

7 December 2022

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Telstra and TPG arrangement for the sharing of active infrastructure and spectrum in regional Australia

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## **Response to Optus submission and Hunt Report of 16 November 2022**

Public version

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# 1 Introduction

- 1 We refer to Optus' submission on the section 87B undertakings offered to the ACCC by the Applicants (**Optus Submission**) and AlixPartners' supplementary report which was prepared for Optus (**Second Hunt Report**), each of which is dated 16 November 2022.
- 2 The Applicants have made extensive submissions, supported by lay, expert and documentary evidence, as to the likely effect of the Proposed Transaction and the adequacy of the section 87B undertakings proffered by the Applicants. The Applicants do not consider it necessary to repeat those submissions.
- 3 However, TPG provides this short submission in response to several aspects of the Optus Submission and Second Hunt Report which are either not supported by evidence or are inconsistent with the evidence before the ACCC.
  - (a) In the Second Hunt Report, Mr Hunt's analysis and findings in respect of the Proposed Transaction are premised on the proposition that the relevant counterfactual is a 5G regional active sharing arrangement between Optus and TPG. However, there is no evidence to support that this is a likely outcome (let alone feasible) if the Proposed Transaction does not proceed. There is, however, a substantial body of evidence that TPG has provided to the ACCC that shows that, if the Proposed Transaction does not proceed, it is unlikely that TPG and Optus would enter into a regional active sharing arrangement in the foreseeable future. TPG considers that it is unsafe to rely on Mr Hunt's findings in the Second Hunt Report, which proceed from an erroneous view of the likely counterfactual based on narrow views of Optus' and TPG's incentives for entering into network sharing deals without regard to competing incentives or the evidence at hand.
  - (b) The Second Hunt Report contains a number of criticisms of Dr Padilla's report of 2 November 2022 (**Second Padilla Report**). Much of Mr Hunt's analysis and findings are addressed in Dr Padilla's third report dated 17 November 2022 (**Third Padilla Report**), and TPG does not intend to repeat the findings and analysis in the Third Padilla Report. However, for the ACCC's benefit, this submission sets out the evidence underpinning the assumptions on which the Second Padilla Report relies, and explains how a number of the criticisms in the Second Hunt Report are unsound given that they are premised on a mischaracterisation of the counterfactual, and a lack of insight into (and, hence, a misunderstanding of) how pricing under the Agreements will work and how the Proposed Transaction is likely to affect market shares in the retail mobile market.
- 4 Capitalised terms in this submission have the same meaning as in the Application and in the Applicants' response to the SOPV dated 1 November 2022.

## 2 The counterfactual relied on by Mr Hunt is not supported by the evidence

- 5 Mr Hunt considers that the likely counterfactual is a regional 5G active network sharing arrangement between Optus and TPG, potentially with a transitional roaming arrangement in the short term.<sup>1</sup> The reason for this view appears to be that Mr Hunt considers that each of Optus and TPG would have commercial incentives to enter into a regional 5G network sharing or roaming arrangement (absent the Proposed Transaction) to lower their costs, allow for a quicker and broader 5G rollout and increase their subscriber bases by making them more competitive vis-à-vis Telstra (and, for TPG, Optus).<sup>2</sup>
- 6 However, this assessment of the potential effects of a wholesale arrangement on Optus and TPG (and, hence, their incentives) is highly dependent on the design, architecture, and commercial terms (including the approach to costs) of any network sharing arrangement between them. If TPG and Optus are not aligned on these, their incentives to consider regional network sharing and enter into discussions in this regard – including those set out in the SOPV relating to Optus earning wholesale revenue and TPG increasing its coverage<sup>3</sup> – will be undermined.
- 7 As explained in Annexure F to the Applicants' submission in response to the SOPV (**Second Counterfactual Submission**), the ACCC cannot assume that, merely because TPG has an incentive to expand its mobile coverage and Optus has an incentive to maximise its revenue, the two parties will strike a deal. As set out in that submission:
- (a) Optus has competing incentives to maintain the *status quo* and derive as much commercial value and rent from TPG as possible in circumstances where it is aware TPG has no other alternative to Optus;<sup>4</sup> and
  - (b) TPG has competing incentives to:<sup>5</sup>
    - refrain from entering into an arrangement with Optus that would materially increase its costs as its customer base increases (so as to become unsustainable);
    - avoid an arrangement with Optus which will cement TPG's position as the MNO which offers materially less coverage in regional areas (and on the basis of an older generation of technology); and
    - avoid an active sharing arrangement with Optus if the design and architecture, and approach to cost allocation means that TPG will bear higher costs than it considers necessary or fair.

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<sup>1</sup> Expert Economic Report of Matt Hunt (16 November 2022) (**Second Hunt Report**), paras 13(a), 34(b) and 40; Expert Economic Report of Matt Hunt (25 October 2022) (**First Hunt Report**), para 39.

<sup>2</sup> First Hunt Report, para 240-241.

<sup>3</sup> Statement of Preliminary Views, para 5.19.

<sup>4</sup> TPG Counterfactual Submission (8 November 2022) (**Second Counterfactual Submission**), para 8; Optus Submission (June 2022), para 7.60; Houston Kemp Report prepared for Optus, para 81; Applicant Response, 61(c).

<sup>5</sup> Second Counterfactual Submission, para 8.

8 It is important that TPG's incentive to expand its coverage is balanced against the commercial feasibility and desirability of any proposed wholesale model. The incentives that Mr Hunt seems to point to in his first report (as set out in paragraph 6 above) need to be balanced against whether the design and architecture (and commercial terms) of network sharing will in fact achieve the outcome on which those incentives rest. He does not undertake this analysis.

[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]

[REDACTED] demonstrate that it is unlikely (and highly speculative to suggest) that TPG and Optus would (even once active sharing became feasible in three to five years) be able to reach agreement on an active sharing commercial model. Their competing incentives (as set out in paragraph 7) would prevent this in future [REDACTED].

9 TPG has already provided the ACCC with a substantial amount of evidence that demonstrates this. In particular, it has provided evidence that shows the following.

(a) Active sharing between TPG and Optus is not feasible in regional areas until [REDACTED]

[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]

[REDACTED] Therefore, active sharing between TPG and Optus in regional areas would not be feasible for at least three to five years with a MOCN not being feasible for at least five years [REDACTED]

[REDACTED]

(b) [REDACTED]  
[REDACTED]  
[REDACTED]

[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]

[REDACTED]  
[REDACTED]

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6 [REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
7 [REDACTED]  
[REDACTED]  
8 [REDACTED]  
9 [REDACTED]  
[REDACTED]  
10 [REDACTED]  
[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

- 10 Mr Hunt's view of the counterfactual does not take this evidence into account. This may be because he has no visibility over the matters set out above (which were further explained in the Second Counterfactual Submission and the Statement of Mr Lopez). However, the unsoundness of Mr Hunt's view of the counterfactual is also a result of the narrow view of commercial incentives he takes and, in particular, his failure to account for the existence of competing incentives. It is important that the ACCC makes an evidence-based decision, and TPG considers that it would be unsafe for the ACCC to rely on Mr Hunt's analysis in reaching its determination.
- 11 The evidence that TPG has provided to the ACCC demonstrates that there is no real commercial likelihood that Optus and TPG would be able to successfully negotiate a roaming or active network sharing agreement (let alone on a 5G basis) in regional areas, at least in the foreseeable future. To

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11 [REDACTED]  
12 [REDACTED]  
13 [REDACTED]  
14 [REDACTED]  
15 [REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]

the extent that they were able to enter any arrangement, it would likely involve TPG having to make significant concessions by agreeing to a [REDACTED] 4G roaming agreement, which would be an adverse outcome for competition when compared with the Proposed Transaction.

12 Further, even if active sharing between Optus and TPG was a real commercial likelihood (which it is not), the Third Padilla Report sets out the errors in Mr Hunt's analysis of the likely competitive effects of the Proposed Transaction compared to that counterfactual.<sup>16</sup>

13 In addition, Mr Hunt also seems to assume that a TPG-Optus active sharing arrangement would somehow involve TPG having more control over the shared RAN than under the Proposed Transaction. In particular, he states that:

- (a) under the Proposed Transaction, TPG will be '*almost entirely dependent upon Telstra*' for network coverage and quality,<sup>17</sup> including as to the location of future sites and the equipment they will utilise,<sup>18</sup>
- (b) whereas under a TPG-Optus active sharing arrangement, this would not be the case as it would involve two operators "*cooperat[ing] to deliver 5G*".<sup>19</sup>

However, there is simply no evidence to support these propositions, and it is unclear how Mr Hunt reaches this conclusion. To the extent this was a realistic counterfactual (which it is not), any TPG-Optus active sharing arrangement would involve a [REDACTED]

[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]

### 3 Mr Hunt's criticisms of Second Padilla Report

14 It is clear that a number of Mr Hunt's criticisms of the Second Padilla Report stem from his lack of visibility over the assumptions adopted by Dr Padilla, his mischaracterisation of the likely counterfactual and a misunderstanding (due to a lack of visibility) of how pricing under the Proposed Transaction will operate, and of the likely effect of the Proposed Transaction on market shares.

15 In relation to each of these, TPG notes the following.

- (a) **Assumptions made by Dr Padilla are reasonable and based on credible evidence.** Mr Hunt suggests that the assumptions in the Second Padilla Report are 'potentially flawed',<sup>22</sup> while admitting that he has limited visibility over the specific assumptions used by Dr

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<sup>16</sup> Third Padilla Report, section 3.

<sup>17</sup> Second Hunt Report, para 39.

<sup>18</sup> Second Hunt Report, para 44.

<sup>19</sup> Second Hunt Report, para 40.

<sup>20</sup> [REDACTED]

<sup>21</sup> [REDACTED]

<sup>22</sup> Second Hunt Report, para 30.

Padilla.<sup>23</sup> The assumptions that Dr Padilla was requested to make for the purposes of the Second Padilla Report (which are commercially sensitive) are not flawed. Those assumptions are reasonable and based on credible evidence available to the Applicants. That evidence has previously been provided to the ACCC and, for convenience, is identified in **Annexure A**.<sup>24</sup>

- (b) **Counterfactual adopted by Dr Padilla is conservative.** Despite TPG considering the relevant counterfactual to be a targeted build (of [REDACTED] sites) in regional areas, Dr Padilla was asked to assume (for each of his reports) that the counterfactual involved a 4G roaming arrangement between Optus and TPG [REDACTED]

[REDACTED] This was a conservative assumption to demonstrate that, even if TPG and Optus entered into a wholesale arrangement in the counterfactual with or without a targeted build (Dr Padilla assumes that the roaming arrangement is in conjunction with a targeted build in his second and third reports, consistent with the SOPV),<sup>26</sup> this would not be likely to substantially lessen competition. These assumptions in respect of a wholesale arrangement in a counterfactual are reasonable in circumstances where:

- as explained above (and in previous submissions), active sharing between TPG and Optus in regional areas is not feasible for at least three to five years and, even then, it is likely that Optus and TPG would not be able to agree on its design and implementation;<sup>27</sup> and
- if the Proposed Transaction does not proceed, Optus would have [REDACTED] a strong incentive to maintain the *status quo* [REDACTED]

- (c) **It is evident that Mr Hunt does not properly appreciate how pricing works under the Proposed Transaction.** In the Second Padilla Report, Dr Padilla finds that TPG's costs would likely be initially higher under the Proposed Transaction than under the SOPV Counterfactual but become lower under the Proposed Transaction as data usage grows.<sup>28</sup> In the Second Hunt Report, Mr Hunt states that it is unclear why growth in data usage per customer would cause the costs under the SOPV Counterfactual to grow faster than the Proposed Transaction.<sup>29</sup> This lack of clarity (and the criticisms that

<sup>23</sup> Second Hunt Report, paras 17, 61 and 67.

<sup>24</sup> Expert Report of Dr Jorge Padilla (26 July 2022) (**First Padilla Report**), paras 1.6 and 1.7; Second Padilla Report, para 1.5.

<sup>25</sup> [REDACTED]

<sup>26</sup> Second Padilla Report, para 1.5(e); Third Padilla Report, para 2.3(a); Statement of Preliminary Views, paras 5.13 and 5.19.

<sup>27</sup> First Counterfactual Submission, paras 19, 22-24 and 32; Second Counterfactual Submission, paras 15, 18(b), 66(a), 73, 78, 83(c) and 105 [REDACTED]

<sup>28</sup> Second Padilla Report, para 3.39.

<sup>29</sup> Second Hunt Report, para 68(b).

surround it in section 5 of the Second Hunt Report) stem from Mr Hunt not having insight into how pricing works under the Agreements.

As the ACCC is aware, [REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
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[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]

(d) **Mr Hunt misunderstands the likely effect of the Proposed Transaction on market shares.** In the Second Hunt Report, Mr Hunt states that:<sup>35</sup>

*'Dr Padilla's assumption that there is very limited market share loss for Optus if it invests in 5G ... implies that TPG would take very limited share from Optus. This is at odds with Dr Padilla's emphasis that TPG would become more competitive and be able to offer lower quality-adjusted prices, and thus win market share in the RCZ ...'*

However, as the evidence provided to the ACCC shows, there is no inconsistency in finding that the Proposed Transaction will make TPG more competitive (and significantly increase its customer numbers)

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30 [REDACTED]  
31 [REDACTED]  
32 [REDACTED]  
33 [REDACTED]  
34 [REDACTED]  
35 Second Hunt Report, paras 18, 54(a)-(b) and 56(d).



while not reducing Optus' market share to a significant extent. ■

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- 16 There are a number of other concerns with First and Second Hunt Reports which have been addressed by Dr Padilla in the Third Padilla Report, which we do not intend to repeat here.

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## Annexure A: Evidence underpinning assumptions in Second Padilla Report

Assumption	Supporting evidence
1.5(b) - annual data usage projections	[REDACTED]
1.5(a) - average annual data usage of post-paid customers	[REDACTED]
1.5(b) - annual data usage projections	[REDACTED]
1.5(c) - data usage in region 2b and 3	[REDACTED]
1.5(d) - Telstra's churn rate	Figure 3 of the Supplementary Statement of Bart-Jan Sweers dated 4 November 2022.
1.5(e) - MNO customer numbers in 2021 and 2031	[REDACTED]
1.5(f) - TPG's variable cost of data	[REDACTED]
1.5(g) - Telstra's estimate of site costs	Paragraph 18 of the Statement of Bart-Jan Sweers dated 12 August 2022.
1.5(h) - customer numbers and market shares in region 2b and 3	[REDACTED]
1.5(i) - Optus' market shares in region 2b and 3	[REDACTED]
1.5(j) - Telstra's post-paid and pre-paid mobile customers	Telstra's post-paid and pre-paid mobile customer numbers are publically available figures published as part of its FY22 results, specifically the spreadsheet <i>Supporting material - FY22 Financial Tables</i> ('Stat Data' worksheet, 'Services in operation' table).
1.5(k) - Optus' cost of upgrading a site to 5G	TPG estimated cost for Optus to upgrade its regional sites to 5G is based [REDACTED] [REDACTED] [REDACTED] TPG has extensive first-hand knowledge of these costs, and confirms that it accounted for the costs of upgrading Huawei equipment in estimating Optus' upgrade costs.
1.5(l) - Optus' mobile customers ARPU	[REDACTED]