

Regulatory Outcomes in a Competitive Market: Mobile Termination Pricing

Angus Henderson provides an overview of the sometimes complex approach taken by the ACCC in determining pricing principles for certain telecommunications services, in this case, the termination of GSM mobile calls.

After 12 months consideration, the Australian Competition & Consumer Commission has issued its draft report on the Pricing Principles to apply to the GSM Termination Service. GSM Termination is a declared service under Part XIC of the *Trade Practices Act, 1974* (Cth) and parties have the opportunity to seek regulatory intervention through ACCC arbitration on the price at which that service must be supplied. These Pricing Principles have been issued following the lodgment of several arbitrations against the incumbent mobile operators. These Pricing Principles will, when finalised, be used by the ACCC to determine the price of GSM Termination and to guide private parties in their commercial negotiations.

REQUIREMENT TO SET PRICING PRINCIPLES

The ACCC is required to make a determination on the price for declared services, such as the GSM Termination Service, following the lodgment of an arbitration. It is not an option for it to decline to intervene for whatever reason (for example, because of the competitiveness of the market).

The amount payable to mobile operators for terminating calls on their mobile networks has been a vexed one in countries with "calling party pays" systems. The price for mobile termination factors into the price consumers pay for fixed-to-mobile and mobile-to-mobile calls. Regulatory authorities have taken different approaches to the pricing issue. Most consider, or seem to be on the verge of concluding, that mobile terminating access is a bottleneck on the basis that there are no substitutes for a call terminating to a mobile phone.

THE ACCESS APPROACH

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draft GSM Termination Pricing Principles that the mobiles market in Australia is becoming increasingly competitive. There are five existing and emerging mobile carriers. Retail pricing is both innovative and aggressive. Mobile penetration is significant, with 48.9% of Australians having a mobile phone. Also, the prices for the wholesale GSM Termination Service are decreasing. In other words, evidence of market failure in the mobile sector or in relation to this service is not at all clear.

The ACCC recognises in its draft Pricing Principles however that for fixed-to-mobile calls, there is evidence that prices for the GSM Termination Service are substantially above costs and prices for this service have not decreased as rapidly

as retail prices. The threat of sustained high prices for the GSM Termination Service justified, according to the ACCC, a role for regulation. Without such regulation, retail prices for Fixed-to-Mobile calls may be adversely impacted and competitive entry into that sector affected.

The ACCC considers that the most appropriate pricing methodology for GSM Terminating Access should be neither a cost-based or a retail minus model, but a price benchmarking model. Under its proposed model, the ACCC states that the appropriate starting point should be the lowest current access price for GSM Termination Services negotiated between any mobile carrier and any fixed carrier. From this point a "glide path"

unique to each mobile carrier will be established. The price for GSM Termination Service offered by a mobile carrier will be reduced under this "glide path" by falls in the mobile carrier's weighted average retail price for the overall mobile package (ie subscription and outgoing call charges).

It favoured this more "cautious approach" to regulating GSM Terminating Services than more interventionist pricing models. The ACCC rejected the short run marginal cost model, first recommended by the ACCC's consultants, on the traditional grounds that such a pricing methodology would not provide for the recovery of capital and operating costs nor common costs.

TSLRIC (Total Service Long Run Incremental Cost), the methodology used by the ACCC to set PSTN declared service pricing, was rejected as an appropriate pricing methodology. The ACCC identified a number of problems with the application of TSLRIC (eg allocation of common costs to access and usage charges, determining best-in-use technology etc). Again these are relatively traditional weaknesses with TSLRIC. The ACCC essentially declined to apply TSLRIC on the grounds that such intrusive regulation could not be justified in the mobile market where the benefits in so doing were not clear.

The ACCC also rejected a retail minus approach, again citing fairly traditional weaknesses with this model. In this case, determining the retail price starting point would be problematic given the range of mobile pricing plans available in Australia.

ANALYSIS OF ACCC'S APPROACH

Finally, the ACCC preferred the retail price benchmark approach to a productivity measure such as CPI-X because the former approach moves in line with the increasing competitiveness of the mobile market rather than a theoretical productivity benchmark.

The ACCC's decision represents a significant shift away from more interventionist pricing models used to price access services over fixed networks using TSLRIC cost modelling. Further, the ACCC did not adopt the overly

simplistic analysis that each mobile phone (irrespective of the number of competitors) is a bottleneck, which can lead to the absurd conclusion that each mobile phone is a separate market. On the other hand, the ACCC rejected the incumbent mobile carriers argument that no intervention was justified on the grounds that competition in the mobile market was strong. The ACCC found that there was some level of control held by the mobile carriers over the customer as well as customer ignorance of the price paid for the GSM Termination Service.

Applying the ACCC's methodology, it should be relatively straightforward for the ACCC to determine the current lowest wholesale GSM Termination Price payable between a mobile carrier and a fixed carrier. It will be more difficult for each mobile carrier's average retail pricing to be determined. The plethora of pricing plans in the mobile sector will require a significant level of monitoring.

It is also interesting to note that the ACCC has also recently issued its draft recommendations to the Minister on the price cap to apply from 1 July 2001. As part of its draft report, the ACCC recommended that retail mobile pricing be removed from the price cap. In so doing, the ACCC recognises the competitiveness of the mobile market. The knock-on impact on the GSM Termination Service Pricing Principles is that the "glide path" the ACCC will use to reduce GSM Terminating Pricing over time will, if the ACCC's recommendations are finalised in their current form and accepted by the Minister, be determined by reductions in the retail Mobile Pricing through competition rather than regulatory manipulation of pricing through or caused by the price cap.

CONCLUSION

The ACCC's GSM Termination pricing approach endeavours to take a pragmatic view recognising the existing competitive state of the Mobiles Market in Australia, the need to encourage and sustain investment in this sector as 3G and other technologies emerge and the relatively benign nature of the market failure in this case. As a result of this decision, the ongoing need for the GSM Termination Service to be regulated will come under increasing scrutiny. The GSM

Termination Service price responsiveness to the ACCC's Pricing Principles will undoubtedly form a significant part of that ultimate decision.

The views expressed in this article are those of the author and not necessarily those of the firm or its clients

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