Australian
Competition &
Consumer
Commission

Mobile Services Review
Mobile Terminating Access Service

Final Decision **on whether or not the Commission should extend, vary or revoke its existing declaration of the mobile terminating access service**

June 2004

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to consumers on Optus' network.[7] All calls to the Optus mobile subscriber must ultimately be terminated on Optus' mobile network.

The Commission has also considered whether other substitutable means of contacting a mobile phone user (such as calls to a fixed-line network, SMS messages, e-mail messages or calls using voice over Internet protocol technology (VoIP)) might be effective in acting as a constraint on the pricing decisions of providers of MTASs. In all cases, the Commission finds these potential substitutes to be lacking in that they either do not replicate the mobility characteristic key to the convenience of calling someone on a mobile phone (in the case of contacting mobile phone users on fixed-line, VoIP or e-mail technologies), and/or do not provide for sufficiently substitutable real time communications (in the case of e-mail and SMS communications). Hence, the Commission concludes that these alternative forms of communication are not sufficiently substitutable to constrain providers of MTASs.

The Commission has also considered whether mobile phone users might be able to constrain the pricing decisions of MNOs. In this regard, some parties to this inquiry have argued that competition for mobile subscribers constrains mobile operators' pricing decisions for the MTAS. The Commission believes, however, that mobile phone users do not have sufficient incentive to base their subscription decisions on which mobile network charges the lowest prices for MTASs. This is because mobile phone users do not pay for calls made to them, and therefore do not pay for the MTAS. That is, under current retail billing arrangements, it is the 'calling party' who pays for most calls to mobile phone users. This billing arrangement is reflected at the wholesale level where it is the carrier whose consumer initiates a call that pays for termination of calls to mobile phone users. Hence, receivers of mobile phone calls do not have to pay for calls made to them, and do not need to pay for the MTAS. Accordingly, mobile phone users generally have no incentive to insist that the mobile network they subscribe to sets lower charges for the MTAS.[8] The Commission therefore believes MNOs are unlikely to be constrained in their pricing decisions for the MTAS by potential subscribers to their network.

Accordingly, the Commission finds that all mobile operators – irrespective of their size – have market power when it comes to terminating calls on their network. In turn, the Commission believes this gives mobile operators the ability to raise the price of the MTAS above its underlying cost of production. This conclusion is consistent with that made by regulators in a number of overseas jurisdictions.

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7 While the Commission acknowledges Vodafone could, via a transit arrangement, provide termination for carriers seeking to interconnect with Optus' GSM mobile telephony network, Vodafone would still, ultimately, need to seek termination of the call from Optus. Accordingly, the Commission believes that such transit arrangements do not overcome the control providers of MTASs have over access to essential infrastructure.

8 The Commission notes exceptions to this can exist where individuals purchase mobile phones for close family members. The Commission expects this segment of the market is not, however, significant enough to constrain mobile operators' pricing of the MTAS. The Commission also believes that mobile operators are able to segment this portion of the market effectively through the use of 'on-net' call plans.

Pricing structures likely to emerge in markets for mobile terminating access and retail mobile services

Not only do MNOs have the ability to raise the price of the MTAS above its underlying cost[9] of production, the Commission believes they also have an incentive to raise prices above cost (inclusive of a normal profit on infrastructure investments). By doing so, mobile operators generate greater-than-normal (or so-called 'economic') profits from providing the MTAS.

Each mobile subscriber therefore brings with it a source of economic profits as it enables the mobile operator to charge above-cost prices for calls made to him/her. As a result of this, the Commission believes that mobile operators may, depending on the level of competition they face when attracting subscribers to their network, seek to attract more subscribers to their networks by subsidising the prices they offer potential mobile subscribers for retail mobile services. This suggests mobile operators may have an incentive to transfer part of the economic profits from pricing the MTAS above cost to retail mobile subscribers in the form of subsidised prices for retail mobile services (e.g. handset subsidies, free access plans etc.). The greater is the level of competition for retail mobile services, the greater will be the incentive to transfer economic profits earned from the MTAS to retail mobile subscribers. The Commission believes, therefore, that mobile operators may determine a cross-subsidised structure of prices with higher-than-cost prices for MTASs and below-cost prices for some retail mobile services.

These expectations are supported by market observations that mobile operators appear to be setting charges for the MTAS that are likely to be at least double the underlying cost of providing this service.[10] Further, in retail markets for mobile services, mobile subscribers are often offered free handsets, or subsidised subscription charges, although there is no evidence that mobile retail pricing as a whole produces insufficient revenue to cover costs.

Impact on the state of competition in the market within which FTM services are provided

One implication of this pricing structure is that above-cost prices for MTASs increase the costs of an essential input for providers of FTM calls. That is, in order for providers of FTM calls to provide this service to their consumers, they need – because of the CPP billing arrangement referred to above – to pay a fee to mobile operators to terminate FTM calls. By raising the price of MTASs above cost, mobile operators increase the cost to providers of FTM calls above the underlying cost of production for this service. In turn, this raises the price of FTM calls.

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[9] References to cost in this report refer to the total service long-run incremental cost (TSLRIC), that is inclusive of a normal return on investment. Where also inclusive of a mark-up to account for some contribution to common organisational-level costs, this measure is sometimes referred to as 'TSLRIC+'.

[10] This is based on observations that the average price charged for the MTAS is 22.5 cents per minute, while estimates of the underlying cost of the service range between approximately 5 and 12 cents per minute. Full specification of the basis for this range of cost estimates can be found in Annexure of this report.

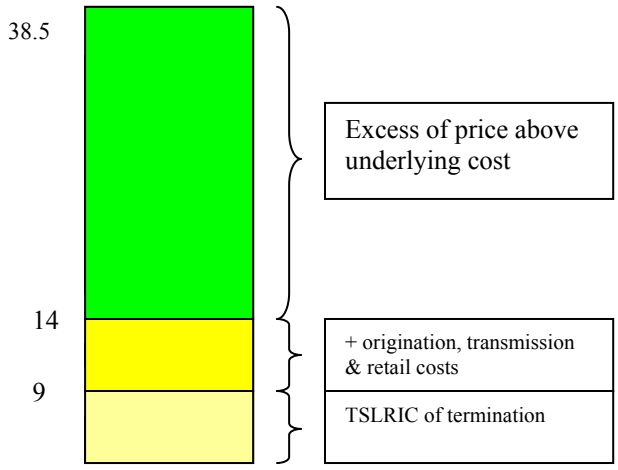

Figure 3 – The excess of the average price for FTM calls above underlying cost

In addition to this, observations coming out of past annual reports prepared by the Commission on price changes for telecommunications services in Australia (the Division 12 Reports) show that the price of FTM calls has declined more slowly than that of other fixed-line services over recent years (despite significant increases in volume and hence expected cost savings due to economies of scale).[12] These observations emerge even more starkly in the recently released Division 12 report for the 2002-03 financial year, which shows the average price of FTM calls fell by less in real terms across all consumer groups during 2002-03 than in previous years. Further, the results show the average price paid by residential consumers for FTM calls increased in real terms over this period by 5.0 per cent.

Overall, the analysis in Chapter Four leads the Commission to believe that the market within which FTM calls is provided is far from effectively competitive. This is leading to higher-than-cost prices for FTM calls and, consequently, substantial losses in consumer welfare. Relative to a competitive market where the price of FTM calls would be expected to more closely resemble a conservatively estimated underlying cost of around 14 cents per minute, the Commission estimates that the current average price of 38.5 cents per minute is reducing consumption of FTM calls by around 2.2 billion minutes per annum.

[12] For instance, in previous years, the average price paid for FTM services declined by 7.9 per cent in 1999-00, 6.2 per cent in 2000-01, 3.2 per cent in 2001-02 and 2.4 per cent in 2002-03. This compares with the average price paid for national long distance (NLD) calls which fell by 9.5 per cent, 6.3 per cent, 8.7 per cent and 4.7 per cent over the same periods. Telstra's Annual Report for 2002-03 also showed that while revenue from FTM calls is now greater than that for NLD calls, the number of FTM call minutes was less than half that for NLD services. This implies a yield for FTM call minutes more than double that of NLD calls.

By continuing to declare a MTAS, the Commission believes competition in the market within which FTM services are provided can be improved. This would be the case if a pricing principle can be devised for the MTAS that ensures a closer association of the price of the service with its underlying cost of production. In doing so, the ability of vertically-integrated fixed and mobile carriers to raise the costs of rival providers of FTM services that do not operate mobile networks would be eroded, and consequent reductions in the price of the FTM service could be expected. Removing the ability of vertically-integrated fixed and MNOs to raise rivals costs could also help to remove their ability to leverage their market power in the market within which FTM services are provided into the retail mobile services market.

Further, setting the price of the MTAS above its underlying cost of provision gives vertically-integrated operators a 'cushion' that enables them to withstand the competitive threat that a more efficient operator in downstream markets could present. Declaration, combined with a pricing principle that ensures the price of the MTAS reduces towards its underlying cost of provision, can ensure equally or more efficient carriage service providers can place competitive pressure on vertically-integrated providers of FTM services to improve their own efficiency and reduce prices paid by consumers of FTM (and possibly other fixed-line services supplied in combination with FTM services such as national long distance and international long distance call) services. Hence, the Commission considers that regulated MTAS charges would provide a stimulus for increased competition from existing FTM providers, and possibly from new entrants. This increased competition can manifest itself in many ways, including reduced prices and improvements in the quality and range of product offerings made available by providers of fixed-line services.

While some parties are currently concerned that reductions in mobile termination rates may not be 'passed-through' to FTM consumers in the form of lower prices for FTM services, the Commission expects that increased competition in the market within which FTM services are provided would create pressures on all providers of this service to pass-through reductions in the price of the MTAS to end-users. If a provider of FTM services chooses not to pass-through reductions in the price of the MTAS, it runs the risk of losing market share to competitors who do. The Commission notes, however, that such pass-through may come in many forms other than simply reductions in the price of FTM call services. For instance, it could also come in the form of reductions in the per call prices of other services sold in the same pre-selected bundle of fixed-line services that also includes national long-distance and international long-distance calls. Further, pass-through may not be uniform across all classes of consumers.

Finally, observations of incomplete pass-through do not necessarily mean that competition has not been improved. As indicated above, improvements in competition can manifest themselves in many forms other than simply full pass-through of price reductions to FTM services.

Impact of declaration in the market within which retail mobile services are provided

As indicated in Chapter Four, the Commission believes that, while the retail mobile services market is exhibiting more encouraging market outcomes than the markets for fixed-line telecommunications services, it is unlikely to be effectively competitive as yet. This is because there continues to be a high level of concentration at the carrier network level (where the combined share of Telstra, Optus and Vodafone is greater than 97 per cent of the market); barriers to effective entry into the market (associated with national coverage and sunk costs) remain high; and established mobile operators (and in particular Telstra and Optus) appear to be earning profits well in excess of those the Commission would expect in competitive markets for these services. In addition to this, the Commission notes that reductions in the prices paid for retail mobile services appear to have slowed in recent years, with some indication that prices increased, on average, during the 2002-03 financial year.[13]

Despite this, the Commission expects the greatest competitive benefit from continued declaration of the service is likely to occur in the market within which FTM services are provided. That said, the Commission expects that declaration has the potential to help promote competition in the retail mobile services market to the extent it serves to overcome the ability established mobile operators might have to frustrate new entrants interconnecting with established networks on reasonable terms and conditions. This issue is discussed in more detail in Chapter Five. The Commission also believes that declaration of the MTAS will lead to a more efficient use of and investment in the infrastructure used to provide retail mobile services. This is discussed in detail in Chapters Six and Seven.

Whilst declaration may be expected to put in place pre-conditions that help to promote competition in the retail mobile services market, the Commission recognises that declaration is likely to affect different mobile operators in different ways. In this regard, the Commission has considered arguments from some mobile service providers that substantial reductions in the price of the MTAS might weaken their competitive position as compared to vertically-integrated fixed and mobile operators. This is because these parties believe there is no imperative on fixed carriers to 'pass-through' lower prices for the MTAS to consumers of FTM services. Accordingly, these parties are concerned that if mobile network operators are required to lower mobile termination rates, their vertically-integrated competitors who operate in the market for FTM services will experience lower input costs without having to reduce the prices they charge for FTM services to the same extent. Further, these parties believe a reduction in the MTAS prices will reduce the revenues of mobile operators more generally, such that they are less able to invest in and deliver new services and keep the retail mobile market competitive.

In general, and as indicated above, the Commission believes that all mobile operators have the ability to raise the price of the MTAS above its underlying cost of production, and that this enables them to earn economic profits when providing this service. Accordingly, all mobile operators are likely to experience reduced economic

[13] That said, the Commission does not believe this necessarily implies it would be appropriate for there to be regulation of retail mobile services at this point in time.

Appropriate pricing principles for the MTAS

When the Commission released its GSM terminating access pricing principles in July 2001, it identified concerns that the existing prices of GSM MTASs were likely to be well in excess of costs, and that this was generating outcomes in a number of markets that were not in the LTIE. However, the Commission considered, at the time, that adoption of a cost-based pricing principle – such as the total service long run incremental cost (TSLRIC) methodology that it uses for determining access prices for other declared services – was not appropriate in this instance. Rather, the Commission sought to develop a relatively light-handed pricing principle that would ensure a gradual reduction in the price of the MTAS towards costs over time.

In particular, the Commission determined that a retail benchmarking pricing principle was most appropriate for the GSM terminating access service. Under this approach, the price of GSM terminating access services for each carrier would be required to decrease in line with reductions in its average price of a bundle of retail mobile services. At the time it released this pricing principle, however, the Commission noted its success would depend, to a large extent, on expected reductions in the average price of the bundle of retail mobile services. Without this, there would be no pressure on providers of MTASs to reduce the price of their service towards cost. In order to measure the success of this pricing principle, the Commission indicated it would monitor changes in the retail price of a bundle of GSM services over an initial two-year implementation period, with a view to reviewing the suitability of the pricing principle in two years time.

The final results of the Commission's retail benchmarking monitoring program are outlined in Chapter Eight of the Report. In summary, the results indicate that the retail price of the bundle of GSM mobile services has not declined as much as the Commission initially expected. Indeed, in some periods, the average price of the bundle of retail GSM services for some carriers has increased. In short, this implies the pricing principle would not, had it been applied in an arbitral setting, be guaranteed to have led to significant reductions (if any) in the price of MTASs towards cost.

Accordingly, the Commission's monitoring of the retail benchmarking pricing principle has led it to believe that a more direct mechanism is needed to generate a closer association of the price of the MTAS with its underlying cost of production. In this regard, the Commission believes that total service long-run incremental cost (TSLRIC) – adjusted for a mark-up to include contributions to common organisational-level costs and set at a level that allows mobile operators a normal return on efficient investments (such mark-ups are sometimes referred to as TSLRIC+) – is the appropriate measure of costs towards which the price of the MTAS should trend.

The Commission has not, however, modelled the TSLRIC+ of providing the MTAS in Australia. It believes such a modelling process would be time consuming and costly to implement. Rather, it has sought to estimate TSLRIC+ using reasonable cost estimates available to it. These include consideration of cost models developed in overseas jurisdictions and TSLRIC+ proxies based on the data provided to it by mobile operators using the RAF. The Commission has also been assisted in this

regard by a report it has commissioned from the consulting firm Analysys. Analysys was responsible for modelling the long-run incremental cost of providing the MTAS for the UK regulator Ofcom (previously Oftel) and has undertaken similar work for regulators in Sweden, Greece and South Korea. Based on its consideration of all these sources of information, the Commission believes the TSLRIC+ of providing the MTAS lies in the range of 5 to 12 cents per minute. Full details of the Commission's investigation into the cost of providing the MTAS in Australia are outlined in The Annexure to this report.

Given the Commission has not formally modelled TSLRIC+ for the MTAS, however, the Commission believes that, for the purposes of its current pricing principles, the price of the MTAS should only trend towards the top of the range of reasonable estimates of TSLRIC+ available to it. Hence, the Commission believes the LTIE would be promoted by the price of the MTAS trending towards 12 cents per minute.

The Commission is concerned, however, that if the price of the MTAS were to fall to 12 cents per minute immediately, this would generate significant and potentially harmful disruption to the operations and planning of a number of telecommunications carriers.

As a result of these concerns, the Commission has determined that this target price should be approached gradually over a succession of periods. Based on market inquiries, the Commission understands the lowest available price in the market for MTAS is 21 cents per minute. However, the Commission understands that some access seekers may be paying as high as c-i-c cents per minute for this service. The Commission believes an appropriate starting point for its gradual reduction in the price of the MTAS should be the lowest available price in the market. Starting from an initial price of 21 cents per minute on 1 July 2004, the Commission believes a steady 3 cents per minute reduction in the price of the MTAS should follow on 1 January in each of the next three years. This would ensure the target price of 12 cents per minute for the MTAS is reached gradually by January 2007. Details of this pricing principle can be found in Chapters Eight and Nine of this report. A full specification of the Commission's pricing principle determination can be found at Appendix D to this report.

The Commission notes, however, that the pricing principle and the price related terms and conditions are indicative only. The pricing principle determined by the Commission is not binding in the event of consideration by the Commission of an access undertaking or arbitration of access dispute. Were the Commission required to make an arbitral determination, or consider an undertaking provided to it in relation to the MTAS, a party may argue against the application of the pricing principles and the indicative price related terms and conditions (including by making submissions in relation to the consultancy report prepared for the Commission by Analysys).

Decision

The Commission has formed a view that declaration of a varied MTAS would be in the LTIE, and is therefore appropriate under Part XIC of the Act. More specifically, the Commission believes the existing declaration of the MTAS should be varied to include voice services terminating on 3G mobile networks. Accordingly, the

	Adjustment Path
1 July 2004	21 cpm
1 January 2005	18 cpm
1 January 2006	15 cpm
1 January 2007	12 cpm

Table 1.1 – Adjustment path for the pricing principle

The pricing principle determination is provided at Appendix D to this report.

1.1 Background

1.1.1 The mobile terminating access service

The mobile terminating access service (MTAS) is a wholesale input, used by providers of calls from fixed-line and mobile networks, in order to complete calls to mobile subscribers connected to other networks.[23]

When a mobile call is made between consumers (or end-users), it will involve two essential elements – origination and termination. Origination refers to the carriage of a call from the end-user who makes, or originates, the call over the network to which this end-user is connected. Termination refers to the carriage of the call to the person receiving the call over the network on which the person receiving the call is connected. Where the person making the call and the person receiving the call are on different networks, a point of interconnection (POI) between these two networks will exist. Origination, termination and the POI are illustrated in Figure 1.1 below.

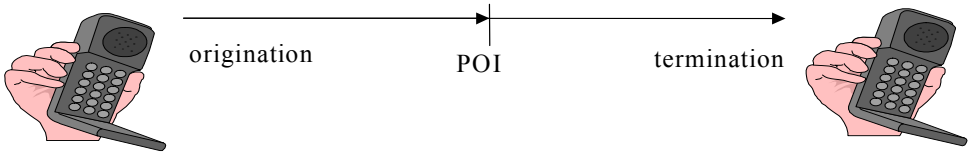

Figure 1.1 - Use of the MTAS to supply a mobile-to-mobile call

Under current commercial arrangements between network owners, the network owner that originates a call to a mobile network will, generally, purchase termination from the network owner that completes the call. The originating network owner will recover these costs, and the costs it incurs from originating the call, through the retail

[23] A full service description for the MTAS for the purposes of this inquiry can be found at Appendix A of this report.

network elements, the access regime may play an important role in ensuring that existing infrastructure is used efficiently.

Paragraph 152AB(6)(a) requires the Commission to have regard to a number of specific matters in examining whether declaration will lead to achievement of this objective. Some of these are considered below.

The technical feasibility of supplying and charging for particular services

This incorporates a number of elements, including the technology that is in use or available, the costs of supplying, and charging for, the services and the effects on the operation of telecommunications networks.

In many cases, the technical feasibility of supplying and charging for particular services given the current state of technology may be clear, particularly where there is a history of providing access. The question will be more difficult where there is no prior access, or where conditions have changed. Experience in other jurisdictions, taking account of relevant differences in technology or network configuration, will be helpful. Generally the Commission will look to an access provider to demonstrate that supply is not technically feasible.

Most of the issues under this criterion are discussed in Chapter Three, which considers the service description and technical feasibility of providing access to a mobile termination service.

The legitimate commercial interests of the supplier or suppliers, including the ability of the supplier to exploit economies of scale and scope

A supplier's legitimate commercial interests encompass its obligations to the owners of the firm, including the need to recover the cost of providing services and to earn a normal commercial return on the investment in infrastructure. The Commission considers that allowing for a normal commercial return on investment will provide an appropriate incentive for the access provider to maintain, improve and invest in the efficient provision of the service.

A significant issue relates to whether or not capacity should be made available to an access seeker. Where there is spare capacity within the network, not assigned to current or planned services, allocative efficiency would be promoted by obliging the owner to release capacity for competitors.

Paragraph 152AB(6)(b) also requires the Commission to have regard to whether the access arrangement may affect the owner's ability to realise economies of scale or scope. Economies of scale arise from a production process in which the average (or per unit) cost of production decreases as the firm's output increases. Economies of scope arise from a production process in which it is less costly in total for one firm to produce two (or more) products than it is for two (or more) firms to each separately produce each of the products.

Potential effects from access on economies of scope are likely to be greater than on economies of scale. A limit in the capacity available to the owner may constrain the

number of services that the owner is able to provide using the infrastructure and thus prevent the realisation of economies of scope associated with the production of multiple services. In contrast, economies of scale may simply result from the use of the capacity of the network and be able to be realised regardless of whether that capacity is being used by the owner or by other carriers and service providers. Nonetheless, the Commission will assess the effects of the supplier's ability to exploit both economies of scale and scope on a case-by-case basis.

The impact on incentives for investment in infrastructure

Firms should have the incentive to invest efficiently in infrastructure. Various aspects of efficiency have been discussed already. It is also important to note that while access regulation may have the potential to diminish incentives for some businesses to invest in infrastructure, it also ensures that investment is efficient and reduces the barriers to entry for other (competing) businesses or the barriers to expansion by competing businesses.

There is also a need to consider the effects of any expected disincentive to investment with any anticipated increases in competition to determine the overall effect of declaration on the LTIE. The Commission will be careful to ensure that services are not declared where there is a risk that incentives to invest may be dampened, such that there is little subsequent benefit to end-users from the access arrangements.

2.4 Pricing principles for declared services

As a result of changes to the telecommunications provisions of the Act in September 2001, the Commission is now obliged to determine pricing principles (PP) relating to services that it declares.[36] The PPs must be in writing and must be made at the same time as, or as soon as practicable after, the Commission declares a service or varies a declared service.

The PPs may also contain price-related terms and conditions relating to access to the declared service. 'Price related terms and conditions' is defined to mean terms and conditions relating to price or a method of ascertaining price.

Before developing PPs, the Commission must publish a draft version, invite public submissions on the draft, and consider any submissions received. Accordingly, the Commission published a draft version of the PPs on 26 March 2004. The Commission must then publish the PPs (in such manner it thinks appropriate). The Commission must have regard to the PPs if there is an arbitration in respect of the declared service.

The practical effect of these changes for the Commission is that the Commission should either call for submissions on PPs as part of a public discussion paper on a proposed declared service or conduct a separate public consultation on PPs as soon as possible after a service is declared. Although the Commission is not bound to follow the PPs in any arbitration, in practice it would unless there was good reason not to.

[36] Act s. 152AQA.

services that require high data transmission rates, such as video calls, are not possible. For example, full Internet graphics may not be available to the end-user of 2.5G services but a simpler set of graphics may be possible.

Essentially, 2.5G and 3G networks allow for the introduction of new mobile services that, due to transmission capacity limitations, are not able to be offered using 2G GSM and CDMA networks. They are also, however, able to provide a range of existing mobile services that are provided on 2G networks, specifically, voice and SMS. Therefore, from a consumer's or end-user's point of view, 2.5G and 3G services are likely to appear as 'add-on' services to existing mobile services, rather than as entirely new communications services.

Is there a distinction between the delivery of voice and data services on each type of network?

Mobile services are typically divided into two categories: voice services and data services.

The introduction of 3G technologies has the potential to blur these categories from a technical perspective.

All current mobile technologies (2G, 2.5G and 3G) transport traffic in the core network as digital packets. Accordingly, voice could be considered to be a data service in this context.

However, a distinction has been made to date by virtue of the use of reserved capacity to handle voice traffic. The packet routing for all mobile services is controlled by circuit switching technology which ensures that the order and route of each packet is the same and is determined by the network.

For 2G services, once packets reach the Mobile Switching Centre (MSC), the data packets are reassembled and forwarded to the mobile handset as a normal voice call. In contrast, packets of data (including voice) are reassembled at the handset on 2.5G and 3G networks (that is, on GPRS, EDGE, 1×RTT and the 3G technologies).

However, the Commission considers that the distinction between voice services and data services remains important from a consumer perspective, at this point in time.

Hence, while the Commission believes a distinction can be made between voice and data services at this time, the introduction of 2.5G and 3G services may blur the distinction between voice and data services in the future. Should this occur, the Commission may need to reconsider the suitability of a service description that focuses only on termination of voice calls on mobile networks.

The extent of consumer take-up of the different types of services available for each technology and the scope for bottlenecks

The level of consumer acceptance of the different services supplied using mobile technologies varies greatly between the services. For some services, such as voice

In the Australian Pay TV industry, Foxtel had control over premium content such as movies and sports which made the subscription packages offered by its rivals relatively unattractive to consumers. It is arguable this tended to limit competition in the Pay TV market and that this gave Foxtel an opportunity to use its control over content to restrict competition in the industry. However, private agreements between Pay TV providers, and the Commission's acceptance of undertakings by Foxtel pursuant to section 87B of the Act, to provide for access to this premium content by competitors, have addressed this problem to some degree.

In contrast, the lack of success of the 'walled garden'[66] approach by ISPs can be attributed to the difficulty in developing content that is sufficiently unique and popular to make other content available to subscribers of competing ISPs unmarketable, and the sheer range of content applications and information on the Internet with which the walled garden must compete. Walled garden content represents a miniscule fraction of all Internet content and most subscribers appear unwilling to forgo that wealth of information by spending their online time in 'the garden'. However, the Commission notes that Telstra's recent announcement that online AFL content will be exclusive to BigPond subscribers (without limiting the other online content available to subscribers) may presage greater use by ISPs of control over premium content to compete in the provision of Internet services.

The Commission considers that it is unclear at this point in time what direction 2.5G and 3G content applications will take. Whilst 3G technology is likely to allow a greater range of Internet applications and content to become available to mobile subscribers, it may also be the case that what is regarded as 'broadcast content' today (such as sports and movie content) will prove a significant driver of 3G development. In this regard, the Commission agrees with the CCC's characterisation of 3G data services as 'developing'.

In any event, the possible solutions to addressing problems of market power in relation to 2.5G and 3G content do not appear to include declaration at this point in time. Declaration can only be made in relation to an eligible carriage service and it is unlikely that access to content could be considered to be a carriage service.

That said, the Commission considers it appropriate in these circumstances to note that it will continue to observe market developments in relation to the supply of data services, in order to allow the Commission to intervene in a timely manner, if necessary, to ensure the LTIE is promoted. However, the Commission will not undertake a specific or separate monitoring program for mobile data services at this point in time.

In signalling its intention to continue observing market developments in relation to data services the Commission notes views expressed by Vodafone in its written submission in response to the Draft Report and in meetings with Commission

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[66] A 'walled garden' refers to the development of content by an ISP specifically for subscribers to the ISP. The theory behind walled gardens is that if the content in the walled garden is sufficiently compelling subscribers will seek to only subscribe to the ISP with control of that content and competition from other ISPs is thereby avoided.

Accordingly, the Commission considers that any service description for a MTAS should provide for access to termination of calls originating on both fixed-line and mobile networks.

3.5 Conclusion

The Commission's decision is that the service description should include FTM and MTM voice termination services regardless of the technology used, but will not include data termination services.

The full text of the Commission's proposed service description is set out in Appendix A to this Report.

For the sake of clarity, the Commission notes that it does not intend the service description of the domestic MTAS to include services that are supplied pursuant to international or domestic roaming agreements. The service description set out in Appendix A applies to voice calls that are received by end-users (B-parties) that are directly connected to the digital mobile network of an Australian terminating carrier (the access provider).

The Commission considers that 'call back' is a strategy to reduce the amount paid for calls and therefore is not a genuine alternative to calling a mobile phone. This view is also consistent with the view formed by the UK Competition Commission in its December 2002 report.

In all cases, therefore, the Commission finds that these alternatives are not sufficiently substitutable for calls to mobile networks. Accordingly, the Commission believes none of these alternative services should be included in the same product market as the MTAS.

In reaching this conclusion, the Commission has had regard to the findings of the Consumer Awareness Survey conducted by the four mobile carriers in 2003. Whilst the survey does indicate consumers use a wide variety of communications methods (such as fixed-line calls, mobile calls, e-mail, SMS and faxes), and that cost is an important factor for consumers when choosing to use alternative means of contacting people other than by calls to mobile networks, the Commission notes that the survey does not indicate the degree of substitutability between these services. In other words, the survey does not indicate the extent to which consumers would substitute away from making calls to mobile networks if an increase in the price of the MTAS (and hence, by assumption the retail price of calls to mobile networks) were to occur. Accordingly, the Commission is not convinced that the survey indicates these other services are sufficiently substitutable to constrain the price of the MTAS.

Whilst the Commission expects that mobile operators would experience some decrease in demand for calls to their networks if they chose to increase the price of the MTAS, the Commission does not believe this would be because of any significant switch by consumers to any of the alternative service offerings considered above. That is, a decrease in consumer demand when a firm increases prices does not necessarily indicate an absence of market power. For example, a monopolist will still face a decrease in demand when it increases prices above cost to profit-maximising levels. Hence, evidence of less demand for FTM calls in response to an increase in mobile termination rates alone would not be evidence of a lack of market power.

<u>To what extent are termination services on different mobile networks substitutable with each other?</u>

Whether or not the MTAS on each individual network should be considered in a product market of its own depends on the extent to which termination on different carriers' networks are substitutable with each other. In other words, to what extent are calls to different mobile networks substitutable with each other?

In its July 2001 Final Report on the pricing methodology for the GSM termination service, the Commission concluded that mobile operators have control over access to all calls that are made to end-users subscribing to their network. That is, if an individual subscriber to another telephony network (fixed, mobile or otherwise) seeks to make a call to an end-user subscribing to a particular mobile network, the first individual's network operator has no option but to seek terminating access on the mobile subscriber's network in order for the call to be completed. As a result of this, the Commission concluded that there is no possibility of substitution, and that this

In establishing the boundaries of the product market, the Commission has considered whether 2.5G services, 3G services, fixed line services and SMS services are substitutes for a mobile call made on a GSM or CDMA network.

3G

When the Commission published its GSM pricing principles in July 2001, 3G services were not yet available and there was some uncertainty about how 3G technology would be applied and what services would be utilised. Since the introduction of 3G services by Hutchison in April 2003, however, it has become clear that voice call services provided on 3G networks compete with voice call services provided on 2G and 2.5G networks. Consequently, the Commission now considers that mobile calls utilising 2G, 2.5G and 3G technologies are sufficiently substitutable to be considered as part of the same mobile services market.

Fixed line

As discussed previously in this section, the Commission considers that due to the lack of mobility associated with fixed-line telephony services, the ability for a fixed-line service to substitute mobile services is limited. A call which originates and terminates on a fixed-line network should therefore not be included in the same market as the market for retail mobile services.

SMS

Similarly, SMS does not provide the same basic characteristics present in a mobile call. SMS offers a comparatively truncated form of communication which does not allow end users to communicate simultaneously. Consequently, the Commission believes that in the event of an increase in the price of mobile calls, the extent of substitution to SMS would be small. That said, the Commission understands that SMS services are sold as part of the same bundle of retail mobile services alluded to above. Accordingly, the Commission believes SMS services are provided in the same market as other retail mobile services.

In relation to the functional dimension of the market, the Commission believes these services are provided at the retail level.

Overall, therefore, the Commission's view is the relevant market is that in which retail mobile services are supplied. This is a national market operating at a retail functional level. It includes retail mobile services provided on 2G, 2.5G and 3G networks and SMS services, but does not include fixed-line services.

4.3 State of competition in the relevant markets

Having established the relevant markets for consideration, this section now seeks to determine the state of competition in these markets. This gives the Commission an insight into the likely effectiveness of competition in the future if the service ceased to be declared. Further, it can also provide some insights into the likely impact of declaration of the eligible service. That is, if competition in the relevant markets is

already effective, then declaration of the eligible service may not significantly promote further competition. That said, consideration of the likely state of competition in relevant markets is complicated in this instance, as the MTAS is already a declared service. Accordingly, analysing the current state of competition in relevant markets provides an indication of the state of competition under current forms of regulation as much as it provides an insight into the state of competition that would be likely to exist in the absence of declaration of the eligible service.

It is important to also note that assessing the effectiveness of competition is not a static analysis limited to a description of current conditions and behaviour. Rather, it is a dynamic analysis concerned with features affecting the competitive supply of services in the future. Nevertheless, current conditions will, in general, provide a solid starting point from which to consider the future effectiveness of competition.

When assessing the effectiveness of competition in a particular market, the Commission examines a range of both structural and behavioural characteristics. From a structural perspective, the Commission considers the linkage between supply of the eligible service and the supply of related services, barriers to entry, concentration levels, and the bargaining power of suppliers and buyers of the relevant services. From a behavioural perspective, the Commission may consider a range of market outcomes, including the level of price competition in the provision of a given service, the price-cost margins available to suppliers of a service, price changes over time, service differentiation, and comparisons with similar services provided in overseas jurisdictions.

Other features the Commission may consider include the regulatory environment and dynamic characteristics of the market (including growth, innovation and product differentiation).

The Commission's assessment of the state of competition in relevant markets begins by outlining the views of interested parties to this inquiry. It then considers the state of competition in each of the three market types outlined in section 4.2 above – the individual markets for the MTAS; the retail mobile services market and the market within which the FTM service is provided.

4.3.1 Views of interested parties

Responses to the Discussion paper

A range of views are expressed by interested parties in relation to the current state of competition in the markets relevant to this inquiry. Telstra, Optus and Vodafone submit that the mobile services market (which they define to include both mobile termination and retail mobile services) is highly competitive, while AAPT, PowerTel, Hutchison, the CCC, CoRE Research, SETEL and ATUG express concerns about the level of competition in any or all of the retail mobile services market and the market within which FTM services are provided.

Telstra argues that the mobile services market is highly competitive. Telstra contends that this assessment accords with the views expressed by the Commission in earlier

Overall, therefore, if the Commission uses Telstra's average yield on FTM calls as a proxy for that of the market as a whole, the Commission estimates that the average retail price of FTM call minutes is likely to be at least double the underlying cost of providing these services. This is illustrated graphically in Figure 4.2 below, which shows the large gap that lies between the average retail prices of FTM calls and the upper-bound underlying cost of around 17 cents per minute. The Commission believes this is one factor which, taken in isolation, appears to indicate that the market within which FTM calls are provided is less than effectively competitive.

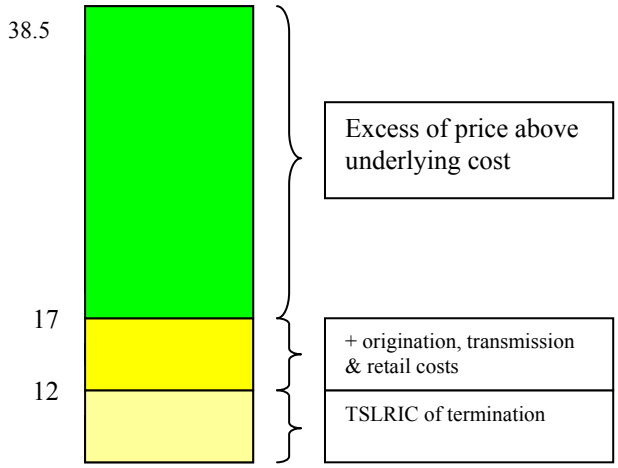

Figure 4.2 – The excess of the average price for FTM calls above underlying cost

That said, the Commission notes that a large proportion of FTM calls are provided 'off-net', involving situations where, in order to provide these calls, a fixed-line service provider will need to acquire a mobile termination service from a mobile carrier it is not vertically-integrated with.[273] In this instance, the ability of the FTM service provider to set prices close to underlying cost will be limited by the extent to which it can acquire mobile termination services at cost. In this regard, the Commission understands that the average price of the MTAS is likely to be around 22.5 cents per minute. Accordingly, the effective cost to a FTM service provider for an 'off-net' FTM call would be likely to be higher at around 27.5 cents per minute (using the same 5 cent estimate of the cost of origination, transmission and retailing costs outlined above). That said, the effective cost of an off-net FTM call is still well below the average yield FTM service providers appear to be earning from the provision of these services. This is illustrated in Figure 4.3 below.

[273] The Commission estimates that approximately 60 per cent of all FTM minutes are provided on an 'off-net' basis.

directly relevant to any of the coverage criteria. Furthermore, if MTAS price reductions stimulate competition to provide FTM services, this would be expected to lead Telstra to fully pass-through any cost reductions, as indicated above, and might lead to the average price of FTM call minutes decreasing by more than the per minute reduction in the price of the MTAS. This would erode or even remove any windfall accruing to Telstra, and, by analogy, to other vertically-integrated carriers. Furthermore, if rival FTM carriers are able to reduce Telstra's share of the market within which FTM services are provided, this would also reduce any windfall from lower termination prices.

In relation to AAPT's comment that a non-dominant carrier might not be inclined to pass-through cost reductions unless its stronger rivals chose to do so, the Commission reiterates its view that pass-through may take time to emerge in full, might be stimulated by new entrants rather than incumbents, and might appear in the form of reductions to other fixed-line services such as NLD and IDD calls. However, this does not militate against declaration or accompanying steps to reduce MTAS prices.

In relation to the assertion by Hutchison Telecommunications that most FTM calls not carried by Telstra represent end-to-end resale of Telstra services, market inquiries conducted by the Commission indicate this is not the case. In any case, even if it were true, FTM 'resellers' might choose to purchase a wholesale end-to-end service from Telstra's competitors, should they lower their charges for wholesale end-to-end services as a result of changes in the price of the MTAS. In other words, pressure would be applied to Telstra to pass-through decreases in the price of the MTAS to its wholesale purchasers of end-to-end FTM calls if its competitors chose to pass-through lower input costs of the MTAS.

Chapter Nine on implementation of pricing principles considers a number of measures that could be undertaken to improve the degree of FTM pass-through in the short term while competitive influences in the market improve.

4.4.3 The impact of declaration on the market within which retail mobile services are provided

The Commission believes that, while the retail mobile services market is exhibiting more encouraging market outcomes than the markets for fixed-line telecommunications services, it is unlikely to be effectively competitive as yet. This is because there continues to be a high level of concentration at the carrier network level (where the combined share of Telstra, Optus and Vodafone is approximately 97 per cent of the market); barriers to effective entry into the market (associated with national coverage and sunk costs) remain high; and established mobile operators (and in particular Telstra and Optus) appear to be earning profits well in excess of those the Commission would expect in competitive markets for these services. In addition to this, the Commission notes that reductions in the prices paid for retail mobile services appear to have slowed in recent years, with some indication that prices appear to have increased, on average, during the 2002-03 financial year.

Despite this, the Commission expects the greatest competitive benefit from continued declaration of the service is likely to occur in the market within which FTM services

the new entrant's subscription package relatively unmarketable[349] and restricting the new entrant's revenue base (from termination charges). Even if established operators do seek termination services from a new entrant, they may have a strong incentive to impose onerous terms and conditions upon such acquisition. For example, they may require supply to be made using unnecessary and expensive network elements. The imposition of such onerous terms and conditions, particularly ones that significantly increase the costs for the new entrant, will make it difficult for the entrant to participate and compete effectively in the market.

Similarly, by refusing to provide termination services to a new entrant, an established operator can inhibit, if not prevent, competition, by restricting the attractiveness of the new entrant's subscription package. As noted above, subscribers expect to be able to contact all other mobile subscribers regardless of network. If an operator cannot offer the ability to call subscribers on other networks, then potential customers are unlikely to subscribe to the new operator. This is particularly so in the case of new entrants, when most calls made on the new operator's network are likely to be to subscribers to the established operators' networks. Again, even if an established operator provides termination services to the new entrant, it may have an incentive to impose onerous terms and conditions on the access seeker. The imposition of such terms and conditions would be likely to increase the costs and/or decrease the attractiveness of the new entrant's subscription package.

Accordingly, the established operators may refuse to provide termination services, or to provide termination services on reasonable terms and conditions, to new entrants in order to restrict a potential competitor's ability to gain market share, and to prevent the loss of subscribers. These incentives are most likely to exist in the provision of MTASs for calls that have originated on mobile telephony networks.

This practice is also likely to be more attractive to established operators in mature markets where the entry of a new operator is unlikely to result in an increase in demand for the established operators' termination services. In mature markets, it is likely that successful entry of a new market participant will be at the expense of the market shares of the established operators, as the participation rate remains steady and a new entrant increases competition for the same consumer group.

5.2.2 New Entrant

In contrast to the established operators, there are strong incentives for a new entrant to both obtain termination services from, and provide termination services to, the established operators.

Firstly, as discussed above, if an operator is unable to offer the ability to call all (or even most) mobile subscribers, consumers are unlikely to subscribe to that operator's network. Therefore, in order to gain subscribers and so enter the market, a new entrant must reach agreement with each established operator for the provision of termination services to the new entrant.

[349] If established operators do not acquire termination services from a new entrant then the new entrant will be unable to offer potential subscribers the ability to receive calls from subscribers on other networks.

6. Will declaration encourage economically efficient use of infrastructure?

As discussed in Chapter Two of this report, when deciding whether declaration of a service will be in the LTIE, the Commission is required to consider whether declaration would be likely to encourage the economically efficient use of infrastructure. In considering this question, the Commission is mindful that such consideration must be made in an environment where the MTAS is already declared. Hence, the Commission addresses this issue from the perspective of considering the likely consequences of continued or varied declaration as opposed to those that would be likely to emerge if declaration were revoked.

As indicated in Chapter Two, the Commission considers that efficiency has three major components – allocative, productive and dynamic. In general, each of these forms of efficiency is enhanced when the prices of given services reflect the costs of providing these services. In more competitive markets, service providers have a greater incentive to lower prices in order to win market share. Accordingly, this incentive helps push prices towards costs, and thereby improves the efficient use of resources, and therefore infrastructure.

Where declaration is likely to promote competition in markets for carriage services or services provided by means of carriage services, the Commission's competition analysis will generally help it to form a view about the impact of declaration on efficiency. For instance, where the Commission finds that declaration can lead to greater competition in downstream markets by helping to ensure prices for the eligible service better reflect their efficient costs of provision, it is likely such declaration will also help promote efficiency in use of telecommunications services. By enabling greater competition in downstream markets, declaration would be expected to improve productive and dynamic efficiency in these markets by giving service providers the incentive to find lower-cost means of producing goods and services in downstream markets, and by encouraging them to invest and innovate in ways that will ensure they produce goods and services of a chosen quality at the lowest possible cost in the future. Further, the Commission would expect allocative efficiency to be improved as it would be more likely that the final prices paid for retail services by end-users will better reflect the efficient costs of provision of these services. In the language of subsection 152AB(2)(e), declaration will be expected to result in the more efficient use of infrastructure used to supply the eligible service. Conversely, a decision not to declare would – on this reasoning – lead to less competition in downstream markets and a less efficient outcome.

A clear implication of this, therefore, is that the level of costs (inclusive of a normal profit) is important in determining whether declaration will lead to a more efficient use of infrastructure. The comparison of costs to prices, and the impact declaration will have on any difference between the two, is a key consideration in whether declaration will lead to a more efficient use of infrastructure.

In addition to this, however, the competitive dynamics associated with a given market structure are also of relevance to considerations of the efficient use of telecommunications infrastructure. In particular, it is important to consider the

prices lead consumers to make less (or shorter) FTM calls than would be consistent with an efficient use of telecommunications infrastructure.

The extent of the cost to society of this inefficiency in use can be measured using the concepts of consumer and producer surplus. In this regard, consumer surplus is defined as the difference between consumers' valuations of a quantity of a service, and the amount paid for that quantity. In general, therefore, if the price of a given service falls, consumer surplus will increase. Producer surplus, on the other hand, is defined as the difference between the cost of producing a quantity of a service and the revenue a producer receives from selling that quantity. Accordingly, a price fall will normally lead to a reduction in producer surplus.

In order to measure whether society, as a whole, benefits or loses from a change in prices, it is necessary to weigh up the changes in both consumer and producer surplus. In particular, if a change in price leads to an increase in one form of surplus, but a decrease in the other, society as a whole can only benefit if the gain outweighs the loss.[405] In the absence of externalities, if a change in price means a closer alignment with cost, society as a whole will gain. The intuition is that by more-closely aligning prices with costs, resources will be better directed to those parts of the economy where they are more highly valued.

To illustrate the efficiency in loss of setting the price of the FTM call minute above their underlying cost of production, consider Figure 6.1 below. In this diagram, the initial retail price of a FTM call is P^0 cents per minute at which level consumers purchase Q^0 minutes of the FTM service. The TSLRIC of production is C^0 cents per minute. Compared to a situation where the price of a FTM minute is set at its underlying cost of production, a price of P^0 cents per minute generates an increase in producer surplus equal to the area A, and a decrease in consumer surplus equal to the area A + B. Overall, society as a whole loses the area B. This area is sometimes referred to as the deadweight loss or efficiency loss of prices being set in excess of the underlying cost of production.

[405] Hence, if a price fall leads to an increase in consumer surplus, but a decrease in producer surplus, society as a whole will only gain if the increase in consumer surplus is greater than the decrease in producer surplus.

efficiency gain will depend on the own-price elasticity of demand for these services and the relevance (and size) of mobile network externalities at the margin. This issue is discussed in the sub-section on the relevance of mobile network externalities below.

6.2.3 The relevance of fixed-line externalities

As indicated above, in response to the Discussion Paper Optus provided the Commission with detailed analysis estimating the welfare loss in the market for FTM calls that will occur from decreasing the price of the MTAS. While there have been changes to the detail, Optus has provided a similar analysis in response to the Draft Report. The key driver of this welfare loss is an argument that decreases in the price of the MTAS will, due to the assumed zero economic profit constraint, force mobile carriers to increase the price of mobile subscriptions to recover, in full, decreases in revenue they experience as a result of decreases in the price of the MTAS. This price increase will lead to a reduction in the number of mobile subscribers. The lost subscribers are assumed to be of equal value to FTM callers. As a result of their departure, FTM consumers will have fewer mobile subscribers to call such that the benefits they receive from FTM calls will be reduced. This loss is only partially offset by the direct efficiency gain discussed in section 6.2.2 above.

In earlier parts of this chapter, the Commission has referred to this argument as the 'fixed-line externality' argument. Optus' arguments regarding the magnitude of this effect are best illustrated with reference to Figure 6.3 below.[412]

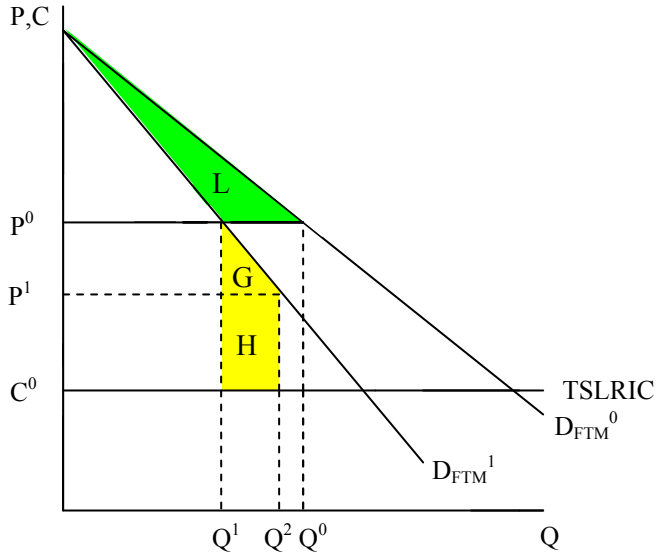

Figure 6.3 – Optus-n/e/r/a's analysis of efficiency implications in the presence of fixed-line externalities

In the first instance, Optus argues that in the absence of regulation, demand for FTM calls can be represented by the demand curve D_{FTM}^0. At an initial price of P^0,

[412] Figure 6.3 is based on Figure 3.3 in n/e/r/a's May 2004 'Joint Products' submission on behalf of Optus. It is also reproduced in Optus' 'Efficient Use' submission, p. 16.

of production, this will generate a welfare loss to mobile subscribers by reducing the willingness of FTM consumers to make FTM calls.

The Commission believes a proper analysis of all externality benefits would require further consideration of the magnitude of these and other possible externality benefits. In this regard, the Commission agrees with AAPT's comments that it would be inappropriate to place undue focus on only one of the possible externality effects that might be expected to impact on the FTM, mobile termination and retail mobile services.[415]

In addition to this, the Commission is concerned that no party to this inquiry appears to have argued that mobile operators will, in the absence of regulation, have any incentive to set a structure of prices across the mobile termination and retail mobile services that would lead to the most efficient use of telecommunications infrastructure in the presence of any such fixed-line network externalities. That is, Optus' analysis is aimed at determining the impacts of reducing the price of the MTAS from its existing price. The analysis does not argue, however, that existing prices for mobile termination and FTM services are optimal in the presence of fixed-line network externalities. The analysis also does not argue that mobile operators would, in the presence of these externalities, have appropriate incentives to set a price for the MTAS that ensures an efficient use of telecommunications infrastructure. In other words, whilst it is possible there may be a fixed-line network externality generated by greater subscription to mobile telephony networks, the Commission has not been presented with any evidence or arguments to suggest that mobile operators internalise the externality generated for fixed-line consumers when they set the price for the mobile termination service. In this regard, the Commission believes it is highly unlikely that mobile operators will choose a price for the MTAS that efficiently internalises externalities enjoyed by fixed-line consumers. This is especially the case for mobile-only operators that do not have a direct billing relationship with FTM consumers.

Hence, it is one thing to say a fixed-line externality exists. It is quite another to argue that in the absence of declaration, mobile operators will efficiently internalise this externality when setting prices for the MTAS such that declaration of the service is not appropriate.

Empirical concerns

Even if the Commission were to entertain consideration of the fixed-line externality argument in isolation of other externality effects, the Commission would still have substantial concerns with Optus' $985 million per annum estimate of the impact of this externality on welfare (efficiency) for consumers of FTM services. As indicated in detail above, the Optus analysis involves a chain of related effects that follow a decrease in the price of the MTAS. In the Commission's view there are weaknesses in every link in the chain. In particular, the Commission is concerned that:

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[415] While n/e/r/a's analysis attempts to model another network externality loss from reducing the price of the MTAS (the loss in welfare felt by remaining mobile subscribers who have less mobile phone users they can call), it makes no attempt to measure the gain in welfare remaining mobile subscribers experience from having more FTM calls made to them as a result of lower prices for FTM services.

integrated carriers would only pay above-cost termination rates for calls which do not terminate on their own mobile networks. It is likely that this lessening of competition in the downstream market within which FTM calls are provided would result in inefficient investment by fixed-line carriers. This is because the Commission believes that above-cost FTM call rates would decrease demand for FTM services leading to the potential for inefficiently low levels of investment in fixed-line network infrastructure used to provide call capacity. In this regard, the Commission disagrees with Frontier Economics that it has failed to use standard economics in establishing that MTAS prices are inefficiently high.

In relation to FTM telephony, the Commission also notes Unwired's argument that it is inhibited in its ability to compete by MNOs being able to charge above-cost prices for the MTAS. The Commission believes that Unwired's submission indicates it is not just fixed-line and mobile network operators that face above-cost prices for the MTAS. It also suggest that above-cost pricing of the MTAS may have the effect of hindering the development and competitiveness of new and emerging technologies that could offer a broader competitive constraint on existing network operators.

In addition to creating the incentive to structure prices for mobile services in a way which hinders efficient investment, the Commission believes that the absence of declaration of the MTAS may create an incentive for established mobile operators either to refuse to provide access to new entrants or to providing access only on terms and conditions which do not allow new entrants to compete effectively. This would increase new entrants' costs relative to established operators' costs and would also inhibit new market entry. It is the Commission's view that this lessening of competition would also result in less than efficient levels of investment in the infrastructure used to provide a range of telecommunications services.

These expected investment outcomes contrast with those which the Commission would expect if the MTAS were regulated in such a way that the price of the service was more closely associated with its underlying cost of production.

The Commission believes, that if continued declaration of the MTAS leads to a closer association of its price and cost, this will promote competition in the market within which FTM services are provided by enabling fixed-only carriers to compete more equally with integrated carriers. This increased competition will in turn promote more efficient investment in the infrastructure used to provide call capacity on the PSTN network.

The Commission is also of the view that continued declaration which results in an appropriate price for the MTAS will encourage mobile operators to recoup more of their investment costs of providing individual mobile services directly from the services which incur the investment costs, rather than cross-subsidising infrastructure investment between services. This is likely to lead to greater efficiency in investment in infrastructure used to provide mobile call services. For instance, the Commission considers that the expected decrease in mobile termination rates to align them more closely with costs would, over time, be expected to provide mobile operators with appropriate incentives to invest efficiently in capacity in mobile networks.

movements are measured in real terms. Accordingly, the actual – or nominal – prices paid by end-users would have increased by an even larger amount during this period.

Evidence of increased competitive forces in the market

The Commission believes that there is no evidence to suggest an increase in competitive forces in the mobile services market since June 2001 that would indicate the existence of greater competitive forces applying to providers of MTASs. Indeed, since this time, one facilities-based competitor (One.Tel) has left the market and the market shares of the remaining carriers appear to have changed little. Further, as discussed in Chapter Four, the mobile services market appears to be less than effectively competitive and that Telstra and Optus appear to be earning rates of return on capital employed well in excess of those expected in effectively competitive markets.

Evidence regarding anti-competitive conduct in the market within which FTM services are provided

A number of parties have alleged that vertically-integrated carriers may be engaging in anti-competitive price-squeezes, price discrimination and bundling in the downstream FTM services market. Most allege this is possible because of the market power some vertically-integrated carriers have in the downstream market within which FTM services are provided caused by the ineffectiveness of the existing MTAS pricing principle. The Commission has commenced separate investigations regarding pricing practices for FTM services in the corporate sector of the market to ascertain the veracity of these claims.[478]

As indicated in Chapter Four of this report, the Commission is also separately conducting investigations into specific allegations of anti-competitive conduct by some carriers in the market within which FTM services are provided under Part XIB of the Act.

Overall assessment of the existing retail benchmarking methodology

In its Draft Decision, the Commission indicated it believes the retail benchmarking methodology has, to date, shown little evidence of its ability to meet its original objective. That is, if applied in any arbitration to date, the methodology would have been unlikely to generate meaningful decreases in the price of the MTAS towards cost. Further, there does not appear to be evidence of the emergence of greater competitive pressures on the pricing of the MTAS. Finally, there continue to be grounds for concern with regard to the possibility of anti-competitive pricing of FTM services in downstream markets.

Hutchison expresses the same concerns above by contending in its response to the Draft Decision that:

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[478] Under a Direction issued on 19 June 2003 by the Minister for Communications, Information Technology and the Arts, the Commission is required to monitor and prepare six-monthly reports for the Minister on competition in the telecommunications industry in the corporate customer segment. The Commission's first report covering the period July-December 2003 is being finalised at the time of writing of this Final Report.