the potential distortionary impacts arising from the imposition of the levy, **nbn** agrees that a narrow eligibility arrangement will result in a greater loss of allocative efficiency. The BCR's conclusions in this regard are well supported by economic theory. However, despite this, the BCR goes onto argue that it believes that this loss of allocative efficiency is likely to be small and outweighed by the productive and dynamic efficiency benefits arising from **nbn**'s improved cost incentives. **nbn** notes however that the BCR's conclusions are not supported by any empirical analysis.

3.4 Fixed to mobile substitution

The BCR argues that mobile networks should not be required to contribute to the levy as mobiles are not currently a competitive substitute for fixed line services. The BCR concludes that:

> *…mobile services are only partial substitutes for fixed line services at this time. While 21 per cent (3. 9 million) of adult Australians elect only mobile services for internet usage, 93 per cent of data is downloaded over fixed line networks, indicated only partial substitutability*.[19]

The BCR's thinking on this issue does not take into consideration that the levy is meant to be a long term policy arrangement. It is an arrangement that will be in effect till 2040. In order for the levy to be successful in the long term, the BCR needs to consider both current and future trends and the results of these considerations needs to inform the initial design of the levy in order to ensure that the levy's design and implementation is future proof. Accordingly we ask that the BCR to give consideration to the issues set out in the following subsections.

Importantly, even if the BCR is not minded to recommend including mobiles into the scope of the levy, at the very least the BCR should make an explicit recommendation that the Minister must cause a review in 5 years' time (or a set period) to specifically look at whether mobiles should be included in the scope of the levy.

Different product attributes versus same basic functionality

Implicit in the BCR's conclusion is the suggestion that because mobile and fixed line networks offer different functionalities they are not substitutes in any respect. It also seems to imply that because mobile networks only account for a small proportion of total data downloads this provides further evidence to suggest that mobile services are not a competitive a substitute for fixed line services. **nbn** submits that such logic is flawed.

nbn acknowledges that mobile and fixed line networks have different functionalities and attributes. However, focusing on these different functionalities risks overlooking the extent to which two differentiated products provides the same basic functionality. For instance, while mobiles allow connectivity and mobility whereas fixed line networks do not, both provide the same basic functionality in the sense that they allow a user to make voice calls and to connect to the internet.[20] Accordingly, even though they have different functionalities and product attributes which in turn is reflected in the usage data this does not negate the fact that they are substitutes in the sense that they provide consumers with alternative means to access telephone and internet services.

If one was to apply the same logic implicit in the BCR's conclusion to public transport, one would conclude that public transport (i. e. bus and train travel) and private vehicle usage are in no way substitute modes of travel. A bus trip is a different travel experience to driving a car. Similarly, travel statistics for the Sydney region reveals that public transport accounts for only 11. 3% of total trips while private vehicle travel accounted of 69. 2% of

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[19] Bureau of Communications Research – Final Consultation Paper, NBN non-commercial services funding options, page 56.

[20] See Banerjee, A 2007, 'Fixed mobile substitution and lessons for broadband', paper presented to the ACCC 2007 Regulatory Conference, Queensland, 26 to 27 July.

total trips. Nevertheless, surveys of public attitudes to public transport consistently show that even though different commuters have different travel preferences, public transport is widely acknowledged to offer an alternative and substitute mode of transportation to private vehicle travel.[21]

Technological change

Even if the current statistics suggest that fixed line and mobile broadband services are only partial substitutes the BCR's recommendations should recognise that there will be further advances in mobile technologies and this will further shift the paradigm of whether, and to what extent, mobiles are substitutes for fixed line services. In this regard we draw the BCR's attention to the ACCC's analysis of the extent to which online content, Pay TV services and video on demand services were are a substitute for brick-and-mortar video rental services. In particular, in its May 2007 Statement of Issues relating Video EZY Australasia's Pty Ltd proposed merger of Blockbuster Australia Pty Ltd the ACCC argued that:

> *"The ACCC understands that at present, the retail sale of DVDs, online rental download services, and pay television are unlikely to be effective substitutes to the rental supply of DVDs at traditional bricks and mortar rental stores for the reasons set out below:*
>
> - *The ACCC understands that the retail price of a new release DVD is substantially higher than the rental price of the same new release DVD.*
> - *Technological barriers (download speeds etc) have meant that consumer take-up of online rental download services has not been substantial and this is unlikely to change within the next two years.*
> - *The exclusivity of films into the rental/retail channel prior to pay television release suggests that there may be limited competition between DVD rental and pay television. The ACCC also understands that approximately 25. 5% of households in Australia subscribe to pay television. Accordingly, pay television may not be an effective substitute for a large proportion of consumers, or pose a significant constraint on the rental supply of DVDs.*
>
> *The ACCC notes that online rental services by postal delivery may be substitutable with the rental services provided at traditional bricks and mortar rental stores. However, the ACCC understands that at present, online rental services do not represent a significant portion of the market, and therefore any constraint posed by online rental services through postal delivery may be limited."*

Despite the ACCC's well-reasoned concerns, based on observable market characteristics at the time, it is now possible to see that the dynamic nature of technological change was not sufficiently accounted for. In particular, due to the growth of online content, increased take-up of pay TV services and illegal downloads the number of video rental business in Australia declined from 1166 in 1999/2000 to just 255 in 2013.[22]

nbn notes that the experience of Video Ezy highlights how in the face of rapid technological change barriers to entry can be lowered and new products can emerge which imposes strong competitive constraints on established products and services. Accordingly, in the face of rapid technological change conclusions drawn on static market characteristics should be treated with a high degree of caution.

Emerging 5G technologies

Network operators are currently making substantial investments in forward looking 5G technology. To the extent that these operators are making such investments, these firms will need to justify these costs with resulting profits. It is to be expected that strategies to increase profits will include efforts to capture a larger share of

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[21] See for example Statistics on public attitudes to transport, https://www.gov.uk/government/collections/statistics-on-public-attitudes-to-transport

[22] Yolanda Redrup, The End of the Video Store Blockbuster to close 300 US stores, 08 November 2013, http://www.smartcompany.com.au/marketing/sales/34486-the-end-of-the-video-store-blockbuster-to-close-300-us-stores.html

consumer's overall IT and communications spend that will likely increase substitution between fixed and mobile services. **nbn** submits that an assessment of how these companies will generate profits on those investments (and the drivers of those profits) should be undertaken by the BCR when they determine the issue of substitutability.

3.5 Networks servicing government, medium and large businesses customers

The BCR recommends that networks serving government, medium and large business customers should not be required to contribute to the levy. In arriving at this decision the BCR notes that excluding these networks is inconsistent with the principles of competitive neutrality and contestability but that its promotes regulatory certainty and consistency and that minimises administrative complexity and business input taxation.

nbn notes that in its assessment of alternative cost allocation methodologies and eligibility arrangements (i. e. a narrow versus broad eligibility) the principles of competitive neutrality and contestability were paramount. However, when considering whether other fixed line networks should contribute to the levy the BCR attributed less importance to these principles without explaining why the BCR did so. This lack of consistency could be perceived as somewhat subjective.

nbn disagrees with the BCR's assertion that including networks serving government and medium and large business customers in the eligibility arrangements would be inconsistent with Parts 7 and 8 of the Telecommunications Act. In any event, it is unclear why that is a determinative factor. To the extent that a fixed network seeks to compete with **nbn** in the provision of services to government, medium and large business customers, the principles of a level regulatory playing field, competitive neutrality and contestability dictates that **nbn** and such a provider should be treated equally. Such a network provider should contribute proportionally to the cost of **nbn**'s fixed wireless and satellite networks and face the same regulatory obligations. Failure to create these conditions will only serve to promote inefficient market entry, resulting in inefficient and wasteful investment in network infrastructure leading to a reduction in allocative efficiency.

Additionally, **nbn** notes that in arriving at its recommendation to exclude networks serving government, medium and large business customers from the eligibility arrangements the BCR has given no consideration to **nbn**'s long term sustainability which will be undermined if **nbn** is placed at a competitive disadvantage in respect of servicing these high value customers. Specifically, a loss of revenues from government, medium and large business customers will adversely impact the overall profitability of **nbn**'s fixed line networks and its ability to cross subsidise the provision of fixed line services in high cost areas that are unlikely to be commercial. [c-i-c]