



Comments of MCI

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Regarding the

Australian Competition and Consumer Commission's

*Mobile Terminating Access Service Draft Decision*

*For additional information, please contact:*

Mary-Jane Salier  
General Counsel, Australia  
MCI, Inc.  
The Forum, 203 Pacific Highway  
St Leonards, NSW 2065 Australia  
(tel) +61-2-9434-5418; (fax) +65-6248-6560  
email: [mary-jane.salier@mci.com](mailto:mary-jane.salier@mci.com)

Joe Welch  
Director, Asia-Pacific Regulatory Affairs  
MCI, Inc.  
26/F Devon House  
Quarry Bay, Hong Kong  
(tel) +852-2233-6198, (fax) 852-2233-6198  
email: [joe.welch@mci.com](mailto:joe.welch@mci.com)

## **INTRODUCTION**

MCI WorldCom Australia Pty Ltd (MCI) welcomes the opportunity to submit comments in response to the Australian Competition and Consumer Commission's (ACCC or the Commission) *Mobile Terminating Access Service Draft Decision*.

MCI applauds the ACCC for recognizing that Australia's mobile termination rate, among the highest in the developed world, must be significantly lowered. We find the Draft Decision clearly reasoned and we appreciate the opportunity to provide further comment in this important proceeding.

Our comments focus on two key points that we urge the Commission to reconsider. First, we believe the rate reduction to 12 cents is a good start but not sufficient. Second, we consider the implementation "glide path" too gradual.

### **REQUEST FOR RECONSIDERATION OF THE 12 CENT RATE**

MCI is encouraged by the Commission's recognition of the need to regulate the termination segment and its move to mandate a lower rate that is in line with the underlying cost of production.

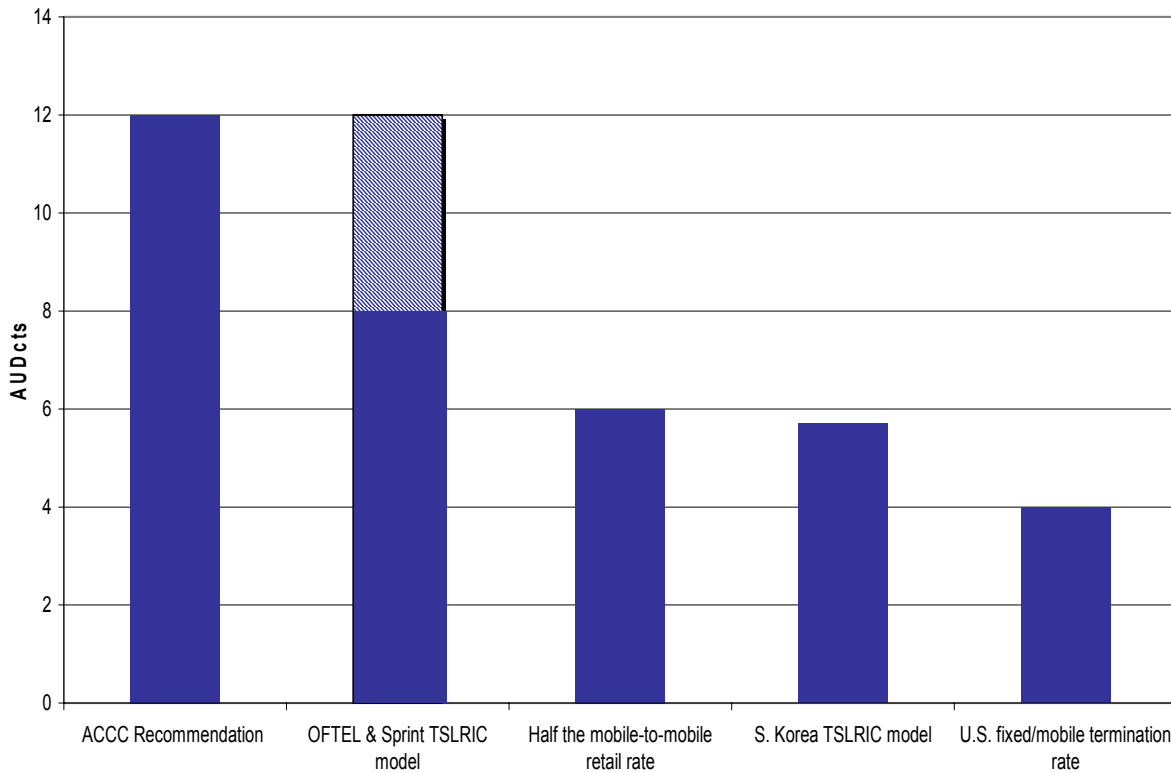
In addition, we support the Commission's decision to determine a target price for the mobile termination service based on a benchmarking against a range of cost estimates for providing mobile termination service.

MCI believes, however, that the record in this proceeding indicates that the recommended 12 cent rate is too high and does not meet the Commission's stated goal to lower the rate toward the underlying cost of provision.

To demonstrate this point, we use the bar chart below. The chart summarizes the record before the Commission in this proceeding. All benchmark rates are in Australian cents.

**Table 1:** Benchmark Data for the Cost of Mobile Termination Service

### Benchmark Data Re Cost Oriented Mobile Termination Rates



The table illustrates clearly that a wide range of TSLRIC cost models and other indicators show that 12 cents is a good start but is not sufficiently oriented toward the underlying cost of production.

The record in the proceeding and the figures in the bar chart (from left to right) are summarized as follows:

ACCC recommendation: 12 Australian cents

This is the rate proposed by the ACCC in its draft decision. It is, by the ACCC's own admission, the top end of the cost benchmark data presented to the Commission in this proceeding.

### OFTEL and Sprint PCS TSLRIC cost model summary recommendation: 8 -12 Australian cents

The OFTEL model was performed for OFTEL in 2001 by the consulting firm Analysys. The Sprint PCS model was developed internally by Sprint in the context of a state regulatory proceeding in the same year, 2001. The ACCC, in its Draft Decision, correctly summarizes these cost models as indicating a rate of between 8-12 Australian cents.

### MTM retail rates in Australia: 5-6 Australian cents

The rate that a mobile operator may offer its retail users for an on-net mobile-to-mobile call, divided by two, can be used as a proxy for the cost of termination. This is because a retail mobile-to-mobile call is comprised of an origination and termination segment. In fact, this can be a conservative way to benchmark the cost of termination since the retail charge to the end user would include additional costs not related to provision of the wholesale termination segment.

The ACCC, in its Draft Decision, includes reference to this basis for inferring the underlying cost of termination in Australia. A number of parties commented to the Commission in this regard, arguing that the true underlying cost of mobile termination in Australia is in the region of 5-6 cents.

### South Korea TSLRIC cost model of 5.7 Australian cents

The National Regulator in South Korea recently completed a TSLRIC cost model study for the mobile termination rate, using the same consulting firm (Analysys) that OFTEL used in the United Kingdom. The model was referenced in comments to the ACCC in this proceeding. The recommended termination rate from the model is the equivalent of 5.7 Australian cents.

### The United States

The U.S. has a reciprocal compensation charging system for termination to fixed line and mobile phone networks. Mobile network operators in the U.S. generally terminate calls from landline phones at the equivalent rate of around 4 Australian cents.

### Summary request for reconsideration on this issue

The table we include above depicts a wide range of TSLRIC cost models and other indicators suggesting that the ACCC's proposed 12 cent rate is a good start but is not sufficiently aligned to the estimated cost of provision. MCI therefore urges the Commission to reconsider its decision to stop at the "top end" of the 5 -12 cent range and instead move to a benchmark rate at least toward the middle of the range i.e. at 9 cents or below.

### **REQUEST FOR RECONSIDERATION OF THE GLIDE PATH**

The Commission in its Draft Decision builds a compelling case that the long term interest of the end-user requires a move away from light handed pricing principles. In taking this strong policy stance, the Commission skillfully dismisses the standard set of hackneyed arguments put forth by mobile network operators around the world.

Unfortunately, the Commission appears to have given a measure of credence to these same arguments when designing a glide path that in effect does not commence until 2005 and does not begin to reflect the underlying cost of provision until two years after that.

In urging the Commission to reconsider the pace of its glide path, we make the following points.

#### Without more immediate relief, end users will continue to suffer

For as long as mobile termination rates remain above-cost (until 2007 by the Commission's own analysis) the long-term interest of end users will suffer as that they are required to pay more than they should to call mobile phones. This is a very clear and quantifiable impact for the Commission to consider.

#### Without more immediate relief, the margin squeeze will continue to foreclose the benefits of competition

For as long as mobile termination rates remain above-cost (until 2007 but the Commission's own admission) vertically integrated fixed/mobile operators and mobile network operators offering fixed-to-mobile calls within Mobile Virtual Private Networks will be able to price their retail services at levels that are close to, or even below the termination rates charged to fixed line operators. This forecloses profitable entry by non-vertically integrated fixed line operators in to the market for fixed-to-mobile calls.

In contrast, as soon as providers of mobile termination charge themselves the same rate as is charged to competitive operators (i.e. when rates are cost-oriented) then there will be multiple mobile and multiple fixed network operators competing to provide fixed-to-mobile calls to business customers. Customers, in turn, will then be faced with a choice of bundles and innovative packages from different types of providers. Competition will then ensure that services are delivered by the most efficient and innovative providers, rather than by the operators most able to leverage a dominant position into downstream markets. For Australia, the slow glide path proposed by the ACCC ensures that this day will not come until 2007 at the earliest.

The “regulatory shock” arguments by the mobile network operators are self-serving and best left rejected

MCI suspects that the ACCC’s decision to delay implementation of a cost oriented rate until 2007 was at least partially based on deference to the mobile network operators’ argument that without this long slow glide path “regulatory shock” would set in, crippling their operations and ability to invest in Australia.

We urge the Commission to again consider the flaws in this tired line of argument, as it did so ably in the text of its Draft Decision. In particular, we find compelling the Commission’s treatment of this issue in the Executive Summary and Chapter Five of its Draft Report. We believe it is worthwhile to review the Commission’s key conclusions in this regard.

1. The Commission first notes that as long as the mobile network operators are able to price the termination segment above its underlying cost of production (as opposed to *excessively* above cost as is the case today) then the service will continue to be a source of economic profit.
2. The Commission expands on this argument by noting that the mobile operators will in fact maintain *significant* profits “given that reductions in the price of the mobile termination service should lead to an increase in demand for the service and a consequent reduction in the unit costs of providing the service as economies of scale are generated.”<sup>1</sup>

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<sup>1</sup> ACCC Draft Decision at xii and page 130.

3. Further, the Commission notes that the overall profitability of mobile operators is affected by a number of factors other than simply the revenue they receive from the mobile termination service including, most particularly, the growth of revenue streams from data, messaging and international roaming services.
4. Finally, the Commission concludes that the growth of other sources of revenue is already taking place – rapidly. For example, the Commission notes that “Telstra’s annual reports indicate that revenues from these sources grew by 94 per cent from \$339 million to \$657 million over the two years from 2000-01 to 2002-03, while the Commission’s Regulatory Accounting Framework (RAF) data indicate revenues from termination and origination increased by a substantially smaller amount over the same period. The Commission also notes that the revenue Telstra earns from data and other value-added services is now substantially greater than that which it earns from the mobile termination and origination services. While the Commission does not have access to comparable figures for Vodafone, information available to it suggests that, although Vodafone is more heavily reliant on wholesale revenues than Telstra, a similar pattern of revenue change would have occurred.”<sup>2</sup>

#### Summary request for reconsideration of the glide path

MCI believes that the ACCC’s Draft Decision gives full treatment to the economic and public policy issues surrounding the need for regulatory intervention in the provision of mobile termination. For the Commission, several principles are now firmly established:

- mobile operators are dominant in the provision of wholesale mobile termination services;
- the rates being charged today are far in excess of the underlying cost of provision;
- the harm to business and residential end-users is extreme; and finally
- the mobile network operators’ “regulatory shock” argument is a self-serving one properly rejected by the ACCC.

With these established principles in mind, we urge the ACCC to reconsider the pace of its glide path.

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<sup>2</sup> ACCC Draft Decision at xii and page 103-104.

For a revised glide path, we ask that the Commission consider the following:

- step 1: replace the 21 cent “first step” with an 18 cent rate effective July 1, 2004
- step 2: move down three cents to 15 cents by the beginning of 2005;
- step 3: move down three cents to 12 cents by the beginning of 2006
- step 4: move down 3 cents to 9 cents by the beginning of 2007 (the ACCC could consider not implementing this final step if 9 cents is deemed inconsistent with a TSLRIC study or a refreshed set of cost benchmarks).

We believe that this four step implementation plan is a reasonable and not overly steep glide path toward a final rate – 9 cents - that reflects the cost of provision based on benchmarks and other comparative indicators.

.As the Commission is aware, the dominant mobile network operators have frozen their rates at roughly 21 cents for many months. The ACCC’s step 1 reduction to 21 cents effective 1 July 2004 is therefore largely a non-event in that it provides little or no relief to consumers or operators struggling to compete in the downstream market. As described above, we ask that the Commission implement less gradual glide path. Should our suggested less gradual glide path be dismissed, we ask in the alternative that the Commission at least consider skipping its “step 1”, i.e., move straight to its step two and implement the 18 cent rate effective in July of this year.

## **CONCLUSION**

MCI, as a global fixed line operator, has significant experience with the competition and public policy issues surrounding the regulation of mobile termination. We again applaud the ACCC for producing a well written and clearly reasoned document in the Draft Decision. With these comments, however, we urge the Commission to conclude its proceeding by taking a somewhat stronger stance on the pace and depth of its glide path.