

Appendix I: Telstra's Overbuild of the Optus HFC Network

- 1.1 In about April 1994, Telstra began the construction of a broadband cable (HFC) telecommunications network (the Telstra Visionstream Network) which was designed to provide carriage of pay TV services and pass 1.1 million homes by 1996. The Telstra Visionstream Network was not designed to provide carriage of local call services.
- 1.2 In about September 1994, Optus, with various joint venture partners, formed Optus Vision and announced an intention to construct a broadband cable (HFC) telecommunications network in Sydney, Melbourne, Brisbane and Adelaide (the Optus Vision Network). The Optus Vision Network was originally planned to pass approximately 2.77 million homes.
- 1.3 The business case for the rollout of the Optus Vision Network depended on the assumption that the degree of overbuild would be relatively low. This assumption was made on the basis that all businesses rolling out networks would seek to maximise their market penetration in the areas chosen for rollout and thus maximise the profitability of the network rollout. The initial business case assumed that 22% of homes passed by the Optus Vision Network would be overbuilt by the end of the 4 year construction period. Optus did not anticipate a higher degree of overbuild, since a higher degree of overbuild would have been loss-making for Telstra.
- 1.4 The business case for the rollout of the Optus Vision Network depended on the supply of pay TV services. That is, the rollout of the Optus Vision Network would not have been economic had it relied for its revenue on telephone and high speed data services alone.
- 1.5 In addition to providing pay TV services, the Optus Vision Network was designed to compete with Telstra's existing PSTN in providing telephone services (including local call services and originating and terminating access for long distance telephone services) and high speed data services. At that time Optus did not supply local call services (except to a handful of corporate customers) and was only able to supply long distance telephone services by acquiring originating and terminating access from Telstra.
- 1.6 The Optus Vision Network's competition with Telstra's PSTN in telephone services would have forced Telstra to lower its prices for telephone services. As a result, had the rollout of the Optus Vision Network proceeded as planned, the level of profits Telstra earned from telephone services would have been reduced significantly.
- 1.7 In late 1994, Telstra announced that it was planning to roll out its cable network to 4 million homes in 3 years (in contrast to the previously stated 1.1 million homes). The new broadband cable telecommunications network (the Telstra Broadband Network) was to supply high speed data services and pay TV services. It was to be constructed more speedily than the rate of construction originally announced. It was designed to duplicate the coverage of the Optus Vision Network: the degree of overbuild is at least 80%.
- 1.8 In late 1994, Telstra also announced the formation of the Foxtel joint venture with News Corporation to supply pay TV services. Optus is aware from publicly available information that Telstra provided Foxtel with highly favourable terms, viz, that Foxtel received from Telstra a fee of \$150 per customer to cover the costs of marketing and that Telstra paid for connection of new customers including wiring at customer premises and installation of set-top boxes.
- 1.9 It is clear to Optus, from its knowledge of the economics of the costs of building and maintaining an HFC cable network in Australia and its knowledge of the revenue from its pay TV business, that the revenue received by Telstra as a result of its investment in the Telstra Broadband Network must have been substantially less than the costs of building and maintaining that network. That is, Telstra's investment in the Telstra Broadband Network

must have had a very large and negative NPV. Telstra's investment could only be justified if it would lead to the elimination or weakening of a competitor in a separate, profitable market – that is, the market(s) in which local telephone services and long distance telephone services are supplied – and thus preserve Telstra's monopoly profits.

- 1.10 The unprecedented level of overbuild by Telstra caused significant impacts for Optus' HFC network. **CiC**
- 1.11 In 1997 Optus announced that it would decrease the size of the planned rollout of the Optus Vision Network. Subsequently, Telstra decreased the size of the planned rollout of the Telstra Broadband Network.
- 1.12 In July 1997 Telstra wrote off \$961 million of its investment in the Telstra Broadband Network. In 2002, Optus wrote down the value of its HFC network by almost \$1.4 billion.
- 1.13 An independent account of these events is provided in a report on "Broadband and Telephony Services over Cable Television Networks" published by the OECD in 2003.¹ This report notes that Australia is one of only two OECD countries where there is significant overlap between cable networks (the other being Portugal).² It also notes that the combined take-up rate for cable television in Australia (taking into account both the Optus and Telstra HFC networks) is "very low compared to other countries".³

¹ OECD Working Party on Telecommunication and Information Services Policies, 7 Nov 2003, "Broadband and Telephony Services over Cable Television Networks", pp25-26.

² Ibid, p25. See also p21.

³ Ibid, p.21.