

Dated 16 June 2017

ATTACHMENT B

Re:

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

GENERAL COMMENTS ON THE DRAFT DECISION

Vodafone Hutchison Australia Pty Limited (VHA) makes the general comments below in response to the Draft Decision of the ACCC of 5 May 2017.

A decision by the ACCC to declare wholesale domestic mobile roaming in regional Australia would be a game changer for mobile telecommunications in regional Australia.

Roaming would deliver lower prices, improved choice of suppliers, access to a broader suite of products and services, access to innovative agricultural/regional solutions (as already supplied by Vodafone in regional New Zealand), enhanced customer service, and improved network coverage.

In this submission, VHA has also provided new evidence to address instances where the ACCC has indicated it does not have sufficient evidence. VHA has provided evidence, for example, that:

- The declaration of wholesale domestic mobile roaming in regional Australia would deliver net welfare benefits to Australians of at least of **\$3.9 billion** (net present value) over a 10-year period, comprising a net welfare gain of at least **\$658 million per annum**:
 - This figure has been independently calculated by Frontier Economics (London) and is confirmed by the Telstra net EBITDA loss calculations in analyst reports, including Goldman Sachs (\$546 million per annum) and Macquarie (\$590 million per annum).
 - This figure is within the estimate of Telstra’s substantial price premium in retail mobiles; independently quantified by The CIE at \$1.4 billion per annum.
- The international experience is that mandated roaming has led to increased and more efficient investment, including the adoption of sharing models to extend regional mobile coverage:
 - A mobile sharing model was proposed in New Zealand by the three mobile network operators in April 2017 that will **increase regional coverage by some 25%**.
 - The international experience from NZ, United States, Canada, Spain, France and South Africa is that mandated roaming has led to increased and more efficient investment.

In this submission, VHA has also tabulated the various key errors in the Draft Decision and has identified the manner in which these errors have affected the ACCC’s analysis, including a detailed commentary explaining the nature and consequences of each error.

Once VHA’s new evidence is considered, and the errors in the Draft Decision are corrected, it is clear that the statutory criteria for declaration of roaming are met. The ACCC should have the confidence to please correct its errors and proceed with declaration, as required by law.

1. VHA agrees with the ACCC’s view that Telstra can share its mobile network without any adverse impact on future investment in regional Australia

VHA agrees with the ACCC that Telstra’s network “*could be better utilised by making Telstra’s network available for use by [VHA’s] customers as a result of declaration*”. Specifically, that “*declaration may result in some efficiency gains in allowing [VHA] to use the excess capacity available on [Telstra’s] existing infrastructure*”.

VHA agrees with the ACCC that *“declaration, coupled with an efficient regulated price, would generally promote economically efficient investment in infrastructure”*. Specifically, that *“if Telstra is required to provide roaming to [VHA] in the Telstra-only area, declaration coupled with an appropriately set regulated price should provide [Telstra] with incentives to maintain and upgrade its existing network”*.

VHA agrees with the ACCC that *“Telstra is unlikely to have strong incentives to continue to expand its coverage footprint in the absence of government subsidies.”* Simply put, Telstra already holds a monopoly and has no competitive incentive to further invest.

VHA also agrees with ACCC Chairman Rod Sims’ public comment on 5 May 2017 that:

“I think there has been a scare campaign in many ways. There has been exaggeration by Telstra about what the effect on investment would be”.

In essence, the ACCC has called out Telstra on its scare campaign. The ACCC has indicated that roaming will not adversely impact investment by Telstra in regional Australia. The ACCC has also recognised that infrastructure-based competition has practical limitations, beyond which network sharing is the efficient solution, particularly in regional areas.

To this extent, VHA agrees with the ACCC’s conclusions. They are logically sound and supported by the evidence.

2. VHA agrees with the ACCC’s conclusion that regional Australians are receiving a poor deal; they are paying too much to Telstra, for poor quality, with no practical choice
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VHA agrees with the ACCC that *“Telstra’s prices for its mobile services are generally higher than those of other MNOs and MVNOs”*. Specifically, that *“Telstra generally charges considerably more for data”* and *“Telstra does not currently offer unlimited voice calls in its low or medium price plans”*. The ACCC concludes *“there is no evidence that Telstra is under pressure to decrease its prices”*.

VHA agrees with the ACCC that *“the average cost of data in Telstra’s low-priced plans is substantially higher than those of its competitors, while its voice call inclusions are much lower, presenting less value for money for consumers than services offered by other mobile service providers. As a result, consumers that strongly value coverage and perceive Telstra as the only viable mobile service provider may choose a higher-priced mobile service than they would otherwise purchase if alternative providers were available”*.

VHA agrees with the ACCC that *“declaration has the potential to lead to some reduction in prices for those who value coverage, but do not have a choice of provider other than Telstra.”*

VHA notes that market power can also be manifested in a reduction in value (by a reduction in breadth of service offering, quality and/or investment), rather than just an increase in prices. Accordingly, Telstra’s market power has led to substantial under-investment by Telstra in regional Australia, as Telstra does not face any degree of competition for expansion of coverage. Generally, Telstra’s investment has been driven by government subsidies or by regulation, not competition.

In essence, the ACCC has recognised that regional consumers are getting a poor deal. They have no practical choice but to acquire services from Telstra for the regional coverage they seek. However, they pay far too much, for reduced quality (in some cases 3G rather than 4G

coverage), and reduced overall value particularly for consumers with a preference for low-price plans.



The ACCC has also recognised that declaration of roaming will cure this situation.

Again, to this extent, VHA agrees with the ACCC's conclusions. They are logically sound and supported by the evidence.

3. VHA disagrees with the ACCC's unfortunate approach of diluting the interests of regional consumers by considering them as immaterial within a wider national market

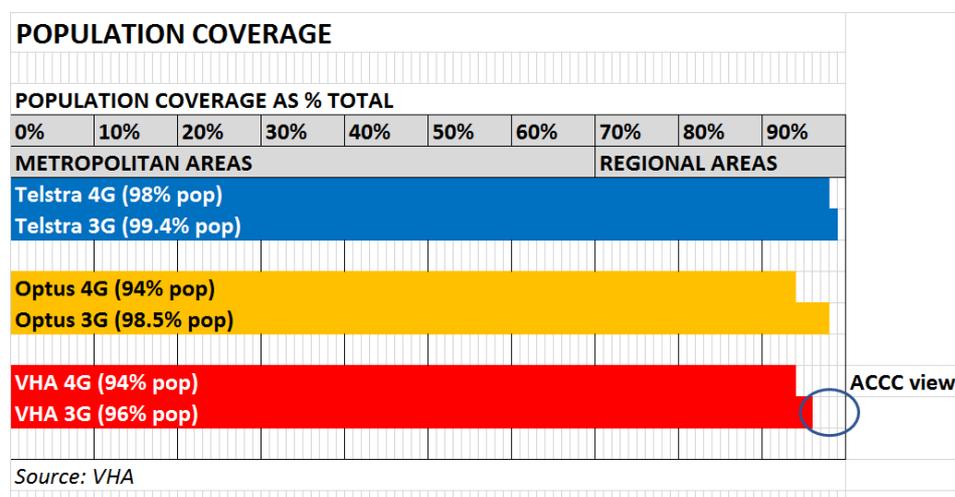
The ACCC has concluded that *"it is possible that declaration could promote competition in the national retail market to a degree"*. However, the ACCC has concluded *"when considered in the context of the national market, the overall impact that this will have on competition is not likely to be significant"*.

In VHA's view, the national market is not the appropriate focus of this declaration inquiry. This inquiry is about the delivery of mobile services to regional consumers. By considering the effect on all mobile consumers, the ACCC has diluted the perceived benefits to regional consumers to a level at which the ACCC has then determined is immaterial.

VHA has identified in this submission that in adopting this approach, the ACCC has made a series of reviewable errors. The ACCC has disregarded structural evidence of market failure in regional Australia, diluted its consideration of regional effects, and focussed purely on behavioural outcomes in a wider national market. Consequently, the ACCC has reached a theoretical conclusion that is not consistent with the underlying regional market reality. In doing so, it has disregarded the long-term interests of regional consumers.

VHA is concerned that the ACCC has regarded the impact of roaming as trivial by considering that roaming will provide coverage only to a small number of regional consumers that live in the Telstra footprint. As VHA evidences in this submission, that view does not recognise the impact of coverage differences throughout regional Australia.

The following diagram illustrates the ACCC’s view, as VHA understands it:



This view looks at difference in population coverage and concludes that only a small proportion of the population, located in regional Australia, do not have access to network choice. On this view, the declaration of roaming is a “3% issue”. On this view, the interests of small proportion of regional consumers are regarded as immaterial relative to the national whole. As VHA understands it, the ACCC appears to hold this view.

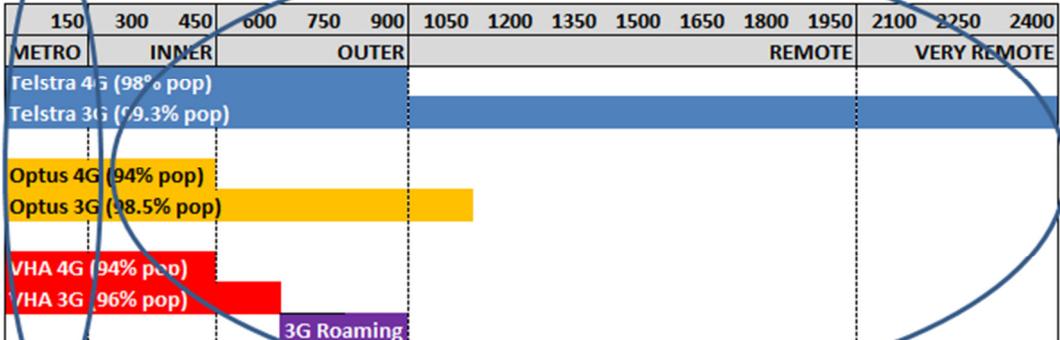
However, this view fails to understand the manner in which small differences in population coverage translate into dramatic differences in underlying network coverage. These differences in network coverage, in turn, result in substantially different outcomes for those consumers that are particularly sensitive to coverage, particularly in regional Australia.

The differences in network coverage in regional Australia have enabled Telstra to dominate the market in regional areas. Even in inner regional areas where there is full 3G/4G network coverage from all three networks, Telstra still has a near 80% market share. Moreover, coverage-sensitive Australians in metropolitan areas are also affected, ultimately affecting some 40% of the total population and some 80% of regional consumers. On this view, the declaration of roaming is a “40% issue” nationally – and an “80% issue” in regional areas. This is VHA’s view.

If declaration of roaming would lead to substantial price movements and a major transfer of consumer welfare by equalising coverage, this would support VHA’s view. As identified below, the quantitative evidence does indeed support VHA’s view, not the ACCC’s view.

GEOGRAPHIC COVERAGE

AREA IN THOUSANDS OF SQUARE KILOMETRES

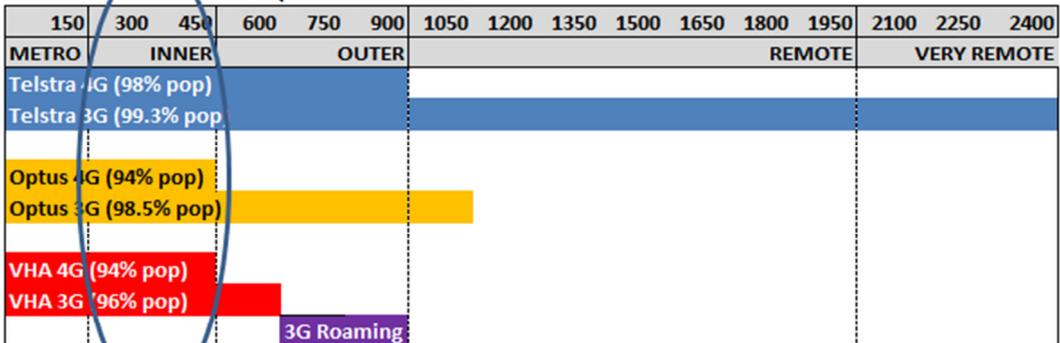


Source: VHA

Metropolitan markets

Regional markets

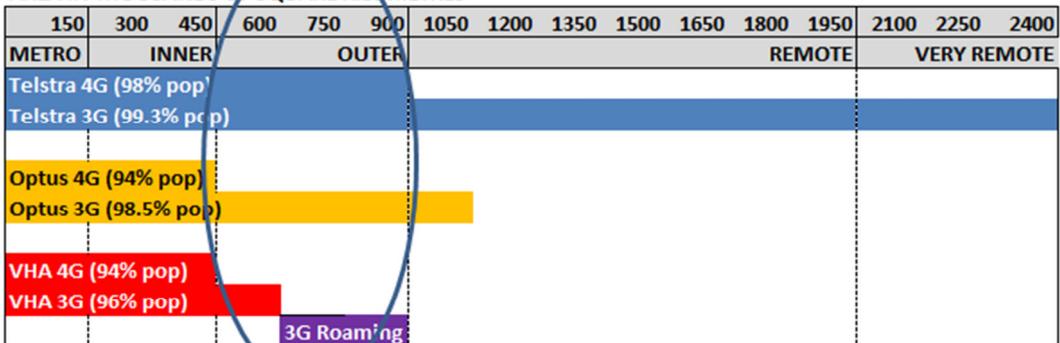
AREA IN THOUSANDS OF SQUARE KILOMETRES



Source: VHA

Telstra still has a near 80% share in inner regional areas, even with full 3G/4G network competition

AREA IN THOUSANDS OF SQUARE KILOMETRES



Source: VHA

Vodafone is dependent on 3G roaming to deliver services in outer regional areas

4. VHA disagrees that there is insufficient evidence of harm to regional consumers. VHA has now evidenced (supported by a range of sources) that the net welfare gains from declaration would be at least of \$3.9 billion (net present value) over a 10-year period, comprising a net welfare gain of at least \$658 million per annum.

While the ACCC's analysis in the Draft Decision points to a finding of competitive harm in regional Australia, the ACCC ultimately dismisses such harm as immaterial. The ACCC's conclusion seems to be entirely subjective and based on qualitative evidence, without any attempt at quantification and without any consideration of the quantification that VHA has provided in evidence.

VHA finds that outcome as highly implausible. All the evidence available (in conjunction with Telstra's own conduct and submissions) points to harm to consumers that is very material – in the order of magnitude of billions of dollars over the term of a service declaration

- In its submissions, VHA has identified that the magnitude of the welfare gains to Australian consumers arising from declaration. VHA initially sought to quantify the Telstra price premium. VHA engaged The CIE as independent experts, under Federal Court rules, to analyse mobile pricing. The CIE concluded that the Telstra price premium was in the order of \$1.4 billion per annum for mobile services.
- With this submission, VHA has now engaged Frontier Economics (London) as independent experts, under Federal Court rules, to identify mobile retail price movements (and resulting welfare benefit to Australian consumers) arising from declaration. Frontier Economics has calculated that the welfare gain to Australian consumers would be in the order of at least **\$3.9 billion** (net present value) over a 10-year period, comprising a net welfare gain of at least **\$658 million per annum**.
- The market agrees. Goldman Sachs published an independent report indicating a net loss of Telstra EBITDA (and hence transfer to consumers) of **\$546 million per annum**. Macquarie Group estimated this net loss in Telstra EBITDA at **\$590 million per annum**, leading to an 8% reduction in the Telstra share price. When the ACCC indicated it had made a draft decision not to declare roaming, the Telstra share price rose by some 5%, providing further confirmation.
- Telstra's conduct also betrays that Telstra regards this issue as significant. Telstra's refusal to supply roaming has occurred because it considers that it would suffer a material loss in retail revenues. To date, Telstra has refused to share information which indicates the magnitude of the retail impact on Telstra, but VHA understands it supports the conclusions identified above.

By any measure, VHA, Telstra and the market itself appear to agree that the benefits to consumers from the declaration of roaming are significant and likely to take the form of lower prices. This supports the "40% view" identified by VHA earlier.

In that light, VHA is concerned by the ACCC's comment that: *"It is difficult to determine exactly how retail pricing of mobile services will change if the ACCC were to declare a mobile roaming service"*. The ACCC has the expertise at its disposal to analyse the evidence and make that determination. VHA considers that the ACCC's failure to do so has led it to conclude that price movements are immaterial, whereas all the evidence proves otherwise.

Irrespective, VHA has now provided evidence of exactly how retail pricing of mobile services will change if the ACCC were to declare a mobile roaming service. This should assist the ACCC to reconsider its current position.

[CIC begins] [CIC ends]

5. VHA considers that the ACCC’s focus on national market outcomes has prevented it identifying the real concern – market failure by natural monopoly in regional Australia

VHA disagrees with the ACCC that: *“the ACCC does not consider that a mobile roaming service is an essential input into retail mobile services as a network operator can extend its own network into an area in order to provide a mobile service”*. This conclusion directly contradicts the ACCC’s conclusion that: *“it is logically plausible that in many remote areas of Australia, it may not be viable for there to be more than one mobile network”*.

VHA considers 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). Each network in the hierarchy has reached its maximum efficient scale. This means that natural (structural) barriers to expansion lead to market failure in the outer regions, derived of mobile network economics and natural monopoly.

The particularly low population density in Australia, in conjunction with first-mover advantages in mobile, has enabled a single network (Telstra) 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. Telstra’s unassailable position has been assisted, among other matters, by Telstra’s fixed line access monopoly and some \$1.9 billion in government subsidies over the last decade.

The perception that VHA is to blame for its lack of geographic coverage because it has “not invested” is therefore demonstrably wrong. Simply put, VHA cannot invest. Telstra’s first mover advantage, has enabled Telstra to capture those areas that can only viably support a single network (i.e., the natural monopoly areas). Optus has followed to capture those areas that can only viably support two networks. VHA has invested and continues to invest as far as it can in the circumstances that it is in.

The ACCC’s conclusion that *“there is no evidence that there is market failure in the national mobile services market”*, fails to recognise that there is evidence of a market failure in **regional** Australia. The impact of this market failure is overwhelming and severe.

As recognised in the Vertigan Review, *“access regulation should control those features of the network that have natural monopoly elements, thereby creating scope for efficient competition at the retail level”*. Declaration of mobile roaming is clearly the solution.

6. However, VHA is concerned that the ACCC appeared to give disproportionate weight to submissions from regional organisations that are highly dependent upon Telstra, which took Telstra’s public posturing at face value, and which contained no facts or evidence

As the ACCC recognises, Telstra’s so-called ‘investment strike’ was calculated to place public and political pressure on the ACCC. This appears to have been exacerbated by the significant political interest in the inquiry. VHA hopes that the ACCC is not influenced by these matters.

However, the public reaction in regional Australia appears to be weighing on the ACCC to a significant extent. When VHA announced that it was commencing legal proceedings, the following quote attributed to ACCC Chairman Rod Sims on 2 July 2017:

“We have consulted extensively with regional Australia in relation to our draft decision, and the majority of views we received from farmer and other stakeholders’ groups were not in favour of the ACCC declaring domestic roaming”.

This comment is also reflected in the Draft Decision:

“Many regional councils, MPs, regional consumers and businesses, and representative groups expressed concern about the likelihood of negative impacts on MNOs’ investment incentives should a wholesale roaming service be declared.”

In this regard, VHA does not understand why the number of submissions in favour or against roaming has been given such prominence in the Draft Decision or in the mind of the ACCC. Most (if not virtually all) of these regional submissions against roaming were motivated by a concern that Telstra would not extend coverage in regional Australia if roaming were declared. The ACCC has already indicated in the Draft Decision that this view is not correct. Indeed, Rod Sims has specifically ‘called out’ Telstra’s scare campaign.

Moreover, if the submissions are not in point, VHA fails to appreciate how they can be relevant to the application of the statutory criteria that the ACCC must apply. The ACCC must consider whether declaration is in the long-term interests of end users by assessing the facts and evidence, not the volume of submissions.

As the ACCC is no doubt well aware, Telstra’s ability to threaten an investment strike arises because of Telstra’s monopoly. That monopoly exists because only one network can economically exist in low population areas. Most of the submissions against roaming failed to recognise that network sharing, by roaming, can break Telstra’s stranglehold on regional Australia to deliver lower prices with improved coverage outcomes.

Indeed, most of the submissions against roaming demonstrably misunderstood the economics of mobile network deployment, the benefits of sharing, and the fact that roaming can promote investment and coverage, not retard it.

It is unfortunate that the ACCC has suggested that the ‘majority view from regional Australia’ affected its decision, where that view was influenced by Telstra’s scare campaign ; a campaign which the ACCC itself has publicly acknowledged.

As the ACCC will be well aware, the ACCC’s decisions may not necessarily be popular. They may (as in this case) have the real potential to be publically and vocally criticised by Telstra, as a powerful company with a formidable public relations team. The ACCC’s decisions may

therefore be misunderstood by a segment of the population (and, ironically, even by those regional consumers who most stand to benefit). However, the ACCC's decisions must, as a matter of law, be in the long-term interests of Australian consumers; however politically unpalatable that may seem to be.

7. If the ACCC's many errors are corrected, the criteria for declaration are met – and declaration of domestic regional mobile inter-carrier roaming should occur

If the ACCC's many errors are corrected, the criteria for declaration are met. VHA has evidenced this in the following table:

Statutory criteria	Correction
Objective of promoting competition in markets for listed services	<ul style="list-style-type: none"> • Competition is promoted in regional areas by overcoming a structural obstacle to market access, thereby enabling end-users to access multiple networks • The welfare benefits of doing so are significant and will reduce prices to both regional and metropolitan consumers. • Access to roaming at a reasonable price in the wholesale market will also deliver lower prices in the retail market, promoting competition • Access to roaming in regional areas will also enable innovative M2M/IOT services to be supplied in regional areas, overcoming a Telstra monopoly.
Objective of achieving any-to-any connectivity in relation to carriage services that involve communication between end-users	<ul style="list-style-type: none"> • Roaming is an interconnection service • Roaming achieves any-to-any connectivity by enabling mobile users to obtain connectivity where they are outside their own network footprint, but in the network footprint of another provider • Roaming on reasonable terms facilitates any-to-any connectivity
Objective of encouraging the economically efficient use of, and the economically efficient investment	<ul style="list-style-type: none"> • Roaming will reduce barriers to entry and expansion, enabling infrastructure-based competition where it is efficient for this to occur. • Otherwise, roaming will promote efficient network sharing in areas where infrastructure-based competition is uneconomic. • Roaming will enable greater sharing to occur, leading to the adoption of more efficient sharing models that will lead to an expansion of coverage.
Promotes the long-term interests of end-users	<ul style="list-style-type: none"> • Magnitude of the welfare gains is in the order of at least at least \$3.9 billion (net present value) over a 10-year period, comprising a net welfare gain of at least \$658 million per annum.

In the interests of regional Australia and the future of competition in the mobile sector, the ACCC needs to spend the time and resources to make an accurate and informed decision. The ACCC should take the time to prepare a high-quality report that addresses the many nuances of mobile coverage in regional Australia. The ACCC should use its inquiry powers to properly gather the evidence it requires, rather than simply asserting it has “insufficient evidence” or the matter is “difficult” or “challenging”. VHA is concerned that the ACCC's apparent (and concerning) rush to conclude this inquiry has led to a superficial analysis that is internally illogical and directly at odds with market complexities and realities.

Notwithstanding the litigation, VHA remains highly supportive of the need for a declaration inquiry. VHA remains willing to assist the team at the ACCC to work through all issues raised in this declaration inquiry to ensure that the ACCC makes a high-quality decision based on an informed consideration of all available evidence.