

**VODAFONE SUPPLEMENTARY SUBMISSION  
TO THE PRODUCTIVITY COMMISSION**



**Telecommunications Competition Regulation**

**Draft Report**

**13 July 2001**

## **1. Introduction**

- 1.1 Vodafone Australia prepared a detailed submission on the Productivity Commission's (PC) Draft Report and presented that submission to the Commission during its public hearings in May.
- 1.2 During those public hearings the PC raised a number of issues in relation to our submission on the draft report. They included:
- Whether Vodafone thought that it would have difficulty in obtaining access to content for 3G products and services;
  - Vodafone's views on the benefits of having an industry specific regime in order to speed regulatory outcomes;
  - Clarification of Vodafone's view on the use of company confidential information by the ACCC; and
  - The benefits of mobile services for low income users.
- 1.3 In this submission we have responded to those issues. In addition, we have also included comments on three further issues that may be of interest to the PC. They include:
- Some initial comments on the recently announced review of the Pre-selection service;
  - GSM termination and some comments on the recent decision by the ACCC; and
  - Information on how the information disclosure regime operates in New Zealand and implications for Australia.

## **2. Content in a 3G world**

- 2.1 At the public hearings the PC was interested in Vodafone's views on whether we consider that we will have difficulty in obtaining access to content in a 3G environment.
- 2.2 3G mobile networks have not yet been built. We consider that a commercial launch of 3G products and services in Australia is likely to be at least 18 months away (we note that Hutchison Telecoms has recently

indicated that they are aiming for a commercial launch of their 3G network at the end of 2002).

- 2.3 There is still a great deal of uncertainty about what types of products and services will be available on 3G networks. However, it would be premature to assume that there will be any problems with obtaining access to content. Due to convergence, we anticipate that there is likely to be a range of different technologies that will enable consumers to access services. Mobile technologies will be but one access technology. Further it is likely that there will be strong commercial incentives for firms to enter into content access arrangements.
- 2.4 More generally, we would be very concerned if the PC was seeking to recommend a pro-active regulatory approach for addressing potential problems with content provision in a future 3G environment. We consider that the focus of regulatory action should be on proven durable market failure. We consider that it is unnecessary and unwise to extend regulatory action beyond this. Areas of the market that demonstrate competitive characteristics should be freed from unnecessary regulatory oversight.

### **3. An industry specific regime and speedier regulatory outcomes**

- 3.1 At the public hearings the PC stated that one of the arguments in favour of an industry specific regime was to ensure speedier regulatory outcomes. In the Draft Report the Commission favoured limiting appeal rights in order to speed outcomes.
- 3.2 While we support the establishment of efficient processes, our view is that the quality of regulatory decisions should not be sacrificed in favour of achieving expedient outcomes. In particular, we consider that natural justice should not be curtailed in an effort to speed regulatory outcomes. Merit reviews are a critical check on ACCC powers as well as a measure of the quality of ACCC analysis. Our view is that any efforts to achieve faster outcomes should be squarely focused on reviewing and improving current arbitration and dispute resolution processes. It is in these areas where delays appear to be most evident. To that end we support the intent of the measures recently announced by the Government.
- 3.3 In addition, we suggest that the PC should examine whether Alternative Dispute Resolution (ADR) procedures, including the ability of the ACCC to contract the arbitration of disputes to private arbitrators, can also be beneficial in improving current processes. We note that this is consistent

with the series of changes to the regime recently announced by the Government.

## **4. Confidential Information**

- 4.1 At the public hearings the PC sought clarification of the following statement in our submission:

If a party claims a piece of information is commercial-in-confidence then it should be treated as such.<sup>1</sup>

- 4.2 The PC was concerned that adopting this approach could severely reduce the amount of information that would be made publicly available. The PC was keen to promote the ability of the ACCC to negotiate with parties to have as much information as possible in the public domain.
- 4.3 To clarify our view, we would strongly support the use of negotiation between parties in an effort to promote greater public availability of information. However, we would not want the ACCC to be able to override the views of private parties where information is legitimately considered to be commercially sensitive.

## **5. Mobile phones and low income users**

- 5.1 At the public hearings the PC pointed to concerns by welfare agencies regarding the high costs of mobile phones for people on low incomes.
- 5.2 We indicated at the hearings that we had evidence to show that a mobile phone service may in fact be a more efficient communication alternative to the fixed line service for low volume users. In late 1999, Vodafone commissioned a study into the costs of mobile phone services. Key conclusions of the study were:
- Mobile prices have fallen substantially;
  - Price reductions are a direct result of competition, not regulation;
  - Low volume users have benefited from aggressive competition;

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<sup>1</sup> Vodafone Draft Report submission, p. 19.

- Despite price reductions there has been a significant increase in the quality of services provided to users of mobile services; and
- Mobile phone services are now cheaper than an equivalent fixed line phone service for low volume users.

5.3 We have provided a copy of this study to the PC.

5.4 Further evidence of the increasing value of mobile services can be found in the ACA's Annual Telecommunications Performance Monitoring Report reports as well as the recent ACCC Telecommunications pricing study.<sup>2</sup> Both these reports provide detailed evidence of the benefits (both price and non-price) that have been accruing to mobile phone users over recent years.

## 6. Pre-selection

6.1 The ACA has recently released a discussion paper exploring a number of options regarding the existing multi-basket pre-selection service.<sup>3</sup> In particular the discussion paper examines a number of options to expand the scope of pre-selection by moving to a multi-basket approach and to increase the range of call types included (such as mobile calls and calls from closed user group systems). The discussion paper also explores whether all carriers (not just Telstra) should be forced to provide a 'pre-selection' option for their customers.

6.2 We believe the approach taken in the discussion paper is seriously flawed and we intend to provide the ACA with a detailed submission setting out our views. The ACA approach appears to be focussed on identifying solutions but fails to establish whether there is actually any problem that needs to be addressed.

6.3 Pre-selection is a regulatory tool that was introduced to address perceived problems in the fixed line market due to the dominance of Telstra. In particular, given the lack of choice for the fixed line service, it was

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<sup>2</sup> See the following internet links for copies of these reports:

[http://www.aca.gov.au/publications/reports/s105\\_report\\_99-00/\\_cont.pdf](http://www.aca.gov.au/publications/reports/s105_report_99-00/_cont.pdf) and  
<http://www.accc.gov.au/new/fs-new.htm>

<sup>3</sup> ACA (2001) *Pre-Selection Review – Preliminary Considerations*, Discussion Paper June, (see also [www.aca.gov.au/number/preselectiondisc.htm](http://www.aca.gov.au/number/preselectiondisc.htm)).

considered a pro-competitive move to mandate pre-selection on Telstra's network. This allowed Telstra customers the option of 'pre-selecting' another carrier to provide international, national and fixed to mobile calls.

- 6.4 As discussed in our Draft Report submission, we consider that 'pre-selection' should be required to pass the new declaration criteria (as outlined in the PC's draft report). This would ensure that any regulatory intervention was focused on areas of durable market failure.
- 6.5 The current arrangements may be causing a number of distortions in the market. For example we would contend that the single basket nature of the current service has dulled competitive pressure on fixed to mobile retail prices. This is because fixed line operators have focused their marketing strategies on being competitive for national and international calls. However, once customers sign up to these services, fixed line operators automatically get the customers 'fixed to mobile' business. Hence, if a "green-fields" approach was to adopted towards this issue, it would appear to make sense to introduce multi-basket pre-selection.
- 6.6 However, given the significant changes that have occurred in the market place, it would be better now to reduce regulatory intervention than attempt to 'plug the holes' in the current regime through the introduction of yet more regulation. Current and prospective competitive pressures will deliver gains to consumers in a significantly more efficient manner than the regulatory alternative.
- 6.7 For similar reasons, it is not appropriate to extend preselection to a broader range of services. Increasing competitive pressure across all areas of the market should signal a clear move towards less regulatory intervention – not more!

## **7. GSM termination**

- 7.1 We would also like to take the opportunity in this supplementary submission to comment further on the ACCC's analysis of GSM termination. This is in the context of this week's release of final pricing principles for this declared service.
- 7.2 As we indicated in earlier submissions, both to the ACCC and the PC, we do not consider that regulatory intervention is warranted for this service. This service was one of the 'deemed' services that were declared when the new regulatory regime was introduced in 1997. It was not subject to the

declaration process. Our view is that if it had been required to follow the declaration process, then it would not have been declared at all.

- 7.3 One of the key concerns expressed by the ACCC is that GSM termination rates are set inefficiently above costs. However, the ACCC produced no evidence to back up this view.
- 7.4 Our price setting decisions are driven by competition, not by the underlying costs of individual product offerings. We consider that the theoretical approach to GSM termination that has been taken by ACCC is seriously flawed. That approach appears to have ignored the commercial realities that influence network operators in the mobile telecommunications industry. For instance, it is simply not realistic to consider termination as a separate market. Vodafone gains revenues from three main sources (access, termination and usage). Prices are set for these revenue sources in order to make an adequate return on our investment as a whole. In such a dynamic market, with a relatively large amount of common network costs, it is not realistic to expect that every price for every product will be set according to the underlying costs of the product. While the ACCC seemed to accept this, it nevertheless chose to pursue regulation of the GSM termination service.
- 7.5 In addition, we note that if market power existed and was used to earn monopoly profits – it would be expected that these super normal profits would be reflected in above average returns across the industry. However, our analysis of industry returns does not suggest such an outcome.
- 7.6 With the existence of common costs and different elasticities for different products, there are good efficiency reasons why firms would rationally set prices that may differ from any theoretical apportioning of costs to different mobile services. Furthermore, this is not unique to mobile operators. It happens in most, if not all, industries and represents a rational and efficient response to the competitive dynamic in each specific market.
- 7.7 The ACCC argues that ‘network effects’ confer ‘market power’ upon mobile operators that allow them to charge inefficiently high termination charges. However, this ignores the wide range of choices for consumers for mobile services on the demand side and a wide range of substitutes for a termination product on the supply side. Because of these competitive forces, there is no economic case for termination to be treated differently (from a regulatory perspective) from other competitive products offered in the mobile market.

7.8 Mobile termination rates have been trending down for a number of years. The ACCC's economic analysis would suggest this to be a perverse result. However, no explanation is given for what is a market reality. Vodafone suggests that the range of countervailing forces facing mobile operators when engaged in interconnection negotiations with fixed-to-mobile operators explain these trends. At the same time, there appears to be been a distinct lack of 'pass through' of lower termination rates to lower retail 'fixed to mobile'. In addition, Australian rates appear to be at the lower end of international comparisons.<sup>4</sup> When all these factors are taken together, it is difficult to understand the reasoning behind the assertion that termination rates are 'too high'.

7.9 Our chief concern with regulation of this element of the mobile market is that its impact will distort efficient prices through the industry and through that distort competition and adversely impact on innovation and investment. This is a dynamic and innovation driven industry that requires a significant amount of entrepreneurial investment in order to deliver new products and services to end-users. The practical impact of the regulation of GSM termination rates (a key revenue stream for mobile operators) will be to chill investment and distort prices. More broadly, regulating GSM termination rates will result in a transfer of wealth from mobile operators to other players in the market (who are not necessarily end-users) and effectively punish those mobile operators for the investments that they have made in a high-risk industry.

7.10 In particular, we note that the following statement by the ACCC:

On the one hand, competitive forces on the wholesale GSM mobile termination service are limited, and integrated mobile carriers have some ability to restrict price competition in the downstream market for fixed-to-mobile calls.<sup>5</sup>

7.11 This appears to limit the focus of regulatory action to integrated carriers. However, we would note that, as a mobile only carrier, Vodafone has no ability to influence the price of fixed to mobile retail prices. The ACCC's approach will potentially cause the least harm to integrated carriers. This is

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<sup>4</sup> For instance, we note information produced by the European Commission and reproduced by OFTEL, which compares termination rates from a number of European countries (see annex A at <http://www.oftel.gov.uk/publications/mobile/ctom0201.htm#Annex%20A>). The data suggests that Australian termination rates appear at the lower end of international rates. This data accords with Vodafone's own internal benchmarking of termination rates across Vodafone Group companies.

<sup>5</sup> Professor Allan Fels, quoted in the ACCC's press release: *A.C.C.C. decides on light-handed approach to mobile phone termination services*, July 10 2001.



because while integrated will lose from lower GSM termination rates (forced by regulatory intervention) they will benefit from gaining higher margins in their fixed line business. The ability to partially (or fully) offset lower GSM termination rates is simply not an option for mobile only carriers such as Vodafone.

## **8. Information disclosure in New Zealand and implications for Australia**

- 8.1 One option to 'grease the wheels' of the current regulatory regime is to increase the amount of information that is made public about regulated services. Greater transparency about key cost and price information has the potential to reduce the incentives on parties to take disputes to the ACCC. Requiring information disclosure on some parties may be one option that could help direct parties to commercially negotiated outcomes.
- 8.2 The New Zealand regulatory regime has had for many years an information disclosure requirement on Telecom New Zealand (TCNZ). This legislative requirement directs TCNZ to make all interconnection agreements public fifteen days after they come into force. Vodafone New Zealand has found such arrangements helpful in gaining information about prices and services offered by TCNZ and has helped "even up" the information flows at the negotiating table when dealing with the TCNZ. The disclosure regime is tightly targeted at the dominant player in the market (TCNZ). While all details of agreements between TCNZ and another party are made public, there are no legislative requirements to publicly disclose interconnection agreements between companies other than TCNZ (e.g. between CLEAR and Telstra-Saturn). This is sensible, as it is a recognition that the disclosure regime should be tightly focused on addressing the market failures that have arisen in the transition to a fully competitive market. Over time and as the market becomes more competitive, regulatory intervention to force information disclosure should become less onerous and eventually be abolished.
- 8.3 However, in the present market environment in Australia, we consider that a limited form of information disclosure may provide an efficient alternative to more interventionist approach. The chief benefit of greater information is to reduce the potential for the dominant carrier to use its market power in an anti-competitive manner. We note that the Government has recently announced changes to the regime that would result in greater disclosure of the results of – and reasoning for – interim and final determinations. We support these changes to the regime.

## **9. Conclusion**

- 9.1 In closing, we reiterate our support for the need for a major review of the current regulatory regime. Vodafone considers it critical that the current regulatory regime moves away from an industry specific approach and embraces regulatory forbearance as a guiding fundamental principle.
- 9.2 The industry worldwide is undergoing widespread and dynamic changes that are reshaping the market landscape. Competition, technology and convergence are driving these changes. For Australia to fully benefit from these global trends, it is paramount that regulators and Government stop treating telecommunications as a special case in need of special competition rules. Rather, regulators and the Government should move urgently towards adopting a more generic approach to dealing with competition issues in telecommunications. Doing this will provide greater transparency and consistency to the regulatory approach and greater certainty to industry as it develops. It will also promote more efficient investment choices as well as lead to greater innovation within the industry. The main beneficiaries of this will be consumers and the companies that best serve their needs.