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26 November 2008

The Manager

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ELECTRONIC LODGEMENT

Dear Sir or Madam

National Broadband Network - Telstra Proposal

In accordance with the Listing Rules, I attach Telstra's proposal in response to the Commonwealth Request for Proposals to roll-out and operate a National Broadband Network for Australia DCON/08/18 (RFP) of 11 April, 2008.

Yours sincerely

Carmel Mulhern
Company Secretary

26 November 2008

Senator Hon Stephen Conroy
Minister for Broadband, Communications
and the Digital Economy
Parliament House
Canberra ACT 2600

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NATIONAL BROADBAND NETWORK – TELSTRA PROPOSAL

Dear Minister,

Introduction

Telstra and the Government share the vision and belief that high-speed broadband is the great enabling technology of our time – for economic prosperity, much needed productivity growth and international competitiveness (especially in the high-value adding services sector), for carbon emissions reduction, for small business, for jobs, for health, for education, for innovation and for equality of opportunity – regardless of whether people live in the cities or beyond.

Since mid 2005 Telstra has championed the need for a Fibre-to-the-Node (FTTN) upgrade to Telstra's existing network (NBN) and has put several proposals to the Commonwealth to make it a reality. Telstra remains very supportive of the current Government's vision, as it was long before the last Federal election.

Telstra is uniquely positioned - with the existing network, skills, knowledge, industry relationships, track-record and financial capacity required for this vitally important national task. It is the only company ready today with the very substantial resources and the commitment to deliver a precision engineered and reliable NBN in a timely way.

Since the Commonwealth issued its Request for Proposals (RFP) on 11 April 2008, the global credit crisis and the sharp fall in the value of the Australian Dollar have fundamentally altered the assumptions on which earlier business cases were built. The continuing difficulties in financial markets and the increasing risks of uncertain customer demand given a slowing economy, require that those who have strong balance sheets, such as Telstra, assess the range of potential investment opportunities with great rigour and an appropriate eye to the increased level of risk.

Telstra Corporation Limited
ABN 33 051 775 556

As the Commonwealth is aware, the issues of: the further separation of Telstra; secure confidentiality (legally and in practical terms); the extended 12 month period over which bids remain open under the RFP; and the opening set of the Commonwealth's proposed commercial terms, have all raised very significant concerns for Telstra.

Unfortunately, these issues have not yet been able to be addressed in a manner that would enable Telstra to submit its fully detailed bid under the RFP today.

However, in the spirit of making the Government's vision a reality, Telstra has invested very considerable effort and skill to develop what I believe is a compelling proposition for the Government's consideration.

Summary of Telstra's Proposal

Subject to various key enablers being in place, Telstra is ready to commit up to $5 Billion on an NBN capable of speeds of at least 25 Mbps and up to 50Mbps in around 65% to 75% of the NBN footprint and between 12 and 20Mbps elsewhere in that footprint. This upgrade to Telstra's existing network will support a wide range of services including IP telephony, high speed Internet, IPTV and video conferencing.

Assuming the Commonwealth participates in the funding arrangements, the NBN will be the world's largest FTTN network by area employing an average of 4,000 skilled staff for the life of the construction phase, and creating many more jobs indirectly during and after construction in both telecommunications and in many other sectors which use the upgraded network to boost productivity and offer exciting new services.

While these new services open up many great opportunities, there are also very significant national security and economic resilience implications. Telstra has selected Alcatel-Lucent as its vendor given its world-leading FTTN capability (90 FTTx deployments worldwide) and highly reliable and secure technology. As part of the merger between Alcatel and Lucent Technologies, Alcatel-Lucent entered into a National Security Agreement with the United States Government to protect the security of many of its products and services. This unique arrangement provides Alcatel-Lucent's customers with confidence in its equipment for securing information and protecting networks and users, including for law enforcement and national security purposes. Telstra's NBN will comply with existing security responsibilities and be consistent with the Government's security objectives in securing information and protecting networks and network users.

With regard to looking after network users, Telstra will continue to offer a basic retail telephone pricing plan (with an eligible pensioners' discount) and additionally, an entry level retail 1Mbps broadband pricing plan at pre-committed levels based on current prices. This means that millions of NBN customers will get broadband 4 times faster than today's entry level 256 Kpbs service, at no extra cost. Annexure A contains further details.

The network will be Open Access, with Telstra's wholesale customers buying wholesale access services on an equivalent basis to Telstra's retail units. Further, Telstra does not seek any overbuild protection - any competitor can build or upgrade its networks at any time to compete with a Telstra NBN.

Telstra has taken careful note of the Government's key objective to maximise coverage and will bring VDSL2 based broadband to as many Australians as possible who do not currently have access to it. Because Australia is highly urbanised, the majority of those currently without fast broadband are located in the major cities, where homes and businesses located more than 1.5km from their local telephone exchange cannot currently get fast fixed broadband using Telstra's existing telephony network. For this reason, Telstra considers that the rollout should start in multiple locations, with a rollout priority based not on geography for its own sake, but on bringing benefits to as many Australians as rapidly as possible. With leadership from the Government and the

prompt passage of enabling legislation, Telstra can have building well underway next year – far faster than any other alternative.

Telstra recognises the many challenges currently facing the Government as a result of the global financial crisis, so Telstra is ready to self-fund the NBN (at a cost of up to $5 Billion) in a majority of the possible footprint (essentially the 5 major capital cities) without a Government funding commitment at this stage – again subject to the relevant enablers being in place. However, if the Government is able to commit the full $4.7B as a loan at concessional interest rates, the full NBN footprint will be between 80% and 90% of the Australian population. The actual population coverage will depend on a range of factors relating to Commonwealth funding, forecast build costs at the time contractual commitments are made, take-up levels and the suite of regulatory settings. In addition, should circumstances change in the future (for example, if take-up rates prove materially greater than expected and additional Commonwealth funding becomes available), Telstra will consider a further expansion of the footprint, subject to investment considerations and prevailing market and regulatory conditions at that time.

The key enablers are: no further separation of Telstra (including no sub-loop unbundling) over the life of the project; competitive forecast rates of return commensurate with the risks of the project and returns expected by Telstra's investors; certainty of NBN build footprint, rollout regulations and technology commitments; Telstra retaining all its Intellectual Property, ownership and management of its networks across Australia; regulatory certainty (of wholesale pricing, services and processes) in practical terms for the life of the project; a commercial, outcomes based approach to each party's contractual rights and obligations; and appropriate ATO rulings about the Government's loan. In addition, this proposal is predicated on there being no further material dislocation in financial markets or an economic contraction.

To enable the implementation of this proposal in an accelerated timeframe, Telstra believes that more rigorous confidentiality arrangements, agreement to high level negotiations with key decision makers (with each party able to cease negotiations if it so chooses) and a fresh contractual starting point are the way forward.

Set out below are the reasons for this approach and further detail to assist the Government's consideration of Telstra's proposal.

High level considerations

Telstra has spent very considerable time and effort attempting to find a way to reach coverage of 98% of the population that is the target in the RFP. However, three factors have made that unreachable at this time. Firstly, the cost to build increases exponentially towards the 98% level, thus requiring a much larger Commonwealth contribution if the NBN is to reach that far. Secondly, the current economic conditions have significantly increased build costs and the cost of capital. For example, key components of an FTTN - optic fibre and computerised nodes - are all priced in Euro or USD and hence are now around 30% more expensive to import than was the case only a few months ago. This has added in excess of $1B to build costs in the proposed footprint alone. Thirdly, higher funding costs and the potential for slower take-up rates in a slower growing economy are also very significant.

Telstra believes infrastructure based competition is good for the industry and the nation. Unlike others, we do not seek any form of overbuild protection. SingTel-Optus, TransAct and others have existing competing fixed cable networks passing the homes of many millions of Australians in capital cities, regional centres and new housing developments that are already at, or are upgradeable to, speeds that match or surpass FTTN based network speeds. All industry participants should be free to invest in expanding and upgrading their networks as and when they wish.

Technological innovation in telecommunications also continues apace and should be encouraged. This means that fixed broadband networks will face even more competition in the years ahead. This dimension is one which sets this project apart from infrastructure projects in other sectors. Wireless

network evolution has seen peak speeds grow more than 100 fold in less than a decade, with Telstra launching 21Mbps early in 2009 and Optus, Vodafone and Hutchison all expanding 3G coverage to around 96% of the population and planning increasing speeds over the years ahead. Although they face usage capacity constraints, over the long life of this project it is likely that wireless networks' speeds will surpass those of an FTTN based network.

Telstra's track record compared to others who have said they wish to be considered demonstrates a very clear choice for the Commonwealth. The major telecommunications infrastructure projects in Australia in recent years have been the construction of competing 3G wireless networks. And the difference in network rollout performance is stark. Telstra announced in November 2005 that it would spend $1B to roll-out a nationwide 3G network to 98% of the population by the end of 2006. It launched that network in October 2006 – faster than planned and within budget. That network will shortly be offering 21Mbps peak speeds to more than 99% of Australians. By contrast, major competitors have taken years to make decisions on network rollouts and the most advanced is nearly 3 years behind Telstra. Competitors have also encountered major problems – indeed, in recent months one of them has publicly blamed its key supplier for major network failures and another has deferred network turn-up indefinitely. In short, there is no substitute for experience and expertise.

The Commonwealth can therefore take much reassurance from the fact that Telstra will bear the commercial and technology risk of the rollout under this proposal.

Conversely, in a spirit of full disclosure, the Government should be aware of the fracturing of Telstra's network that would occur with sub-loop unbundling which, despite the fact that it has not been done anywhere else in the world, is proposed by some competitors. Such a proposal would decrease the physical security of the nation's fixed line communications system, cause higher fault levels (as multiple operators open the network to work on it), decrease efficiency (increasing costs that would ultimately be passed on to consumers) and importantly, remove the ability of the network to be upgraded in future using DSM technologies. The security of highly detailed engineering and operational information would also be put at further risk. This would create major difficulties for Telstra in meeting the Government's current national security requirements, let alone the problems it would pose as those needs evolve.

When considering alternatives that are proposed, timing is also vitally important. A recent study has estimated that Australia loses well over $100M in GDP for every month that this project is delayed – with a commensurate loss of employment, tax revenue and quality of life. At this time of substantial economic uncertainty, continuing delay is particularly damaging. Because of its existing resources, Telstra's Proposal offers the Commonwealth a much more certain and faster route to its objectives and a much needed uplift in GDP more quickly than any other alternative.

Finally, Telstra notes that the Government has an exciting and ambitious programme for high technology innovation, including the potential for projects of global significance such as the Square Kilometre Array. Reaching agreement on the NBN would lay a very strong foundation for further collaboration on many valuable projects where Telstra's proven capabilities may provide the winning edge for Australia.

Separation and the RFP Process

Telstra has devoted substantial resources participating in the RFP process and has prepared a very detailed proposal for the upgrade of its existing network to deliver fast broadband services to as many Australian households and businesses as is feasible.

Given public debate about the further separation of Telstra, on 29 August and 26 September 2008 I wrote to the Commonwealth seeking its confirmation that further separation of Telstra will not be sought, required or imposed as part of the NBN regardless of who is selected as the winning proponent. This issue is critical to Telstra because of the impact of the uncertainty caused by the

debate on Telstra's ability to plan for the future, including its development of a comprehensive proposal for the rollout, financing and operation of an NBN.

Given the importance of this issue, and notwithstanding the meeting on 16 October with your officials about this, I reiterate that Telstra's concerns regarding separation are a result of two key considerations:

First - there is no "problem" that requires such dramatic intervention as the further separation of Telstra. Accounting separation reports issued by the ACCC since 2003 have clearly demonstrated that there is no systematic discrimination against Telstra's wholesale customers. Quarterly operational separation reports issued by the ACCC since 2005 have shown the same thing. As the former Ofcom commissioner responsible for the separation of BT, Mr Kip Meek has noted, further separation is not only unnecessary in Australia, but its costs would far outweigh any benefits.[1]

Second – we now have substantial evidence of the failure of separation in the UK and NZ to deliver large scale NBN investment in either country. On the contrary, there is very direct evidence that no benefit has flowed to consumers, but instead, the main effect has been a dramatic reduction in the separated companies' market value in the last 2 years, resulting in a very significant reduction in their ability to spend the very large sums of capital required across their networks to deliver fast broadband to a majority of their customers.

In relation to the RFP process, the Commonwealth is aware that Telstra's concerns are:

- The potential use of information contained in Telstra's bid, which the Commonwealth takes ownership of under the RFP terms, to assist separation and harm Telstra.

- The 12 month period over which an RFP bid must be capable of acceptance (and hence the opportunity cost to Telstra – particularly in the current financial climate) in circumstances where there is no prospect of agreement being reached if separation is not ruled out as an objective of the Government.

- The contractual terms that the Commonwealth has initially proposed, which would make the management and construction of an NBN significantly more costly and create risks to the successful proponent that Telstra believes would significantly reduce the commercial viability of the project for an integrated Telstra and would make an NBN unworkable if separation is required.

As a result of the above, without the necessary clarification having been given and after very extensive consideration, Telstra has concluded that it is not currently in a position to lodge a highly detailed proposal in response to the RFP.

The path to a successful NBN

However, Telstra believes that the ultimate goals of both the Government and Telstra – to see a world class NBN built, with possible public funding in areas not commercially funded - is achievable if both parties start from a mutual understanding of the issues.

The role of the Commonwealth

[1] Kip Meek is the former Ofcom Commissioner responsible for negotiating the functional separation undertakings with BT, now chair of the Broadband Stakeholders Group in the UK. He submitted an expert report to the NBN regulatory consultation. His report can be found at: http://www.dbcde.gov.au/communications_for_business/funding_programs__and__support/request_for_submissions_on_regulatory_issues/submissions/Indigenous_consultimg_group.pdf

Telstra believes that the Commonwealth can best facilitate the construction of an NBN by:

- Establishing the regulatory settings and, in particular, providing the investment and regulatory certainty that will make investment in an open access network possible. An outline of the regulatory framework proposed is at Annexure C.

- Providing concessional funding (in amounts and timing that meets the Commonwealth's many competing priorities) for the construction of the NBN using the most efficient technologies in areas beyond those that are commercially funded. As a provider of that funding, the Commonwealth's role is then to verify that fast broadband services are delivered to the market in funded areas on pre-agreed terms. Telstra considers that this ought to be a relatively simple process of confirming outcomes delivered.

Telstra's Capabilities

1. The NBN is an FTTN upgrade to Telstra's existing network and the new infrastructure deployed will be mixed with Telstra's existing plant and equipment. As with any asset refurbishment, the ownership, day-to-day operation and further augmentation of the network are matters for the existing asset owner to determine, in consultation with relevant stakeholders. As such Telstra does not conceive of it as something which needs the Commonwealth as a joint venture partner.

2. No other company has Telstra's:

   - Demonstrated commitment to Australia – including over $20B of capital investment in Australia in the last 5 years and the support of over 1.4 million Australian shareholders.

   - "A" grade credit rating and the financial and operational ability to fund a significant NBN build.

   - Existing breadth and depth of wholesale relationships and already embedded regulatory safeguards (such as the existing Operational Separation regime) to deliver Open Access to enable a thriving, competitive, telecommunications industry.

   - Outstanding track record in network development, project management and all-round reliability – as recently demonstrated with the world leading Next G™ Network and the scalable capability of Telstra's Next IP™ core network launched in April 2007, which boosted core network capacity some 77 times.

   - Detailed understanding of national security and critical infrastructure requirements – including for education, health and defence.

   - Ability to build the NBN as a single, national, fully integrated network, with end-to-end accountability for the quality of network services and the ability to upgrade that network nationally at some future time.

   - Thousands of highly trained and qualified field staff and telecommunications engineers.

   - Detailed technical and "on-the-ground" practical knowledge of the existing network to minimise customer disruption during the build phase.

   - Existing vendor relationships with the world's leading FTTN vendors such as Alcatel-Lucent.

- Existing end-to-end network management and support systems and the ability to upgrade the network seamlessly at some future time (beyond the scope of this project).

- Detailed understanding of Australian consumer and business customer preferences and future growth profiles.

- Attractive alternatives (both interim and once the NBN is built) to facilitate the Government's Fibre Connection to Schools (FCS) initiative.

- Demonstrated history of supporting Australian and New Zealand small to medium enterprises (SMEs), and capability to offer a wide range of opportunities for SMEs in the build phase and beyond.

In addition to the laying of many tens of thousands of kilometres of new fibre and the construction and installation of many tens of thousands of nodes, Telstra's proposal will upgrade the existing network to support the wide range of advanced services that are possible will require very substantial expenditure and skilled engineering in copper line remediation and upgrades, IT and network management systems development, further core network development, and other significant activities.

For these reasons Telstra considers that, compared to any possible alternative, it offers a far superior outcome (indeed the only outcome that will see this project commence promptly and be delivered as promised) to the Commonwealth and the Australian people.

Open Access

The network will be Open Access with a range of wholesale access services available to access seekers on an equivalent basis to Telstra's retail units. Access seekers will be able to distinguish their product offerings, develop new and differentiated services and choose from a variety of speed tiers, just as Telstra's retail units will be able to do. Annexure B contains high level details of the core wholesale product offerings.

Next Steps

Should the Commonwealth see merit in exploring the possibilities further, Telstra believes that fruitful discussions can occur in a timely way if both parties proceed on the basis that:

1. Both parties acknowledge that the further separation of Telstra is not on the agenda and that both are free to end negotiations at any time.

2. Further information provided by Telstra remains the property of, and is confidential to, Telstra and may only be used by the Commonwealth for the purpose of entering into negotiations with Telstra. If the Commonwealth agrees, Telstra will forward a short form confidentiality agreement as a precursor to detailed discussions.

3. Telstra sees the necessary contracts as straightforward documents that appropriately protect the Commonwealth's and Telstra's interests, whilst at the same time minimising compliance costs for both parties and focussing on outcomes delivered. Telstra looks forward to starting the discussions based on this approach.

4. Discussions between the Government and Telstra should occur at senior levels. Telstra appreciates the Commonwealth's concerns regarding probity, but considers that discussions can progress far more quickly if decision makers participate and they are not constrained in the way that has occurred to date. Time is of the essence given current market conditions and various decisions that Telstra and the Government will continue to need to make.

I remain hopeful that the Government will engage with Telstra on the basis of this letter. The Australian people and economy deserve the benefits that only Telstra can offer – a world-class NBN upgrade – built in a timely, secure and efficient manner by the only organisation with the skills, resources and financial strength to do so.

Yours sincerely,

Donald McGauchie AO
Chairman

cc The Prime Minister

ANNEXURE A

Retail Commitments

Assuming the enablers are in place, Telstra will undertake to the Commonwealth to make available for the life of the NBN Agreement a basic telephone pricing plan (with an eligible pensioners' discount) and an additional basic broadband pricing plan (1Mbps) to customers acquiring NBN services based on current prices.

Basic telephone pricing plan 2009-10

	Consumer Customer	Business Customer
Monthly fee	$29.95	$39.95
Untimed local calls	$0.20	$0.22
STD calls	$0.39 connection fee, $0.25 per min, with cap of $3.00 for the first 3 hours of calls commencing between 7pm and midnight everyday	$0.35 connection fee, $0.24 per min
Calls to Telstra mobiles	$0.39 connection fee, $0.37 per min, with cap of $3.00 for the first 20 minutes of calls commencing between 7pm and midnight everyday	$0.35 connection fee, $0.37/min
Calls to other mobile	$0.39 connection fee, $0.42 per min	$0.35 connection fee, $0.37/min
International calls	Standard IDD rates, without 0018 discounts	Cap not available

This proposal is subject to a requirement that the customer must not acquire an NBN Broadband carriage service on the same line from a person other than Telstra.

Basic Broadband pricing plan 2009-10

	Consumer Customer	Business Customer
Speed	1 Mbps/256 kbps	1 Mbps/1 Mbps
Download Limit	200 Mb	1 GB
Price 1	$29.95	$65
Price 2	$39.95	$75

Price 1: customer is also supplied with an NBN telephone service by Telstra.

Price 2: customer is not supplied with an NBN telephone service by Telstra.

Telstra would be entitled to vary the pricing plans subject to a CPI cap.

ANNEXURE B

Open Access Services

HAS (High-speed Access Services)

The HAS is a high-speed access service providing contended asymmetric data transmission using the copper local loop access for the last mile using VDSL2 technology, with backwards compatibility for ADSL2+ and ADSL1 protocols. The HAS provides connectivity from the end user premises, through the access node to an ethernet aggregation point (or EAP). The HAS is a shared access service, meaning that all HAS traffic for all access seekers and Telstra's retail units is carried in a shared pipe from the access node to the EAP.

The HAS is designed as a consumer grade offering based on today's ADSL "internet grade" service offering, although some service providers may choose to offer business type services using the HAS. The HAS is only available on an end user access where there is a PSTN service operating on it.

The monthly charges for HAS end user access will be included in the special access undertaking. Other applicable charges will not be subject to the special access undertaking and therefore will be subject to ongoing supervision by the ACCC.

DSL line transmission rate	**Monthly Charge 2009-10**	
	25Mbps Service Area	**Remaining NBN Service Area**
1Mb/s downstream and 256kb/s upstream	*STCA	*STCA
6Mb/s downstream and 1Mb/s upstream	*STCA	*STCA
12Mb/s downstream and 1Mb/s upstream	*STCA	*STCA
Up to 20Mb/s downstream and 1 Mb/s upstream	Not available	*STCA
25Mb/s downstream and 2Mb/s upstream	*STCA	Not available

*STCA – to be provided Subject to Confidentiality Agreement

EHAS (Enhanced High-speed Access Services)

The EHAS is a high-speed access service providing the option of shared or dedicated bandwidth between the access node and the EAP using VDSL2, ADSL2+ and ADSL1 protocols over the copper loop. The supply of EHAS will be legally enforceable as part of the regulatory mechanisms set out in Annexure C.

The EHAS provides dedicated bandwidth from the ethernet aggregation switch to the access node onto which all uncontended traffic may be directed. The dedicated bandwidth on EHAS supports traffic prioritisation mechanisms.

The shared bandwidth on the EHAS is designed to carry best efforts "internet grade services."

The EHAS is designed to support triple-play services such as voice over broadband, streaming IP-TV, VoD, video conferencing and internet access.

1Mbps downstream and 256kbps upstream	*STCA
6Mbps downstream and 1Mbps upstream	*STCA
12Mbps downstream and 1Mbps upstream	*STCA
Up to 20Mbps downstream and 1 Mbps upstream (where available)	*STCA
25Mbps downstream and 2Mbps upstream (where available)	*STCA

*STCA – to be provided Subject to Confidentiality Agreement

BAS (Business Access Service)

The BAS is a high-speed dedicated point-to-point ethernet access service with symmetric access speeds over VDSL2. The BAS is designed as a business grade offering.

The BAS includes:

- symmetric end user access at a range of port speeds from 1Mbps/1Mbps to 4Mbps/4Mbps;
- a point-to-point ethernet access service;
- end user bandwidth at a committed access rate of 1:1 contention; and
- dual path redundant fibre links between the access nodes and the EAS.

As is the case today for business grade DSL services, the BAS will not be subject to any specific regulatory instrument but will be excluded from future regulation by the ACCC via an anticipatory access exemption. All price and non-price terms and conditions for the BAS will be subject to commercial agreement.

ANNEXURE C

Regulatory and Legislative Package

(a) ***TPA Part XIC***

- Part XIC NBN Legislative amendments
- Part XIC NBN Special Access Undertaking:
  - covering the High-speed Access Service to be provided by Telstra over the NBN (see Annexure B)
- Part XIC Ordinary Access Undertakings
  - ULLS
  - LSS
  - WLR
  - LCS
  - OTA
- Part XIC Exemption Orders
  - Anticipatory Access Exemption Order (includes EHAS supply obligation – See Annexure B)
  - Ordinary Access Exemption Order
- Ministerial Pricing Determination

(b) ***TPA Part XIB***

- Part XIB NBN Legislative amendments
  - To enable Minister to deem conduct exemption granted.
- Part XIB NBN Conduct exemption

(c) ***Enabling provision for a Compensation Deed between the Commonwealth and Telstra***

(d) ***Land Access Legislative Amendments***

(e) ***General Regulatory Amendments to align the regulatory regime to the Open Access NBN architecture***