



**Supplementary submission to the  
Australian Competition and Consumer  
Commission**

**in support of the  
Application for Authorisation of  
the HFC Subscriber Agreement between  
NBN Co Limited and SingTel Optus Pty Ltd  
and other Optus entities**

**5 December 2011**

## Introduction

Optus refers to the application for authorisation lodged by NBN Co Limited (**NBN Co**) relating to the HFC Subscriber Agreement between NBN Co and Optus dated 23 June 2011 (**HFC Agreement**).

Optus understands that, as part of its consideration of the authorisation application, the ACCC is likely to be considering the issue of whether under the counterfactual where the HFC Agreement is not authorised the Optus HFC network (**HFC Network**) would be likely to act as an "effective competitive constraint" on the National Broadband Network (**NBN**).

In this submission, Optus provides further information on the reasons why, if the HFC Agreement is not authorised, the HFC Network will not act as a competitive constraint on the NBN or on retail service providers (**RSPs**) supplying services over the NBN, including Telstra. Optus has also taken the opportunity to provide some further information on the economics of the HFC Agreement.

Optus requests that this supplementary submission be excluded from the Commission's Public Register on the basis that this submission is a document in respect of Optus' commercial activities that are confidential to Optus.

## Summary

In assessing the public benefits and detriments of the conduct the subject of the authorisation application, the ACCC must compare the position which would or would be likely to exist in the future.<sup>1</sup> In making this assessment, the ACCC is required to consider "*probable effects rather than possible or speculative effects*".<sup>2</sup>

Optus submits that, under the counterfactual where the HFC Agreement is not authorised, there is no evidence or other basis for considering that the HFC Network would be likely to act as an effective competitive constraint. In Optus' submission, the HFC Network does not have the potential to act as a competitive constraint on the NBN.

This view is supported by the following:

1. Optus does not currently have the technical ability to supply wholesale access services over its HFC Network and has no plans (or incentive) to upgrade the HFC Network to do so in the future;
2. The HFC Network does not currently act as an effective competitive constraint on the Telstra copper network, or on RSPs supplying services over the Telstra copper network, including Telstra;
3. The inherent limitations of the HFC Network means that it will be less able to compete against the NBN;
4. **[RESTRICTION OF PUBLICATION OF PART CLAIMED]**; and
5. The NBN will be subject to strict regulatory controls which limits the impact of any possible competitive constraint that the HFC Network could have on the NBN.

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<sup>1</sup> *Australian Performing Rights Association* (1999) ATPR 41-470 at 42,936

<sup>2</sup> *Re Queensland Independent Wholesalers Ltd* (1995) ATPR 41-438 at 40,960-40,961 citing *Queensland Co-operative Milling Association Ltd* (1976) ATPR 40-012 at 17,243.

In addition, Optus submits that, even if it were hypothetically possible for the HFC Network to act as an effective competitive constraint on the NBN, any loss of such competitive impact would be outweighed by the public benefits that would arise if the HFC Agreement were to proceed.

We expand on each of these points below.

### **The supply of wholesale access services over the HFC network**

If the HFC Agreement does not proceed, the HFC Network will not provide an alternative platform for RSPs in the market for wholesale access services.

As explained in Optus' submission in support of the authorisation application dated 26 August 2011 (**Optus Submission**), Optus does not provide wholesale access services over the HFC Network and has no plans to do so in the future. It is not currently possible for Optus to supply wholesale access services over the HFC Network as there are technical difficulties associated with providing wholesale access that would require a major upgrade to the network to be overcome.<sup>3</sup>

In Optus' response to the ACCC's information request dated 23 September 2011 provided on 10 October 2011 (**October Response**), we explained that Optus is unlikely to undertake the necessary upgrades to the HFC Network in the future. Upgrading the HFC Network to provide wholesale access services will require a significant capital investment<sup>4</sup>. Optus submits that there will be no incentive for Optus to make such an investment in a post-NBN environment because it is unlikely to recover its investment as a result of competitive pressures exerted by the NBN due to its superior technical capabilities, its nationwide coverage and the likely improved access arrangements that would be available on the NBN.

The possibility that Optus or a third party acquirer would invest the capital required to upgrade the HFC Network to compete for the supply of wholesale access services in a post-NBN environment has been considered in the Frontier report submitted to the ACCC in support of the authorisation application on 2 December 2011 (**Frontier Report**).

Specifically, in section 5.3 of the Frontier Report, it is recognised that, in its present form, wholesale services supplied over the HFC Network would not likely be attractive to RSPs due to its comparatively limited geographic footprint relative to the NBN.

Further, in relation to whether a potential acquirer would make the necessary investment, Frontier concludes that:

*"However, to be able to compete with the NBN, a potential acquirer of these assets would need to invest considerable sums of capital in sunk assets in order to increase the coverage and capability of the Optus HFC network so that it would be able to provide wholesale services that would attract consumers to it instead of the NBN. Given the natural monopoly characteristics of investments in the infrastructure necessary to provide high-speed fixed broadband services, we do not believe such investment would be likely to be economic (and therefore attractive to a potential investor)."*<sup>5</sup>

Frontier also notes that it is questionable whether Optus would sell its HFC Network in totality given it intends to retain all fibre components of its HFC Network and that this then would have potential consequences for any acquirer of the remaining parts of the HFC Network in light of the *National Broadband Network Measures - Access Arrangements Act 2011* (**NBN Access Act**) wholesale-only requirements. In relation to this, Optus confirms that it would not sell the fibre parts of the HFC

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<sup>3</sup> Optus Submission, paras 2.13-2.17. 5.13

<sup>4</sup> Optus October Response, page 8.

<sup>5</sup> Frontier Report, para 99.

Network given that these are also used to support Optus' mobile and business customer services. Further, it is also important to note that the fibre components of the HFC Network constitute the backbone of the network and the other parts of the network are reliant on the fibre components.

Accordingly, Optus submits that there is clear evidence that the HFC Network will not act as a direct competitive constraint in relation to the supply of wholesale access services if the HFC Agreement does not proceed.

### **The HFC Network does not provide an effective competitive constraint on the Telstra copper network**

Optus submits that a key indicator of whether its HFC Network could act as an effective competitive constraint on the NBN (either indirectly at the wholesale level, or on RSPs at the retail level) is whether the HFC Network has acted as an effective competitive constraint on the Telstra copper network. The NBN will be of similar size and scope to the Telstra copper network and will effectively carry the traffic of all services formerly connected to the Telstra copper network once that network is de-commissioned. Both networks provide connection to the customer premise for the purpose of carrying both voice and broadband services.

Optus submits that there is clear evidence to demonstrate that the HFC Network has not acted as an effective competitive constraint on the Telstra copper network.

As explained in the Optus Submission, there is currently a lack of effective competition in the fixed line market, which is dominated by Telstra.

Currently, only 4.8% of fixed line broadband services in operation in Australia are supplied over the Optus HFC Network. The HFC Network has a limited geographic footprint and, as explained in the Optus' response to the ACCC's information request dated 14 November 2011, provided 22 November 2011 (**November Response**), in over 15 years, Optus has only been able to achieve a penetration rate of approximately 36% of serviceable premises in the areas it serves in competition with Telstra's HFC and copper networks.

As indicated in Optus' November Response, the number of customers on the HFC Network has remained static over the last few years. The HFC Network is a mature **[RESTRICTION OF PUBLICATION OF PART CLAIMED]**.

While the HFC Network is technically superior to the Telstra copper network in many respects, it is Optus' experience that the limited scale and the fact that wholesale access is not provided over the HFC Network have been the key reasons why the HFC Network has not acted as an effective constraint on Telstra.

These points have been recognised by the ACCC:

*"The ACCC has noted in its consideration of the relevant markets in chapter 3 that alternative networks to Telstra' CAN, such as Optus' HFC network, may be a competitive alternative for the owners of these networks, however, they are confined to the extent to which they provide a competitive alternative for other access seekers. Optus' HFC network, which is the largest piece of alternative competitive infrastructure to Telstra's CAN, has a limited*

*geographic footprint which ensures it can not act as a competitive alternative on a national scale”<sup>6</sup>*

The HFC Network’s limited scale compared to Telstra’s access network infrastructure was recognised by the Tribunal in its decision on Telstra’s appeal of the ACCC’s Final Determination in that matter. In its decision, the Tribunal stated that:

*“Telstra is the largest provider of retail and wholesale services over its CAN. Telstra’s CAN is separated into 5,069 ESAs.”<sup>7</sup>*

On the other hand the Optus HFC Network is limited in scale, as was noted by the Tribunal:

*“Optus has deployed an aerial HFC network in metropolitan Sydney, Melbourne and Brisbane which overlaps 262 of Telstra’s ESAs.”*

Accordingly, Optus submits that, as the HFC Network does not act as an effective competitive constraint on the technically inferior Telstra copper network, it is very unlikely to act as a competitive constraint on the technically superior NBN (which will be of similar size and scope to the Telstra copper network) if the HFC Agreement does not proceed.

Optus notes that this is supported by the Frontier Report where it states:

*"In the absence of the HFC Agreement, this is unlikely to greatly change in the future. Where Optus is only able to capture approximately 5% of fixed broadband services at present using its HFC network to compete against Telstra’s copper network, it is unlikely it will be able to capture any more market share if it uses its HFC network to compete against services provided over the NBN. This is due to the increased functionality and performance of the NBN relative to Telstra’s existing copper network, and the commitment of NBN Co to price its entry level products at levels comparable with those for existing broadband services".<sup>8</sup>*

### **Inherent limitations of the HFC Network**

Optus submits that the inherent limitations of the HFC Network mean that it will be less able to compete against the NBN and, as a result, it will struggle to retain customers on the HFC Network in competition with the NBN over time.

In particular, as indicated in the Optus Submission, the NBN will have a number of advantages over the HFC Network in terms of:

- The geographic scope of the NBN and the number of customers it will be able to supply;
- The technical capability of the NBN, which will be superior to the HFC Network both in the short term and the long term; and
- The fact that it will be an open access wholesale only network that will be utilised by a significant number of RSPs.

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<sup>6</sup> ACCC, *Fixed Services Review Declaration Inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR, Final Decision* July 2009, page 85

<sup>7</sup> Application by Telstra Corporation Limited [2009] ACompT1, para 37-40

<sup>8</sup> Frontier Report, para 109.

In addition, Optus notes that there are economic and legislative impediments to Optus upgrading or expanding the HFC Network. As explained in the Optus Submission<sup>9</sup>, the NBN Access Act will prevent Optus from expanding the HFC Network to serve its own retail customers in direct competition with the NBN. Should Optus wish to expand the HFC Network then it will only be able to provide wholesale based services over the network. As noted above, there is no investment case to support such a scenario.

Accordingly, it is expected that the gap between the NBN and the HFC Network will grow over time as the NBN is upgraded and the HFC Network remains technically static.

This is supported by section 4.2.1 of the Frontier Report which concludes that any competition between Optus and NBN Co will be geographically limited and short lived. The Frontier report also states:

*"While it may be the case that Optus finds it economic to continue to provide services to some of its consumers using its HFC network in the future in the absence of the HFC Agreement, we do not believe this is likely to be significant over time. As indicated in section 4.2.1 above, any enduring competition from services provided over the Optus HFC network in the absence of the HFC Agreement is likely to be limited in duration."<sup>10</sup>*

### **[RESTRICTION OF PUBLICATION OF PART CLAIMED]**

#### **Additional economic material**

As noted above, Optus also takes this opportunity to provide some additional economic material in support of the authorisation application.

#### *Loss of efficiency benefits*

As previously submitted, the HFC Agreement is expected to result in significant efficiency benefits.<sup>11</sup>

*NBN Co's access costs are likely to be higher due to a lower customer base*

Optus submits that NBN Co's access costs (and therefore its pricing) is likely to be higher if the HFC Agreement does not proceed.

If the HFC Agreement does not proceed, this will result in NBN Co having a much smaller customer base than it would otherwise have due to Optus' 504,000 HFC customers remaining on the HFC Network, at least in the short term.

As explained in the Optus Submission, Optus' HFC customers are located in the more affluent suburbs of the capital cities of Sydney, Brisbane and Melbourne. As such, these customers are likely to generate higher than average ARPU because of a higher than average propensity to take multiple services and higher tier broadband plans.<sup>12</sup> Optus expects that the early migration of these customers to the NBN will result in economic benefits for the NBN, while in contrast if NBN Co does not have these customers that could have an adverse financial impact.<sup>13</sup>

*Optus will face higher costs to serve customers off both the HFC Network and the NBN*

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<sup>9</sup> Optus Submission, paras 6.26 and 6.27.

<sup>10</sup> Frontier Report, para 110.

<sup>11</sup> Optus Submission, section 6

<sup>12</sup> Optus Submission, paras 6.28-6.29

<sup>13</sup> Optus Submission, paras 6.28-6.31; see also Frontier Report, paras 73, 138

Optus will face higher costs to serve its customers on both the HFC Network and the NBN if the HFC Agreement does not proceed and it is forced to continue to service its existing HFC customers on the HFC Network.

As explained in the Optus Submission, if the HFC Agreement does not proceed, Optus would incur additional and ongoing capital expenditure and operating expenditure in the order of **[RESTRICTION OF PUBLICATION OF PART CLAIMED]** for the HFC Network that it would not incur if the HFC Agreement were to proceed. The requirements for Optus to maintain two networks (unlike all other RSPs) will reduce its flexibility to match competitor offers.<sup>14</sup>

Optus anticipates the per customer costs on the HFC network will increase over time as Optus loses customers to the NBN.<sup>15</sup>

Further, if the transaction does not proceed Optus' cost to serve each customer on the NBN will be higher. **[RESTRICTION OF PUBLICATION OF PART CLAIMED]**

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<sup>14</sup> Optus Submission, paras 6.7 - 6.9

<sup>15</sup> Optus November Response, page 4