# ACCC Mobile Review - Sydney Public Hearing 11.9.2003

# Mobile Terminating Access Services

## The need for regulation

1. The principal issue for this Inquiry is how best to reduce the retail price of Fixed to Mobile (F2M) calls.
2. Clearly reducing the terminating access price is a necessary step in achieving that. It is however, a long way short of a sufficient step. Indeed in Hutchison's view, a reduction in the terminating access price without certainty that those reductions will be reflected in lower F2M prices is tantamount to asking Hutchison and others to put a lot of money in Telstra's pocket. Why would Hutchison, a recent entrant, want to create a windfall for Telstra and why is this in the best interests of the industry or consumers?
3. Just to make Hutchison's view on this perfectly clear. Hutchison supports a reduction in terminating access charges but **only** if it has certainty that any such reduction will be reflected in lower F2M retail prices for residential consumers and SMEs. It is important to emphasise these particular consumers, and not to be persuaded by those who refer to the lowering, **on average**, of F2M prices. Averages are inherently misleading but particularly so in this context, where F2M prices for corporates are decreasing but prices for consumers at the other end of town, are static or on the increase.
4. For those who argue that the invisible hand of the market place will operate to reduce significantly, terminating access charges and then F2M prices, Hutchison says this just won't happen without regulatory encouragement.
5. The best predictions of likely future conduct are based on evidence of experience to date. That experience is 1, terminating access charges have fallen over the last 3 years, although not substantially and 2, F2M prices have decreased for corporates and increased for the rest of us. In Hutchison's view the reason terminating access charges have fallen is largely due to Telstra having both, witnessed overseas developments and read the writing on the wall locally. Telstra (and Optus) thought that by facilitating a reduction in terminating access charges, albeit insignificant and

incremental reductions, they would be able to later point to the successful operation of market forces, with a view to saying that regulation is unnecessary, thereby ensuring no greater reduction in terminating access charges and no regulation at all of F2M prices.

6. Getting back to recent experience:

   - F2M prices for residential customers and SMEs have been increasing: Hutchison deals with the statistics in its written submission.
   - The ACCC's report *'Telecommunications competitive safeguards for the 2001-2002 financial year'* makes the following observations:
     - the fixed-to-mobile market is *'a long way from being effectively competitive'*;
     - real prices for F2M calls declined over 2001-02 by 3.2% on ***average***. This is much slower than in previous years; and
     - based on Telstra's Annual Report for 2001 –02, Telstra's ***average*** retail price for F2M calls was 38.5 cents per minute. This was 0.5 cents per minute lower than for 2000-01.

7. Why is Hutchison interested in lower F2M prices? There are 3 reasons:

   - Lower F2M prices will stimulate demand for F2M calls. Reductions in revenue for mobile players resulting from lower terminating access prices, will be offset by the increased revenue resulting from the greater number of calls made to and by mobile subscribers, given the availability of voicemail and the like.
   - Telstra's on-net F2M call rates are significantly less than its off-net F2M call rates. This differential pricing is designed to encourage large corporates in particular, to acquire both fixed line and mobile services from Telstra. Lower terminating access prices will reduce the scope for Telstra to use its market power to differentiate so greatly between on-net and off-net call rates.
   - Lower F2M call rates will provide consumers with a real choice as to how they make a voice call. Consumers will not need to avoid F2M calls because the price is inflated.

## Market power

8. The Commission has asked Hutchison to address three specific questions today:
   - whether mobile carriers have market power;
   - whether the Commission should be concerned if the price of termination exceeds costs; and
   - the relevance of externalities

9. Hutchison's position is straightforward: termination charges are significantly above the cost of providing the service and they should not be.

10. Hutchison believes these charges should be reduced otherwise distortion will continue in the fixed to mobile market. This reduction will not happen without regulation. Accordingly, Hutchison does not believe the Commission needs to focus on market power. However, Hutchison will address the Commission's question.

11. Regardless of the market definition adopted, and associated issues of market power, there are peculiar features of the terminating access service that make regulation necessary.

12. The peculiarity is that the party acquiring the service does not choose the supplier. That is, with the terminating access service, a person phoning a mobile phone can not choose which mobile carrier will provide terminating access services. Rather, the B-party (the person receiving the call) chooses which mobile carrier will provide those services.

13. Because the party choosing the supplier does not pay for the service, there will always be incentives for mobile carriers to charge excessively for terminating access services.

14. There are 3 distinct reasons mobile carriers have the incentive and ability to charge excessive prices:
    - consumer ignorance;
    - fixed carriers do not differentiate between off-net retail prices; and
    - human nature, being what it is, mobile subscribers care more about the cost they incur in making a call than receiving a call.

    I deal with each in turn.

- **consumer ignorance:** by consumer ignorance, we mean a sufficient number of people do not know the mobile network they are calling from a fixed line, therefore they acquire a service when they do not know the price. In this circumstance, mobile carriers can increase terminating access prices as the person acquiring the service does not base their decision to acquire the service on price. A number of carriers, including Hutchison, commissioned a survey on consumer ignorance. As with all good surveys, the results are entirely equivocal. I note however, one clear proposition which emerges: at least 40% of people don't know the network they are calling. So, mobile carriers are in the enviable position of supplying a service to people who, in 40% of cases, do not know and are unable to determine the price of that service.
- Now moving to **differentiation of off-net prices**. Let's assume that 100% of fixed to mobile callers know the mobile network they are calling. Then assume that those callers know the price of termination to each network. Even then mobile carriers can still charge excessive prices for termination services. The reason for this is that fixed network operators generally charge one price for off-net fixed to mobile calls regardless of the network you are calling. If a customer pays the same rate to their fixed line provider regardless of who supplies the terminating access services, even with perfect knowledge of networks and terminating access prices, the fixed to mobile caller can not take advantage of the different termination prices. In this situation, with no customer ignorance, mobile carriers can still price at above cost levels.
- So, let us examine my third point: **human nature**. Assume we have abolished customer ignorance as to networks, assume fixed to mobile callers know the price of terminating access charges AND assume that fixed network operators pass this saving through to consumers in itemised bills. Even then, mobile carriers are likely to set excessive termination charges because subscribers care more about the cost they incur for making a call than they do about the cost incurred by a fixed line subscriber calling them. Mobile subscribers will happily trade off lower outgoing call cost for higher incoming call prices. In this situation, mobile carriers will continue to set excessively high mobile terminating access charges.

## Should the Commission be concerned that termination services are above cost?

15. It has been suggested that although terminating access prices are too high, there should be no regulation because overall mobile carriers do not make excess profits. Hutchison disagrees with this position.

16. It is also argued by proponents of above cost pricing that because there is a low elasticity of demand for fixed to mobile calls, inputs to those calls should be priced excessively. Hutchison disagrees with this position and makes three points in this regard:

    - no evidence has been provided to demonstrate there is low elasticity of demand for fixed to mobile calls. One estimate from 5 years ago is not sufficient evidence;
    - the customer choosing the mobile carrier should bear the cost of being serviced by that network. It is not economically reasonable to ask others to pay this cost as it distorts the demand for fixed to mobile calls as well as the demand for mobile services. The economic inefficiency associated with such conduct was accepted by the UK Competition Commission; and
    - while increasing the cost of a product with a low elasticity of demand is a good way to raise money, it is not logical to do so, as individual services should bear their own costs.

## Externalities

17. The Commission has asked Hutchison to comment on relevant externalities to pricing mobile termination services.

18. Hutchison does not have evidence of any externalities. Accordingly we prefer not to comment on the relevance of hypothetical externalities, except to say:

    - the Commission considered the existence of externalities in 1999 and rejected them. They are even less likely to exist in a more mature mobile market; and
    - The UK Competition Commission has recently cast doubt on the usefulness of externality arguments.