Pricing Methodology for the GSM Termination Service
WorldxChange's Submission to the ACCC's Draft Report
8 March 2001

WorldxChange welcomes this opportunity to respond to the Commission's December 2000 draft report entitled "Pricing Methodology for the GSM Termination Service" ("**Report**").

WorldxChange does not believe that forbearance, retail-minus or benchmarking are appropriate pricing approaches.

Rather, WorldxChange concurs with those service providers that submit that pricing of the GSM terminating access services should be cost-based.

1 Access Pricing Principles

The Commission has stated that an access price that is consistent with the legislative criteria delineated under Part X1C of the *Trade Practices Act* ("**Act**") should be "consistent with the levels that would occur if the access provider faced the threat of being displaced as a supplier."[1]

This proposition yields four broad pricing principles, the first of which is that access prices should "not exceed the minimum costs an efficient firm will incur in the long run in providing the service."[2] Although the Commission considered both the short run marginal cost and the total service long run incremental cost approaches ("**TSLRIC**"), it has preliminarily rejected both approaches in favour of the benchmarking approach. WorldxChange submits that the Commission should reconsider the application of cost-based pricing for GSM terminating access services, particularly the TSLRIC approach.

The Commission preliminarily decided to base GSM terminating access services pricing on the lowest weighted average retail price of the declared service. However, use of the benchmarking approach without further investigation as to whether the benchmark price is an accurate reflection of the efficient cost of providing the declared service will serve only to further entrench any distortions in the pricing due to, for example, cross-subsidisation.

The Commission has recognised the existence of market failure with respect to GSM termination access services pricing. The access regime was established to correct such market failure. If the starting point for the glide path is based on a price that is reflective of the current market failure, WorldxChange fails to see how basing pricing on that flawed figure will correct market failure. WorldxChange submits that any benchmark price must be an accurate reflection of the efficient cost of supplying the declared service. To that end, the Commission should apply the TSLRIC approach.

TSLRIC is generally applied in cases where the declared service is well developed, necessary for competition in dependent markets, and where the forces

[1] *Access Pricing Principles -- Telecommunications* (ACCC July 1997) at page 11.

[2] *Access Pricing Principles -- Telecommunications* (ACCC July 1997) at page 11.

of competition or the threat of competition work poorly in constraining prices to efficient levels.[3] The Commission rejected the use of the TSLRIC on the basis that these preconditions had not been met. WorldxChange disagrees.

WorldxChange submits that the service is sufficiently well-developed to permit estimation of the TSLRIC. As noted by another access seeker in its submission, the technology itself is in excess of 20 years old, and the termination service has been available in Australia since 1993.[4] Also, with the pending sale of the C&W Optus network, there will necessarily have to be a valuation of the GSM network by industry participants. Certainly the Commission and its experts could conduct a similar valuation.

As for deciding whether the declared service is necessary for competition in dependent markets, WorldxChange notes that most fixed-to-mobile calls are made by consumers who have made a preselection determination. In order to determine whether the downstream market is dependent, WorldxChange submits that the Commission should consider the effects on downstream markets by isolating the fixed-to-mobile service and disregarding the other services in the basket.

In determining whether competition or the threat thereof fails to constrain prices to efficient levels, WorldxChange notes that the three dominant networks, Telstra, C&W Optus, and Vodafone together hold in excess of 99% of the market. As noted in the Commission's Report, the market shares are 45.2%, 34.8% and 19.4%, respectively.[5] Notwithstanding the presence of three wholesalers, competition is not functioning at the wholesale level. This is evidenced by the fact that all three networks offer wholesale prices above their retail prices. Although competition may be driving the price down in the retail market, it is indicative of market failure that the wholesale prices of all three network providers remain above their retail prices. Clearly, the existence of three networks has not worked effectively to constrain prices.

Accordingly, WorldxChange submits that the criteria for applying TSLRIC have been met. Although it presents some challenges, under any circumstances, estimating the TSLRIC is a lengthy and time-consuming process. To the extent that the Commission considered this factor in favouring the benchmarking approach in order to avoid further delay of the pending GSM arbitrations, WorldxChange submits that the benchmarking approach based upon the average weighted retail price be used for the limited purpose of arriving at interim pricing.

WorldxChange notes that Telstra, C&W Optus and Vodafone have all raised various arguments against application of the benchmarking approach as well. The Commission has already concluded that forbearance is inappropriate given that "indications are that the termination element of the mobile services market remains significantly above cost, which suggests that although competition in the overall market is working to reduce retail prices, some elements of the market may be affected by market failure."[6]

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[3] *Access Pricing Principles -- Telecommunications* (ACCC July 1997) at page 35.

[4] AAPT Submission 20 February 2001 at page 10.

[5] Report at 27.

[6] Report at 5.

If the Commission has rejected forbearance, and industry participants see vast problems with the benchmarking approach, WorldxChange submits that the best alternative is application of the TSLRIC. This will result in cost-based pricing in accordance with the access pricing principles, and will correct the current market failure. Lower prices reflective of the efficient cost of supplying the declared service will promote competition and will be in the long-term interests of end-users.

2 The relevant market

WorldxChange submits that the relevant market for measuring the appropriate price for GSM terminating access services is the wholesale market for GSM access services.

The Commission has stated that the provision of a mobile call involves the interaction of four 'joint products.'[7] They include GSM (undeclared) origination services, GSM termination services, mobile access (subscription) services, and outgoing call services. The Commission has stated that revenue streams from GSM termination, mobile access services and outgoing call services are interdependent in that a change in one revenue stream will cause a change in another stream.[8]

To the extent that this is so, WorldxChange submits that the Commission should examine the issue of cross-subsidisation in further detail in order to determine whether benchmarking will be an accurate reflection of the declared GSM terminating access services.

To peg prices to changes in the lowest weighted average retail price presumes that there is a strong correlation between retail and wholesale prices. However, the fallacy of this belief is belied by the fact that the three dominant networks offer wholesale services at a price greater than they offer retail services and that there has been little downward movement in wholesale prices. Because of the difficulty and expense in establishing a mobile network, and because there are no substitutes for mobile services, there is clearly a wholesale market that is separate from the retail market. WorldxChange submits that the Commission should examine its market definition more closely.

Also, notwithstanding that there are three networks, they are currently functioning, for all practical purposes, as a monopolist. Service providers have no bargaining power because they, by and large, have no services to offer the networks. Essentially, the service providers must take the prices imposed upon them by the wholesalers. The wholesalers have no real incentive to sell on a wholesale basis because they have the capability of selling the services directly to retail customers, including those presently using the services of service providers. As such, although the networks must provide access pursuant to the access regime, they are able to provide access as a monopolist.

[7] Report at 5.

[8] Report at 5.

WorldxChange further submits that consumers do not have control over the termination of a fixed-to-mobile call. It is of no consequence whether the consumer placed the call or is receiving the call because the call will necessarily be terminated on the network the mobile user subscribes to. Therefore, the mobile networks dominate access. Service providers such as WorldxChange must provide a full array of products, including terminating access on each of the three networks. It would simply be commercially unviable to offer such services on only one or two of the networks. A consumer who places a fixed-to-mobile call likely does not know which network the call will be terminated on and therefore would need access to all three networks.

Each of the network operators is using the service providers' lack of choice in purchasing GSM terminating services to artificially inflate the wholesale price. So, although there may be competition in the retail market, there is not in the wholesale market due to the lack of substitutability for GSM terminating access services.

Until such time as the networks are connected and transit services are available, competition will not flourish. Because of this monopolistic nature of the three networks, regulation in the wholesale market is required, and pricing should be cost-based.

3 The benchmarking approach

If the Commission does decide to use a benchmarking approach to pricing the GSM terminating access services, WorldxChange makes the following submissions.

As noted above, the Commission has acknowledged that "indications are that the termination element of the mobile services market remains significantly above cost, which suggests that although competition in the overall market is working to reduce retail prices, some elements of the market may be affected by market failure."[9]

After concluding that prices are significantly above cost, the Commission then decided to establish a benchmark based on the lowest weighted average retail price. WorldxChange submits that choosing the initial benchmark based on the retail price when the Commission has acknowledged that competition is not working is logically flawed. Furthermore, WorldxChange fails to see how this will serve to correct the market failure that is resulting in prices currently being significantly above cost. If anything, such an approach will further entrench inefficient pricing. In addition, the wholesalers will have little incentive to reduce retail prices if wholesale prices are to be pegged to them.

WorldxChange submits that, as a matter of logic, corrective pricing must be competitive and that competitive pricing will be established only if the benchmark is appropriately chosen in a manner that will facilitate competition. For example, it could be cost-based. Only if the initial starting point of the benchmark is appropriate will the subsequent glide path yield appropriate results.

[9] Report at 5.

WorldxChange proposes that the Commission consider alternative starting points as the benchmark. It would, for example, be worthwhile investigating what the internal transfer rates are for GSM terminating access services within the three networks. A starting point could be based on the average internal transfer price of the three networks. Or, perhaps some other proxy could be used that is reflective of the efficient cost of providing the declared service.

4 Conclusion

WorldxChange submits that pricing should be cost-based in order to correct the ongoing market failure in the GSM terminating access services wholesale market. To use a benchmark that has been recognised as flawed will serve only to entrench the problem further. If the Commission decides to use a benchmarking approach, it is essential that the starting point be such that it facilitates competition in order to meet the long term interests of end-users. It is illogical to chose a retail price to do that. The price must be based either on the efficient cost of supplying the declared service, or, at the very least, the internal transfer price.