Mobile Services Review

Telstra's Supplementary Response to the Discussion Paper of the Australian Competition and Consumer Commission

July 2003

1 Introduction

This submission represents Telstra's further response to the Commission's inquiry into the declaration of mobile services and other, related matters. As a general observation, Telstra believes that the Commission appears to have overlooked an analysis of competition in the market, which Telstra submits should be the fundamental analysis underpinning the most basic element of any inquiry into the regulation of a service.

Instead, the Commission has decided to first look at the issue of variations to declarations, service descriptions and pricing principles for all mobile services. For some services, such as 3G and roaming, responding to the Commission's questions seems pointless, as a reasonably robust competition analysis would most likely find that regulation, and hence further consideration of issues such as pricing principles, was unnecessary.

It is also difficult for Telstra to respond to the issues and questions raised by the Commission without an understanding of what might be driving the Commission's competition concerns. Until the Commission has undertaken a competition analysis, Telstra can only speculate as to the Commission's potential concerns and provide responses on this basis. Telstra would however, expect the opportunity and would be willing to provide further responses once the Commission's competition analysis becomes available.

Notwithstanding these concerns, the remainder of this submission outlines Telstra's views on the outstanding issues not covered in its initial response to the Commission's discussion paper, namely, mobile originating access, domestic and international roaming and 3G mobile services.

2 Domestic GSM and CDMA originating access service

It is Telstra's understanding that the purpose of the domestic GSM and CDMA originating access service ("**mobile origination service**") was to achieve the objective of any-to-any connectivity, and not for the purposes of promoting competition or economic efficiency. It was intended to ensure that the providers of special services had a process in place to make their services available to mobile end-users in the event that mobile carriers refused to route calls to their services. If a mobile operator refused to route calls through to the special service (ie the 1300 taxi service in the Commission's example) then the provider of that special service could achieve connectivity by purchasing originating access from the mobile carrier. This view is supported by the fact that the declaration of the mobile origination service covers only 13/1300 and 1800 services and hence, was for the purpose of ensuring connectivity between mobile end-users and the providers of special services.

In practice, mobile operators have been diligent in ensuring that their customers have access to all special services, as preventing access to services reduces the attractiveness of their mobile network. In other words, the strong competition between mobile carriers has provided sufficient incentives for mobile operators to ensure connectivity with special service providers.

Insofar as Telstra is aware, there are currently two different models for the provision of mobile originating access to 13/1300 and 1800 services. In relation to 1800 services, the special service provider purchases mobile origination services. However, Telstra provides mobile originating access to most 13/1300 services by paying a Special Service Contribution Fee to special service providers, an arrangement equivalent to purchasing terminating access from these providers. There has been no difficulty or dispute with either of these arrangements. As far as Telstra is aware all special services are currently provided to all mobile end-users. Hence, in Telstra's view the continued regulation of the mobile origination service is unnecessary.

Extending the declaration to mobile origination generally is unlikely to promote competition or economic efficiency, given the competitive nature of the mobiles market. Unlike fixed network services, there are very limited opportunities for access seekers to add value for consumers in the provision of mobile network services. The majority of mobile calls must be carried on the mobile network of the terminating mobile carrier so the location of the called party can be determined. On fixed network services, access seekers can compete, for example, in the provision of the long-distance component of calls. However, there is very little opportunity for this in the mobile network. Rather, the main opportunity for competition from service providers without a mobile network is in the retailing functions of mobile services. In this regard, Telstra notes that there is already very strong retail competition provided by resellers and strong competition in the provision of mobile network services. Telstra submits therefore, that the declaration of originating access is highly unlikely to promote the long-term interests of end users ("**LTIE"**).

Telstra considers that regulation is unnecessary for promoting efficient use of and investment in infrastructure. If anything, revocation of the existing declaration is likely to improve the incentives for efficient investment, as the uncertainty surrounding the possible imposition of heavy-handed regulation that could prevent efficient cost recovery by the Commission would be eliminated.

Therefore, given that the mobiles market is already very competitive and the only rationale for regulating the mobile origination service - any-to-any connectivity - is no longer applicable because competitive pressures now provide mobile operators with sufficient incentive to make all special services available to their customers, it is Telstra's view that ongoing regulation of the mobile origination service is unnecessary and should be revoked at the earliest possible opportunity. Telstra does not believe that the continued regulation of the mobile origination service is necessary and hence strongly opposes any broadening of the service description. As a result, Telstra does not believe that it is necessary to consider pricing principles for mobile origination. Since deeming the mobile origination service, the Commission has never been required to develop, let alone implement, a set of pricing principles for the mobile origination service.

3 Domestic inter-carrier roaming

Domestic inter-carrier roaming is currently provided in Australia on GSM and CDMA networks through commercial agreements. Australia's three smallest networks (Orange, Three and Vodafone) make extensive use of domestic inter-carrier roaming to extend their coverage. In particular:

- Hutchison's Orange customers roam onto Telstra's CDMA network outside of the bounds of Hutchison's own CDMA network;

- Inter-carrier arrangements allow Vodafone's customers to roam onto Telstra's GSM network in parts of Victoria and Tasmania where Vodafone does not have network coverage; and
- Hutchison 3G and Vodafone have an agreement that enables the 3G customers of Hutchison's WCDMA network to roam onto Vodafone's 2G GSM network.

The existence of these roaming agreements demonstrates that the larger mobile network operators, such as Telstra, have incentives to reach commercially negotiated arrangements for the provision of domestic inter-carrier roaming services, without a regulatory mandate. Provision of domestic roaming services allows mobile network providers to achieve greater economies of scale through increasing network utilisation in areas where there is excess capacity. Given these incentives and the positive commercial outcomes that have eventuated, there is no valid justification for regulating domestic inter-carrier roaming services.

Telstra considers that regulation of domestic inter-carrier roaming would not only be unjustified but would have a negative impact on the progress of the mobile market by reducing the incentives of all mobile network operators to extend coverage through network investment. If declaration were to occur, potential access providers would face reduced incentives to invest in expanding their network coverage for at least two key reasons. First, they would face regulatory uncertainty over the recovery of the cost of network expansion. Second, they would lose the incentive to expand their coverage to differentiate their service from other networks. Coverage is one element of competition in the mobile markets, and the service differentiation benefits that can be achieved are likely to be one of the drivers of network expansion. A declaration of national roaming could remove these service differentiation benefits, because every time a network increased its coverage, all other carriers would automatically also have access to that coverage. The implication is that the incentives for mobile networks to increase coverage could be dampened.

Incentives to invest in new coverage could also be reduced for smaller networks (ie, potential access seekers), particularly if regulatory error results in access charges that are below the efficient level. There would likely be a heavier and more permanent reliance on domestic roaming than in the current situation. The result would be that consumers would miss out on the dynamic efficiencies that are achieved through network competition.

Telstra notes that mobile network operators have options other than domestic inter-carrier roaming when considering expansion of their coverage. Networks can, for example, engage in some form of network sharing. This allows them to achieve productive efficiencies, while retaining greater control over the functionality and service levels provided to their customers than they would have if they used domestic roaming. Site sharing, which is the lightest form of network sharing, is common in Australia (Telstra currently shares sites with Optus, Vodafone and Hutchison) and is a way in which productive efficiencies and environmental benefits can be achieved without compromising the ability for mobile networks to manage their services. Declaration of domestic inter-carrier roaming would distort the mobile network operator's decision between network sharing and domestic roaming. Telstra submits it would likely lead to an inefficient overuse of roaming and inefficiently low levels of network build.

Accordingly, Telstra does not believe that a declaration of domestic inter-carrier roaming will encourage the economically efficient use of and economically efficient investment in mobile network infrastructure.

Further, Telstra does not believe that declaration would promote competition in downstream markets given that the competitive process already delivers inter-carrier roaming agreements. Regulation would undermine incentives to invest for both access seekers and access providers, potentially undermining competition in downstream markets and removing incentives for service differentiation through coverage expansion.

With respect to the any-to-any limb of the LTIE test, Telstra notes the Commission's conclusion in the previous inquiry. That is, any-to-any connectivity involves the connection of a customer to a network rather than communication between two customers already connected to networks. Thus any-to–any connectivity is not relevant to domestic inter-carrier roaming.

Telstra, therefore, is strongly of the view that the domestic inter-carrier roaming service should not be regulated, and that there is no valid justification for declaration. Regulation of inter-carrier roaming is unnecessary and potentially damaging to the LTIE. It is unnecessary because competition has delivered a number of commercially negotiated roaming agreements, and damaging as it has the potential to undermine important incentives to efficiently invest and continually innovate for improved products and services.

Given the current level of competition and the number of commercially negotiated roaming agreements in place, combined with the significant risks associated with regulation, it seems clear that the potential costs of declaring national roaming would far outweigh the benefits. Moreover, regardless of the pricing principle used, regulatory intervention in the pricing of the service risks distorting market outcomes.

Two pricing principles identified by the Commission that could be applied to domestic inter-carrier roaming are total service long-run incremental cost ("**TSLRIC**") and retail-minus avoidable cost ("**RMAC**"). With respect to TSLRIC, the Commission has asked whether the costs of implementing a cost-based pricing model would outweigh the benefits. Telstra is firmly of the view that a light-handed approach should be taken because the costs of detailed modelling would not be justified.

Telstra considers that the application of RMAC would be problematic and completely inconsistent with encouraging efficient investment. The areas where domestic roaming is most likely to be requested are in relatively high-cost areas. Given that retail charges are geographically averaged, an RMAC approach could well lead to domestic roaming charges that are considerably below the costs of provision. For this reason, Telstra would have serious concerns with the use of RMAC.

4 International inter-carrier roaming

The Commission's main concerns in respect of the outbound and inbound international inter-carrier roaming services appear to be whether Australian carriers are able to earn monopoly rents from provision of international roaming services and whether customers are sufficiently informed of the pricing for these services.

The issue of whether monopoly rents can be earned cannot be properly examined by considering individual services, but instead must be considered over the broader basket of services provided by mobile networks because of the linkages between the individual services. As discussed in Telstra's initial response of 19 June 2003 in relation to mobile terminating access, Telstra considers that the mobile market is highly competitive. It follows that mobile operators do not have the ability to earn monopoly rents. Therefore, the only justification for regulating the international roaming service would be if the Commission believed that the way mobile operators recover their costs from different mobile services is inconsistent with the LTIE. The Commission has not addressed this issue in its report. However, given that the group of consumers who benefit from low mobile charges are the same customers that may pay more for international roaming services, the justification for the regulation of international services on the basis of distributional concerns would appear to be non-existent.

Even if a narrower approach were to be taken to analysing international roaming services, Telstra believes that there are a number of strong competitive pressures that constrain the pricing of international roaming services. These are discussed separately below for outbound and inbound services.

Outbound international roaming

Mobile network operators face a number of competitive pressures when pricing outbound international roaming services. First, they face the prospect of customers switching to other networks who provide lower international roaming charges. The resulting competitive pressure is likely to be strongest from those customers who make heavy use of roaming services, for example, business customers who travel extensively. However, given that Telstra's international roaming prices are the same for all customers, lower-use customers will also benefit from the pressure exerted by high-use customers. Second, customers have the option to use prepaid services while overseas. Prepaid SIM cards are readily accessible in many international destinations and can provide an attractive alternative to roaming. Third, customers have the option of using fixed lines in the destination country, for example, with international calling cards. All of these factors serve to constrain the pricing of outbound international roaming services.

Telstra therefore considers that regulatory intervention in the pricing of outbound international roaming services is unnecessary. This view is consistent with the approach taken by the European Commission of excluding retail international roaming services from the list of markets that it considers are candidates for *ex ante* regulation.

In addition, there is a significant problem with introducing a price cap on international outbound roaming services as suggested by the Commission. The retail price of internationally roamed calls for Australians is dependent to a large extent on the prices set by overseas operators, as well as foreign exchange fluctuations. If a price cap was imposed, Australian operators could be subject to a margin squeeze from unfavourable exchange rate movements, or from overseas operators either raising their charges, or not reducing their charges sufficiently to enable Australian operators to meet the retail price cap.

Inbound roaming services

There is significant competition for inbound roaming services. The majority of foreign mobile providers have non-exclusive commercially negotiated international roaming agreements with each major network in Australia and their customers can choose which network they roam on in Australia based on these negotiated charges. This implies that there is healthy competition at the wholesale level, as they would have all commercially negotiated their charges knowing there are substitutes for the service.

Further, the rates charged by Telstra to international operators are not excessive and are comparable with the prices paid by domestic mobile users. Given this, Telstra cannot see any justification for regulating inbound international roaming services provided by Australian networks. It would clearly not be in the LTIE, as price regulation of international inbound services would simply constitute further wealth transfers away from Australian end users (who as a result of price declines in international inbound rates would face higher charges for retail mobile services) to either overseas consumers or foreign mobile network operators.

Consumer awareness of international roaming charges

The Commission appears to be concerned over customer awareness of international roaming prices. Telstra's website contains a full description of the charges for roaming on each operator in foreign countries. This is updated monthly with exchange rate information. In addition, Telstra provides a customer service line that is accessible from anywhere in the world. Telstra has an international roaming guide, which describes the way in which the charges are applied and explains that international roaming rates can be high and vary considerably between countries. The guide recommends that customers check the rates before leaving Australia, either by calling Telstra or by accessing Telstra's website.

5 3G mobile services

Given the immature stage of development of 3G mobile services in Australia, Telstra finds it concerning that the Commission would even be contemplating the regulation of such services at this point in time. The majority of services that the Commission cites are not even currently provided, hence determining service descriptions or considering appropriate pricing principles is impossible.

Consistent with the views expressed above, Telstra would strongly oppose any move to regulate 3G services and believes that if the Commission were to proceed to do so it would undermine incentives for investment in 3G technology in Australia. The Commission already comments on the slow implementation of 3G services in Australia – the only impact that regulation would have is to further slow or cease the development of this technology. Therefore, Telstra believes it is inappropriate to respond to the Commission's questions regarding the form of regulation, its impact on the LTIE and the pricing principles that should apply.