Optus Submission to

Australian Competition and Consumer Commission

in response to

ACCC Draft Report on reviewing the declaration of the mobile terminating access service

April 2009

Table of Contents

1. Introduction 3

2. Potential for Above-cost Pricing and Connectivity Breakdown 4

Above cost pricing and bargaining power 4
Connectivity 8

3. Duration of the Declaration 10

1. Introduction

1.1 In December 2008 the ACCC began its review of the declaration of the mobile terminating access service (MTAS) and released a discussion paper for comment.

1.2 In its January 2009 submission to the review, Optus submitted that the established mobile and integrated operators (Telstra, Optus, Vodafone and Hutchison) have sufficient bargaining power that they do not require regulated access to the MTAS. Accordingly, Optus proposed that the ACCC restrict mobile regulation to termination of FTM calls from the small fixed operators and termination of MTM calls from new entrant mobile operators.

1.3 In March 2009 the ACCC released its draft report on the declaration of the MTAS. In the Draft Report, the ACCC proposed to extend the current MTAS declaration for a period of five years without altering the service description. It considered that the current MTAS service description should not include termination of SMS, MMS and other data services or mobile network services deployed in aircraft operating within Australia.[1] It did not propose to accept Optus' proposal to restrict the declaration to small fixed operators and new entrants, due to concerns relating to the potential for above-cost pricing and connectivity breakdown.

1.4 Whilst concurring with the ACCC's preliminary views on data services and services deployed in aircraft, Optus is disappointed that the ACCC does not propose to accept its proposal to restrict the declaration to small fixed operators and new entrants. The ACCC's reasoning on the potential for above-cost pricing and connectivity breakdown has some merit when applied to new entrant mobile operators and the smaller fixed line operators. Indeed, it is clear from the ACCC's decisions on this issue that the MTAS declaration is designed to protect such operators.

1.5 However, the ACCC's concerns do not justify regulated rates for the established carriers, since there is no serious imbalance in bargaining power between them – particularly given the impending merger between Vodafone and Hutchison. The ACCC's concerns relating to connectivity breakdown or above-cost charging of calls from the main operators are not well founded. The ACCC itself recognised in 2004 that there is no serious risk of connectivity breakdown for established operators, noting that: [2]

> *…the Commission considers that market forces are generally such that mobile operators will enter into agreements allowing termination of voice calls on their networks in the absence of declaration.*

1.6 Finally, Optus considers that the extension of the declaration for five years is excessive, given the rapidly evolving nature of the markets in question. The length of the declaration is particularly incongruous considering the ACCC is proposing to extend the declaration of fixed line services by only one year.

[1] ACCC, *Mobile Terminating Access Service*, Draft Report, March 2009, p.14
[2] ACCC (2004), *Mobile Services Review: Mobile Terminating Access Service*, p.132

2. Potential for Above-cost Pricing and Connectivity Breakdown

2.1 In its January 2009 submission to the review, Optus took the view that the established mobile and integrated operators (Telstra, Optus, Vodafone and Hutchison) have sufficient bargaining power that they do not require regulated access to the MTAS.

2.2 In the Draft Report, however, the ACCC took the view that in the absence of declaration there was potential for above-cost pricing and connectivity breakdown. Its draft view was that this potential existed even in the cases of established MNOs and integrated operators with countervailing bargaining power, because of the existence of asymmetric traffic flows.[3] The ACCC noted its belief that asymmetric traffic flows among fixed only, mobile only and integrated network operators creates an incentive for MNOs to raise the MTAS price above its underlying cost of production irrespective of the origin of calls.[4]

2.3 Asymmetric traffic flows may well be relevant to the *incentives* of operators to prefer a higher or lower rate. However, the existence of incentive is insufficient justification for regulation aimed at controlling market power: the real question is whether mobile operators would have the *ability* to raise the MTAS price above its underlying cost of production.

2.4 Optus considers that the ACCC's concerns about the potential for above-cost pricing and connectivity breakdown are misplaced. These issues are examined further below.

Above cost pricing and bargaining power

2.5 The ACCC has a longstanding belief that MNOs have control over access to termination services provided on their networks and are largely unconstrained by competitive forces when setting the price of termination services on their networks. The ACCC has stated its belief that in the absence of continued regulation of the MTAS, MNOs would set the price of this service above its underlying cost of production.[5] That is, the ACCC's position is that – without regulation – each MNO is a monopolist, able to set its own MTAS price free of constraint.

2.6 Optus submits that the ACCC's position is unrealistic, since it does not take into account the bargaining strength of the respective parties in a negotiation over MTAS prices.

Determinants of bargaining strength

2.7 In a 2005 paper, Binmore and Harbord analysed bargaining over fixed-to-mobile termination rates and challenged the conventional wisdom that

[3] ACCC, *Mobile Terminating Access Service*, Draft Report, March 2009, p.26
[4] ACCC, *Mobile Terminating Access Service*, Draft Report, March 2009, p.12
[5] ACCC, *Mobile Terminating Access Service*, Draft Report, March 2009, p.26

mobile operators are able to act as monopolists in pricing call termination on their networks.[6] The paper focused mainly on the case of a new entrant operator bargaining with the fixed line incumbent, however many of the insights are also applicable to the more general case.[7] Binmore and Harbord found that the MTAS price in such a bargaining situation would be determined by the relative bargaining power of the two parties. The paper noted:[8]

> *To assess whether the circumstances endow one or both agents with significant market power, it is therefore necessary to investigate the extent to which one party or the other has bargaining strategies available that allow them to force a final deal that favours their own side.*

2.8 The leading strategic factors that determine the nature of such a deal are set out in the paper.[9] They include the parties' payoffs in the event of agreement or deadlock, the parties' outside options, and differing degrees of impatience, risk tolerance and information. Binmore and Harbord found that that there was likely to be a significant degree of bargaining power on the part of buyers of mobile termination services. An important insight from the paper is that a MNO has no outside option, because an agreement over termination rates is necessary for its business.[10] Another is that the more impatient bargainer (or the more risk averse bargainer) ends up with a relatively smaller gain from bargaining since the less impatient bargainer can credibly threaten to delay an agreement unless the more impatient bargainer makes concessions. [11]

2.9 It follows that it is insufficient for the ACCC to proceed on the basis that MNOs are unconstrained when setting the price of termination services on their networks. It is clearly necessary to examine the bargaining strength of the relevant operators in order to determine whether a commercially negotiated outcome would be likely to lead to MTAS prices in excess of cost.

---

[6] Binmore and Harbord (2005), *Bargaining Over Fixed-to-Mobile Termination Rates in the Shadow of the Regulator*

[7] According to the paper, the key difference is that an existing operator brings a large termination business 'pie' to the bargaining table, from which it obtains a share of the benefits, while a new entrant brings no such 'pie' at all, since nearly all of its future subscribers will come from existing 2G networks. However the fruits of bargaining are divided between the bargaining parties in both cases. Binmore and Harbord (2005), *Bargaining Over Fixed-to-Mobile Termination Rates in the Shadow of the Regulato*r, p.19

[8] Binmore and Harbord (2005), *Bargaining Over Fixed-to-Mobile Termination Rates in the Shadow of the Regulato*r, p.8

[9] Binmore and Harbord (2005), *Bargaining Over Fixed-to-Mobile Termination Rates in the Shadow of the Regulato*r, p.9

[10] In the paper this argument is made by reference to a new entrant, however it is also true for an operator with an existing basis.

[11] Binmore and Harbord (2005), *Bargaining Over Fixed-to-Mobile Termination Rates in the Shadow of the Regulato*r, pp.20-21

Bargaining strength of Vodafone and Hutchison

2.10 In its draft report, the ACCC questioned whether Hutchison and Vodafone could be regarded as established players with similar bargaining power as vertically integrated MNOs such as Telstra and Optus. In forming this opinion, the ACCC appears to rely on the assumption that a lower relative market share equates to a weaker bargaining position.

2.11 However as noted above it is incorrect to assume a lower relative market share equates to a weaker bargaining position. The relative bargaining power of the parties will depend on the structure of their payoffs, and how impatient or risk averse they are. In this regard, Hutchison and Vodafone are likely to be in a comparable position to Telstra and Optus. All parties are in the position where they must agree on termination rates. As noted above, no party has an outside option, because an agreement over termination rates is necessary for the business of all parties. Whilst a new entrant with no established business would be more impatient that an established operator, that is not the case here: all parties have an established mobile business.

2.12 Optus submits that Hutchison and Vodafone can be regarded as established players in the mobile market for a number of reasons. Both Hutchison and Vodafone have significantly contributed to the Australian mobile market in recent years.

2.13 As the number three and four MNOs, Vodafone and Hutchison, respectively have contributed significantly to the Australian mobile market. Vodafone is a facilities-based competitor, in that it operates 2G and 3G mobile networks, which will both ultimately reach 95 per cent of the Australian population. In addition, Vodafone is a strong competitor in the supply of prepaid mobile products. For example, the CEO at Vodafone Australia, Russell Hewitt continually comments that Vodafone maintains strong growth in prepaid and contract connections despite the challenging economic environment. [12]

2.14 Hutchison, despite being the number four MNO, is regarded as a vigorous and effective competitor in the mobile telecommunications services market. Notably, the growth in Hutchison's market share implies that there is no imbalance in bargaining power between MNOs, therefore it is still able to exert competitive pressure within the mobile services market.

2.15 For example, the Group MD of Hutchison Whampoa and Chairman of HTAL, Canning Fok has been noted acknowledging that:

> *"Since its inception, 3 has established a track record of innovation – from challenging the status quo by launching Australia's first 3G*

[12] Vodafone, "Vodafone Australia reports strong growth in prepaid and contract connections," News Release, 22 July 2008, http://www.vodafone.com.au/stelprd/groups/webcontent/documents/webcontent/dev_005939.pdf
Vodafone, "Vodafone Australia defies downturn with strong Christmas quarter," News Release, 3 February 2009, http://www.vodafone.com.au/stelprd/groups/webcontent/documents/webcontent/dev_006853.pdf

network with new services such as mobile TV and mobile internet, to changing the market with the introduction of cap plans." [13]

2.16 In particular, it is a strong competitor in the supply of lower-priced post-paid mobile products. For example, Hutchison currently offers the widest range of lower-priced capped plans under its 3 brand, from $19 to $49 per month,[14] and has recently launched two shared consumer capped plans offering up to two services on its $79 per month plan or up to three services on its $109 per month plan. [15]

VHA merger

2.17 In February 2009, Hutchison and Vodafone announced an agreement to merge their Australian mobile operations. The proposed Vodafone-Hutchison Australia (VHA) merger will be a 50:50 joint venture between the two MNOs, which will continue to "market its products and services under the Vodafone brand, but will retain exclusive rights to use the 3 brand in Australia during a transition period and thereafter." [16]

2.18 The impact VHA will likely have in the mobile market is through its increased bargaining power. Such that, as Vodafone notes:

> *"Following completion of the merger which is expected in mid-2009, the Vodafone brand will continue and it is our intention to combine the best of both companies so that we deliver even more competitive and innovative products and services to our combined customer base.* ***We will be able to do this by drawing upon and combining the global expertise and buying power of 2 of the largest international mobile companies, Hutchison and Vodafone."*** [17] [emphasis added]

2.19 The transaction benefits of the proposed VHA merger are considered to include:

- The creation of a stronger mobile operator with the necessary scale to compete in the Australian mobile market, which will better utilise existing network arrangements and increased coverage to 95 per cent of the population;
- Drawing from the best offerings of both Vodafone and 3, to provide consumers with an even broader product offering; and

[13] Vodafone, "Hutchinson and Vodafone agree to merge Australian telecom operations to form a 50:50 joint venture," Media Release, 9 February 2009, http://www.vodafone.com.au/stelprd/groups/webcontent/documents/webcontent/dev_006869.pdf
[14] Refer to 3 website for more information, http://www.three.com.au/plans
[15] Refer to 3 website for more information, http://www.three.com.au/plans
[16] Vodafone, "Hutchinson and Vodafone agree to merge Australian telecom operations to form a 50:50 joint venture," Media Release, 9 February 2009, http://www.vodafone.com.au/stelprd/groups/webcontent/documents/webcontent/dev_006869.pdf
[17] Vodafone, "Vodafone Hutchinson Merger FAQs", Media release, 17 February 2009, http://vodafone.custhelp.com/cgi-bin/vodafone.cfg/php/enduser/std_adp.php?p_faqid=3255

- Achieving economies of scale across internal processes, in order to achieve expenditure synergies. [18]

2.20 Thus even if the ACCC's approach were correct, the impending merger between Vodafone and Hutchison will soon create a powerful new competitor and put the market shares of the three remaining mobile operators on a more equal footing.

2.21 It follows from this discussion that if the declaration were revoked MNOs would not have the ability to control their own MTAS prices. Even if they wished to raise prices above cost, they would not have the ability to do so. Optus submits that the ACCC's concerns do not justify regulated rates for the established carriers, since there is no serious imbalance in bargaining power between them – particularly given the impending merger between Vodafone and Hutchison. The ACCC's fears of above-cost charging of calls from the main operators are not well founded.

2.22 Optus' proposal will achieve the key benefit of declaration identified by the ACCC in 2004: the promotion of competition from fixed-only operators in the market in which FTM services are provided and from new entrants in the retail mobile services market. For the remaining players, in the absence of declaration, commercial negotiation would result in an outcome consistent with the long term interests of end users.

Connectivity

2.23 In the Draft Report the ACCC took the view that in the absence of declaration there was potential for connectivity breakdown, noting that the continued declaration of the MTAS prevents any possibility of a carrier, and in particular a new entrant, being refused access to the mobile termination services of other operators. [19] It considered that "the potential for connectivity breakdowns continues to exist in MTM calls or calls terminating on 'established' networks due to the bottleneck feature inherent in the MTAS service even though particular carriers may have a certain degree of countervailing bargaining power in relation to particular MTAS markets." [20]

2.24 Optus submits that any-to-any connectivity is likely to be achieved irrespective of whether the MTAS is regulated, particularly for the established MNOs (Telstra, Optus, Vodafone and Hutchison). Connectivity breakdown is simply not a real risk for these established carriers.

2.25 In its previous examination of the declaration of the MTAS in June 2004, the ACCC expected the benefits would arise primarily in relation to new entrants to the market. It recognised that, in order to compete, it was essential for a new entrant to be able to terminate calls on competing networks and receive calls from competing networks. It also recognised that, without a declaration,

---

[18] Vodafone, "Hutchinson and Vodafone agree to merge Australian telecom operations to form a 50:50 joint venture," Media Release, 9 February 2009, http://www.vodafone.com.au/stelprd/groups/webcontent/documents/webcontent/dev_006869.pdf
[19] ACCC, *Mobile Terminating Access Service*, Draft Report, March 2009, p.30
[20] ACCC, *Mobile Terminating Access Service*, Draft Report, March 2009, p.30

the established competitors would have an incentive to not interconnect with the new carrier:[21]

> *New entrants to the mobile services market rely on their ability to interconnect with all mobile network operators so that they can provide a full end-to-end service to consumers that subscribe to their network (…) Having control over access to all consumers directly connected to their networks gives established mobile operators the ability to frustrate a new entrant's ability to offer a full end-to-end service to its subscribers (…) Declaration can help overcome this potential threat.*

2.26 While the impact of new entrants garnered the most attention in this analysis and was the main consideration in relation to any-to-any connectivity, the ACCC also discussed whether declaration of MTAS would affect established carriers, noting that: [22]

> *Where there are a number of established mobile operators with substantial subscriber numbers, each operator will have an incentive to reach an interconnect agreement with every other operator, in order to:*
>
> - *gain revenue from termination charges levied on the operator of the originating network; and*
> - *attract and maintain a subscriber base by allowing for calls to and from subscribers on all other networks.*
>
> *Accordingly, the Commission considers that market forces are generally such that mobile operators will enter into agreements allowing termination of voice calls on their networks in the absence of declaration.*

2.27 It is clear from the above that the ACCC itself has recognised there is no serious risk of connectivity breakdown for established operators. Optus agrees with this view. MNOs must reach agreement over termination with all established operators in order to meet their customers' needs.[23] Further, as Vodafone has pointed out, "*history shows us that MNOs provided interconnection for these services long before regulation was imposed, or was thought of being imposed.*" [24] [emphasis added]

2.28 Under Optus' proposal, all MNOs would remain subject to the standard access obligations regarding termination of FTM calls from the small fixed operators and termination of MTM calls from new entrant mobile operators. It follows that the ACCC's concerns relating to new entrants and smaller competitors would continue to be allayed in relation to these carriers.

2.29 On this basis Optus submits that the objective of achieving any-to-any connectivity would be unaffected by its proposal.

---

[21] ACCC (2004), *Mobile Services Review: Mobile Terminating Access Service*, pp. xiv-xv

[22] ACCC (2004), *Mobile Services Review: Mobile Terminating Access Service*, p.132

[23] In the paper this argument is made by reference to a new entrant, however it is also true for an operator with an existing basis.

[24] Vodafone, *Discussion paper reviewing the declaration for the domestic mobile terminating access service*, January 2009, p.9

3. Duration of the Declaration

3.1 In the Draft Report, the ACCC set out its preliminary views on the issues and proposed to extend the current MTAS declaration for a period of five years.

3.2 Optus considers that the extension of the declaration for five years is excessive, given the rapidly evolving nature of the market. Recent years have seen significant change, including the auctioning of 3G spectrum in 2003 and switch off of the CDMA network in 2008, the emergence of dual mode mobile handsets capable of use on both the GSM and satellite networks such as the "Optus Thuraya service" and the release of VoIP compatible mobile handsets, such as the Nokia X-series and the Three SkypePhone.

3.3 These technologies will only become more widespread in coming years. Even if the ACCC does not consider that in 2009 the emergence of mobile VoIP and dual mode handsets has eroded mobile operators' control of the mobile termination bottleneck, the conclusion may need to change in 2010 or 2011. Optus submits that in order for regulatory regime to keep pace with developments in such a dynamic market, the ACCC must revisit regularly its analysis of the declaration.

3.4 Further, the length of the declaration is particularly incongruous considering the ACCC is proposing to extend the fixed line service declarations by only one year:

> *"The ACCC's current view is that it would promote the LTIE for the declarations to be extended by 12 months to 31 July 2010 pursuant to section 152ALA(4). The ACCC currently favours a relatively short extension of each of the declarations so that it can monitor and assess significant legislative and regulatory developments that may affect the communications sector during that time."* [25]

3.5 In particular, the ACCC highlighted the impending NBN roll-out as a significant addition to the telecommunications sector:

> *"A 12-month extension allows for the consideration of implications arising out of the Federal Government's current NBN process… the ACCC's application of the current access regime would almost certainly need to be altered with the significant introduction of a new access technology."* [26]

3.6 Optus considers that these "significant legislative and regulatory developments" will have profound effects throughout the communications sector including in the mobile space.

3.7 Optus submits that the MTAS declaration should not be extended for a period longer than two years.

---

25 ACCC, Fixed Services Review – Declaration inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR, Discussion Paper, November 2008, p.8

26 ACCC, Fixed Services Review– Declaration inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR, Discussion Paper, November 2008, p.8