



## **A MONITORING REPORT ASSOCIATED WITH THE IMPLEMENTATION OF THE PRICING METHODOLOGY FOR THE GSM TERMINATION SERVICE**

### **BACKGROUND AND PURPOSE**

In 1997, the Australian Competition and Consumer Commission (the Commission), in consultation with the Australian Telecommunications Authority (AUSTEL), deemed the Domestic GSM Originating and Terminating Services (the GSM origination and termination services) to be declared.<sup>1</sup>

In 1999, the Commission was notified of several access disputes in relation to GSM origination and/or termination services. The main issue in these disputes was the price terms and conditions of access. The Commission conducted a public process outside the access disputes to consider the appropriate pricing principles for GSM termination services.<sup>2</sup>

In July 2001, the Commission finalised its inquiry into the appropriate pricing principles for the GSM termination service and released the final report on *Pricing Methodology for the GSM Termination Service* (the final report). In the final report, the Commission concluded that, on balance, the most appropriate pricing methodology is a form of 'retail benchmarking'. Under this approach, changes in each mobile carrier's GSM termination access prices will be benchmarked against the retail price movements of that carrier's overall mobile package. The Commission was of the view that this approach uses a reasonable proxy for the efficiency improvements and competition pressures on mobile prices – the price fall in the retail segment of the market – to provide a benchmark for price falls to continue to occur for the GSM termination service.

The Commission also stated in its final report that it recognised the limitations of the retail benchmarking approach, that it would undertake monitoring activities to determine whether there is a need to extend the benchmarking approach beyond an

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<sup>1</sup> The GSM origination service is an access service for the carriage of voice or voice-grade calls from GSM mobile phone users to a point of interconnection for the purpose of providing special number services such as 13/1300 and 1800 number services. The GSM termination service is an access service for the carriage of telephone calls (i.e., voice, data over the voice band) from a point of interconnection to B-parties assigned numbers from the GSM number ranges of the Australian Numbering Plan and directly connected to the access provider's network.

<sup>2</sup> Whilst these pricing principles focused on the pricing for termination services, the Commission recognised that origination services raised similar issues.

initial two-year implementation period, and that if continued retail price falls do not eventuate, the Commission may need to reconsider the pricing principle at the time of the next review.

The Commission is currently conducting a review into the appropriateness of extending, revoking or varying the current declaration of the mobile termination service and the retail benchmarking pricing principle it has previously specified for the service.<sup>3</sup> This is in conjunction with a fuller review of competition and regulation in domestic mobile markets more generally. The scope and process of the general review are discussed in *Mobile Services Review 2003*, an ACCC Discussion Paper, which the Commission released in April 2003.

At the outset, the Commission wishes to make it clear that disclosure of this information should not be seen as any indication that the Commission has reached initial views as to whether or not mobile termination services should continue to be declared under Part XIC of the Act or the appropriate pricing principles that should apply for such services.

The purpose of this report is to publicly disclose information outlining the results of the Commission's monitoring of retail GSM price changes to date. The Commission believes this will:

- facilitate commercial negotiations with respect to the declared GSM termination service; and
- inform interested parties as to the effectiveness of the retail benchmarking methodology, and hence their views as to the appropriateness of its continued application, in order that these parties may provide better informed submissions to the Commission's ongoing Mobile Services Review.

The remainder of this report outlines the retail benchmarking method (including how the Commission has calculated retail price movements) and the final results of the Commission's analysis of retail benchmarking information to date.

## **THE RETAIL BENCHMARKING METHODOLOGY**

Subsequent to releasing the final report, the Commission sought the views of mobile carriers and service providers regarding details and issues associated with implementing the retail benchmarking pricing principle.<sup>4</sup> In particular, the Commission consulted the industry on several implementation issues, the most important of which were:

- the determination of the starting access price to which the benchmarking pricing principle would be applied;

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<sup>3</sup> In March 2002, the GSM termination service declaration was varied to include CDMA termination services. The pricing principle was subsequently extended to cover access to CDMA termination services in September 2002.

<sup>4</sup> These views were sought with regard to access disputes pending at that time and more generally.

- the time period for assessing retail price movements;
- the services for inclusion in determining retail price movements;
- the method of calculating retail price movements;
- any adjustment for changes in the quality of services;
- the possibility of carry-over 'credits' between pricing periods; and
- the collection and disclosure of information associated with this pricing principle.

After considering the submissions of carriers and interested parties, the Commission released an addendum to the final report in December 2001 to provide further guidance to industry on the Commission's preferred methodology for implementing the retail benchmarking pricing principle.

Issues regarding the implementation of the retail benchmarking pricing principle, and how these issues were finalised in the addendum to the final report, are summarised below.

#### *The starting access price*

At the time the addendum to the final report was released, all GSM origination and termination access disputes that were pending at the start of the Commission's public process to determine appropriate pricing principles had been withdrawn. Therefore, the Commission only provided guidance on the approach it was likely to take in applying the retail benchmarking pricing principle in any future access disputes. In this regard, the Commission indicated that the starting access price would be the most recent agreed access price between the access seeker and access provider. This should be an agreed price that did not take the retail benchmarking approach into account in commercial negotiations.

#### *The time period for assessing retail price movements*

The Commission and the reporting carriers agreed that retail price movements would be determined on a six-monthly basis.

The retail benchmarking reporting periods are generally in line with each carrier's six-monthly reporting period for its Regulatory Accounting Framework (RAF) reports.<sup>5</sup> The carriers and the Commission agreed that, for administrative ease and minimisation of compliance costs, the information provided to the Commission for its monitoring purposes would be submitted in accordance with the same six-monthly timeframes as the RAF reports and would, where relevant, contain disaggregations of RAF line-items.

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<sup>5</sup> The RAF is the set of information collected by the Commission from a range of carriers using record-keeping rules for the telecommunications industry issued under section 151BU of the *Trade Practices Act 1974*.

For Telstra, the six-month periods are 1 January to 30 June and 1 July to 31 December. In particular, Telstra has submitted (or will submit) retail benchmarking data covering the following periods:

- January to June 2001;
- July to December 2001;
- January to June 2002;
- July to December 2002; and
- January to July 2003 (report due to be submitted later this year).

For Optus, the six-month periods are 1 April to 30 September and 1 October to 31 March. In particular, Optus has submitted (or will submit) retail benchmarking data covering the following periods:

- October 2000 to March 2001;
- April to September 2001;
- October 2001 to March 2002;
- April to September 2002; and
- October 2002 to March 2003 (report due to be submitted later this year).

For Vodafone, the six-month periods were initially 1 April to 30 September and 1 October to 31 March in accordance with its financial reporting timeframe. Following discussions with the Commission, however, Vodafone has submitted (or will submit) retail benchmarking data covering the following periods:

- July to December 2001;
- January to June 2002;
- July to December 2002; and
- January to July 2003 (report due to be submitted later this year).

*The services for inclusion in determining retail price movements*

The Commission has collected information from mobile carriers with respect to their retail revenues from the following GSM-related services:

GSM RETAIL REVENUES:

*Call revenue*

Outgoing voice calls

Voicemail

Short message service (SMS)

*Rental revenue (or subscription/access)*

*Customer connection revenue*

*Equipment sales (or sale of handsets)*

In addition, the Commission has collected data on retail customer connection costs and usage volumes:

GSM CONNECTION COSTS:

Handset subsidy paid to dealer  
Cost of purchasing handsets from manufacturers

GSM VOLUMES:

Total outgoing voice call minutes  
Total SMS messages  
Total voicemail minutes

*The calculation of retail price movements*

In its addendum to the final report, the Commission indicated that a yield method would be used to determine retail price movements using ‘revenue per minute’ as a proxy for average prices.

Under the yield method, average retail prices are determined by dividing a carrier’s total mobile revenue from retail activities by the total number of minutes from origination services in a given period. In this way, a revenue per minute figure for a mobile carrier is derived (i.e., a proxy for average prices) that can be compared between periods in order to determine the retail price movements. The specifics of this calculation are outlined below:

$$(1) \quad \frac{\text{Revenue from retail mobile services}}{\text{Mobile minutes from originating services}} = \text{revenue per minute} = \text{average price}$$

$$(2) \quad \frac{\text{Revenue per minute}_2 - \text{Revenue per minute}_1}{\text{Revenue per minute}_1} = \text{\% change in average price}_{1 \Rightarrow 2}$$

Voice calls and voicemail services are grouped together in yield calculation, taking into account relevant revenues and call minutes associated with voice calls and voicemail services. To incorporate SMS services, where usage is measured by the number of messages and not by the number of minutes, a yield method (in terms of average price per message) is applied to derive a price change. Both sets of price changes are then revenue-weighted to derive an overall retail price change.

The yield approach outlined above takes into account free minutes provided as part of the overall retail package and does not enable carriers to substitute free minutes for lower call prices in order to avoid lower access prices for GSM termination.

As there has been increased take up of ‘SIM<sup>6</sup>-only’ plans or pre-paid plans that do not include handset subsidies, the Commission also considered an adjustment was needed to the implementation method to take account of the effects of this trend. In this

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<sup>6</sup> Subscriber Identity Module cards

regard, the Commission determined that handset subsidies (a cost figure) will be deducted from retail revenues in calculating price movements.

In summary, for each of the three mobile carriers, a revenue-weighted index for the average retail price of the GSM mobile service is determined for each six-month period. The movement in the average retail price is then calculated as the percentage change in the revenue-weighted index from one period to the next.

#### *Adjustments for changes in the quality of services*

With regard to changes in quality of mobile services, the Commission determined that retail price movements would not be likely to be adjusted to account for changes in the quality of services from one period to another, unless there is compelling evidence of an impact on the retail price changes occurring during a six-month period. The Commission is of the view that, generally, calculating quality changes would be problematic and complex.

To date, no carrier has provided compelling evidence that would lead the Commission to make adjustments for changes in quality.

#### *Possibility of carry-over 'credits'*

In consultation with the industry, the Commission considered whether retail price movements should be implemented on a period-on-period or on a cumulative basis. Under a period-on-period basis, changes in access prices would be based on the change in the average retail price for each six-month period. In contrast, under a cumulative basis, changes in access prices would be based on the change in the average retail price since the setting of the initial access price, i.e. from 1 July 2001.<sup>7</sup>

This issue would become important if disputes over access prices re-emerged whilst the retail benchmarking pricing principle is in effect. If parties negotiated access prices on the basis of forecast retail price changes, which were different from the actual retail price changes that eventuated, under a cumulative approach the Commission would have to take that difference into account in an access dispute, i.e. allow for 'credits'.

On balance, the Commission considered that retail price movements should be implemented on a period-on-period, and not on a cumulative, basis. A period-on-period approach does not allow for mobile carriers to build up 'credits' for reductions in access prices which are greater than retail price movements.

#### *The collection of information and disclosure in an aggregated form*

In order to implement the retail benchmarking pricing principle, the Commission indicated in the addendum to the final report that it would collect information on retail

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<sup>7</sup> The cumulative retail price change basis is similar to the methodology used in monitoring Telstra's compliance with price control arrangements under section 151CM(1)(b) of the Act.

revenues and minutes of use for GSM services mainly through the RAF, with some scope to supplement this information from other data sources.

Based on further discussions with the reporting carriers in 2002-03, the Commission resolved the following issues with the carriers:

- The carriers would provide certain RAF line items in disaggregated form to enable the Commission to calculate price movements in accordance with its methodology;<sup>8</sup>
- The retail benchmarking information would be submitted to the Commission on a voluntary basis rather than under a new record-keeping rule for this purpose; and
- The retail benchmarking information to be submitted to the Commission would not need to be audited, having regard to possibly higher compliance costs on the part of the carriers.

Further, the Commission indicated to participating carriers that it would publicly release retail benchmarking information in an aggregated form. The Commission believes disclosure of such information would help facilitate the operation of Part XIC of the *Trade Practices Act 1974* as it:

- would facilitate commercial negotiations with respect to the declared GSM termination service; and
- will inform interested parties as to the effectiveness of the retail benchmarking methodology, and hence their views as to the appropriateness of its continued application, in order that these parties may provide better informed submissions to the Commission's ongoing Mobile Services Review.

## **RESULTS OF ANALYSIS OF RETAIL BENCHMARKING INFORMATION TO DATE**

### ***Telstra's retail price movements***

The six-month period from January to June 2001 serves as the base period for the index for the average retail price of Telstra's GSM mobile services. Table 1 below shows the period-on-period percentage changes in Telstra's average retail price from the base period to the period with the latest available data, July to December 2002.

**Table 1 Telstra's retail price movements**

	Jan-Jun 2001	Jul-Dec 2001	Jan-Jun 2002	Jul-Dec 2002
Telstra	base period	-1.4%	+7.5%	-1.7%

*Source: information provided to the Commission by Telstra*

<sup>8</sup> The Commission had not proposed to publicly disclose disaggregated data under this process. The Commission notes, however, that a separate public process is underway relating to the disclosure of 'market indicator information' collected under the RAF pursuant to sections 151BUA-C of the *Trade Practices Act 1974*.

Table 1 reveals that Telstra's average retail price for its GSM mobile services decreased by 1.4% from January-June 2001 to July-December 2001; increased by 7.5% from July-December 2001 to January-June 2002; and decreased by 1.7% from January-June 2002 to July-December 2002.

Telstra is due to submit to the Commission its retail benchmarking information for the final reporting period, January-June 2003, later this year.

### ***Vodafone's retail price movements***

Table 2 below shows the period-on-period percentage changes in Vodafone's average retail price from the base period to the period with the latest available data, July to December 2002. The six-month period from July to December 2001 serves as the base period for the index for the average retail price of Vodafone's GSM mobile service.

**Table 2 Vodafone's retail price movements**

	Jan-Jun 2001	Jul-Dec 2001	Jan-Jun 2002	Jul-Dec 2002
Vodafone		base period	+3.6%	-9.0%

*Source: information provided to the Commission by Vodafone*

As shown in the table, Vodafone's average retail price for its GSM mobile services increased by 3.6% from July-December 2001 to January-June 2002; and decreased by 9% from January-June 2002 to July-December 2002.

Vodafone is due to submit to the Commission its retail benchmarking information for the final reporting period, January-June 2003, later this year.

### ***Optus' retail price movements***

As indicated above, Optus has aligned its retail benchmarking reports with its six-month reporting periods under the RAF. Accordingly, its reports cover the six-month periods from 1 April to 30 September and from 1 October to 31 March.

The six-month period from October 2000 to March 2001 serves as the base period for the index for the average retail price of Optus' GSM mobile services. Table 3 below shows the period-on-period percentage changes in Optus' average retail price from the base period to the period with the latest available data, April to September 2002.

**Table 3 Optus' retail price movements**

	Oct 2000– Mar 2001	Apr–Sep 2001	Oct 2001– Mar 2002	Apr–Sep 2002
SingTel Optus	base period	+9.9%	+6.8%	-3.7%

*Source: information provided to the Commission by Optus*

Table 3 shows that Optus' average retail price for its GSM mobile services increased by 9.9% from October 2000-March 2001 to April-September 2001; rose further by



6.8% from April-September 2001 to October 2001-March 2002; and fell by 3.7% from October 2001-March 2002 to April-September 2002.

Optus is due to submit to the Commission its retail benchmarking information for the final reporting period, October 2000-March 2003, later this year.