



**Submission on Draft MTAS Prices 2009-2011**

**December 2008**

## **Introduction**

The CCC welcomes the opportunity to comment on the Commission's draft pricing principles for the Mobile Terminating Access Service.

The CCC and its members have been active participants in discussions about the regulation of this service for many years. This is because the service is important to the CCC members in its own right but also because of the detrimental effect the historical over-pricing of MTAS has had on competition generally.

## **Retail Prices, Pass Through, and Commission Contributions**

The Commission is clearly greatly concerned and disappointed that there has not been sufficient competitive pressure to drive retail prices down as fixed to mobile termination rates have fallen. Indeed, it is implicit in the draft decision that this forms a large part of its reasoning for not reducing MTAS rates.

The failure of the past regulatory rate reductions to be reflected in retail price falls has clearly shaken the confidence of the Commission in the efficacy of competition as a device to create pass through of cost reductions to consumers.

However, the CCC submits that the experience to date reflects a lack of competition and not the failure of the Commission's basic reasoning that competition is the best device to create retail price pass through.

The CCC submits that there is a wider context that explains the retail price rises by Telstra that the Commission observes. That is, fixed line competition generally is in retreat and Telstra's market power on the rise.

This is particularly the case in relation to wholesale-based fixed line competition, although investment in ULLS-based competition has also clearly slowed in the past year.<sup>1</sup>

Further, Telstra's increases in its market share, revenues and profitability are clear evidence that the competitive outcomes that were intended by the policy settings are not occurring.

Evidence from the US suggests that there is a direct relationship between the weakening of wholesale competition and the over-recovery by incumbents.

As an illustration of this, Selwyn has described how in the US local access prices from 1983 to 2004 rose, while long distance prices fell over the same period.<sup>2</sup> His explanation

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<sup>1</sup> Market Clarity has recently reported that: "carriers and service providers seem to have spent much of 2008 "marking time" on their infrastructure plans" and that planned DSLAM installations by competitors had fallen from 254 in February 2008 to 84 in December.

of this is that little competition developed at the last mile, where the incumbents retained their control of bottleneck infrastructure post the structural separation of AT&T, while competitive entry flourished in the long distance markets and later Internet service markets.

Separately, Selwyn et al have shown that the profits enjoyed by US incumbents from bottleneck access prices have reached “dizzying heights” as regulation of these services has been withdrawn.<sup>3</sup>

None of this should be surprising, yet there seems to be evidence that regulators in some countries have responded with a misplaced determination to reduce regulation of the last mile. Seemingly, regulators have lost sight of the obvious consequences of prematurely withdrawing regulation that has sustained fixed line competition, even in the face of the increasing profitability of incumbents and the increasing concentration of the industry.

There is no evidence that this approach is leading to stronger competition. There is a great deal of evidence emerging that it is leading to a decline in competition and an alarming increase in margins for bottleneck services, which inevitably increase prices to consumers.

In this context, the CCC submits that a decision by the Commission not to further reduce wholesale mobile terminate rates paid by fixed line competitors to Telstra because of a lack of fixed line competition becomes self-fulfilling. Further, it would be another in a series of decisions by the Commission itself that have had the effect of weakening fixed line competition to the point where the Commission is now indicating its serious concerns about market failure and the impact on consumers.

The weakness in fixed line competition is not new, and in fact the CCC has for some years been warning the Commission both that competitive forces in the fixed line market are weakening, and that the Commission has contributed to this problem through its actions.

The CCC submits that a series of Commission pricing decisions have contributed directly to the gradual undermining of wholesale-based competition in fixed line services by allowing Telstra to over-recover and price discriminate in fixed line markets against wholesale competitors.

These decisions include:

- Flawed retail minus methodology leading to widening gap in revenue per line wholesale/retail.
- Failure of Commission to move from a single retail service benchmark to an average of retail line rental products to establish WLR prices.

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<sup>2</sup> When the Competition Died – and What We Can Learn from the Autopsy, Lee L Selwyn, Economics and Technology Inc December 5 2005.

<sup>3</sup> Special Access Pricing and the US Economy, Economics and Technology Inc, August 2007

- A failure to not put in place any effective mechanism to deal with anti-competitive cross subsidy by Telstra in bundling of retail services, despite its vertical and horizontal integration and the obvious opportunity for actions to thwart competition through retail bundles.
- Decisions to allow Telstra exemptions for wholesale regulated services in some locations where competitors have invested in DSLAM rollouts, despite evidence that there was no effective voice competition from these investments.

In making these decisions, the Commission has sought to systematically push competitors toward quasi-infrastructure based competition in the form of the ULLS by making the wholesale alternatives less attractive, or completely unavailable.

However, this has had the effect in the real, commercial world of causing competitors to completely withdraw from some geographic areas. It is clear that there are numerous and intractable difficulties for competitors trying to wholly replace wholesale services with ULLS-based alternatives under present arrangements, especially for voice product markets. This means the Commission's notion of how competition would develop has been misplaced.

In other words, the Commission has successfully forced competitors to withdraw from wholesale based competition but has not successfully made ULLS-based voice services a viable alternative. What the Commission is seeing in the increasing Telstra retail prices for fixed to mobile calls is just one example of Telstra taking advantage of this development.

Evidence from the US, where the wholesale market has declined dramatically and over recovery by incumbents risen equally dramatically since the regulator there took a similar approach, should have caused the Commission pause before now and reconsider this approach.

Against this background, the CCC submits that it is not an appropriate or logical action by the Commission to lock in for three years what are clearly above cost MTAS indicative prices as a response to the growing evidence of failing competition. Such a decision simply further undermines any residual competitive wholesale fixed line industry and locks in over recovery by Telstra.

The Commission's decision to pass the problem of retail price pass to the Government for consideration is all the more reason that the Commission should focus on the simple question of what MTAS rate represents its best estimate of cost and to move toward that point.

The CCC acknowledges that Commission must take into account the interests of various parties in determine what pricing principles to set for the next three years, including consumers, competitors and MNOs.

If the Commission takes the view that it is unable or unwilling to resolve the problem of retail pass through to satisfy the interests of consumers, and that this is properly a question requiring a policy response, it should be free to consider best regulatory practice in the interests of other stakeholders in the tasks for which it does wish to retain responsibility.

The Commission refers to its desire to provide certainty to MNOs in the draft decision, but does not refer to the needs of competitors, in particular, the needs of fixed line competitors.

The CCC submits that the Commission has a responsibility to discharge in relation to those stakeholders as well as MNOs, and that it has not met that responsibility in the draft decision.

### **Basis of Cost Calculation**

The most detailed analysis of the cost of termination on mobile networks that the Commission refers to in its draft decision is the WIK modeling, which results in cost estimates of around 6cpm, about 50% below the proposed indicative prices.

The Commission includes some overseas benchmarking but the CCC submits that this does not appear to reflect reported recent developments. For example, it has been reported that the French regulator proposes to reduce the MTAS rate to 3-4 Euro cents per minutes by 2010.

The CCC is also disturbed to note that there is an absence of any reference to the examples of situations that members of the CCC have been brought to the Commission's attention where Telstra has offered some users retail prices well below 9cpm.

The CCC understands that various of its members have taken to the Commission specific examples of retail prices below 9cpm being offered by Telstra to retail customers, but the Commission has failed to take any action. That Telstra is able to offer such prices in the most competitive parts of the market, such as corporate, should be persuasive evidence to the Commission that validates the WIK cost estimates.

MTAS rates clearly remain above Telstra's cost because it retains the ability to cross-subsidise. This means fixed line competitors are unable to influence price for F2M retail because Telstra is able to continue to under price in competitive markets, forcing competitors to recover margins where they can.

If the Commission does not believe it is appropriate to take action under Part XIB powers in response to examples of this conduct, but then also ignores the evidence of this conduct in its XIC deliberations, access seekers can only conclude that the Commission has put this issue in the too hard basket. This in turn is reflected in a lack of confidence in

the Commission more generally to be willing to confront Telstra. Again, this can only contribute to the weakening of competition.

By nominating a draft MTAS rate of 9cpm, the Commission is proposing a price 50% above the most rigorous and specific information on cost that the Commission has available to it.

Fixing model prices at this level for three years does not provide “certainty” to the market, it simply allows monopoly rents. The evidence of Telstra’s willingness to offer retail price below MTAS rates in some instances suggests that this will continue to be a problem retarding the development of fixed line competition for three years if the indicative price remains fixed.

### **Industry Structure, Events in the Coming 12 months and Recommendations**

The Commission indicates that it expects to be in possession of more information about the actual costs of MTAS to MNOs in the next 12 months as a result of record keeping rules it has issued. Further, it has indicated that it will recommend to the Government that it consider a policy mechanism to force retail pass through of the MTAS reductions to date. It should be expected that the Government will have indicated how it intends to respond to this in the next 12 months.

The CCC submits that a third significant development in the next 12 months of relevance to the MTAS indicative prices will be the Government’s decision as to how to proceed with the National Broadband Network.

It is clear that the vertical and horizontal integration of Telstra is at the core of its market power, as reflected in the increases in retail fixed to mobile prices identified by the Commission. It is reported that the Government has received three proposals for a national access network that would be owned and operated on a structurally separated basis.

If the Government supports such a proposal, Telstra fixed line market power is likely to be significantly reduced, with potentially important implications for retail competitiveness and price movements across a range of retail services.

Therefore, it is entirely possible that one or more of the following things could occur in 12 months or less:

- The Commission might confirm that MNO termination costs are well below 9cpm through information gathered under the RKR
- The Government may have indicated that it will introduce retail price controls to reduce the retail price of fixed to mobile calls in line with past MTAS price reductions.

- The Government may have moved to act in ways that will reduce Telstra's fixed line market power in more permanent ways through addressing the structural impediments to sustainable competition in communications markets in the NBN processes.

Yet, despite the strong potential for any or all of those developments in the next year, the Commission is proposing in its draft decision to "set and forget" MTAS indicative prices at 9cpm for a full three years. It does not give itself the opportunity to revisit the decision even while acknowledging that it is expecting to be in possession of more and better information in the near future.

The CCC submits that this is not a responsible course of action.

Recognising the above possible developments, the CCC recommends that the Commission set the MTAS indicative price at 9cpm for 12 months only, to be revisited at the end of 2009.

CCC further recommends that the Commission indicate that it intends take further action to adjust MTAS indicative prices after first 12 month period, subject to:

1. what is shown by the information it has sought from MNOs through the RKR's,
2. the Government's response to the Commission's advise on policy intervention, and/or
3. what structural changes to the industry emerge from the NBN process.

In order of priority, the CCC recommends that the Commission indicates in its final decision that the further course of action for the final two years of the period of the indicative prices will be one of the following:

1. Introduce a two year glide path to the Commission's best estimate of cost
2. Reduce indicative prices to 6cpm and 6cpm
3. Reduce indicative prices to a maximum 7cpm in 2010 and 6cpm in 2011.
4. Reduce indicative prices to a maximum of 7cpm in 2010 and/or 2011.

In so doing, the Commission will signal to all industry participants that it has not abandoned its commitment to the regulatory principle that access prices should accurately reflect costs, that it remains concerned to balance the interests of all parties affected by its decisions, and that it will act in a timely manner as soon as warranted by changing circumstances and/or better information.

## **Contact**

The CCC is happy to provide further material or to expand on the issues raised in this submission.

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