6 July 2017

Ms Clare O'Reilly
General Manager, Mobiles, Transmission and Consumer
Infrastructure Regulation
Australian Competition and Consumer Commission
Level 20, 175 Pitt Street
Sydney NSW 2000

Dear Clare

Domestic Mobile Roaming Declaration Inquiry 2016

We refer to the ACCC's ongoing inquiry into whether or not to declare a domestic mobile roaming service. This letter sets out additional information requested by the ACCC at our meeting on 28 June 2017 in relation to this matter.

[redacted]

Frontier Report

Also attached to this letter at **Annexure 1** is a brief summary of Telstra's concerns with Frontier Economics' report entitled 'The Consumer Impact from Domestic Roaming', 15 June 2017 which forms Attachment E of Vodafone's latest submission to the ACCC (the **Frontier Report**).

Telstra requests that the information in this response be treated as commercial-in-confidence as indicated given it contains Confidential Third Party Arrangements Information. We refer to the letter to the ACCC dated 16 June 2017 setting out Telstra's submission in support of its claims for confidentiality for further detail on this category of confidential information. The information identified as commercial-in-confidence in this letter is particularly sensitive as under its arrangements with third parties, Telstra is required to limit disclosure of third party information.

If you would like to discuss these issues further, please contact me on [redacted] or [redacted]

Yours sincerely

JeBond

Justine Bond
General Manager, Competition – Regulatory Affairs
Corporate Affairs
[redacted]

Annexure 1: Concerns with the Frontier Report

Telstra has identified a number of immediate concerns with the Frontier Report which warrant further consideration by the ACCC:

- **The Frontier Report ignores the welfare loss that declaration will cause**: Frontier was not instructed by Vodafone to consider the impact of declaration on incentives to invest. Therefore, the Frontier Report, while it purports to model the consumer welfare impact of roaming, does not consider the significant welfare loss, particularly to regional and rural communities, as a result of the investment disincentive impacts of declaring mobile roaming. In a separate consultancy, Frontier has recognised the importance of continuing investment, stating that "*[in] the mobile sector, investment is likely to be the main driver of consumer benefits and social welfare*".[1]

- **Frontier has made over simplistic and erroneous assumptions about mobile services and mobile markets in developing its economic model**:

    - Frontier's model assumes that geographic coverage is the only factor which defines differentiation, which is incorrect. Although geographic coverage is an important point of competitive differentiation, it is not the only factor on which MNOs differentiate their offering.[2]

    - Frontier's model has not accounted for differences in coverage between Optus and Vodafone and have assumed that, without declaration, Optus and Vodafone offer products with the same geographic coverage, which is incorrect. Optus is continuing to build network in regional and rural areas and its commercial roaming agreement with Vodafone does not appear to provide Vodafone with roaming across Optus' entire coverage footprint.

    - Frontier's model oversimplifies the vertical structure of the mobile market and does not recognise that both Optus and Vodafone are actually competing suppliers at the wholesale level.

    - Frontier appears to have ignored Boost's low-cost, "national" product offering.

    - Frontier appears to have ignored the pending entry of TPG and the additional competition TPG could add to the market.

- **Frontier's Differentiated Bertrand model has not been appropriately calibrated**: A Differentiated Bertrand model is capable of dealing with multiple factors of differentiation, and when calibrated properly, can show that if one form of differentiation is removed, firms' optimal strategies might be to focus on other forms of differentiation that could result in the same or even higher prices in certain circumstances. Frontier made no attempt to calibrate its model to provide for the testing of multiple factors of differentiation and, as noted above, has assumed that geographic coverage is the only factor which defines differentiation, which is incorrect.

- **There is no evidence that Frontier's Differentiated Bertrand model results in equilibrium**: The Frontier Report does not demonstrate that its calculations represent an equilibrium state of the Differentiated Bertrand model. For economic models, equilibrium is the outcome of a dynamic process (e.g. competition between firms) and represents a 'stable' outcome of the model. If a model is not in equilibrium, then the dynamic process being modelled is not complete and any results presented are not an accurate representation of the market being modelled. An

[1] Frontier Economics, *Assessing the case for in-country mobile consolidation,* Report prepared for the GSMA, February 2015.
[2] See, Telstra Corporation Limited, *Submission in response to ACCC's domestic mobile roaming declaration inquiry discussion paper*, 2 December 2016, s 2.1; Telstra Corporation Limits, *Submission in response to ACCC's Draft Decision,* 16 June 2017, s 2.

equilibrium in a Differentiated Bertrand model captures the optimal price for each firm, with each firm's optimal price dependent on the price set by competing firms. While the Frontier Report specifies the impact on price from mandated roaming (using ARPUs as a proxy for price), there is no indication that the resulting prices represent optimal Differentiated Bertrand model prices. If Frontier's Differentiated Bertrand model is not in an equilibrium state, we cannot have confidence in either the price changes that Frontier presents or the consequential calculation of welfare benefits which are dependent on those price changes.

- **Frontier's calculation of the domestic roaming charge of $5 per subscriber has no reference to the cost of supplying a mobile network in regional and rural Australia and relies on an unsubstantiated estimate of Telstra's "economic rent"**:
    - This type of pricing assessment is unconventional, is not referenced to the actual cost of supplying mobile services in regional and remote areas (or any type of benchmark costs), and is therefore likely to drastically understate the actual wholesale price of any mobile roaming service provided in regional and rural Australia.
    - Frontier provides no reason for why a cost per subscriber fee is more suitable in this instance over a usage based charge (ie cost per minute etc) or the other options given.
    - Frontier's calculation of the domestic roaming charge is driven largely by an assumption that a proportion of Telstra's ARPU is economic rent. This relies on Mr Feasey's calculation that Telstra derives $2.1 billion in economic rent, which is fundamentally flawed. Mr Feasey himself acknowledges that his calculation "*obviously need[s] to be treated with caution*".[3]
    - The Frontier Report does not attempt to substantiate it's "*more conservative assumption"* that 10 per cent of Telstra's ARPU is economic rent and in fact states that "*we do not offer an opinion as to what Telstra's economic rent may actually be*".
- **Frontier's estimation of Telstra's ARPU is incorrect**: The numbers presented by Frontier do not calculate ARPU on a consistent basis across Telstra, Optus and Vodafone. Correcting for this, Telstra's ARPU would be lower than what Frontier uses. Telstra does not believe that Frontier has an accurate and comparable estimate of Vodafone's ARPU.
- **There are inherent difficulties in analysing the consumer welfare impact of declaration on the basis of share prices**: The Frontier Report considers the share market reaction to the ACCC's Draft Decision on Telstra's market capitalisation, but does not discuss or attempt to address the inherent limitations of quantifying the consumer impacts of declaration on the basis of changes in share prices. For example, market uncertainty and speculation prior to the Draft Decision complicates any assessment that attempts to attribute changes in share price to the consumer welfare impact of declaration following the ACCC's Draft Decision. Further, there are difficulties in determining the point-of-time at which effect on share price of the ACCC's Draft Decision should be observed.
- **Vodafone has not made Frontier's model available and so Telstra has not been able to verify any of the inputs or the calculations**: Given the issues outlined above, Telstra has serious doubts as to the accuracy of Frontier's model and calculations as many of the inputs appear to be unsubstantiated or over simplistic.

[3] Report of Richard Feasey dated 11 March 2017, fn 16; see also, Telstra, *Response to Vodafone's Supplementary Submission*, 16 June 2017, s 5.2.