

Dated 16 June 2017

ATTACHMENT F

Re:

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

Comments on aspects of the ACCC's Domestic Roaming

Declaration Enquiry Draft Decision

Richard Feasey

16 June 2017

1. I have been asked by Vodafone Hutchison Australia (VHA) to comment on the ACCC's provisional conclusions as to the likely impact of declaration on competition in general, and on retail pricing in particular, in the Australian mobile telecommunications market. These findings are presented in Sections 6.2.1 and 6.2.2 of the draft decision (I do not address the likely impact of declaration on market entry, which is considered in Section 6.2.3).
2. I start by presenting my understanding of the ACCC's position and the basis for its provisional conclusions. I then examine the evidence upon which the ACCC relies and the evidence on which it ought to rely. I conclude by considering whether the ACCC's draft conclusions appear well founded.

The ACCC's overall position

3. In the draft decision, the ACCC states that it proposes not to declare a domestic mobile roaming service on the basis that it is not satisfied the Long Term Interest of End Users (LTIE) would be served by doing so. In coming to this view, the ACCC is required to weigh up various factors, of which the most significant in this context are the likely impact of declaration on competition and retail prices paid by consumers and the likely impact on future investments by firms. The ACCC appears to have concluded that the effect of declaration on both prices and investment might best be characterised as 'ambiguous but in any event small'. This means that any net effect on the LTIE, whether positive or negative, is expected to be modest and would not make much difference one way or another. The draft decision suggests that ACCC does not risk doing great harm by declaration but nor, in its view, is it likely to do much good.
4. The ACCC arrives at this view because, first, it considers that the existing national retail mobile market (as it defines it) is 'generally showing signs of reasonably effective competition' (page 23). This is a rather striking phrase and not one which suggests much confidence on the part of the ACCC about the performance of the market. Most regulators prefer to define markets as being

either ‘effectively competitive’, ‘not effectively competitive’ or ‘prospectively competitive’¹. The ACCC’s more qualified conclusion appears to be the result of two main factors.

5. First, the evidence of competition in the national retail mobile market (as defined by the ACCC) is rather mixed:
 - a. MVNOs have been gaining market share until 2014 but the ACCC does ‘not see evidence of [MVNOs] placing significant competitive constraints on the MNOs’ (page 24). MVNO market share has not grown, in aggregate, since 2014.
 - b. Amongst the MNOs, the market leader, Telstra has been gaining market share at the expense of both VHA and Optus since 2010 and now holds about 45% of the market (more if MVNOs are excluded). Shares amongst the MNOs have been stable since 2014. (page 25). To put this in context, the average market share of the leading operator in the European Union currently stands at around 35%, similar to the US. Australia in fact had the second highest leading market share and second highest HHI score (behind China in both cases) of any country assessed in Ofcom’s 2016 International Mobile Communications Market Report².
 - c. Average annual prices for a range of baskets have been falling by 2% p.a. since 2008 (page 27). To put this in context, weighted prices in the UK across a similar (but not directly comparable) group of tariff baskets fell by 38% in 2016³. Prices for another set low usage baskets fell by over 10% in 13 out of 27 European markets in 2015, by over 10% in 12 out of 27 for medium usage baskets, and by over 10% in 14 out of 27 for high usage baskets⁴.
 - d. The ACCC finds high levels of switching, with 71% of MNO subscribers having switched in the past (page 26). On the other hand, it notes that many regional customers have nobody to switch to.
 - e. The ACCC finds that operators compete on other services, such as exclusive TV content, as well as on price.

¹ There is an annual debate in the US as to whether the FCC will declare the cellular market as being ‘effectively competitive’ in its annual Wireless Competition report, which it has declined to do since 2010.

² See https://www.ofcom.org.uk/data/assets/pdf_file/0026/95642/ICMR-Full.pdf, figure 3.49 and 3.50, p.116-117

³ *ibid*, p.53.

⁴ See http://ec.europa.eu/newsroom/dae/document.cfm?doc_id=18583, figure 22, p.34

- f. The ACCC finds there is evidence of competition on factors other than price, including upgrading networks, ‘quality’ (a term which the ACCC does not define precisely but which appears to refer to site density⁵), ‘reliability’ and increasing network coverage (page 28). At the same time, the ACCC also recognises that the prospects of these benefits extending to those areas where Telstra currently enjoys a network monopoly are limited (page 46).
 - g. Although the ACCC claims that competition drives coverage, at least to some degree, it also concludes that ‘a high proportion of metropolitan consumers’ do not actually care much about coverage and that it may not be ‘determinative’ in their choice of network provider (page 34).
6. Second, the ACCC finds that competitive conditions differ by geography, with customers in regional or rural areas experiencing weaker retail competition than those in urban areas (pages 37 and 43). When neither VHA nor Optus operate a network in a regional area, those living and working there have a choice of only one MNO provider, Telstra. This is reflected in Telstra’s very high market share in those areas, higher than it enjoys in either urban areas or nationally. Since the ACCC also finds that Telstra’s customers pay higher prices than customers of VHA or Optus, it follows that consumers in regional areas with no choice but Telstra (which the ACCC says amount to 200,000 consumers (page 37)) are also paying higher prices, on average, than their urban counterparts. In addition, the ACCC notes that consumers in rural areas may not enjoy upgrades to the Telstra network, or may have to wait longer for them (page 29).
7. As I noted in an earlier report, if the ACCC were to believe that current market conditions were effectively competitive, then the prospects of declaration improving upon them would be poor and the case for declaration correspondingly weak⁶. However, the ACCC is careful not to present such a clear conclusion, taking instead a stance which I find offers both a rather bleak outlook for Australian consumers but which supports the ACCC’s claim that the prospects for any improvement from declaration are still likely to be rather limited.
8. It would be difficult for other regulators I know to declare victory on a market that was judged to be only ‘generally reasonably effective competitive’. Perhaps recognising this, the ACCC has

⁵ I am not certain that those responding to surveys will necessarily understand the difference between ‘quality’ and ‘coverage’ insofar as both relate to the capacity to access data or make a call. Results which rely on this distinction need, I think, to be treated with caution. If ‘quality’ is taken to refer to network speed or voice call quality, then the ANU/ACCAN survey suggest consumers attach significantly less importance to these factors than to coverage, see Table 31, p.74

⁶ Feasey 2nd Report, para 8

decided to consult on a range of measures other than declaration which it considers might improve the competitive dynamics of the Australian mobile markets and which it presumably thinks have better prospects of achieving results than declaration (or of achieving the same results for less risk). These measures are described in Section 9 of the draft decision. I make no attempt to assess them in this report. Normally, I would expect a regulator to take a view on the impact of other, supposedly less invasive, measures before assessing the case for declaring domestic roaming. The ACCC is proceeding the other way around. This means, I assume, that the ACCC's proposal not to declare domestic mobile roaming, and the analysis on which it is based, cannot rely upon any particular assumptions about adoption or effectiveness of these other measures. In what follows, I therefore ignore them, as I believe the ACCC must do in its final decision.

9. Thus, I understand the ACCC's position to be (although it does not say this in such clear terms in the draft decision) that it would leave the current retail mobile market undisturbed, even if it were to not to adopt any of the other measures outlined in Section 9. In other words, the ACCC's position is that it believes a 'generally reasonably effective competitive' market is sufficient to meet the needs of the Australian population, and that it is possible that nothing better can be obtained in the foreseeable future.
10. The next task is to understand the ACCC's position on the likely impact of declaration on competition in general and retail prices in particular. Section 6.2.1 contains the ACCC's views on competition in general, whilst 6.2.2. addresses the impact on retail prices.
11. All parties agree that declaration of domestic roaming would allow VHA and Optus to match Telstra's network coverage. However, the ACCC differs from both VHA and Telstra (Optus' position on this and other matters is much less easy to understand) in coming to the conclusion that this will not make much difference to competition in the retail mobile market and so will have little benefit for consumers. Again, the ACCC's position is expressed in rather convoluted language: that there is 'insufficient evidence' that declaration would improve competition to a 'significant extent' (page 51). This is not, therefore, a finding about what the evidence tells us, but a statement about the burden of proof which the parties - and VHA in particular - face in this enquiry. I take it to mean that the ACCC accepts that declaration could in principle have such a 'significant' impact, but that it does not believe it has evidence to come to this view. I examine whether this is a credible position for the ACCC to take in the next part of this report (see from paragraph 25 onwards).
12. The ACCC examines the impact on competition by considering regional consumers and urban consumers separately. It starts with regional consumers, apparently on the basis that it has found competition to be even less than 'generally reasonably effective' in regional areas and so the

prospects for improvement as a result of declaration would be correspondingly higher⁷. It finds that these consumers may not benefit much from declaration, or at all. This is for three reasons (page 52):

- a. First, it considers that regional consumers may already be able to access ‘relatively competitive prices’ - even though the ACCC finds elsewhere in the draft decision that they are likely to pay significantly more than their urban counterparts.
- b. Second, it considers that regional customers, like their urban counterparts, may not actually value coverage very much. In such a case, declaration would not alter their position.
- c. Third, it considers that other dimensions of competition which regional consumers do value, such as ‘quality’, may be diminished by declaration if we assume that VHA or Optus were otherwise to invest in their own networks in these areas. Those consumers that value ‘quality’ and who live in those areas would then, in the ACCC’s view, be worse off as a result.

13. The ACCC then considers the position of urban consumers. It first makes the same point as was made in relation to regional consumers: that there are ‘a large number of’ urban consumers who do not value coverage much and so declaration would have no impact upon competition for them (page 52). It then considers the impact on pricing, which I address below at paragraphs 16-23.

14. Before I do this, it is important to unpick the ACCC’s position on ‘quality’ for reasons that will become apparent later. As already noted, the ACCC does not accept that coverage is necessarily an important dimension on which firms compete, since it finds ‘quality’ and ‘reliability’ are more important to most consumers (pages 30-34). In taking this view, the ACCC seems to think that these other factors would, at best, be unaffected by declaration. However, the ACCC also implies (page 51) that it thinks ‘coverage’ and other network factors are, at least to some extent, currently being traded off against each other. That is, the advantage in coverage which Telstra enjoys over VHA and Optus forces the latter firms to improve their network ‘quality’ and reliability if they

⁷ I would have taken a different approach for several reasons. First, the large welfare gains from any intervention are likely to arise where the majority of the population reside, since even smaller effects on large numbers will outweigh large effects for small numbers. Second, the ACCC itself accepts that nationally averaged pricing ensures that it is the conduct of consumers in urban areas which will determine the prices which their regional counterparts will pay. Third, a ‘geographic approach’ ignores the critical feature of this case, which is that different customer segments face different competitive conditions based on their relative valuations of coverage, rather than where they live. It is true that regional customers have fewer providers from whom to choose, but what really matters in this enquiry is not more choice for regional consumers, but the impact of declaration on the prices paid by consumers who value coverage, wherever they reside.

cannot compete effectively on coverage (as the ACCC also assumes). Differences in coverage therefore ‘sharpen’ competition on other dimensions, including ‘quality’ but also price.

15. What happens if declaration then eliminates differences on coverage? The ACCC’s position might lead us to think that if differences in coverage are eliminated, then incentives to differentiate on other non-price network characteristics, such as reliability or ‘quality’ may also diminish. The ACCC is indeed concerned about Optus’ incentives to invest in network coverage and to differentiate on the basis of quality in areas where it does not currently have network, and which it believes declaration will weaken⁸ (in contrast, it does not believe VHA would invest much in new networks, with or without declaration). At the same time, the ACCC seems unconcerned about the impact of declaration on network quality in those urban areas where MNOs already compete with each other, since ‘the ACCC considers that MNOs already have strong incentives to compete on the quality of their networks in areas where there is infrastructure-based competition given the importance of network quality to consumers’ (page 73). This explains why the risk of diminished competition on ‘quality’ is restricted, in the ACCC’s mind, to those living in regional or rural areas (or served by those networks) and does not feature in the ACCC’s competitive assessment for urban consumers, who can continue to rely upon competition to safeguard their interests after declaration. I return to this important assumption in the next section (see from paragraph 25 onwards).
16. Before doing so, we need to consider the impact of declaration on retail pricing. The ACCC notes that it received conflicting arguments on the impact of declaration on pricing, some of which I offered in earlier reports⁹. The ACCC finds that it is not possible to determine what will happen with certainty, but that ‘any improvements in pricing are likely to be minor’ (page 55). This is because it appears to believe that some consumers will lose and some will gain under either of the two scenarios it presents, and that the net effect overall will be modest, even if still positive. It is difficult to be clear on exactly what the ACCC thinks about each effect, since it makes no attempt to quantify anything or to model it, as most other regulators would do.
17. I consider the lack of any attempt to quantify the likely effects of declaration to be a significant flaw in the draft decision. My earlier reports in this enquiry were both intended as an initial attempt to quantify, or at least place boundaries around, the various different outcomes which need to inform the overall calculus of the LTIE. My first report was an attempt to provide the

⁸ ‘The ACCC considers the incentive to differentiate itself is likely to be strong for Optus if it extends into the Telstra-only area. This is because it is highly unlikely that it will completely match the network reach of Telstra. As such, the ACCC considers that Optus’ incentives to make efficient investments to compete with Telstra on network quality in the Telstra-only area are likely to be affected by declaration’, Draft Decision, page 72. I do not assess the merits of this finding in this report.

⁹ Feasey 1st Report, paragraphs 60-85

outline of the model which I would expect a regulator to build, and the second included attempts to put some numbers on key variables, such as the likely magnitude of the profits which Telstra might derive from the market power it enjoys by virtue of its superior network coverage¹⁰. I would expect the ACCC, with the information gathering powers it holds, to do a far better job than I in modelling various scenarios and assumptions in order to better understand the likely consequences of its actions. I find this rather extraordinary, and in stark contrast with the way in which regulators in Europe or New Zealand would assess, for example, whether an intervention to reduce prices paid for MTAS would serve the LTIE. This involves a similar degree of uncertainty and controversy about the likely impact on retail prices, and the consequences for different groups of consumers, as the ACCC faces in this enquiry. Uncertainty leads regulators to model a range of scenarios and produce plausible ranges rather than precise results. But it does not mean they cannot or do not attempt the exercise. As examples of what I have in mind, the ACCC might consider the modelling which was undertaken by the Commerce Commission in order to understand the implications for consumers of proposals to reduce MTAS in 2006¹¹ or that undertaken by the European Commission in 2009¹². There are numerous other examples with which I am sure the ACCC is already familiar.

18. It is important when discussing prices to recall the distinction between absolute prices and quality adjusted prices, which both I and Professor Yarrow explained in previous submissions¹³. It is not necessary for retail prices to fall in absolute terms for consumers to be better off. Provided quality (by which we mean coverage in this context) increases, it may not be necessary for absolute prices to fall at all, and may even be possible for them to rise, whilst consumers may still be considerably better off. The ACCC's position is not as clear on this as it could be, but I understand their position to be that a significant number of urban consumers who do not value coverage could nonetheless be forced to take more expensive tariffs with greater coverage as a result of declaration. When an improvement in quality is imposed upon the customer in this way then any increase in price is to be regarded as both an absolute price increase and an increase in the quality adjusted price, because the difference in quality is valued by those customers at zero.

19. The impact of declaration on retail pricing is also likely to depend on two key assumptions:

- a. The first relates to the underlying wholesale prices which the ACCC would apply, as I explained in earlier reports¹⁴. If the ACCC were to set wholesale prices inappropriately,

¹⁰ Feasey 2nd Report, paragraph 35

¹¹ The model is available at <http://www.comcom.govt.nz/dmsdocument/4735>.

¹² http://ec.europa.eu/smart-regulation/impact/ia_carried_out/docs/ia_2009/sec_2009_0599_en.pdf, p.29-30 for summary results

¹³ A point made numerous times, for example Feasey 2nd Report, paragraph 72

¹⁴ Feasey 1st Report, paragraphs 97-152

this would affect prices in the retail market and could have poor consequences for consumers. However, I note that the ACCC's reservations about retail price movement do not rely upon any lack of confidence on its part when it comes to setting wholesale prices appropriately. The ACCC is confident that it could set an efficient price which allowed Telstra to recover the costs of maintaining and upgrading its existing network infrastructure (page 72) and I assume that such a price also underpins the ACCC's assessment of retail price effects in Section 6.2.2.

- b. The second relates to assumptions about the current level of retail pricing in general, and particularly of Telstra's prices. The ACCC examines this point briefly in p.39-40 of the draft decision. It finds that Telstra's prices are generally higher than for other MNOs and MVNOs. The magnitude of the price differential varies by tariff, but appears to be consistently higher in all cases, sometimes extraordinarily so. Although the ACCC claims that Telstra's prices are 'similar' for medium cost (\$40-59) plans, Telstra in fact only appears price competitive in plans above \$60. The ACCC concludes that 'Telstra's prices are subject to competitive constraint' (page. 39), which I note is not the same thing as saying that the ACCC regards Telstra's prices as being 'competitive' or that this 'competitive constraint' is strong. Firms with 'significant market power' are still subject to weak forms of competitive constraint. Moreover, this finding appears to rely entirely upon the observation that Telstra's prices for data have declined in recent years as support for this finding¹⁵.

20. I noted in earlier reports that Telstra's higher retail prices may reflect the higher costs and quality of its network¹⁶. This is an issue which might be resolved by careful examination of Telstra's profits or its network costs, and which I addressed in an earlier report when discussing the cost and coverage models which Ovum had submitted to the ACCC on behalf of Telstra and the statements Telstra executives made about withholding investment¹⁷. It appears that the ACCC has chosen not to address these points or the evidence I provided. Instead, its later conclusions about the modest impact of declaration on retail pricing rely upon an unsupported assumption that Telstra's current prices reflect its higher costs and not market power.

21. The ACCC accepts the claims of Telstra and Optus that the industry would be likely to adjust its retail prices in one of two ways in response to declaration (page 54). The first option, and it

¹⁵ There is, for example, no empirical examination of how Telstra's prices have moved in response to price changes from other firms, nor what those changes have meant for switching rates between firm.

¹⁶ E.g. Feasey 2nd Report, paragraph 8

¹⁷ Feasey 2nd Report, paragraphs 20-41

appears the most likely in the view of the ACCC, involves the retention of ‘nationally consistent pricing’. This has two potential consequences:

- a. The ACCC accepts that declaration would allow VHA and Optus to offer competitive services to those who value coverage, and that these are likely to be offered at prices which are lower than those offered by Telstra today. It provides no indication of the magnitude of the price effect, referring variously to ‘some reduction’ (page 51), that Telstra’s prices will ‘fall slightly’ (page 55) and ‘it is possible that declaration may not lead Telstra to lowering its prices to any significant extent’ (page 55). The ACCC concludes that ‘Overall, this would see regional consumers paying slightly less than they currently do’ (page 56). As I note later, the ACCC does not say whether urban consumers who value coverage might also benefit, although I have already noted that the ACCC attempts to argue elsewhere in the draft decision that most urban consumers value ‘quality’ and ‘reliability’ above coverage in any event.
 - b. The ACCC also believes that VHA and Optus may, as a result of declaration, require consumers who do not value coverage and who were otherwise content with their existing tariffs from VHA and Optus to now pay for higher price tariffs which offer national coverage which they do not value. The reason the ACCC gives for assuming that VHA and Optus would do this is because they would ‘prefer to use a simpler retail plan structure’ and because it ‘would lead to higher profits’ (page 56). If VHA and Optus were to do this, and consumers had no choice but to buy more expensive services which they did not value, then the effect of declaration would be to make them worse off.
22. The second option is described as ‘location-based’ or ‘de-averaged’ pricing, although the ACCC does not provide much detail as to how it might work in practice. The main scenario appears to involve VHA and Optus recovering the costs of roaming on the Telstra network from separate, usage based charges, rather than from a ‘nationally consistent’ or averaged prices which would allow a user to incur the same charges irrespective of the location at which they used the network. Assuming Telstra followed VHA and Optus in this practice, then regional users (and urban users who valued and relied upon regional coverage) might find themselves forced to pay geographic ‘usage based’ charges which reflected the higher costs of providing services in those regional areas. The ACCC considers that such users may find themselves worse off, relative to the charges they currently pay, as a result. The ACCC does not consider the impact upon the prices paid by urban users.

23. The ACCC also refers to an option in ‘MNOs move to offer two separate products, one with limited geographic coverage and a more expensive plan with greater coverage’ (page 56), which it seems to think has the same adverse properties as the move to ‘usage based’ charges in rural areas referred to in the previous paragraph. The ACCC does not, however, explain why it thinks this would be the case.
24. Before I turn to critically assess what the ACCC has said, I should note that I will assume, in doing so, that the ACCC takes the position which I advanced in an earlier report¹⁸, namely that the interests of all Australian consumers are to be weighed equally and that no particular set of geographic interests or preferences is to be accorded greater significance than any other. I say this because it is not always clear from the draft decision that this is the view the ACCC takes. On several occasions, for example, the ACCC refers to the potential for prices to increase for regional consumers, but makes no reference to the associated consequences for other groups of consumers¹⁹. Nonetheless, I will assume that when the ACCC refers to ‘improvements in pricing’ it has in mind the net effect on the welfare of consumers as a whole, which might result from reductions in prices for some groups of consumers and increases for others. I explain later why I do not think any consumer should expect to pay higher quality adjusted prices as a result of declaration, but even if that were the case, I assume it would still be possible for the ACCC to find declaration to be in the LTIE.

Does the evidence support the ACCC’s provisional conclusions?

25. In this section, I offer a critical assessment of the ACCC’s provisional findings insofar as they relate to the likely consequences for competition and for retail prices. I find the draft decision contains a considerable number of significant flaws, and that these arise either because the ACCC adopts positions which are logically inconsistent, which are at odds with or not supported by the evidence upon which the ACCC relies, or are conclusions for which no evidence is offered in the draft decision itself and which are contradicted by other evidence which the ACCC appears to have ignored or by basic economic theory. I conclude that, whilst no single error may be sufficient to cause the ACCC to adopt a different decision, the cumulative effect of the many errors which I identify in this section ought to lead it to abandon its draft decision against declaration and come to a different view.

¹⁸ Feasey 2nd Report, para 6

¹⁹ For example: “If MNOs move to offer two separate products, one with limited geographic coverage and a more expensive plan with greater coverage, or charge consumers more to use their services in regional areas, it would lead to higher prices for the use of mobile services in regional areas. Overall, this would disadvantage regional consumers and those who value coverage”, p. 56

26. I need to make two introductory comments before moving to the substance. First, it is common and probably appropriate for a regulator's 'provisional' findings to be presented in rather tentative and qualified terms. But I think some of the ACCC's language in the draft report takes this to another level; where competition is described as 'generally reasonably effectively competitive' and Telstra's prices are 'subject to competitive constraints' rather than being 'competitive'. I accept that the world is complex, predictions are difficult to make, and markets can rarely be described in black and white terms. But much of the ACCC's caution seems to arise from a lack of hard empirical evidence to underpin its views. I believe that much of the evidence which the ACCC requires to resolve points decisively one way or the other depends upon commercially sensitive data held by Telstra. This is data to which nobody other than the ACCC could obtain access, and which Telstra is unlikely to volunteer if it is unhelpful to its own commercial position, as it is likely to be. In such circumstances, I think it is incumbent upon the ACCC to exercise its legal powers fully, narrow the information gap and demand that the data now be provided under appropriate safeguards. If the ACCC does not have sufficient evidence on which to form a clear view in its draft decision – and then model it empirically- then it ought, in my view, to do everything it reasonably can to acquire it and to do so before making a final decision²⁰.

27. Second, I would urge the ACCC to step back from the detail and consider its overall position. As I understand it, the ACCC's position is that declaration of domestic roaming would have little impact on the lives of most Australian consumers or upon the commercial prospects of those who serve them. In the ACCC's view, VHA is wrong to think that being able to offer national coverage would significantly alter its capacity to compete with Telstra, and Telstra is equally mistaken to think that coverage confers significant competitive advantages or perhaps even market power which it ought to fight hard to retain. The senior management in all three MNOs have invested a substantial proportion of their organisation's resources in recent months on an issue which is, in fact, of little commercial consequence for any of them. Telstra's management was apparently prepared to invest a further \$450-550 million over 3 to 5 years in an attempt to preserve its current position, a claim which I take to provide a good but crude indication of the commercial value at stake for Telstra but which the ACCC apparently does not²¹. I assume the ACCC believes that investors were similarly misinformed about the likely consequences for

²⁰ I offered several examples of evidence for which the ACCC could ask Telstra in my 2nd Report: 'I would expect Telstra to have a good understanding of how different groups of urban users view the trade off between coverage and price, and think that information would be of assistance to the ACCC', para 18 and 'In my view, the ACCC ought to require Telstra to provide much more detail as to the profitability, properly measured, of its mobile operations over a significant period of time. In doing so, great care must be taken to ensure that costs which are common between Telstra's fixed and mobile businesses are allocated in a transparent and appropriate manner. This would allow the ACCC itself to form a clearer view as to whether Telstra's current prices are consistent with competitive returns', para 24.

²¹ Feasey 2nd Report, paragraph 41

competition and for Telstra's profits when they sent Telstra's share up 5% on the morning the ACCC's draft decision was announced²².

28. It is of course possible to reconcile these positions if the net impact on the LTIE were to be modest because some very large potential benefits were offset by some similarly large potential costs in the ACCC's overall calculus. In this case, the ACCC's decision might be finely judged even if both Telstra and VHA felt they each had a great deal to gain or lose commercially from the decision. But that is not the view the ACCC presents in this draft decision, which is that the marginal nature of any net benefit or loss arises because the benefits or losses are themselves marginal (albeit without making any effort to quantify what 'marginal' might mean in this context). I do not know, therefore, how the ACCC would reconcile its views with the conduct of the industry over the past year, both opponents and advocates of declaration. Perhaps it simply disregards it. I think, at the least, it ought to give the ACCC pause for thought before we consider the evidence in more detail.
29. I have already made a number of references to the ACCC's less than fulsome description of the mobile market as 'generally showing signs of reasonably effective competition', but there are a few more to make here. First, it is worth noting that none of the data which the ACCC offers in relation to market shares or industry price trends provides compelling evidence of effective competition, as I indicated earlier when presenting it. Other data, such as the fact that Australian prices compare relatively favourably with the US and Canada (page 28) provides no meaningful insights without knowledge of the costs of providing services in those markets. The key evidence to which most regulators I know would turn – the extent to which MNOs can sustain returns on their employed capital which exceed the cost of that capital – is not considered at all by the ACCC in the draft decision.
30. Second, the facts of the Australian market mean that we are not interested in some 'aggregate measure of competition', as is presented in the draft decision. It is, I think, accepted by all parties that an important feature of the Australian market is that different groups of consumers with different preferences enjoy different competitive outcomes. I explained in my first report why consumers who reside in urban areas and who do not value coverage are very likely to achieve effectively competitive outcomes²³. However, the position of consumers who reside in urban and regional or rural areas and who value coverage is quite different, since they currently face little

²² Indeed, if the ACCC's theory that declaration would allow the MNOs to tacitly co-ordinate to raise retail prices were correct and understood by the markets, Telstra's share price ought to have fallen when the draft decision was issued.

²³ Feasey 1st Report, para 72 and 82

choice but to buy from Telstra. The draft decision makes no attempt to assess, or even fully recognise, the differences in competitive conditions faced by different groups of consumers.

31. It would appear that a key reason why the ACCC has ignored differences in competitive conditions arising from differences in preferences about coverage is that the ACCC thinks that most consumers in urban areas and many in rural areas do not value coverage much, and that competition is instead conducted on other dimensions such as ‘quality’ or reliability. The ACCC is of course right that consumers will have a wide range of preferences and that operators will respond to these. But it does not follow that just because some consumers will switch networks because a network is unreliable or of poor quality (as the ACCC’s Figure 4 on page 31 and the discussion which follows it claims to show), that most or even many consumers regard either reliability or quality (which is in any event likely to be closely associated with coverage) as the key basis for choosing networks.
32. The ACCC seems equivocal on this point. It notes that Telstra itself submits that coverage ‘is an important factor for consumers when selecting mobile service provider’ (page 30) and the ACCC agrees that it does ‘certainly appear to be a factor in choosing service provider for many of those living in metropolitan areas’ (page 31) Survey data submitted by Optus also shows ‘coverage is the most important factor for most consumers’ (page 34). ANU survey data shows that network coverage was an important consideration in choosing a service provider for 75% of respondents (page 34). International data from Ovum suggests network coverage is the second most important factor after price (page 34). Bizarrely, the ACCC seems to think that the evidence just cited shows that coverage does *not* matter, since it then refers to [other] ‘market data which suggests coverage is an important factor in selecting mobile provider’ which is redacted (page 34). [c-i-c begins] [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED] [c-i-c ends] I do not understand how the ACCC, on the basis of the evidence it presents, can conclude that coverage ‘is not a determinative factor for a high proportion of metropolitan users’ and I do not know what it means by a ‘high proportion’. Would the 30% of customers in urban areas who subscribe to Telstra and pay less than \$60 a month represent a ‘high proportion’ of users? What if only a third of those users subscribed to Telstra for coverage reasons, and the others subscribed for ‘quality’ or reliability or some other reasons? The draft decision provides no insight.
33. What do the other consumers value? Many clearly value price, which is why VHA and Optus have, over a long period of time, (and MVNOs more recently) been able to obtain a significant

market share in urban areas by offering consistently lower prices (but inferior coverage) relative to Telstra. But if all consumers valued price and none valued coverage, Telstra would not be able to sustain a national market share of 45% whilst charging prices that the ACCC's own evidence shows to be very substantially higher than VHA or Optus for the many urban consumers spending less than \$60. The ACCC could, and should, ask itself (by asking Telstra) what proportion of the Telstra's existing urban customer base spends less than \$60, since these are customers who appear willing to pay prices substantially above those available from other suppliers on the market. Either these customers are hopelessly ill-informed about their options – in which case it is hard to see how the ACCC could find the Australian mobile market anything other than 'not competitive' – or they are prepared to pay more for better coverage or quality or both.

34. Telstra itself certainly believes that its customers value coverage, and the evidence of its conduct to which the ACCC refers supports this view. Telstra devotes a significant proportion of its advertising budget to promoting its coverage advantage over rivals, something which makes little commercial sense if the recipients of these claims do not care about it. It has also invested heavily to extend coverage to extremely remote rural areas, prior to the more recent co-investment arrangements with Government. These are investments which the ACCC itself accepts make little economic sense for other operators to replicate. Why would Telstra do this unless it expected to extract some form a commercial return from doing so? If only a small number of consumers cared about coverage, then it is difficult to see what form these commercial returns could take. And Telstra has not, so far as I am aware, written off the value of any of these coverage investments on the basis that it no longer expects to make a return upon them. Telstra's conduct is, in my view, wholly consistent with a view that a significant proportion of Australian mobile consumers value coverage highly, and wholly inconsistent with the ACCC's claim that they do not.
35. The ACCC's treatment of its own evidence on this point is also flawed and does not support the point which the ACCC seeks to make. In figure 4, the ACCC compares changes in retail market share with changes in network coverage and concludes that there is no correlation between the two. It goes onto argue, using data prepared by Analysys Mason for Optus (figure 5, page 32), that VHA's market share is more closely correlated to TIO complaints and concludes that 'service quality is also an important factor' in selecting a provider. However, the question the ACCC is seeking to answer in this enquiry is not 'why do some consumers move from or to VHA?' but 'can VHA and Optus compete effectively with Telstra for consumers who value coverage and, if not, how many such consumers might there be?'. I am afraid that the ACCC is trying to answer the wrong question.

36. First, the ACCC's Figure 4 compares population coverage and not geographic coverage with market share. The ACCC does not seem to have asked itself whether population or geographic coverage might be the more relevant measure and so does not present any evidence to support its choice of population coverage as the form of coverage that matters. This is an error in my view, for reasons which I explained in an earlier report²⁴. The ACCC's conclusion that Figure 4 shows that VHA and Optus fail to gain customers despite small improvements in population coverage simply confirms my view that it is geographic, not population coverage that matters. It also supports my view that it is large relative differences, not small absolute increments, that determine consumer behaviour when it comes to coverage. I explained in my first report that Telstra's coverage superiority extended to 1.4 million km², almost 20% of the total landmass, in 2015²⁵. Why would consumers who value coverage switch to VHA and Optus because population coverage had increased a few percentage points over the period, if the geographic coverage differences remain so vast? It would be surprising if many did. I also explained that if I were wrong and this were not the case then we would expect to see both VHA making incremental investments in coverage and gaining national market share as they went. Replication of Telstra's network, or something close to it, might then eventually be possible²⁶. The ACCC itself accepts in the draft decision that this is not how the market appears to be behaving or is likely to behave (page 45). As a result, the ACCC shares my pessimism as to the prospect of either VHA or Optus ever coming close to replicating Telstra's coverage footprint²⁷.

37. The TIO evidence is of no assistance either, since it shows that some VHA customers value reliability but tells me nothing about what the other two thirds of VHA's customers or those who subscribe to Telstra, value, nor how consumers in Australia will select networks in the absence of catastrophic network failures. None of this casts doubt on my central claim that the evidence of the conduct of the MNOs themselves, and the resulting prices and market shares we see in the Australian market, suggests that a significant proportion of the urban and regional population – although of course not all - either choose Telstra because they value the coverage its network offers, or would do so (and benefit) if that coverage were available at a lower price. I have not found any evidence in the draft decision which would allow the ACCC to come to a contrary conclusion and I think they are wrong to do so.

38. The ACCC's conclusion is odd. It finds 'no evidence that extensive coverage is essential for a service provider to compete in the national mobile service market' (page 34). It is not clear what

²⁴ E.g Feasey 1st Report, para 20-21, 2nd Report, para 44

²⁵ Feasey 1st Report, para 17-18

²⁶ Feasey 2nd Report, para 16. This was Professor Yarrow's view (that Telstra's was eventually replicable), but is a view which the ACCC does not accept (p.45)

²⁷ Feasey 2nd Report, para 42-57

‘extensive coverage’ means in this context, but if the ACCC means that a failure to match Telstra will not lead to Optus or VHA exiting the Australian mobile market, then the ACCC is addressing a claim which nobody has made, so far as I am aware. VHA and Optus could of course continue to compete for consumers who do not value coverage and I would expect those consumers will continue to be well served by the competitive process. However, the question at issue in this enquiry is a different one: whether VHA and Optus can compete for consumers who do value coverage and whether, if they cannot, those customers will end up paying higher prices to Telstra than they otherwise would if declaration were made. Despite my efforts to explain the analytical framework (on which I think both Professor Yarrow and I agreed) in my earlier reports²⁸, the ACCC fails to address the correct question in its discussion of coverage as a basis for competition in the draft decision.

39. Once we understand competition as relating to groups of consumers, and not to a single undifferentiated market, we can turn to the next question, which is whether VHA and Optus still constrain the pricing of Telstra, even if those operators are unable themselves to offer services which meet the coverage needs of a significant group of urban consumers.
40. Again, I explained this issue in my second report when discussing the ‘chain of substitution’²⁹. I explained that if the chain worked, low price offers with restricted coverage might still constrain Telstra’s prices. Urban consumers who bought Telstra services would be protected as a result and, through national pricing, so would regional or rural consumers. I explained that Professor Yarrow thought the chain worked, I argued that it did not.
41. Given the critical nature of this issue, I would have expected the ACCC to devote considerable attention to it in the draft decision. Instead I find the simple assertion on page 39 that ‘Telstra’s prices are subject to competitive constraint’. No evidence is offered to support this claim, other than that Telstra’s prices for data services have fallen in recent years. The implication of this is that firms who do not face competitive constraints never change their prices. Since this is plainly wrong, I find that the ACCC offers no credible evidence at all to support its claim that Telstra’s prices are being constrained through the operation of the chain of substitution. This is astonishing, given that this point is central to the issue of whether declaration would be in the LTIE.
42. It is useful to consider the evidence which the ACCC does present on pricing. This appears in Table 5 for post-paid tariffs. For prepaid, the ACCC simply says that ‘Telstra generally charges considerably more for data than other mobile service providers’ (page 39). This is an

²⁸ See Feasey 2nd Report, esp. para 7

²⁹ Feasey, 2nd Report, para 15

understatement at best. The ACCC actually finds that Telstra charges up to 10 times the price of its competitors for sub \$25 plans (on a unit cost basis) and twice VHA and Optus for plans in the \$40-60 range. Taken together, I assume these represent a significant proportion of prepaid users and plans.

43. Figure 5 reveals a similar picture for post-paid tariffs. Unit costs for sub \$40 plans are 3 times the price of VHA and Optus (actually 'more than' 3 times rather than 'nearly' 3 times, as the ACCC suggest in their commentary). The ACCC describes unit costs for more expensive plans as 'similar'. In fact, the figures show Telstra to be 66% more expensive than VHA and 25% more expensive than Optus for plans between \$40 and \$60 and 28% more expensive than VHA for plans above \$60. I find the ACCC's description of the data presented in Figure 5 to be misleading and inaccurate. It is difficult to avoid the impression that the ACCC is seeking to downplay Telstra's prices.
44. I do not know whether the ACCC's data is correct, but these are factual matters which ought not to be difficult for a competent regulator to determine and so I assume that it is. The question which then arises is whether it is reasonable to conclude, on the basis of this evidence (since the ACCC offers no other), that Telstra's prices are subject to competitive constraints.
45. It is theoretically possible to answer affirmatively and to conclude that Telstra's prices reflect differences in its costs of supply, or short term pricing power which will quickly be competed away. The second explanation seems implausible given that the prices being quoted for Telstra follow a significant reduction which the ACCC attributes to competitive pressures. Prices in earlier periods were even higher.
46. The ACCC could have examined the first theory by seeking to understand, as most regulators I know would, whether Telstra has been able to maintain non-competitive profits in its mobile business over a sustained period of time. I have suggested the ACCC ask Telstra for financial data which would allow it to do precisely that, but it appears that the ACCC has not done so. In the absence of such evidence, I also explained in an earlier report how the Ovum model submitted by Telstra might provide some indication of the profits which Telstra could extract from its coverage advantage and why this was evidence of market power³⁰. The ACCC's draft decision does not engage with this evidence either, or with the issue of Telstra's profits in any other context that I can see. I consider this a serious omission and a major flaw in the draft decision.

³⁰ Feasey 2nd Report, paragraphs 20-41

47. In the meantime, I am left asking myself whether the costs of providing coverage in regional areas is such that Telstra needs to charge a unit price to the majority of consumers which is between 25% and 1000% higher than that available from VHA or Optus in order to recovers all its costs. Are these prices which are subject to a ‘competitive constraint’ as the ACCC claims? It is impossible to be definitive, but I consider that pricing differentials of this magnitude are much more likely to provide evidence of significant market power than to reflect underlying differences in total Telstra’s costs relative to rivals³¹. Even if Telstra’s coverage means that its average unit network costs are 50% higher than VHA or Optus, then a significant number of Telstra’s customers are still paying substantially more than a ‘competitive’ price and Telstra will be earning significant (and sustainable) excess returns. These are matters to which the ACCC is required to turn its mind in this enquiry, but to which it has completely failed to do so.
48. Thus far, I find that the ACCC has failed to present any evidence which would allow it to conclude that the mobile market was ‘generally reasonably effectively competitive’. Even if the evidence on aggregate market shares, prices and other outputs supports the ACCC’s provisional conclusions on market performance – which they do not – they are of no relevance to the issue at hand. What matters in this enquiry is whether competition for consumers who value coverage is effective or, if it is not, whether it is constrained by competition for consumers who do not value coverage through the operation of the ‘chain of substitution’. Although Professor Yarrow and I disagreed as the findings on this point, I think we agreed that this was the correct analytical point from which to approach the issue. The ACCC’s draft decision fails to recognise any of this, and is deeply flawed as a result.
49. If this framework is adopted, two questions arise. The first is whether there are a significant proportion of consumers in both rural but also urban areas who value coverage highly and who would both choose a provider which offered superior coverage and pay non-competitive prices to do so. The second is whether, if such a group exists, they are nonetheless protected from excessive pricing by constraints imposed by competition for other consumers by means of a chain of substitution.
50. I find that the ACCC seeks to engage with the first question, but that the evidence it relies upon does not support its conclusions. It also ignores evidence which points to the opposite conclusion. It fails, first, to ask whether consumers value population or geographic coverage (or both) and

³¹ I use the term ‘significant market power’ to refer to Telstra’s capacity to extract revenues which significantly exceed its total costs, including a reasonable return on its investments. Any firm with large fixed costs, as Telstra has in providing coverage in regional Australia, will need to have a degree of market power in order to sustain prices above marginal cost (otherwise, Telstra (or VHA or Optus) would be unable to finance its activities over the long term). This why regulators invariably look to a firm’s profits to assess the extent to which firm earns returns beyond those required to cover its total costs, both fixed and variable.

relies only on evidence about population coverage. It also wrongly assumes that evidence that some consumers value other attributes such as reliability or ‘quality’ is sufficient to disregard coverage. It misinterprets and misrepresents the survey data on which it relies, and it ignores evidence from the firms themselves, both in submissions and in terms of their actual commercial conduct, all of which suggests that coverage is important to a significant proportion of Australian consumers and, hence, of commercial significance to the firms who compete for their business. I do not understand how a public authority can consider that commercial firms so misunderstand the preferences of their customers.

51. I find that the ACCC also fails on the second question, as to whether Telstra’s current retail prices reflect competitive constraints imposed by VHA and Optus. The pricing evidence which the ACCC does consider – but which it often misrepresents in the draft decision - shows that a substantial proportion of Telstra’s customers pay much more than they would for comparable services on VHA or Optus. Prices are not ‘similar’. However, the ACCC fails completely to take the next step and ask itself whether these differences in prices can be explained by reference to differences in network costs. It has made no attempt to assess whether the profits which Telstra earns from its mobile operations reflect the application of ‘competitive constraints’. Nor has it made any attempt to compare prices with costs. It has, in short, no evidence that would allow it to conclude that those Telstra customers who value coverage are paying ‘competitive’ prices today or that their interests will be safeguarded by ‘reasonably effective competition’ in the future. What evidence the ACCC does present in the draft decision points in the opposite direction.

Implications of declaration for pricing

52. I turn now to consider the likely consequences of a declaration for competition and for pricing. Some of this ground has already been covered since, for example, the impact of declaration on the prices paid by Telstra customers who value coverage depends upon your view of the prices which those same customers pay today. Similarly, if you think that very few customers in urban areas value coverage, then the effect of declaration is likely to be of little interest to the majority of customers and to have a very modest impact on the market. I have already provided my views on these points in earlier reports and, to the extent relevant, in earlier parts of this report.
53. Thus, in relation to competition generally, I have already considered the ACCC’s evidence that the prices paid by regional consumers to Telstra are already ‘competitive’ and that, in any event, consumers do not select Telstra on the basis of its superior network coverage. I have explained why I think both assumptions are false and why the evidence presented by the ACCC either does

not support them or in fact contradict them. It follows, as a matter of theory rather than evidence, that if the prices currently charged by Telstra are ‘excessive’, perhaps by a significant margin, then the introduction of more effective retail competition as a result of the declaration will, all else the same, result in a significant reduction in prices to ‘competitive’ levels. It also follows that, if a significant proportion of consumers in urban and rural areas do in fact value coverage significantly, then a significant proportion of consumers will benefit from a significant reduction in prices and the resulting impact on the LTIE will be much more significant than the ACCC suggests in its draft report³².

54. I then have a point to make about the impact of declaration on competition for ‘quality’ and reliability. I accept that a proportion of consumers will attach significant value to these aspects of the service, but I do not agree that declaration would have an adverse impact on either. To recap, the ACCC’s position is that ‘quality’ may be adversely effected because Optus may not extend its network in certain regional areas. I assume (and the ACCC does not appear to take a different view), that Optus would instead choose to roam on the Telstra network in these areas, as well as in areas where Optus would not have otherwise deployed any network at all. Is the ‘quality’ which Optus offers following declaration thereby diminished? I do not think so. The ‘quality’ of Optus’ own network is now supplemented by the ‘quality’ of Telstra’s network and, taken together, consumers who value quality will be unambiguously and substantially better off. I again find that the ACCC is asking the wrong question and making the wrong comparison in comparing the ‘quality’ that Optus offers today with that it would offer it extended its network. That is not, however, the relevant comparison and it is quite wrong to suppose that ‘quality’ can only be improved by building networks and not by roaming on another (high quality, reliable) network³³.

55. I do not address directly in this report whether declaration would have an adverse impact on investments in network quality (as opposed to coverage) and which would adversely affect those consumers who value quality. However, I have noted that the ACCC concludes that this is only a concern in relation to areas where MNOs do not compete with each other, and that competition between MNOs in urban areas is sufficient to avoid any such effect.

Nationally averaged prices

³² Note that the consumers benefiting from lower prices will be those currently obtaining coverage and paying higher prices to Telstra for it, but also those who currently with VHA and Optus who cannot afford greater coverage at Telstra’s current prices, but who would subscribe to a ‘competitive’ offer which offered more coverage at a better price, even if that price were more than they currently pay today.

³³ The same logic also applies to VHA, and so the aggregate gain in network ‘quality’ for consumers as a whole as a result of declaration is greater still.

56. The ACCC appears to come to a quite different, and in my view contradictory, conclusion about how MNOs might compete in the urban areas when it comes to consider competition not on quality but price. In the case of prices, the ACCC believes that competition will not protect consumers in urban areas. Instead, it argues that the three MNOs may, either of their own accord or as a result of tacit collusion (it is not very clear which), charge consumers (in urban areas who do not value coverage and would not use it) prices which are above the competitive level. The ACCC considers that the MNOs may do this because they would all ‘prefer to use a simpler retail pricing plan’ (presumably without tacitly colluding) or because it would produce ‘higher profits’ (which suggests tacit collusion). In coming to this view, they reject my earlier claim that such an outcome would be ‘far fetched’ (page 55)
57. Let us consider the tacit co-ordination issue first. The ACCC will know that it is not enough to argue that firms have an incentive to engage in a common activity because it would produce higher profits for all of them. All firms have incentives to avoid competition and to co-ordinate their activities in order to achieve such a result. Firms are unable to do so not because they do not want to, but because they are unable to ‘escape’ from competition. Formal agreements or cartels are unlawful and attract fierce penalties if they are detected. Absent such agreements, firms may seek to establish a ‘tacit’ agreement under which firms co-ordinate their conduct by observing each other’s behaviour rather than through formal agreement. In the case we are concerned with here, the MNOs would have to tacitly agree not to offer urban customers who do not value coverage a tariff which suited their needs, but to require them to take a more expensive nationally averaged tariff instead. Although all MNOs would profit by doing this, any individual MNO would also profit by deviating from the agreement and offering those urban consumers a cheaper tariff which better suited their needs. Moreover, in this particular case, establishing the tacit agreement would require that two of the three MNOs (VHA and Optus) withdraw tariffs that already exist in the market today³⁴. In most markets, the short term advantage which a firm will obtain from meeting a consumer’s needs better than its rivals ensures that competition prevails and that all firms compete. Tacit co-ordination requires conditions which are very unusual and cases of co-ordination in economic markets are few and far between. Cases involving the co-ordination of retail prices in telecommunications markets, as the ACCC proposes here, are almost non-existent³⁵.

³⁴ It would also require Telstra to desist from introducing a restricted coverage tariff of its own (see footnote 38) and/or withdrawing the MVNO arrangements which it currently has and which allow those MVNOs to offer restricted coverage tariffs on the Telstra network.

³⁵ I have been personally involved in almost all of tacit co-ordination cases in the mobile industry over the past 15 years, including those in Europe and Canada. I know of only one case in which an authority has claimed that MNOs can tacitly collude in pricing to a portion of the retail market, being Italy in the Hutchison/WIND merger

58. The ACCC claims that firms have incentives to raise prices in its draft decision but fails to engage in their capacity to do so. I am left to speculate as to how the ACCC expects the three Australian MNOs would co-ordinate to achieve the pricing outcome which it anticipates, nor what the conditions are which the ACCC regards as relevant to their ability to do so. However, the first and obvious point is that the ACCC cannot believe that the MNOs are able to co-ordinate their activities today, since it also finds current conditions to be ‘generally reasonably effective’. I take it that the ACCC could not and would not come to this view if it thought that the MNOs were already able to tacitly co-ordinate to sustain retail prices above the competitive level today. The evidence of differences in the prices charged by Telstra on the one hand and by VHA and Optus (and TPG, a prospective network entrant) on the other, already discussed, ought to be sufficient to demonstrate that they cannot. Something therefore needs to change in order that a tacit agreement could be established after declaration.
59. Second, as just noted, the ACCC has clearly said it does not think that the MNOs could co-ordinate in relation to investments in network quality following a declaration. On the contrary, it believes that competition between the operators will continue to ensure that quality meets consumer requirements. Thus, the ACCC’s position is that the MNOs *could not* co-ordinate on some important dimensions of competition, such as quality, following declaration, but that they *could* co-ordinate on prices to a particular group of consumers.
60. Two important questions then arise:
- a. Is it ‘far fetched’ to suppose that the MNO could co-ordinate so as to impose nationally averaged prices on urban consumers who do not value coverage?
 - b. If MNOs could and did impose such prices, does it follow that declaration would not be in the LTIE?
61. It is well established that there are a number of conditions which render markets more susceptible to tacit co-ordination of the kind which the ACCC seems to be anticipating. It is helpful if markets are reasonably stable, with little prospect of new entry (not the case here, with TPG entering), and if the firms have similar interests. Similarity of interest may occur if firms have similar market share, similar cost structures, and if they are able to ignore short terms benefits that may arise from deviating from the tacit agreement in favour of the long term benefits from co-ordination.

case (at http://ec.europa.eu/competition/mergers/cases/decisions/m7758_2760_3.pdf). The conditions in that market were wholly unlike those I observe in Australia.

62. The Australian mobile market has few, if any, of these characteristics today. Telstra dominates the market and appears to extract the majority of the profits that are earned (although I have noted that the ACCC has failed to consider the evidence which allow us to determine this conclusively), whilst VHA and Optus are both struggling to compete for various, but different, reasons. The firms have different market shares, network architectures and scope of their commercial operations. In order to sustain non-competitive prices and profits, as the ACCC suppose, these three firms would now have to tacitly agree to raise prices to their existing urban customers who did not value coverage whilst, at the same time, competing for urban consumers who did not value coverage (since the ACCC still expects prices for those consumers to fall, albeit ‘slightly’, rather than rise) and also competing for regional consumers. In other words, the three MNOs would all agree not to compete on price for a specific group of consumers, whilst apparently competing for every other group of customers and competing for all customers on quality and other non-price factors. Why and how could the MNOs agree to compete for some customers and not for others? How would they identify who was who? The draft decision does not say.
63. Nor does it explain why and how the ACCC expects firms to achieve this outcome. Nothing has changed in the market under this scenario except the introduction of a regulatory obligation upon access providers (e.g. Telstra) to supply domestic roaming services to access seekers (e.g. VHA and Optus). The ACCC, in other words, seems to be the agent of the co-ordination and the higher prices which the ACCC expects to arise. How might this occur? It is true that the introduction of domestic roaming will require some degree of technical interaction and co-ordination between the firms to implement the service. The conclusion of pricing arrangements may also involve some commercial interactions between the firms. But this is the case today, and has been the case in the past, when various commercial roaming arrangements have been introduced in Australia. So far as I am aware, the ACCC has never suggested before that such arrangements led to the co-ordination of retail prices, and it has not, so far as I am aware, presented any evidence in this inquiry that this had in fact occurred. Nor am I aware that any other regulator has ever suggested this when they imposed obligations to supply domestic roaming in their markets.
64. How would such agreements be implemented and enforced? The imposition of higher prices on reluctant consumers cannot be achieved by simply agreeing to retain existing arrangements or to avoid introducing lower prices in future. Instead, VHA and Optus must first both withdraw existing tariffs from the market and force their customers onto higher price tariffs which offer coverage which they do not value. There are large number of tariffs to withdraw, all of which may expire at different times. I note that the ACCC is sceptical about the ability of MNOs to impose usage based roaming charges on consumers because ‘this would be a fairly significant change from the way mobile services have been provided and priced for many years, which may mean

that MNOs are reluctant to adopt such a model' (page 56) but at the same time it appears to consider that forcing existing customers to migrate to higher price tariffs by withdrawing their existing tariffs can be accomplished, not just by one MNO acting alone, but through collective action by all of them. If one MNO were to fail to withdraw some reduced coverage tariffs by the agreed time (how would that date be decided?), then the other MNOs require an effective punishment mechanism to ensure that it does. The least incredible mechanism I can envisage would involve the other MNOs suspending the agreement and offering a reduced coverage tariff of their own. In such a case everybody would revert to the 'competitive' outcome in the hope that this will then persuade the deviating MNO to return to the terms of the agreement. Urban consumers who did not value coverage would find themselves offered attractive reduced coverage tariffs for a period, only to find that they are then withdrawn quickly as the co-ordinated agreement was restored. Thus, in the unlikely situation that such an agreement was implemented, it would quickly break down and competition would be restored.

65. So far as I am aware, no regulator or competition authority has ever contemplated a theory of tacit co-ordination of the kind that I have presented above and on which I think the ACCC would have to rely³⁶. It would seem to involve operators co-ordinating on the prices and terms offered to a group of customers, whilst competing on price for everybody else and on quality for everybody. It would involve the regulator being the agent which facilitates the establishment of the co-ordinated agreement. It would involve operators being prepared to collectively withdraw existing pricing arrangements from the market, but to then reintroduce them to punish anybody who deviated.

³⁶ See previous footnote. I know of no regulator that has found that regulated domestic roaming facilitates tacit co-ordination of retail prices. I am familiar with the views of the Canadian regulator, the CRTC. The CRTC decided in May 2015 that operators should provide inter-carrier roaming on a regulated basis, both in areas where access seekers had already deployed their own network or might do so in future, and in areas where they did not. The larger Canadian operators already had existing commercial roaming arrangements with many of the smaller operators but the CRTC effectively concluded that the existing suppliers were tacitly colluding when setting the terms of existing *wholesale* agreements (although it made no formal finding of collective dominance). The CRTC required the large operators to file a new set of 'cost based' tariffs with the CRTC by November 2015, including the supporting models and documentation, on a confidential basis. In the meantime, the CRTC capped roaming rates at then existing levels. Since then it appears that the larger Canadian operators have been engaged in a series of private negotiations with the smaller. One of these complained that the new terms of agreement were worse than those that already applied, leading the CRTC to issue a decision in November 2015 requiring the larger operators to reinstate the then existing terms alongside the new rates. In August 2016, the CRTC announced that it intended to allow firms to enter into negotiated arrangements which might differ from those required by the regulation (so called 'off tariff' rates), at least until the final regulated tariffs were approved. As far as I am aware, the CRTC has at no point suggested that the MNOs are able to engage in tacit co-ordination of *retail* prices, as the ACCC suggests in its draft decision. Rather, the CRTC has been concerned that it has failed to eliminate the opportunity for tacit co-ordination in *wholesale* markets. Two years later, the CRTC has still to impose rates itself.

66. Let us, instead, suppose that all of the MNOs (and MVNOs) in Australia share the same unilateral incentives, and that these lead them all to eliminate restricted coverage tariffs because it is ‘simpler’ to offer a single national tariff instead. What is the impact on consumers and the LTIE?
67. Declaration and the resulting capacity of VHA and Optus to offer coverage in regional areas would again mean that the nationally averaged prices offered by all three MNOs were lower than those currently charged by Telstra. These prices would likely be higher than those currently charged by VHA and Optus since they would need to reflect the need to contribute to the higher fixed costs of roaming in regional areas.
68. The consequences for those consumers currently on Telstra tariffs is straightforward – they are all unambiguously better off as nationally averaged prices for their existing services fall as a result of competition from Optus and VHA. The question that remains is by how much these prices fall.
69. The ACCC does not examine this issue, but it seems to assume that they would fall by the same amount as in the case where urban coverage tariffs were retained by VHA and Optus (and by Telstra via some of its MVNOs). In other words, the only thing that changes in the ACCC’s view is that the urban tariffs are withdrawn from the market. I am not sure that is a correct assumption. Whatever the tariff structure or tariffs offered, the introduction of competition between VHA, Optus and Telstra across all the market as a whole ought to compete prices (again, across the market as a whole) down to ‘competitive’ levels in which normal returns are earned on assets. If the higher costs of regional coverage are to be recovered from all users, irrespective of their valuation of coverage, then the price paid by each individual user ought to be lower than if these same fixed costs are to be recovered only from that part of the population which values coverage. Thus, I think it is more reasonable to suppose that the nationally averaged tariff would be lower if urban tariffs were withdrawn than if they were not³⁷. Those consumers currently on Telstra tariffs would, as a result, be even better off if urban tariffs were withdrawn, even though some of their urban counterparts would likely be worse off. In this way, the competition that is enabled by the declaration would ensure that consumers overall were better off, irrespective of the tariff structure which is adopted by the MNOs.
70. Moreover, the position of consumers currently on VHA and Optus tariffs if urban tariffs were withdrawn is complex and does not mean that are all worse off:

³⁷ I assume here that the regulated domestic roaming tariff would change to reflect the volumes of subscribers who purchased ‘roaming’ services, but that the fixed costs of coverage that are to be recovered remain unchanged and unvariable to subscriber numbers.

- a. Urban consumers of VHA and Optus who do not value coverage at all would be worse off as a result of being forced onto higher price national tariffs.
- b. Urban consumers of VHA and Optus who value coverage but are not currently prepared to pay the prices charged by Telstra for national coverage would now have an opportunity to pay lower prices in return for greater coverage. There are two groups:
 - i. Some consumers would willingly switch to a national tariff with greater coverage offered by VHA or Optus (or Telstra), even if a cheaper tariff with less coverage had remained available. These consumers will be better off, and would be unaffected by the withdrawal of the existing tariff because they would have switched anyway.
 - ii. Those who would still not willingly have switched to a national tariff at the new prices may be worse off as a result of the withdrawal of their existing tariff.

71. The net effect of all this is difficult to predict, but there is no reason to *assume* that consumers will be worse off overall *unless* the ACCC is claiming that the MNOs would tacitly co-ordinate their conduct. Absent this, it is not even clear that customers currently on VHA and Optus tariffs would be worse off, in aggregate (some will, but others won't). And Telstra customers will all be better off, since they will retain their current service at a lower price (lower even than they would obtain in the event that urban tariffs remained). This shows why the consequences of declaration for the LTIE is an empirical matter and not something on which the ACCC can come to a conclusion by assumption. If we are to rely on assumption, then we should assume that the additional competitive pressures that result from declaration will mean that consumers prices overall are lower, not higher, as a result.

Locally deaveraged prices

72. I turn now to consider the other scenario considered by the ACCC, namely that MNOs would offer different tariffs to different consumers depending on their coverage requirements. The ACCC seems to consider this a less likely outcome and, perhaps as a result, devotes even less attention to it in the draft decision. I think this is another error.

73. The brevity of the description on page 56 makes it difficult to always be clear what the ACCC has mind. One scenario appears to involve 'MNOs move to offer two separate products, one with

limited geographic coverage and a more expensive plan with greater coverage'. I understand this to mean that VHA and Optus would retain their existing tariffs, with reduced coverage, to meet the needs of existing or prospective customers, largely in urban areas, who value price but are prepared to compromise on coverage. At the same time, VHA and Optus would use the availability of domestic roaming on Telstra's network following declaration to introduce a new set of (more expensive) tariffs with coverage which matched Telstra and which therefore competed with it for consumers who value coverage greatly. In order for this strategy to be effective (i.e. switch customers away from Telstra), VHA and Optus would have to offer tariffs that are lower than those currently charged by Telstra. Given the evidence provided by the ACCC as to what Telstra currently charges, that ought not to be difficult. Prices payable by those on existing VHA or Optus tariffs would therefore remain largely unchanged³⁸. But prices payable by those taking the new VHA or Optus tariffs would clearly be lower than they would currently be expected to pay for an equivalent service from Telstra, and Telstra would likely lower its own tariffs in order to respond³⁹. No consumer would be worse off in these circumstances, and consumers as a whole would be unambiguously better off.

74. Far from considering this a less likely outcome, I consider this to be by far the most likely outcome of declaration in a competitive market in which different groups of consumers have different preferences in relation to prices and coverage (and no doubt other factors as well). I see it as the outcome to be expected in the absence of tacit co-ordination on the part of the MNOs. I therefore find it very strange that the ACCC should devote a single sentence to this outcome (which I explained at length in earlier reports), particularly when it also erroneously claims that it would 'lead to higher prices for the use of mobile services in regional areas'. Even on the ACCC's own evidence and reasoning, that is the wrong conclusion to draw.
75. To recap, the ACCC finds that the mobile market is already 'reasonably effectively competitive' and that Telstra's prices are 'constrained'. That means the prices currently paid to use Telstra's services in regional areas (where it is the only provider of such services) are considered by the ACCC to be reasonably competitive. The introduction of a domestic roaming service then allows VHA and Optus to compete with Telstra to offer those same mobile services in regional areas. Unless the ACCC is also to claim that in this scenario all three MNOs are going to tacitly co-

³⁸ I simplify. Lower nationally averaged tariffs will also place downward pressure on urban tariffs (i.e. there will be some substitution between the two), whilst Telstra may also compete more aggressively for urban consumers who do not value coverage in response to losing share amongst consumers who do value coverage. Tariffs offering urban coverage are therefore likely to fall (relative to the counterfactual) as a result of declaration.

³⁹ Telstra can be expected to reduce its existing tariffs as VHA and Optus acquire a share of customers who value coverage. But Telstra may also be prompted to launch its own reduced coverage tariffs (either under its own or under a sub-brand) in order to compete more effectively with VHA and Optus for consumers in urban areas who do not value coverage.

ordinate to raise prices to regional subscribers who value coverage (something which it did not suggest they could do in the ‘nationalised pricing’ scenario, where it thought that tacit co-ordination would be confined to exploiting urban consumers who did not value coverage, not regional consumers who did) then more competition from VHA and Optus *cannot* result in higher prices. At worst, prices are already effectively competitive and will be unchanged by the entry of two competitors. The question is therefore by how much prices might fall. Again, this is an empirical matter which the ACCC needs to address, but which it cannot answer by assumption.,

76. The ACCC seem to offer a third version of the ‘deaveraged’ pricing scenario, being one in which VHA and Optus continue to offer one set of tariffs for calls in urban areas, but another, likely ‘usage based’ set of charges to reflect the higher costs incurred when customers roam on the Telstra network in regional areas. It is also possible that Telstra might then follow suit, ‘de-averaging’ its own retail pricing so as to offer a higher price mobile service in regional and rural areas, reflecting higher coverage costs rather than any lessening of competition, but lower prices in urban areas, reflecting lower costs⁴⁰. The ACCC concludes that ‘Overall, this would disadvantage regional consumers and those who value coverage’ (page 56).

77. It is not clear that the ACCC considers this scenario very likely. Nonetheless, it merits considerations. I have just argued that the MNOs would retain a more limited ‘urban’ coverage tariff alongside a nationally averaged tariff in the event of declaration, so it is not unreasonable to ask why they might not also introduce a more limited ‘regional’ coverage tariff as well? The ACCC’s position seems to be that just as an ‘urban’ tariff which limited usage to low cost parts of the network would be likely to be cheaper than a nationally averaged tariff which assumed an element of usage in higher cost, regional areas, so a ‘regional tariff’ which limited usage to high costs parts of the network would be likely to be more expensive than a nationally averaged tariff.

78. I agree with these assumptions, but there is a flaw in the ACCC’s reasoning which I have explained at length in earlier reports⁴¹. This may be best illustrated by imagining that three tariffs are offered:

- a. A nationally averaged tariff, cheaper than that offered by Telstra today but more expensive than an ‘urban coverage’ tariff

⁴⁰ That is, the fixed costs of providing regional coverage would be recovered from those customers who utilise such coverage and the fixed costs of providing urban coverage would be recovered from urban customers. VHA and Optus only incur the latter types of costs, which their urban tariffs will reflect. Their regional tariffs would then be determined by the roaming costs they face, which I assume would include a contribution to fixed costs of regional coverage. Telstra would then ‘de-average’ its tariffs in order to match VHA and Optus.

⁴¹ Feasey 2nd Report, paragraphs 61-65

- b. An 'urban coverage' tariff
- c. A 'regional coverage' tariff which would be more expensive than the nationally averaged tariff referred to in (a), reflecting a higher contribution to rural coverage costs

79. Now consider the options available to consumers:

- a. Urban consumers who do not value coverage will not regard a more expensive nationally averaged tariff (a) as a good substitute for their lower cost 'urban coverage' tariff (b).
- b. A regional consumer facing an expensive 'regional coverage' tariff (c) will not regard a cheaper 'urban coverage' tariff (b) as a good substitute, since the latter does not provide the regional coverage which they require
- c. A regional consumer facing an expensive 'regional coverage' tariff (c) will, however, regard a cheaper nationally averaged tariff (a) as a good substitute, since it offers better coverage at a lower price

80. It follows from this that unless the MNOs can identify in advance where the purchaser of a particular mobile subscription lives, or where they intend to use their phone, or can otherwise prohibit regional users from buying nationally averaged tariffs, then what Professor Yarrow referred to as 'inter-area arbitrage' between (a) and (c) will be unavoidable. As a result, the MNOs will not be able to sustain 'regional' tariffs (c) but they will be able to retain low price 'urban' tariffs (b).

81. The only way in which MNOs might be able to retain separate 'urban only' and 'regional only' tariffs that I can see is if all MNOs were to:

- a. Impose 'usage based' charges which varied by geography such that a tariff which offered national coverage would offer different levels of usage (i.e. different unit costs of consumption) depending on the geographical location at which calls were made or data consumed. A consumer with a \$50 tariff who lived in a regional area would then find they could consume less data or make fewer calls than their counterpart in urban areas on the same tariff.
- b. Withdraw tariffs which offered national coverage and insist that all consumers choose between urban coverage only or regional coverage only tariffs. This would be despite the

fact that many consumers in Australia would clearly prefer to buy a tariff which offered national coverage. Consumers who wished to obtain national coverage would then need to acquire two tariffs, and possibly two SIM cards.

82. The same questions arise under either of these scenarios as arose in relation to the imposition of nationally averaged tariffs:

a. Is it 'far fetched' to suppose that the MNO could co-ordinate in the ways just described to impose de-averaged prices on all consumers?

b. If MNOs could and did impose such prices, does it follow that declaration would not be in the LTIE?

83. The same considerations apply in answering the first question as before. The ACCC would have to believe that all three MNOs would tacitly agree to withdraw the current nationally averaged tariffs and replace them with tariffs where the unit cost of consumption varied by geography (effectively the opposite of its 'nationally averaged' scenario). The MNOs would, in particular, have to agree on the geographic boundaries that would apply, and these would have to be broadly the same for each operator (otherwise the inter-area arbitrage issue would still arise). Any individual MNO would still have strong incentives to deviate from the agreement by reintroducing a nationally averaged tariff where the unit cost of consumption did not vary by usage, since they would gain a large number of regional consumers and urban consumers who value coverage (but who were currently being forced to buy two SIMs to achieve 'national' coverage) by doing so. There would therefore need to be some form of credible punishment mechanism to deter such conduct. As before, it is not clear what that would be, since if the other MNOs also reverted to offering nationally averaged tariffs that allowed for inter-area arbitrage, then the market would revert to non-coordinated, competitive outcome and the 'regional' tariffs would quickly be withdrawn.

84. I therefore arrive at the same conclusion as in relation to the scenario which envisaged the collective withdrawal of tariffs which offered limited coverage. So far as I am aware, no regulator or competition authority has ever contemplated a theory of tacit co-ordination to deaverage prices of the kind that I have presented above. The ACCC refer to Hutchison's introduction of 'usage based' charges in the past, but my understanding is that this was a unilateral action by one MNO and there was no suggestion of collective action or tacit co-ordination in that case. Again, the ACCC's scenario would involve operators co-ordinating on the prices and terms offered to a group of regional customers, whilst competing on price or quality elsewhere in the market. Again,

it would involve the regulator being the agent which facilitates the establishment of the co-ordinated agreement. It would involve operators being prepared to collectively withdraw existing, popular, simpler tariffs from the market and replacing them with more complex tariffs which we do not generally see in other mobile markets today.

85. This scenario also raises other issues. For example, if regional consumers could be forced to pay higher prices through the imposition of usage based charges which varied by geography, why doesn't Telstra, which faces little or no competitive constraints in regional areas today, already apply such charges? The ACCC's scenario requires us to believe that declaration, which otherwise results in more competition, will nonetheless also result in the collective imposition of a set of tariffs by all three MNOs which Telstra, facing less competition, is itself unable to impose today. I think that is indeed 'far fetched'.
86. Even if regional consumers were required to pay a different and higher price for their consumption, would declaration operate against the LTIE? Once again, I conclude that the ACCC is not entitled to come to this conclusion. It is an empirical question with which the ACCC has again failed, thus far, to engage.
87. It is obvious that the fact that regional consumers and those who value coverage may pay more than they currently do under nationally averaged pricing arrangements does not mean that consumers as a whole are worse off or that the LTIE is not thereby improved. Again, the effects are complex:
- a. First, more competition in rural areas as a result of declaration will mean that deaveraged prices will be lower than they might have been absent declaration. Whether they are higher or lower than the nationally averaged prices charged by Telstra today is an empirical question which depends, amongst other things, on the access charge arrangements which the ACCC adopted⁴². It is not possible to assume the answer.
 - b. Second, even if regional prices were higher (than today's nationally averaged prices) in the deaveraged scenario, they will be accompanied by lower prices for those using mobiles in low cost urban areas. Not only will these prices be lower than today's nationally averaged prices, but they will be lower than today's urban prices. Urban consumers who do not value coverage will therefore be unambiguously better off.

⁴² In this report I have ignored – as the ACCC have done - the question of how wholesale roaming charges might be structured, and the implication this might have for the structure of retail prices. I discussed this issue in my 1st Report, see paragraphs 132-134.

c. Third, I also take issue with the assumption that all consumers who value coverage will be worse off with price deaveraging. Under any tariff offered by a mobile operator, a consumer is required to buy a service which has a price based upon an assumed amount of usage across the network as a whole and a corresponding contribution to the fixed costs of providing that service. Those consumers who end up using more of the higher (fixed) cost parts of the network than the average will receive a 'subsidy'. Those users on the same tariff who use more of lower cost parts of the network than the average, or who simply use less altogether, will pay those subsidies. This reflects the fact that MNOs cannot perfectly match individual coverage requirements to the contribution which each consumer is asked to make to the fixed costs of providing coverage. The result is that there are subsidies as between different groups of users on different tariffs, as well as between individual users on the same tariff. Overall, the aim of the MNO is to recover its fixed network costs (and more, if it can) across its total population of users by making assumptions about their relative willingness to contribute. If, however, unit costs of consumption were to vary by geography then those who consume more services in the high fixed cost parts of the network would pay more (than the previous averaged price) but those who used less than the average in those same parts of the network would pay less. Consumers who were poor at anticipating or estimating how much they would actually use regional coverage would be likely to find themselves better off as a result of deaveraging. A better matching of prices to costs, combined with competition across a greater part of the market, is normally associated with better consumer outcomes and greater economic efficiency.

88. Once again I find myself returning to the same point, which is that the ACCC appears more concerned with distributional effects than with the LTIE. The 'deaveraging' of retail prices does not change the level of prices or the costs of providing and maintaining the network that need to be recovered. The extent to which those coverage costs are recovered and any excess profits are earned depends on the extent of competition or the opportunities which firms have to exploit market power. These determine the division of any surplus between consumers as a whole and producers as a whole. The structure of prices will undoubtedly determine how these surpluses are divided amongst different groups of consumers but, since the ACCC must treat all consumers as having equal weight, the structure of prices should be of little consequence in its assessment of the LTIE. That is why I have again focussed in this report on the question of whether a particular structure of prices might reveal a capacity on the part of the MNOs to tacitly co-ordinate. If the MNOs could tacitly co-ordinate, this would reduce competition and establish a degree of collective market power which would alter the division of any surplus between consumers as a whole and the MNOs. Consumers as a whole could well be worse off as a result of declaration if a

particular tariff structure arose from tacit co-ordination. But if a new retail tariff structure were to arise from competition instead (i.e. as result of the unilateral decisions that are taken by each firm), then there is no exercise in market power and consumers as a whole *cannot* be worse off, even if a particular tariff structure may still have adverse distributional consequences for particular groups of consumers. This is a critical point which it is not clear, on the evidence of the draft decision, that the ACCC has yet to fully grasp.

89. If the ACCC is to hold to the position that is offered in the draft decision, then I think it will need to explain in its final decision:

- a. how an increase in competition arising from declaration would leave consumers as whole worse off; or
- b. how declaration will allow the Australian MNOs to tacitly collude in order to leave consumers as a whole worse off; or
- c. how the ACCC can have regard to the distributional consequences of declaration and weigh the interests of some groups of consumers above those of others.

90. I consider that (c) is not available to the ACCC, and that (a) and (b) are both untenable for the reasons explained in this report.

Comments on the ACCC Draft Decision in its domestic mobile roaming declaration inquiry

15 June 2017

1 My instructions

- 1.1 I have previously submitted an expert report dated 1 December 2016 (my *First Report*) and a supplementary report dated 8 March 2017 (my *Supplementary Report*) to the Australian Competition and Consumer Commission (**ACCC**) in connection with the ACCC's current Domestic Mobile Roaming Inquiry (the *Inquiry*). The First Report outlined my opinions in my capacity as an economic expert in response to certain questions in relation to the Inquiry that had been put to me by Norton Rose Fulbright Australia (**NRFA**), legal representatives for Vodafone Hutchison Australia (**VHA**); the Supplementary Report provided comments on other parties' submissions provided to the Inquiry.
- 1.2 In May 2017, the ACCC released its draft decision in relation to the Inquiry (the *Draft Decision*). The ACCC has provided the opportunity for comment on its Draft Decision. I have now been instructed by NRFA to review and comment on the Draft Decision by the ACCC in the Inquiry. This Note outlines my resulting comments.
- 1.3 I acknowledge that I have read the Federal Court of Australia's Harmonised Expert Witness Code of Conduct and I agree to be bound by it. My qualifications and experience are outlined in the First Report.

2 Introduction and summary of conclusions

- 2.1 The ACCC in its Inquiry asked whether a wholesale roaming service should be declared in order to promote competition in retail markets and to encourage the efficient use of and investment in infrastructure and thereby promote the long term interest of end users (*LTIE*). In its Draft Decision, the ACCC has concluded that, given the current state of the market, declaration would not promote the LTIE to an extent that would justify declaration.

2.2 I have reviewed the Draft Decision. Based on this my review, it is my view that the Draft Decision has given insufficient consideration to, or erred in its consideration of, the following four main factors of central relevance to the Inquiry and the fundamental question posed by it:

- a. The impact of national pricing by Telstra and the other mobile network operators (*MNOs*) on the state of competition. The Draft Decision appears to have concluded that uniform pricing competition ensures competitive pricing in the remote areas. In my view, the Draft Decision has not sufficiently considered the potential for uniform pricing to dampen competition in the urban and other potentially competitive areas, despite submissions to the Inquiry on this point.
- b. The extent to which the differences in coverage are the outcome of genuine competition between the three MNOs. The Draft Decision states that it believes that Telstra's (and, to a lesser extent, Optus's) greater network coverage is as much the outcome of competition among MNOs as it is a competitive differentiator. In view of the high value that certain customers place on network coverage in choosing their provider, I would certainly agree that MNOs are likely to have the incentive to expand their coverage and to remain ahead of their competitors on this dimension of competition – or in the case of the other MNOs, to close the coverage gap. However, this incentive does not imply that all MNOs have equal *ability* to invest to expand their coverage. The Inquiry has been provided with substantial evidence that Telstra benefits in the Telstra-only areas from subsidies received to build facilities in those areas, and from the likely natural monopoly status of the facilities in those areas once they are built. Both these factors place the other MNOs at a substantial and likely highly persistent competitive disadvantage in terms of competition for coverage, with consequent likely substantial negative impact on the LTIE. In my view, the Draft Decision has not given sufficient consideration of these sources of asymmetry between Telstra and the other MNOs. These asymmetries make it difficult in my view to conclude that the differences in coverage are (as the Draft Decision concludes) the positive outcome of competition in a way that will promote the LTIE.
- c. The possibility for partial declaration featuring declaration of existing assets and technologies but access holidays for new investments and technologies. In making its decision, the ACCC's choices can include full declaration, no declaration, or partial declaration in combination with an access holiday for new investments/technologies, in accordance with its consideration of the policy mix that best promotes the LTIE. 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. However, the Draft Decision appears not have materially considered such partial declaration as being potentially the best alternative to promote the LTIE, and instead appears only to have considered the options of full declaration or no declaration before deciding in favor of no declaration, despite submissions being made to it on partial access holidays as viable policy options.
- d. Whether access pricing is feasible. Setting access prices in support of the mandated access to declared facilities is a well-understood science and art, at which the ACCC and many comparable international telecommunications regulators have significant

experience. In my view, while the Draft Decision has rightly written that determining an appropriate access price would be “challenging”¹, the Draft Decision has not given sufficient consideration to its ability to determine that appropriate access price on the basis of its and comparable regulators’ wealth of experience and technical expertise in this field.

2.3 The ACCC has produced a detailed consideration of a number of the factors relevant to the Inquiry in its Draft Decision. However, the Draft Decision might give more consideration to the four important factors I have outlined above. Due consideration of these factors is likely to be highly important in a full analysis of the impact of declaration on the promotion of competition in retail markets, and to encouraging the efficient investment in and efficient use of infrastructure – and therefore on the LTIE. It would be to the benefit of the LTIE for the ACCC to give further consideration to these factors before making a final decision.

2.4 I will now outline these four considerations.

3 The impact of national uniform pricing on the state of competition

3.1 Consideration of the impact of national pricing by Telstra and the other mobile network operators (*MNOs*) on the state of competition appears to be a key consideration in the Draft Decision. The Draft Decision explains that the ACCC considers “that national uniform prices mean that consumers benefit from effective competition in non-regional areas” and that “[w]hile some of Telstra’s prices are higher than those of its competitors, [the ACCC has] found that effective competition in the national market still constrains Telstra’s pricing”.² The Draft Decision also concludes that “it does not appear that Telstra’s coverage advantage is leading to significant competitive detriment in the national market or in regional areas”.³ Based on these statements, and other supporting statements in the Draft Decision, the Draft Decision appears to have concluded that uniform pricing competition ensures competitive pricing in the remote areas. The Draft Decision appears to dismiss the prospect that local monopoly power in the Telstra-only areas, combined with national pricing, may lead to a competitive detriment in both the Telstra-only areas and the non-regional (potentially competitive) areas. In my view, this conclusion is likely mistaken and difficult to reconcile with the evidence.

3.2 An important difficulty with the Draft Decision’s conclusion is that it has considered the potential transmission spillover mechanism in one direction but not in the reverse direction. The Draft Decision appears to rely on spillover effects from the competitive areas into the Telstra-only areas to conclude that competition in the competitive areas will restrain Telstra’s pricing, including in the Telstra-only areas, by way of the transmission mechanism of national uniform pricing. However, national uniform pricing can operate as a transmission mechanism in the opposite direction – it can operate to transmit the lack of competition in the Telstra-only areas into the competitive areas, thereby dampening competition in those competitive areas. The Draft Decision appears to rely on the first, without adequately

¹ Draft Decision, page 5.

² Draft Decision, page 3.

³ Draft Decision, page 3.

considering the second. However, in my view, the second is more likely – it is more likely, and more commensurate with that evidence, that Telstra’s market power (and the consequent lack of competition) in the Telstra-only areas will be transmitted into the competitive areas, with a likely dampening of competition in the competitive areas, by way of uniform national pricing. The apparent omission in the Draft Decision of adequate consideration of this mechanism is an important factor that materially influences important conclusions regarding the impact of declaration on the state of competition in the relevant markets, and conclusions that follow on from this, including the likely impact on the efficient use of infrastructure in case of declaration.

3.3 It is well established that market power in one product or geography can be leveraged into increased market power in another product or geography. The Inquiry was presented with evidence that these principles and mechanisms are well established and understood in the competition law and economics fields; moreover, they are commonly well understood and routinely applied by competition agencies including the ACCC. In a related context, it has been found that national uniform pricing in geographically dispersed grocery retailing markets can lead to a general strategic incentive to soften competition in competitive markets, and thereby to overall profits.⁴

3.4 The Inquiry was furthermore provided with expert evidence supporting the likelihood that Telstra’s market power in the Telstra-only areas is likely leading to higher prices in the competitive non-regional areas. My First Report outlined the economic mechanisms by which market power is likely being leveraged from the natural monopoly areas into the potentially competitive areas, and the extent to which these mechanisms are broadly accepted in modern competition economics, law, and enforcement. Moreover, the report by Mr Richard Feasey (the **Feasey Report**) concluded similarly, when he wrote that ““I consider that competition in Australia’s retail mobile markets is ineffective as a result of Telstra’s refusal to supply roaming. A relatively small number of consumers in regional Australia have no choice of supplier at all, since Telstra is the only firm to offer them coverage. A much larger number of consumers in suburban and urban areas which appear to be competitive are also ‘captive’ to Telstra because they value network coverage which neither of Telstra’s rivals, Optus and Vodafone, is able to offer today. Both sets of ‘captive’ customers pay too much for their mobile services as a result. Another group which also values coverage simply cannot afford it at the prices charged by Telstra today“.”⁵ This is consistent with the conclusions in my First Report.

3.5 In addition, the evidence presented to the Inquiry supports a conclusion that Telstra’s prices are higher, and that they are higher at least in part because of Telstra’s market power in the Telstra-only areas. The evidence to the Inquiry contained in the CIE Report is that Telstra’s prices are substantially higher than for equivalent prices by its competitors. The Draft Decision also accepts that “some of Telstra’s prices are higher than those of its

⁴ For instance, see Dobson, P.W., and M. Waterson (2008), “Chain-Store Competition: Customized vs. Uniform Pricing”, Warwick Economic Research Papers, No. 840.

⁵ Richard Feasey, Issues arising in relation to the ACCC’s domestic roaming declaration enquiry, November 2016, paragraph 5.

competitors”⁶, without concluding that there materially exist Telstra products for which prices are lower in an off-setting manner – it therefore seems to me that the Draft Decision appears to accept the existence of an overall price premium paid by Telstra customers.

- 3.6 It also appears to me uncontroversial that there are groups of customers who highly value or require wide national coverage and are willing to pay a greater price for it. This is consistent with the information on customer preferences provided by Telstra in its submission dated 2 December 2016, and it is consistent with evidence provided in the Feasey Report.
- 3.7 The Draft Decision also accepts that Telstra has a significant coverage advantage over the other MNOs and is the only provider that customers can choose if they need coverage in many regional and remote areas. For instance, the Draft Decision writes that “some consumers are likely to have a limited choice of mobile provider, and in many regional and remote areas, Telstra is the only viable network provider”.⁷ Moreover, the Draft Decision accepts that there is not effective competition in some parts of the wholesale mobile roaming market, finding that “in more regional and remote areas, and particularly in the Telstra-only areas, ... competition in the wholesale roaming market is not effective ... because Telstra is the only provider of roaming services in those areas, and has appeared unwilling to negotiate commercial roaming agreements.”⁸ Nonetheless, the Draft Decision dismisses the acknowledged ineffectiveness of competition in this market as less important than the downstream or retail market. However, as is expressed earlier in this Section, competition in the retail market is likely to be negatively affected by Telstra’s market power in the Telstra-only areas – competition in the retail market is therefore not likely to be a “cure” for the ineffectiveness of competition in co-locational parts the wholesale market.
- 3.8 Further illuminating the broader picture of the market, the Draft Decision appears to accept that for customers requiring coverage “in regional areas where customers do not have the same choice [as in urban areas], switching is less likely to occur”⁹, as a consequence of the differences in coverage. This lower incidence of switching by end users who have less choice is consistent with a lower level of competition, and consequently higher prices due to higher market power, at the retail level in those areas. The statement in the Draft Decision is therefore consistent with a conclusion that the level of competition is lower in respect of consumers who highly value wide coverage and who are thereby effectively bound to Telstra as a provider.
- 3.9 The broader picture before the Inquiry therefore is that:
- a. there are significant areas where customers do not have an effective choice of provider other than Telstra – including both customers who live in those areas and who live out-of-area but who value coverage in those areas; and
 - b. those customers pay a higher price because they are less able to switch away from Telstra.

⁶ Draft Decision, page 3.

⁷ Draft Decision, page 3.

⁸ Draft Decision, page 22.

⁹ Draft Decision, page 22.

- 3.10 This picture is the archetypical scenario of the existence of market power, leading to the existence of higher prices through dampened competition. This is likely to be the case both for customers within Telstra-only areas and for out-of-area customers requiring roaming service in Telstra-only areas. This conclusion is supported by the ability of Telstra to generally charge higher national uniform prices than its competitors, in the competitive urban areas as well as in the Telstra-only areas. The natural conclusion from this picture is that Telstra's market power in being the only provider in parts of the country is dampening competition both in the Telstra-only areas and in the potentially competitive areas. In my view, the opposite conclusion (as is proposed in the Draft Report) is difficult to sustain on the facts and difficult to reconcile with accepted principles of competition analysis. I encourage the ACCC to consider these factors more fully when deliberating on its final decision in forming a final view commensurate with the promotion of the LTIE.

4 Differences in coverage: the outcome of competition?

- 4.1 The second important factor in the Draft Decision is the extent to which the differences in national coverage are the outcome of genuine competition between the three MNOs.
- 4.2 The Draft Decision states that the ACCC believes that Telstra's (and to a lesser extent, Optus's) greater network coverage is as much the outcome of competition among MNOs as it is a competitive differentiator between the different MNOs. Differently put, the Draft Decision considers that Telstra's market power in consequence of the Telstra-only areas is the natural consequence of Telstra competing with the other MNOs to have superior coverage.
- 4.3 I would agree as a general principle that one of the dimensions of competition in Australian mobile telephony is competition over coverage, as I also stated in my Supplementary Report. Where there is competition over coverage, it is natural that MNOs will have an incentive to attempt to outstrip the coverage of their competitors. However, the reverse effect must also be true – just as Telstra has the incentive to compete with its competitors by exceeding their coverage through investment, its competitors also have a comparable incentive to invest to prevent Telstra from exceeding their coverage, or to catch up to Telstra's coverage.
- 4.4 Yet, on observing the outcomes in the market, one can see a very substantial difference in the level of coverage, and the likely persistence of this difference, as the salient feature of competition (or lack thereof) in the Telstra-only areas. The likely reason is that, while the other MNOs (Optus and VHA) likely have a comparable incentive to close the coverage gap, they do not have the comparable *ability* to do so, relative to Telstra's ability to establish and to expand the coverage gap. This is an important factor in explaining the apparent persistence of the coverage gap (accepted repeatedly in the Draft Decision). In turn, this likely persistence in the coverage gap going forward is likely to result in a persistence of a relative weakness in competition in the Telstra-only areas, and in the competitive areas by way of national uniform pricing.
- 4.5 The ACCC has been provided with substantial evidence that Telstra benefits in the Telstra-only areas from subsidies received to build facilities in those areas, and from the likely natural monopoly status of the facilities in those areas once they are built. The Draft

Decision acknowledges this in statements such as that “it is highly unlikely that [Optus] will completely match the network reach of Telstra”.¹⁰ A primary reason for the entrenched position of significant parts of the country as Telstra-only areas is that those areas are effectively natural monopoly areas, by virtue of the level of demand in those areas and the cost of serving those areas with facilities. The Draft Decision noted the importance of co-investment programs such as the Mobile Black Spot Program in extending services to a number of areas with low population density. Moreover, the Inquiry has received evidence that mobile telephony services in the lowest population density remote areas are likely to be natural monopolies, meaning that facilities in those areas would be uneconomic to duplicate and would be unlikely to be duplicated.¹¹ As a consequence, in my view the available evidence points to a strong conclusion that Telstra has a substantial coverage advantage that is *unlikely to be challenged* under the current arrangements.

- 4.6 Both these factors, the asymmetric subsidies received by Telstra to extend its coverage to the Telstra-only areas, and the natural monopoly characteristics of Telstra’s facilities once they have been constructed, place the other MNOs at a substantial and likely persistent competitive disadvantage in terms of competition for coverage, with consequent likely substantial negative impact on the LTIE. The Draft Decision appears to accept that there will likely be significant persistence in the coverage gap between Telstra and the other MNOs. However, in my view, the Draft Decision has not given sufficient consideration of these sources of asymmetry between Telstra and the other MNOs. These asymmetries are a fundamental source in the coverage gap, and the likely persistence in the coverage gap. The existence of these asymmetries make it difficult to conclude that the differences in coverage are (as the Draft Decision concludes) the “outcome of competition”.
- 4.7 Moreover, even if the coverage gap had been the outcome of a one-time process of pure competition (which I doubt, as explained above), this does not necessarily imply that this guarantees competition in the retail market in the future. In fact, this is unlikely to be the case here. Telstra, having achieved its position as the only provider in substantial sections of the geographic area of the country, is likely to maintain this position, and any putative future competition for coverage is unlikely materially to erode this position.
- 4.8 In coming to its conclusions that this is unlikely, the Draft Decision appears to be drawing obliquely on notions of “competition for the market” in concluding that competition over coverage leads to competitive outcomes as observed by retail consumers. Competition for a market rather than competition in a market can indeed lead to efficient competitive outcomes for consumers where competition is not otherwise feasible (e.g. because of natural monopoly considerations) – under certain conditions. First, an efficient auction or other allocation mechanism leads to the successful competitor being left with a competitive level of profits, rather than to monopoly profits. Second, and of crucial importance in this case, efficiency of competition for the market from the end consumer’s perspective typically requires either periodic re-auctioning, or post-auction price regulation. If there is neither periodic re-bidding nor post-auction price regulation, persistently inefficient market power is likely to result, to the detriment of consumers and the state of competition. This latter, unsatisfactory outcome

¹⁰ Draft Decision, page 71.

¹¹ First Report, Section 3.

is likely to be the situation in the markets in question. Telstra had the first mover advantage in certain areas, and it is now unlikely to be displaced as the only provider in those areas. As a result, Telstra has market power in respect of those areas that is likely to persist. In my view, this undesirable outcome has resulted in parts of the wholesale roaming market, *and* in those parts of the retail market affected by it, being afflicted by persistent market power that is unlikely to be displaced. This is because the coverage advantage of Telstra in the Telstra-only areas is likely to persist. In consequence, Telstra's market power affecting the wholesale market and the retail market that derives from it is likely to persist.

5 Access holidays for new investments and new technologies

- 5.1 The Draft Decision's preliminary view is that declaration of wholesale mobile roaming is not merited. An important aspect of the Draft Decision is that, in forming its preliminary view, it appears to consider principally the binary alternatives of no declaration and full declaration of the service at issue.
- 5.2 However, these two binary outcomes are not the only two options available to the ACCC. The Draft Decision may also have considered the important potential intermediary position of partial declaration combined with access holidays. This intermediate option might comprise partial declaration of services based on existing facilities and technologies but grants an access holiday for services based on certain new services and/or certain new technologies (I shall call this option ***partial declaration***). My understanding is that such a decision of partial declaration is open to the ACCC.
- 5.3 A decision of partial declaration would likely achieve most of the objectives and economic outcomes that promote the LTIE. In particular, in respect of preserving and enhancing efficient investment incentives, a decision of partial declaration would be likely to *enhance* those efficient investment incentives.
- 5.4 The Draft Decision, in discussing competition for coverage, recognizes that an essential element in this competition is the incentive to have greater coverage than one's competitors – to establish a coverage gap. Currently, investment incentives do not appear to me to be efficient. There is a persistent coverage gap. The Draft Decision recognizes that Telstra does not have strong incentives to further expand this coverage gap, meaning that Telstra does not currently have strong investment incentives. The Draft Decision acknowledges that, currently, "Telstra's commercial incentive to continue to increase its network is low".¹² The Draft Decision also recognizes that "Telstra is unlikely to have strong incentives to continue to expand its coverage footprint in the absence of government subsidies. As Telstra's current coverage footprint is already significantly bigger than its closest competitor, we do not consider that an additional increase in coverage is likely to provide materially more competitive benefit."¹³ In my view, this conclusion is correct, and likely also applies to incentives to upgrade technology in Telstra-only areas – Telstra's incentives to increase its network into new Telstra-only areas, and to upgrade its technology in the Telstra-only areas, is likely to be low.

¹² Draft Decision, page 71.

¹³ Draft Decision, page 70.

- 5.5 The Draft Decision also recognizes that the other MNOs are highly unlikely to invest sufficiently to match Telstra's geographic footprint, indicating that the other MNOs also do not have efficient investment incentives and abilities in respect of competition for coverage, for reasons including the likely natural monopoly status in Telstra-only areas as outlined above.
- 5.6 A partial declaration including access holidays on new facilities/technologies would have a strong prospect of reviving efficient investment incentives. Declaration of existing assets would substantially close the coverage gap (in addition to enhancing competition in retail markets): as a result, Telstra would receive a substantially increased incentive to re-establish its coverage gap. As a direct consequence, Telstra's incentives to expand its coverage would be immediately and substantially expanded – in a similar way, its incentives to upgrade its technology as a means of opening another gap with its competitors would also be immediately and substantially expanded. This would likely be materially supportive of the LTIE.
- 5.7 Combining partial declaration with targeted access holidays on new facilities or technologies would mean that these incentive gains are entirely preserved, to the benefit of the LTIE. An arguable difficulty for investment incentives created by full declaration is that this may dilute an MNO's incentives to expand its coverage, in particular if declaration is not accompanied by an appropriately set access price. Essentially, full declaration would mean that if Telstra invests in new facilities, the other MNOs would be entitled also to use the services of those facilities. An expressed concern with access provision is that where the access is not supported by an appropriate access price, this mandated access may thereby dampen the incentive for investment in those new facilities and technology upgrades.
- 5.8 If an access holiday is credibly granted on new facilities (and new technologies), this incentive problem can essentially be entirely avoided. This is the widely accepted core reason why targeted access holidays can be a desirable policy instrument to preserve investment incentives. As I address in my First Report, an access holiday is essentially an ex ante commitment by a regulator to an investor in a new facility (or technology associated with a facility, etc.) that it will not be subject to access regulation for a specific period of time. During that time, the owner of the facility can exploit those facilities as it chooses, including by charging prices for access that it wishes, or by denying access to that facility to competitors.¹⁴ An "access holiday" thereby is simply a period of time during which a new infrastructure facility would not be subject to any access regulation; during this time, the owners of the new facility would be free of mandated access and other regulation. Access holidays may be appropriate in circumstances where it is difficult to preserve the correct investment incentives on the access provider through the wholesale access price; they can potentially operate as tools to remove economically inefficient delays in infrastructure investment by the access providers that would otherwise occur as a result of the regulatory truncation of profits problem.¹⁵ They do this by enabling the regulatory authority to overcome

¹⁴ See J. Gans & S. King (2004), "Access Holidays and the Timing of Infrastructure Investment", *Economics Record*, Volume 80, Issue 248, page 89.

¹⁵ See e.g. J. Gans & S. King (2004), "Access Holidays and the Timing of Infrastructure Investment", *Economics Record*, Volume 80, Issue 248, pp. 89-100.

an inability to commit to *ex post* access prices, which prevents a hold-up problem and enables the socially-desirable investment to proceed. I also note in my First Report that the limited purpose of access holidays is to preserve the access provider's *forward-looking* investment incentives, which means that their application should be limited to certain upgrades (by which I include technology upgrades) and new sites; they are not generally appropriate for already existing infrastructure.

- 5.9 An access holiday thereby ensures that the operator is able to retain the entire benefits of investments in new facilities or technologies for the period of the access holiday. The arguable incentive problems potentially caused by mandated sharing of new investments (absent an appropriate access price) are thereby avoided, in particular if an appropriate time limit on the access holiday is set. This desirable aspect of access holidays is well known and broadly accepted. Similar strongly positive incentive considerations are also commonly understood to be the central mechanism in high-powered incentive regulation regimes for utilities – in those regimes, operators are typically entitled to retain the entire benefits of productivity improvements between regulatory reviews (typically on five year periodicity), thereby creating strong incentives for operators to invest in the desirable productivity improvements. In this way, efficient incentives on new facilities and technology upgrades can be substantially strengthened by the access holiday aspect of such a partial declaration.
- 5.10 Declaration of existing facilities would thereby be likely to enhance the investment incentive of Telstra to invest in new facilities and technology upgrades to re-establish its national coverage advantage. Access holidays on new facilities and technology upgrades would be likely to preserve this investment incentive by permitting Telstra to retain the entire benefit of these investments within the access holiday period. The consequence would likely be enhanced efficient investment incentives, enhanced competition for coverage, resulting in enhanced competition in retail markets and thereby in enhanced efficient use of infrastructure. The result would manifestly promote the LTIE.

6 Access pricing

- 6.1 The Draft Decision recognizes the likely benefits to the LTIE in the event of a declaration in the presence of an appropriate access price. The Draft Decision has found that “declaration, coupled with an efficient regulated price, would generally promote economics efficient investment in infrastructure”¹⁶. However, the Draft Decision has concluded that “pricing would be problematic”¹⁷, without providing significant elaboration.
- 6.2 Setting access prices in support of the mandated access to declared facilities that preserve desirable investment incentives is a well-understood science and art. The ACCC, along with many comparable international telecommunications regulators, has significant experience at access pricing with a view to preserving desirable investment incentives, including deep experience in access pricing in telecommunications industries. Moreover, to my understanding, the Inquiry has received substantial expert evidence regarding different concrete options for the setting of appropriate access prices, including concrete options

¹⁶ Draft Decision, page 64.

¹⁷ Draft Decision, page 64.

along with their respective properties and means of implementation, to assist the ACCC in evaluating the most desirable options for setting an appropriate access price. This evidence was contained in the Feasey Report and in the independent expert report by Frontier Economics (the **Frontier Report**), among other sources. In particular, the Frontier Report to my understanding found that each of the methods it proposed would have certain challenges in implementation but that none of these challenges was insurmountable. This is commensurate with my own expert experience that access pricing is a complex endeavor but that the complexities are commonly well managed by professional regulatory agencies with appropriate experience, including the ACCC.

- 6.3 While I was not asked to provide an opinion on access pricing in my First Report, I stated that that mandated access can encourage the efficient use of and investment in infrastructure, in the presence of an appropriate access pricing level and structure which preserves the desirable incentives (such as the incentives for the access provider to upgrade its network, upgrade extend its network, and invest in cost-saving technology). I also stated that an experienced telecommunications regulator will commonly be in a strong position to understand the various considerations relevant to setting an access price that preserves the desirable incentives on access providers and access seekers that result in efficient and desirable outcomes in the long-term interests of end-users. I remain of this view.
- 6.4 Therefore, while the Draft Decision has in my view rightly written that determining an appropriate access price is challenging, the Draft Decision has not given sufficient weight to its ability to determine that appropriate access price on the basis of its and comparable regulators' wealth of experience and technical expertise in this field. As a consequence, the Draft Decision has in my view underappreciated the prospects for a successful access price setting process in the event of a declaration, with consequent promotion of the LTIE process.

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