

Dated 16 June 2017

## **ATTACHMENT H**

**Re:**

**Vodafone Hutchison Australia Pty Ltd submission to the Australian  
Competition and Consumer Commission**

# Declaration can promote regional coverage

## 1 Overview

In its Draft Decision, the Australian Competition and Consumer Commission (ACCC) made a finding:

“The ACCC considers that this means Telstra is likely to retain some incentives to participate in these [publically funded] programs, but the extent to which it will do so and the amount of co-funding that it would be willing to expend may be smaller if a mobile roaming service is declared.”

It is unclear how the ACCC came to this conclusion. In effect the ACCC is implying that a tender process is more effective if only one bidder can make an effective bid, compared to where multiple bidders can make effective bids. The ACCC's position is illogical.

VHA has provided evidence to the ACCC concerning Telstra's ability to capture public funding for building and extending mobile reach in Australia, e.g., the Mobile Blackspots Programme. Furthermore, VHA has provided evidence to the ACCC that over the last decade, Telstra has received some \$2 billion in public funding to support its network expansion, effectively creating a \$2 billion barrier to entry. Telstra's market power is so entrenched it is able to subsidize costs and privatise benefits, which then further entrenches its market power, in a vicious cycle.

In the New Zealand context where domestic mobile roaming is regulated, there is strong evidence that regulated domestic roaming is driving economically efficient investment outcomes. The three mobile operators (Vodafone, Spark and 2degrees) in New Zealand made a submission to the New Zealand Government's Rural Broadband Initiative Extension and Mobile Black Spot Fund, proposing to jointly build mobile coverage in regional New Zealand, delivering a 25% increase in geographic coverage across New Zealand.

Given the above, the ACCC cannot credibly make the argument that a situation where a monopolist can capture public funding is better than a possible counterfactual where there is effective competition for public funding that is likely to lead to economically efficient investment outcomes to the benefit of all Australians.

The ACCC's position is also devoid of any consideration of the possibility of declaration on terms that would likely encourage economically efficient investment in regional Australia. VHA has submitted a further independent expert report by Dr Derek Ritzmann that addresses this important point. Dr Ritzmann concludes:

“There are strong reasons to conclude that the LTIE may best be promoted by a partial declaration with certain access holidays. In particular, such a policy mix may spur greater investment by both invigorating and preserving Telstra’s incentives to invest in new assets and technologies to remain ahead of its competitors in coverage.”<sup>1</sup>

## 2 Attachments

Enclosed within this document are:

- slide pack presentation made to the ACCC on how declaration can promote regional coverage;
- email from Norton Rose Fulbright (Dr Martyn Taylor) of 26 May 2017 providing various responses to questions asked by the ACCC during a meeting with the ACCC; and
- [CIC] [REDACTED] [CIC] by the three mobile operators in New Zealand to the government of New Zealand that would provide an increase in regional coverage by 25.

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<sup>1</sup> Derek Ritzmann, *Comments on the ACCC Draft Decision in its domestic mobile roaming declaration inquiry*, see paragraph 2.2.



# Declaration of regional mobile roaming

Vodafone Hutchison Australia  
24 May 2017

**PUBLIC VERSION**

# Overview

## 1. New Zealand infrastructure sharing

- mandated roaming promotes increased regional coverage by promoting efficient sharing
- ACCC also has the opportunity to promote regional coverage by rewarding **new** investment
- if roaming **is** declared, this materially lowers barriers to investment by Optus, VHA, TPG

## 2. Draft retail pricing analysis by ACCC

- Telstra's price increment is significant and is not explicable by cost or quality alone
- there is evidence of very real and substantial harm to consumers
- so-called 'uniform national pricing' hides substantial geographic disparities in **value**

## 3. Future 'without' declaration

- [CIC]
- [CIC]
- no requirement for Telstra-Optus to charge 'uniform national prices' as market dynamics change

## 4. Further observations

- national market does not imply a homogenous market – stark differences in market share
- Boost is contractually restrained by Telstra and is in negotiations to migrate to VHA
- roaming is an interconnection service, akin to MTAS, so promotes any-to-any connectivity





# **1. New Zealand infrastructure sharing**

# NZ media release – 4 April 2017



## MEDIA RELEASE

Tuesday 4 April, 2017

### **Vodafone, Spark and 2degrees submit joint proposal to enhance broadband and mobile services for rural communities.**

Vodafone, Spark and 2degrees today announced a joint proposal to improve rural broadband and mobile infrastructure. The three telecommunications providers have made a submission to the Government for the delivery of high speed broadband and mobile infrastructure using the Rural Broadband Initiative Extension (RBI2) and Mobile Black Spot Fund.

If successful, the bid would see Vodafone, Spark and 2degrees invest hundreds of millions of dollars over the life of the project, including a capital contribution of \$75m to establish the infrastructure. The investment package also includes the contribution of spectrum, ongoing operating expenditure and other resources required to deliver and run this significant infrastructure deployment programme. This more than matches the Government's own contribution of \$150m, via the Telecommunications Development Levy (TDL).

Vodafone Chief Executive Russell Stanners said, "Rural New Zealand is a key driver of our country's economic growth and productivity and for these sectors to remain competitive they need fast broadband and mobile coverage – not just in offices, but on farms, in schools, and on the roads. The combination of the Government's RBI funding and this investment by the three mobile network operators presents a once in a generation opportunity to deliver both competitive ultra-fast broadband and world class 4G mobile infrastructure to areas of New Zealand that today have neither."

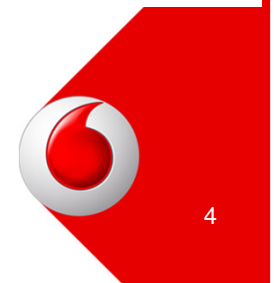
Spark Managing Director Simon Moutter said, "Fast broadband and mobile connectivity is the lifeblood of the economy so making sure we can find a way to extend it deep into rural New Zealand is a critical task. The reality is that Spark, Vodafone and 2degrees working together in this way provides the only economically viable way to deliver both quality mobile and wireless broadband infrastructure to the more challenging and remote rural areas of New Zealand."

2degrees Chief Executive Officer Stewart Sherriff said, "2degrees has a proud history of investment and innovation in New Zealand, we are therefore very happy to be part of this proposal to address the digital inequity between urban and rural communities. If successful this joint infrastructure investment bid will enable 2degrees to compete strongly to provide rural households and businesses – and domestic and international tourists – with the products and services they deserve".

Existing mobile networks cover well over 90% of the areas where New Zealanders live and work, however there are still remote land areas of the country without mobile coverage. The proposal would see in the order of 500 new cell sites delivering a 25 per cent increase in land coverage across New Zealand. Thousands of rural households and businesses would gain access to fast broadband as well as quality mobile coverage, and more than 1,200 kilometres of additional mobile coverage along state highways. Extended coverage on state highways means the public will have better access to emergency services, and police, fire and ambulance officers will be better equipped to coordinate operations from isolated locations.

The tourism sector will also benefit, extending its ability to promote New Zealand to the world and allowing visitors to more easily share their experiences with family and friends.

ENDS



# New Zealand regional sharing proposal

- Vodafone New Zealand, Spark and 2Degrees (as the three MNOs in New Zealand) submitted an innovative joint proposal to the NZ government in the context of NZ's Rural Broadband Initiative (Phase 2) and Mobile Black Spot programme.
- Under the joint proposal, the three MNOs will jointly build and share mobile and/or wireless broadband infrastructure to extend coverage to less economic areas of regional/rural New Zealand, utilising government funding to do so.
- This is an innovative arrangement that involves sharing of active and passive mobile network infrastructure and spectrum in regional New Zealand, utilising government funding, to extend coverage and realise synergies and efficiencies.
- The proposal is intended to be a long-term collaboration between the New Zealand government and the private sector in relation to rural connectivity
- Such an arrangement has been possible in New Zealand because domestic roaming was historically mandated. Such an arrangement may be possible in Australia if domestic roaming were declared, but otherwise will not be possible.





## Mobile coverage in NZ will increase by 25%

- NZ proposal applies to 520 new cell sites, delivering a **25% increase in land coverage** (including >1,200km of additional mobile coverage along state highways).
- By spreading the cost between the three parties, the proposal will achieve greater coverage more cheaply and significantly faster compared to a situation where the MNOs attempt to individually build out coverage.
- In NZ, there are also areas similar to Australia that are natural monopoly areas that can only viably have a single mobile network infrastructure, hence roaming has to date provided the means to achieve competitive retail supply in those areas.
- [CIC]
- .
- Spark Managing Director Simon Moutter commented on the benefits of sharing:

*“The reality is that Spark, Vodafone and 2degrees working together in this way provides the only economically viable way to deliver both quality mobile and wireless broadband infrastructure to the more challenging and remote rural areas of New Zealand.”*



## ACCC has real ability to promote regional coverage

- What appears to have been missed in the roaming debate is the very real ability of mandated roaming to lead to **improved** coverage outcomes in regional Australia.
- VHA considers that a commercial roaming agreement itself promotes network build:
  - Roaming reduces the barriers to network build. Roaming allows immediate market entry into **any location**, that can be followed by investment once market share has grown **in that location**. ACCC's modelling of national conditions does not recognise that incremental investment by MNOs is determined by **local** market conditions.
  - Roaming price can balance incentives to invest. VHA has continued to invest, notwithstanding Optus roaming because it is cheaper for VHA to build, than buy. Roaming gives VHA the option to build, by lowering the barriers to build. (*In period after network issues, VHA diverted CAPEX to fix network issues – this is historic*)
- As evidenced by the NZ proposal and by VHA's experience in Australia, the mandating of roaming **removes disincentives to share**. In turn, this will lead to the evolution of sharing arrangements and realisation of coverage efficiencies.
- Importantly, if the ACCC declared regional roaming, but carved out all new investment from roaming for a reasonable period, **this would stimulate regional coverage by rewarding new investment**. Ironically, ACCC can deliver improved coverage.





## **2. Retail pricing analysis**

# ACCC finds evidence of harm to regional consumers

## **ACCC finds Telstra pricing is higher than other providers:**

- “Telstra is substantially more expensive at nearly three times the cost offered by other providers.” (p40)

## **ACCC finds limited transmission of metro competition to Telstra national pricing:**

- “We consider that these trends suggest that Telstra’s competitors exercise some competitive constraint on Telstra, forcing it to react to industry-wide pricing. However, there is no evidence that Telstra is under pressure to decrease its prices to gain new customers.” (p42)

## **ACCC finds Boost is not a credible competitor for regional consumers:**

- “Despite Boost appearing to have the same or similar coverage footprint to Telstra based on publicly available information, it does not appear to stress this coverage advantage in its advertising. Boost only has a small number of services in operation (SIOs), relative to Telstra, Optus and VHA.” (p42)
- “Accordingly, while services from Boost are a potential alternative for price conscious consumers seeking wide geographic coverage, the ACCC considers that the availability of Boost may not be having a significant impact on the prices paid by consumers who require or value regional coverage.” (p42)

## **ACCC finds regional competition is less effective than metro competition:**

- “Given this, the ACCC’s preliminary finding is that competition in regional mobile services areas is likely less effective than in the national market overall due the increased likelihood that price-sensitive consumers are unable to match a preference for wide geographic coverage with a low-price plan.” (p43)

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# The evidence demonstrates this harm is material

## Telstra's price increment above VHA and Optus is very substantial:

- CIE identified Telstra price increment above market. CIE identified this increment as unusual compared to other countries. CIE methodology is robust and ACCC welcome to engage with CIE directly to test this.
- ACCC's analysis has missed some fundamental 'apples with apples' points – see next slides.

## Telstra's price increment is not causally explicable by cost differences:

- VHA's experts reverse-engineered Ovum and found the Telstra increment is vastly higher than costs of increased coverage. Telstra increment not explicable by coverage cost. Telstra is pricing well above cost and hence generating excess profits (see slides in Annex).

## Telstra's price increment would be materially impacted by roaming competition:

- [CIC]
- Goldman Sachs published analyst report (14 March) that calculate lost Telstra **profits** if roaming were declared at \$546 million **in the next financial year alone**. This confirms Telstra's and VHA's view. See Annex to these slides, noting this is an independent report identifying the impact on Telstra pricing.

## Uniform national pricing is not an effective constraint on Telstra market power:

- The retail mobiles market is not homogenous. Competition is intense between VHA and Optus, but Telstra is insulated from competition for consumers that prioritise coverage – conferring market power.
- Uniform national pricing does not reflect real regional differences in value. Metro consumers receive a much better network quality (eg 4G) for the same price than does regional Australia (eg 3G).



# ACCC finds against material harm, due to pricing analysis

ACCC's conclusion is based largely on ACCC's pricing analysis – so the accuracy is critical:

- “Overall, we do not consider that consumers who require Telstra coverage are suffering a significant detriment when compared to consumers in other areas who have wider choice of service provider. This is because **Telstra's retail offers have improved in recent years and are close to its competitors in some price categories**, and the fact that Boost services may be available in the Telstra only areas.” (p42)
- “Further effective competition in the national market **will continue to deliver these consumers any price reductions** which occur as a result of conditions in the broader market. The ACCC also observes that **different retail prices between competitors is a sign of competition** rather than otherwise” (p42)

The ACCC's pricing analysis is not robust and contains some fundamental errors.



# VHA concerns with pricing analysis in Draft Decision

- Draft analysis leaves impression that Telstra pricing is much closer to VHA and Optus than is the case.
- Draft only compares month-to-month SIM-only plans which, in VHA's case, are 12% of the post-paid base. There is no data presented on the 49% of customers who take post-paid handset plans or the 39% of customers who take 12-month post-paid SIM-only plans.
- Draft analysis does not weight the data. The analysis overweights the nearness of high-priced plans that the majority of consumers do not take. [CIC]
- **If this distribution were true for Telstra, then on the ACCC's figures for average monthly access fee divided by monthly allowance, Telstra's weighted average unit price (\$24/GB) is more than double VHA (\$10/GB).**
- Axes on the ACCC's charts suggest prices are broadly similar by 2016, but ACCC's table demonstrates that Telstra's average of monthly access prices divided by monthly data allowances **are 67% higher than VHA and 25% higher than Optus on a per gigabyte basis.**



# A more sophisticated analysis is critical on this issue

- The core difficulty in comparing mobile price plans is that the different plans have many different variables and sub-components, including voice minutes, provider and data allowances.
- Given such difficulties, VHA engaged CIE as an independent expert to undertake a hedonic pricing analysis for the purposes of an 'apples with apples' comparison.
  - Hedonic pricing breaks up the overall price of a plan into the prices of sub-components, such as voice minutes, provider, data allowances and content. It does so using statistical models to decompose the price paid for products into the value of each characteristic.
  - Hedonic pricing has been used to determine the value placed on various characteristics of real estate, automobiles and other products such as personal computers.
- The CIE was engaged by VHA as a true independent expert under Federal Court rules. The ACCC is welcome to engage with The CIE directly to understand and test the analysis undertaken by The CIE if this would provide the ACCC with greater confidence as to the accuracy of this work:
  - ACCC does not appear to have considered the merits of CIE' approach – it only reported the headline
  - ACCC included Professor Jonathan Pincus' report, which was prepared by Telstra, which attempts to critique the CIE work
  - ACCC does not include any reference to the CIE's refutation of Professor Pincus' critique as provided by VHA on 13 March 2017. By not referencing this work, the Pincus' critique is given more weight in the public domain than is warranted. VHA is unclear why this is the case, given CIE is robust.







### **3. Future without declaration**



## **4. Further observations on Draft Decision**

# Additional points in Draft Decision that raise concerns

## 1. National retail market does not imply homogenous market:

- VHA disagrees with ACCC's geographic retail definition, but for the purposes of these slides adopts the ACCC's national market. However, a **national market does not imply a homogenous market**.
- ACCC focusses on competition in metro Australia as a proxy for national market, but VHA is seeking access to roaming in regional Australia. The focus should be on regional effects/outcomes and the long-term interests of **regional** consumers.

## 2. ACCC has not considered the other downstream dependent markets

- ACCC has not considered "**services supplied by means of carriage services**" as required by s152AB(2)(b). In a regional context, that includes markets for innovative M2M solutions in regional areas that are facilitated by regional roaming. VHA will make further submissions on these issues.

## 3. Boost is competitively irrelevant in practice and may migrate to VHA:

- Boost does not provide any constraint on Telstra and is competitively irrelevant. Boost is restrained by Telstra (media comments imply to a high degree). [CIC]

## 4. Roaming is actually an interconnection service:

- The Draft Decision reaches a conclusion that domestic mobile roaming is not an interconnection service, hence any-to-any connectivity is not relevant. However, roaming involves the supply of 'roaming originating access' and 'roaming terminating access', so inherently involves the interconnection of networks (i.e., **roaming is actually a type of MTAS**).





## **ANNEX SLIDES**

**Further detail if  
helpful to the ACCC**

# Extracts from Goldman Sachs report on roaming (1)

## What happens if domestic roaming is declared?

TLS mobile network covers 99.3% of the population and over 2.4mn km<sup>2</sup> of land (with 1mn km<sup>2</sup> where it is the only provider), giving it a significant coverage advantage across regional Australia. This has resulted in TLS having a dominant share of the regional market (6.3mn subs, c.80% share), and justified their price premium (c.15% over last 3 years) across metro Australia in our view.

## We estimate the potential EBITDA impact to TLS at A\$546mn

We consider the potential impact that could have on TLS FY18 mobile earnings. We expect incremental wholesale payments received would be more than offset by loss of subscribers (primarily in regional Australia) and loss of their price premium. The loss of price premium has a much more material impact on earnings, given lost subscriber earnings are partly offset by additional wholesale earnings. We note that a range of outcomes exist outside what we present and this presentation is for illustrative purposes.

### Exhibit 5: We estimate there are 7.7mn mobile subscribers across regional Australia

Australian mobile market by region (Dec-16)

	Population (%)	Population (mn)	Mobile Penetration	Mobile Subs	Telstra Share	Telstra Subs
Major Cities	71%	17.3	133%	23.1	42%	9.8
Inner Regional	18%	4.4	120%	5.3	78%	4.1
Outer Regional	9%	2.2	100%	2.2	90%	2.0
Remote	1%	0.2	75%	0.18	100%	0.2
Very Remote	1%	0.2	25%	0.06	100%	0.06
<b>Regional Australia</b>	<b>29%</b>	<b>7.1</b>	<b>109%</b>	<b>7.7</b>	<b>82%</b>	<b>6.3</b>
<b>Total Australia</b>	<b>100%</b>	<b>24.4</b>	<b>126%</b>	<b>30.8</b>	<b>52.2%</b>	<b>16.1</b>

Goldman Sachs identifies 7.7 million regional subscribers that are impacted directly or indirectly by roaming

Goldman Sachs notes that Telstra's market share for regional subscribers is in the order of 82%.



# Extracts from Goldman Sachs report on roaming (2)

## Exhibit 7: We estimate a A\$546mn earnings impact (-13%) if roaming is declared

TLS – Estimated earnings impact of declaring mobile roaming (FY18E)

Potential earnings impact		
Mobile wholesale payments earned	GS Comment	
Current non-TLS regional subs (mn)	1.4	
Lost subscribers due to roaming (mn)	2.3	
<b>Total non-TLS regional subs (mn)</b>	<b>3.7</b>	
Optus/VHA avg. ARPU (\$/sub/m)	35.2	1H17 blended ARPU
Time roaming on TLS network	66%	TLS has 82% share currently
Total wholesale revenues (mn)	1029	
Margin	70%	AYS (MVNO) gross margin is 32-33%
<b>Mobile wholesale EBITDA (mn)</b>	<b>721</b>	
Loss of regional subscribers		
		GS Comment
Current regional share	82%	Regional share (82%) trends to market share (52%) despite superior regional store footprint.
Loss of share	30%	
<b>New regional Share</b>	<b>52%</b>	
Loss of Subscribers (mn)	2.3	
TLS ARPU (A\$/sub/m)	38.2	1H17 blended ARPU
EBITDA margin of lost subs	60%	vs. 41% 1H17 mobile margin
<b>Lost EBITDA (mn)</b>	<b>-635</b>	
Loss of price premium		
		GS Comment
Current subscribers (mn)	16.1	
Lost subscribers (mn)	2.3	
Subscribers (mn)	13.8	
TLS ARPU decline	10%	Currently c.15% premium
<b>Lost EBITDA (mn)</b>	<b>-631</b>	Lost revenues at 100% margin
<b>Net Mobile EBITDA impact (mn)</b>	<b>-546</b>	
FY18E Mobile EBITDA (mn)	4,198	
<b>Downgrade</b>	<b>-13.0%</b>	

Telstra receives new revenues from Optus and VHA for wholesale roaming services

Roaming competition causes Telstra to lose market share in regional Australia

Loss of market share in regional Australia causes Telstra to drop its prices, leading to lower average revenue per user (ARPU)

Source: Company Data, Goldman Sachs Global Investment Research.



# Network sharing models

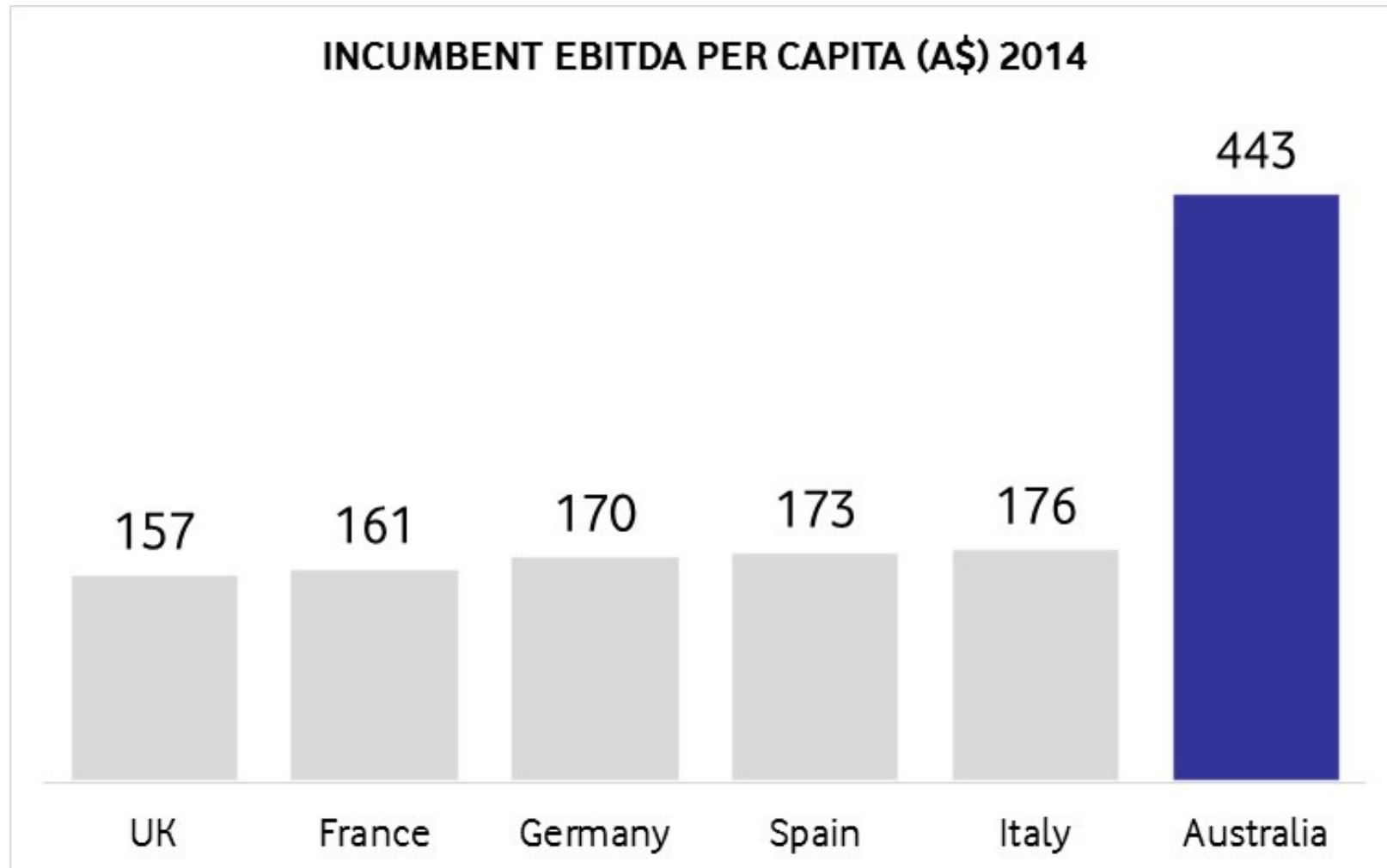
	Passive sharing Co-location	Passive sharing Co-investment	Active sharing ("Multi Operator Radio Access Network" MORAN)	Active sharing + spectrum pooling ("Multi Operator Core Network" MOCN)	Roaming
<b>Shared</b>	Towers, Transmission, Power)	Towers, Transmission, Power	+ Radio Access Network (RAN): Antennas etc	+ Spectrum	Full sharing: single network providing to multiple operators
<b>Commercial model</b>	Landlord/ tenant, commercial rates	Co-investment	Various	Various	Wholesale roaming payments to network operator.
<b>Complexity</b>	Low	Medium	High	High	Low
<b>Where</b>	Blackspots Telstra	VHA/Optus eJV, Blackspots VHA/Optus	UK, Greece, rural Romania		NZ, S. Africa, Canada, USA, Spain

## Vodafone has been driving roaming/infrastructure sharing agreements across the globe

Country	Roaming/sharing agreement
<b>UK</b>	2G/3G/4G: Whole of UK split into 2 zones with reciprocal active sharing with 02 (Telefonica)
<b>Spain</b>	3G reciprocal active sharing on 4,000 regional/remote sites (Orange)
<b>Italy</b>	2G/3G/4G: Consolidation to common grid in areas <35k inhabitants (TIM)
<b>India</b>	2G/3G: Three way JV for world's largest towerco "Indus" + reciprocal 3G national roaming on full footprint (Airtel and Idea), & JV for joint Wifi deployment (Airtel)
<b>Ireland</b>	2G/3G/4G: Passive network and transmission sharing (3)
<b>Greece</b>	2G/3G active sharing (Wind)
<b>Romania</b>	4G Active sharing in rural and regional, plus common grid planning in urban (Orange)
<b>New Zealand</b>	Commercial agreement on full footprint national roaming service and price (2 Degrees), plus new regional RAN sharing arrangement announced 2017
<b>South Africa</b>	Commercial agreement on full footprint 2G/3G national roaming (Cell C)



# Comparators point to Telstra super profits



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## Taylor, Martyn

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**From:** Taylor, Martyn  
**Sent:** Friday, 26 May 2017 11:06 AM  
**To:** [withheld]  
**Cc:**  
**Subject:** Domestic mobile roaming inquiry - follow-up to action points on VHA  
**Attachments:** 2017-03-16 GS TLS On Roaming.pdf

Dear Clare and team,

On behalf of VHA, many thanks for taking the time to meet with us yesterday. We took some a number of action points in the meeting, so respond as follows:

1. **Effectiveness of Boost:** The ACCC raised a question in relation to VHA's perception of Boost. As discussed, our take is that Boost is almost certainly subject to restraints from Telstra that preclude Boost advertising its network coverage, based on our experience with Telstra Wholesale. There is also a comment in the following article that Telstra has influence over the pricing of Boost: "*Telstra said pricing decisions for Boost Mobile were made and agreed to by both companies*" See <https://www.itnews.com.au/news/telstra-pressures-boost-to-cut-data-allowance-369600>

The ACCC commented in the meeting that Boost's availability in the market is important (and we note the ACCC has mentioned Boost some 20 times, compared to say 6 mentions of innovation). VHA considers that Boost's coverage availability is not known to consumers and, in any event, the continued availability of Boost is not assured. Boost is beholden to Telstra as a reseller of Telstra's network services, so there is no guarantee that Boost will continue to offer full coverage at lower price points – or, for that matter, continue to offer full coverage at all. In the same manner that Telstra has denied roaming to VHA, Telstra could equally deny resale to Boost at any time.

[CIC]

2. **Goldman Sachs report:** We attach a full copy of the Goldman Sachs report that we mentioned. The ACCC's analysis in the draft decision points to a finding of competitive harm, but the ACCC ultimately dismisses any such harm as immaterial. We find that outcome highly implausible. All the evidence available (in conjunction with Telstra's own conduct and submissions) points to harm to consumers that is very material indeed – in the order of magnitude of billions of dollars over the term of a service declaration. Given such large numbers, we are concerned that the ACCC has not sought to identify the net benefits of declaration (and hence the promotion of LTIE) by quantifying these effects:
  - The Goldman Sachs report is indicative. Goldman Sachs provides the insight that VHA and Optus would gain new revenues as a consequence of roaming because they would win more customers to their networks. These customers would generate revenue when they were not roaming. Given this assumption, Goldman Sachs has assumed that Telstra's wholesale roaming charge would be set at a level equivalent to the VHA and Optus retail price, so VHA and Optus would make no margin on roaming and simply recover costs.
  - With this assumption, Goldman Sachs has proposed that Telstra would capture a **70% profit margin** on roaming. This is substantially higher than Telstra's current WACC, set at 5.89% under the MTAS FAD. This suggests there is ample scope for the ACCC to set lower wholesale charges (such as retail minus) in order to allow VHA and Optus to at least recover their retail costs. Moreover, the ACCC would have significant discretion as to the wholesale price that it set in order to optimise the objectives of Part XIC.



- With these assumptions (which are highly favourable to Telstra), Goldman Sachs has forecast a loss in Telstra profits (and direct transfer to Australian consumers) of **\$546 million per annum**. Goldman Sachs has also indicated the sensitivity of this outcome. For example, if the Telstra wholesale margin was halved from 70% to 35%, the transfer in welfare to Australian consumers would increase to some **\$900 million per annum**.

These numbers have not been audited by VHA, but they do illustrate why VHA considers that it is important that the ACCC undertakes modelling in order to more accurately determine the magnitude of the net benefits of declaration. In VHA's view, the ACCC's claim that the effects are not material is not supported by the evidence.

3. **Geographic variations in competition:** In our meeting, the ACCC described its conceptual model of the retail mobile market as involving competing networks that may win or lose market share based on consumer perceptions of quality over time, hence very much a 'macro' view. The ACCC suggested we give this some thought, as VHA's view of the market was very much a localised view. As indicated, VHA analyses retail mobile market competition through the lens of different cities and different regions, as we suspect does Telstra, Optus and TPG. VHA's investment decisions are based on forecast local market shares in particular regions – and VHA competes as much by investment as it does by price.

We have some thoughts in response to your comments (and will be making these points in our submission):

- We consider that the ACCC's model may work from a metro consumer perspective, but it seems to us to miss the nuances of competition in regional Australia (or, for that matter, differences in competitive dynamics in different geographic areas). These different competitive dynamics lead to different market shares in different geographic areas – which is a clear indication to us that the market is not homogenous. With respect, we think the ACCC's market analysis therefore misses many critical nuances and dynamics of competition in the retail mobiles market.
- We consider that each network has economic limits to coverage derived of the economics of density, creating a hierarchy of networks in descending size (i.e., a cascade). This means that natural (structural) barriers to expansion lead to market failure in the outer regions, derived of network economics (and natural monopoly). The particularly low population density in Australia, in conjunction with first-mover advantages, has enabled a single network to dominate regional Australia in a way that cannot be challenged. Simply put, geographic areas with low population density are not contestable, so are susceptible to natural monopoly and first-mover capture.
- We consider the idea of nationally uniform prices can disguise Telstra's excess profits. In our view, there exist a myriad of price points that are each (ostensibly) nationally uniform. We think price discrimination is occurring because Telstra has market power and can therefore set higher 'nationally uniform' price points than other MNOs. Because of Telstra's market power, Telstra can choose not to offer a set of lower price points, knowing that many consumers are captive to higher price points.
- In doing so, Telstra may (in effect) tactically choose to lose metro market share in cheaper market segments, knowing that in doing so Telstra will force other consumers in metro and regional areas to pay higher prices as their coverage preference means that they will not substitute a full coverage product from Telstra with a reduced coverage product from competing MNOs. In this manner, Telstra is optimising 'lost metro profits' in the cheaper market segment against 'excess regional profits'.

4. **Trade-off between quality and price:** As discussed, the draft decision does not appear to recognise that market power is reflected more in quality, than in price. We agreed to explain in more detail what we meant by this – and our concept of 'value'. We think 'value' is a function of price and quality. If price is nationally constrained, geographic market power will therefore tend to result in reduced value through reduced quality (and hence reduced investment).

- We think that while 'price' can be argued to be nationally averaged, quality is not. It is the combination of price and quality that determines 'value' to consumers. We think that the 'value' that metro consumers receive is far greater than regional consumers for the same price - reflecting underlying differences in quality between regional and metro areas.
- We therefore think that market power is also manifested in a reduction in value (by a reduction in quality and investment) rather than simply an increase in price. Accordingly, market power has led to under-investment in regional Australia. We think this absence of competition contributes to reduced cellular

density, reduced coverage, and inferior technologies in low density areas where Telstra has market power.

- We think that while all consumers value “quality”, the concept of quality in metro is conceived differently than in regional Australia. In metro, ‘quality’ is interpreted in terms of cellular density and spectrum capacity, but in regions ‘quality’ is conceived in terms of coverage. This means that superior coverage can confer market power in regional Australia and barriers to expansion mean that this market power is not contestable and is enduring. It also means that regional market power will lead to reduced regional coverage.

As discussed, we still have serious reservations with aspects of the draft decision – and the process more generally. [CIC].

Kind regards

Martyn

**Martyn Taylor** | Partner  
Norton Rose Fulbright Australia  
Level 18, Grosvenor Place, 225 George Street, Sydney, Australia  
Tel +61 2 9330 8056 | Mob +61 45 777 4711 | Fax +61 2 9330 8111  
martyn.taylor@nortonrosefulbright.com

## **NORTON ROSE FULBRIGHT**

Profile: <http://www.nortonrosefulbright.com/people/56359/>

