Optus Submission to

Australian Competition and Consumer Commission

on

Mobile services

June 2003

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1. Overview

1.1 Optus welcomes the opportunity to provide a submission to the ACCC's review of mobile services. This submission will shortly be supplemented with further submissions expanding on the points raised below and addressing in detail the questions raised by the ACCC in its discussion paper.

1.2 The mobile services market is highly competitive. Market shares are evolving and new entry, particularly via third generation services, means competition at the retail and facilities level is vigorous. Competition has meant that the prices for mobile services have fallen substantially since their introduction. We note that the ACCC has supported this view and recommended to Government that mobile-to-mobile and mobile-to-fixed services be excluded from the retail price control regime.

1.3 Regulatory intervention in the mobile market would harm consumer welfare and would likely slow and even reverse the growth of mobile telephony penetration. This is not in the interests of end users of mobile or fixed services. Optus believes the threat of regulation has proved unnecessary in driving prices to competitive levels and as such the declaration of mobile termination services should revoked.

1.4 Market forces drive the structure of monthly mobile access, originating minute prices, mobile handset charges and mobile termination fees. Proposals to impose alternative structures will lead to a loss in consumer welfare. There is no evidence of market power in the termination of calls to a mobile network. Such a view ignores the fact that mobile subscribers place significant value on receiving calls. In fact, the evidence suggests the exact opposite. Termination rates have fallen substantially over the past 5 years. This outcome would not have occurred if carriers had market power in terminating services.

1.5 An important implication of the way prices are set for each of the services in the mobile bundle is that a change in the price of one element will likely require a change in the price of other services in the bundle. This is because the basic requirement of the revenue streams is to cover the long-term costs of providing mobile telephony services, including fixed, common and usage sensitive costs. Such a charging structure is not unique to mobile services. For example, newspaper companies collect revenue from customers subscribing to their papers as well as advertising revenue from business wanting to purchase advertising space in the paper and market their products to the subscribers.[1]

1.6 In the context of the ACCC's current review, because competition is effective and monopoly margins cannot be maintained, if termination charges were to be reduced as a result of regulation, the prices set by carriers for origination and, to a lesser extent, subscription would likely increase.

[1] We note that the ACCC has not claimed that newspaper companies have "market power" even though they clearly control access to "the termination" of advertising to their subscribers. This contrasts with the ACCC's continued declaration of mobile termination on the belief that mobile carriers have market power because they control access for their subscribers.

1.7 To expand upon this argument, assume termination was regulated at a rate below existing levels. This would not allow the mobile carrier to recover the total cost of operating its mobile business. The expectation that these costs will not be recovered would prevent future investment in new mobile networks and discourage the efficient maintenance, replacement and upgrading of the current networks.

1.8 International developments in relation to the mobile termination service have been prolific. Optus has engaged consultants to provide a critique of these developments and an analysis of their relevance to the Australian market and regulatory regime. The consultants' report will be provided as a supplementary submission. Optus' own analysis shows that the ACCC has misrepresented some of the developments. In particular, the German regulator's decision to not impose price reductions was represented as being because "rates were still less expensive in Germany than in the UK" (page 39). The reality is that the German regulator concluded that "defining a network as its own market perpetuates regulation as each operator is by definition dominant for terminating calls on his network and will be so for ever, which contradicts the idea of regulation as transitory" and that "consumers buy a 'package' of mobile services and are aware of the value of availability, i.e. the costs of incoming calls, packages are substitutable as they are more or less homogeneous to the customers, which is an indication for a single national market".[2]

1.9 Similarly, the ACCC discussion of the UK regulator's decision ignored the true basis of the decision which was to consider the distributional effects on a particular class of end-user – being fixed to mobile users who do not own a mobile service. This issue is not relevant in the Australian regulatory context given the *Trade Practices Act 1974* does not differentiate between end-users in assessing whether regulation is in their interests. Moreover, we note that the UK market has a very different structure: in particular, it does not have a single dominant integrated fixed and mobile carrier. In Australia, there is such a single dominant player, Telstra. Unlike BT in the UK, Telstra has strong incentives to reduce termination payments from its fixed customer base. This adds to the competitive termination environment of negotiation, transit and arbitrage.

1.10 Retail fixed-to-mobile services are important to this review and are certainly of relevance because they are a downstream service of mobile termination. However, competition in the retail fixed-to-mobile market is not affected by termination rates or by ignorance on the part of the calling party. There are adequate market forces to ensure an efficient pass-through of negotiated termination rate reductions.[3] For example, there are numerous carriers and providers competing for long distance and fixed to mobile services and the retail fixed to mobile rate is regulated in the retail price control arrangements (as recommended by the ACCC).

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[2] Matthais Kurt, President, Regulator Authority for Telecommunications and Posts, Harvard University, Boston, 16.04.2002.

[3] Even if the ACCC believe the retail fixed to mobile market has monopoly characteristics, a rational profit maximising monopolist will pass on a reduction in marginal cost (eg. termination rates) in lower retail prices.

1.11 Optus believes the only potential beneficiary of a heavy-handed termination rate reduction is Telstra. In the short term Telstra would benefit from less than complete pass-through, and the benefit could endure if the lack of pass through is not competed away. In the long term, termination rate reductions would likely mean increases in origination and subscription rates – this would advantage Telstra by reducing substitution from fixed to mobile telephony, thereby perpetuating the dominance of the legacy fixed incumbent network.

1.12 In terms of consumer ignorance of fixed to mobile rates, empirical evidence supports Optus' view that many fixed to mobile calls are repeat calls and that many callers are likely to know the price of the call and the mobile network they are calling. Around 70% of people are aware of the network used by the person they most commonly call on a fixed-to-mobile basis. Almost 30% of people know the network of their fifth most commonly called person. Since prices are set at the margin, it is highly unlikely that the price of terminating calls will lead to market failure.

1.13 Revoking the declaration of terminating services will likely have a positive impact on competition and lead to reductions in terminating rates and increased competition in downstream markets such as fixed to mobile telephony. Termination rates have fallen at least as fast as retail mobile-to-mobile services. They have also tracked prices for retail fixed-to-mobile services. Falls in termination rates are driven by competition for terminating services; efforts to stimulate usage; transit arrangements; and pressure from the dominant fixed carrier, Telstra. Revoking the declaration will stimulate investment by removing regulatory risks from raising capital for mobile services infrastructure. Increased investment, new entrants and new networks will increase competition across the mobile services market. Competition in downstream markets, in particular retail fixed to mobile services, is not fostered by maintaining the declaration of mobile termination.

1.14 However, if the ACCC decides that customer ignorance is a problem it can take action to ensure that the terminating network be identified to the user of a fixed to mobile service. Telstra, as the principal fixed operator, already identifies when a fixed customer calls customers of its mobile network.[4]

1.15 The ACCC has a range of options to address consumer ignorance that are far more appropriate than price regulation. These include directing fixed carriers to increase the level of billing information provided to customers and promoting information lines and other technology based means to indicate to fixed to mobile callers the network being called and the relevant retail charges.

1.16 More pernicious regulatory interventions, such as retail minus and TSLRIC are inappropriate and inconsistent with a national market definition for mobile services. Such interventions would imply the ACCC has taken the narrowest market definition for the terminating service. Implementing TSLRIC for a service involving considerable demand uncertainty and technological change would involve real regulatory risks. It would also create significant structural adjustments in carriers' revenue streams, increase investment uncertainty and disrupt new entry into the mobile services market.

[4] Carriers also already encourage the formation of closed user groups across fixed and mobile networks.

1.17 The ACCC's inclusion of third generation services in this review is overzealous, and reflects an incorrect analysis of market power being associated with termination. New investment in networks intensifies competition in all aspects of the mobile services industry. However, the ACCC has taken a perverse view on market power in the termination market based on a belief that "once an end-user is connected to a mobile network, the terminating mobile carrier has control over access to mobile termination of that end-user" (page 31).

1.18 The ACCC's view implies that individuals (for it is those individuals that choose their mobile network) have market power in the termination of calls to themselves. To see this we need to imagine that each subscriber joined a separate mobile network. Under the ACCC regulatory thinking, it would declare the terminating service for that mobile network on the basis that the terminating carrier had control over access. That would make little sense. Customers value being called and would feel the full effect of increases in termination charges – that is, no-one would call that network if it set prices too high.

1.19 It is therefore likely to be inappropriate to distinguish between mobile termination services on the basis of technology. All radio technologies AMPS, GSM, CDMA, WCDMA are used to provide "mobile services", just like copper and optical fibre are used in fixed networks. The entry of new technologies intensifies competition for all "mobile services" and should lead to the revoking of the declaration, not the expansion of regulation.

1.20 Finally we note that declaration is not required to ensure any-to-any connectivity. A mobile service is only useful if it can be used to connect to other mobile and fixed services. To provide this end-to-end service in a competitive market all operators must conclude terminating agreements with all other mobile carriers – it is not feasible to market a service that excludes calls to or from particular carriers. This creates a need to negotiate and conclude agreements with all other carriers and leads to rational competitive outcomes.