Bundling in Telecommunications Markets – Comments on ACCC Draft Information Paper

Introduction

PowerTel welcomes the opportunity to provide a submission on this critical competition issue, which has dogged the industry since deregulation. As guidance for interpreting our submission PowerTel has selectively chosen to comment on sections of the Commission's Discussion Paper. Extracts from the Discussion Paper are in bold italic text.

General

PowerTel is constantly confronted by the anti-competitive bundling practices of its more vertically integrated competitors. These bundling practices are very effective in excluding PowerTel from certain market segments.

PowerTel considers that these practices should be considered to be anti-competitive because the more vertically integrated players are using their market power in one market to defeat competition in another.

Anti-competitive bundling by vertically integrated players significantly reduces the addressable market of other competing carriers and CSPs. Competing carriers and CSPs, which are equally efficient or even more efficient than their vertically integrated counterparts are simply unable to compete on their merits.

For example, PowerTel is unable to compete in the top end of the corporate market. This market segment is dominated by Telstra largely because of Telstra's ability to bundle a full suite of services and leverage its market power in one or more markets to defeat competition in others.

While this practice may result in some short-term discounts to end-users, it is clearly not in the LTIE. Once competitors are squeezed out using such methods, the relevant market segment is left with an oligopoly of vertically integrated carriers.

Section 2.1

There are various selling strategies for bundling in telecommunications markets. One strategy consists of the products being available either individually or in a package. For example, Telstra's GSM and CDMA mobile telephony services are available on an unbundled basis and also on a bundled basis with (at least) fixed telephony services in its "Rewards Packages".

A further strategy involves the supply of one service (the tying product) conditional on one or more other services (the tied products) also being supplied. This is commonly referred to as tying. In this case the tying product is only available on a bundled basis. For example, pay TV can only be obtained from Telstra in its "Rewards Packages" if at least fixed telephony services are also acquired.

The bundling of competitive and non-competitive products is a general tactic employed by vertically integrated carriers where they have a distinct advantage over competitors that cannot offer the customer the non-competitive service at the required price points to successfully win the business. These products are tied to competitive products in both the wholesale and corporate markets.

It is to the long-term detriment of the market resulting in the lessening of competition when “bottle-neck” services, eg Fixed to Mobile (F2M), are bundled with competitive products and services. Non-vertically integrated carriers cannot compete on an equal footing with their vertically integrated counterparts because these “bottle-neck” services cannot be offered under the same terms and conditions. The end game of the vertically integrated carrier is to increase future profit margins by minimising the market by progressively driving the competition out.

Section 2.3

In terms of benefits, bundling can allow carriers or CSPs to exploit economies of scope between bundled goods, and economies of scale if the bundling conduct has significant impacts on consumer demand. Consumers can gain when these benefits are passed on in the form of lower retail prices or quality improvements.

Economies of scale from bundling practices can only be achieved if related products are bundled together. The observation in today’s marketplace is that this is not happening, as unrelated products are being offered under bundled packages.

Further, bundling can enable carriers or CSPs to discriminate between the price of services when they are supplied as a part of a bundle and when they are supplied individually. This allows carriers and CSPs to set prices such that profits are maximised and efficiency increased. Price discrimination can be defined as the practice of charging different prices to different consumers, for the same goods, where the price differences do not reflect differences in the cost of supply. Carriers or CSPs can also price discriminate via other means, such as different pricing for different geographical areas, and discounts for “consumer loyalty”.

Current bundling practices encourage the cross-subsidisation of certain products in favour of more profitable products and services (i.e. a vertically integrated carrier has the ability to sell one product at below the average cost of the non-vertically integrated carrier as long as the second profitable product is being acquired). The non-vertically integrated carrier does not have this luxury, as it is unable to cross-subsidize to win business without significant and often detrimental consequences to its business plans.

The practice of selling below Declared Service headline rates needs to be investigated as a matter of urgency as this practice is severely impairing non-vertically integrated carriers from competing fairly in the market.

Section 3.1.1

Section 45 of the Act prohibits contracts, arrangements or understandings that restrict dealings or affect competition. For example, sub-paragraph 45(2)(a)(ii) states that a corporation shall not make a contract or arrangement, or arrive at an understanding, if a provision of the proposed contract, arrangement or understanding has the purpose, or would have or be likely to have the effect, of substantially lessening competition.

Section 46 proscribes misuse of market power by corporations that have a substantial degree of power in a market. This section prohibits taking advantage of that power for the purpose of eliminating or substantially damaging a competitor, preventing the entry of a person into any market, or deterring or preventing a person from engaging in competitive conduct in any market. The Commission does not have the power to authorise conduct, which contravenes or is likely to contravene section 46.

Current bundling practices being ring fenced by sections 45 and 46 of the Act are of major concern to competitive carriers. Vertically integrated suppliers are currently using their market power to significantly lessen competition. The short term affect maybe that the customer sees benefit from packaged price reductions, however, it is not in the LTIE if the competition is forced out of the marketplace by a combination of predatory pricing and the bundling of "bottleneck" services.

Section 4

Bundling by the vertically integrated suppliers is commonplace in today's market. This practice is significantly reducing the "addressable market" for equally or more efficient competitors, which cannot compete on the merits of their own efficiencies and competitive advantages (e.g. better customer service, faster service activations, lower product by product pricing).

Both the conditions of reducing the addressable market and vertical price squeezing are being triggered by the vertically integrated supplier.

Often in tender situations for corporate, government or wholesale business the non-vertically integrated suppliers end up losing out because they cannot compete with the bundled offers being made.

Section 4.1

When a carrier or CSP bundles services and has substantial market power in at least one of the markets for those services the Commission will inquire into whether the "addressable market" of competing carriers and CSPs is significantly reduced. The addressable market refers to the proportion of consumers in a particular market that are, in effect, available to competitors.

How does the Commission propose to assess this? Will the Commission seek to obtain anecdotal evidence, from either the customer or the competing carrier, that addressable markets are being minimised through anti-competitive behaviour? PowerTel holds the view that it would be extremely difficult to get customers to "testify" to this type of behaviour for fear of potential reprisals from vertically integrated supplier.

The reason for making such inquiries is that by bundling the service for which it has substantial market power, a carrier may be able to significantly reduce its competitors' addressable markets for the other services in the bundle. This may occur if the carrier has market power and:

- ***sets prices at levels such that the pricing strongly encourages a significant proportion of consumers to purchase the bundle of services rather than individual services from competing carriers and CSPs;***

- ***only supplies the services for which it has substantial market power within the bundled package, thus "capturing" sales of the other services in the bundle for which it faces competition;***

In PowerTel's view the two prevalent conditions in today's marketplace are the conditions highlighted above. The addressable market is significantly reduced where competing carriers and CSPs are not able to supply some of the services within the bundled offerings. Classic cases of this are when F2M and/or Local Calls are offered as part of a bundle by vertically integrated providers, as competitive carriers are unable to achieve the price points required to win the business. This situation is most common in the corporate market where anti-competitive bundling practises are rife.

For example, PowerTel purchases F2M services from these carriers at rates which exceed those offered by these same carriers to end-users on a bundled basis. As a result PowerTel, an equally efficient provider, is not able to compete in these markets because of this vertical price squeeze.

Section 4.1.1 Pricing and bundling

Predatory pricing and vertical price squeezes

Predatory pricing describes situations where a carrier or CSP with substantial market power takes advantage of that power by setting prices below a particular measure of cost which results in it sacrificing short-term profits. Such conduct may involve a corporation taking advantage of its market power for the purpose or effect of substantially damaging or eliminating a competitor, or competitors more generally, or preventing or deterring a firm from engaging in competitive conduct in any market.
For example, it may force equally-efficient competitors to exit the market and deter future competitive entry. Alternatively, it may have the purpose or effect of substantially lessening competition.

PowerTel holds the firm view that if competitive carriers are prevented from operating effectively in the various market segments then the telecommunications market as a whole will shift over time to a duopoly or oligopoly environment as the competition is forced out of the marketplace because of the inability to generate adequate profit margins for their primary product offerings. This is ultimately not in the LTIE as eventually prices will rise and service levels will fall.

In contrast, while a vertical price squeeze requires that an integrated carrier possess market power, it is not necessarily the case that losses are incurred. An integrated carrier can achieve a price squeeze by reducing the margin between the retail price it charges in the downstream market and the wholesale access price it charges for an essential input to the downstream service such that an equally-efficient competitor using that input will not be viable. The margin could be reduced by lowering the retail price for a service and/or raising the wholesale access price for an essential input.

The F2M situation is a prime example of this as prices are being offered by the incumbents to corporate customers that are below what the incumbent charges competing carriers to acquire the same service. Hence the non-mobile provider would be forced to sell below cost on the mobile component and attempt to cross-subsidise this with the margin on the product where it has a competitive edge.

The long-term result of this is that the competitive carrier will not be able to obtain acceptable profit margins on the product where it has a competitive edge and hence will eventually be forced out of the market. This is not in the LTIE as monopoly rents will be levied and service levels will degrade.

Testing for predatory pricing and vertical price squeezes

With the Commission's approach to price testing does it propose to obtain competitive information from the End User? It is PowerTel's view that this may prove to be a difficult exercise as the End User may be reluctant to provide information on fears that they may be subject to retaliatory actions from incumbent suppliers.

NERA provides its views about how to address these complications. Where the market of concern is narrower than the bundled package, it proposes that (price or cost) information relating to the non-relevant services(s) should be removed. This means that information relating to the provision of only the service or service in the relevant market is tested. In instances where it is considered that the market includes bundled and unbundled supply of services, NERA considers that the price and cost information should be weighted to reflect the proportion of bundled and unbundled supply in the relevant market(s).

PowerTel would like to explore the reason why the Commission proposes to apply a weighting methodology to bundled and unbundled services?

NERA's report also notes that "aggregate" imputation tests have the benefit of allowing for economies of scope and scale (which may occur as a result of bundled service provision) to be more readily incorporated.

The Commission considers that a market-by-market approach to imputation testing is likely to be appropriate, particularly when assessing the impact on competition in defined markets. This said, the Commission acknowledges that complications will occur in applying imputation tests to bundled packages, particularly where market definitions and the bundled packages do not coincide. In this regard, it considers that NERA's proposed approaches will likely overcome such difficulties. The Commission also considers it may be necessary to take into account economies of scope and scale relating to bundled service provision.

It is PowerTel's observation that it is rarely the case that services are bundled that provide for economies of scale benefits. In most cases perhaps the only benefit may be the potential cost savings derived from a "one-bill" scenario. The common practise is that quite unrelated products are bundled, usually "bottleneck" products such as F2M form the cornerstone of the bundle. This immediately eliminates the suppliers that do not have this service as part of their infrastructure based product suite.

The Commission notes that if a predatory pricing or imputation test based on average total costs is passed, a marginal cost approach would also be passed. In essence, a marginal cost approach sets a higher threshold for establishing that pricing conduct is likely to be anti-competitive than an average total cost test.

PowerTel provides qualified support for the use of the average cost method or any method that lowers the threshold for triggering an investigation into anti-competitive behaviour, as this may be more reflective of the true cost of supplying the individual services in the bundle. PowerTel further agrees that use of the average total cost approach is a good initial test for quickly establishing whether anti-competitive behaviour is being practised by vertically integrated carriers.

In the event that the conduct does fall inside the "grey area", the Commission is likely to consider other factors to assist it in determining whether the conduct is anti-competitive. Some issues which may be relevant to this consideration are listed below.

PowerTel also suggests the addition of the following to the list suggested by the Commission:

- Are retail prices offered by the incumbent similar to or below wholesale/interconnect prices offered to competitors?
- Are non-competitive tying products being offered as part of the bundle?

If these conditions are being triggered then it is perhaps a clear indication that anti-competitive practices are being adopted by vertically integrated carriers.

5 Information gathering and bundling conduct

As noted, RKRs are a flexible power which allow the Commission to request various types of information for different purposes. In this regard, it is likely to be the most appropriate power for the ongoing collection of specific information, not just tariffs, from carriers or CSPs. This will also allow the Commission to have readily available information that may potentially be relevant to the consideration of whether particular bundling conduct is anti-competitive.

How does the Commission propose to assess this? Does it propose to extend RKR provisions to obtain information from the End User? Will the Commission seek anecdotal evidence that addressable markets are being minimised through anti-competitive behaviour? PowerTel holds the view that it would be extremely difficult to get customers to "testify" to this type of behaviour on fears that they may be subject to retaliatory actions from incumbent suppliers.

5.1 Regulatory Accounting Framework

The Commission already receives comprehensive information on costs, revenues and usage from Telstra, Optus, Vodafone, AAPT and Primus under the Telecommunications Industry Regulatory Accounting Framework (RAF) RKR. This RKR requires these carriers to provide financial information to the Commission on a regular basis, allowing the Commission to compare the (historical) unit cost of various services and provide increased transparency to assist in conducting imputation or predatory pricing tests. The RAF data may form the basis for such a test (although additional information may be required to properly undertake the test), or it may assist in providing a "sanity check" of a predatory pricing or imputation test using different data.

PowerTel suggests that the gathering of anecdotal evidence from competitive carriers may also be useful as a sanity check. The investigation of bundling practices within the corporate and government sectors should readily supply the Commission with evidence of the potential anti-competitive behaviour.

5.3 Potential public disclosure of information

PowerTel is fully supportive of any public disclosure of RKR information where it assists in promoting competition. As PowerTel has indicated in previous submissions, and also collectively noted by various industry bodies and carriers, one of the major deficiencies currently in the industry is the lack of transparency.