Domestic Mobile Terminating Access Service Declaration Inquiry

ACCC's Final Decision

June 2014

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List of abbreviations and acronyms

A2P	application-to-person
ACCAN	Australian Communications Consumer Action Network
ACCC	Australian Competition and Consumer Commission
ACMA	Australian Communications and Media Authority
c-i-c	commercial in confidence
CPP	calling party pays
FAD	final access determination
FTM	fixed-to-mobile
LTIE	long-term interests of end-users
MMS	multimedia messaging service
MNO	mobile network operator
MOAS	mobile originating access service
MTAS	mobile terminating access service
MTM	mobile-to-mobile
MVNO	mobile virtual network operator
OTT	over the top
SIOs	services in operation
SMS	short message service
CCA	*Competition and Consumer Act 2010*
VHA	Vodafone Hutchison Australia
VoIP	voice over internet protocol

1 Executive Summary

The Australian Competition and Consumer Commission (ACCC) has reached a final decision in the domestic mobile terminating access service (MTAS) declaration inquiry to declare mobile voice and SMS termination services for five years.

The ACCC has found that mobile network operators (MNOs) have a monopoly over the voice and SMS termination services on their networks and that, currently, there are no effective substitutes for such services. As a result, the ACCC is of the view that MNOs have the ability and incentive to deny, or set unreasonable terms of access to these termination services in the absence of declaration. This would detrimentally affect both wholesale and retail markets for mobile services. The ACCC therefore considers that declaration of both mobile voice termination and SMS termination services is in the long-term interests of end-users (LTIE).

The MTAS service description will be varied so that it covers both termination of voice calls and termination of SMS messages. The amended service description for the MTAS is at Appendix A.

1.1 Mobile voice termination services

The ACCC considers that declaration of mobile voice termination services will be in the LTIE because it is likely to:

- promote competition in the downstream markets for retail mobile services and fixed voice services, by ensuring wholesale mobile voice termination charges are cost based;
- promote the achievement of any-to-any connectivity by ensuring MNOs are unable to refuse, or set unreasonable terms or conditions of, access to mobile voice termination services to other network operators; and
- encourage the economically efficient use of, and investment in telecommunications infrastructure, by preventing above cost prices for mobile voice termination service.

1.2 SMS termination services

The ACCC considers that declaration of SMS termination services, including application to person (A2P) SMS, will be in the LTIE because it is likely to:

- promote competition in:
    - the downstream retail market for mobile services;
    - the wholesale A2P SMS market, by allowing MNOs to offer lower off-net A2P SMS rates; and
    - the downstream A2P markets, by allowing SMS aggregators and A2P service providers to offer lower rates to their customers;

- promote the achievement of any-to-any connectivity by ensuring MNOs are unable to refuse, or set unreasonable terms or conditions of access to SMS termination services; and
- encourage the efficient use of, and investment in telecommunications infrastructure, by discouraging above cost SMS termination prices.

2 Introduction

The ACCC has made its final decision on the declaration of mobile termination services. The ACCC has decided to extend the declaration of the MTAS for a period of five years. The ACCC has also decided to vary the MTAS service description to include SMS termination services. The amended service description is provided in Appendix A.

This final report explains the ACCC's assessment framework and its reasons to extend and vary the declaration of the MTAS.

On 23 May 2014, the ACCC commenced the MTAS final access determination (FAD) inquiry. At the same time it also released a consultation paper on non-price terms and conditions and supplementary pricing issues for a number of declared services. The MTAS FAD may set regulated prices for the MTAS, and non-price terms of access.[1]

The ACCC has extended the expiry date of the current MTAS FAD until the new FAD comes into force. The ACCC will release a discussion paper into setting primary pricing terms and conditions for the MTAS in mid-2014.

2.1 Consultation Process

The previous MTAS declaration is due to expire on 30 June 2014. On 27 May 2013, the ACCC commenced an inquiry into whether the MTAS declaration should be extended, varied, revoked, allowed to expire or a new declaration made.[2] It published a discussion paper which sought views about whether declaration of the MTAS continued to be in the LTIE. The ACCC received eight submissions in response to the discussion paper. In August 2013, the ACCC sought further information from industry about SMS, multimedia messaging service (MMS), and voice termination services. This information was provided on a confidential basis and is not publicly available.

In December 2013, having considered submissions and responses to the information request, the ACCC released the report on its draft decision to the inquiry (the draft decision). In the report the ACCC set out its preliminary view to extend the declaration of mobile voice termination services for five years, and to declare SMS termination services for the first time, also for five years.

The ACCC received submissions from seven stakeholders in response to the draft decision. In addition to views on the draft decision, some submissions also raised the issue of whether A2P SMS services should be excluded from a declared SMS termination service. In considering this issue, the ACCC has undertaken further consultation and obtained additional information from stakeholders.

[1] See subsection 152BCI(3) of the *Competition and Consumer Act 2010* (CCA).
[2] In compliance with Division 3 of Part 25 of the *Telecommunications Act 1997*.

Further information about the MTAS declaration inquiry, the discussion paper, the draft decision and public submissions received, are available at the ACCC's website.

2.2 Structure of this report

The report is structured as follows:

Chapter 3 sets out the background to the MTAS inquiry.

Chapter 4 sets out the ACCC's assessment approach to making decisions in a declaration inquiry.

Chapter 5 sets out the ACCC's views on whether declaration of mobile voice termination should be extended.

Chapter 6 sets out the ACCC's consideration of fixed to mobile pass-through issues.

Chapter 7 sets out the ACCC's views on whether SMS termination services should be declared.

Chapter 8 sets out the ACCC's views on whether MMS termination services should be declared.

Chapter 9 sets out the ACCC's view on other issues raised in the inquiry, including mobile originating access services issues, and the duration of the declaration.

Appendix A provides the amended MTAS service description.

3 Background

The ACCC first regulated a mobile voice termination service in 1997 by deeming it to be a declared service. At the time, all mobile networks were either networks which were an analogue advanced mobile phone system, or digital global system for mobiles. The ACCC deemed mobile voice termination services offered over both networks to be declared. In 2002, the ACCC varied the 1997 declaration to include mobile voice termination services provided over code division multiple access mobile networks.

In 2004, the ACCC made a new mobile termination access service declaration, which was technology neutral. This meant that mobile voice termination services on 3G mobile networks were included in the declaration. The ACCC reviewed this declaration in 2009 and decided to extend it for five years until 30 June 2014.

3.1 What are mobile voice termination services?

Every phone call involves an 'origination' from the network making the call and a 'termination' onto the network receiving the call. Mobile voice termination services are wholesale services provided by a mobile network operator (MNO) to fixed-line network operators and other MNOs to receive and terminate voice calls on its mobile network. Mobile voice termination services are essential for calls to be made between subscribers connected to different mobile networks, and for calls to be made from fixed networks to mobile networks.

The network operator that originates the call purchases terminating access from the MNO that completes, or terminates, the call. The originating network owner will recover these costs, and the costs it incurs from originating the call, through the retail price it charges its customers for providing the call.

3.2 Why has the ACCC regulated mobile voice termination services?

The ACCC has previously found that each MNO has a monopoly over the termination of voice calls on its own network and that there are no substitutes for such voice termination services. An end-user making a call to another person cannot select the mobile carrier who will terminate the call, as this choice has already been made by the called party. Further, when choosing which network to join, the called party does not take into account the cost of terminating calls on that network. This is because under the calling party pays (CPP) system in Australia the called party does not bear this cost.

Because of these factors, the ACCC has concluded that each MNO has market power over the termination of calls on their networks and the ability and incentive to set unreasonable terms and conditions of access to the mobile voice termination service. Accordingly, the ACCC has found that regulation of mobile voice termination is necessary in order to ensure that access to this service is not denied, that terms and conditions of access are reasonable, and to promote competition in the downstream markets which require mobile voice termination services**.**

3.3 What are SMS termination services?

SMS is a short messaging service that allows a mobile user to send text messages to other mobile users. SMS messages may comprise up to 160 characters of text and are usually sent using the signalling channel of the mobile network. The signalling channel is distinct and separate from the channel that is used to carry voice calls.

Types of SMS services include:

- mobile-to-mobile (MTM) SMS services – these are SMS sent between two mobile subscribers; and
- application-to-person (A2P) SMS services – these are semi-automated or fully automated SMS sent using an application (usually an online portal) to mobile subscribers.

SMS termination services are wholesale services provided by MNOs to other MNOs to receive and terminate SMS, including MTM and A2P SMS, on their networks. The network that originates an SMS message pays the network that terminates the SMS message on their network to do so. SMS termination services are required each time an end-user sends an SMS to an end-user connected to a different mobile network and, as such, are essential to providing retail SMS services. The CPP arrangement that applies to voice calls also applies to SMS messages. That is, the end-user sending the SMS pays to send it and not the party who receives the SMS.

In these ways, SMS termination services have many of the same characteristics as MTM voice termination services.

3.4 ACCC's consideration of SMS termination services

Prior to this inquiry, the ACCC has not regulated SMS termination services. In the 2009 MTAS declaration inquiry, the ACCC considered whether SMS termination should be declared, but decided not to extend the MTAS service description to include these services. This was because the ACCC considered that SMS termination services were still exhibiting significant growth, were subject to ongoing commercial agreements and there had been no demonstrable market failure.[3]

However, based on the information provided in the current declaration inquiry, the ACCC considers that the SMS market has changed since 2009 and that this warrants reconsideration of whether SMS termination services should be declared.

[3] ACCC, *Mobile Terminating Access Service - Final Report on reviewing the declaration of the mobile terminating access service*, May 2009, p. 11 (2009 MTAS Declaration Final Report).

4 The ACCC's assessment approach

The ACCC may declare a service if it is satisfied that declaring the service would promote the LTIE.[4]

As required by the *Competition and Consumer Act 2010* (CCA), when determining whether declaration will be in the LTIE, the ACCC will have regard to the extent to which extending, varying or revoking the existing declaration is likely to achieve the following objectives:

- promoting competition in markets for listed services (telecommunications services);
- achieving any-to-any connectivity in relation to carriage services that involve communication between end-users; and
- encouraging the economically efficient use of, and the economically efficient investment in, the infrastructure by which telecommunications services are supplied.[5]

These objectives are related, and in many cases the LTIE will be promoted because declaration is likely to result in the achievement of all of these objectives. However, in other cases, the ACCC may find the LTIE is promoted by balancing the achievement of the different objectives against each other.

4.1 Promoting competition

When considering whether declaration will promote competition in markets for listed services, the ACCC first identifies the markets relevant to this assessment. Typically, the ACCC will consider the market in which the eligible service is provided and any markets in which competition may be promoted.[6] In identifying the scope of the markets the ACCC will consider the eligible service, or downstream services relying on the eligible service, and any substitutes for those services.

The ACCC is not required to precisely define the markets for the purposes of a declaration inquiry. It is sufficient to broadly identify the scope of the markets likely to be affected by the eligible service, having regard to the product, function, geographic and temporal dimensions of the market.[7]

Once the relevant markets are identified, the ACCC will assess the state of competition in those markets. In undertaking this exercise, the ACCC takes into account the concept of effective competition. This entails consideration of factors such as concentration level, barriers to entry,

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[4] Subsection 152AL(3) of the CCA.

[5] Subsection 152AB(2) of the CCA.

[6] ACCC, *Telecommunications services – Declaration provisions – a guide to the declaration provisions of Part XIC of the Trade Practices Act*, July 1999, p. 40 (Declaration Guide).

[7] See Declaration Guide, pp. 41– 42; *Foxtel Management Pty Ltd v Australian Competition and Consumer Commission* [2000] FCA 589 at [172] per Wilcox J.

the linkage between supply of the eligible service and the supply of downstream services, and relevant behavioural features such as price changes over time.[8]

In assessing whether declaration is likely to promote competition in the relevant markets, the ACCC looks at whether it will remove obstacles to end-users gaining access to services.[9] In doing so, the ACCC considers the likely state of competition in the future with declaration compared to that without declaration.

In considering the effect of the declaration, the key issue is whether declaration will assist in establishing conditions by which improvements in competition will be more likely to occur. The question of whether competition will actually improve or increase will be highly relevant but is not determinative.[10]

4.2 Achieving any-to-any connectivity

When considering the achievement of any-to-any connectivity, the ACCC assesses whether declaration will ensure that end-users supplied with carriage services are able to communicate with other end-users of the service, regardless of the network they are connected to.[11]

This objective is particularly relevant when considering services that require interconnection between networks.

4.3 Encouraging the efficient use of, and investment in, infrastructure

In the ACCC's view, encouraging the economically efficient use of, and investment in, infrastructure requires analysis of three types of economic efficiency:

- productive efficiency, which is achieved where individual firms produce the goods and services that they offer to consumers at least cost;
- allocative efficiency, which is achieved where the prices of resources reflect their underlying costs so that resources are then allocated to their highest value uses; and
- dynamic efficiency, which reflects the need for industries to make timely changes to technology and products in response to changes in consumer tastes and in productive opportunities.[12]

Again, the ultimate question in the context of this objective is whether declaration will create an environment whereby the carriers and end-users have incentives to undertake efficient use of, and investment in, infrastructure.[13]

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[8] Declaration Guide, pp. 44–45.
[9] Subsection 152AB(4) of the CCA.
[10] Declaration Guide, p. 48.
[11] Subsection 152AB(8) of the CCA.
[12] Declaration Guide, p. 55.
[13] ibid.

The ACCC is also required to consider the technical feasibility of providing and charging for the service, the legitimate commercial interests of suppliers of the service and the incentives for investment in infrastructure.[14]

4.3.1 Technical feasibility

When determining the technical feasibility of providing and charging for the service, the ACCC will have regard to the following matters:

- whether supplying and charging for the services is feasible in an engineering sense, i.e. having regard to the technology that is in use or available;
- the costs involved in supplying and charging for the services, and whether these costs are reasonable; and
- the effects or likely effects that supplying and charging for the services would have on the operation or performance of telecommunications networks.[15]

Where the ACCC determines it is technically feasible to supply and charge for the eligible service and that declaration will promote competition, it will generally consider that declaration is likely to encourage the efficient use of the infrastructure used to supply the service unless this would discourage efficient investment.[16]

4.3.2 Legitimate commercial interests of the suppliers of the service

The legitimate interests of access providers include their ability to exploit economies of scale and scope.[17] The ACCC considers that it also includes the need to recover the costs of providing services and to earn a normal commercial return on the investment in infrastructure. Allowing for a normal commercial return provides an appropriate incentive for the access provider to maintain, improve, and invest in, the efficient provision of the service.

4.3.3 Incentives for investment

When considering the incentives for investment, the ACCC must have regard to the risks involved in making the investment.[18] The ACCC will consider whether declaration will lead to pricing for the eligible service that eliminates incentives for inefficient investment in existing infrastructure. The ACCC also considers that the effect of declaration on incentives to invest in new infrastructure that brings innovative benefits is important. In particular, the ACCC will consider whether declaration is likely to create an environment that encourages investment in new infrastructure which promotes dynamic efficiency.

[14] Subsection 152AB(6) of the CCA.
[15] Declaration Guide, p. 57.
[16] ibid, pp. 57–58.
[17] Subsection 152AB(6)(b) of the CCA.
[18] Subsection 152AB(6)(7A) of the CCA.

5 Should mobile voice termination services continue to be declared?

The ACCC has concluded that the continued declaration of mobile voice termination services will promote the LTIE.[19] It has therefore decided to extend the declaration of mobile voice termination services for five years. In reaching this final view, the ACCC has had regard to submissions received during the inquiry, and the extent to which declaration of mobile voice termination services is likely to result in the achievement of the objectives set out in Chapter 4.[20]

The following discussion outlines the ACCC's findings on the likely effect declaration will have on each of these objectives.

5.1 Promotion of competition

In determining whether declaration of voice termination services will promote competition in markets for listed services, the ACCC has first identified the relevant markets for the services in question and assessed the state of competition in those markets. The ACCC has then made an assessment of whether declaration is likely to promote competition in the relevant markets.

5.1.1 The relevant markets

5.1.1.1 Summary of the draft decision

In the draft decision the ACCC found the markets relevant to mobile voice termination services are:

- the markets for wholesale mobile voice termination services on each MNO's network;
- the downstream market for retail mobile services; and
- the downstream market for retail fixed voice services.

Wholesale market

In the draft decision, the ACCC found that the market in which mobile voice termination services are supplied are the separate wholesale markets for voice termination services on each MNO's mobile network. This was because the ACCC found each MNO has exclusive control over access to mobile voice termination services on their network, and that there are no substitutes for these services.

[19] Subsection 152AL(3)(d) of the CCA.

[20] As required under s 152AB(2) of the CCA.

Downstream retail markets

In the draft decision the ACCC found that the downstream markets in which declaration of mobile voice termination services may promote competition were the retail market for mobile services and the retail market for fixed voice services.

The ACCC found that mobile voice termination services are an essential input to two types of downstream retail services, MTM calls and fixed-to-mobile (FTM) calls. The ACCC recognised that both of these services are typically provided in bundles of retail services. MTM calls are provided as part of mobile service bundles which usually include mobile-to-fixed calls, SMS, MMS and data services. FTM calls are usually provided as part of fixed voice bundles which include other fixed line calls.[21] The ACCC noted that the different services in the bundles are complementary to each other, and they are acquired and used together. For these reasons, the ACCC considered it appropriate to define the relevant downstream markets as the market for retail mobile services and the market for retail fixed voice services.

Further, in defining the relevant downstream markets, the ACCC found there are currently no effective substitutes for MTM or FTM calls. The ACCC considered whether voice-over-internet protocol (VoIP) services are currently an effective substitute for traditional mobile or fixed voice services, but concluded that they were not for three reasons:

- while the use of VoIP services is growing strongly, there are still a significant number of end-users that are not using them;
- VoIP generally requires access to a reliable data connection, which may not be available to a significant number of mobile and fixed voice services end-users; and
- technical limitations, such as reliance on an intermediate device, mean that some VoIP services may not function during power outages.

Finally, the ACCC found that mobile voice services are not currently an effective substitute for fixed voice services. While acknowledging the continued growth of mobile services and the decline of fixed voice services, the ACCC considered the replacement of fixed voice services by mobile services is only occurring in a segment of the market. The ACCC therefore considered that for the majority of end-users, mobile services are a complement to fixed voice services.

5.1.1.2 Submissions to the draft decision

Only Telstra made submissions on the ACCC's market definitions in the draft decision. Telstra argued that the ACCC's downstream market definitions are too narrow and that there should be one downstream voice market rather than two separate markets as defined in the draft decision, because:

[21] These include local calls, national long distance calls, international calls and fixed-to-mobile calls.

- FTM services continue to be provided as part of a basket of fixed voice services and cannot be considered as a separate downstream market; and
- increased convergence between fixed and mobile services, and the availability of alternatives such as VoIP and over the top (OTT) messaging services, mean it is no longer appropriate for the ACCC to attempt to define separate markets on the basis of the type of technology used to make a particular call.[22]

Telstra also submitted that recent market developments support fixed-mobile substitution. Such developments include:

- a steady decline in fixed line services in operation (SIOs), with a net decline of 1 per cent in 2012–13;
- Telstra's ongoing reduction in public switched telephone network product revenue, which decreased by $460 million in 2012–13;
- continuing growth in the number of mobile phone users without a fixed-line voice service at home, which increased by 18 per cent in 2012–13;
- diversification in communications services used, and a related decline in consumers identifying fixed-line voice services as their most used communications service; and
- growth in the use of OTT communications services such as mobile VoIP.[23]

5.1.1.3 ACCC's final view

The ACCC has considered the arguments raised by Telstra in its submission, but remains of the view that the relevant markets in which to examine the continued declaration of the MTAS are:

- the markets for wholesale mobile voice termination services on each MNO's network;
- the downstream market for retail mobile services; and
- the downstream market for retail fixed voice services.

The ACCC does not accept the argument that the relevant downstream market is a single market for voice termination services. The reasons for this are outlined below.

Is there a single downstream retail market?

The ACCC does not consider mobile services are provided in the same market as fixed voice services. For the two services to be in a single retail voice services market they must be effective substitutes for each other. However, the ACCC considers that for most end-users, mobile

[22] Telstra Corporation Limited, *Response to the Commission's Domestic Mobile Terminating Access Service Declaration Inquiry – Report of the ACCC's Draft Decision (Public Version)*, pp. 6–7, (Telstra Submission).
[23] Telstra Submission, pp. 7–8.

services are mainly used as a complement to fixed voice services, rather than a substitute. There are a number of reasons for this.

Mobile only consumers are a small segment of the market

Substitution between fixed and mobile services tends to only occur in a segment of the market. As at June 2013, there were 3.68 million Australian consumers who had a mobile service but no fixed-line service.[24] While this is an increase of 18 per cent from June 2012, it represents only 21 per cent of the Australian adult population.[25] Most of these mobile only users are aged under 35, live in metropolitan areas and/or reside in low income areas.[26] In contrast, only around 3 per cent of people over 65 are mobile only users.[27] For most consumers, communications services are complementary, with consumers using multiple services and devices to meet their different communications needs.[28]

Differences between fixed and mobile service

As the ACCC found in the fixed line services declaration inquiry, some pricing features of fixed line services are unlikely to be replicated for mobile services, such as untimed local call features.[29] The ACCC also found that some end-users are hesitant to abandon their fixed line service, due to mobile service price premiums or perceived premiums.[30] There is also a perception that mobile networks are less reliable and offer patchy coverage, particularly in rural areas.[31] Therefore, for some end-users, fixed voice services remain distinct from mobile voice services.

VoIP and OTT services are not effective substitutes

Telstra also submitted that the availability of alternatives such as VoIP and OTT services means that it is no longer appropriate for the ACCC to attempt to define separate markets on the basis of the type of technology used to make a particular call. The ACCC does not agree with this view.

As discussed above, the ACCC accepts that the availability of VoIP and other OTT services is relevant to determining whether there are substitutes for fixed and mobile voice services. However, the ACCC does not consider that the availability of such services means that mobile

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[24] See Australian Communications and Media Authority (ACMA), *Communications Report 2012–13*, November 2013, p. 19.
[25] ibid.
[26] ibid.
[27] See ACMA, *Research Snapshot – Australians cut the cord*, 5 July 2013.
[28] The ACMA also notes the complementary use of communications services. See, ACMA, *Communications Report 2012-13*, p. 20.
[29] See, ACCC, *Public Inquiry into the fixed line services declarations – Final Report*, April 2014, pp. 15, 19–20 (FSR Final Report).
[30] ibid.
[31] ibid.

and fixed voice services are in the same market. The availability of these services does not affect the ACCC's assessment of whether mobile and fixed services are substitutes for each other, particularly considering it does not yet consider VoIP services are a substitute for either service.

FTM service market

Finally, Telstra argued that FTM services cannot be considered as a separate downstream market because they are provided as part of a basket of fixed voice services.[32] The ACCC agrees with this view, and has defined the relevant downstream market as the market for retail fixed voice services, and not the market for FTM calls.

5.1.2 State of competition in relevant markets

5.1.2.1 Summary of the draft decision

Wholesale voice termination markets

In the draft decision the ACCC found the wholesale voice termination markets are not competitive.

The ACCC considered that each MNO continues to have a monopoly over voice termination services on its network, and there are no substitutes for these services. As such, the ACCC considered that in the absence of regulating voice termination services, MNOs could exercise monopoly power by denying access or by imposing unreasonable terms of access, such as inefficiently high prices. Therefore it found that wholesale voice termination markets are not competitive.

Retail market for mobile services

In the draft decision the ACCC found the retail market for mobile services was in a state of transition.

The ACCC made a number of observations about competition in this market. It found that a number of developments suggest competition is improving:

- the number of mobile voice services in operation (SIOs) have grown;
- mobile call minutes have increased;
- there are a number of mobile service providers including mobile virtual network operators (MVNOs) providing retail services;
- retail prices for mobile calls have fallen considerably since the MTAS declaration in 2004; and

[32] Telstra Submission, p. 7.

- MNOs have invested heavily in improving the quality and coverage of their networks as well as acquiring radiofrequency spectrum.

However, the ACCC also noted that:

- retail price competition has become more subdued in recent years;
- the retail market for mobile services appear to be more concentrated today than in the previous declaration inquiry; and
- there has been some consolidation of MVNOs in recent years.

Retail market for fixed voice services

The ACCC noted that the total number of fixed line voice SIOs is declining but the number of providers offering services increased during 2011–12. However, the ACCC expressed the preliminary view that the retail market for fixed voice services remains highly concentrated, with Telstra the dominant player with a market share of 66 per cent at the time.[33]

5.1.2.2 Submissions to the draft decision

Telstra submitted that competition in the Australian mobile sector continues to thrive. Telstra argued that retail prices for mobile services have continued to fall, and that a slower decline in retail mobile services prices is inevitable in a maturing market. Telstra also submitted that mobile service providers are competing vigorously for market share, and are responding to changing consumer demand for data services rather than voice and SMS services.[34]

Vodafone Hutchison Australia (VHA) submitted that the level of competition in the downstream retail markets remain low and has deteriorated since the MTAS FAD inquiry in 2011.[35] VHA submitted that in the fixed voice services market, Telstra's market share has remained virtually unchanged since 2004, at over 65 per cent.[36] It contends that in order to compete against Telstra, smaller fixed network operators would need to merge. VHA also considered that despite the declaration of the MTAS, barriers to entry to the fixed voice services market are significant.

In the mobile services market, VHA considered that barriers to entry also remain significant and will likely increase as consumers and providers transition to mobile data services. VHA also

[33] Telstra's market share was 66 per cent as at June 2012. This was the most current data available to the ACCC at the time of the draft decision. See, ACCC, *Telecommunications competitive safeguards for 2012–13 and Changes in prices paid for telecommunications services in Australia 2012–13*, February 2014, p. 25 (ACCC Telecommunications Reports).
[34] Telstra Submission, p. 10.
[35] VHA, *Declaration of domestic mobile terminating access service – Submission to the Australian Competition and Consumer Commission (Public Version)*, 14 February 2014, p. 8 (VHA Submission).
[36] The ACCC has reported that the Telstra's retail fixed voice market share was 68 per cent at June 2011, 66 per cent at June 2012 and 63 per cent at June 2013. See, ACCC Telecommunications Reports, p. 25.

observed that reductions in the MTAS in past years have resulted in increased concentration, and distorted competition, in the mobile services market.[37]

VHA considered that the lack of competitiveness observed in the downstream retail markets is a result of the lack of pass-through of reductions in MTAS rates to retail FTM prices and the asymmetric impact of MTAS reductions on smaller MNOs.[38] These issues are discussed further in Chapter 6.

Other stakeholders did not specifically comment on this issue.

5.1.2.3 ACCC's final view

Wholesale voice termination markets

The ACCC remains of the view that wholesale voice termination markets are not competitive because each MNO has a monopoly in the wholesale market for voice termination services on its network.

Retail market for mobile services

The ACCC considers competition in the retail market for mobile services is in a state of transition as the focus of competition is shifting from traditional voice and SMS services to data services. As outlined in the draft decision, the ACCC considers that the mobile services market has exhibited signs of effective competition at times, while at other times competition has appeared to be more subdued.

The ACCC considers that the mobile services market is, and is likely to remain, relatively concentrated due to the limited number of MNOs and high barriers to entry. However, the ACCC also considers that the three MNOs have all reached significant scale and have acquired key infrastructure assets, brand name and customer bases such that each has the ability to exert competitive pressure on the others. While the ACCC considers that each has some flexibility to adjust retail offerings in order to maximise profit, the overall market dynamics tend to force each to respond competitively to competitors and consumers. A number of aspects of the mobile retail services market are considered below.

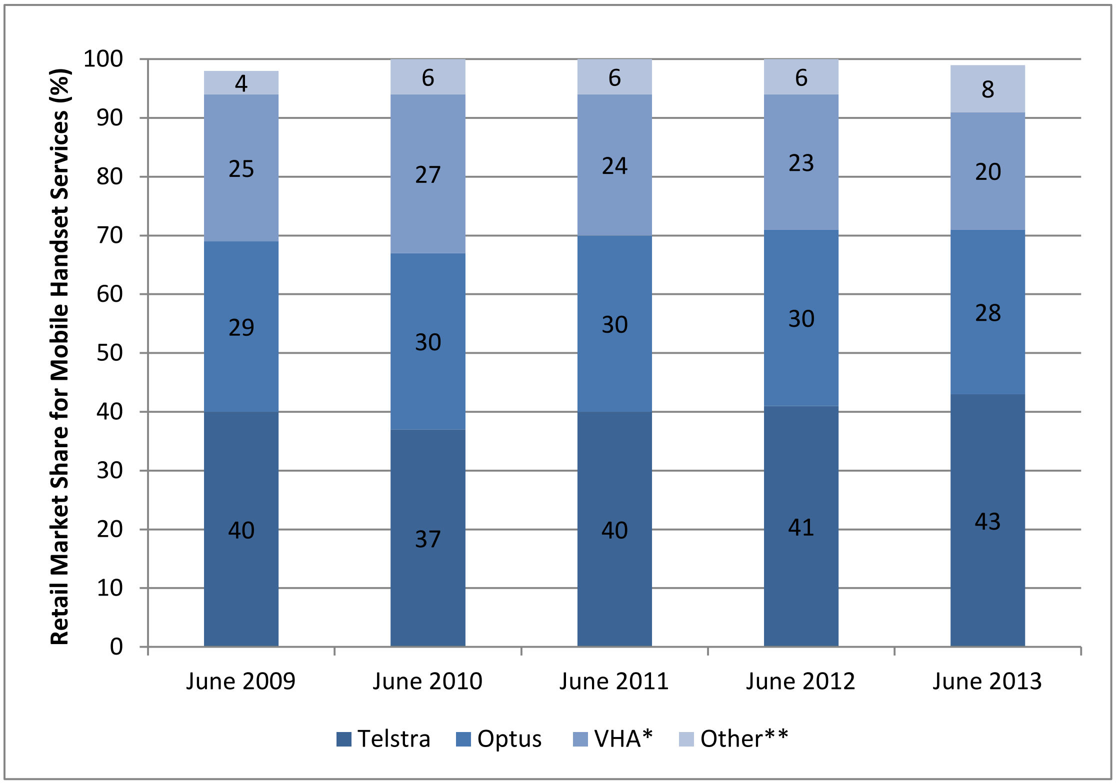
Market concentration

The retail market for mobile service is dominated by the three MNOs. The market shares of each MNO have changed slightly since the previous MTAS declaration inquiry in 2009. Telstra's market share has increased from 40 per cent in June 2009 to 43 per cent in June 2013. In the same time, Optus' market share has fallen slightly from 29 per cent to 28 per cent and VHA's

[37] VHA Submission, p. 8.
[38] ibid, p. 9.

has fallen from 25 per cent to 20 per cent. In the same period, the combined market share of MVNOs' increased from 4 per cent to 8 per cent. This is shown in Figure 5.1 below.

Figure 5.1: Retail market shares of mobile network providers from 2009 to 2013.



Source: ACCC Division 12 RKR and data from carriers.

* The market share figure for VHA for June 2009 is the combined market shares for Vodafone Australia and Hutchison Australia for that year.

**This category includes the market share of MVNOs.

Notes: Market share calculations are based on the number of subscribers. Totals do not add up to 100 in all years due to rounding.

Figure 5.1 shows that the largest MNO, Telstra, has increased its market share in the past five years, while the smaller MNOs' market shares have decreased. While the changes have been small, the ACCC considers this reflects a slight increase in concentration in the retail mobile services market. Although the market share of MVNOs has also increased throughout the period, their overall market position remains weak compared to the MNOs.

The ACCC considers that there are significant barriers to entering the mobile services market as an MNO. This is because the cost of investing in essential mobile infrastructure, such as base stations, and other assets, such as radio spectrum, can be prohibitively high.

The role of mobile virtual network operators

A service provider may enter the market as an MVNO, which resells services acquired from an MNO. However, an MVNO's ability to make retail offering is highly dependent on the terms of the wholesale agreement it has with an MNO. This means that the potential for an MVNO to expand and compete with MNOs is limited.

Typically, MVNOs target niche segments of the market, and offer innovative pricing structures and/or value-added services.[39] The ACCC considers that there is value for MNOs in wholesaling mobile services to MVNOs, as it allows them to utilise network capacity more efficiently and to earn additional revenue from segments of the market they might not otherwise reach. However, it is unlikely that an MNO will offer wholesale terms of access which will allow MVNOs to significantly erode the MNO's own market share. Because of this, although the barriers to entry as a MVNO may be low compared to entry as an MNO, the impact MVNOs can have on competition in the market is more limited.

There are around 50 MVNOs in Australia but they collectively account for only around 8 per cent of the retail mobile services market. The exit of a number of high profile MVNOs in recent years including ispONE, Kogan Mobile, and Savvytel demonstrates the instability in the MVNO market.

While the impact that MVNOs have had on competition in the mobile retail services market may be limited, the ACCC also considers that MVNOs play an important role in this market. The presence of MVNOs is beneficial to end-users, providing greater product differentiation, innovative pricing and better value plans.

Price competition

As observed in the draft decision, price competition in the retail mobile services market seems to have been less vigorous in recent years. In 2012–13, the average real price for retail mobile services fell by 1.2 per cent, only marginally higher than the decrease of 1 per cent in the previous year. These price movements are consistent with previous years and reflect a general plateauing of price reductions.[40] This compares to an average yearly decrease of 3.7 per cent in the five years prior to 2011–12.[41]

Price competition may be more subdued due to the mobile services market nearing saturation. The number of mobile SIOs in Australia as at June 2013 was around 31 million, making the mobile penetration rate in Australia around 135 per cent.[42] The growth in the number of mobile

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[39] ACCC Telecommunications Reports, p. 34.

[40] ibid, p. 35.

[41] ibid, p. 113.

[42] This calculation is based on a population of around 23 million as at June 2013. See, Australian Bureau of Statistics, *3101.0 Australian Demographics Statistics, Jun 2013*, December 2013, viewed 26 May 2014,

SIOs in 2012–13 is 3 per cent, the same as in 2011–12, but significantly less than the average of 12 per cent growth prior to this.[43]

Importance of data services

The ACCC notes that consumers are increasingly using mobiles handsets for data services. In 2012–13, the number of users accessing the internet on their mobile handset grew by 21 per cent. Further, between June 2013 and June 2014 the volume of data downloaded on mobile handsets rose by 97 per cent.[44]

The increasing demand for data over mobile handsets means that the quality of data services on a mobile network has become a focus of competition between mobile service providers. All three MNOs have continued to invest in their 3G networks and have launched 4G networks which offer better data rates and lower latency than 3G networks. In April 2013, Telstra and Optus also acquired radiofrequency spectrum in the 700MHz and 2.5GHz bands, which will likely be used to provide 4G services in metropolitan and regional areas.

Retail market for fixed voice services

As noted in the ACCC's fixed line services declaration final report, the market for fixed line voice services remains highly concentrated.[45] Telstra remains the dominant player in this market, with a market share of 63 per cent at June 2013, and benefits from its ability to exploit economies of scale and scope.[46] While market share is a significant measure of competition, the degree of competition within fixed line voice services also depends on how those services are supplied. As the operator of the only national customer access network, Telstra has benefitted from its vertical integration.[47]

Figure 5.2 shows the retail market shares of fixed voice service providers from 2009 to 2013.

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http://www.abs.gov.au/AUSSTATS/abs@.nsf/allprimarymainfeatures/61D19DFBD033B48FCA257CA7000DCB16?opendocument.

[43] ACMA, *Communications Report 2012–13*, November 2013, p. 80.

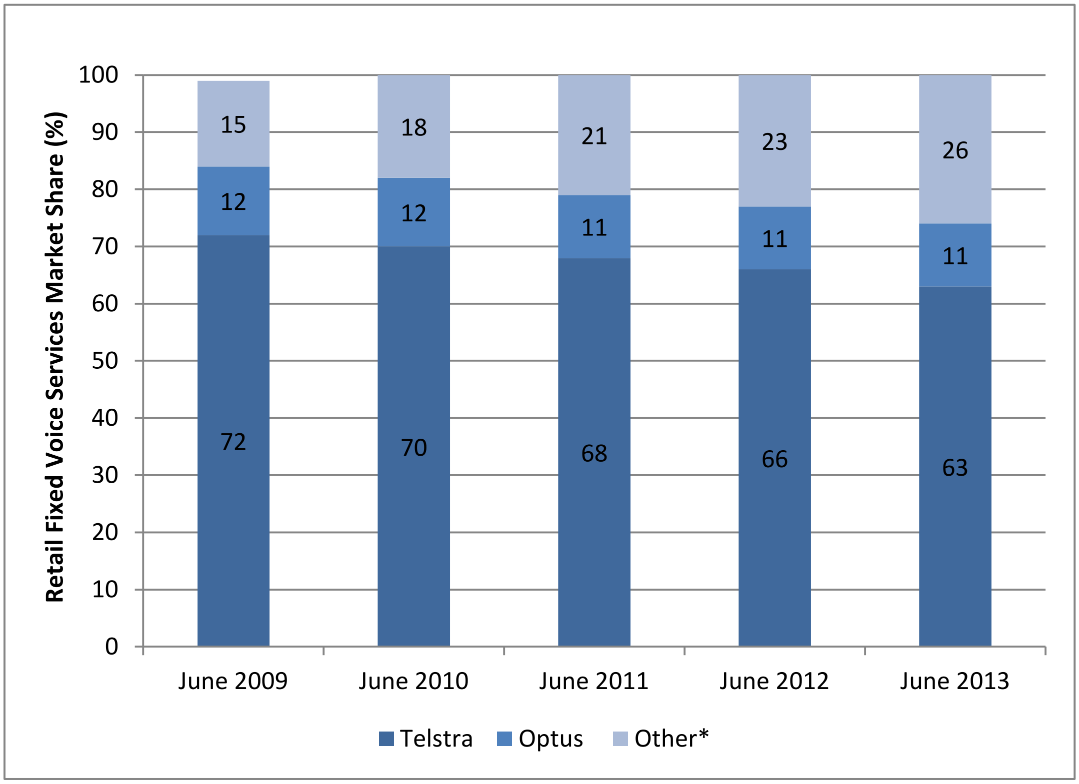
[44] ibid, p. 27.

[45] See, FSR Final Report, p. 18.

[46] ACCC Telecommunications Reports, p. 25.

[47] See FSR Final Report, p. 18.

Figure 5.2: Retail market shares of fixed voice service providers from 2009–13.



Source: ACCC Division 12 RKR, data from carriers and ACMA Communications Reports for 2010–11, 2011–12 and 2012–13.

Note: Market share calculations are based on subscriber numbers.

* The 'Other' category includes the market shares of AAPT, iiNet, Macquarie Telecom, Primus, TPG and Verizon among others.

Average real prices for fixed voice services continue to decline, with a reduction of 4.9 per cent in 2011–12, and 3.2 per cent in 2012–13.[48] Real prices for FTM calls decreased by 11.7 per cent during 2012–13, and consistent with previous years, it is the greatest contributor to average real price reductions for fixed voice services.[49]

The ACCC considers that there is some competition in the fixed voice service market, which has seen a gradual reduction in the prices for fixed voice services. However, the structure of the market is still highly concentrated with Telstra the dominant provider.

[48] The call components of fixed line services have fallen every year for the past decade. See ACCC Telecommunications Reports, pp. 99–101.
[49] ibid.

5.1.3 Effect of declaration on competition

5.1.3.1 Summary of the draft decision

In the draft decision, the ACCC considered that the continued declaration of mobile voice termination services would promote competition in the downstream retail markets for fixed voice services and mobile services.

The ACCC considered that declaration of mobile voice termination services would not impact the structure of the wholesale markets for voice termination services. However, it found that it would continue to ensure access to mobile termination services on each MNO's network on reasonable terms.

The ACCC considered that extending declaration, combined with regulated pricing, would ensure that the price of mobile voice termination services are kept close to the cost of providing those services. This would promote competition in both the mobile and fixed voice services markets as the ACCC expected that savings in mobile termination rates will be passed onto consumers in the form of lower retail prices or service innovations in these markets.

In relation to the fixed services market, the ACCC found declaration of mobile voice termination services would also reduce any advantage a fixed network operator who is also an MNO (i.e. a horizontally integrated operator) would have over a non-integrated fixed network operator. It would also prevent MNOs from charging inefficiently high termination charges to fixed network operators.

5.1.3.2 Submissions to the draft decision

Submissions generally agreed that extending the declaration of mobile voice termination services would promote competition in the relevant downstream retail markets.

While not specifically commenting on the effect of declaration on the promotion of competition, Telstra supported the draft decision to continue declaration of mobile voice services. Telstra noted that the mobile voice termination services are a bottleneck and this is unlikely to change.[50]

Optus submitted that since the declaration of the MTAS in 2009, the level of competition in the relevant downstream markets has not improved sufficiently to prevent exploitation of MNOs' monopoly power in the wholesale mobile voice termination markets.[51] Specifically, Optus considered that the level of competition in the retail mobile services market has reduced since 2009 with Telstra extending its market power. Optus argued that Telstra's improved market position is likely to continue. Optus also considered that the fixed services market has not

[50] Telstra Submission, p. 6.

[51] Optus, *Submission in response to ACCC Draft Decision Report – Domestic Mobile Terminating Access Service (MTAS) Declaration Inquiry (public version)*, February 2014, p. 5 (Optus Submission).

sufficiently changed to warrant the ACCC altering the views it reached in the 2009 declaration inquiry on the level of competition and the benefits of MTAS declaration in this market.[52]

Macquarie Telecom agreed that declaration of mobile voice termination services would promote competition in the relevant downstream markets as it will ensure that charges for voice termination services will approach their cost. However, they cautioned that competition on the basis of equivalent cost structures is only possible if MNOs actually pass the regulated MTAS prices through to MVNOs. Macquarie Telecom noted that in its experience, such pass-through is neither immediate nor in full.[53]

AAPT and the Australian Communications Consumer Action Network (ACCAN) did not specifically comment on this issue, but both agreed with the ACCC's draft decision that mobile voice termination services should continue to be declared.[54]

VHA considered that, in theory, declaration of mobile voice termination services will promote competition. However VHA argued that declaration, in the absence of a FTM pass-through mechanism and economically sound pricing policies, will distort competition in the relevant market.[55] These submissions are discussed in the Chapter 6.

5.1.3.3 ACCC's final view

Wholesale markets for voice termination

Each MNO continues to have a monopoly over terminating voice calls on their networks. The declaration of mobile voice termination services will not change this structural characteristic. In the absence of an effective substitute for the voice termination service, MNOs will continue to have a monopoly over the service.

However, consistent with the draft decision, the ACCC considers that because mobile voice termination services are an important input to the supply of fixed and mobile retail voice services, declaration of mobile voice termination services will promote competition in the downstream markets for retail services. The reasons for this are discussed further in the following sections.

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[52] Optus Submission, p. 6.

[53] Macquarie Telecom, *Submission to the Review of the Declaration of the Domestic Mobile Terminating Access Service*, 14 February 2014, p. 2 (Macquarie Telecom Submission).

[54] Australian Communications Consumer Action Network, *Submission to the Domestic Mobile Terminating Access Service Declaration Inquiry*, 14 February 2014, p. 1 (ACCAN Submission); AAPT Limited, *Domestic Mobile Terminating Access Service (MTAS) Declaration Inquiry Report of the ACCC's Draft Decision – Submission by AAPT Limited*, February 2014, p. 1 (AAPT Submission).

[55] VHA Submission, pp. 5–7.

Downstream retail markets

Consistent with the draft decision the ACCC considers extending declaration of mobile voice termination services will continue to promote competition in the retail markets for fixed voice services and mobile services.

Voice termination services are an essential input to the provision of MTM and FTM calls in the relevant retail markets. In the absence of regulation, MNOs have the ability, and may have an incentive to exercise their market power in the wholesale markets for voice termination service to deny the provision of this input on reasonable terms, or to set the price of access at inefficiently high levels.

Extending the declaration of mobile voice termination services, when coupled with regulated prices in the MTAS FAD, will ensure that prices for the services are more closely aligned to the costs of providing the services. This will promote competition in the relevant retail markets in the following ways.

First, in the absence of declaration, inefficiently high termination charges will create a higher retail price floor and may lead to on-net/off-net price discrimination at the retail level.[56] This is likely to disadvantage smaller MNOs, or potential new entrants, as such networks will be less attractive to consumers. This is because on a small network an end-user will have to make more off-net calls than they would on a large network. By setting mobile voice termination charges closer to cost in an MTAS FAD, such price discrimination is less likely to occur. This ensures that smaller MNOs will be able to lower their retail prices (for both on and off-net services) and compete more effectively with larger MNOs.

Secondly, in the retail market for fixed voice services, the regulation of mobile termination service will reduce the competitive advantage that a horizontally integrated operator has over its non-integrated competitors. This is because a non-integrated fixed network operator has to pay termination charges for all FTM calls while a horizontally integrated fixed network operator only needs to pay termination charges for FTM calls that terminate on mobile networks other than its own. This advantage is particularly pronounced in Australia because one integrated operator, Telstra, is a large MNO, meaning a significant proportion of FTM calls terminate on its network.

Thirdly, in both the fixed and mobile retail service markets, declaration of mobile voice termination services will provide operators with greater flexibility in making retail offers, which encourages competition. When an operator lowers its retail prices or offers greater inclusions in

[56] That is, as mobile voice termination rate represents a cost to an MNO in providing off-net mobile calls, the higher the termination rate is, the higher the retail price of off-net mobile calls is likely to be as the MNO will seek to recoup its cost of providing the service. Very high termination rate can therefore result in significant differences in the prices of on-net and off-net mobile calls.

retail plans, its subscribers are likely to make more voice calls.[57] This increases termination payments by the operator to other MNOs, and adversely affects the operator's interconnection balance.[58]

Therefore, high termination charges can lead to significant costs to an operator if it makes retail offers that encourage its subscribers to make more calls to mobiles. This restrains the operator from making such competitive offers. As a result, because continued declaration of mobile voice termination services will encourage cost based pricing of such services, it will enable operators to compete on price more freely than they would be able to in the absence of declaration. This includes competing on included value plans and call rates, as well as encouraging innovative pricing structures.

The ACCC also considers that as mobile voice termination rates are likely to form part of the charges that MVNOs pay to MNOs for wholesale mobile services, declaration coupled with regulated pricing is likely to encourage MNOs to set wholesale charges that are more closely aligned with voice termination costs. The ACCC considers this will allow MVNOs to more effectively compete in the retail market for mobile services.

The ACCC notes that since mobile voice termination service was first declared in 1997, there have been significant reductions in retail prices for both fixed and mobile voice services. Retail prices for mobile services have declined by around 51.7 per cent and prices for FTM calls have declined by around 67.4 per cent.[59] The ACCC considers that the regulation of mobile voice termination service has contributed to this decline in retail prices over the years.

For these reasons, the ACCC considers that declaration of mobile voice termination services will continue to promote competition in the downstream markets, and that this will ultimately benefit end-users in the form of lower prices, better quality services and greater innovation.

5.2 Any-to-any connectivity

5.2.1 Summary of the draft decision

In the draft decision, the ACCC considered that while interconnection between MNOs may occur in the absence of declaration, MNOs could potentially set unreasonable terms of, or high prices for, access to mobile voice termination services, so as to prevent the achievement of any-to-any connectivity. In this respect, smaller operators may be particularly vulnerable as they are likely to have less bargaining power. Therefore the ACCC was of the preliminary view that the continued declaration of the MTAS will promote the achievement of any-to-any connectivity.

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[57] Moreover, it is also likely that lower retail prices or higher included values will attract mobile subscribers who are heavy user of mobile services.

[58] That is, the net termination payments that an operator makes.

[59] These figures represent the fall in the average real prices for these services. See ACCC Telecommunications Reports, p. 98.

5.2.2 Submissions to the draft decision

Submissions on this issue all agreed that the declaration of mobile voice termination services will promote the achievement of any-to-any connectivity.

However, VHA noted, that given the extent of actual interconnection between MNOs, the impact of declaration on any-to-any connectivity is likely to be minimal.[60]

5.2.3 ACCC's final view

Consistent with its view expressed in the draft decision, the ACCC considers that in light of MNOs' ability to deny interconnection or set unreasonable terms for providing termination services, the continued declaration of mobile voice termination services is likely to promote the achievement of any-to-any connectivity.

5.3 Efficient investment in, and use of, infrastructure

5.3.1 Summary of the draft decision

In the draft decision the ACCC found declaration of mobile voice termination services is likely to encourage the efficient investment in, and use of, infrastructure. In reaching this view, the ACCC considered that:

- it is technically feasible to supply and charge for the provision of mobile voice termination services;
- the legitimate commercial interests of the supplier of mobile voice termination services could be met by setting price terms in an FAD at a level that reflects the costs of providing the service plus a normal rate of return; and
- declaration and regulated pricing of mobile voice termination services which allows the MNOs to recover the efficient costs of providing the service and a normal rate of return, will provide MNOs with incentives to invest efficiently and discourage inefficient investment.

5.3.2 Submissions to the draft decision

Submissions on this issue generally agreed that the declaration will encourage the economically efficient investment in, and use of, infrastructure.

However, VHA submitted that while the declaration is required to encourage efficient use of, and investment in, infrastructure, it is doubtful declaration of the MTAS has done so in the relevant

[60] VHA Submission, p. 9.

markets to date due to a lack of pass-through of reductions in the MTAS rates to FTM prices. This is dealt with in Chapter 6.

5.3.3 ACCC's final view

The ACCC remains of the view that extending declaration of mobile voice termination services is likely to promote the economically efficient investment in, and use of, infrastructure by which mobile and fixed voice services are provided. This is because declaration will allow the ACCC to set regulated prices for the service in the MTAS FAD, which will result in prices for the service being more closely aligned with the costs of providing the service than they would be in the absence of declaration. Prices that reflect the efficient cost of providing mobile voice termination services are likely to encourage productive efficiency, allocative efficiency and dynamic efficiency.

The ACCC considers that declaration of mobile voice termination services will promote allocative efficiency. Declaration allows the ACCC to set regulated prices for mobile voice termination services that are more closely aligned with the costs of providing the service. This is likely to promote allocative efficiency in the provision of mobile voice termination services. By doing so, it encourages MNOs to set retail prices that are more aligned with the costs of providing retail fixed and mobile voice services, which in turn encourages consumers to use the infrastructure required in a more economically efficient manner.

Productive efficiency is achieved where individual firms produce the goods and services that they offer to consumers at least cost.[61] Declaration of mobile voice services may promote productive efficiency and eliminate inefficient investment incentives, as it will lead to cost based pricing, so that MNOs only recover the efficient cost of providing the service.

Dynamic efficiency reflects the need for industries to make timely changes to technology and products in response to changes in consumer tastes and in productive opportunities.[62] The ACCC considers that the declaration of mobile voice termination services may promote dynamic efficiency in two ways.

First, declaration is likely to encourage dynamic efficiency through its effect on competition in the relevant retail markets. As competition is promoted in these markets, MNOs and fixed network operators are more likely to promptly respond to changing consumer tastes and make investment in new technology and infrastructure to accommodate these changes. The ACCC notes that there has been significant investment by all three MNOs in their mobile networks in recent years, including in the upgrade of 3G networks and the rollout of 4G networks. The ACCC considers that this has been spurred by competition and surging consumer demand for better network quality and mobile data services.

[61] Declaration Guide, p. 55.
[62] ibid.

Secondly, declaration makes it possible for the ACCC to set regulated prices for voice termination services in a way that encourages dynamic efficiency. That is, prices for the regulated service could be determined on a forward-looking basis, based on the best-in-use technologies, to create incentives to invest in these technologies. This is a pricing issue which will be considered in the upcoming FAD inquiry.

The ACCC notes VHA's arguments that the declaration of the MTAS has not promoted the economically efficient use of, and investment in, infrastructure in practice. The ACCC considers that these arguments relate more directly to the extent of MTAS price reductions, its effect on individual MNOs and the waterbed effect, which are issues that are more appropriately considered in the context of the FAD inquiry.[63] The ACCC does not consider that these issues detract from the fundamental principles that underlie the ACCC's views on the effect of declaration on the efficient use of, and investment in, infrastructure.

5.4 Conclusion

For the reasons set out in this section, the ACCC has reached its final view that the continued declaration of mobile voice termination services will promote the LTIE as it is likely to:

- promote competition in the relevant retail markets;
- promote the achievement of any-to-any connectivity; and
- encourage the economically efficient investment in, and use of, infrastructure.

[63] In this context, the waterbed effect refers to the relationship between the MTAS rate and retail mobile prices. The claim is that if the waterbed effect exists, a reduction in the MTAS rate will lead to an increase in retail mobile prices. This is because MNOs will seek to recoup the lost revenue resulting from the reduction in MTAS rate from its downstream subscribers through an increase in retail mobile prices. This is analogous to pushing down a waterbed in one place and causing it to rise in another place.

6 Fixed to mobile pass-through issues

The ACCC has considered whether reductions in MTAS prices were being passed through to end-users of FTM services (FTM pass-through) in the 2011 MTAS FAD inquiry, and in previous pricing principles determinations. In the draft decision, the ACCC indicated that all pricing issues, including whether a FTM pass-through mechanism is required, will be considered in the upcoming MTAS FAD inquiry.[64]

6.1 VHA's Submission to the Draft Decision

In response to the draft decision, VHA submitted that the ACCC must consider the issue of FTM pass-through as part of the declaration process. In summary, VHA submitted that:

- FTM pass-through is not merely a pricing issue, as declaration will not promote the LTIE unless the ACCC ensures that MTAS reductions are passed through to FTM end-users;
- reductions in the MTAS rate over the past decade have not been comprehensively passed through to end-users of FTM service, but have increased monopoly rents for fixed network operators, particularly Telstra;
- Telstra's FTM margins have increased from 37 per cent at the end of 2004 to 64 per cent in the third quarter of 2013, and this has contributed to Telstra accruing $1.4 billion in unrealised consumer benefits from the lack of pass-through; and
- due to the lack of FTM pass-through, reductions in the MTAS rate in the past have not promoted competition or encouraged efficient use of, and investment in, infrastructure.[65]

VHA also argued that the ACCC should adequately recognise and appreciate the observed negative impact of the lack of FTM pass-through in the declaration final decision and address these issues in the subsequent FAD inquiry.[66]

6.2 ACCC's final view on fixed to mobile pass-through issues

The ACCC acknowledges that the pass-through of MTAS price reductions to end-users is an important consideration in assessing whether the declaration will promote the LTIE, particularly in determining whether the declaration will promote competition in the relevant markets.

As discussed in Chapter 5, declaration of the mobile voice termination, combined with regulated pricing, will reduce the retail price floor for MTM and FTM calls in the downstream market, which would enable MNOs to compete more freely on prices. The pass-through of voice termination price reductions in the form of lower retail prices for these downstream services is one of the means by which the declaration promotes competition in the relevant retail markets. In

[64] ACCC, *Domestic Mobile Terminating Access Service Declaration Inquiry – Report of the ACCC's Draft Decision*, 13 December 2013, p. 8 (Draft Decision Report).

this respect, the ACCC notes the function of declaration is to assist in establishing conditions by which competition can be improved.[67]

The ACCC considers that there are indications that the reductions in the MTAS rate have been passed through to benefit end-users in the form of lower FTM call rates. The ACCC has examined the movements in Telstra's average FTM call rates and compared them with the reductions in MTAS rates from 2005–06 to 2012–13.[68] These are shown in table 6.1.

Table 6.1: Comparison of average FTM prices and MTAS rates from 2005–06 to 2012–13

	2005–06	2006–07	2007–08	2008–09	2009–10	2010–11	2011–12	2012–13	Total
Change in MTAS rate (cents/minute)	-3.00	-3.00	-4.50	0.00	0.00	0.00	-1.50	-2.10	**-14.10**
Change in average FTM call price (cents/minute)	-2.00	-0.93	0.51	4.46	-4.00	-2.66	-0.96	-6.20	**-11.77**

Source: ACCC, *Imputation testing and non-price terms and conditions reports,* from September quarter 2004 to June quarter 2013.

As table 6.1 shows, there have been consistent reductions in Telstra's FTM call rate apart from in the years 2007–08 and 2008–09. The reductions in average FTM call rate have been, in most years and in total, lower than the reductions in MTAS rates over the period.

However, the ACCC notes Telstra only incurs voice termination charges for off-net FTM calls (i.e. calls from Telstra's fixed line network to a non-Telstra mobile network). Taking this into account, the ACCC has also compared the total savings for Telstra from reductions in MTAS rates and changes in FTM call revenues over the same period.[69]

[65] VHA Submission, pp. 5–10.
[66] VHA Submission, p. 13.
[67] Declaration Guide, p. 48.
[68] These calculations have used 2004–05 as the base year.
[69] For the purpose of this analysis, the ACCC used the combined market share of non-Telstra MNOs as a rough estimate of the proportion of total FTM minutes that were off-net in each year.

Table 6.2: Comparison of changes in FTM revenues and savings in MTAS payments from 2005–06 to 2012–13

	2005–06	2006–07	2007–08	2008–09	2009–10	2010–11	2011–12	2012–13	Total
Estimated savings in MTAS payments ($million)	-54.79	-54.87	-85.83	0.00	0.00	0.00	-16.69	-25.40	**-237.58**
Changes in FTM call revenue ($million)	-64.23	-30.35	16.94	110.44	-118.19	-75.11	-19.75	-146.97	**-327.23**

Source: ACCC, *Imputation testing and non-price terms and conditions reports*, from September quarter 2004 to June quarter 2013.

Notes: The estimated savings in MTAS payments are calculated by multiplying the changes in MTAS rate by estimated off-net FTM minutes. The off-net FTM minutes are estimated figures based on the assumption that the proportion of FTM minutes going to each MNO is proportional to their respective market shares. Changes in FTM call revenue are calculated by multiplying the changes in average FTM call price by the total FTM minutes for the relevant years.

This comparison shows that from 2005–06 to 2012–13, the accumulated reductions in FTM call revenue is larger than the accumulated reductions in the MTAS rate.

However, the ACCC is aware that no definitive conclusions can be drawn from this preliminary analysis. The ACCC understands that there may be other factors, such as changes in the costs of other inputs in providing FTM services, which may have affected retail FTM prices.

On the other hand, the ACCC also considers that Telstra may have passed through the reductions in the MTAS rate in other ways. As FTM services are purchased in a bundle with other fixed voice services, the reductions in the MTAS rate could be reflected in the prices of other elements of these bundles. In this respect, the ACCC agreed with the view of the Australian Competition Tribunal in the 2011 MTAS FAD inquiry that access seekers should have the flexibility to determine the form in which any cost reductions may be passed through to the retail fixed services market.[70]

Overall, the ACCC considers that declaration of mobile voice termination services has promoted competition in the fixed voice services market and this is consistent with the reductions in average FTM call prices over the past eight years. The ACCC is of the view that the continued

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[70] ACCC, *Inquiry to make a final access determination for the Domestic Mobile Terminating Access Service (MTAS): Access Determination Explanatory Statement*, 7 December 2011, p. 35; See also *Vodafone Network Pty Limited & Vodafone Australia Limited* [2007] ACompT 1 (11 January 2007), [289]–[290].

declaration of the MTAS will continue to have a positive impact on the fixed voice services market.

As indicated in the draft decision, the ACCC will consider issues relating to FTM pass-through more fully in the upcoming MTAS FAD inquiry.

7 Should SMS termination services be declared?

The second major issue considered during the MTAS declaration inquiry is whether SMS termination services should be declared. Currently, the MTAS service description only covers termination of voice services and does not apply to SMS termination services.

Consistent with the draft decision, the ACCC has concluded that declaration of SMS termination services for mobile-to-mobile (MTM) SMS is in the LTIE.

In response to the draft decision the ACCC received submissions that the proposed MTAS service description should be changed so that A2P SMS services are excluded from a declared SMS termination service. The ACCC also received a submission supporting the inclusion of A2P SMS. The ACCC sought further submissions on this issue and conducted targeted market inquiries to gather information about A2P SMS markets. Based on this information, the ACCC formed a preliminary view about whether these services should be included in declaration.

The ACCC notified key stakeholders of its preliminary views on the declaration of A2P SMS termination to provide stakeholders with an opportunity to provide further comments and information. The ACCC has carefully considered responses to its preliminary view as well as other submissions and information obtained during market inquiries. Based on this information, the ACCC has concluded that termination of A2P SMS services should be declared as it is in the LTIE.

Therefore, the ACCC has decided to vary the MTAS service description to cover SMS termination services, for both MTM and A2P SMS termination services. The amended service description is at Appendix A.

In reaching this final view, the ACCC has had regard to the extent to which declaration of SMS termination services is likely to result in the achievement of the objectives set out in Chapter 4.[71]

The following discussion outlines the ACCC's views on the likely effect the declaration of SMS termination services for both MTM and A2P SMS will have on each of these objectives.

7.1 Promotion of competition

The ACCC has taken the same approach to determining whether declaration of SMS termination services will promote competition in the relevant markets is outlined in Chapter 5 for mobile voice termination services. That is, the ACCC has identified the markets in which the eligible services are provided and the markets in which competition may be promoted, the state of competition in those markets, and the effect that declaration may have on competition in those markets.

[71] As required under s 152AB(2) of the CCA.

7.1.1 The relevant markets

7.1.1.1 Summary of the draft decision

In the draft decision, the ACCC found the markets relevant to the declaration of SMS termination services were:

- the markets for SMS termination services on each MNO's mobile network (the wholesale market in which SMS termination services are supplied); and
- the market for retail mobile services (the downstream market in which declaration may promote competition).[72]

The relevant wholesale market

In the draft decision the ACCC found that SMS termination services are sold to MNOs separately from other services. It also concluded that these services are essential to deliver an SMS to another mobile network, and that there are no effective substitutes for SMS termination services. The ACCC therefore found that, similarly to mobile voice termination services, there is a separate market for SMS termination services on each MNO's network.

The relevant downstream retail market

In defining the relevant downstream market in which competition may be promoted, the ACCC found that the market in which retail SMS services are supplied is the same market in which other mobile services, like mobile voice and data services, are supplied. As SMS termination services are necessary to supply retail SMS services, the ACCC considered that this was the relevant downstream market which would be affected by declaration.

In considering the relevant downstream market, the ACCC found that OTT messaging applications are not an effective substitute for SMS services. This was because these messaging applications require a smartphone, which only a portion of Australians used, and a data connection.[73] Further, there are many different OTT messaging applications available to consumers, but for end-users to communicate, they must have the same application. In contrast, SMS services can be sent between any two mobile users, without the need for a smartphone, the same application or data connection.

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[72] Draft Decision Report, pp. 31–32.

[73] At the time of the Draft Decision Report, the most current data showed that, around 49 per cent of Australians used a smartphone. See, ACMA, *Communications Report 2011–12: Report 3 – Smartphone and tablet take up and use in Australia Summary Report,* November 2012.

7.1.1.2 Submissions to the draft decision

The relevant wholesale markets

Parties generally agreed with the ACCC's definition of the relevant wholesale markets. Optus agreed that there are separate markets for SMS termination on individual MNO's networks, for the same reasons that there are separate markets for the termination of voice calls on individual MNO's networks. Optus states that for SMS, 'the sending party's network *must* use the SMS termination service of the receiving party's network in order to successfully send an SMS to the receiving party' and that there are no supply side alternatives, including data based-OTT services.[74] It considers that this view is supported by the lack of price movement in the wholesale SMS termination market despite the increased availability of OTT services.[75]

Similarly, Macquarie Telecom agreed with the ACCC's construction of the relevant wholesale market.[76] Telstra also acknowledges that there are 'no alternative substitute inputs in the wholesale SMS market'.[77] Further, AAPT and iiNet also supported such a construction of the SMS termination market in their submission to the MTAS discussion paper.[78]

Relevant downstream retail market

Parties differed in their views on the definitions of the relevant downstream market. Macquarie Telecom agreed with the ACCC's draft decision that the relevant downstream market is the retail market for mobile services.[79] Optus 'largely agreed' with the ACCC's draft decision and submitted that the provision of wholesale SMS termination services impact competition in the 'related downstream retail market for the provision of SMS services.'[80] However, it submits that the ACCC's identification of retail bundled mobile products is not as accurate as it could be.[81]

Optus acknowledged that SMS services are sold within a bundle of mobile services, but submitted that there are two bundled products, a voice/SMS bundle, and a voice/data/SMS bundle, and not a single bundled product as set out in the draft decision. It argues that this is necessary as not all retail mobile subscribers have an active data subscription or a smartphone to use a data connection.[82]

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[74] Optus Submission, p. 8.
[75] Optus Submission, p. 8.
[76] Macquarie Telecom Submission, p. 3.
[77] Telstra Submission, p. 19.
[78] AAPT Submission, p. 5, iiNet Submission p. 1.
[79] Macquarie Telecom Submission, p. 3.
[80] Optus Submission, p. 9.
[81] Optus Submission, p. 9. .
[82] See Optus Submission, pp. 9–11.

Telstra and VHA did not agree with the ACCC's position in the draft decision that there are no effective substitutes for SMS services, with both submitting that OTT messaging applications are an effective substitute. Telstra submitted that smartphone penetration has increased from 49 per cent in May 2012, and is likely to reach **[c-i-c]** per cent by 2016.[83] Similarly, VHA noted that smartphone penetration is now above 49 per cent, and predicted that smartphone penetration will be over 70 per cent at June 2014.[84] Both parties argued that this means the majority of mobile phone users have the ability to use smartphone messaging applications.

In addition, Telstra considered that a number of other factors mean OTT message services are an effective substitute for SMS. It argued that widespread unlimited SMS offers are evidence of strong competition between such OTT services and SMS. It also suggested that the OTT messaging market is continuing to develop, and that there are now some applications that enable a user to sync multiple accounts and send messages across many different applications. Further, it noted that a number of regulators in other jurisdictions have recognised that OTT messaging applications are a substitute for SMS.[85]

Optus and Macquarie Telecom both made submissions to the discussion paper that OTT messaging applications are not fully effective substitutes for SMS termination services.[86] Optus argued that such applications cannot be considered an effective substitute as they do not allow an end-user to by-pass SMS termination services to deliver messages to all phones.[87] It also argued that even if SMS and OTT messaging applications were in the same market, declaration would still promote competition in the supply of messaging based services as it would enable MNOs to compete against data based OTT providers. [88]

ACCAN submitted that there are segments of the population who are less likely to use a smartphone and have access to OTT services for messaging.[89] It submitted that 53 per cent of consumers earning less than $60,000 a year have a smartphone, compared to 76–78 per cent of those earning over $60,000. Further it noted that smartphone use is far lower in consumers aged over 55 (39 per cent), than it is for those aged between 18 and 34 (85 per cent).

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[83] Telstra Submission, p. 4.
[84] VHA Submission, p. 11.
[85] Telstra Submission pp. 20–21.
[86] Macquarie Telecom made submissions to the discussion paper that data based messaging services are only a partial substitute for SMS. See, Macquarie Telecom, *Submission to the Review of Declaration of the Domestic Mobile Terminating Access Service*, 5 July 2013, pp. 9–10 (Macquarie Telecom Discussion Paper Submission).
[87] Optus Submission, p. 4.
[88] Optus Submission, pp. 4, 10.
[89] ACCAN Submission, p. 2.

7.1.1.3 ACCC’s final view

Wholesale markets for termination services

The ACCC remains of the view that the relevant markets in which SMS termination services are supplied are the separate wholesale markets for SMS termination services on each MNO’s network. This is because, from the information provided during the inquiry, the ACCC understands that:

- SMS termination services are sold to MNOs separately from other mobile services and not in a bundle with other mobile services;
- SMS termination services are required for an MNO to provide SMS, and each MNO has a monopoly over such services; and
- there are no alternative services which would allow an MNO to send an SMS to a user on another MNO’s network.

The ACCC considers that the wholesale markets for SMS termination services on each MNO’s network are the relevant wholesale markets for both the termination of MTM and A2P SMS. This is because, as the ACCC understands, MNOs do not distinguish between the types of SMS when offering a wholesale SMS termination service.

The relevant downstream markets

The ACCC considers that the following markets are the downstream markets which are relevant to declaring an SMS termination service:

- the mobile retail services market;
- the wholesale A2P SMS services market; and
- the downstream A2P services markets.

Mobile retail services market

Termination of SMS services are an essential input into the mobile retail services market. This is because, SMS termination services are required in order to supply a service which allows a mobile subscriber to send an SMS to an end-user connected to another network.

Consistent with the draft decision, the ACCC considers that the market within which retail SMS are provided is the same market in which other mobile services, including voice and data services, are provided. This is because these services are generally sold as part of a single bundle of complementary mobile services. As SMS termination services are necessary to provide retail SMS services, the ACCC considers that a relevant downstream market which will be affected by declaration is the market for retail mobile services.

The ACCC does not consider there are two separate bundled markets as suggested by Optus. This is because although there are mobile service bundles which offer only SMS and voice services, these bundles still compete with bundles that also include data services.

The price of mobile bundles which include data are often comparable to mobile bundles which do not, and in many cases bundles including data can be better value than those that do not. [90] This means that users who do not wish to use a data service may still choose a bundle that includes a data service as they are often better value. Further, there are very few mobile plans on offer under which no data service is available. Therefore, the ACCC does not consider the two different types of bundles are in different markets.

Further, the ACCC does not consider that at this point in time, there are any effective substitutes for SMS services. The ACCC acknowledges that OTT messaging applications are functionally similar to SMS services, as they allow mobile users to communicate by sending instant short text messages. However, the ACCC has found that there are particular characteristics of OTT services which mean they are currently not effective substitutes.

First, OTT messaging applications require a smartphone and connection to a data service. In contrast, SMS messages can be sent and received using any mobile phone and do not require a data service. The ACCC acknowledges that smartphone use has increased between 2011–12 and 2012–13, from 49 to 64 per cent of Australians 18 years and over.[91] However, there are still a significant number of consumers who do not have smartphones, with around 30 per cent of mobile subscribers not using such devices.[92] This means that about 30 per cent of mobile users will not be able to use OTT messaging applications, and will rely on SMS to send and receive text messages. It also means that smartphone users will still rely upon SMS services to communicate with a significant number of mobile users not using a smartphone.

Secondly, the ACCC still considers that it is significant that both the sender and receiver of OTT text messages must use the same application in order to send messages to each other. As there are many different OTT messaging applications, some of which can only be used on specific smartphones, not all users with smartphones will be able to contact each other using these services. While some new applications may have been developed that allow consumers to send messages between these applications, there is limited evidence that they are widely used. In contrast, SMS services can be sent between any two users of a mobile phone.

In addition, data from the ACMA indicates that in the six months to May 2013 only 35 per cent

[90] For example, Virgin Mobile offers a $19 long expiry plan, which offers no data allowance and $15 dollars of credit and unlimited SMS to be used in 6 months. It also offers a $19 per month cap plan, which offers $100 of call credit, 250MB of data and unlimited SMS, to be used in 28 days.

[91] This represents an increase of 8.67 million people to 11.19 million people. See ACMA, *Communications Report 2012-13*, p. 8.

[92] The ACMA reports that 94 per cent of people 18 years and over use a mobile phone. ACMA, *Communications report 2012-13*, p. 25.

of Australians used ‘instant messaging’ applications while 84 per cent used texting from a mobile phone.[93] This suggests that of the 64 per cent of Australians using a smartphone, a large proportion are not yet using OTT messaging service and are still using SMS.

Therefore, the ACCC considers that OTT messaging services are not yet an effective substitute for SMS services because SMS services can be sent between any two mobile users but:

- OTT messages can only be used by consumers with a smartphone and connection to a data service; and
- OTT messaging requires both users to have the same application.

Wholesale application to person SMS market

The ACCC also considers that declaration of SMS termination services will impact the wholesale A2P SMS market. This is because SMS termination services are essential for MNOs to provide wholesale A2P SMS services.

The wholesale A2P SMS service market is the market where MNOs provide wholesale A2P SMS services to SMS aggregators and on some occasions directly to A2P SMS service providers. The wholesale services basically operate as follows:

- an MNO accepts A2P SMS sent by SMS aggregators or A2P SMS service providers at an SMS centre and send it to the intended mobile subscriber;
- the recipient mobile subscriber can be connected to either the MNO’s network (on-net service), or another MNO’s network (off-net service); and
- the MNO may also provide a reply path, so that the mobile subscriber can reply to the A2P SMS if required.

Because SMS termination services are required to provide off-net A2P SMS services, the ACCC considers that declaration of SMS termination services is likely to affect this market.

Downstream application to person SMS services markets

The downstream A2P SMS services markets are the markets in which wholesale A2P SMS services are an input. The ACCC considers that there are broadly two downstream markets:

- the market in which SMS aggregators supply services to A2P SMS service providers, and
- the market in which A2P SMS service providers (and sometimes MNOs and SMS aggregators) sell retail A2P SMS services to end-users.

The ACCC understands that some market participants may acquire and supply services slightly differently to this. For example, it is possible that an A2P SMS service provider acquires some services from an SMS aggregator and others directly from MNOs. It is also possible that some

[93] ACMA, *Communications Report 2012-13*, p. 20.

A2P SMS service providers resell services to other A2P SMS service providers, thereby creating further layers in the supply chain. However, the ACCC considers that even if the exact nature of the arrangements differ, they all depend on the services provided in the upstream wholesale A2P SMS services market.

For the purpose of examining the competitive effects of declaring SMS termination, the ACCC considers it useful to group the two downstream markets together.

The ACCC considers that the end-users of A2P SMS services include the businesses who acquire services from A2P SMS providers as well as their customers to whom the SMS are sent. An end-user does not have to be a household or individual and can be a business which uses the service in the supply of its goods or services.[94]

7.1.2 State of competition in the relevant markets

7.1.2.1 Summary of the draft decision

Wholesale market for SMS termination services

In the draft decision the ACCC found that the markets for SMS termination services on each MNOs network were not competitive. It considered each MNO had a monopoly over the termination of SMS on its network, and that there were no substitutes for these services. As a result it found that MNOs have the incentive and ability to exploit their market power over the services. Information received during the inquiry supported this conclusion, with evidence that commercial negotiations for SMS termination had been unsuccessful in lowering SMS termination prices for over a decade, and that these prices were well above cost.

Market for retail mobile services

As referred to in Chapter 5, in the draft decision the ACCC found that competition in the market for mobile retail services was in a state of transition. In particular the ACCC found that price competition appeared to be more subdued in recent years than it had been during the previous declaration inquiry in 2009.

In considering whether SMS services should be declared in the draft decision, the ACCC also examined retail SMS offers available to consumers. The ACCC's preliminary analysis showed that there were a wide range of plans with different SMS options available to consumers. The ACCC also found that there were a considerable number of unlimited SMS plans available, but that these plans were on average $60 per month, and required end-users to sign up to long term contracts (commonly one to two years). The ACCC also found that there were many plans which did not offer unlimited SMS, and where the cost of sending an SMS was between 25 and 30 cents. These plans tended to cost less per month.

[94] Declaration Guide, p. 32.

7.1.2.2 Submissions to the draft decision

Wholesale market for SMS termination services

Parties differed in their views on the level of competition in SMS termination markets. Optus submitted that the wholesale markets for SMS termination services are not competitive, and that MNOs have exercised monopoly power over the termination of SMS on their networks.[95] It submitted that SMS termination rates have remained unchanged for a number of years, at inefficiently high levels that are significantly above the cost incurred to provide the service.[96]

However, other submitters disagreed with the ACCC's draft decision, and argued that SMS termination markets are functioning effectively, and are not bottleneck services. Telstra argued that 'there is no evidence of market failure in the provision of SMS termination services' and that balanced traffic, combined with consumer demand for any-to-any connectivity means that there is no incentive to block, or impose unreasonable terms and conditions of, access to SMS termination services.[97] It submitted that, at present SMS termination rates are negotiated on a commercial basis, and these arrangements have worked well for over a decade. [98]

Further, Telstra also submitted that SMS termination services cannot be characterised as bottleneck services in the same way as mobile voice termination services, because there are effective substitutes for SMS services (as discussed above).[99] It noted that for a service to be a bottleneck there must be no alternative input or process which enables a competitor to produce an equivalent final good or service at comparable cost; and there must be no alternative, substitutable final good or service that can be manufactured or sold at a comparable price without using that input.[100] It therefore argued that because OTT messaging applications are an effective substitute for SMS, SMS termination services could not be a bottleneck.

In its submission to the discussion paper VHA submitted that it is unnecessary to declare SMS termination services because the markets in which SMS are supplied are functioning effectively absent declaration.[101] VHA also submitted that mobile operators have limited ability and little incentive to exploit any market power associated with SMS termination.[102]

Mobile retail services market

Submissions received on the state of competition in the retail market for mobile services were

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[95] Optus Submission, p. 3.
[96] Optus Submission, p. 3.
[97] Telstra Submission, p. 3.
[98] Telstra Submission, pp. 4, 18.
[99] Telstra Submission, pp. 3–4.
[100] Telstra Submission, pp. 18–19.
[101] VHA Discussion Paper Submission, p. 7.
[102] VHA Discussion Paper Submission, p. 8.

discussed earlier in Chapter 5. In addition to the submissions discussed earlier, Telstra and VHA both submitted that retail SMS offers are very competitive.

Telstra submitted that the retail market for SMS is 'fiercely competitive' and that this is illustrated by the large number of retail plans incorporating different SMS offers for consumers, and competitive SMS pricing between service providers.[103] Telstra argued that there are a wide selection of retail plans available to consumers, including unlimited and price per text options.[104] It submitted that where a consumer does not acquire an unlimited SMS plan, this is typically because they have chosen a pre-paid plan or a bundle that better suits their usage and preferences. Similarly, VHA also submitted that the SMS market is already competitive, and that SMS retail prices have fallen significantly since 2003.

7.1.2.3 ACCC's final view

Wholesale market for SMS termination services

The ACCC has considered the submissions from stakeholders, but remains of the view that SMS termination markets are not currently competitive.

As mentioned above, the ACCC considers that each MNO has a monopoly over the provision of SMS termination services on their network, and there are no effective substitutes for these services. This is because there is technically no alternative to the SMS termination service for delivering an SMS message to an end-user on a different mobile network.

Also, the ACCC does not agree with submissions by Telstra and VHA that commercial negotiations are working well and that MNOs are constrained in their ability to use their monopoly power over the service due to countervailing bargaining power.

The ACCC has considered evidence obtained during the inquiry that suggests that MNOs are using their monopoly power over SMS termination services to keep SMS termination prices high, and that commercial negotiations are not working effectively to reduce those prices.

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[103] Telstra Submission, p. 13.
[104] Telstra Submission, p. 13.

First, information received during the inquiry clearly shows that SMS termination services are currently priced well above the efficient costs of providing the service. At a minimum, several hundred SMS can be sent in the same network capacity required for a minute of voice calls. For example:

- VHA estimated that **[c-i-c]**.
- Optus claimed **[c-i-c]**.
- The *2007 WIK Consult Mobile Termination Cost Model for Australia* assumed 432 SMS can be sent per minute of voice on a 2G mobile network.

This means that the SMS termination costs should be significantly lower than voice termination costs. Under the MTAS FAD, the regulated price of mobile voice termination, which is based on the cost of providing mobile voice termination services, is currently 3.6 cents per minute. However, confidential information from industry shows that SMS termination rates are well in excess of this **[c-i-c]**.

Secondly, information provided during the inquiry indicates that commercial negotiations for SMS termination services are not working effectively. The evidence suggests that although there has been a continual increase in SMS use by consumers since 2003, SMS termination rates have remained constant in this time.[105] Optus has indicated that SMS rates have not changed in over a decade, and that it has **[c-i-c].**

In addition, the ACCC disagrees with Telstra's submissions that SMS termination services are not a bottleneck due to the availability of substitutes for downstream retail services. As discussed above, the ACCC does not consider that OTT messaging applications are currently an effective substitute for SMS services.

As a result the ACCC does not consider the SMS termination market is currently competitive.

The retail market for mobile services

As discussed above, the ACCC considers that competition in the retail market for mobile services is in a state of transition with competition appearing to be subdued at times.

Looking specifically at SMS retail offers, the ACCC acknowledges that there are many choices available for consumers and that there are many unlimited SMS offers available. However, consistent with the draft decision, the ACCC does not consider that either the retail market or SMS offers available to consumers are as competitive as suggested by Telstra and VHA. The ACCC's analysis of retail mobile plans available at March 2014, shows that while many retail plans offer consumers unlimited SMS for a monthly fee, there are also many plans which do not offer unlimited SMS and where the cost of sending an SMS appear high.

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[105] Ovum estimates the total number of SMS has grown from 12,829 million in the first half of 2009, to 17,115 million in the first half of 2013. Ovum data also suggests that the rate of growth in SMS use is slowing. See, Ovum, *Australian Mobile Market Statistic and Analyzer:1H 2013*, September 2013.

The ACCC has reviewed approximately 237 retail mobile services plans. These include low, medium and high cost plans, prepaid and postpaid plans, and plans from the three MNOs and a selection of MVNOs and resellers, such as Amaysim, Boost, Go Talk, TPG, Dodo and TransACT. The following table summarises the different types of SMS offers available in the 237 retail plans examined.

Table 7.1: Summary of SMS retail prices.[106]

Price per SMS or included SMS	Number of Plans
Unlimited	115
25-30 cents	75
9-15 cents	39
SMS included (20-800)	8
Total	237

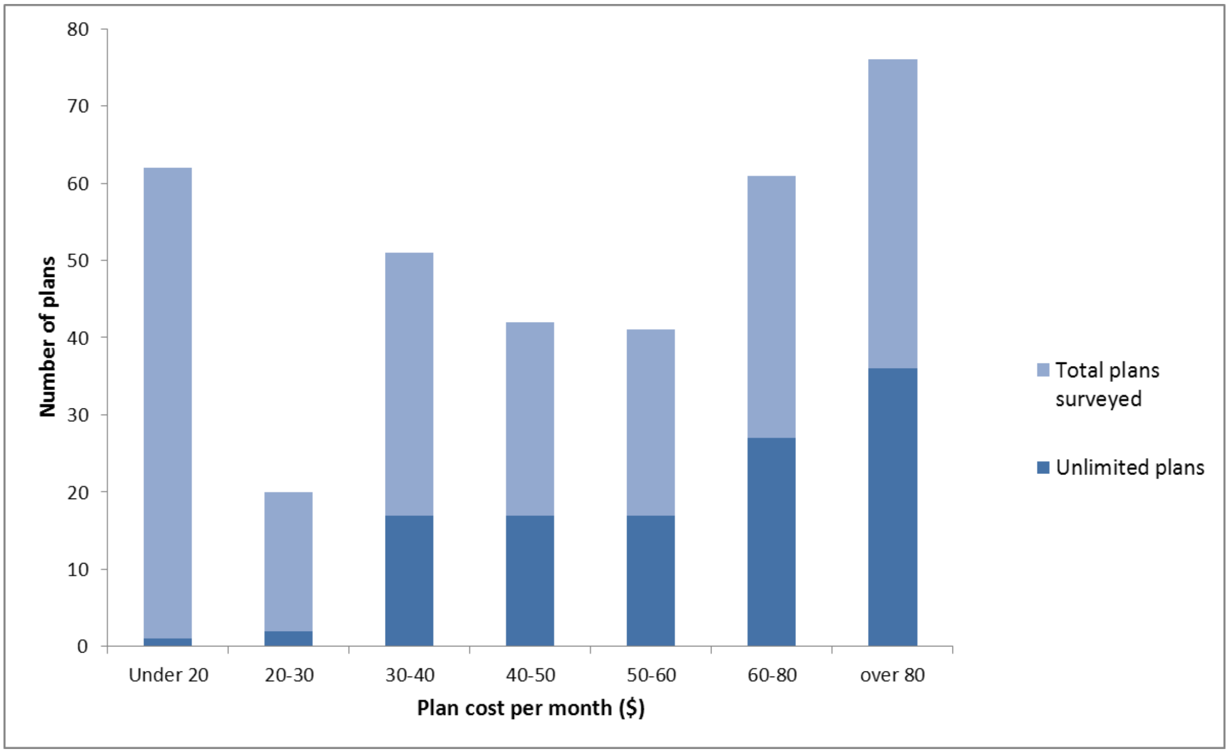
Source: Mobile service provider websites.

Of the 237 plans reviewed, approximately 115 offer unlimited SMS. Of these unlimited SMS plans, the majority were offered by MNOs. The prices of these plans ranged from around $25 to $140 per month.[107] However, the average cost was relatively high, at around $63 per month. In addition, the majority of plans with unlimited SMS were postpaid which require users to commit to a long term contract (commonly one to two years). The following figure illustrates the number of unlimited plans available at different price points.

[106] All per SMS prices are the advertised or headline rates.

[107] The ACCC notes that there was a single unlimited SMS plan available from the Vaya (an MVNO) for $18 per month. However, there were a number of unlimited plans available $25 per month.

Figure 7.1: Number of unlimited SMS plans available at different price points.



Source: Mobile service provider websites.

Of the 122 plans which did not offer unlimited SMS, around 75 plans charged between 25 and 30 cents per SMS, and around 40 plans charged between 9 and 15 cents. The average cost of such plans was about $35 per month, with many of these plans being lower cost, for example $9.95 per month, $20 per month and $30 per month.

The ACCC considers that this analysis of retail SMS offers shows that for consumers who spend less on their mobile service, SMS services can be expensive. For example, for consumers who wish to spend less than $30 per month on their mobile service there are few unlimited SMS offers available. Of the 237 plans surveyed the ACCC found only three that offered unlimited SMS at less than $30 per month. For consumers who do not wish to commit to a long term contract there are also relatively few unlimited SMS offers available. For plans that do not include unlimited SMS, the cost to send an SMS is often between 25 and 30 cents. The ACCC considers that this rate is very high when compared to the estimated cost of providing an SMS service.[108]

The ACCC is not satisfied that price competition for retail SMS services is as intense as Telstra and VHA have contended in their submissions. Instead, the evidence from the market suggests that the majority of SMS offers available to low spend consumers are priced well above the cost of providing the service.

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[108] [c-i-c]

Wholesale market for application to person SMS services

The ACCC considers that competition in the wholesale market for A2P SMS services is limited due to significant on-net/off-net pricing differentials caused by high SMS termination rates.

The only suppliers of wholesale A2P SMS services are the three MNOs. This is because they control access to mobile end-users on their networks, and because only an MNO can send an SMS to another mobile network (that is, only MNOs interconnect with each other to exchange SMS traffic). As noted above, MNOs supply both on-net and off-net wholesale A2P SMS services. This means that an SMS aggregator can have an A2P SMS sent to a mobile subscriber either by buying an on-net wholesale service from the MNO the subscriber is connected to, or buying off-net wholesale A2P SMS services from another MNO.

However, the ACCC understands that there is generally a substantial price difference between on-net and off-net wholesale A2P SMS services. **[c-i-c]** Because the off-net prices include above cost SMS termination charges, it is likely that this contributes to the considerable difference in on-net and off-net prices.

The ACCC also considers that this price differential is likely limiting competition in this market. Currently, SMS aggregators predominantly buy on-net services from each MNO. The ACCC considers that this is because the significantly higher off-net prices discourage SMS aggregators from purchasing off-net services. This means that SMS aggregators purchase on-net wholesale A2P services from each MNO in order to reach all mobile subscribers.

MNOs do not have to actively compete for the provision of wholesale A2P SMS services and do not have incentives to reduce the price of on-net services.

Downstream application to person markets

The ACCC considers that the downstream A2P SMS markets are generally competitive. However, the ACCC also considers that limited competition in the wholesale A2P SMS market may be restricting pricing in these markets.

The ACCC understands that there are a large number of SMS aggregators and SMS providers operating in the downstream A2P SMS markets. There appear to be about 10–20 SMS aggregators acquiring A2P SMS services from the MNOs, though many more operate from overseas. There appear to be well over 20 A2P SMS service providers that acquire services from SMS aggregators.

A2P SMS providers and SMS aggregators in these markets generally offer similar types of services, applications and value-added features and functions. Further, the ACCC considers that the barriers to entry into these markets are likely to be low. In general, an A2P SMS service provider, or SMS aggregator, needs to have web connectivity, an online platform and SMS applications in order to provide services.

However, the ACCC considers that limited competition in the upstream wholesale market may limit the minimum prices that can be offered by SMS aggregators and A2P SMS service providers. Prices charged by A2P SMS service providers or SMS aggregators, to end-users and/or resellers range from around 4 cents to 20 cents depending on a range of factors, such as the volume of SMS sent and whether the service is prepaid or postpaid. The ACCC notes that these prices are significantly above the estimated costs of providing SMS termination services.

7.1.3 How will declaration affect competition?

7.1.3.1 Summary of the draft decision

Competition in the wholesale market

In the draft decision the ACCC considered that declaration of SMS termination services would be unlikely to increase competition in the wholesale markets for SMS termination services on each MNO's network, as each MNO will maintain their monopoly over the service. However, it found that declaration would ensure that access to SMS termination services is not denied to any MNO, that prices for the service are more closely aligned with the costs of providing it, and that the service is provided on reasonable terms and conditions. The ACCC found that these outcomes would be likely to promote competition in the downstream retail market for mobile services.

Competition in the retail mobile service market

In its draft decision, the ACCC found that declaration of SMS termination services would promote competition in the market for retail mobile services. This was because:

- SMS traffic flows between operators were sufficiently imbalanced that SMS termination rates could impact the downstream retail market for mobile services;
- high SMS termination charges may be passed onto consumers in the form of higher retail rates; and
- the ability of MNOs and MVNOs to offer competitive retail services may be restricted because of high SMS termination rates.

As a result the ACCC found that declaration of SMS termination services, coupled with regulated pricing in the MTAS FAD, would promote competition in the downstream retail market for mobile services.

7.1.3.2 Submissions to the draft decision

Competition in the wholesale market

Only Optus submitted on this issue. It contended that because the wholesale markets for the termination of SMS on each MNO's network do not currently face competition, declaration when coupled with cost based pricing would promote competition in the provision of wholesale SMS services on each MNO's network.[109]

Competition in the retail mobile service market

Submitters differed in their views on how declaration of SMS termination services may impact competition in the retail market for mobile services.

Telstra and VHA did not agree with the ACCC's position and submitted that declaration of SMS termination will not promote competition in the retail market for mobile services. As discussed earlier, both parties considered that the retail SMS offers are already very competitive, and that declaration will therefore be of little benefit. Telstra submitted that the retail market in Australia has not been adversely impacted or constrained by the existence of commercially agreed SMS interconnection rates.[110]

Telstra and VHA also submitted that SMS traffic between MNOs is balanced.[111] Telstra argued that one effect of this traffic balance is that SMS termination rates have no effect on the downstream retail market. Further it submitted that even if there are small imbalances in SMS traffic flows between MNOs, they are unlikely to be significant enough that the resulting SMS termination costs are passed onto consumers in higher retail prices or foregone investment. Telstra also submitted that there is no evidence to suggest that current SMS termination prices are impacting mobile retail plans, and that recent changes to allowances in retail plans have not been made in response to SMS termination rates, but changing consumer preferences for data services.[112]

Optus agreed with the ACCC's draft decision that declaration would promote competition in the downstream retail market for mobile services. In particular, it agreed with the ACCC's finding that there is evidence that high SMS termination prices are impacting the mobile retail plans available to consumers, and that declaration of the service, when coupled with cost based pricing, is likely to improve competition in this market. It also argued that the current pricing of SMS termination limits the ability of MNOs to compete in the downstream retail mobile market by imposing inefficient costs and reducing the amount of value included within bundled products.[113]

Optus made confidential submissions [**c-i-c]**.

Macquarie Telecom submitted that declaration of SMS termination should promote competition in the market for mobile services. It submitted that declaration of SMS termination services

[109] Optus Submission, p. 9.
[110] Telstra Submission, p. 9.
[111] VHA Submission, p. 4; Telstra Submission, pp. 3, 14.
[112] Telstra Submission, p. 14–15.
[113] Optus Submission, p. 10.

should result in cost-based wholesale charges being determined which in turn is expected to result in significant wholesale cost reductions. This in turn is expected to stimulate competition in the retail market for mobile services as cost savings are passed through to end-users. It also argued that this should result in both MNOs and MVNOs competing on the basis of equivalent cost structures for such services, as long as there is pass-through of the regulated MTAS rates from MNOs to MVNOs.[114]

ACCAN agreed with the ACCC's conclusion that SMS termination services should be declared, and considered that high SMS termination charges are 'likely to be felt most acutely by low income, older Australian and people with disabilities.'[115]

7.1.3.3 ACCC's final view

Competition in the wholesale market

As discussed above, each MNO has a monopoly over the provision of SMS termination services on their network. The ACCC considers that in the absence of declaration, this monopoly power gives MNOs the ability and incentive to either deny access or set unreasonable terms of access to the service. This conclusion is supported by evidence that SMS termination rates are well above the cost of providing the service, and that commercial negotiations have been unsuccessful in lowering SMS termination rates for a number of years.

Therefore, consistent with the draft decision, the ACCC considers that declaration of SMS termination services, when coupled with regulated prices in an FAD, will ensure that access to SMS termination services is not denied to any MNO, is supplied on reasonable terms and conditions, and is priced closer to the efficient cost of providing the service. The ACCC does not consider that this will impact the structure of the wholesale markets for the provision of SMS termination services, as each MNO will continue to have a monopoly over this service. However, the ACCC does consider that this will promote competition in the downstream market for mobile retail services for the reasons outlined below.

Equality in bargaining power

As noted above, VHA and Telstra have both made submissions that MNOs do not have the ability or incentive to set unreasonable terms of access to SMS termination services, because when purchasing such services, MNOs have countervailing bargaining power. Further, Telstra submitted that the balanced nature of SMS traffic, when coupled with consumer demand for any-to-any connectivity, means that there is no incentive to block access or impose unreasonable terms of access to SMS termination services.[116]

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[114] Macquarie Telecom Submission, p. 3.
[115] ACCAN Submission, p. 2.
[116] Telstra Submission, p. 3,

VHA made similar submissions to the MTAS declaration inquiry discussion paper, arguing that because each MNO both offers and purchases SMS termination services, 'suppliers of SMS termination services face countervailing buyer power when negotiating terms of access', and that this makes declaration of an SMS termination service unnecessary.[117]

The ACCC has considered these views, but has found that there is clear evidence that each of the MNOs does not necessarily have sufficient countervailing bargaining power to lower SMS termination rates. Submissions to the inquiry do not dispute that SMS termination rates have remained unchanged for at least a decade. Further, Optus argues that it has been unsuccessful in achieving lower SMS termination rates in commercial negotiations.

In addition, confidential SMS traffic and revenue data shows that SMS traffic is not so balanced that each of the MNOs has no incentive to keep SMS termination prices high. The data shows that the imbalance in SMS traffic between operators has resulted in some MNOs consistently making a profit from SMS termination, while others consistently make a loss.

Competition in the retail market for mobile services

The ACCC maintains that declaration of SMS termination services will likely promote competition in the retail market for mobile services.

As mentioned above, the ACCC considers that in the absence of declaration, SMS termination rates are likely to remain at their current levels, which are well above the efficient costs of providing the service. Declaration of the service will allow the ACCC to set regulated prices for SMS termination in the MTAS FAD, which will lead to these prices being set closer to the efficient cost of providing the service. This in turn, is likely to promote competition in the downstream retail market for mobile services for a number of reasons.

Traffic imbalances are not insignificant

The ACCC does not agree with the argument that SMS traffic between MNOs is so balanced that high termination rates can have no impact on competition in the downstream retail market. Instead, the ACCC considers that high SMS termination rates may be impacting the ability of some MNOs to compete, and that there is the potential for the costs of SMS termination to be passed onto consumers.

Confidential information provided to the ACCC during this inquiry indicates that SMS traffic is not perfectly symmetric and there are differences between the number of SMS sent and received by each of the MNOs.

Telstra has argued that traffic data shows that SMS traffic is balanced, and that the percentage difference between SMS sent and received is small. However, the ACCC does not consider a small percentage difference between the traffic sent and received means SMS termination rates

[117] VHA Discussion Paper Submission, pp. 7–8.

will have no effect on competition.

The ACCC recognises that when considered as a percentage difference, the difference between the number of SMS sent and received by each MNO may appear small. However, the ACCC considers that because the number of SMS sent in total is so high, a small percentage imbalance translates to a large difference in the total number of SMS sent and received. When this is coupled with high SMS termination rates, small percentage imbalances in SMS traffic gives rise to not insignificant net SMS termination payments.

Further, the ACCC notes that the revenue implications for each MNO arising from imbalances in MTM voice traffic are of a similar scale to those arising from imbalances in SMS traffic. **[c-i-c]**

Overall, the implication of traffic imbalances is that MNOs that send more SMS than they receive make a loss on SMS interconnection. The ACCC considers that such losses may limit the ability of such MNOs to make competitive retail offers as they have higher wholesale costs than MNOs who do not make a loss on SMS interconnection. The ACCC also considers that there is the potential for such costs to be passed onto consumers in the form of higher retail prices.

High termination rates affect competition even where traffic is balanced

The ACCC considers that, even if SMS traffic was balanced, it does not mean SMS termination rates would have little impact on the downstream retail market for SMS services. As discussed in relation to voice termination, termination rates represent a perceived marginal cost to an MNO in providing retail SMS services, at least with some pricing packages. When an MNO lowers its retail price for SMS or increases SMS inclusions in a plan, it may encourage end-users to send more SMS. This may lead to more messages being sent from a network than being received, which will in turn result in greater termination costs to the MNO. This creates a greater negative interconnection balance. The higher the termination rate, the larger this effect becomes.

This means that high SMS termination rates may discourage MNOs from making retail offers that have the potential to create, or worsen, a negative interconnection balance. That is, high termination rates will discourage MNOs from offering competitively priced retail plans that will encourage users to send more SMS, as they have the potential to create a negative interconnection balance with their competitors.

If SMS termination services are declared and SMS termination charges are more closely aligned with efficient costs, the result may be that there is greater competitive pressure on retail prices. This is because, any negative interconnection balance generated by offering more competitive retail plans will be lower. This will in turn mean that MNOs are not discouraged from offering competitive retail plans that increase their market share, and encourage their users to send more SMS messages.

Evidence that high termination rates are affecting the retail mobile services market

The ACCC considers that there is evidence that the high SMS termination rates are impacting competition in the retail market in the ways described above. For example, there is evidence that high termination rates are impacting the ability of MNOs which make a net loss from SMS termination to compete in the retail market. **[c-i-c]**

There is also evidence that supports a finding that SMS termination rates may be a disincentive for MNOs to make more competitive retail offers. Optus made confidential submissions that **[c-i-c]**.

Further, while there are many unlimited SMS plans available to consumers, this does not mean that high SMS termination rates are not being passed onto consumers. The ACCC notes that for a large number of plans the cost to send an SMS is very high. As discussed earlier, of the 237 plans surveyed, for about 32 per cent of plans the price of sending an SMS is between 25 and 30 cents per SMS, and for 17 per cent of the plans the price is between 9 and 15 cents per SMS. The majority of these plans were lower cost, month-to-month plans. Further, for consumers wishing to spend less than $30 per month there are very few unlimited SMS offers available.

The ACCC considers that this suggests high SMS termination charges may be passed onto some consumers in the form of high retail prices. As outlined above, a retail charge of 25 to 30 cents per SMS is well above the ACCC's estimates of the costs of providing the service.

The ACCC also notes that it is possible high SMS termination rates are impacting the retail prices of some unlimited SMS plans. As SMS services are offered as part of a bundle of mobile retail services, it is possible that high SMS termination rates may be leading to increased prices for other aspects of the bundled service (for example voice or data services). The ACCC received confidential submissions from service providers that this is currently occurring and that high SMS termination rates have led to reductions in voice and data inclusions for some unlimited SMS plans.

In the absence of declaration, the ACCC considers that SMS termination rates will remain high, and that the potential of these rates to reduce competition in the downstream market will continue. However, declaration of the service will allow the ACCC to set regulated prices, which will be more closely aligned with costs. In turn this will reduce MNOs wholesale costs, allowing MNOs who make a net loss on SMS termination to better compete. This may lead to wholesale savings being passed onto consumers in the form of lower retail prices. In particular, declaration has the potential to lower SMS prices for consumers who wish to spend less on a mobile service.

The impact on MVNOs

The ACCC considers that high SMS termination rates may currently have a negative impact on the ability of MVNOs to compete in the retail market for mobile services. The ACCC understands that MVNOs are not directly charged for SMS or voice termination services. However, as discussed in relation to voice termination, the ACCC considers that the SMS termination rate is likely to form part of the charge that MVNOs pay to MNOs for wholesale mobile services.

As mentioned above, the majority of unlimited SMS plans are offered by the MNOs. Of the 117 unlimited plans only 26 are offered by MVNOs (excluding Virgin Mobile).[118] Where MVNOs do charge for sending an SMS, the average price is 19 cents. This supports a finding that high SMS termination charges may be impacting the ability of MVNOs to compete on retail SMS pricing.

The declaration of SMS termination services can lead to regulated pricing in an FAD that improve the ability of MVNOs to negotiate lower wholesale prices for SMS with the MNOs. If reductions were passed onto MVNOs, it would improve their ability to offer competitive retail offers, including more competitive SMS plans. While the ACCC acknowledges that MVNOs may have a small market share of 8 per cent they play an important role in the retail market, often targeting their offers to lower spend groups of consumers. The ACCC considers that improving the ability of MVNOs to offer competitive retail prices, has the potential to improve competition in the retail market, particularly for lower spend consumers.

Conclusion

Therefore, the ACCC considers that it is likely declaration of SMS termination services will promote competition in the downstream mobile market for retail services, particularly by improving the retail offers available to lower spend consumers.

Competition in application to person SMS services markets

The ACCC considers that declaring SMS termination service will promote competition in the wholesale market for A2P SMS services, and that this will, in turn, promote greater pricing competition in the downstream A2P SMS services markets.

The ACCC considers that the declaration of A2P SMS termination services, coupled with regulated pricing, will significantly reduce the cost to the MNOs of providing off-net services by reducing SMS termination rates. This will enable and encourage MNOs to offer lower prices for wholesale off-net SMS services.

The ability and potential for the MNOs to offer cheaper off-net prices means that it is likely to become commercially viable for SMS aggregators to buy both on-net and off-net services from a single MNO. This will likely increase competition between MNOs for A2P SMS services, and lead to reductions in both off-net and on-net prices.

Reductions in the wholesale A2P SMS prices charged by MNOs will reduce the costs to SMS aggregators and A2P SMS service providers in the downstream markets. As these markets appear to be effectively competitive, it is likely that cost reductions will be passed onto A2P SMS service providers and the end-users of A2P SMS services.

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[118] The ACCC has excluded Virgin Mobile as it is a wholly owned subsidiary of Optus, and therefore will not face the same issues in acquiring services from an MNO as other MVNOs do.

For these reasons, the ACCC considers that the declaration of SMS termination services is likely to promote competition in the wholesale and downstream A2P SMS services markets.

7.2 Achievement of any-to-any connectivity

7.2.1 Summary of the draft decision

In the draft decision, the ACCC found that, similar to MTM voice termination services, declaration of SMS termination services would be likely to promote the achievement of any-to-any connectivity by ensuring that MNOs do not deny smaller MNOs, or new entrants, access to SMS termination services, either at all or on reasonable terms.[119]

The ACCC acknowledged that SMS interconnection was being achieved between the MNOs in the absence of declaration. However, it noted that MNOs have the ability to deny access to SMS services and set unreasonable terms of access, such as inefficiently high prices, and that declaration would ensure that access to SMS termination services would not be denied in the future.

7.2.2 Submissions to the draft decision

Macquarie Telecom and Optus agreed with the ACCC's draft decision that declaration of SMS termination services would promote any-to-any connectivity. Optus agreed that declaration would promote any-to-any connectivity by ensuring that access to SMS termination services is not denied to any other party.[120] Macquarie Telecom submitted that because each MNO can exercise monopoly power over access to its own network, the declaration of SMS termination services is necessary to ensure any-to-any connectivity.[121]

Telstra and VHA do not consider that declaration will promote any-to-any connectivity. As mentioned above, Telstra submitted that balanced SMS traffic and consumer demand for any-to-any connectivity means that there is no incentive for MNOs to block, or impose unreasonable terms and conditions of, access to SMS termination services.[122] It also submitted that any-to-any connectivity is already well established as MNOs have interconnected for over a decade and there is no evidence or prospect of a carrier being refused access to the mobile termination services.[123] VHA submitted that the ACCC has not provided any evidence that any-to-any connectivity is not being achieved in the absence of declaration.[124]

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119 2009 MTAS Declaration Final Report, pp. 27–28.
120 Optus Submission, p. 10.
121 Macquarie Telecom Submission, p. 3.
122 Telstra Submission, pp. 3, 23–24.
123 Telstra Submission, pp. 4, 27.
124 VHA Submission, p. 12.

Further, Telstra also argues that any increase in the disparity of market shares in the mobiles market will not result in greater bargaining power for any operator. It considers that this is clearly demonstrated by the fact that as Telstra's market share has increased, it has become a net out-payer for SMS termination.[125]

7.2.3 ACCC's final view

Consistent with the draft decision, the ACCC considers that declaration of SMS termination services will promote the achievement of any-to-any connectivity. While the ACCC acknowledges that access to SMS termination services is currently being achieved in the absence of declaration, the ACCC considers that declaration of SMS termination services will ensure that access to SMS termination services is not denied to any party in the future. There are a number of factors that the ACCC considers may make it more likely SMS interconnection will not be achieved in the future absent declaration of the service.

First, it appears that SMS termination rates have remained unchanged for an extended period of time and appear to be above cost. This indicates that currently there are difficulties negotiating interconnection of SMS services, which have not existed in the past.

Secondly, in recent years the difference between market shares of the MNOs has increased. If this difference in market shares continues to increase, it may result in some MNOs having greater bargaining power in SMS termination negotiations than they currently do. In turn this may mean that they are able to deny access to SMS termination services unless unreasonable terms and conditions are agreed to.

The ACCC notes Telstra's submission that as its market share has increased it has become a net out-payer for SMS termination services, and this clearly shows that increased market share does not lead to greater bargaining power in SMS termination negotiations. The ACCC does not agree with this view. The ACCC considers that increasing market share gives an MNO greater bargaining power as the fewer subscribers there are on a network the smaller the incentive to interconnect with that network. The fact that an MNO is a net out-payer for termination services does not affect their bargaining power, but may affect the level at which they set termination rates.

Finally, as with MTM voice termination, declaration of SMS termination services will ensure that access to SMS termination will not be denied to new entrants to the mobile services market. The ACCC considers that this reasoning applies, no matter the origination of the message, and applies to both MTM and A2P and messaging.

Therefore, the ACCC considers that declaration of SMS termination will be likely to promote the achievement of any-to-any connectivity by preventing any MNO denying access to the service on reasonable terms and conditions in the future.

[125] Telstra Submission, p. 27.

7.3 Encouraging efficient investment in, and use of, infrastructure

7.3.1 Summary of the Draft Decision

In the draft decision the ACCC found that declaration of SMS termination services is likely to encourage economically efficient investment in, and use of, infrastructure.

In reaching this view, the ACCC considered that:

- it is clearly technically feasible to supply and charge for SMS termination services;
- taking into account the legitimate commercial interests of SMS termination suppliers, aligning prices with the cost of providing the service plus a normal rate of return would provide an appropriate incentive for access providers to maintain, improve and invest in the efficient provision of the service; and
- allocative, productive and dynamic efficiency are promoted when the prices of a service reflect the costs of providing that service.[126]

7.3.2 Submissions

7.3.2.1 Mobile-to-mobile SMS

Optus and Macquarie Telecom agreed with the ACCC's preliminary view that the declaration of SMS termination services will promote the efficient investment in, and use of, infrastructure.

Optus submitted that this is because declaration of SMS termination services will lead to prices for SMS termination services being more closely aligned with the efficient costs of providing the service. Optus also agreed that declaring SMS termination services, combined with efficient cost-based pricing is consistent with the legitimate commercial interests of access providers.[127]

Macquarie Telecom submitted that declaration would result in efficient cost-based pricing for wholesale services which will ensure that MNOs receive sufficient compensation when they supply SMS services. It also considered that with appropriate pricing signals, MNOs will avoid making inefficient investment decisions, provided that pass-through of regulated prices from MNOs to MVNOs is immediate and in full.[128]

Telstra and VHA disagreed with the ACCC's preliminary view. Telstra submitted that there is already economically efficient use of and investment in mobile infrastructure and declaration of SMS termination services will have no impact on this. Specifically, Telstra considered that:

- there is strong evidence of high investment in mobile services, particularly to facilitate data services, and regulation of SMS termination rates is unlikely to result in any dynamic efficiency gains; and

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[126] Draft Decision Report, pp. 44–45.
[127] Optus Submission, pp. 10–11.
[128] Macquarie Submission, p. 3.

- the competitiveness of the mobile sector ensures that resources are allocated to their most efficient use, and SMS termination rates have not impacted on the ability of the mobiles sector to ensure that consumers are able to access SMS services.[129]

VHA submitted that the current treatment of SMS termination has not been an impediment to investment as network demand from SMS is insignificant compared to voice and data and does not significantly affect the need for investments in new infrastructure. VHA also argued that declaration would not encourage efficient use of infrastructure as the provision of SMS services uses spare network capacity. Moreover, end-users often purchase plans with unlimited SMS and would not be charged for individual SMS.[130]

7.3.2.2 Application-to-person SMS

Both Optus and Telstra made submissions that declaring A2P SMS services, when coupled with regulated prices, would lead to an increase in spam SMS. Telstra submitted that including A2P SMS services in the declaration of SMS termination services risks increasing the levels of spam SMS being sent to consumers.[131] Similarly, Optus also made submissions that declaring A2P SMS would also increase spam SMS.[132] In particular, Optus is concerned that declaration of A2P SMS termination will increase off-net A2P SMS, which it will not be able to effectively manage.[133]

However, Macquarie Telecom made submissions that it doubts that cheaper SMS termination would result in an increase in unwarranted spam SMS, as the *Spam Act 2003* provides a 'significant and sufficient deterrent'. It also concerned about the 'materiality of network congestion' claims, mainly due to the low network capacity required to send an SMS.[134]

Similarly, Message4U submitted that A2P SMS are used to provide many legitimate services, and it did not provide any spam services. Further, it questioned whether increased congestion is actually a concern for MNOs, considering the low network capacity taken to send an SMS.[135]

7.3.3 ACCC's final view

7.3.3.1 Mobile-to-mobile SMS

The ACCC considers that declaration of SMS termination services is likely to promote allocative, productive and dynamic efficiency. As discussed above, the ACCC considers that current SMS termination rates are significantly above the efficient costs of providing the service

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[129] Telstra Submission, pp. 27–28.
[130] VHA Submission, pp.12–13.
[131] Telstra Submission, pp. 29–30.
[132] Optus Submission, p. 11.
[133] Optus, *Response to Thomson Geer's submission on behalf ofMessage4U*, 16 April 2014, p. 3.
[134] Macquarie Telecom, *Response to Thomson Geer's submission obo Message4U*, 16 April 2014, p. 2.
[135] Thomson Geer on behalf of Message4U, *Submission to the ACCC's Draft Decision*, 8 April 2014, pp. 4–6.

and declaration will lead to regulated pricing that is more closely aligned with the efficient costs of providing the service. This will:

- enable MNOs to set retail prices for SMS services that encourage efficient use of mobile infrastructure by end-users (allocative efficiency);
- create incentives for MNOs to operate more efficiently in the provision of SMS termination services (productive efficiency); and
- encourage MNOs to continue investing in existing and new infrastructure in response to consumer demand (dynamic efficiency).

The ACCC notes arguments from VHA and Telstra that the declaration of SMS termination services is unlikely to have any impact on investment incentives of MNOs. The ACCC understands that network demand from SMS termination services may be small compared to voice and data services. This may mean that the effect of declaration on the need to undertake investment specifically in relation to the provision of SMS terminations services is minimal. However, the ACCC considers that, as with the assessment of voice termination services, the effect of declaration of SMS termination services on competition in the retail mobile services market will help to create incentives for MNOs to invest in existing and new infrastructure in response to consumer demand.

The ACCC also considers that the declaration of SMS termination services is likely to encourage economically efficient use of mobile infrastructure by MNOs and end-users, in particular by promoting allocative efficiency. This is because declaration will help to eliminate inefficiency associated with above-cost pricing at the wholesale level and thereby encourage MNOs to set retail prices that encourage more efficient use of infrastructure by end-users.

As mentioned above, the ACCC notes that although some mobile plans include unlimited SMS services such that end-users' use of SMS services are unlikely to be affected by the price of SMS, there is a significant portion of retail plans on the market that do not include unlimited SMS. Many of these plans are less expensive and are likely to appeal to vulnerable and price sensitive consumers. Further, for mobile plans which do not include unlimited SMS services, lower prices may encourage more consumers to take up such services. The ACCC is therefore of the view that the potential for declaration to enable MNOs to lower retail prices or offer more generous inclusion of SMS which will thereby encourage end-users to more efficiently use the spare capacity of the mobile network.

The ACCC also maintains its preliminary view in relation to the technical feasibility of providing and charging for SMS termination services and the legitimate commercial interests of the MNOs in providing the service as expressed in the draft decision.

For these reasons, the ACCC considers that declaration of SMS termination services is likely to encourage the economically efficient investment in, and use of, infrastructure by which mobile services are provided.

7.3.3.2 Application to person SMS

The ACCC has considered the submissions that argue that declaring A2P SMS may increase spam SMS. While the ACCC is not persuaded that these submissions are strictly relevant to the criteria which must be applied before declaring a service, it has nevertheless considered the submissions in light of the potential impact a significant increase in SMS spam may have on network congestion. Specifically, whether declaring termination of A2P SMS could impact the efficient investment in, and use of infrastructure used to supply SMS services, by increasing spam SMS and network congestion.

Declaration of SMS termination services will not directly affect MNOs' relationships with SMS aggregators or A2P service providers. If the ACCC declares termination of A2P SMS, and makes an FAD for the service, the terms and conditions in the FAD will only be available to MNOs when acquiring A2P SMS termination services from another MNO. This is because only MNOs are able to purchase such termination services.

Therefore, even if the ACCC declares termination of A2P SMS services, MNOs will still be free to set the terms and conditions of access to wholesale A2P SMS services, or refuse to supply the service, as they see fit. For example, MNOs will still be free to price wholesale A2P SMS service in a way they consider will discourage the sending of spam SMS over their networks, or that would manage network traffic. Declaration of A2P SMS services will not force MNOs to price A2P SMS services at such a low level that there will be an increase in spam SMS.

Further, the ACCC considers that there are already a number of ways to manage and deter the sending of spam SMS. The majority of A2P services providers and SMS aggregators have strict spam policies and procedures that they use to monitor and discourage sending of spam SMS using their services. Similarly, the ACCC understands that MNOs are also able to monitor whether spam SMS are being sent over their network, and are able to block such traffic. Further, the *Spam Act 2003* prohibits the sending of spam SMS in Australia, and imposes significant penalties for contraventions of the Act. As such the ACCC considers that there are sufficient measures in place to deter spam SMS.

Finally, as the ACCC does not consider that declaring A2P SMS is likely to lead to an increase in spam SMS, it also does not consider that it is likely to lead to an increase in network congestion. Even if there is some increase in spam SMS, because sending SMS uses a low level of network capacity, it is unlikely that it will result in congestion of mobile networks.

The ACCC considers that declaration, coupled with regulated pricing, is likely to reduce the prices for wholesale A2P SMS services that MNOs supply to SMS aggregators. The ACCC considers that these reductions are efficient as they reflect a closer alignment of prices to the underlying costs of providing the service. The ACCC considers that this will encourage more efficient investment in infrastructure. Further, the ACCC considers that the promotion of competition in the wholesale A2P SMS and downstream A2P SMS markets is likely to encourage greater innovation in the supply of A2P SMS services.

For these reasons, the ACCC considers that the declaration of SMS termination, including the termination of A2P SMS messages, will likely encourage the economically efficient use of, and investment in, infrastructure by which mobile services are provided.

7.4 Conclusion

For the reasons outlined above, the ACCC considers declaration of SMS termination services (for both MTM and A2P SMS) is in the LTIE, and has decided to vary the MTAS service description as set out in Appendix A to cover SMS termination.

8 MMS termination

The ACCC has determined that declaration of MMS services would not be in the LTIE, and that therefore the services should not be declared. The reasons for this are outlined below.

8.1 What are MMS termination services?

MMS allows mobile users to send messages containing multimedia content, such as images, audio and video files. MMS are transmitted over a mobile network using capacity set aside for data, whereas SMS are delivered using capacity in the signalling part of the mobile network. While MMS messages are sent using packet switching technology, they differ from OTT messaging applications because they are not sent over the internet.

MMS termination services are required for an MMS to be sent between two users on different networks. As with voice and SMS termination services, MMS termination is provided by an MNO to terminate an MMS message on its network.

8.2 Summary of the draft decision

In the discussion paper the ACCC sought views on whether MMS termination services should be declared.

Few stakeholders addressed this issue in their submissions. Telstra submitted that MMS termination should not be declared since the provision of this service is already subject to satisfactory commercial arrangements and the retail market for MMS is competitive. Telstra also argued that several OTT applications for smartphones, like Facebook, Instagram and Photostream represent effective substitutes for MMS.[136]

Macquarie Telecom was the only submitter that claimed MMS services should be declared. It submitted that MNOs have a monopoly over MMS termination and as a consequence wholesale rates for this service are considerably in excess of the underlying cost of providing the service and have remained at the same level in recent years. Macquarie Telecom acknowledges that consumer take up of MMS services are low, but argues that regulation of termination charges at lower levels would increase end-user demand.[137]

8.3 ACCC's final view on MMS Termination

Consistent with the draft decision, the ACCC has decided not to declare MMS termination services.

The ACCC acknowledges that each MNO has a monopoly over the provision of MMS termination services on their network. However, except for Macquarie Telecom, submitters have

[136] Telstra Submission, p. 28.
[137] Macquarie Telecom Submission, pp. 4–5.

not expressed concern that MNOs are using this monopoly power to set unreasonable terms of access to MMS termination services. The ACCC did not receive submissions from any MNO that commercial negotiations for MMS termination services are not working well.

Further there does not appear to be the same level of concern with MMS termination pricing that there is with SMS termination pricing. Unlike SMS, which are limited to 160 characters, MMS are not messages of standardised length, and vary in size. This means that some MNOs are using a simplified tiered pricing structure, in which the price of terminating an MMS is dependent on the size of the message. Further, **[c-i-c]**.

In addition, based on data provided by MNOs, the take up of MMS services is low compared with SMS usage. The number of MMS sent by consumers appears to be approximately two per cent of the number of SMS being sent. This suggests that MMS services are not of the same importance to consumers as other mobile services. As a result, the ACCC considers that declaration of MMS services is unlikely to have a significant impact on competition in the downstream retail mobile services market.

Given the lack of industry concern around MMS termination rates and interconnection negotiations, and the low usage of MMS services, the ACCC does not consider that declaration of MMS termination services is in the LTIE. Therefore the ACCC has decided not to declare the service.

9 Other issues

9.1 Changes to the service description

9.1.1 Technological developments

In this inquiry, the ACCC considered whether technological developments, such as the roll out of 4G mobile networks and the NBN meant there was a need to amend the MTAS service description. The ACCC expressed the preliminary view in the draft decision that it is not necessary to change the service description to respond to these developments. The ACCC considered that voice termination services offered over 4G networks or originating on the NBN should be covered by the MTAS, and that the current MTAS service description was sufficient to do so. The ACCC also considered that there is no need to remove references to gateway exchanges in the MTAS service description to ensure technology neutrality as there are no plans to change mobile interconnection arrangements in the industry.[138]

The ACCC did not receive further submissions on this issue in response to the draft decision report.

Therefore, consistent with the draft decision, the ACCC has decided that it is not necessary to amend the service description in response to developments in 4G mobile networks and the NBN.

9.1.2 References to the Trade Practices Act 1974

As noted in the draft decision, the ACCC will amend the MTAS service description so that references to the *Trade Practices Act 1974*, are replaced by references to the CCA.

9.2 Mobile originating access service

In its submission to the discussion paper, AAPT submitted that the ACCC should commence an inquiry into whether to declare a mobile originating access service for calls to freephone and local rate numbers (a MOAS). AAPT considered that such an inquiry is necessary due to the ACMA's proposed changes to the Telecommunications Numbering Plan, which would make calls to 1800 numbers free from mobile phones. It was concerned that the ACMA's changes may lead MNOs to increase the costs of the MOAS.

In the draft decision, the ACCC indicated that it did not consider it necessary to conduct such an inquiry at the time. The ACCC noted that the ACMA was yet to make a final decision on any changes to the Numbering Plan and any new arrangements may not be implemented until 1 January 2015. The ACCC indicated that it would continue to monitor the situation and will

[138] Draft Decision Report, p. 49.

give further consideration to the issue once the outcomes of the ACMA's consideration of arrangements for calls from mobile networks to 1800 numbers are clear.[139]

In its submission to the draft decision, AAPT submitted it was disappointed that the ACCC would not conduct a declaration inquiry for the MOAS, but was encouraged by the ACCC's intention to continue monitoring the situation. AAPT also noted the difficulty in reaching agreed commercial outcomes with respect to the new MOAS rate and any form of guidance from the ACCC as to the pricing of the MOAS is likely to incentivise and facilitate parties reaching agreement.[140]

Consistent with the draft decision, the ACCC remains of the view that it is unnecessary to commence an inquiry into whether to declare a MOAS at this time. However, the ACCC will continue to monitor the development of the proposed freephone and local rate number arrangements.

9.3 Duration of the MTAS declaration

A service declaration must specify an expiry date.[141] The expiry date should occur between three and five years after the declaration was made unless the ACCC considers there are circumstances that warrant a shorter or longer period.[142]

In the draft decision, the ACCC considered that declaration of the MTAS should be varied to include the SMS terminations services and be extended for five years commencing when the current MTAS declaration expires.[143]

Macquarie Telecom made submissions on this issue and supported the ACCC's preliminary view on the basis that it provides access seekers with a more certain operating environment which is thereby less risky. Macquarie Telecom also submitted that a five year declaration sits comfortably with a two year FAD. It argued that a two year FAD reflects the period of commercial agreements and different end dates for the FAD and the declaration eases the workload for the ACCC and industry.[144]

Consistent with the draft decision, the ACCC considers that the MTAS declaration should be extended for five years. This means that the MTAS declaration, as varied to include SMS termination services, will commence immediately after the expiry of the current MTAS declaration on 30 June 2014 and will expire on **30 June 2019**.

[139] ibid, p. 50.
[140] AAPT Submission, p. 1.
[141] Subsection 152ALA(1) of the CCA.
[142] Subsection 152ALA(2) of the CCA.
[143] Draft Decision Report, p. 50.
[144] Macquarie Telecom Submission, p. 5.

The ACCC notes Macquarie Telecom's submission in relation to the term of the MTAS FAD and will consider this issue in the upcoming MTAS FAD inquiry.

Appendix A – Service description

Domestic Mobile Terminating Access Service

The domestic mobile terminating access service is an access service for the carriage of voice calls and short message service (SMS) messages from a point of interconnection, or potential point of interconnection, to a B-Party directly connected to the access provider's digital mobile network.

Definitions

Where words or phrases used in this Declaration are defined in the *Competition and Consumer Act 2010*, or the *Telecommunications Act 1997* or the *Telecommunications Numbering Plan 1997*, they have the meaning given in the relevant Act or instrument.

Other definitions

B-Party is the end-user to whom a telephone call is made or an SMS message is sent.

Digital mobile network is a telecommunications network that is used to provide digital mobile telephony services.

Point of interconnection is a location which:

(a) is a physical point of demarcation between the access seeker's network and the access provider's digital mobile network, and

(b) is associated with (but not necessarily co-located with) one or more gateway exchanges of the access seeker's network and the access provider's digital mobile network.

Short message service (SMS) is the provision of messages up to 160 characters of text using capacity in the voice signalling channel of a mobile network.