



Submission on the Draft Report on Pricing Methodology for the GSM Termination Service

This submission is the result of the culmination of the many perspectives and experience within CTIN team. While Prof Coutts lead the discussion, the CTIN team in addition to Reg Coutts consisted of Graeme Holm (ex Vodafone), Brian Louey-Gung (ex Telstra, Link and Iridium), Trevor Jordan (ex Telstra) and Paul Chapman (independent). Paul Chapman our senior research economist drafted this submission and evaluated for inclusion the variety of views provided.

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Preface

The decision by CTIN to respond to the ACCC review was stimulated by a role-play as part of a training exercise conducted by Professor Coutts of CTIN for a Singapore operator. The three teams representing the incumbent, the new player and regulator. When presented with the opportunity to commercially negotiate an interconnect agreement, the two operator teams reached a mobile termination price double what they had been given as a starting assumption. While of significant benefit to both parties it would be arguably be to the detriment of customers in the market place. This role play brought it home that “leaving to the market” was not the best option. Needless to say the regulator team was unclear how to proceed!

Introduction

In December 2000, the Australian Competition and Consumer Commission (ACCC) called for responses to its Draft Report concerning the issue of termination charges for GSM services.

This paper provides comments and suggestions from the Centre for Telecommunications and Information Networking (CTIN). The paper deals directly with the report and comments critically on some aspects of it.

The CTIN believes that, on balance, the ACCC proposal to resolve the problem by monitoring trends for termination charges against other relevant charges is pragmatic and broadly welcome. Nonetheless, the CTIN believes that more is required. In particular, it recommends that the ACA undertake the monitoring and that it makes public the conditions under which it would judge that monitoring to have failed and the steps it would then take.



The Problem

Mobile termination charges are levied by a mobile network operator on fixed and other mobile networks owners for calls which originate on their networks and terminate with the operator. These charges are then passed on to the caller.

We understand that, in Australia, these charges are reciprocal, bilateral and confidential: what one operator charges another is the same as what the second charges the first and these charges might differ from those either operator charges a third.

These charges are contentious because they are anomalies which fall outside the competitive processes that are driving efficiency elsewhere in the telecommunications industry. Put simply, the A party caller cannot choose the B party's phone company and so can bring no pressure to bear on the termination charges.

The result is that termination charges are set in excess of costs. The Report has provided no evidence on the charges or on the gap between charges and costs (a point taken up below) but a recent report by Ovum estimates that in four locations in the Asia-Pacific region, the charges for mobile termination are 10-15 times that for fixed termination whereas costs are only 5-6 times greater (Ovum, 2000, p 5). The same report adds that the ACCC's own estimates suggest that the charges for termination exceed the costs by an order of magnitude.

The matter is serious not simply because high prices are likely to leave current wireless technologies underutilised and networks undersized. More importantly, wireless will be a large part of the telecom future and getting the linking prices right will be crucial in encouraging innovation and the long term interests of end users.

Mobile termination charges are also an issue elsewhere in the world. Oftel, the UK telecom regulator, has referred the matter to the Mergers and Monopolies Commission. The US is also addressing the issue as it moves towards calling party pays and the recent Ovum report points to discussions currently proceeding between operators and regulators in a number of countries.

Of course, when Telstra had a monopoly in Australian telecommunications, the price of termination would have been an internal matter and would have been set to reflect costs, albeit with a monopolist's margin. But bringing competition to an industry which can only function as a network raises the problem of interconnection: how to ensure that the prices of connecting between different companies are reasonable?

Before looking at the ACCC's proposals, it is important to be clear as to why is it that one of the mobile operators does not take the lead and cut the charge to the fixed networks? If they did, the B parties would then have an incentive to switch to them because their friends and family and customers could then call them more cheaply. This is not full blown competitive pressure but it would increase the demand for operators which charged lower prices.

The problem is that the price elasticities are unfavourable. All the estimates available, including our own, suggest that demand is inelastic with respect to termination charges so that it responds less than proportionately to the change. This means that the reduction in termination charges creates a revenue loss for the leading firm.

There are other possible solutions, some of which are discussed below and all of which require that the Commission become involved. But, firstly, this paper considers the draft Report itself.



The Draft Report

The Commission's Report deals only with termination charges for GSM services. As such it is but one step in a process of public consultation which addresses a range of issues surrounding mobile services, including those raised in the five disputes concerning mobile charges that are currently before the ACCC.

This immediately raises a point of procedure. None of the disputes concern termination charges and in all cases "the main issue ... is the price and conditions of access" (ACCC, 2000, p 3). Even though termination charges are a declared service, without a dispute over access CTIN's understanding is that the Commission's powers to intervene under the Telecommunications Act are limited. We return to this point in making proposals below.

Nonetheless, the Commission clearly believes that there is a problem and it states that "the termination element of the mobile services market remains significantly above costs" (ACCC, 2000, p 5). A significant weakness is that the Report contains no data to support this claim. The ACCC bases its observation simply and somewhat enigmatically on its "market inquiries".

The lack of evidence raises a number of issues. On the one hand, the Commission needs to do more: it must clarify the extent of the problem to show that it is worthy of attention and that the proposed solution is proportionate to it. On the other, the lack of information calls into question the ability of the Commission to provide a transparent and effective process of monitoring in future, as its proposals suggest it will do.

There is a further weakness apparent in the Commission's conception of the problem. In commenting on mobile-to-mobile termination charges, the Commission argues that there is "no .. advantage .. in sustaining high GSM termination" (p 5) because mobile operators are both buyers and sellers of termination access. If calls to and from other networks are equal and call patterns are regular, there can be no advantage in settling on high charges. A similar claim is made for mobile termination services more generally regarding this "countervailing power" (p 13).¹

However, that way of putting matters is a misconception. Mobile termination are charges passed on to consumers who have no control over those charges. The operators are simply collecting the charge on each other's behalf and it is to the advantage of both to agree on high charges. The interests of one do not countervail against the interests of the other. To conceive of the problem as the Commission has done understates both the harm and the difficulty associated with it.

Finally, the ACCC argues that CDMA is a substitute for GSM technology but that 3 G technologies are not. The CTIN believes the evidence shows clearly that 3 G services will directly compete with GSM and should be brought into the Commission's thinking.

These weaknesses should be set against some very considerable strengths of the Draft Report.

The proposed response to the problem is subtle and astute. The ACCC recommends establishing a "glide path" such that mobile termination charges will be set against the trend in "the overall mobile package (access and outgoing calls)" (p 6). The reasoning is pragmatic: these overall charges are declining through a combination of competition and regulatory pressures. To the extent that termination charges do not fall in line with them, it is implied that they are in need of further regulatory action, although (and this is a major problem) what this might be is not clear.

In addition, the Commission comments sensibly on the critical issue of so called closed user groups, stating that they can 'place more of a competitive focus on access prices for mobile termination" (p 14) and can mitigate the problem at hand. Certainly, at present, as the ACCC also notes, they are too few to provide a strong competitive stimulus.

¹ The Commission states elsewhere in the Report that "even though a mobile carrier may have control over access to GSM termination, its ability to raise prices is tempered by the fact that GSM termination is not negotiated in isolation and that mobile carriers are usually buyers of services from other carriers" (p 13).



Some Suggestions

The CTIN believes that any regulatory action in regard to mobile termination charges should be light-handed and yet must be strident if it is to be effective. While the Centre supports the broad thrust of the Commission's recommendations, like the analysis itself, they are not without weaknesses.

Essentially, the problem is that the ACCC does not consider itself able to detail what it knows of mobile termination charges or how it intends to undertake the monitoring. It is understood that some of the information involved will be confidential but, as it stands, the information flow is all within the loop of regulator and regulated.

This process lacks transparency and the CTIN is of the view that the Commission should be more forthcoming about the extent of the problem and the progress made in solving it. This need not involve providing company-specific information as it is as much to do with making the process clear. The references to "market inquiries" found within the draft Report are imprecise and unhelpful.

In short, one of the key problems with termination charges is that they are cosily secret. CTIN believes that part of the appropriate response involves requiring that mobile operators place information concerning their termination charges in the public domain. This will bring to the attention of the mobile phone owners the cost others incur in calling them. Alone it is not enough but it will help complete the information link from the charging regime to the choice of operator.

If it works well, the proposal will exert competitive pressure on the operators who are expensive and reward those who move on these charges and so it will help dislodge the competition log jam.

CTIN does not believe that the Commission's proposal to rely on confidential monitoring of undisclosed charges is likely to be effective nor will it meet the requirement of transparency. The Commission's proposals need to be made more open and explicit and they need to be extended to make clear what steps will be taken if monitoring is found to be insufficient.

We suggest that the ACCC might not be the best organisation to undertake this work. Despite that one of the most lauded benefits of creating the Commission was that it would avoid too close a relationship between an industry sector and government officials which regulate and assist it, the Commission's recommendations in this instance can give the impression that we have returned to the previous system.

A better way of implementing what we reiterate is a good recommendation would be to put it in the hands of the ACA which already has a brief to monitor certain industry developments. The CTIN believes also that the ACA should then make public its plans should the monitoring show that further initiatives are required. In particular, public confidence would likely be enhanced if it were made clear how closely termination charges should track others before further action is taken and what that action would be.