Analysis of Markets and Competition in the ACCC Mobile Services Review Draft Decision

A REPORT PREPARED FOR VODAFONE AUSTRALIA

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Introduction

1 Introduction

Frontier Economics Pty Ltd (Frontier) has prepared this report for Vodafone Australia in response to the ACCC's Draft Decision on the Mobile Terminating Access Service. We understand that Vodafone Australia is concerned with the Draft Decision, and in particular the apparent intention of the ACCC to:

- extend mobile termination charge regulation to the 3G network; and
- to adopt pricing principles that drive the price of termination charges to a benchmarked target of 12 c/minute.

We believe that certain elements in the analysis presented in the Draft Decision are not robust, and we raise serious questions about the conclusions drawn by the ACCC.

Frontier has provided three other reports on behalf of Vodafone Australia that have been submitted to the Commission during this review process:

- *Market Definition Issues in the ACCC's Mobile Services Review 2003* (June 2003);
- *International Approaches to Market Definition: Relevance o the Definition o the Market in which the Mobile Termination Service is Supplied* (September 2003); and
- P*rinciples Governing the Regulation of Fixed-to-Mobile Termination* (September 2003).

Building on the framework established in these earlier reports, this report:

- comments on the treatment of market definition in the Draft Decision (Section 2);
- reviews the conclusions drawn by the ACCC regarding the market power in the mobile termination market (Section3); and
- critiques the ACCC's assessment of the level of competition in the retail mobile services market (Section 4).

2 Market definition

2.1 THE APPROACH OF THE DRAFT DECISION

The Draft Decision proposes to distinguish the mobile termination service market from the market for retail mobile services. The Draft Decision elects not to include these two services within the same (cluster) market because the two services are sold to different categories of buyer:

> While the Commission agrees there are some complementarities in demand and supply with regard to the mobile termination and retail mobile services, the Commission is not convinced that these forms of complementarity mean that the provision of mobile termination services (as opposed to the ability to receive calls) should be considered as being *sold* in the same bundle as other mobile services sold at the retail level to mobile subscribers. This is because standard cluster market analysis is usually applied in cases where the bundle is *sold* to a single consumer. The distinguishing feature between normal cluster market analysis and the scenario that exists with regard to mobile telephony services is that, for mobile services, different elements of the proposed bundle (or cluster) of services are *paid* for by different consumers. That is, while the mobile subscriber pays for outgoing calls and subscription, under a CPP model it is the party originating MTM and FTM calls that pays (indirectly) for termination services when its carrier purchases termination services in order to provide FTM and MTM calls. In other words, while the provision of mobile termination services provides benefits to both the maker and receiver of a call (and is therefore jointly-consumed), it is not paid for by both consumers.[1]

This view of the Draft Decision follows directly from its explanation of recent approaches to the definition of mobile telecommunications markets in Europe. But, as has frequently been observed by Australian courts and commentators, the Australian approach to market definition does not follow that of other jurisdictions.[2] In particular, Australian courts consider substitution of both demand and supply when they define markets. The result is that 'Australian and New Zealand courts are prepared to define markets more broadly than appears to be characteristic of the EEC approach'.[3]

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[1] Draft Decision, p 39.

[2] See Burchett J in *News Limited v Australian Rugby Football League Ltd* (1996) ATPR 41-466 at 41,677; Nicholson J in *Regents Pty Ltd v Subaru (Aust) Pty Ltd* (1998) ATPR 41-647 at 41,174; and Maureen Brunt, "Australian and New Zealand Competition Law and Policy" (1992) Reprinted in Maureen Brunt, *Economic Essays on Australian and New Zealand Competition Law,* Kluwer, 2003, 239-87.

[3] Brunt, *Ibid,* 251.

2.2 THE RELEVANT PRODUCT

The Draft Decision's opinion as to the meaning of 'standard cluster market analysis' is inconsistent with the approach that has been taken over many years by the Australian courts, the Tribunal and, indeed, by the Commission itself. The Draft Decision states, in the paragraph quoted above that "standard cluster market analysis is usually applied in cases where the bundle is *sold* to a single consumer. The distinguishing feature between normal cluster market analysis and the scenario that exists with regard to mobile telephony services is that, for mobile service, different elements of the proposed bundle (or cluster) of services are *paid* for by different consumers."

In submissions made in this Inquiry by Frontier, we quoted the test that was proposed for a cluster of services by the Tribunal in *Sydney International Airport* . It is hardly surprising that that decision adopted a cluster market for airport services when, clearly, the services sold by Sydney Airport are sold to different categories of buyers. As the Tribunal stated: "Such airports also typically provide a bundle of services (for example, international and domestic passenger services and freight services."[4]

A recent striking example of a cluster market where the business in question sold its services to quite distinct groups of customers is *ACCC v Rural Press.* In that case, the ACCC pleaded a publication market that embraced both advertising services and news information, where the advertising was sold to advertisers and the news information was sold to purchasers of the paper:

> The ACCC contends that the relevant market is the market for the provision of services by the publication of regional newspapers containing information and news and advertising, and providing the opportunity for advertising, in the Murray Bridge are (including the Mannum area).[5]

Rural Press disputed this market, not on the ground that it was a cluster and so too wide, but on the ground that it was too narrow. The trial judge (Mansfield J) adopted the cluster market pleaded by the ACCC.[6] The same arguments were rehearsed at the Full Court, where again the Court supported the ACCC. The argument was not repeated before the High Court.[7]

In *Rural Press,* the ACCC was pleading a cluster market whose dimensions were very similar to those adopted by the Tribunal in *Re 7-Eleven Stores.* In that decision the Tribunal defined a "market for the publication and distribution of

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[4] *Sydney International Airport* (2000) ATPR 41-754 at 40,771.

[5] *ACCC v Rural Press Limited* (2001) ATPR 41-804 at 42,735.

[6] See para 108.

[7] HCA 75 (11 December 2003) para 27.

metropolitan daily newspapers offering two interconnected products: news, information and entertainment; and classified and display advertising."[8]

These examples from different cases involving newspapers illustrate the proposition that it is quite standard for the courts, the Tribunal and the Commission (in its pleadings) to adopt a cluster market where a business produces services that are sold to distinct groups of customers. This is not only standard; it is good economics.

2.3 SUPPLY SUBSTITUTION

It is well established that markets are defined by courts in Australia to include products that are substitutes in supply. The cases refer to reactions on the supply side in response to a sufficient price incentive. They draw a distinction between supply reactions from firms that are already within the relevant market and supply reactions from firms that are not within the relevant market. The latter type of supply reaction involves entry to the market. The distinction between a reaction from a new entrant and a reaction from an incumbent depends on whether existing capacity can be utilised or whether new capacity is required. This distinction is clearly explained by the Tribunal in *AGL Cooper Basin Natural Gas Supply Arrangements,*[9] quoting a passage from *Telecom Corporation of NZ Ltd v Commerce Commission:*

> We include within the market those sources of supply that come about from redeploying existing production and distribution capacity but stop short of including supplies arising from entirely new entry. Thus 'the long run' in market definition does not refer to any particular length of calendar time but to the operational time required for organising and implementing a redeployment of existing capacity in response to profit incentives.[10]

The notion of supply-side substitution should not be thought to be limited to the production of physical goods. Just as the Tribunal in *AGL Cooper Basin* had no trouble dealing with supply-side substitutability in the context of services provided by pipelines, so it is possible to deal with supply-side substitutability in the case of services provided by mobile networks.

There are strong economies of scope linking the provision of (to use the language of the Draft Decision) mobile termination services and retail mobile services. Once an incumbent has incurred the fixed costs of building a mobile network, it will use exactly the same network to provide both termination and

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[8] *Re 7-Eleven Stores Pty Ltd, Australian Association of Convenience Stores Incorporated and Queensland Newsagents Federation* (1994) ATPR 41-357 pp 42,672-3.

[9] *Re: AGL Cooper Basin Natural Gas Supply Arrangements* (1997) ATPR 41-593 at 44,210.

[10] Quoted from *Telecom Corporation of NZ Ltd v Commerce Commission* (1991) 3 NZBLC 99-239 at 102,363.

origination services. Indeed, capacity that was used to provide termination services could readily be used to provide origination services.

Does this mean that mobile service providers would switch capacity between the two services in response to 'a sufficient price incentive'? The answer is clearly no. The reason such switching cannot occur is that, when a mobile service provider attracts a new customer, the service provider gets the business of the origination services and the termination services that go with that customer. It is only because of this bundling characteristic that we cannot observe reactions on the supply side of the kind that would, according to the authorities, compel the two services to be classified within the one market.

A similar example relates to the service provided by airports in allowing aircraft to take off and land. Clearly, the same physical capacity can be used to provide either take-off or landing services, which can be charged for separately. However, any difference in the price between take-off or landing prices would not be expected to induce any substitution away from one and towards the other. Despite this lack of responsiveness to price differences between take-offs and landings, it would be incorrect to consider the services of providing take-off and landing services as being anything other than in the same market. By considering termination services to be in a separate market than origination services, the ACCC has fallen into error.

2.4 MARKET DEFINITION NEEDED TO ANALYSE MARKET STRUCTURE

The definition of markets matters for proceedings under Part IV of the Trade Practices Act if only because of certain statutory constraints. Market definition matters also for authorisation decisions of the Commission and the Tribunal because of their adoption of a structure-conduct-performance methodology.[11] Any careful application of this methodology demands a definition of the relevant market(s) because one cannot measure concentration or analyse barriers to entry without first determining what are the boundaries to the market; one cannot analyse the height of barriers to entry without being clear what is being entered.

This leads to an obvious problem with the markets that are defined in the Draft Decision: they are inconsistent with a structure-conduct-performance methodology. Entry to the mobile termination services market of the Draft Decision necessarily involves entry into the retail mobile services market; and entry as a carrier into the retail market necessarily involves entry into the wholesale market. Furthermore, the relative sizes of the various wholesale termination markets is likely to be very similar to the market shares of the retail

[11] See Maureen Brunt, '"Market Definition" Issues in Australian and New Zealand Trade Practices Litigation', Reprinted in Maureen Brunt, *Economic Essays on Australian and New Zealand Competition Law,* Kluwer. 2003, at 191.

mobile market. That is, in the language of the Tribunal and the courts, there is one field of competition and not many – as the Draft Decision would have it.

3 Market power in the mobile termination services markets

3.1 THE APPROACH OF THE DRAFT DECISION

The Draft Decision assesses the state of competition in the mobile termination services markets by examining both structural and behavioural indicia of competition and market power.

3.2 STRUCTURAL INDICATORS

3.2.1 Market concentration

The Draft Decision discusses two structural indicators of competition in the mobile termination services markets: market concentration and barriers to entry. The discussion of market concentration is dealt with quite summarily. Because the Draft Decision opted to define the mobile services on each individual mobile network as a separate product market, it follows that each network has 100 per cent of the sales within its own market: 'Therefore, each mobile network operator can heavily influence the prices paid for the supply of termination services on its network, and in doing so has the ability [to] set termination charges well above the underlying cost of providing the service.'[12]

This reasoning applies no matter how many termination services any network supplies. Even if a network provider built a network that offered coverage throughout Australia and could attract only one customer, the logic of the Draft Decision would be that the operator would have a market share of 100 per cent and would have the ability to 'set termination charges well above the underlying cost of providing the service'.

The implicit assumption is that a network firm with one customer could exercise market power and make monopoly profits. Clearly however, such a firm would make significant losses (given its fixed costs), but under the Commission's logic it would be in the public interest to regulate the termination charges of this firm.

Merely to put this proposition is to show it to be either wrong or very poorly formulated. Investing in a mobile network involves substantial fixed costs and these fixed costs can only be recovered by attracting a large number of customers. It is not clear what costs the Draft Determination has in mind when it refers to the 'underlying cost of providing the service'. But if it is referring to

[12] Draft Decision, p 56.

long-run average cost then the proposition in the preceding paragraph is clearly wrong.[13]

A mobile network provider can attract customers to its network to cover its fully allocated costs by attracting new customers or by luring customers from other networks. Both of these methods will involve competition with other networks. This form of competition cannot be said to occur in retail markets but not wholesale markets, because this is the form of competition that might enable an operator in a mobile termination services market to break even. To define markets so that each network provider has a perfect monopoly of its own customers is to define away this form of competition.

Revenue from the provision of termination services can transfer from one operator to another in response to competition. But this competition may principally take the form of competition for retail customers. If this form of competition can cause revenue to be transferred among competitors, which it clearly can be, then the competitors should be classified as being in the same market.

3.2.2 Barriers to entry

The analysis of barriers to entry in the Draft Decision also betrays the impossibility of trying to fit the Commission's definition of termination market into the standard structure-conduct-performance schema of industrial economics. The Draft Decision analysis is as follows:

> As discussed above in section 5.2, the Commission does not believe there are practical substitutes available for termination services on a particular operator's network. Therefore, an absolute barrier to entry into the market exists, as another operator is unable to provide termination services on any other operator's network.[14]

Barriers to entry may be defined in many different ways. Perhaps the most-commonly accepted definition is that a barrier is a competitive advantage that incumbency gives an incumbent over a potential entrant. If this definition is applied to one of the Draft Decision's terminating services markets, the most-likely potential entrant would be any other mobile operator. In order to analyse the condition of entry, one must then ask: what assets would it need to acquire in order to enter; and what disadvantages would it suffer compared with the incumbent in acquiring these assets?

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[13] The Draft Decision does seem to have some notion of long-run average cost in mind because it states (p 57): 'In principle, prices are said to be at competitive levels when they are close to or at cost, allowing for a normal rate of return.'

[14] Draft Decision p 56.

The thought experiment suggested by the Draft Decision is that one has to imagine another operator providing 'termination services on any other operator's network'. This thought experiment seems to suggest that entry would only occur if the new entrant captured in an instant all the termination services of the incumbent. If some of these termination services transferred from the incumbent to the new entrant, the Draft Decision would seem to say that there has been no entry at all.

This is to treat entry barriers in a way that is quite contrary to the standard literature. The standard literature looks at what one would need to do to take market share from the incumbent. According to the Draft Determination's definition of a mobile termination market, each network operator has a 'monopoly over the provision of mobile termination services on its own network.'[15] It has a monopoly because it provides all the termination services for a particular group of (retail) customers – namely its own retail customers. According to these definitions, that monopoly would be lost if one of its retail customers were to transfer to another network. Or, perhaps the logic of the Draft Determination would prefer to characterise this as a shrinking in the size of one termination market and an expansion of the size of another.

The use of the notion of entry in this way is highly contrived. It is contrived because (as with the case of analysis of concentration) the definition of termination markets adopted by the Draft Determination simply does not fit the standard structure-conduct-performance schema of industrial economics.

3.3 DRAFT BEHAVIOURAL INDICATORS

The Draft Decision presents two behavioural indicators of competition in the (wholesale) mobile termination market. The first is changes in average prices over time. The second is the profitability of the termination service.

3.3.1 Changes in average prices over time

The first behavioural criterion by which competition in the mobile termination market is assessed is changes in prices over time. The Draft Decision states:

> In a competitive market, where the number of units consumed increases over time, it is expected that providers will experience economies of scale. This reduced cost per unit is then expected to be reflected in a lower price per unit for the service supplied. [16]

These two propositions are inconsistent with economic theory. With respect to the first proposition, in a competitive market in which the number of units

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[15] Draft Decision, p 56.

[16] Draft Decision, p 57.

increases over time, it is not expected that providers will experience economies of scale. This has been known since the work of Cournot in the first half of the nineteenth century. Cournot pointed out that unexhausted economies of scale were inconsistent with a competitive market structure.

The second proposition seems to reflect the idea that prices will be determined by average rather than marginal costs. It may be true that, in a competitive market, entry and exit in the long run brings prices into line with average costs. However, this will not be true of a given number of firms with given capacity.

The final point to be made about this section of the analysis of data in the Draft Decision is inconsistent with the criterion that it purports to use. The criterion established is that the market is competitive if prices decline over time. The data presented by the Draft Report are consistent with this criterion, i.e. prices have declined over time. This should have led the Draft Decision to conclude that the mobile termination market was competitive. However, the Draft Decision appears to have adopted the implicit criterion that the rate of decline of prices in a competitive market should be constant over time. The Draft Decision reports that the rate of decline in prices of termination services has decreased in recent years. From this it concludes that mobile network operators are enjoying above-normal profits for the supply of mobile termination services. This simply does not follow.

4 Competition in the retail mobile services market

Frontier has previously argued that the relevant market in which mobile termination services is provided is the mobile telephony services market. In order to assess the competitiveness of this market, the Commission ought to have undertaken the following steps:

- assessed market concentration levels among existing players in the mobile telephony market. This analysis should be undertaken over a reasonable length of time, of at least 5 years;

- assessed barriers to entry into the mobile telephony market;

- assessed the profitability of existing firms over a suitable length of time. When assessing profitability, it should use an appropriately valued, forward-looking asset base. It should take into account the fact that entrants into this market would typically expect their profit levels to be low (or even negative) in the early period of their investment, and higher in the later stages of the investment. If a firm considered that such higher returns were not possible in the later stages, then it would be unwilling to bear the costs of lower returns in the early stages;

- assessed patterns of prices offered to mobile telephony subscribers over time (both subscription and calling charges); and

- assessed the degree of innovation and differentiation in service delivery. In the mobile telephony market, product differentiation (in terms of different call plan and handset packages, value-added services such as voice-mail, directory assistance, pictures, ringtones, email and so on) is an important element in the way that service providers compete against one another.

In our view, had the Commission undertaken such an analysis, it would have formed the view that the mobile telephony service market was competitive.

In the following sections, we contrast this approach with the approach taken by the Commission. This shows that the Commission has made two errors:

- it purports to assess competition in a 'retail mobile services market', but its analysis does no such thing; and

- it makes incorrect inferences from the data available, and uses irrelevant and incomplete data to arrive at its conclusions.

4.1 THE APPROACH OF THE DRAFT DECISION

As with its analysis of competition in the termination markets, the Draft Decision deals with competition in the retail mobile services market by analysing both structural and behavioural indicia of competition.

4.2 STRUCTURAL INDICATORS

The Draft Decision presents data and argument concerning three characteristics of the structure of the retail mobile services market: market concentration, barriers to entry and market growth.

4.2.1 Market concentration

The Draft Decision purports to presents data about concentration in the retail mobile services market. However, it seems to have no data that is confined to this market. The data that are presented relate to mobile services as a whole. They make no distinction between revenue from the retail mobile services market and revenue from the wholesale termination service. The fact that analysts present data on the basis of combined termination and origination services is consistent with our view that a market cannot be sensibly defined in relation to termination services alone. For this reason, the Commission has not analysed the market that it purports to analyse.

4.2.2 Barriers to entry

The Commission's discussion of barriers to entry highlights the fact that its market definitions separating wholesale termination services and retail mobile services do not make sense. In its discussion of barriers to entry to the retail mobile services market, the Draft Decision refers to matters such as access to spectrum, the importance of achieving wide geographic coverage and sunk costs. These would appear to be barriers to entry to anyone building a new mobile network overall, that is a network that would be capable of providing origination and termination services. Again, the Commission has not in fact analysed the market which it purports to analyse.

If the Commission were correct in assuming that wholesale termination and mobile retail markets were indeed separate, this would imply that a participant in the termination market could enter the mobile retail services market – and in fact would be the most likely candidate to do so, given that such a participant would obviously have an available network. The fact that all participants in the wholesale termination market are already and automatically participants in a retail services market strongly suggests that there are not two separate markets at all.

4.2.3 Market growth

The Draft Decision lists market growth as one of the structural indicia of competition and market power:

Whether a market is growing, or declining, can have significant implications for the potential erosion of market power over time. Markets that are growing rapidly are more likely to see new entry, the erosion of market power and greater competition over time.

The data presented in the Draft Decision show that the rate of growth in mobile revenue in recent years has been very high, compared with the rate of growth of the economy as a whole. This continues to be the case for the latest data that are available.

However, the Draft Decision does not content itself with drawing the obvious inference from this high rate of growth. Rather, it focuses its attention on the rate of growth of the rate of growth. It notes that, although the mobiles business continues to show very high rates of growth (compared with, say the economy as a whole), theses rates of growth have been declining. It draws inferences from this fact rather than from comparisons with the criteria that it propounded at the start of the section. Therefore, the Commission has made an incorrect inference from the data available to it.

4.3 BEHAVIOURAL INDICATORS

The Draft Decision proposes three behavioural indicators of the state of competition in the retail mobiles market: changes in prices of services over time, the profitability of participants over time and the degree of product differentiation.

4.3.1 The profitability of participants over time

The Draft Decision proposes that the rates of return on investment are an indicator of the competitiveness or otherwise of a market:

A competitive market can be expected to deliver goods and services to consumers at minimum cost. In principle, prices are said to be at competitive levels when they are close to or at cost, allowing for a normal rate of return over the longer term. (At any single point in time, profits may be high. However, in a competitive market, this would trigger new entry, and high profits would be competed away.)

The clear implication is that if prices are above competitive levels (as indicated by rates of return above normal rates) then markets are characterised by market power. This reasoning is standard in the literature.

There are several difficulties with the 'evidence' presented by the Commission in respect of the profitability of the retail mobile services market.

The first difficulty is the obvious fact that none of the data actually relate to that the 'market' as defined by the Draft Decision, but rather to the provision of

mobile services overall. Therefore, once more, the Commission has not actually analysed the market which it purports to analyse.

The second point to note is that the Commission has relied on a variety of snapshot pictures of player profitability. The snapshots in themselves are an odd collection of information from disparate sources. In the case of a mobile network services operator, a snapshot (even if accurately taken) of profitability at any point in time would not provide any sensible information on which to base policy decisions. A run of data is clearly required. It is entirely possible that investors in network capacity were prepared to invest large sums of capital with little prospect of making high returns in the early years of the life of that investment, so long as there was at least some prospect of recouping some of these early losses in later years. By taking snapshots of possible indicators of profitability only from recent years, the Commission does not paint an accurate picture of the real return on capital. Therefore, the Commission has taken incomplete information to arrive at its conclusions.

The third point to note is that references to accounting figures on profits are extremely unlikely to correspond to any economic measure of monopoly profit. This is because:

- the capital base is unlikely to be defined in a way that is helpful to such calculations. It is highly unlikely to be defined in an optimised, forward looking fashion that is the Commission's standard approach in defining capital bases in other circumstances; and
- economics suggests nothing about gross margins and EBITDA. These measures may be thought to be given some meaning through international comparisons (although these are not referred to).

Finally, the Commission appears to rely heavily on industry analyst views and estimates. This is not an appropriate basis on which to base policy decisions. Industry analysts do not have perfect information, and in some instances do not have good information on industry costs and profits, particularly as defined in an economic sense. Views on key parameters and predictions for the future often vary widely among analysts.

4.4 THE COMMISSION'S CONCLUSIONS ON INCREASING COMPETITION THROUGH REGULATION

The Commission concludes that regulation of fixed to mobile termination rate is only likely to achieve a 'limited impact on the level of competition in the market within which retail mobile services are provided.'

The chief benefit claimed by the Commission of regulating fixed to mobile termination rates is that competition would be increased in the market in which fixed to mobile services are offered.

The Commission's logic may be summarised as follows. Vertically integrated carriers (Telstra and Optus) are able to offer lower fixed to mobile rates than their non-vertically integrated fixed network competitors. This is because they can charge themselves lower termination rates than they charge their competitors. If termination prices fall, then non-integrated fixed network providers would be able to offer fixed to mobile call rates that are more competitive with those offered by Telstra and Optus. This would encourage entry into the fixed telephony market.

The Commission acknowledges that this strategy might harm non-vertically integrated owners of mobile networks, such as Vodafone. However, the Commission dismisses this concern as being a short-term issue, which might be reversed if competition in the fixed market leads to more fixed to mobile call minutes being made.

This should be recognised as being an extremely high-risk strategy.

The barriers to entry into the fixed line market are very high. The most obvious barrier to entry is the very large sunk cost associated with entry into a market characterised by economies of scale over a very wide output range. Given the fundamental nature of the market, the prospects of new entry should always be considered low, no matter what the arrangements are in relation to fixed to mobile termination rates. This should come as no surprise to the Commission: it is the reason why many of Telstra's fixed line offerings are currently regulated.

The Commission's analysis of why entry into the fixed telephony market would be encouraged should be considered, at best, wishful thinking. The Commission has failed to analyse the remaining barriers to entry to this market. If it had, it would recognise that mobile termination rates are unlikely to play an important role in any player's decision to enter.

The major effect of the regulation would be to transfer revenue from mobile telephony service providers such as Vodafone to fixed line service providers such as Telstra. This revenue-transfer effect is likely to have negative impacts on competition in the market for mobile telephony services.

Mobile telephony service providers are highly unlikely to benefit from an increase in fixed to mobile call minutes, as claimed by the Commission. This is because the elasticity of demand for fixed to mobile calls has consistently been found in international studies to be low.[17] This low elasticity of demand implies that very few extra fixed to mobile call minutes will eventuate from the Commission's

[17]Frontier Economics 2003, *Review of Price Elasticity of Demand for Fixed Line Rental*, Report Prepared for Vodafone New Zealand, August.

proposals. Therefore, there should be no expectation that an increase in call minutes will make up for the revenue lost by reducing fixed to mobile termination charges.

Mobile telephony service providers such as Vodafone will be forced to increase other prices (subscription prices and/or call prices) if fixed to mobile termination charges are reduced. This is likely to reduce the attractiveness of mobile telephony services to consumers, and result in fewer mobile subscribers making fewer mobile calls.

This is likely to have implications for the ongoing competitiveness of the mobile telephony market. Incentives to invest in mobile telephony networks will be reduced.

In summary, the Commission's proposals threaten to dampen competition in one of the few telecommunications areas where competition is active and vibrant. It would risk this outcome in the hope that competition among fixed telephony service providers would be increased, ignoring the fundamental barriers to entry that are associated with that market.

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