



23 February 2017

Dear Martyn

## **RESPONSE TO COMMENTS BY JJ PINCUS ON CIE HEDONIC REGRESSIONS**

### *Introduction*

We have been instructed by Norton Rose Fulbright, on behalf of Vodafone Hutchison Australia, to provide a letter giving our expert opinion with respect to the Report of JJ Pincus dated 24 January 2017, prepared on behalf of Telstra Corporation Limited. We have also considered the interpretation of the Pincus Report by Telstra in its submission to the ACCC on 25 January 2017.

A copy of our letter of instruction is set out in full in Annex A.

I have read the Harmonised Expert Witness Code of Conduct (annexure A to Federal Court of Australia Practice Note GPN-EXPT) and agree to be bound by it.

### *Response to Report of JJ Pincus*

The central arguments made in the Report of Professor Pincus can be distilled into three areas:

- 1 CIE interpret estimates of a price premium as reflecting the market power of providers, and this interpretation is not justified by their analysis
- 2 CIE compare Telstra's prices to the average of all other providers, instead of to the price of the second most expensive provider
- 3 A number of minor issues noted by Prof. Pincus

### *Interpretations of the price premium*

The main argument of the Report of Prof. Pincus is that the CIE has concluded, based on our statistical analysis of price premiums, that Telstra has market power, and that this interpretation is not correct. Statements made by Prof. Pincus in evidence of this are set out in box 1.

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## 1 Statements made by Pincus (2017) about market power

“The CIE stated that there is an explanation for Telstra’s premia – structural defects in the markets that have given rise to Telstra’s having market power” (Pincus 2017: 2)

...“unjustifiably interpreted their estimates of Telstra’s price premia as indicators of Telstra’s market power” (Pincus 2017: 3)

“the CIE identified Telstra’s excess premia as evidence of and measure of market power” (Pincus 2017: 4)

“Therefore, in its effort to measure the extent of Telstra’s market power” (Pincus 2017: 5)

... “the CIE would incorrectly attribute the price difference to market power, rather than to service differentiation” (Pincus 2017: 11)

“the CIE were driven to an unsatisfactory ‘explanation’ of Telstra’s price premia – market power” (Pincus 2017: 12)

“the CIE claimed that their statistical analysis ‘suggests that structural issues are limiting the ability for competition to drive down market prices’ (CIE 2016: 1), and that the excess price premia can be taken as indicators of the extent of Telstra’s market power” (Pincus 2017: 5)

We agree with Prof. Pincus that the price premium for Telstra by itself is not sufficient evidence of market power.

**The purpose of the CIE report and our statistical analysis was to estimate the price premium of Telstra over other providers.**

The CIE report does not seek to use statistical analysis to determine the cause of the price premium. The CIE report discusses interpretation of the price premium only in the examples set out in box 2.

## 2 CIE (2016) discussion of cause of price premiums

“The level of price premium for the incumbent in the Australian market does not appear in overseas markets we have considered in previous analysis (The CIE, 2015). This suggests that structural issues are limiting the ability for competition to drive down market prices.” (The CIE 2016: 1)

“Our 2015 work identified five main impediments to the functioning of telecommunications markets that have led to the market price premiums observed.

- 1 Telstra has historically received, and continues to receive, subsidies such as the Universal Service Obligation and NBN Co. agreement
  - Telstra has not used these subsidies to provide lower prices for Australian consumers
  - Instead, these subsidies have allowed Telstra to entrench its market dominance
- 2 Regulated transmission prices
  - The regulatory approach could lead to transmission prices exceeding the cost of supply
  - Telstra faces lower costs to providing downstream services than firms that are not vertically integrated, creating barriers to competition
  - The ACCC has recently reduced regulated price premiums for regional areas by 78 per cent,

reducing the influence of regulated transmission prices as an impediment to competition

- 3 Disparity in spectrum holdings in regional areas
  - The disparity in spectrum holdings between operators and the lower availability of spectrum in regional areas act as a barrier to competition
  - The release of more spectrum in regional areas will improve network quality for mobile communications if the licence holder utilises that spectrum
  - The high cost of spectrum creates a barrier to entry to the mobile market
- 4 Ownership and access to facilities (such as mobile base stations)
  - Co-location avoids unnecessary duplication of infrastructure and promotes competition
  - The current facilities access regime does not set prices, and therefore facilities access is effectively not mandatory
  - While access arbitrations have been effective at resolving disputes, they are rare
  - Co-location of mobile facilities is not common in regional areas where Telstra owns the vast majority of mobile base stations
- 5 Consumer decisions over telecommunications services show that consumers are slow to change
  - Shifts in market share away from Telstra as markets become more competitive shows that consumers take time to change to better value providers
  - Slow consumer response to better deals is evident in fixed line markets in particular
  - Changes to competition and reductions in Telstra’s price premium over other networks will take time to be reflected in market share as consumers will only change providers gradually
  - Impediments to better consumer decisions include a lack of systematic information about coverage and quality of mobile and fixed line services.” (The CIE 2016, pp. 2-3, pp. 6-7)

“The premium for Telstra reflects both limited competition and differences in service coverage, both of which have emerged from structural issues within the Australian telecommunications market. There are many areas where Telstra is the only service provider, particularly in regional areas. This means regional consumers are heavily affected by Australia’s telecommunications market structure.” (The CIE 2016, p. 6)

“The CIE (2015) estimated the price premium for fixed line services to be \$20/month, which is slightly higher than the \$17.6 premium estimated in the model presented in this report.

These results suggest that there has not been an overall trend towards increasingly competitive pricing since the CIE’s previous study.” (The CIE 2016: 30)

These statements do not support the view put by Prof. Pincus that the CIE’s work is seeking to estimate the extent of market power held by Telstra.

- The CIE report does not use the term ‘market power’.
- The CIE does not claim that the excess price premia can be taken as indicators of the extent of market power.
- The CIE report does not claim that its statistical analysis of the Australian price premium has identified structural issues.

- Prof. Pincus has quoted half a sentence in drawing this conclusion (Pincus 2017: 5). As shown in Box 2, the full paragraph notes that it is the differences in price premiums between Australia and other international prices that suggested structural issues.

**Comparison of Telstra plans and non-Telstra plans**

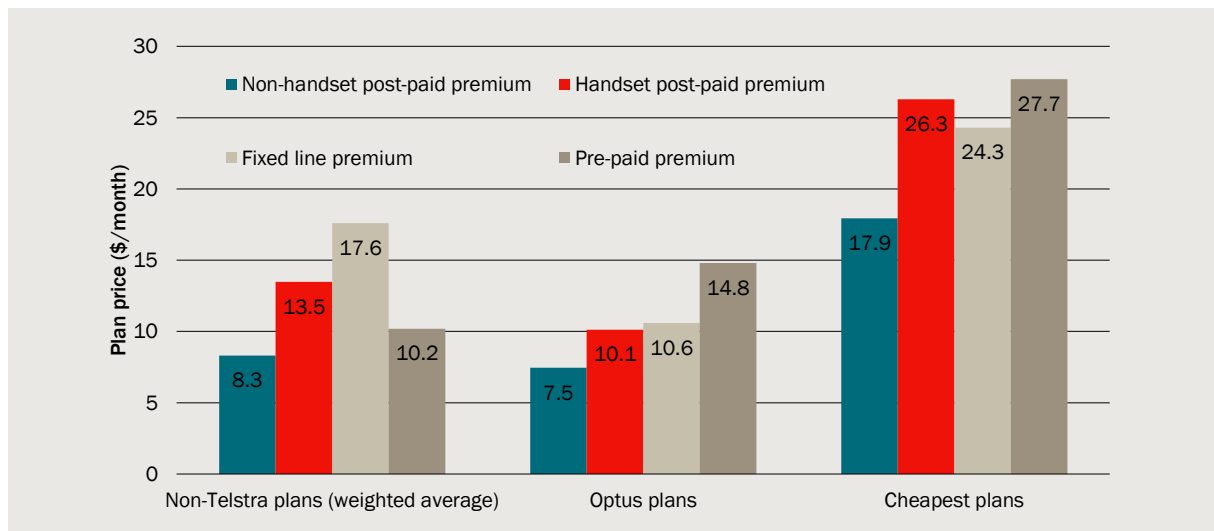
Our findings do support the conclusion that “Australian telecommunications consumers pay a substantial price premium to Telstra over other operators in both fixed and mobile services” (CIE 2016: 1). To justify this conclusion we have measured the weighted average difference between Telstra and non-Telstra plan prices.

If we had sought to justify the interpretation of the premium as reflecting market power, then a different comparison may have been relevant. Chart 3 shows estimates of Telstra’s mobile premium and fixed line premium relative to:

- non-Telstra plans (as shown in The CIE 2016),
- Optus plans (as discussed by Prof. Pincus), and
- The cheapest provider

Telstra’s post-paid premium (handset and non-handset) relative to non-Telstra plans is similar to the premium relative to Optus plans. The premium relative to Optus fixed line plans is lower. The premium relative to Optus pre-paid plans is higher. Telstra’s premium relative to the cheapest plans are much higher. These different premia may have different interpretations, however in our report we have clearly stated that our intention is to measure the premium for Telstra plans relative to non-Telstra plans.

**3 Different estimates of Telstra’s mobile and fixed line premia**



Note: The cheapest plans for post-paid, fixed line and pre-paid plans are those from Virgin Mobile, TPG Internet and ALDI respectively.  
Data source: The CIE.

### *Minor arguments*

Having addressed the two major arguments made by Prof. Pincus, we turn to other minor points made by his report.

- Prof. Pincus states that the CIE compares the price of Telstra plans to the average of other providers (Pincus: 2)
  - For clarity, the CIE compared to a weighted average of other providers based on their share of the market.
- Prof. Pincus states “The CIE data shows that one of Telstra’s competitors, Virgin Mobile, earns a premium over Telstra” (Pincus 2017: 2)
  - This statement is incorrect. Table 3.1 in our report (The CIE 2016: 20) shows that while the value of data is higher for Virgin Mobile post-paid plans, their plans have a large negative price premium. This is shown by the large negative coefficient on the Virgin Mobile provider variable for both plans with and without handsets.
  - The overall differences reflect a combination of the price differences for each attribute, with Virgin generally having one of the lowest overall prices depending on the bundle of characteristics.
- Regarding The CIE’s approach to accounting for included entertainment content, Prof. Pincus argued “the correct procedure would be, before running the regression, to subtract the value of content from the dependent variable, plan cost” (Pincus 2017: 11)
  - This assertion is not justified in Prof. Pincus’ report, nor why it would make a difference to the estimated premia.
- We also note that Telstra appears to have misinterpreted Pincus (2017)
  - “In any event, the ‘price premium’ identified by the CIE was dramatically overstated (by more than two thirds), including because the CIE focused on the difference between Telstra’s price and the average price of Telstra’s competitors” (Telstra 2017: 2)
    - ... The price premium was specifically defined as the difference between Telstra and a weighted average of other providers.
    - ... The overstatement referred to by Pincus (2017) was the fixed line premium, not the total price premium (which also includes the mobile price premium)
    - ... Chart 3 above notes differences for mobile and fixed line. The mobile price premia of Telstra relative to a weighted average is not more than two thirds higher than the mobile price premia relative to Optus
  - “The CIE’s analysis, in fact, shows Virgin has a price premium in post-paid mobile over all other competitors, including Telstra. The CIE’s assertion that price premium reflects market power is not credible in the face of the Virgin result” (Telstra 2017: 2)
    - ... Our results do not suggest Virgin has a price premium over all other competitors including Telstra, with Virgin typically one of the lowest priced brands.

### *Closing*

The CIE report sought to estimate the price premia paid by Telstra customers over other customers. The critique provided by Prof. Pincus does not refute our estimates of the Telstra price premium in any way.

The CIE agrees with Prof. Pincus that a price premium is not sufficient evidence of market power. This is not an assertion that was made in our report.

The CIE is happy to provide access to the dataset of mobile and fixed line plans collected and analysed for this project.

Yours sincerely



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23 February 2017

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**Confidential and privileged**

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Dear Phil

**Expert advice and opinion - ACCC Domestic Roaming Declaration inquiry**

We act for Vodafone Hutchison Australia Pty Ltd (**VHA**) and are authorised to engage you and the CIE to provide further expert report (**Report**) in connection to the above matter.

To the extent possible, you must observe the Federal Court of Australia's general practice note for expert evidence published in October 2016 in providing the Report (see Attached).

**Background**

On 5 September 2016, the Australian Competition and Consumer Commission (**ACCC**) commenced an inquiry into whether to declare a wholesale domestic mobile roaming service (**Domestic Roaming Service**). As part of this inquiry, the ACCC released a discussion paper (**Discussion Paper**) for public consultation on 26 October 2016.

Telstra Corporation Limited (**Telstra**) made 2 submission to the Discussion Paper:

- dated 2 December 2016 (the **Primary Submission**); and
- dated 25 January 2017 (the **Supplementary Submission**).

Both the Primary and Supplementary Submissions are published on the ACCC website.

**Instructions**

Please provide a report addressing the report by Professor Jonathan Pincus submitted by Telstra in its Supplementary Submission.

**Timing**

We will require the Report to be finalised by **13 March 2017**.

APAC-#40400560-v1

## Confidentiality and privilege

You agree that:

- this letter and all communications (whether electronically maintained or not) between us, and between you and our client, are confidential. These communications may be subject to legal professional privilege. Accordingly, please ensure that you mark all documents in the following manner: Confidential – subject to legal professional privilege;
- you must take all steps necessary to preserve the confidentiality of our communications and of any material or documents created or obtained by you in the course of preparing your report;
- you must not disclose the information contained in our communications or obtained or prepared by you in the course of preparing your report without obtaining consent from us;
- you must obtain our consent before disclosing to any person that you have been engaged to provide an opinion in this matter;
- you must not provide any other person with documents which come into your possession during the course of preparing this report, whether created by you or provided to you by us or our client, without obtaining consent from us.

Your duty of confidentiality continues beyond the conclusion of your instructions.

If you are ever obliged by law to produce documents containing any of this confidential information (whether by subpoena or otherwise) please contact us immediately so that we may take steps to claim legal professional privilege on behalf of our client.

Any internal working documents and draft reports prepared by you may not be privileged from disclosure and may be required to be produced in any subsequent litigation.

Please contact me on 02 9330 8056 if you have any questions about this matter.

Yours faithfully



Martyn Taylor  
Partner  
Norton Rose Fulbright Australia



## Attachment

### Extracts from the FCA general practice note for expert evidence

#### 4. ROLE AND DUTIES OF THE EXPERT WITNESS

- 4.1 The role of the expert witness is to provide relevant and impartial evidence in his or her area of expertise. An expert should never mislead the Court or become an advocate for the cause of the party that has retained the expert.
- 4.2 It should be emphasised that there is nothing inherently wrong with experts disagreeing or failing to reach the same conclusion. The Court will, with the assistance of the evidence of the experts, reach its own conclusion.
- 4.3 However, experts should willingly be prepared to change their opinion or make concessions when it is necessary or appropriate to do so, even if doing so would be contrary to any previously held or expressed view of that expert.

- ***Harmonised Expert Witness Code of Conduct***

- 4.4 Every expert witness giving evidence in this Court must read the *Harmonised Expert Witness Code of Conduct* (attached in [Annexure A](#)) and agree to be bound by it.
- 4.5 The Code is not intended to address all aspects of an expert witness' duties, but is intended to facilitate the admission of opinion evidence, and to assist experts to understand in general terms what the Court expects of them. Additionally, it is expected that compliance with the Code will assist individual expert witnesses to avoid criticism (rightly or wrongly) that they lack objectivity or are partisan.

#### **Harmonised Expert Witness Code of Conduct<sup>1</sup>**

##### **APPLICATION OF CODE**

1. This Code of Conduct applies to any expert witness engaged or appointed:
- (a) to provide an expert's report for use as evidence in proceedings or proposed proceedings; or
  - (b) to give opinion evidence in proceedings or proposed proceedings.

##### **GENERAL DUTIES TO THE COURT**

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

##### **CONTENT OF REPORT**

3. Every report prepared by an expert witness for use in Court shall clearly state the opinion or opinions of the expert and shall state, specify or provide:
- (a) the name and address of the expert;
  - (b) an acknowledgment that the expert has read this code and agrees to be bound by it;

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<sup>1</sup> Approved by the Council of Chief Justices' Rules Harmonisation Committee

- (c) the qualifications of the expert to prepare the report;
- (d) the assumptions and material facts on which each opinion expressed in the report is based [a letter of instructions may be annexed];
- (e) the reasons for and any literature or other materials utilised in support of such opinion;
- (f) (if applicable) that a particular question, issue or matter falls outside the expert's field of expertise;
- (g) any examinations, tests or other investigations on which the expert has relied, identifying the person who carried them out and that person's qualifications;
- (h) the extent to which any opinion which the expert has expressed involves the acceptance of another person's opinion, the identification of that other person and the opinion expressed by that other person;
- (i) a declaration that the expert has made all the inquiries which the expert believes are desirable and appropriate (save for any matters identified explicitly in the report), and that no matters of significance which the expert regards as relevant have, to the knowledge of the expert, been withheld from the Court;
- (j) any qualifications on an opinion expressed in the report without which the report is or may be incomplete or inaccurate;
- (k) whether any opinion expressed in the report is not a concluded opinion because of insufficient research or insufficient data or for any other reason; and
- (l) where the report is lengthy or complex, a brief summary of the report at the beginning of the report.

**SUPPLEMENTARY REPORT FOLLOWING CHANGE OF OPINION**

- 4. Where an expert witness has provided to a party (or that party's legal representative) a report for use in Court, and the expert thereafter changes his or her opinion on a material matter, the expert shall forthwith provide to the party (or that party's legal representative) a supplementary report which shall state, specify or provide the information referred to in paragraphs (a), (d), (e), (g), (h), (i), (j), (k) and (l) of clause 3 of this code and, if applicable, paragraph (f) of that clause.
- 5. In any subsequent report (whether prepared in accordance with clause 4 or not) the expert may refer to material contained in the earlier report without repeating it.

**DUTY TO COMPLY WITH THE COURT'S DIRECTIONS**

- 6. If directed to do so by the Court, an expert witness shall:
  - (a) confer with any other expert witness;
  - (b) provide the Court with a joint-report specifying (as the case requires) matters agreed and matters not agreed and the reasons for the experts not agreeing; and
  - (c) abide in a timely way by any direction of the Court.

## CONFERENCE OF EXPERTS

7. Each expert witness shall:
  - (a) exercise his or her independent judgment in relation to every conference in which the expert participates pursuant to a direction of the Court and in relation to each report thereafter provided, and shall not act on any instruction or request to withhold or avoid agreement; and
  - (b) endeavour to reach agreement with the other expert witness (or witnesses) on any issue in dispute between them, or failing agreement, endeavour to identify and clarify the basis of disagreement on the issues which are in dispute.