

MOBILE SERVICES REVIEW

SUBMISSION BY THE COMPETITIVE CARRIERS' COALITION ON THE ACCC'S DRAFT DECISION ON THE MOBILE TERMINATING ACCESS SERVICE

The Competitive Carriers' Coalition ("CCC") welcomes the opportunity to make this submission on the ACCC's draft decision on the mobile terminating access service (the "**Draft Decision**") under Part XIC of the *Trade Practices Act 1974* (Cth) (the "**TPA**").

Summary

The CCC generally supports the Commission's approach and methodology in the Draft Decision.

In particular, the CCC supports the hybrid cost-based pricing methodology used by the Commission to determine the charges for the mobile terminating service ("**MTS**"). The CCC also supports the quantum of the MTS charges, as proposed by the Commission in the Draft Decision.

However, the CCC is concerned about the impact of the Commission's proposed adjustment path towards a closer association of prices and costs for the MTS, as set out in the Draft Decision.¹ The CCC notes that MTS access seekers have been paying around 21cpm for MTS for the best part of 18 months. This is acknowledged by the Commission in the Draft Decision to be almost double the appropriate, cost-based price. Were the Commission to set 21cpm as the first price point in the adjustment path for MTS charges (commencing July 2004), this would provide no relief for access seekers and would only prolong for another eight months the current, inflated price of MTS.

The CCC further considers that the Commission's proposed decision to delay the implementation of a reduction in MTS charges is contrary to the object of Part XIC of the TPA,² in that it will not promote the long-term interests of end-users of services for which the MTS is an input (the "**LTIE**"); indeed, there is a strong likelihood that it will harm the LTIE.

Accordingly, this submission focuses on the CCC's concerns in this regard and urges the Commission to immediately implement the reduction in MTS charges in the Draft Decision, using the following adjustment path:

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

¹ See esp. Draft Decision, section 8.2.5.

² See section 152AB of the TPA.

Specific Comments

The Commission states in the Draft Decision:

...the Commission believes adoption of such a [TSLRIC] pricing principle would be time consuming and costly to implement, and immediate adoption could generate significant ‘rate shock’ into the mobile industry. Were adoption of a TSLRIC pricing principle to be immediately implemented in July 2004, it is likely the price of the mobile termination service would fall very substantially in a short space of time. This would be likely to generate significant and potentially harmful disruption to the operations and planning of a number of telecommunications carriers.³ (Emphasis added.)

And later in the Draft Decision:

Given concerns about the possibility of significant adjustment costs (or ‘rate shock’) generated by an immediate fall in the price of the mobile termination service to such a benchmarked measure, the Commission believes an ‘adjustment’ mechanism should be implemented that ensures the price of the service gradually trends towards this benchmark over a succession of periods.

The Commission has therefore decided to adopt a pricing principle for the mobile termination service that generates a gradual reduction in the price of the mobile termination service so that it reduces to a level that represents a closer association of price and the best cost measures the Commission has available to it.⁴ (Emphasis added.)

In other words, the Commission recognizes that the previous retail benchmarking approach has been inadequate in meeting its objectives⁵ and therefore proposes to adopt a hybrid cost-based approach to determine MTS charges. However, this conclusion is tempered by an apparent concern on the part of the Commission that an immediate adoption of its proposed MTS price would somehow inconvenience those parties who have, to date, been benefiting from excessive access prices.

The CCC queries this approach, for the following reasons.

1. *There is no policy basis for the Commission’s proposed “adjustment mechanism”*

The CCC notes the Commission’s use of the term “rate shock”. This notion forms the basis of the Commission’s proposed decision to delay the implementation of the reduction in MTS charges. However, the CCC respectfully submits that the reasons for adopting such an approach are not substantiated by the Commission, either on policy, economic or legal grounds.

Typically, the term “rate shock” is used in the context of interest rates or exchange rates, to describe the likely chilling effect which a sudden and substantial increase in rates might have on investment or capital markets.

The term “rate shock” has no legal meaning and does not appear to be contemplated by any of the criteria in section 152AH of the TPA. The CCC notes that “rate shock” is *not* one of the criteria which determine the LTIE under Part XIC of the TPA, nor is it supported by any of those criteria;

³ Draft Decision, p.xvi.

⁴ Draft Decision, p.165.

⁵ See Draft Decision, p.159: “Overall, the Commission 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 mobile termination services towards cost. Further, there does not appear to be evidence of the emergence of greater competitive pressures on the pricing of mobile termination services. Finally, there continue to be grounds for concern with regard to the possibility of anti-competitive pricing of FTM services in downstream markets.”

and even if it were, the CCC considers that the Commission has not provided sufficient explanation or justification for adopting a “rate shock” approach.

Even where the term is used in relation to areas other than interest rates or exchange rates (for example, water rates or council rates), it almost always refers to an *increase* in rates, rather than a decrease.

Further, there does not appear to be any suggestion (nor, in the CCC’s respectful view, any justification) by the Commission for drawing a connection between a decrease in regulated prices for MTS and the effect on business plans⁶ of one party (or a small group of parties) in a wholesale market (such as, in the present case, dominant mobile network operators (“**dominant MNOs**”)). In other words, the Commission does not appear to have provided any logical or analytical link between a putative “rate shock” and an impact on the business plans of dominant MNOs.

2. *The Commission’s proposed “adjustment mechanism” prolongs the principal mischief which the Commission has identified in the Draft Decision*

It is clear from the Draft Decision that the Commission accepts that the retail benchmarking approach has not fulfilled the object of Part XIC of the TPA (and may even have negated it).⁷ The CCC regards this as a clear instance of regulatory error, which is further demonstrated by the following factors:

- the Commission finds in the Draft Decision that there continue to be strong non-competitive and/or anti-competitive forces within the market for MTS and fixed-to-mobile services (“FTM”);
- fixed network operators (such as CCC members) have for quite some time been (and still are) agitating for cost-based pricing (as is their entitlement under Part XIC of the TPA, given that MTS has been a declared service for seven years),⁸ and
- dominant MNOs continue to resist regulatory intervention in respect of pricing for MTS.

Accordingly, the CCC submits that these factors justify an urgent need to remedy the regulatory error created by the retail benchmarking approach, rather than an approach which effectively prolongs the existing deficiency.

In addition, the CCC notes that one of the key principles of Part XIC of the TPA, in determining interconnect prices, is that the access provider is entitled to recover its *direct costs* and is not entitled to profiteer from the supply of declared services (such as MTS) to access seekers. This is expressly provided in section 152AH(1)(d) of the TPA and is highlighted in the Commission’s *Access Pricing Principles*:⁹

Direct costs are those costs necessarily incurred (caused by) the provision of access. As stated in the explanatory memorandum

⁶ See Draft Decision, p.167, under the sub-heading: “What is the starting date and price?”

⁷ See fn.5.

⁸ The MTS was declared as from 1 July 1997: ACCC, *Deeming of Telecommunications Services*, 30 June 1997.

⁹ *Access Pricing Principles – Telecommunications, July 1997, ACCC.*

... ‘direct’ costs of providing access are intended to preclude arguments that the provider should be reimbursed by the third party seeking access for consequential costs which the provider may incur as a result of increased competition in an upstream or downstream market. (*Trade Practices Amendment (Telecommunications) Bill 1996 Explanatory Memorandum* p. 44)

This requires that an access price should not be inflated to recover any profits the access provider (or any other party) may lose in a dependent market as a result of the provision of access.

In the CCC’s view, this gives further weight to the argument that dominant MNOs ought not be entitled to continue to derive excess profits from the MTS and that the Commission’s proposed adjustment mechanism ought to be immediately implemented.

3. *The Commission’s proposed “adjustment mechanism” exacerbates a diminution in consumer welfare*

The notion of consumer welfare is central to the LTIE and indeed the TPA.¹⁰ This raises the following issues:

- the Commission makes the following observation in the Draft Determination:

“Overall, the analysis in Chapter Five 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 an 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.”¹¹

This particularly highlights the continuing loss of consumer welfare caused by excessive MTS charges and the need to immediately implement a reduction in MTS charges; and

- the Commission further states in the Draft Decision:

“Removing the ability of vertically-integrated fixed and mobile network operators 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.”¹²

This suggests that customer losses (from fixed network operators to dominant MNOs) due to the latter group having the ability to leverage their market power (including by bundling) will be substantial over time and will become increasingly difficult to reverse. This will lead to further customer losses (in markets for all relevant bundled services) and therefore substantial revenue losses for fixed network operators. However, it will also lead, over time, to practically irreversible losses in consumer welfare: as dominant MNOs leverage market power to attract more and more customers, this augments their ability to increase prices, reduce quality of services (or resist pressure to improve services) and reduce consumer choice.

¹⁰ Section 2 of the TPA provides: “The object of this Act is to enhance the welfare of Australians through the promotion of competition and fair trading...”

¹¹ Draft Decision, p.ix. The Commission’s figure of 14cpm for the estimated underlying cost of providing a FTM call, includes origination, transmission and retail costs, as well as termination.

¹² Draft Decision, p.x.

4. *Dominant MNOs have had between two and seven years to prepare for the introduction of cost-based pricing for MTS*

Dominant MNOs have patently had sufficient time to prepare for the introduction of cost-based pricing for MTS. Notwithstanding their extensive attempts to delay the matter, they were aware as from 1 July 1997 that its time would come.

The CCC submits that to prolong dominant MNOs' excessive MTS charges is tantamount to a policy of artificial protection of a small group of carriers and is contrary to the objects of Part XIC of the TPA and the TPA *in toto*.

5. *The possible disruption to the operations and planning of dominant MNOs is an insufficient basis for the proposed "adjustment mechanism" and is likely to harm the LTIE*

A key reason given by the Commission for proposing the "adjustment mechanism" is that if a TSLRIC pricing principle were to be immediately implemented in July 2004, "it is likely the price of the mobile termination service would fall very substantially in a short space of time. This would be likely to generate significant and potentially harmful disruption to the *operations* and *planning* of a number of telecommunications carriers." (Emphasis added.)¹³

In the CCC's submission, any ostensible disruption to dominant MNOs' operations is spurious, as any reduction in MTS charges would be simple and transparent (for all carriers) to implement. The CCC struggles to understand what operations issues, if any, an immediate reduction in MTS charges would entail.

Any ostensible disruption to dominant MNOs' planning is similarly spurious, as they have had up to seven years to prepare for the introduction of cost-based pricing for MTS.

In any event, the CCC is very concerned that the Commission appears to be adopting a role of protecting the business plans of individual participants. The CCC stresses that the Commission's proper role in the present context is to determine a cost-based price for MTS in accordance with the LTIE, not to protect the commercial interests of individual participants.

Finally, the CCC submits that a delay in the implementation of the Commission's proposed "adjustment mechanism" is more likely to result in continuing disruption to the planning, budgeting, cash flow and contingent liabilities of fixed network operators and that a proper assessment of the LTIE demands that the Commission give sufficient weight to these considerations. In particular, the CCC submits that a failure by the Commission to give sufficient weight to these considerations is likely to impair the ability of fixed network operators to compete in relevant markets (including the market for FTM). In this regard, section 152AB(2)(c) of the TPA provides that, in determining whether a particular thing promotes the LTIE, regard must be had to the extent to which the thing is likely to result in the achievement of the objective of promoting competition in markets for listed services (which, in the present matter, includes FTM).

¹³ Draft Decision, p.xvi.

6. *There is no basis for the Commission's proposed timeframe for its proposed "adjustment mechanism"*

It appears that the Commission has chosen an arbitrary timeframe for implementing its proposed "adjustment mechanism".

In addition to the other matters set out in this submission, the CCC considers that 30 months is an excessive timeframe and queries on what basis the Commission considers this to be an appropriate timeframe. Rather, the CCC submits that if there is to be any "adjustment mechanism", an 18 month implementation period is more reasonable, in that it accommodates the interests of all parties.¹⁴

Conclusion

Given the Commission's conclusion that dominant MNOs are likely to be deriving monopoly rents from the MTS¹⁵ (and, by extension, have been doing so for up to seven years), combined with the fact that fixed network operators have been paying between 200% and 500% too much for MTS across that period,¹⁶ the CCC considers it quite astounding that the Commission is proposing to further delay the implementation of the reduction in MTS charges as proposed by the Commission in the Draft Decision.

After all, a key policy basis of Part XIC of the TPA is to provide for cost recovery by access providers in supplying declared services such as MTS, rather than supporting the ongoing derivation of monopoly rents from the supply of such services.

The Commission's statutory duty involves the weighing of competing tensions: on the one hand the Commission has identified *possible* inconvenience to dominant MNOs by immediately implementing the proposed reduction in MTS charges; on the other hand, fixed network operators have for some time endured *actual* substantial losses by paying excessive prices for MTS (which, after all, by virtue of being a declared service, is supposed to be supplied by access providers on reasonable terms and conditions, including price).

At best, the Commission's proposed "adjustment mechanism" is counter-intuitive; at worst, it is devoid of any legal basis. In the CCC's submission, there is no justification for delaying the implementation of the proposed reduction in MTS charges.

¹⁴ The CCC notes that, under section 152AH of the TPA, the Commission is required to consider the interests of *all* relevant persons.

¹⁵ Draft Decision, p.59: "Whilst the mere existence of a monopoly does not automatically imply that prices will be set at a level inconsistent with that expected in competitive markets, the Commission considers that both the structural and behavioural characteristics of the mobile termination services markets indicate that mobile network operators are using their market power in their individual markets to extract monopoly rents and enjoy economic profits from the provision of wholesale mobile termination services. Accordingly, the Commission considers that the state of competition in each of wholesale mobile termination services markets is not competitive."

¹⁶ Based on the Commission's "conservative" indicative range of 5cpm of 12cpm in the Draft Decision: see Draft Decision, section 5.3.

Accordingly, the CCC urges the Commission to immediately implement the reduction in MTS charges in the Draft Decision, using the following adjustment path:

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

The Competitive Carriers' Coalition
May 2004