Submission to the Australian Competition and Consumer Commission

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Response to Hutchison's Undertaking in relation to the Domestic Digital Mobile Terminating Access Service

December 2005

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1. Introduction

1.1 Vodafone welcomes the opportunity to comment on the Hutchison Mobile Terminating Access Service (MTAS) Discussion Paper issued by the Australian Competition and Consumer Commission (the ACCC) on 18 November 2005.

1.2 Hutchison has lodged undertakings with the ACCC to supply MTAS in the following three classes:

- Public Mobile Telecommunications Service (PMTS) 'Dual Rate'
- PMTS 'Single Rate'
- Non-PMTS

1.3 Each class is presented as a separate undertaking for both HTAL (2G network) and H3GA (3G network) so Hutchison has six ordinary MTAS undertakings in total.

1.4 Vodafone believes that all six of Hutchison's undertakings are not reasonable in the terms of section 152AH of the *Trade Practices Act* 1974 (the TPA) and, therefore the undertakings cannot be accepted by the ACCC under section 152BV of the TPA.

1.5 The ACCC's general pricing principle for telecommunications is that access prices should be cost based[1]. However, Hutchison has not provided cost modelling or any relevant analysis that demonstrates their undertakings are based on the costs of supplying MTAS. Therefore, the price terms and conditions contained in the undertakings are unreasonable.

1.6 In making this submission Vodafone has followed, where possible, the Commission's discussion paper on Hutchison's undertaking for MTAS. Due to Hutchison's lack of analysis to support their undertakings, it has been difficult for Vodafone to provide in depth comments on the Hutchison undertakings. Vodafone response is therefore confined to a limited number of areas.

[1] ACCC (1997) Pricing Principles Telecommunications - A guide, p14

2. Pricing Principles

2.1 The ACCC promotes the statutory criteria and the long term interests of end users (LTIE) are best addressed by MTAS rates based on using the Total Service Long Run Incremental Costs (TSLRIC+) approach. Under TSLRIC+, MTAS rates are typically adjusted for an equi-proportionate mark-up (EPMU) to include contributions to fixed and common costs and set at a level that allows operators a normal return on efficient investments associated with providing the service[2].

2.2 However, the Commission does concede that cost-based pricing can take many variants, depending on what is included in costs, how these costs are allocated, and how they are measured (particularly common costs and capital costs)[3]. Vodafone believes that allowing fixed and common costs using Ramsey pricing principles is also consistent with a TSLRIC+ methodology.

2.3 Vodafone's access undertaking MTAS target rate (of 16.15 cents per minute) is based on a reasonable and conservative estimate of the forward looking costs of providing the MTAS. Vodafone's target price for MTAS is based on a Fully Allocated Cost (FAC) approach, which is underpinned by current cost asset valuation principles to ensure a closer approximation of forward-looking efficient economic costs of supplying MTAS.

2.4 Vodafone's access undertaking is also supported by economic modelling and analysis in relation to the welfare maximising MTAS price. Vodafone believes that welfare maximising MTAS prices most promote the LTIE. This modelling and indicates that substantially higher prices than 16.15 cents per minute (cpm) could reasonably be justified for an access undertaking. While Vodafone chose not to explicitly adopt this analysis in the price terms of the Undertaking, this analysis does suggest that the price terms proposed by Vodafone are very conservative.

2.5 Based on this modelling and also the cost modelling, Vodafone considers a target MTAS rate of 16.15 cpm to be a reasonable and conservative and also consistent with the statutory criteria. It should be noted that Vodafone's MTAS undertaking only relates to terminating voice calls on Vodafone's 2G mobile network. Vodafone believes that is necessary to take into account costs associated with the deployment of 3G networks and operating two mobile networks in parallel when delivering appropriate MTAS prices.

[2] ACCC (2004) Mobile Services Review Mobile Terminating Access Service, p xviii
[3] ACCC (1997) Pricing Principles – Telecommunications, a guide, p28

2.6 As outlined in the Vodafone access undertaking, Vodafone implicitly adopts Ramsey pricing to allocate and recover fixed and common costs across the various products and services it supplies. As the demand for mobile termination is relatively inelastic compared with the demand for outgoing calls and subscription, Vodafone attributes a higher proportion of fixed and common costs to mobile termination than will be the case under Vodafone's undertaking.

2.7 For Vodafone to move from allocating fixed and common costs based implicitly on a Ramsey allocation to allocating common costs on an EPMU allocation, promoted by the ACCC, requires substantial price changes for mobile termination, outgoing calls and subscription services.

2.8 Vodafone therefore believes the glide path for MTAS, shown below, to the target MTAS rate of 16.15 cpm is necessary and will manage the change of prices on customers and internal business planning from the reallocation of fixed and common costs based on EPMU. The use of a glide path for MTAS is in the LTIE and is consistent with the statutory criteria.

Validity period	Usage Charge (Cents per minute)
1. 1 July 2004 to 31 December 2004	21
2. 1 January 2005 to 31 December 2005	19.38
3. 1 January 2006 to 31 December 2006	17.77
4. 1 January 2007 to 30 June 2007	16.15
5. Any subsequent Validity Periods	16.15

3. The Undertakings

3.1 As a preliminary matter, Vodafone notes that Hutchison does not distinguish between the costs of providing MTAS a 3G network and on a 2G network. Hutchison appears to simply adopt the ACCC's preferred target termination rates for both access to the 2G network and access to the 3G network. However, the ACCC's target termination rate of 12 cpm commencing 1 January 2007 is based on benchmarked overseas termination rates for 2G only.

3.2 Vodafone's view regarding 3G termination rates are outlined in Vodafone's submission to the mobile service review, and the situation has not changed — Vodafone is unaware of any publicly available TSLRIC+ modelling for establishing the cost of termination on a 3G network. Vodafone therefore cannot understand how Hutchison can substantiate the price of 12 cpm for termination on their 3G mobile network.

3.3 The 3G infrastructure has been rolled out at a significant cost to all carriers. Carriers have the added cost of concurrently operating 2G networks. Vodafone submits that during this time there are additional and legitimate costs for 3G that need to be recovered through MTAS pricing.

Not in the long term interest of end users

3.4 Vodafone does not believe Hutchison's undertakings are in the LTIE. Hutchison has not provided any evidence to support their assertion that MTAS rates of 12 cpm, 18 cpm for Non-PMTS termination, or 21 cpm for mobile-to-mobile termination in the proposed dual rate undertaking are rates that will promote the LTIE.

3.5 This is to be contrasted with the detailed economic modelling that Vodafone conducted as part of its access undertaking, which has been subjected to the scrutiny of the ACCC and telecommunications market participants. The modelling demonstrates that a MTAS target rate of 16.15 cpm would promote the LTIE.

3.6 Vodafone considers that the rates contained in each of the undertakings Hutchison has lodged would not be in the LTIE on the basis that these rates will not achieve the objective of promoting competition or the objective of encouraging the economically efficient use of, and the economically efficient investment in infrastructure. These are two matters to which regard must be had when considering whether the undertaking will promote the LTIE.[4] The reason for this is because the rates Hutchison has selected are the prices "published" by the ACCC in their Final Decision.

[4] Section 152AB(2)(c) and (e).

3.7 However, these prices were indicative only and were not based on any Australia specific cost modelling or analysis. The ACCC target price of 12 cpm was based on unadjusted overseas cost benchmarks (other than for currency) and also Telstra's Regulatory Accounting Framework reports and to a lesser extent, those of Optus. Vodafone submits that this methodology is not consistent with the LTIE and is not a robust or reasonable methodology for calculating or estimating TLSRIC+ or producing an estimate of the range of TSLRIC+ for MTAS. Hutchison has arbitrarly chosen the ACCC indicative prices without itself demonstrating that the basis of these prices are such that it is reasonable and consistent with the statutory criteria.

3.8 Vodafone's MTAS undertaking and the supporting modelling and documentation (and also the modelling conducted by Optus in support of their MTAS undertaking) is the best available information to the ACCC informing appropriate MTAS prices. Vodafone's modelling demonstrates that a reasonable and conservative estimate of the efficient costs of providing the MTAS is 16.15 cpm and as such, an Undertaking proposed by Hutchison requiring Vodafone to price MTAS at 12 cpm is inconsistent with the LTIE.

3.9 More specifically, a carrier choosing the fall back rate of 21 cpm, from Hutchison's dual pricing structure, would merely give Hutchison a windfall and this would not promote the LTIE. Hutchison states that the LTIE will be promoted if carriers choose 21 cpm as any benefits Hutchison receives from a higher rate of MTAS will be used by Hutchison to drive further product innovation and reductions in retail prices[5]. This arrangement may benefit Hutchison's customers and Hutchison's interests but would fail to promote the long term interests of all end users in the telecommunications market.

3.10 Furthermore, this proposition by Hutchison must mean that other carriers should be able to price MTAS at 21 cpm because they too,adopting Hutchison's logic, would drive further product innovation and reductions in prices for subscription services and outgoing calls. According to Hutchison's argument, this too must be in the LTIE.

3.11 In terms of competition, Vodafone believes that the mobiles market as effectively competitive[6]. As the mobile market develops, price is not the only way mobile carriers compete for market share. Increasingly customers want not only low prices for calls but increased quality of service and have demand for functions such as data services and improved existing services.

3.12 Any-to-any connectivity is unlikely to be further promoted through MTAS pricing proposed by Hutchison.

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[5] Hutchison, Submission to the ACCC Access undertakings, domestic digital mobile terminating access service, October 2005, p10

[6] Vodafone submission on the ACCC draft decision on mobile termination access service, 30 April 2004 p18

The ACCC also notes that economically efficient investment in infrastructure for mobile termination is promoted by MTAS rates that are based on forward looking efficient costs of supplying the service. According to the ACCC, in the absence of forward looking efficient prices, a misallocation of resources will occur, whereby there will be an under or over investment in the service depending on the mobile termination rate. For example an MTAS rate of 12 cpm, is actually below the estimated forward looking efficient cost of Vodafone providing mobile termination – based on the modelling in the Vodafone undertaking.

Legitimate Business Interests

3.13 A rate of 12 cpm for MTAS puts Vodafone's legitimate business interests at risk, not just in terms of new investment but also in terms of current operations. A rate of 12 cpm for MTAS is less than the forward looking efficient cost to Vodafone of supplying mobile termination. The PwC model demonstrated that Vodafone could sustain a MTAS price of 16.15 cpm in 2007. Vodafone would be unable to recover its efficient costs of providing the MTAS if the service were priced at 12 cpm.

Interests of those who have rights to use the declared service

3.14 Hutchison's MTAS undertaking rates are not in the interests of access seekers because the undertaking rates are not shown to be based on the cost of supplying MTAS.

3.15 A reciprocal rate of 12 cpm for MTAS does not reflect forward looking efficient costs.

3.16 In terms of Hutchison's dual MTAS rate for PMTS which potentially involves Hutchison supplying the MTAS at 21 cpm, Hutchison acknowledges that supplying MTAS at this may benefit Hutchison commercially'[7].

3.17 Hutchison has submitted a higher MTAS rate for non-PMTS calls of 18 cpm compared with mobile MTAS of 12 cpm for the same service. While Vodafone agrees with Hutchison's view that fixed-to-mobile prices are unlikely to reduce in line with reductions in MTAS prices, Vodafone does not believe that Hutchison's approach of having a higher rate for non-PMTS services, compared with PMTS carriers is an appropriate way to promote fixed-to-mobile "pass through". Vodafone submits that the pass through "safeguard" that Vodafone has put forward in its undertaking is a more appropriate mechanism to provide incentives to fixed carriers to reduce their fixed-to-mobile prices reduce.

[7] Hutchison (2005), Submission to the ACCC Access undertakings, Domestic Digital Mobile Terminating Access service, p10

3.18 Differential pricing between MTAS for PMTS and Non-PMTS may also frustrate pricing agreements through arbitrage opportunities. Carriers may be able to disguise calls and make them appear to be mobile calls when in fact they are originating from a fixed line in order to take advantage of the termination pricing differential. The rate Non-PMTS carriers end up paying for MTAS would not be 18 cpm but would be in fact somewhere between 12 cpm and 18 cpm.

Economically efficient operation of a carriage services, telecommunications network of facility

3.19 The economically efficient operation of the termination service is encouraged by termination rates which reflect forward looking efficient costs. Hutchison has not provided any evidence to support its assertion that 12 cpm reflects these costs.

4. The Undertakings: terms and conditions

An immediate decline in the MTAS price to 12 cpm would generate significant and potentially harmful disruption to the operation of Vodafone and will not be in the LTIE

4.1 An immediate reduction in the price for MTAS to 12 cpm is likely to cause significant disruption to Vodafone's pricing and business strategies. Vodafone believes the LTIE would not be promoted by potentially sudden price changes for subscription and outgoing calls. Current pricing structures are used for long-term business planning, commercial and marketing projects.

4.2 Vodafone promotes that the use of a pricing glide path is necessary to meet the statutory criteria[8]. The ACCC has advocated the use of a glide path so carriers avoid substantial adjustment costs from the decreasing termination rates to 12 cpm[9]. The ACCC has more recently confirmed its support for a glide path in its draft decision on Optus' MTAS undertaking released in November 2005[10].

[8] Vodafone Access undertaking Mobile Termination Access Service, 23 March 2005, pv

[9] ACCC (2004) *Mobile Services Review, Mobile Terminating Access Service*, final decision, p216

[10] ACCC (2005) Optus's undertaking with respect to the supply of its Domestic GSM Terminating Access (DGTA) Service, Draft Decision, p179

4.3 Hutchison argues that carriers should have low adjustment costs from decreasing MTAS to 12 cpm in the absence of glide path because of regulatory developments of mobile termination rates in other jurisdictions[11].

4.4 Vodafone disagrees that an adjustment path to an identified target price is not necessary on the basis of international regulatory cases. Hutchison quotes international cases from the ACCC's Discussion paper on the Mobile Services Review. Hutchison failed to mention that Germany did not target MTAS prices, and Italy and France have only regulated termination on fixed-to-mobile calls.

4.5 Outside Europe, the ACCC noted that:

> '*to date, domestic mobile termination charges have not been a primary focus for regulatory authorities in the US, Canada and Asian nations such as Singapore and Japan*'[12].

4.6 The regulatory cases described by the ACCC actually show a variety of responses to regulating mobile termination and are not in any way indicative of what could or should occur in the Australian regulatory setting.

The proposed reciprocal price of 12 cpm in the PMTS undertaking is not a fair or reasonable cost of providing the service.

4.7 Vodafone believes that Hutchison's choice of a rate of 12 cpm for MTAS is not reasonable. It appears from Hutchison's supporting submission that Hutchison has based the 12 cpm MTAS solely on the ACCC's Final Decision on Mobile Terminating Access Service. As outlined in Vodafone's Access Undertaking the method the ACCC used to derive its target price for MTAS is not a robust or appropriate methodology for estimating TSLRIC+ or producing a range of reasonable estimates of TSLRIC+ of MTAS for the following reasons:

- overseas cost estimates used were not adjusted to reflect Australian market conditions;
- the unadjusted historic cost accounting data was taken from the Regulatory Accounting Framework, which was mainly based on Telstra's data and to a lesser extent data on Optus' operations; and
- there are significant limitations of using overseas benchmarking for deriving MTAS costs for Australian mobile carriers (which was also recognised by the Commission's own consultants).

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[11] Hutchison, Submission to the ACCC Access undertakings, domestic digital mobile terminating access service, October 2005, p8

[12] ACCC Mobile Service Review 2003 *An ACCC discussion paper*, p39.

4.8 While Vodafone accepts that the concepts of cost based pricing and a glide path are necessary elements of an appropriate final declaration decision, the part of the Commission's decision that proceeded to infer from limited overseas comparisons, high level observations concerning Regulatory Accounting Framework (RAF) data and other inputs, is redundant in light of the actual cost data now available through the access undertaking that Vodafone has lodged with the ACCC.

4.9 Vodafone is concerned that Hutchison has not demonstrated in any way how 12 cpm relates to the costs, and in particular their costs, of supplying mobile termination. Hutchison has stated previously that 12 cpm is 'likely to cover the costs of providing this service'[13]. Vodafone's PwC model (submitted as part of the Vodafone access undertaking) shows that 12 cpm for MTAS will not cover the efficient cost of providing MTAS in Australia.

The 21 cpm 'fallback' price is not beneficial for Vodafone in providing price certainty

4.10 Vodafone disagrees with Hutchison's claim that the fall back price of 21 cpm guarantees price certainty. Hutchison promotes the dual pricing approach as a choice for the access seeker[14]. However the choice for access seekers is rather limited between a below forward looking efficient cost rate of 12 cpm for MTAS or the top end of the MTAS band of 21 cpm, which in some cases is above current commercial arrangements for MTAS. This structure constrains the negotiation between carriers, and may prevent carriers achieving the efficient price for the mobile termination.

4.11 Hutchison simply selected the 21 cpm rate for MTAS based on their last commercially negotiated rate, a rate which is not, on the basis of the material which Hutchison has provided, obviously derived from TSLRIC+ pricing principles.

4.12 Hutchison itself claims:

> *that while Hutchison does not intend to suggest that the rate of 21 cpm is in any way reflective of the underlying cost of providing the MTAS, this optional rate is appropriate when coupled with the offer of the lower, reciprocal rate of 12 cpm.*[15]

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[13] Hutchison's Response to the Australian Competition & Consumer Commission's draft decision on mobile terminating access, Mobile Services Review 2003, 30 April 2004, p4

[14] Hutchison Access Undertaking p7

[15] Ibid p6

4.13 However, Hutchison does not explain why the 21 cpm for MTAS is reasonable when it is coupled with a rate of 12 cpm for MTAS.

Reasonableness of Hutchison's proposed price of 18 cpm for the Non- PMTS Undertaking

4.14 Hutchison has not discussed how the price of 18 cpm for non-PMTS termination was determined or how it reflects the cost of supplying mobile termination.

4.15 Hutchison states that:

> 18 cpm is a *14% reduction on the last commercially negotiated price Hutchison has offered and paid for MTAS and referable to the adjustment path contained in the MTAS pricing principle*[16]*.*

4.16 Hutchison does not explain what a 14% decrease from their last negotiated price means in terms of TSLRIC+ pricing. The price of 18 cpm is simply part of the glide path in the ACCC's final decision on mobile termination and bears a numerical relationship to the other numbers on the path. Hutchison's simply picking one of the numbers from the glide path is nonsensical and not reasonable.

4.17 Hutchison's undertaking for non-PMTS is not in the LTIE and will not ensure pass through of reductions in MTAS prices through to retail fixed to mobile prices. Hutchison does not discuss the impact of their pass through mechanism – 18 cpm for non-PMTS compared with 12 cpm for PMTS termination - on fixed line carriers.

4.18 Hutchison criticises Vodafone's use of a fixed-to-mobile safeguard, for addressing the issue of a lack of pass through in the fixed to mobile market, on the grounds that fixed carriers have rejected the pass through mechanism. Criticism is to be expected from fixed carriers as they want to maintain (and possibly) increase their margins on fixed-to-mobile retail prices.

4.19 Vodafone also notes that, while carriers may have argued against the pass through safeguard the matter is before the ACCC and no final decision has been made. Fixed line carriers would no more likely accept paying 6 cpm more for termination compared with mobile carriers. Vodafone submits that its safeguard remains the appropriate method to encourage fixed carriers to reduce their fixed-to-mobile prices.

[16] Ibid p11

4.20 Non-PMTS calls include mobile calls originating from overseas. Hutchison has not provided any cost modelling or supporting evidence as to why MTAS prices for calls originating from within Australia should be different from those originating from outside Australia. The cost of providing mobile termination to a mobile call from another carrier should be the same irrespective of the origination of the call inside or outside Australia.

Appropriateness of the differential pricing structures in the PMTS and Non-PMTS Undertaking

4.21 Vodafone finds Hutchison's undertaking of differential pricing structure for PMTS and non-PMTS inappropriate. The pricing structure is not based on any cost modelling or any substantial evidence as to why a differential price is justified.

4.22 Hutchison argues the MTAS pricing differential for non-PMTS of 18 cpm compared with 12 cpm for PMTS is a practical means of testing whether or not an appropriate degree of pass through will occur in the absence of a specific pass through mechanism[17].

4.23 This is not a directed response to the lack of pass through of MTAS prices in the fixed to mobile market so retail prices for fixed to mobile calls are unlikely to decrease as a result of Hutchison's differential pricing structure.

4.24 Vodafone recommends the fixed-to-mobile safeguard, outlined in the Vodafone access undertaking, as a more directed response in ensuring fixed to mobile retail prices come down by targeting retail prices themselves. Targeting fixed to mobile retail prices directly will result in a net increase in consumer welfare and economic efficiency, rather than simply a value transfer from providers of MTAS to fixed originating operators.

[17] Ibid pg11