Hutchison Telecoms

Hutchison Telecommunications (Australia) Limited

and

Hutchison 3G Australia Pty Limited

Response to the Australian Competition & Consumer Commission's draft decision on mobile terminating access

Mobile Services Review 2003

30 April 2004

Telecommunications operations of
Hutchison Whampoa Limited

Hutchison Telecoms

1. Introduction

Hutchison Telecommunications (Australia) Limited (***HTAL***) and Hutchison 3G Australia Pty Limited (***H3GA***) (together ***Hutchison***), welcome the opportunity to respond to the Commission's draft decision: *Mobile Services Review: Mobile Terminating Access Service* (the ***Draft Decision***).

While Hutchison agrees generally with the Commission's approach in relation to the regulation of the mobile terminating access service (***MTAS***), Hutchison submits that the long term interests of end-users (***LTIE***) would be best served by:

- ensuring that the reductions in the MTAS charge are phased in over a quicker period of time than that envisaged by the Commission; and
- requiring the lower MTAS charges to be passed through to end-users in the form of lower F2M prices. To this end, the Commission should urge the Minister to make a Ministerial Determination imposing a retail price control on Telstra for F2M calls.

In this submission:

Section 2 considers the Commission's assessment of the relevant markets;

Section 3 discusses the proposed pricing principle; and

Section 4 addresses the need for and mechanisms to achieve "pass-through".

2. The Commission's assessment of the relevant markets

3G services

Hutchison agrees with the Commission's views in relation to services offered on 3G networks, and in particular, the following conclusions:

- mobile calls utilising 2G, 2.5G and 3G technologies are sufficiently substitutable to be considered part of the same mobile services market;[1] and
- it is too soon to regulate access to content services, however the Commission should monitor access to premium content to ensure a bottleneck does not develop.[2]

[1] ACCC, *Draft Decision, on the mobile terminating access service* at page 52.

[2] ACCC, *Draft Decision, on the mobile terminating access service* at page 22-23.

Mobile services market

Hutchison agrees with the Commission's view that the mobile services market is not effectively competitive.[3] The three largest mobile carriers collectively account for 97.9% of subscribers in the retail mobile services market.

Fixed to mobile market

Hutchison agrees with the Commission's assessment that the market which has the potential to benefit most from a reduction in MTAS charges is the market in which F2M calls are supplied.

Hutchison agrees with the Commission that:

- The market in which F2M calls are supplied is a national market for the provision of the pre-selected bundle of F2M calls, national long distance and international calls at the retail level. These services are considered to be part of the same bundle of services because of complementarities in their provision and because they are offered as a bundle in pre-selection offerings by carriers.[4]
- The F2M market is not effectively competitive.[5] The existing market structures provide vertically-integrated fixed and mobile network operators with considerable scope and incentive to use their control over access to the mobile termination service to engage in anti-competitive price-squeeze behaviour.[6]

Hutchison however disagrees that high MTAS charges are the main source of ineffective competition in the F2M market. The low degree of competition in the F2M market exists due to:

- Telstra's continued dominance at the infrastructure level such that other suppliers of F2M calls are dependent upon their principal competitor for access to essential inputs;
- a large part of the competition which does exist is dependent on the resale of F2M calls supplied by Telstra;
- the existence of significant cross-subsidisation of selected services through bundling and specific targeting of corporate customers;
- Telstra's dominant share of all retail telecommunications markets; and
- Telstra's significant degree of vertical and horizontal integration.

Further, the evidence available to the Commission indicates that retail prices for F2M calls are maintained at high levels irrespective of the level of the MTAS charge. This is illustrated by the fact that the average per-minute revenue for F2M calls is likely to be in excess of both the underlying cost of all F2M calls and the effective cost of providing 'off-

[3] ACCC, *Draft Decision, on the mobile terminating access service* at page 84.

[4] ACCC, *Draft Decision, on the mobile terminating access service*, at page 50.

[5] ACCC, *Draft Decision, on the mobile terminating access service* at page 93.

[6] ACCC, *Draft Decision, on the mobile terminating access service* at page 93.

net' F2M calls.[7] In other words, regardless of the cost of acquiring the MTAS, there are insufficient competitive forces in the relevant market to ensure that retail prices for F2M calls decrease.

Hutchison also believes there are likely to be separate markets for the supply of F2M calls to corporate customers and residential customers. This is considered further in section 4.4 below.

3. Pricing principle

Hutchison commends the Commission on adopting a pragmatic and useful pricing principle: a 12cpm target price to be achieved by following a pre-determined "adjustment path".

The retail benchmarking pricing principle adopted by the Commission in 2001[8] has not achieved its objectives of:

- meaningfully reducing the MTAS charge (access prices are still significantly above costs);[9]
- preventing integrated carriers from engaging in discriminatory pricing in connection with the supply of F2M calls;[10] or
- meaningfully reducing retail prices for F2M calls, which are still significantly above costs. In fact, the price for F2M calls appears to be more than double the underlying costs of providing the service.[11]

Hutchison believes the pricing principle described in the Draft Decision can achieve the first of these objectives and if combined with an appropriate pass-through regime can assist in meeting the other objectives also. Hutchison makes the following comments about the proposed pricing principle:

- adopting a benchmark MTAS price which is closer to the underlying cost of providing the service is a practical and speedy short term measure which avoids the delay and expense of developing TSLRIC models; and
- 12 cpm is a reasonable estimate of the TSLRIC of providing MTAS and therefore protects the legitimate business interests of mobile carriers as it is likely to cover the costs of providing the service.

Hutchison submits however that the adjustment path proposed by the Commission is not in the LTIE because it takes too long to achieve the 12 cpm target price. In Hutchison's view,

[7] ACCC, *Draft Decision, on the mobile terminating access service*, at page 88.

[8] ACCC, *Pricing methodology for the GSM termination service*, July 2001.

[9] ACCC, *Draft Decision, on the mobile terminating access service* at page 159.

[10] Integrated carriers (carrier that operate both a fixed and a mobile network) are able to engage in discriminatory behaviour by supplying F2M calls based on the underlying cost of providing the relevant service rather than the actual cost faced by other industry participants.

[11] ACCC, *Draft Decision, on the mobile terminating access service* at page 99.

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the Commission should adopt an adjustment path which leads to a 12cpm MTAS charge by January 2006 as follows:

	Adjustment path
January 2005	18 cpm
July 2005	15 cpm
January 2006	12 cpm

This adjustment path (coupled with pass-through) achieves:

- a faster reduction in MTAS charges such that it reduces the period in which consumers will continue to pay excessive prices for F2M calls; and
- greater short term benefits for competition in the F2M market.

It is also consistent with the approach adopted overseas and represents an appropriate balance considering the interests of both consumers and carriers/service providers.

3.1 Rate shock

The Commission has chosen to phase in the target price of 12 cpm over three years on the basis that a sudden decrease in MTAS prices could cause substantial adjustment costs as it may disrupt the pricing and business strategies of mobile network operators.[12]

Hutchison does not believe that the transition it proposes would disrupt pricing and business strategies. Hutchison makes the following points:

- The regulated reduction to the target price of 12 cpm should not be construed as a "sudden" change. Regulated reductions in MTAS charges have been anticipated in the industry for some time for the following reasons:
  - since 2001, the Commission has regulated MTAS through retail benchmarking with the objective of achieving a reduction in MTAS charges;[13]
  - in April 2003, the Commission foreshadowed that its preferred pricing principle in the MTAS context is TSLRIC, a pricing principle which would be likely to result in a price significantly lower than current rates; and
  - the reduction has taken place in the context of the following international developments:[14]
    - the UK regulator (Oftel) imposing a price cap for MTAS of RPI-9% on Vodafone and BT in 1999;

[12] ACCC, *Draft Decision, on the mobile terminating access service*, at page 167.

[13] ACCC, *Discussion Paper, mobile services review*, April 2003 at page 49.

[14] ACCC, *Discussion Paper, mobile services review*, April 2003 at page 35.

- the UK regulator (Oftel) imposing a price cap for MTAS of RPI-12% on Vodafone, BT, T-Mobile and Orange in 2000-01;
- the French regulator (ART) imposing obligatory 40% reductions for MTAS prices on Orange and SFP in November 2001, with the reduction to be achieved by 1 January 2004;
- in March 2003, the Italian regulator mandated a maximum charge for MTAS for Telecom Italia and Vodafone to apply with 30 days of the decision;
- the Dutch regulator (OPTA) released rules in March 2002 requiring MTAS charges to be reduced in line with EU best practice by April 2003; and
- in Portugal, the regulator (Anacom) announced indicative MTAS price reductions in May 2002 for MTAS and required operators to reach interconnection agreements within 10 days based on the indicative price.

- Carriers have had at least 12 months to reconsider their pricing and business strategies in response to the developments referred to above. In those circumstances, it is not appropriate that regulation requiring the reduction of MTAS charges is unnecessarily delayed to suit the pricing plans of individual carriers.
- The incumbent mobile carriers are in a financial position to accommodate a reduction in the MTAS charge to 12 cpm within a tighter timeframe. As the Commission acknowledges in the Draft Decision, 'on the basis of the EBITDA enjoyed by all mobile carriers and the estimated high ROEE for Telstra and Optus, the Commission is of the opinion that the mobile services industry is enjoying high levels of economic profit overall'.[15]
- In the event that lower MTAS charges are reflected in lower retail prices for F2M calls, the loss in revenue mobile carriers will experience will be off-set by the increased revenue arising from increased F2M call minutes.

4. Pass-through

The Commission comments that pass-through in the form of lower retail F2M prices of a substantial proportion of reductions in termination charges is not essential as it will hardly influence the size of the consumer benefits and efficiency gains.[16]

Hutchison disagrees. In its view, regulatory intervention to achieve pass-through is essential because:

- without pass-through any reduction in MTAS charges merely results in a significant revenue windfall for Telstra.[17] Telstra will be able to use that windfall to distort

[15] ACCC, *Draft Decision, on the mobile terminating access service*, at page 82.

[16] ACCC, *Draft Decision, on the mobile terminating access service*, at page 169.

competition in the F2M market and the mobile services market (for example, by passing reductions through to selected classes of subscribers in a discriminatory manner);

- the Commission indicates that it expects, in the short-term, only partial 'pass-through' of the lower MTAS charges to end-users.[18] Even assuming that there is partial pass-through, Hutchison believes that any such pass-through will only benefit corporate customers or customers taking a bundle of services. The Commission acknowledges there is evidence to indicate that different categories of end-users have enjoyed different levels of price reductions.[19] Hutchison does not expect residential and small-business customers that choose not to acquire bundled services to benefit from lower F2M prices. Requiring that lower MTAS charges are reflected in lower retail prices for **all** end-users is in the LTIE;
- without pass-through there is unlikely to be significant consumer benefit, particularly in relation to residential and small business customers as there is only limited competition in the F2M market. Without regulatory intervention MTAS reductions are unlikely to be passed through to consumers; and
- retail prices for F2M calls are being maintained at high levels irrespective of the level of the MTAS charge. This indicates that there are presently insufficient competitive forces to ensure that lower MTAS charges are passed through to consumers.

4.1 A significant windfall to Telstra

In its Annual Report for 2003, Telstra reported that it billed 3,944 million F2M minutes in the 2002-03 financial year. The Commission has indicated that MTAS charges are about 22.5 cpm. Clearly, reducing the MTAS charge by almost 50% would result in a substantial cost saving to Telstra.

The calculations below show that unless Telstra passes through to consumers the reduction in MTAS charges, it stands to gain a windfall of over $120 million per year.[20]

[17] Gans and King, in their report to the Commission '*Price regulation of mobile termination: Promoting competition and investment in telecommunications*', relevantly state:

> *'a reduction in mobile termination charges under the existing rules may lead to little if any reduction in retail fixed to mobile prices and may lead to an increase in the prices of mobile services. Such a result, while potentially creating a windfall gain to Telstra, would harm end users'.*

[18] ACCC, *Draft Decision, on the mobile terminating access service* at page 169.

[19] ACCC, *Draft Decision, on the mobile terminating access service* at page 89-90.

[20] For the purpose of this analysis, Hutchison assumes that the mobile to mobile termination minutes are largely symmetrical and net out to zero. Accordingly, the focus is on fixed-to-fixed mobile minutes. Telstra acquires the MTAS from Optus, Vodafone and Hutchison for the purpose of providing F2M calls to its subscribers. Telstra also supplies the MTAS to other providers of F2M calls for the purpose of their providing F2M calls to their subscribers.

	MTAS charge of 22.5 cpm	MTAS charge of 12 cpm
Telstra subscriber F2M call minutes 2002-03[21]	3,944 million	3,944 million[22]
Telstra market share in the mobile services market[23]	45.8%	45.8%
Telstra subscriber F2M call minutes terminating off-net[24]	2,137.65 million	2,137.65 million
Telstra costs	$480.97 million	$256.52 million
Non-Telstra subscriber F2M call minutes[25]	2,093 million	2,093 million
Non-Telstra subscriber F2M calls terminating on Telstra's mobile network[26]	958.59 million	958.59 million
Telstra revenue	$215.68 million	$115.03 million
NET amount paid by Telstra in MTAS charges	$265.29 million	$141.49 million
NET BENEFIT TO TELSTRA OF REDUCTION IN MTAS	**$123.8 million**	

In 2002-03, Telstra reported a net profit of $3,394 million. In this context, the $123.8 million net benefit to Telstra by reducing the MTAS charge by 50% without requiring pass-through would have a significant positive impact on Telstra's profitability. Even if Telstra passed through 50% of MTAS reductions, it would still increase its profitability by $62 million.

The significance of the windfall Telstra stands to gain if pass-through is not mandated is made further apparent when one considers the much lower level of profit made by Telstra's competitors.

4.2 Detriment to competition

The Commission has indicated that it expects pass-through to occur in the long run through increased competition in the F2M market.[27] In Hutchison's view the F2M market is unlikely to be "effectively competitive" for some time, with the result that, at least in the short term, Telstra will receive a substantial windfall.

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[21] ACCC, *Draft Decision, on the mobile terminating access service*, at page 85.

[22] For the purpose of this analysis, we assume that there is no increase in F2M call minutes.

[23] ACCC, *Draft Decision, on the mobile terminating access service*, at page 62.

[24] Assuming that 54.2% of F2M calls terminate on a non-Telstra mobile network based on the subscriber numbers for each mobile carrier.

[25] ACCC, *Draft Decision, on the mobile terminating access service*, at page 85.

[26] Assuming that 54.2% of F2M calls terminate on a non-Telstra mobile network based on the subscriber numbers for each mobile carrier.

[27] ACCC, *Draft Decision, on the mobile terminating access service*, at page 100.

Allowing Telstra to retain a substantial windfall will assist it to further entrench its position of dominance in the Australia telecommunications industry. Further, Hutchison submits that Telstra may use any gain to distort the F2M market and the mobile services market because:

- it has been suggested that MTAS charges are used to cross-subsidise mobile access charges and call charges in the mobile services market. If Telstra retains this windfall it will be able to continue to cross-subsidise its mobile access and call charges. In contrast, mobile only carriers, who will not participate in the windfall will find it more difficult to compete in the mobile services market; and
- information previously provided to the Commission by Hutchison indicates that Telstra's F2M call prices to its corporate customers are substantially below 12 cpm. If Telstra is permitted to retain its windfall, it will be able to continue to maintain such discriminatory and anti-competitive pricing.

Telstra's position in the wholesale market further exacerbates the problems associated with lack of pass-through. The Commission estimates that Optus, AAPT and other fixed carriers have 34.7% of the F2M market. Hutchison submits that Optus, AAPT and the other fixed carriers would acquire a large portion of their F2M calls as end-to-end services from Telstra. Those carriers would then supply consumers on a resale basis. Therefore, if pass-though is not mandated, because the cost to Telstra of supplying calls at wholesale will be greatly reduced, Telstra will enjoy a significantly larger margin at the wholesale level of the market. This has two consequences:

- Telstra can more easily engage in a vertical price squeeze in relation to its resellers; and
- Telstra will earn significant additional profits (in addition to the windfall already identified).

4.3 Distribution of benefits to consumers

The Commission has indicated that it would expect a monopolist to retain about 50% of the reduction in MTAS with the remainder to be passed through to customers. Hutchison's concern in leaving fixed line operators to distribute MTAS reductions as they see fit, is that the reductions will be passed through only to selected groups of subscribers, if at all.

Hutchison believes there is overwhelming evidence that savings in MTAS charges are generally not passed through to residential and small business customers but are used to engage in anti-competitive retail pricing practices in the provision of F2M services in the corporate market[28] and in providing discounts to customers that bundle F2M calls with other telecommunications services.

[28] At the Sydney hearing for the Mobile Services Review, Telstra acknowledged that by pass through it is referring to pass through on a global average basis. Telstra was unable to answer a question regarding its internal transfer price for MTAS. In other words, Telstra will continue to reflect lower MTAS charges in lower F2M prices for the corporate and government segments and in particular in lower 'on-net' pricing.

Hutchison has identified 2 types of customers likely to receive lower F2M prices as a result of any reduction in MTAS charges – corporate customers and customers taking a bundle of telecommunications services.[29]

(a) corporate customers

The Commission has recognised that Telstra has selectively targeted corporate customers with greater pass-through of reductions in costs for F2M calls in both its draft decision[30] and in public comment, such as that of Chairman Graeme Samuel below:

> *"The benefits are not being shared evenly across all consumer groups. For example, prices paid by small business actually increased by 2.4% during 2001-02. And preliminary indications for 2002-03 suggest that prices paid by bigger business are reducing while prices paid by small business and consumers are going up."*[31]

Hutchison understands from the Commission's Draft Decision that the selective passing through of cost reductions to corporate consumers has led other carriers to make complaints to the Commission.[32] Hutchison notes that those complaints are being investigated separately by the Commission.

In this context, Hutchison also notes Telstra's recent increases to line rental in the residential market, but not the business market.[33]

(b) bundled residential customers

Telstra is engaging in anti-competitive bundling by selectively discounting services to encourage consumers to use exclusively Telstra services. The effect of Telstra's discounting strategy is to leverage its market power in the fixed line market into the mobile market in order to foreclose the mobile services market to competitors such as Hutchison. If pass-through is not regulated, this anti-competitive conduct will be exacerbated. In particular, Hutchison points to the following examples:

Telstra Rewards: a 5% discount for taking fixed line services and one more service (internet, mobile or FOXTEL) from Telstra and a 10% discount for taking fixed line services and two more services (internet, mobile or FOXTEL) from Telstra; and

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[29] Hutchison notes Macquarie Research Equities' comment in the paper *Access line price increases: One for the road,* dated 30 April 2004, that Telstra has selectively passed through increases in basic access costs in a manner which encourages subscribers to take a bundle of services and which increases prices in the less competitive residential market.

[30] ACCC, *Draft Decision, on the mobile terminating access service*, at page 100.

[31] Graeme Samuel, ACCC, speech to the Australian Telecommunications Users Group, *Promoting Competition and Fair Trading*, 4 March 2004 at page 2.

[32] ACCC, *Draft Decision, on the mobile terminating access service* at page 91: "In considering whether the conduct of vertically-integrated carriers represents anti-competitive conduct, the Commission notes it is both conducting an inquiry into current pricing practices in the corporate sector of the market and conducting separate inquiries with regard to alleged anticompetitive conduct over the provision of FTM services".

[33] *AustralianIT*, Labor to freeze Telstra line rental, 3 May 2004; Macquarie Research Equities, *Access line price increases: One for the road*, 30 April 2004.

Family Phones Bonus: a 50% discount on F2M, M2M and M2F call costs between eligible services on the same bill (discount applies in addition to Rewards).[34]

The example below compares the retail price charged by Telstra for bundled residential customers for F2M calls to Telstra mobiles[35] with costs faced by a fixed line competitor for providing the same call. Clearly, this conduct affects not only the F2M market, but also the mobile services market as customers are less likely to take mobile services from a carrier other than their provider of fixed line services.

Telstra HomeLine Complete	
flagfall	33c
rack rate for a F2M call to Telstra mobile[36]	49.5cpm
rate for a F2M call to Telstra mobile with 10% Rewards	44.5cpm
rate for a F2M call to Telstra mobile with 10% Rewards and Family Phones Bonus	**22.25cpm**
rack rate for a F2M call to a non-Telstra mobile[37]	**53.5cpm**

Linking reductions in MTAS charges to mandated reductions in F2M prices for **all** consumers would provide a means of ensuring that this foreclosing effect does not continue as customers would benefit from lower F2M prices regardless of whether they take a bundle of services.

4.4 Different markets for calls supplied to residential and corporate customers

As mentioned in section 2, Hutchison believes there may be two separate markets for F2M calls supplied to each of residential and corporate customers. This is because:

- the 'bundle' of services comprising F2M calls, national long distance and international calls is **generally** supplied to end-users. This is particularly in relation to residential customers. However, the position is different in relation to other customers including corporate customers. The 'bundle' of services which is offered to, and acquired by, these corporate customers differs from that acquired by residential and small business customers. While the 'bundle' may include F2M, national long distance and international calls, it generally includes other services including mobile services;

[34] <www.telstra.com.au/rewards/index.htm?tR=3hm>

[35] This example is limited to considering F2M calls to Telstra mobiles, as based on subscriber numbers, it is expected that 45.8% of F2M calls terminate on Telstra's mobile network.

[36] Including flagfall, based on a 2 minute call.

[37] Including flagfall, based on a 2 minute call.

- the pricing offered to corporate customers differs substantially to the pricing offered to residential and small business customers. For example, residential and small business customers acquire F2M calls on prices specified in the SFOA whereas corporate customers, are able to negotiate their prices including on the basis of the 'bundle' of services they acquire; and
- due to the different product groupings and pricing structures offered to corporate customers, it is unlikely that, at the corporate level, the market comprises F2M calls, national long distance calls and international calls.

The existence of different markets for residential and corporate customers provides an additional reason to ensure reductions to MTAS charges used to supply calls to the residential market should not be used to cross-subsidise F2M prices in the corporate F2M market.

4.5 Linking reductions in MTAS charges to pass-through

The Commission concluded in its Draft Decision that competitive pressures in the F2M market would compete away any windfall to Telstra as a result of the reduction in MTAS charges. For the reasons outlined in sections 2 and 4.4 above, Hutchison does not expect the competitive pressures in the F2M market to be sufficient to achieve significant pass-through of a reduction in MTAS charges to consumers generally. Accordingly, regulatory intervention is required in order to ensure reductions in MTAS charges result from reduced F2M retail prices for all consumers.

Hutchison believes the best method for linking reductions in MTAS charges to pass-through is through the introduction of a specific retail price control under the *Telecommunications (Consumer Protection and Service Standards) Act 1999* (the ***Telecoms (CPSS) Act***).

Hutchison acknowledges that the Commission has no power to determine retail price controls but urges the Commission to make a recommendation to the Minister that an appropriate retail price control be implemented.

The retail price control regime is set out in Part 9 of the Telecoms(CPSS) Act. The purpose of the price control arrangements has been described as follows:

- to ensure that prices are fair and reflect efficient provision cost;[38]
- to ensure that benefits of efficiency changes are shared equitably among customer groups;[39]
- to effect price restraint in a monopoly market;[40] and

[38] *Australian Telecommunications Services: A New Framework*, Statement by the Minister for Transport and Communications, AGPS, Canberra, 25 May 1988 at page 146.

[39] *Australian Telecommunications Services: A New Framework*, Statement by the Minister for Transport and Communications, AGPS, Canberra, 25 May 1988 at page 147.

[40] *Australian Telecommunications Services: A New Framework*, Statement by the Minister for Transport and Communications, AGPS, Canberra, 25 May 1988 at page 149.

- to prevent excessive prices in markets where a dominant supplier faces no constraints from competition on its pricing freedom.[41]

In its 2001 report, the Commission considered the case for imposing a retail price control on F2M calls. The Commission stated:

> *The Commission believes there is an excessive gap between retail price and full cost inclusive of the termination charge and that this can partly be addressed by inclusion of fixed-to-mobile calls in the price cap.*[42]

One of the reasons the Commission recommended a broad price cap rather than specific sub-caps, was to enable Telstra to recover its indirect costs and profits from those services where demand is least sensitive to changes in price.[43] The Commission reiterates this view in the Draft Decision.[44]

Hutchison submits that a retail price control which ensures that lower MTAS charges are reflected in lower retail prices for F2M calls is appropriate because:

- F2M calls are currently included in a broad price cap which includes other services such as national long distance and international calls. However, as the Commission acknowledges, the current broad price cap has exerted a weak constraint on Telstra's F2M pricing.[45] In fact, real prices for F2M calls only declined by 3.2% during 2001-02.[46] It is unlikely therefore that the existing retail price control will have any effect in ensuring that lower MTAS charges are passed through to consumers.

- One of the reasons the Commission decided in February 2001 to impose a retail price control on F2M calls was because of the differential between retail prices and costs (including termination costs). The proposed reduction in the MTAS charge to 12 cpm will increase even further the difference between retail prices for F2M calls and the costs of providing the service. The current retail price control is unable to ensure that retail prices reflect the costs of provision.

- The Commission's assessment is that there will be partial pass-through. In other words, without regulatory intervention, competition in the F2M market will be insufficient to ensure that retail prices for F2M calls are reflective of underlying costs. This is precisely the situation in which the retail price control regime was meant to operate.

- If there is to be any pass-through, it is more than likely that corporate customers will benefit to the exclusion of residential and small business customers. A retail

[41] *Discussion paper, Telstra retail price controls arrangements,* DCITA, December 1998 at page 4.

[42] *Review of Price Control Arrangements, An ACCC report*, dated February 2001 at page 24.

[43] *Review of Price Control Arrangements, An ACCC report*, dated February 2001 at page 44.

[44] ACCC, *Draft Decision, on the mobile terminating access service* at page 171.

[45] ACCC, *Draft Decision, on the mobile terminating access service* at page 171.

[46] ACCC, *Draft Decision, on the mobile terminating access service* at page 89.

price control can ensure that **all** end-users benefit equitably and promote the long term interests of **all** end-users.

- An appropriate retail price control is one which requires Telstra to reduce its retail prices for F2M calls by an amount commensurate with the reduction in the MTAS charge. **This is consistent with the price control regime recommended by the Commission in its February 2001 report**. Hutchison's reasoning is:
  - one of the costs of providing F2M calls is the cost associated with acquiring the MTAS;
  - the cost of acquiring the MTAS is not incurred when providing national long distance and international calls. In other words, the MTAS charge is **not** a common cost incurred by Telstra in connection with the provision of all the services in the relevant basket; and
  - the reduction in a direct cost of providing F2M calls should be reflected in lower retail prices for F2M calls. Indeed, that is the Commission's rationale, as set out in the draft report, for continuing to regulate the MTAS.
- Such a retail price control is consistent with Government policy. Senator Alston, as Minister for Communications, Information Technology and the Arts suggested that the Government is concerned that reductions in MTAS are reflected in F2M pricing:

  > *One option the ACCC is considering is moving from a retail benchmarking approach to a cost-based termination charge. The key would be to ensure that reduced wholesale termination charges flowed through to retail fixed-to-mobile charges.*[47]

While broad price caps (under the current retail price controls) are preferred by the Commission because they allow Telstra to set prices efficiently across all its products, in this instance a specific narrow cap is appropriate for a short period to introduce the required competitive pressure into an otherwise uncompetitive market.

In their submission to the Mobile Services Review dated 26 June 2003, Professors Gans and King suggest a price cap for F2M calls in the form CPI-X-T where T represents the reduction in MTAS charges. If such an approach were adopted, the Commission would need to consider carefully the appropriate basis on which to apply the cap. For example, if the cap applied on average to all F2M calls then it would not achieve pass-through to all customers on a non-discriminatory basis. Rather, the cap should apply not only on average but also to narrower call classes, for example, off-net F2M calls made by customers with the lowest 50% of bills. This is more likely to ensure equitable distribution of the MTAS price reduction.[48]

[47] Senator Richard Alston, opening address to 2003 Congress of the Australian Mobile Telecommunications Association, 25 September 2003.

[48] Hutchison refers the Commission to the submissions lodged by Professors Gans and King at 54 to 57. There Professors Gans and King outline a proposed retail price control including a control which could be added to the existing price cap imposed on Telstra. Hutchison supports their submissions on this issue.