Australian Competition and Consumer Commission

Domestic mobile roaming inquiry 2016

Third Report of Professor George Yarrow

15 June 2017

Prepared for: Telstra Corporation Limited

1. This paper provides both my comments on the ACCC's Draft Decision (DD) not to declare roaming and, in response to the ACCC's invitation to comment on Vodafone's supplementary submission, my response to Mr Feasey's report of 11 March which formed part of that submission. A copy of my instructions from Gilbert + Tobin, on behalf of Telstra Corporation Limited, is set out in Annexure A.

2. In responding to Mr Feasey's report, which comments on my earlier submissions to the ACCC, I do not propose to add any further point-by-point commentary of my own. Rather I will focus on what I believe to be a shared understanding of a central aspect of competition in mobile telephony, which Mr Feasey refers to as non-price competition (terminology that I am happy to adopt).

3. I do this because I believe the same, shared understanding underpins the assessment set out in the DD. Using terminology adopted in the business strategy literature, it might be called the 'kernel' or core of that assessment.[1] It is what brings coherence to the evaluation of the wide range of sometimes disparate issues and types of information that the ACCC has necessarily had to consider, not least to ensure that, for the purpose in hand (making a declaration decision), it has not neglected reasoning and evidence that might be highly salient to its decision.

4. My view is that, when properly applied to the facts, this shared understanding of the nature of non-price competition leads to the conclusion reached by the ACCC in respect of declaration. What follows will, I hope, help further explain why, but in summary:

   - To me the marketplace dynamics look like what I would call 'normal competition', which I think is coterminous with what the ACCC calls 'reasonably effective competition'. Telstra's coverage advantage puts additional competitive pressures on Optus and VHA, to which those two companies have responded in different ways, i.e. have made different strategic choices. These responses in turn have put additional competitive pressure on Telstra. This is how competition works, which, as I discuss below, appears to be the common ground between Mr Feasey and myself. It is therefore to be expected, and indeed is positively desirable, that a competitive process should allow rivals to vie with one another for customers by developing networks characterised by differences in coverage, quality or technology. The importance of such competition is heightened in mobiles by the very substantial contributions to the LTIE that are driven by the relatively rapid rate of introduction of successive generations of technology.

   - Declaration could be expected not only to reduce competition to sustain and extend coverage, but also to have adverse implications for price competition associated with coverage differentials. Price competition is the most effective method of discovering the value that consumers place on different product/service characteristics, including coverage. Absent the possibility of sustainable differences in coverage, there is little or no motivation for businesses to seek to discover its value to consumers. Hence this

[1] Richard Rumelt, *Good Strategy, Bad Strategy: the difference and why it matters,* Crown Business, 2011..

dimension of price competition becomes largely redundant and the general effectiveness of price competition is thereby reduced.

The kernel/core of the competitive assessment

Mr Feasey's views on non-price competition

5. At paragraph 23 of his 11 March report, Mr Feasey first cites and then questions the following statement in my first report: " … a general rule-of-thumb is that, if price undercutting by one competitor can be quickly matched by price responses from others – i.e. if the price cut offers only transitory competitive advantage – do not expect much of price competition in a market."

   The citation is accompanied by a reference to Footnote 8 where Mr Feasey himself says:

   "My own experience of mobile markets is that price changes can be matched quickly, and that prices fall quickly. That is why the challenge in mobile has always been to find non-price (quality) advantages which are harder or take longer to replicate."

   That seems to me to make the same, or at least a very similar, point. I therefore agree with the sense of these two sentences, but add the following comments:

   i. While prices can fall quickly, they can also increase quickly. For example, in a situation where, if they made use of the declared service, the costs of access seekers would rise, they would have immediate incentives to raise prices quickly. Indeed, if access seekers had full knowledge of the fraction of the existing price differentials with Telstra that were sustained by the pre-declaration coverage differentials, an obvious strategy for them to adopt would be to seek to quickly increase prices by the full amount of those price differentials. Telstra would then have no incentives to reduce its prices (if it did so, and as Mr Feasey implies, its price cuts could be quickly matched). The result of such pricing strategy would be higher prices for customers of the access seekers and no change in the access provider's prices to its own customers. Average prices in the market would rise, but the effect would be concentrated on the access seeker's customers. While it is by no means certain that access seekers would respond to the elimination of coverage differentials by *leading* the post-declaration price adjustments, it is a plausible outcome, because it is in the interests of all businesses that things proceed in this way. It might be said to be the "the way to bet."[2]

   ii. The challenge "to find non-price (quality) advantages" described in Mr Feasey's second sentence is to be found in sectors and markets across the economy, not only in mobile telephony. It is not unusual. What is more distinctive in mobiles, however, is that the differentiation process is particularly heavily focused on seeking advantages that require capital investments in infrastructure which bring ('embody') technological innovations.

[2] "The race is not always to the swift, nor yet the battle to the strong, but that is the way to bet." (Attribution uncertain).

iii. Care is required to distinguish advantages to businesses and advantages to consumers. The two are not always well aligned: for example, the profitability of certain types of 'horizontal product/service differentiation' can sometimes be significantly in excess of the benefits it confers on consumers. The pricing outcome described in (i) above is an example of such a potential misalignment in relation to quality differentiation. The equalisation of coverage in that case would have the unintended consequence of harming the existing customers of access seekers whilst increasing access seekers' profits.

iv. The relevant 'advantages' in non-price characteristics are not all to do with differences in quality (as Mr Feasey's second sentence tends to suggest). As I explained in my first report, differentiation can occur in both horizontal and vertical dimensions. A mobile handset with black casing would not normally be said to be of higher quality than a handset with white casing, whereas one with a higher memory capacity or faster processor speed typically would be. The distinguishing feature of quality differentiation is that, if offered two variants of a product/service (which are identical in all respects except one and are offered at the same price), all, or virtually, all consumers would favour one product/service (the 'higher quality' version) over the other. The reference to quality in the second sentence of Mr Feasey's Footnote should therefore be deleted because it is too restrictive: firms compete to find non-price advantages across a spectrum of product/service characteristics, not all of which are properly classified as 'quality' characteristics.

v. The words "that is why" which open the second sentence in Mr Feasey's Footnote should also be deleted. The statements in both sentences are, leaving quibbles aside, correct in my view, but there is no logical connection between them. If, counter to the facts in mobile telephony, prices were relatively rigid or sticky for some reason, businesses would still seek out non-price advantages and there are contexts in which the payoffs from such non-price advantages can be *higher* than if prices were quickly changeable. E.g. rigid prices that are high in relation to costs positively encourage extra effort to gain volume by non-price means, since each unit of volume acquired is worth more.

Non-price competition in general and quality competition in particular

6. Given these points, the kernel of the reasoning can be examined by first considering any one (of possibly many) product/service characteristics that yields a non-transitory competitive advantage. The reasoning that follows is of a general nature, although the specific set of characteristics that is of primary interest comprises those that involve investment in extending, upgrading or improving networks.

7. Let the change in a product/service characteristic be represented by Δx, which in the case of coverage would be measured by an increase in the area or fraction of the population for which a given type of product/service is available. Mobile operators will be interested in the mapping that links a change in a characteristic to a change in profits:

$$M: \quad \Delta x \rightarrow \Delta \pi - \Delta C(x)$$

where $\boldsymbol{\pi}$ is the operator's net revenue before deducting the cost incurred in changing the product/service offering and $\Delta C(x)$ is the cost of making the change.

8. The strength of the mapping between the change in net revenue and the change in the characteristic, which can be measured as $\Delta\pi/\Delta x$, is an aspect of the relevant incentive structure and it will be affected by the intensity of competition. That is because competition is a process that rewards performance *relative to rivals*. Other things equal, greater competition gives rise to a higher $\Delta\pi/\Delta x$.

9. As explained in my first report, declaration could be expected to have a relatively simple and direct anti-competitive effect. When what is involved is investment to cover a previously uncovered area or population, declaration would render the advantage afforded by the investment much more quickly and easily replicable. That is, the competitive advantage it potentially affords would be eliminated or substantially reduced. In Mr Feasey's words, mobile operators would not be able to "find advantages which are harder or take longer to replicate". In consequence investment in coverage could be expected to suffer: it would no longer afford opportunities for creating sustainable competitive advantage. Put another way, if $\Delta\pi/\Delta x$ is reduced, less investment in expanding or sustaining coverage is to be expected.

10. It is relevant to note at this point that coverage is a 'quality' dimension of non-price competition. It is, I think, common ground that incremental coverage is of value to consumers in all parts of Australia and there is no need to repeat all the reasons for that here. It can simply be stated that, in the vernacular, incremental coverage 'lifts all boats', albeit (unlike the sea), not by equal amounts. Whilst it is almost certainly true that, at the level of an individual citizen, incremental coverage likely matters much more to those living in rural and regional areas than to those living in metropolitan areas, it is also true that the latter are much more numerous. Hence the aggregated value of metropolitan consumer benefits from increased coverage can be expected to be a highly salient factor when assessing the effects of declaration.

11. In this respect coverage differs from horizontally differentiating characteristics, whose benefits tend to fall only on sub-sets of the population of consumers. A horizontal product/service characteristic may appeal to some customers but not others and the interests of those others will not be advanced by the availability of the additional products. Indeed, they may possibly suffer: they derive no benefits from the extra products/services on offer, but may face higher prices consequential on increased costs.

A comment on market definition

12. The existence of widely-shared benefits from increased coverage is a fact that is also highly relevant for market definition. I share the view of the DD that market definition is a purposive exercise and note that its evolution in competition law and economics stemmed initially from requests from US judges for factual clarification in merger cases that they were called on to decide. Roughly speaking, it was a request from the courts of the form "please tell us first what this case is about and what are the main features of the current context you believe should be taken into account when assessing *the effects of the merger*".

13. The general purpose of market definition exercises is *information discovery*, more precisely discovery of the salience of particular pieces of evidence and information. Unfortunately, in competition law cases it has too often come to be used as a rhetorical device, but the DD does not fall into that trap.

14. As in merger cases, declaration decisions have a strong binary component (yes/no) and, since the relevant effects are not confined to, say, the current Telstra-only areas, the assessment must be wide enough to encompass them. Speaking strictly technically, *any* initial market definition should lead to the same eventual answers, but to the extent that a particular starting point is associated with a judgment as to where assessment efforts are best focused, a poor starting point makes the assessment journey harder and riskier.

15. Since the economic arguments for and against declaration all tend to emphasise the effects of coverage differentials on the national market, my judgment is that the DD approaches market definition in the most appropriate way.

The multiplicity of non-price dimensions of competition

16. It is clear that there are many potential dimensions of service differentiation and competition in mobile telephony. In my first report I indicated that coverage is just one dimension of a sub-set of dimensions that can broadly be viewed as pertaining to the quality of the service (i.e. forms of vertical differentiation). To these can be added a set of characteristics/dimensions that can be classified as horizontal differentiation. Then again there is price competition, which itself can take a variety of different forms. There is therefore very considerable scope for strategic differentiation, by which I mean the ability of a business to position itself within a multi-dimensional strategy space that is available to it.

17. It may be worth stressing that this is a relatively normal situation across markets and, to repeat an earlier point, the whole concept of competition is based on the notion that businesses strive to differentiate themselves from competitors in one way or another, because rewards are linked to their ability to do so. The distinguishing characteristic of *effective* competition, as it is generally understood, is simply that this process of differentiation aligns the rewards/payoffs to businesses with advancements in the interests of consumers. Business A thrives relative to business B when it offers something that is both distinctive, i.e. <u>not</u> offered by B, and of value to consumers.

18. Problems occur (competition becomes ineffective) when this alignment is weak, non-existent or even negative (i.e. businesses benefit by doing things that are bad for consumers) and one way in which this can happen is when the dimensionality of competition is reduced, particularly by the loss of vertical/quality dimensions. The much-studied cases of homogeneous or near-homogeneous products/services (where there are no, or very restricted, opportunities for product/service differentiation) are cases in point. It is not coincidence that near-homogeneous-good oligopolies feature prominently in the various contexts with which competition law and policy has found itself engaged.

19. In my first report I focused on the point that declaration would reduce the dimensionality of competition by eroding the payoffs from differential performance in coverage. What struck me most about the factual position in Australia was that, in very challenging geographical and demographic circumstances, such high levels of coverage have been achieved at uniform, national prices and with only modest recourse to mandatory income transfers between different groups of citizens (e.g.s. relatively low levels of publicly funded support for network expansion; no universal service levy). For the reasons given, my considered view was (and is) that this highly benign outcome derives from the net revenue ($\boldsymbol{\Delta\pi}$) yields that are associated with coverage differentials.

20. The DD has, appropriately, also considered another, related aspect of multi-dimensionality. As a general matter, even if strategic differentiation in multiple dimensions is feasible there can be circumstances in which one product/service characteristic is so important that a hard-to-erode/match competitive advantage achieved in that dimension severely restricts competition across all other dimensions. The question, put in its starkest terms, is: *is equality of coverage "essential" for effective competition in the round?* Mr Feasey's view is that it is: my view is that it is not. The DD, based on reasoning from the evidence which I would describe as compelling, also answers in the negative.

21. When considering this question there are some general points to be noted arising from the fact that coverage is simply one aspect of product/service *availability*. Availability is a generic issue in markets and it has a number of different aspects. A desired product/service may not be available:
    A) at all, in any of its variants (e.g. in areas not currently covered by any MNO),
    B) in one of its variants (e.g. a higher quality variant associated with '4G' coverage, or a particular retail service offering),
    C) intermittently (e.g. recurrent loss of signal),
    D) occasionally (e.g. loss of signal when there is a technical failure at a local mast).

22. Analogous availability effects in the grocery trade are: (A) there is no local grocery store, (B) there is a store, but it stocks a limited product range, (C) the store sometimes has an item in stock and sometimes doesn't and (D) the item is normally available, but is occasionally subject to supply chain disruptions. In the electricity sector the analogues might be (A) off-grid premises with no on-site generation capacity, (B) off-grid, but with on-site generation and storage capacity, (C) ditto, but with limited storage capacity, (D) on-grid premises without on-site back-up.

23. There are trade-offs for businesses as to how they allocate resources to improving performance in these different dimensions of availability, guided by the different valuations placed on the relevant form of availability by consumers. It is, I think, uncontentious that the first type of non-availability, type A (no coverage), has the largest adverse impact on an individual (potential) consumer affected by it, and for the reason given – the likely reduction in the incentives to expand or sustain investment in more remote areas – declaration can be expected to exacerbate those adverse outcomes.

24. The main point, however, is that, for the great bulk of Australia's population, the other aspects of availability can reasonably be expected to be the more important concerns. Metropolitan consumers, for example, may intermittently or occasionally be inconvenienced by service non-availability in a remote area (as when travelling in those areas, but the effect is similar to the non-availability effects that they can encounter in much less remote localities). In all cases, they are willing to pay to reduce the risks of these unwanted inconveniences, whatever their underlying cause.

25. Mr Feasey makes the same point when he talks of the option value afforded by coverage and the point can be generalised. A mobile device linked to a network service can be viewed as a product/service that affords the consumer a large bundle of time-dated options, each comprising an opportunity to make a communication at a moment in time. Non-availability at any given time simply means that the option cannot be exercised at that moment. It therefore is easy to understand why, as Mr Feasey has correctly argued, metropolitan customers might be willing to pay for greater coverage – it increases the number of exercisable options – even in the event that the extra options are never actually exercised. There is value in reducing the risk of non-availability, even if that non-availability is, *ex post*, never actually encountered as an issue at those times when the consumer does choose to exercise the option.

26. For competing MNOs, then, there is an obvious counter-strategy to Telstra's lead in national coverage: it is to offset the type A and type B non-availability ('the extent of coverage') arising from Telstra's coverage advantage by investing to improve network availability in those areas that they do cover, i.e. improving type C and type D availability ('the depth of coverage'). There is therefore nothing to suggest that equalisation of the 'extent' of coverage is essential for effective competition.

27. However, to the extent that there might be lingering doubts, I think that they are assuaged by the DD's reasoning concerning the evidence exhibited in Figures 1 and 4. Whilst there are always risks of over-interpretation when examining univariate charts in contexts where market shares can be expected to be influenced by a whole range of factors, the magnitudes and, *a fortiori*, the timing of changes shown in these diagrams are highly informative. In 2009, the market shares of Optus and VHA are shown at around 30% and 27% respectively, notwithstanding Telstra's significant lead in coverage. That alone indicates that the coverage gaps, which were significantly larger then than they are now, did not prevent the establishment of large, economically viable businesses in the market.

28. The subsequent, very substantial loss of market share by VHA is, as I understand matters, largely attributable to performance weakness in relation to network availability, but there is no indication that coverage in rural and regional Australia was the major factor (although Figure 4 does show a slight decline in VHA's national coverage between 2008 and 2011, which is unlikely to have helped matters). And, as the later numbers indicate, VHA was able to halt the downward trend in market share by improving its own availability performance across the market, possibly assisted to at least some extent by improved coverage, but, given the nature of the network performance issues the DD describes, likely to a much greater extent by improved performance within its existing coverage area.

29. To me, this looks like normal competition. Telstra's coverage advantage has no doubt put additional competitive pressure on Optus and VHA, to which those two companies have responded in different ways, i.e. have made different strategic choices. Those strategic responses can in turn be expected to have put increased competitive pressures on Telstra. That is how competition works, as is indicated by the second sentence in Mr Feasey's Footnote 8.

Price competition

30. At this point, let me turn to Mr Feasey's point that prices in mobile telephony can fall quickly. As indicated, I agree with that, but emphasise again the points that (a) prices can also be quickly increased and (b) achievement of non-price advantages that are relatively hard to replicate or counter quickly does not alter this pricing flexibility: what it does is to affect the ways in which such flexibility is used.

31. Product/service differentiation, whether vertical or horizontal in nature, tends to reduce cross-price elasticities of demand, because of heterogeneity among consumers in preferences and circumstances (e.g.s. in their level of incomes, their locations, etc.). In teaching examples it is often inferred from this that product/service differentiation tends to 'soften' price competition, but close inspection of the assumptions made when this inference is drawn reveals that the benchmark/counterfactual position (of product/service homogeneity) is based on assumptions that the price competition is 'one off' in nature (i.e. a 'one-shot game') and that there are no output or capacity constraints. These assumptions are remote from reality in most market contexts, including in mobile telephony. Pricing competition tends to be a 'repeated game', not a 'one-shot' game, and output/capacity constraints tend to be a real presence.

32. For reasons given in my first report, it is very difficult to predict what prices would look like in any counterfactual that retained the product/service homogeneity assumption but dropped either or both of the 'one-shot-game' and no output/capacity constraint assumptions. The only relatively safe conclusion is that, if an equilibrium exists (and it might not), it will be characterised by a single, common price charged by all competitors. The Folk Theorems of repeated games point only to a price level somewhere between short-run avoidable costs and the monopoly price. What then can be said about the counterfactual?

33. A full answer would require a monograph, but let me summarise the general tendency in a proposition: *product/service differentiation tends to make price levels at the high end of the possible spectrum much more difficult to sustain*. Reasons for this include that (a) it creates differences of interests among businesses as to what common price level would be most profitable for each of them individually and (b) it reduces the effectiveness of 'punishment mechanisms' in the event of price cutting by one supplier.

34. The most fundamental point, however, is to do with the additional uncertainties that confront businesses when products/services are differentiated.

35. When products/services are homogeneous (not differentiated), businesses will *know* that cross-price elasticities of demand are very high, and hence there is very little of commercial value to discover. When product/services are differentiated, these cross-price elasticities are much less certain. They will depend upon all the heterogenous factors that influence individual consumption decisions, which themselves tend to change over time and which, when significant technological change is occurring, can reasonably be described as being in a state of constant flux.

36. If, as I think it should be, competition is viewed as a discovery process, price competition can be seen as the aspect of a more general process which is focused on discovering what it is that consumers, in all their heterogeneity, want and are willing to pay for. Information can obviously be obtained from market research – by asking questions directly, by asking about underlying attitudes, and so on – but there is nothing quite like confronting consumers with actual choices and observing their decisions and behaviours as a way of learning about their behaviours and inclinations (i.e. as a 'heuristic'). This 'experimental' approach is therefore a common feature of differentiated goods markets. It is how businesses build up pictures not only of the overall cross-elasticities of demand for the bundled combinations of product/service characteristics offered to consumers, but also of the values that consumers attach to variations in the individual characteristics themselves.

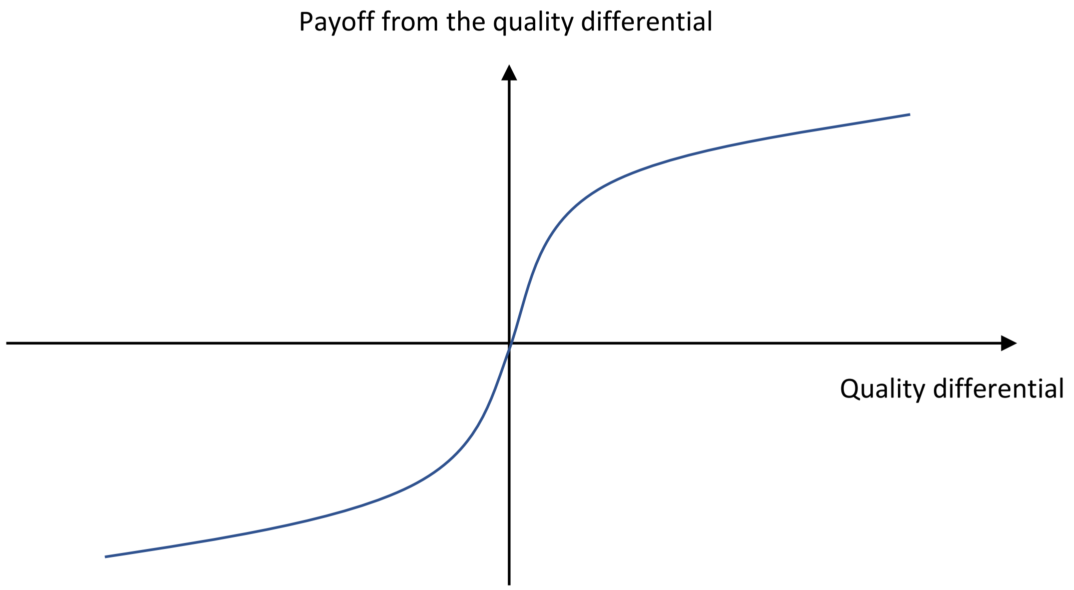
37. Coverage – whether defined in terms of the availability of a service at all or of a more specific service (4G, 5G) – is, as already stated, a quality characteristic whose value to consumers is something to be discovered. As things stand in Australia, there is competition to discover their value, e.g. to find out how much consumers would be willing to pay for increments or to avoid decrements in coverage.[3] Price competition is therefore an important aspect of current arrangements and it would be something that could be expected to suffer, in the coverage dimension, in consequence of declaration. There would be no strong incentive for businesses to seek to discover the value that consumers place on coverage, if there were no sustainable differences in coverage to be valued and 'priced'.

[3] Coverage can fall as well as rise since, over time, it will require continuing investment for it to be sustained at any given level. Indeed, in a growing market and if measured as the fraction of the population who can receive service, it can fall even if all existing assets are maintained (which may account for the VHA numbers between 2008 and 2011 in Figure 4 of the DD).

38. It might nevertheless be argued that the value of this aspect of the competitive discovery process should be discounted because, even without equalisation, there is nothing much of value left to discover in the first place. That is, just as businesses supplying undifferentiated products already know that cross-price elasticities are high and don't need to experiment by changing prices, so it might be 'known' that extra coverage will not add much value because coverage is already very high and the differentials between the leading MNOs are already very low. Speaking roughly, this would be to say that competition to date has been so successful that it is now largely redundant and can be safely set aside. This is a view that I think should feel suspect on an intuitive basis and in this case any such intuition is soundly based.

39. It ignores the point that coverage can contract as well as expand and it is fundamentally wrong, at a methodological level, to base an economic judgment about value solely on a physical measure (the fraction of Australians who do not currently have access to a mobile service by virtue of geography). More specifically such an argument would neglect the points that (a) what is at issue is the value to a business, $\boldsymbol{\Delta\pi}$, of an *incremental* advantage, $\boldsymbol{\Delta x}$, and (b) that incremental advantages can increase as the competitive 'race' becomes tight. We see this effect in sporting competitions of all types: the winner or top dog is particularly heavily rewarded, *irrespective of the margin of victory*. In the current context, this leads naturally to questions concerning the contribution to a corporate 'brand value' of being able, truthfully, to advertise a business as being the 'national leader' in coverage.

40. The diagram below shows a plausible pay-off structure for a company in duopolistic competition with a rival in a quality dimension. The quality advantage for the company of interest can be positive or negative. As drawn, the financial rewards flowing from any given small increment in quality relative to the rival (measured by the slope of the curve) are highest when the relative quality difference is small. In the limit of 'winner takes all' incentive structures, the curve collapses into a step function, with the step occurring at the point where the quality differentiation is zero.



41. I would claim only that this sigmoid shape of the reward function is a realistic possibility in many quality differentiation contexts. It tends to appear naturally in economic models of quality differentiation because (a) willingness to pay for additional quality tends to be strongly, positively correlated with income and (b) income distributions tend to be characterised by uni-modal functions. In effect, the sigmoid nature of the relationship then flows from the *cumulative* distribution function of income.

42. If such a relationship is found to be empirically relevant, the implication of the coverage figures shown in Figure 4 of the DD is that competitors will, over time, come to place *higher incremental value* on expanding into currently uncovered areas. That is, coverage of areas that had earlier looked commercially unattractive (because of the higher costs involved) will come to look more commercially interesting as coverage differentials contract. Moreover, even where uncovered areas would remain unprofitable, if government financial support were to be provided to tip the profitability balance, the amount of such support required would be reduced (relative to a situation characterised by a reward structure in which the tightening effect does not occur).

43. The main points though are that (a) in practice there is usually considerable uncertainty about the precise shape and positioning of the rewards function and (b) competition is usually the best discovery method/process available when seeking clearer sight of the form and position of the function, which derives from consumer preferences and ability to pay.

44. A fundamentally important lesson that can be drawn from economic history and the history of economic thought is that, notwithstanding the uncertainties (and indeed largely because of them) we can be confident about the efficacy and desirability of the experimental discovery process that we call competition without knowing what it will, in the event, discover. It is, therefore, a strength of the DD, not a weakness, that it says that *"We consider that the effect of declaration on retail prices is uncertain."* It is a simple statement of a reality, and recognition of reality does not preclude reasoned judgment on the relevant issues. Rather it is a necessary condition for good judgment.

The regulatory risks of declaration

45. Mr Feasey appears to find my scepticism about the ability of a regulator to determine an effective wholesale access regime that would not lead to an increase in retail prices to consumers in remote localities, yet would maintain incentives to invest in coverage, to be *"… odd given that much of the regulatory debate, to which he has contributed significantly, over the past 30 or so years has been concerned with addressing precisely these kinds of challenges"* (Mr Feasey's paragraph 64). In reply to that it can be said that 30 or so years of experience provides a useful education in how to distinguish schemes of arrangement that are both realistically feasible and advantageous from schemes and arrangements that are not!

46. On the basis of my experience, which is a history of some modest successes and some modest failures, and with one caveat, I fully concur with the judgment of the DD when it says, at page 5, that: *"In general, we consider that if Telstra is required to provide*

roaming to access seekers in the Telstra-only area, declaration coupled with an appropriately set regulated price should provide it with incentives to maintain and upgrade its existing network. ….. However, the ACCC notes that setting appropriate access prices would be challenging."

47. The caveat is simply that "challenging" should be read as one of those understatements that are commonly to be found in the decision documents of shrewd regulators.

48. The problem is twofold. First, the appropriate access prices will depend on assessments of consumer valuations of incremental coverage, i.e. assessments of the kind of functional relationship illustrated in the diagram above. There is no reason to think that a public authority will be superior to a competitive discovery process in that task, and lots of reasons to think it will be inferior (these are to do with structural factors such as incentives, procedural constraints, lack of competition in governmental assessment processes, and so on).

49. Second, to maintain investment incentives the incremental infrastructure costs incurred in expanding or maintaining coverage in rural and regional locations need to be remunerated. The attraction of the current arrangements is that competition in coverage not only provides a non-coercive mechanism that generates a large slice of that finance (sourced from consumers in other areas), but also does so in a way that directly links contributions to cost recovery with the benefits afforded to particular sub-sets of consumers. Those consumers who value coverage more highly, as revealed in their willingness to pay for it, tend to make the bigger contributions. Those who value coverage less can opt for services that are offered at lower prices. Declaration would undermine this financing mechanism, the point that struck me most forcibly when first looking at the issues.

50. If the existing financing mechanism is undermined it raises the question of what alternative would replace it, assuming that high-cost incremental investment in coverage is still to be adequately remunerated. Additional government support is a possibility, as is a 'universal service levy', but I assume that neither can be mandated by the ACCC as part of a declaration decision. That leaves access prices, and it is difficult see how these could possibly do the trick, i.e. how the DD's "challenging" problem could be overcome. It is very far from obvious to me that there exists an access price, or set of access prices, that could simultaneously satisfy the two conditions that (i) access seekers would be willing to pay and (ii) existing incentives for incremental coverage would be replicated. Some haystacks contain no needles.

George Yarrow

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15 June 2017

By email

Professor George Yarrow
Chairman, Regulatory Policy Institute

Email: George.Yarrow@rpieurope.org

Dear Professor Yarrow

Response to the Australian Competition and Consumer Commission regarding potential declaration of a wholesale domestic roaming service on behalf of Telstra Corporation Limited

1 Background

1.1 We refer to our letters dated 30 November 2016 and 23 January 2017, engaging you on behalf of Telstra Corporation Limited (**Telstra**) to provide a report in relation to an inquiry commenced by the Australian Competition and Consumer Commission (**ACCC**) into whether to declare a wholesale domestic mobile roaming service (**ACCC Inquiry**).

1.2 As you are aware, the ACCC invited submissions to the Discussion Paper from mobile network operators. Submissions were provided by a number of operators, including Telstra and Vodafone Hutchison Australia Pty Ltd (**VHA**). In addition to the submission and supporting material provided by VHA dated 1 December 2016, VHA provided a second report of Mr Richard Feasey dated 11 March 2017.

1.3 On 5 May 2017, the ACCC released a draft decision proposing to not declare a domestic mobile roaming service (**Draft Decision**).

1.4 We have been instructed to engage you, on behalf of Telstra, to prepare a further report based on your expert opinion. As with respect to your previous engagement, your report is for use by Telstra in relation to the ACCC Inquiry. Telstra may seek to rely upon your report in any subsequent review of the ACCC's final decision. If that occurs, we will contact you.

1.5 By this letter, we set out our written instructions to you.

2 Scope of work

2.1 You are retained to provide an expert report which addresses:

(a) the second report of Mr Richard Feasey dated 11 March 2017; and

(b) the ACCC's Draft Decision.

3 Guidelines for preparing your report

3.1 While you have not been engaged in respect of any legal proceedings, Telstra is seeking a robust and rigorous independent expert report. We request that you prepare your report in accordance with Federal Court of Australia *Harmonised Expert Witness Code of Conduct*. A copy of the Code of Conduct is enclosed at **Attachment A**.

3.2 In particular, in preparing your report, we ask that you please:

(a) identify your relevant area of expertise and provide a curriculum vitae setting out the details of that expertise;

(b) only address matters that are within your expertise;

(c) where you have used factual or data inputs please identify those inputs and the sources;

(d) if you make assumptions, please identify them as such and confirm that they are in your opinion reasonable assumptions to make;

(e) if you undertake empirical work, please identify and explain the methods used by you in a manner that is accessible to a person not expert in your field;

(f) confirm that you have made all the inquiries that you believe are desirable and appropriate and that no matters of significance that you regard as relevant have, to your knowledge, been withheld from your report; and

(g) do not provide legal advocacy or argument and please do not use an argumentative tone.

4 Confidentiality and legal professional privilege

4.1 Presently, your report and all correspondence between us (excluding this letter) is subject to legal professional privilege. In addition, the information we have provided to you is commercially sensitive and confidential. For these reasons, we request you do not disclose or discuss your report, our correspondence or any information we provide to you with any third parties.

Yours faithfully
Gilbert + Tobin

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Attachment A

Harmonised Expert Witness Code of Conduct
(Annexure A to Federal Court of Australia Practice Note GPN-EXPT)

APPLICATION OF CODE

1. This Code of Conduct applies to any expert witness engaged or appointed:

   (a) to provide an expert's report for use as evidence in proceedings or proposed proceedings; or

   (b) to give opinion evidence in proceedings or proposed proceedings.

GENERAL DUTIES TO THE COURT

2. An expert witness is not an advocate for a party and has a paramount duty, overriding any duty to the party to the proceedings or other person retaining the expert witness, to assist the Court impartially on matters relevant to the area of expertise of the witness.

CONTENT OF REPORT

3. Every report prepared by an expert witness for use in Court shall clearly state the opinion or opinions of the expert and shall state, specify or provide:

   (a) the name and address of the expert;

   (b) an acknowledgment that the expert has read this code and agrees to be bound by it;

   (c) the qualifications of the expert to prepare the report;

   (d) the assumptions and material facts on which each opinion expressed in the report is based [a letter of instructions may be annexed];

   (e) the reasons for and any literature or other materials utilised in support of such opinion;

   (f) (if applicable) that a particular question, issue or matter falls outside the expert's field of expertise;

   (g) any examinations, tests or other investigations on which the expert has relied, identifying the person who carried them out and that person's qualifications;

   (h) the extent to which any opinion which the expert has expressed involves the acceptance of another person's opinion, the identification of that other person and the opinion expressed by that other person;

   (i) a declaration that the expert has made all the inquiries which the expert believes are desirable and appropriate (save for any matters identified explicitly in the report), and that no matters of significance which the expert regards as relevant have, to the knowledge of the expert, been withheld from the Court;

   (j) any qualifications on an opinion expressed in the report without which the report is or may be incomplete or inaccurate;

   (k) whether any opinion expressed in the report is not a concluded opinion because of insufficient research or insufficient data or for any other reason; and

(l) where the report is lengthy or complex, a brief summary of the report at the beginning of the report.

SUPPLEMENTARY REPORT FOLLOWING CHANGE OF OPINION

4. Where an expert witness has provided to a party (or that party's legal representative) a report for use in Court, and the expert thereafter changes his or her opinion on a material matter, the expert shall forthwith provide to the party (or that party's legal representative) a supplementary report which shall state, specify or provide the information referred to in paragraphs (a), (d), (e), (g), (h), (i), (j), (k) and (l) of clause 3 of this code and, if applicable, paragraph (f) of that clause.

5. In any subsequent report (whether prepared in accordance with clause 4 or not) the expert may refer to material contained in the earlier report without repeating it.

DUTY TO COMPLY WITH THE COURT'S DIRECTIONS

6. If directed to do so by the Court, an expert witness shall:

(a) confer with any other expert witness;

(b) provide the Court with a joint-report specifying (as the case requires) matters agreed and matters not agreed and the reasons for the experts not agreeing; and

(c) abide in a timely way by any direction of the Court.

CONFERENCE OF EXPERTS

7. Each expert witness shall:

(a) exercise his or her independent judgment in relation to every conference in which the expert participates pursuant to a direction of the Court and in relation to each report thereafter provided, and shall not act on any instruction or request to withhold or avoid agreement; and

(b) endeavour to reach agreement with the other expert witness (or witnesses) on any issue in dispute between them, or failing agreement, endeavour to identify and clarify the basis of disagreement on the issues which are in dispute.