
TELSTRA CORPORATION LIMITED

Response to the Commission's Mobile Terminating Access Service– Final Access Determination Discussion Paper

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EXECUTIVE SUMMARY

Telstra welcomes the opportunity to provide this submission to the Australian Competition and Consumer Commission's (**Commission**) Domestic Mobile Terminating Access Service – Final Access Determination Discussion Paper, August 2014 (**Discussion Paper**).

The Discussion Paper seeks stakeholder views on the issues the Commission considers relevant to determine the primary price terms for mobile voice termination services and short message service (**SMS**) termination services in the Mobile Terminating Access Service (**MTAS**) final access determination (**FAD**). Specifically, the Discussion Paper consults on how the Commission should approach the pricing of the MTAS, seeking views on the overall methodology that should be adopted and how this methodology should be implemented.

Consumers in Australia continue to benefit from a thriving and dynamic mobiles market with high levels of investment and ongoing improvements in the customer experience. Customers have also benefited from a price perspective – a study by the Canadian Radio-Television and Telecommunications Commission (**CRTC**) found Australian voice and data prices amongst the lowest in almost every category examined.¹ At the same time, between 2006 and 2013, average revenue per subscriber in the Australian mobiles market (across Telstra, Optus and Vodafone) declined by 11 per cent overall, despite the significant increase in data usage.² In short, the current regulatory approach taken to the mobiles sector is working well for consumers.

The declaration of the MTAS (for voice termination) has contributed to the current competitive state of the mobiles sector by addressing an enduring bottleneck for the termination of voice services to mobile networks of other providers. The delivery of mobile interconnection services (both regulated and non-regulated) also contributes to the customer experience by facilitating competition, any-to-any connectivity and encouraging the economically efficient use of, and investment in, mobile infrastructure. However, this should not be overstated in terms of customer outcomes at the retail level. The declared MTAS is a wholesale service provided by mobile network operators (**MNOs**) that enables calls and SMS messages to be received by mobile phone users. While important, the MTAS represents only a small part of the mobile services provided by MNOs. As such, the approach to regulating the MTAS taken by the Commission in a FAD should be proportionate to the likely impact on the long-term interests of end-users (**LTIE**).

Telstra is committed to providing high quality and reliable mobile services to its customers and helping them to stay connected wherever they are. This is reflected in Telstra's ongoing investment in its mobile network to provide the best coverage, service reliability and data capacity. In the 2014 financial year, Telstra invested \$1.1 billion in its mobile network and, having achieved 87% coverage of the Australian population with 4G, recently announced it planned to invest around \$1 billion in the mobile network in the 2015 financial year.³ In top of this, in 2013 Telstra committed \$1.3 billion to secure spectrum to provide additional mobile coverage and capacity in the future. In addition to broadening and deepening 4G coverage, Telstra's investments have also increased the coverage of its 3G network to 99.3 per cent of the Australian population. This investment reflects the continually changing nature of the mobiles sector which is now highly data-centric as end-users shift away from traditional mobile voice and SMS services.

A cost-based symmetric approach to pricing the MTAS is in the LTIE

Telstra agrees with the Commission that a cost-based approach to pricing the MTAS is consistent with the legislative criteria under the *Competition and Consumer Act 2010* (**CCA**) and most likely to deliver

¹ Canadian Radio-television and Communications Commission, *Communications Monitoring Report 2013*

² Ovum, *Australian Mobile Market Statistics and Analyzer 2H 2013*

³ Telstra Corporation Limited Financial Results and Annual Report for the year ended June 2014

efficient prices that are in the LTIE. Telstra also supports the Commission's preliminary view that a uniform pricing approach to fixed-to-mobile (**FTM**) and mobile-to-mobile (**MTM**) termination services is appropriate. Asymmetric pricing raises the risk of arbitrage and, in the absence of calling externalities, will result in inefficiencies that are not in the LTIE.

There is no need to set price terms for SMS termination

Telstra does not agree with the Commission's preliminary view that a consistent approach to regulatory pricing for voice and SMS termination services is necessary or appropriate. Specifically, Telstra does not believe it is necessary to set price terms for SMS, including Application-to-Person (**A2P**), termination services at this point in time. This is because Telstra considers that:

- a) The absence of a relationship between the cost of voice and SMS termination, as well as the limited number of observable appropriate benchmarks, make it difficult to set a regulated rate for SMS termination in the absence of a costly and time-consuming cost modelling process.
- b) The benefits of undertaking a cost modelling process would be significantly outweighed by the costs and time it would take to develop the model. The impact of any regulated SMS termination price is likely to be insignificant given relatively balanced traffic levels and the high proportion of customers on unlimited SMS or capped value retail mobile plans.
- c) There is a high risk of regulatory error in determining SMS termination charges due to the nature of the SMS market in Australia – amongst other things, the use of alternative messaging services and platforms continues to evolve rapidly making the accuracy of any regulatory assumptions highly uncertain.

In the event that the Commission is minded to set price terms for SMS, Telstra's view is that A2P termination services should be specifically excluded. A2P termination services are distinct from traditional SMS termination service in a number of ways, such as the nature of the service provided and traffic characteristics, which means that there is no reason for the Commission to pursue a regulated price for these services. If the Commission does determine that an A2P price should be set *between mobile network operators* for this traffic type, Telstra believes it is desirable to clarify in the final FAD that the FAD for SMS only applies to termination services handed over by one MNO to another MNO.

The impact of mobile market changes is uncertain

Telstra agrees with the Commission's view that the mobiles market has changed since the previous MTAS FAD inquiry in 2011. While overall mobile penetration growth is slowing, the use of mobile phones is continually evolving and growth is being driven from other sources such as smartphones, machine to machine and other non-voice based devices and services. End-users have continued to shift away from the previously dominant mobile voice and SMS services towards data services and over-the-top (OTT) applications. This is reflected in the ongoing investment in mobile networks to increase capacity by all MNOs.

In the absence of detailed analysis, Telstra does not necessarily agree with the Commission that economies of scale are like to have reduced the cost per minute of providing mobile voice termination services. Increased levels of mobile investment (including spectrum costs) and structural changes to the provision of mobile services suggest that it is more likely that the per minute costs of providing the MTAS have remained relatively stable.

It is possible that 4G technology (which includes voice over LTE) may have the potential to lower the cost of supplying the MTAS in the future, although it is too early to estimate what the actual impact may be if at all. At present, given they are not used to provide voice calls and traditional SMS, 4G networks are not directly relevant to the provision of the MTAS. Telstra is still considering its technical and commercial options in regards to when deployment of voice and SMS over 4G/LTE will occur. There is

still significant uncertainty associated with such deployment, including the need to develop industry standards and the likelihood that MNOs will need to support the supply of the MTAS over 3G and 4G/LTE in at least the early stages of deployment. Accordingly Telstra's view is that the new FAD should be based on current network deployment only. Any adjustments to the duration of provisions in the FAD based on speculative timing of MNOs offering voice and SMS services over 4G networks would not be appropriate.

TSLRIC+ continues to be the most appropriate methodology for pricing the MTAS

The Commission has previously adopted TSLRIC+ based pricing methodology to set the MTAS price on the basis that this approach, among other things, encourages competition and economically efficient investment; allows efficient access providers to fully recover costs; and protects the interests of those who have rights to use the MTAS. TSLRIC+ continues to be the most appropriate methodology for pricing the MTAS in Australia. A TSLRIC+-based pricing for the MTAS will promote the LTIE as it is a cost-based methodology that allows a return on efficiently invested capital and the recovery of efficient common costs.

Other pricing methodologies considered in the Discussion Paper, specifically Pure LRIC and Bill and Keep (**BAK**), will not promote the LTIE nor satisfy the remaining statutory criteria that the Commission must have regard to. Among other things, the fact that these methodologies do not allow for the recovery of common or network joint costs incurred by an efficient multi-product MNO will result in inefficient mobile market outcomes that are not in the legitimate business interests of carriers or in the LTIE.

Telstra agrees with the Commission that the WIK model, which is based on a 2G network, is no longer fit-for-purpose and should therefore not be used to estimate the costs of providing mobile termination services. Ideally, the Commission would develop a new TSLRIC+ model for the MTAS. However, there are practical limitations to achieving this given the timeframes set out in the Discussion Paper. The development of a new cost model will require significant consultation with industry on, for example, the appropriate form and inputs. This is likely to take a significant amount of time and effort, for both the Commission and industry stakeholders.

As such, Telstra considers that a more pragmatic approach would be to use the results obtained from engineering economic cost models in other jurisdictions (which are based on a TSLRIC+ or equivalent approach) to inform the range of prices that could apply in Australia for MTAS voice termination. In doing so, appropriate adjustments need to be made to account for differences in overseas market conditions and regulatory approaches. The use of international benchmarking, although not Telstra's preferred approach, represents the most appropriate option given the need for timely regulatory decision-making.

There is no need for mandated fixed-to-mobile pass-through

Telstra does not support the introduction of a mandated pass-through of MTAS reductions for integrated operators. Telstra does not believe there is any reason for the Commission to depart from its position in the 2011 FAD Inquiry that a mandatory pass-through requirement would prevent flexibility in determining the form in which price reductions are passed on and could be circumvented through access agreements with terms and conditions that depart from the terms of a FAD. This position was also reflected in the Final Decision in the MTAS 2013/14 declaration inquiry (**Final Declaration Decision**) where the Commission considered that declaration of the MTAS has promoted competition in the fixed voice services market and that this is consistent with the reductions in average FTM call prices over the past eight years.

Telstra also considers that a mandated FTM pass-through requirement would distort competition by preventing parties from being able to pass-through reductions in the MTAS to other components of a fixed services bundle where they may be more highly valued by consumers. It would also appear to go beyond the scope of regulating wholesale access to the MTAS, as provided for by the CCA, and instead

could be considered an attempt to regulate prices in the (highly competitive) downstream retail market over which the Commission has no jurisdiction.

Further, there is no evidence that MTAS reductions have not been passed through to date or any suggestion that this will occur in the future, thus negating any requirement for a mandated pass-through mechanism. Claims by stakeholders that Telstra has experienced a windfall gain from the reduction in the MTAS rate by not passing through MTAS rate reductions to customers are erroneous and misleading. Telstra has more than passed through the reductions in the MTAS to its customers as demonstrated by Telstra and the Commission's own analysis in the Final Declaration Decision.

Transitional arrangements depend on the nature and scale of price changes

Telstra considers the preliminary view of the Commission that future regulated prices for mobile voice termination and SMS termination are likely to be lower than current regulated and commercial rates to be premature given the absence of detailed cost information and/or analysis. It is Telstra's position that any views on the requirement for transitional arrangements would best be formed once the nature of any price change is known. This is because different transitional arrangements are appropriate in different circumstances.

Regulated terms and conditions should align with the MTAS declaration

The Commission should give strong weight to the objective of regulatory certainty by setting MTAS FAD prices that align with the full period of the MTAS declaration. The new MTAS FAD should therefore apply from the expected expiry of the existing FAD in mid-2015 until 30 June 2019.

01 INTRODUCTION

1. Telstra welcomes the opportunity to comment on the Commission's Discussion Paper.
2. Telstra provides this submission on the basis that the Commission intends to publish a proposal on pricing methodology around October 2014. This submission raises issues that Telstra believes the Commission should take into account before proposing the adoption of a preferred pricing methodology, Telstra will provide a more detailed submission on that pricing methodology once the Commission's proposal is published.
3. This submission is structured as follows:
 - a. Section 2 sets out Telstra's views on the overall approach the Commission should take towards pricing the MTAS
 - b. Section 3 provides Telstra's comments on mobile market changes since the 2011 MTAS FAD and the impact on the efficient cost of providing the MTAS
 - c. Section 4 sets out Telstra's position on the appropriate methodology for pricing the MTAS, including
 - i. That a TSLRIC+ based pricing approach is in the LTIE when setting MTAS prices
 - ii. Why a pure LRIC and Bill and Keep approach would not be in the LTIE
 - iii. That international benchmarking is the most pragmatic approach given the time constraints facing the Commission
 - d. Section 5 sets out Telstra's position of fixed-to-mobile pass-through
 - e. Section 6 provides Telstra's view on transitional arrangements
 - f. Section 7 sets out Telstra's position on the duration of regulated terms and conditions
 - g. Section 8 addresses non-price terms and conditions
 - h. The Appendix sets out Telstra's responses to the questions raised by the Commission in the Discussion Paper

02 APPROACH TO PRICING THE MTAS

2.1. A cost-based approach to pricing the MTAS is in the LTIE

4. The Discussion Paper sets out the Commission's position that a cost-based approach to pricing the MTAS is generally consistent with the legislative criteria that the Commission is required to have regard to under the CCA. Specifically, a cost-based approach to pricing the MTAS will:
 - a. Promote allocative efficiency in downstream markets for the MTAS, thereby promoting competitive and dynamic efficiency; and
 - b. Ensure that carriers are able to recover the direct cost of providing the MTAS, thereby protecting their legitimate business interests.

In doing so, the Commission considers that a cost-based approach to pricing the MTAS will promote the LTIE.

5. Telstra agrees with the Commission that in the context of MTAS, a cost-based approach to pricing the service is consistent with the legislative criteria under the CCA and most likely to deliver efficient prices that are in the LTIE.

2.1.1. The approach to pricing fixed-to-mobile and mobile-to-mobile termination should be the same

6. Mobile voice termination services are defined as an access service for the carriage of voice calls from a point of interconnection, or potential point of interconnection, to a B-Party directly connected to the access provider's digital mobile network. This definition reflects the fact that the cost of termination to the access provider of the B-Party is the same regardless of the type of network from which the A-Party calls. That is, the cost of termination is the same whether the call is received from a fixed or mobile network.
7. The Commission has previously expressed the view that, although FTM and MTM terminations are technically identical, the market dynamics in the retail mobile services market and fixed voice service market are different. In the 2011 MTAS FAD inquiry the Commission considered that regulated MTAS pricing may have become less relevant for MTM termination and proposed the adoption of a commercially negotiated BAK arrangement. This proposal was ultimately dismissed primarily due to concerns about the risk of arbitrage if the FTM termination rate was higher than the MTM termination rate.
8. In the Discussion Paper, the Commission again raises the question of whether there are different factors that should be taken into account in determining the pricing approaches for FTM termination and MTM termination. Specifically, whether FTM and MTM termination services should be regulated using different pricing approaches.
9. As in previous submissions, Telstra maintains that mobile voice termination services are homogenous services that should be priced the same way regardless of whether a call originates from a fixed or mobile network. Telstra's views in relation to the potential introduction of a BAK arrangement for MTM voice termination are discussed in section 4.4 of this submission. However, Telstra notes that the concerns previously raised in relation to asymmetric pricing of FTM and MTM voice termination services are still relevant for the forthcoming regulatory period. Asymmetric pricing - whether between services or between MNOs - raises the risk of arbitrage and, in the absence of calling externalities, will result in inefficiencies that are not in the LTIE. Accordingly, Telstra considers that it would not be appropriate to adopt a different pricing approach for FTM and MTM voice termination services.

2.1.2. There is no requirement to set price terms for SMS termination services

10. The Discussion Paper sets out the Commission's preliminary view that a consistent pricing approach for voice and SMS termination services is likely to be appropriate. However, the Commission notes that the small number of international jurisdictions that have regulated SMS termination have not always adopted a consistent pricing approach for voice and SMS termination. In arriving at its preliminary view, the Commission considers that a practical approach should be taken. For example, if there is evidence of a relationship between the cost of providing SMS termination and the cost of providing voice termination, the Commission considers that it may be possible to firstly estimate the costs of providing voice termination and then apply that relationship to estimate the costs of SMS termination.
11. First, Telstra considers that the Commission should not set prices for SMS termination services. Although the Commission has determined to declare SMS termination, it is not necessary to set price terms for SMS, including Application-to-Person (A2P), termination services at this point in time. There is a high risk of regulatory error in determining SMS termination charges due to the nature of the SMS market in Australia – amongst other things, the use of alternative messaging services and platforms continues to evolve rapidly making regulatory assumptions highly uncertain.
12. Second, at a practical level it is unlikely the Commission will be able to reasonably determine price terms for SMS, given the time and cost involved in the development of an appropriate forward-looking cost model and the scarcity of benchmark information from comparable jurisdictions. Other approaches – such as applying a simple adjustment to voice MTAS rates will result in arbitrary outcomes and will lead to significant regulatory error.
13. Third, given the fact that the retail market for SMS services is both clearly competitive (with the majority of end users availing themselves of free (or unlimited) SMS services as part of their bundled mobile offers, as well as increased competition from over-the-top substitutes to SMS – and that setting regulatory prices is likely to lead to regulatory error, any potential benefits of undertaking the aforementioned cost modelling or benchmarking process would be significantly outweighed by the costs and risks of doing so.
14. If the Commission were to set prices for SMS termination services, Telstra agrees that a consistent pricing approach for voice and SMS termination services is necessary. That is, the same cost-based pricing methodology should be used to estimate the costs of providing voice and SMS termination services. The Commission's suggestion that a simple cost relationship could be inferred for voice and SMS services would not be appropriate due to the risk that this could result in an under-recovery of the costs of SMS termination, which would not be in the LTIE.
15. These points are discussed in more detail below.

The benchmarks available for SMS termination are limited

16. As discussed in section 04 of this submission, Telstra considers that in the absence of a cost model, an appropriately adjusted international benchmarking approach could be used to estimate cost-based termination rates in Australia. In the case of voice termination rates, there are numerous examples of international jurisdictions from which cost estimates can be drawn. However, in the case of SMS termination, available benchmarks are extremely limited. This is primarily because only a small number of jurisdictions have chosen to regulate SMS termination charges.
17. In the Discussion Paper, the Commission includes SMS termination rates from seven countries to provide an indication of regulated prices in international jurisdictions. However, not all those jurisdictions would be suitable for inclusion in an international benchmark sample due to

differences in services regulated, lack of comparability to the Australian context and deviations in regulatory approach. The table below provides examples for the jurisdictions included by the Commission.

Table 1 - Price regulation of SMS in other jurisdictions as presented by the Commission in the Discussion Paper⁴

Country	Service	Comparability	Approach
India ⁵	2GSM, CDMA and 3G	Significant differences in population density	Cost-based rates based on proportional capex and actual opex allocations.
New Zealand ⁶	2G only, mixed 2G and 3G, 3G only models	Different geography and network coverage requirements; similar urbanisation and population density	International benchmarking of three countries using a TS-LRIC approach
China ⁷	Service included in cost calculations unknown	Significant differences in population density	Details of cost methodology not made public
Colombia ⁸	Service included in cost calculations unknown	Market structure differences – high proportion of pre-paid customers (approx. 80%), low smartphone penetration, low 3G penetration. Higher population density.	Pure LRIC
France ⁹	Combined 2G and 3G	Similar urbanisation, includes overseas territories. Higher population density.	Cost accounting methodology (possibly FDC – top-down calculation)
Denmark ¹⁰	Combined 2G and 3G	Similar urbanisation. Higher population density.	LRAIC+
Poland ¹¹	3G UMTS	Lower urbanisation; higher number of MNOs. Higher population density.	Stated cost orientation requirement – pure LRIC bottom-up model for voice MTAS

18. Appropriate application of international benchmarking requires the Commission to have access to the cost model used in each jurisdiction, or the underlying cost information, in order to make the necessary adjustments to account for the Australian context. Unless the Commission has access to this information for the majority of international jurisdictions, it will be extremely difficult to collate an appropriate benchmark sample.

19. Telstra notes that the New Zealand Commerce Commission (NZCC) used a limited benchmark sample of three countries – Denmark, Israel and Malaysia – all of which differ significantly from

⁴ Population density data sourced from World Bank (<http://data.worldbank.org/indicator/EN.POP.DNST>)

⁵ India service and approach information sourced from Telecom Regulatory Authority (<http://www.trai.gov.in/>)

⁶ New Zealand information sourced from New Zealand Commerce Commission (<http://www.comcom.govt.nz/>)

⁷ China information sourced from Ovum, The Global Regulation of Mobile Termination Rates, 11 Feb 2014

⁸ Colombia information sourced from Ovum, *ibid*.

⁹ France information sourced from Ovum, *ibid* and NZCC (<http://www.comcom.govt.nz/>)

¹⁰ Denmark information sourced from Ovum, *ibid*.

¹¹ Poland information sourced from Ovum, *ibid*.

Australia in terms of population density and mobile network design, as well as market structure. Further, although an indicative TSLRIC price was published for SMS termination, the Malaysian regulator ultimately concluded that the price of SMS should not be regulated.

20. Section 4.3 of this submission discusses international benchmarking in more detail.

The cost of developing a cost model for SMS termination outweighs the benefits

21. As noted by the Commission, developing a cost model will be time and resource intensive for the Commission and stakeholders. In the case of SMS termination, the limited applicability of the rates that would be derived from a cost model means that the costs of doing so would significantly outweigh the benefits.

22. For example, **[C-I-C]**

23. **[C-I-C]**. However, Telstra's position is that it is important not to overstate the potential benefits of regulating SMS termination services in terms of the impact on downstream retail markets. The declared MTAS is a wholesale service provided by MNOs that enables voice and SMS messages to be received by mobile phone end users. While important, it represents only a small part of the mobile services provided by MNOs. As such, the approach taken to regulating the MTAS by the Commission should be proportionate to the likely impact on the LTIE. This is particularly the case with SMS termination as the majority of consumers are on unlimited SMS plans or plans that include a capped SMS value or allowance. The impact on consumers of a regulated SMS termination rate will therefore be relatively small and the cost in developing a model that may benefit a very small proportion of customers would be disproportionate to the benefits received by those customers.

24. Telstra does not dismiss the long-term interests of those customers who are not on unlimited or included value plans. However, these customers typically choose pre-paid or alternate plans for a variety of reasons – generally to most closely align with individual preferences or usage patterns for mobile services (for example, higher inclusion of voice calls or data allowances). These customers are also those who overwhelmingly substitute SMS for OTT messaging applications. This is supported by Telstra research into OTT applications which showed that, where unlimited SMS is not included in retail mobile service plans, OTT messaging applications are the preferred method for communicating with friends and family on the basis that they are free and/or cheaper than traditional SMS services.¹² Further, where unlimited SMS is confined to domestic texts, consumers switch to OTT messaging applications are the preferred method of communicating internationally. Again, any impact of regulated SMS termination rates for these customers is likely to be small.

¹² Telstra internal research

The nature of SMS in Australia means there is a high risk of regulatory error

25. There is always a risk of regulatory error in setting price controls. This is because setting a regulated charge for a service will require a set of assumptions to be made regarding the likely use of that service (for example, the trajectory of volumes and costs) over the intended regulatory period. Where a service is relatively stable there is a relatively low risk of getting these assumptions 'wrong' and the risk of regulatory error is therefore low. However, where there is uncertainty about the service and likely developments looking forward, the risk of regulatory error in setting a regulated charge is high. Telstra considers that this is the case with SMS.
26. In the Final Declaration Decision the Commission concluded that it does not consider that OTT applications are currently effective substitutes for SMS due to the following characteristics:
- OTT messaging 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.
27. As set out in previous submissions by Telstra, the market for SMS in Australia has increasingly faced the constraint of substitution to OTT applications, such as WhatsApp and Facebook Messenger, as well as other social media platforms. This trend is set to continue as smartphone penetration continues and consumer preferences evolve. At the time of the Final Declaration Decision, the Commission cited smartphone penetration of 64 per cent of Australians in 2012-13. This has continued to increase with current estimates of between 73 and 83 per cent penetration, with forecasts of 93 per cent penetration by 2018.¹³ This suggests that the ability of mobile phone users to access OTT messaging applications will be near ubiquitous at some point during the regulatory period. Telstra considers that the uncertainty associated with this and the resultant impact on the volume of SMS introduces a level of regulatory risk with setting a price for SMS termination services.

2.1.3. The Commission should make arrangements for the supply of A2P termination services explicit

28. In the event that the Commission is minded to set price terms for SMS termination services, Telstra's view is that A2P termination services should be specifically excluded, consistent with the approach taken by the NZCC. A2P termination services are distinct from traditional SMS termination services in a number of ways. The provision of bulk SMS is an emerging or nascent service compared to traditional SMS and raises issues of potential congestion and the management of risks around SPAM. Importantly, they are provided to bulk SMS providers or aggregators as an end-to-end service rather than a standalone termination service (as provided between MNOs).
29. As noted by the Commission in its Final Declaration Decision, the terms and conditions in the FAD will only be available to MNOs who:
- "...will still be free to set 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 services in a way they consider will discourage the sending of spam SMS over their networks, or that would manage network traffic."¹⁴*
30. The Commission's stated position suggests that the current process of negotiating A2P end-to-end services would still apply irrespective of whether a regulated price for A2P termination is set in

¹³ Communications Day, 27 June 2014.

¹⁴ ACCC, Domestic Mobile Terminating Access Service Declaration Inquiry – Final Decision, June 2014, p.58

relation to the traffic handed over between MNOs. As acknowledged by the Commission in the Final Declaration Decision, downstream markets for A2P services are effectively competitive. At the wholesale level, Telstra considers that the approach taken by A2P service providers or SMS aggregators in negotiating separately with MNOs results in prices that reflect the cost of the service being provided and the underlying costs of the network on which the service is ultimately provided whilst at the same time taking into account any value added elements of the service. There is therefore no reason for the Commission to pursue a regulated price for A2P termination services. Further, as suggested by the Commission, to do so would compromise the ability of MNOs to manage issues such as spam and network congestion, which would not be in the LTIE.

31. In the event the Commission does determine that an A2P price should be set *between mobile network operators*, in line with the Commission's comments noted above, Telstra believes it is desirable to clarify in the final FAD that the FAD for SMS only applies to termination services handed over by one MNO to another MNO.

03 MOBILE MARKET CHANGES SINCE THE 2011 MTAS FAD

32. The Discussion Paper sets out mobile market developments since the MTAS FAD Inquiry in 2011 that the Commission considers may be relevant to the pricing of mobile termination services. These include the high mobile penetration rate in Australia and the fact that more people than ever before are using mobile phones to make phone calls. Growth rates in the number of services in operation (SIOs) have slowed in recent years. However this does not suggest that the mobiles market itself is not growing. Rather it suggests that the number of SIOs is reaching saturation point which is inevitable in a maturing market. Growth in the mobiles market is instead being derived from other sources – for example, the growing demand for data reflected in high levels of network investment and the increased penetration of smartphones.
33. In Australia mobile voice minutes have continued to grow and the volume of SMS being sent is significant, albeit slowing. At the same time, the use of mobile phones continues to evolve. Consumers are increasingly using their mobile phones for purposes other than traditional voice and SMS services. Such purposes include internet browsing, instant messaging, social network and other over-the-top (OTT) applications. Telstra expects that consumers will continue to shift their mobile usage away from traditional services to data-centric applications. As a result, Telstra has committed significant investments to improving network coverage, service reliability and data capacity particularly through its growing 4G network.

The cost per minute of mobile termination has remained relatively stable despite the 4G rollout

34. The Commission considers that “...the steady increase in voice traffic on mobile networks since the 2011 MTAS FAD inquiry is likely to have reduced the cost per minute of providing mobile voice termination services due to economies of scale.”¹⁵ This is primarily based on continuing growth in the number of voice call minutes originating from mobile phones. At the same time, the Commission noted that the volume of SMS is significant and has been predicted to peak in 2014.
35. Telstra agrees with the Commission that, while growth in the number of post-paid handheld mobile services in operation (SIOs) is slowing, the number of voice call minutes originating from mobile phones continues to grow. However, Telstra does not agree that this necessarily means that the cost per minute of providing mobile voice termination services has fallen due to economies of scale. In a static environment, this would be the case. However, the increase in mobile voice call minutes has coincided with investment (including spectrum costs) to improve mobile network coverage and quality across the 3G and 4G networks. Data usage has shifted onto 4G networks (where available) increasing the allocation of costs of the 3G network onto voice and SMS services. Telstra's position is that it is more likely that, on balance, these factors mean that the cost per minute of termination services has remained relatively stable.
36. It is possible that 4G technology (which includes voice over LTE) may have the potential to lower the cost of supplying the MTAS in the future, although it is too early to estimate what the actual impact (if any) may be. In the short term it is also likely that voice over LTE (**VoLTE**) and VoLTE SMS will be less technically efficient than 3G voice and SMS, although this will improve over time as technical enhancements are introduced. This may cause the unit costs of MTAS provision to rise in the initial stages of the deployment of voice and SMS termination services over 4G networks.
37. Telstra also considers that the inclusion of 4G or LTE technologies in any cost modelling is likely to have minimal impact on the per unit efficient cost of mobile termination services. In this regard,

¹⁵ ACCC, Mobile terminating access service – final access determination discussion paper, August 2014, p. 7

Telstra notes that the inclusion of LTE technologies in a mobile cost model was considered by Analysys Mason on behalf of NITA, the Danish regulator as part of upgrades to its LRAIC model in 2011/12. Analysys Mason found that:

“...based on our experience in other jurisdictions, the inclusion of LTE technologies in a mobile cost model has almost no impact on the pure LRIC of termination and only a (relatively small) downwards impact on the LRAIC+ of termination. Therefore, given the current uncertainties of eventual usage and roll-out, and the fact that it would add complexity to the cost model for very little impact, we will not include LTE in the upgraded cost model.”¹⁶

The deployment of mobile termination services over 4G remains uncertain

38. The Commission notes that all three MNOs have launched their 4G mobile networks since the last MTAS FAD. At present, these networks are used to provide data services only rather than voice calls and traditional SMS. As a result, as detailed above, at present 4G networks are not directly relevant to the provision of the MTAS. The relevance of 4G networks over the coming FAD period is also unclear.
39. Telstra has previously advised the Commission that it is still considering its technical and commercial options in regards to when deployment of voice and SMS over 4G/LTE will occur. There is still significant uncertainty associated with such deployment, including the need to develop industry standards and that fact that it is likely that MNOs will need to support the supply of the MTAS over both 3G and 4G/LTE in at least the early stages of deployment. As a result, the impact of any provision of mobile termination services on 4G – should this occur within the next FAD period – is likely to be insignificant in terms of the impact on the efficient costs of provision.
40. Accordingly Telstra's view is that the new FAD should be based on current network deployment only. Further, Telstra does not believe that any adjustments to the duration of provisions in the FAD based on speculative timing of MNOs offering voice and SMS services over 4G networks would be appropriate. Basing the estimates of efficient cost of the MTAS provision on current network deployment will also remove the risk of regulatory error that would be associated with seeking to incorporate the uncertainty of 4G network deployment.
41. It should be noted that this approach is consistent with the view that TSLRIC+-based pricing (and other forward-looking cost-based approaches) should be based on the “best in use” technology with respect to the particular service. Although 4G LTE networks are being deployed by all Australian MNOs, the provision of voice services (as well as SMS services) is primarily delivered through 3G network technology, and therefore remains the appropriate technological benchmark for the purposes of costing mobile voice (and, if necessary, SMS) termination services, within a forward-looking costing framework.

¹⁶ Analysys Mason, Report for the National IT and Telecom Agency (NITA) – 2011/12 upgrades to NITA's original mobile LRAIC model: Final model reference paper, 6 September 2011 (ref:19176-326)

04 METHODOLOGIES FOR PRICING THE MTAS

4.1. Introduction and summary

42. As is acknowledged in the Discussion Paper, there are a number of potential approaches that the Commission could adopt in setting prices for the MTAS. In determining the most appropriate approach to setting regulatory access prices for a declared service – including the MTAS – it is important to consider the objectives of regulatory access pricing, the particular features and dynamics of the relevant infrastructure or service and the dynamics of the relevant markets, as well as the practical requirements of different pricing approaches. Taking these factors into account in the current context, cost-based prices, using a TSLRIC+ costing approach are most likely to promote the LTIE and other statutory criteria.
43. Telstra believes that the Commission, in determining MTAS prices designed to best promote the LTIE and meet the other statutory criteria, should set symmetric prices for the MTAS based on a TSLRIC+ methodology. A TSLRIC+ based price for the MTAS will best promote the LTIE as it provides an access provider with an expectation of a return on efficiently invested capital and the recovery of efficiently incurred common costs.
44. Telstra does not consider that the other pricing methodologies considered in the Discussion Paper, specifically Pure LRIC and Bill and Keep (**BAK**), will promote the LTIE nor satisfy the remaining statutory criteria that the Commission must have regard to. The fact that these methodologies do not allow for the recovery of common or network joint costs incurred by an efficient multi-product MNO will result in inefficient mobile market outcomes that are not in the legitimate business interests of carriers or in the LTIE.

4.2. Long run incremental cost (LRIC) methodologies

45. A TSLRIC+ based price for MTAS will best promote the LTIE as it provides an access provider with an expectation of a return on efficiently invested capital and the recovery of efficiently incurred common costs. Consistent with the approach reflected when Pricing Principles were last set, Telstra considers that where the Commission sets price terms for the MTAS, employing a TSLRIC+ methodology based on a hypothetical new entrant will encourage an access provider to efficiently use infrastructure by minimising its own costs in supplying the MTAS, support investment and innovation and promote competition. Specifically, the Commission should:
 - a. For voice termination, set symmetric prices for the MTAS (for both MTM and FTM) based on a TSLRIC+ methodology.
 - b. For SMS termination, refrain from setting price terms – due to the significant risk of regulatory error and the likelihood that the potential benefits to end users of setting price terms will not outweigh the costs and risks of doing so (see section 2.1.2). However, if the ACCC is minded to set a price for SMS termination, Telstra considers that the best and most pragmatic approach is to employ a TSLRIC+ methodology, consistent with voice MTAS.
46. Telstra agrees with the Commission that the WIK model, which is based on a 2G network, is no longer fit-for-purpose and should therefore not be used to estimate the costs of providing mobile MTAS. Ideally, the Commission would develop a new TSLRIC+ model. However, Telstra understand that there may be practical limitations to achieving this given the timeframes set out in the Discussion Paper. The development of a new cost model will require significant consultation with industry on, for example, the appropriate form and inputs. This is likely to take a significant amount of time and effort on the behalf of the Commission and industry stakeholders to resolve. A protracted regulatory process would result in regulatory uncertainty which in turn, would have negative implications for ongoing industry development. Such an outcome would be undesirable

given the telecommunications industry is currently preparing to undergo significant challenge and change as it transitions to the NBN. Therefore, in place of a fulsome cost model and in order to expedite the regulatory process, Telstra proposes that the Commission look to use international benchmarking as an appropriate proxy to inform costs, and thus prices.

47. This section sets out why Telstra considers that a TSLRIC+ approach to pricing the MTAS is appropriate in more detail.

A TSLRIC+ methodology continues to promote the LTIE

48. The Discussion Paper notes that the Commission has previously adopted TSLRIC+ based pricing for the MTAS on the basis that this approach, among other things, encourages competition and economically efficient investment; allows efficient access providers to fully recover costs; and protects the interests of those who have rights to use the MTAS.

49. Indeed a TSLRIC+ cost methodology has been endorsed by the Commission on multiple occasions:

“...an appropriate method for estimating the costs of the most efficient operator in supplying the MTAS is using a bottom-up model, to generate a TSLRIC+ estimate (incorporating an equi-proportionate mark up or EPMU approach for common costs).¹⁷;

“The ACCC remains of the view that TSLRIC+ is an appropriate framework for pricing the MTAS.”¹⁸ (2009); and

“...the ACCC considers that the use of TSLRIC+ with an inclusion of common costs remains the most appropriate cost based approach to regulating the MTAS” (2011).¹⁹

50. Telstra considers that, based on strong current market conditions, characterised by high investment in next generation infrastructure; strong competition at the retail level for the provision of both mobile and fixed services; and falling prices (in real terms),²⁰ there is no requirement to alter this pricing approach and to do so may lead to inefficient market outcomes.

51. Specifically, TSLRIC+ will continue to promote the LTIE by:

- a. Encouraging the efficient use of infrastructure and investment in mobile infrastructure;
- b. Continuing to promote competition which is in the LTIE;
- c. Promoting the legitimate interests of an efficient access provider; and
- d. Providing for regulatory certainty.

This is discussed in more detail below.

Encouraging efficient use of infrastructure and investment in mobile infrastructure

52. A TSLRIC+ methodology characterised by an appropriately estimated efficient operator incentivises an access provider to achieve economic efficiency. Prices set based on engineering standards which employ best in class network technology and most efficient network design will

¹⁷ ACCC, *MTAS Pricing Principles Determination*, 1 July 2007 to 31 December 2008, pg. 20

¹⁸ ACCC, *Domestic Mobile Terminating Access Service Pricing Principles Determination and indicative prices for the period 1 January 2009 to 31 December 2011*, March 2009), pg. 12

¹⁹ ACCC, *Inquiry to make a final access determination for the Domestic Mobile Terminating Access Service*, Access Determination Explanatory Statement, 2011

²⁰ See *Telecommunications competitive safeguards for 2012–13*, Changes in the prices paid for telecommunications services in Australia 2012–13, pg. 29-35.

incentivise an MNO to produce goods and services most valued by consumers (allocative efficiency) at the lowest possible cost (productive efficiency) to maximise economic returns.

53. A TSLRIC+ pricing methodology to price MTAS services will provide an access provider with the appropriate incentives to continue to invest in mobile infrastructure. As Hausman concludes in his evaluation,

"A mark up above TSLRIC²¹ is required to provide the correct level of economic incentives for new network investment and innovation."²²

54. Since 2006 Telstra has invested over \$5 billion in the expansion and innovation of its mobile services, including the roll out of next generation technologies.²³ Other MNOs have made similar levels of investment in their mobile networks in order to compete effectively on coverage and quality, most evident in the ongoing rollout of 4G networks.

55. Increased investment will lead to MNO's continuing to innovate. Mobile services continue to evolve at rapid pace and are now principally used as enablers of data-centric services such as M-commerce/payments, social networking and video consumption in conjunction with traditional voice. A TSLRIC+ methodology will ensure an access provider is afforded an opportunity to recover all relevant costs resulting in a market that is equipped to dynamically respond to consumer's changing needs. This continued investment and innovation will also lead to an increase in consumer welfare through efficiency improvements. A recent report by the Centre for International Economics noted the benefits of mobile generally had contributed 2% to GDP in the period 2006-2013.²⁴

Continue to promote vigorous competition benefitting end users

56. Economic theory supports the proposition that a TSLRIC+ methodology mimics the effects of effective competition, where efficiency is maximised. This has been recognised by the Commission.

"The ACCC has previously stated that an access price based on TSLRIC+ is consistent with the price that would prevail if the access provider faced effective competition, and usually best promotes the LTIE."²⁵

57. In this regard, a TSLRIC+ methodology is widely recognised as producing efficient pricing outcomes, which in turn will best promote competition. If prices are set using a different methodology there is a risk that this could result in below cost pricing. This will not be in the LTIE. TSLRIC+ ensures an access provider has the best opportunity of recovering its costs in the supply of MTAS, even in the short term.

²¹ In the Discussion Paper, the Commission defines the 'relevant increment' under a TSLRIC methodology as including total network traffic, including the MNO's own terminating traffic, and originating traffic. TSLRIC does not make provision for common overhead costs. This is the main distinction between TSLRIC and TSLRIC+. Therefore, we interpret the statement by Jerry Hausman to be suitable to a TSLRIC+ methodology.

²² Jerry Hausman, Regulation by TSLRIC: Economic effects on Investment and Innovation, MMR-Beliage, 2/1999, available at <http://economics.mit.edu/files/1022>. Whilst Hausman's conclusions principally related to fixed network elements, Telstra conclude that similar conclusions apply to mobile.

²³ Telstra annual report 2014,

http://www.telstra.com.au/uberprod/groups/webcontent/@corporate/@aboutus/documents/document/uberstaging_280884.pdf,

²⁴ Research report prepared for the ACMA by The Centre for International Economics, The economic impacts of mobile broadband on the Australian economy, from 2006 to 2013, April 2014

²⁵ ACCC, Domestic Mobile Terminating Access Service Pricing Principles Determination and indicative prices for the period, 1 January 2009 to 31 December 2011, pg. x

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58. Although other methodologies canvassed in the Commission's Discussion Paper may result in lower prices for the MTAS in the short term (and in turn, possibly lower retail services), such a view is myopic. Telstra considers that alternate approaches to pricing the MTAS will result in inefficient and unsustainable competition in the long run where cost recovery must be achieved. Such an outcome would not be in the LTIE.
59. Further, the criterion of "promoting competition" is a broad concept that must be considered in its totality. The effects of competition are many and varied and can include price reductions, improvements in quality and innovation which will all ultimately impact on consumer welfare. It is therefore necessary to consider all of these aspects when assessing which methodology will appropriately promote the LTIE. TSLRIC+ is the methodology best equipped to deliver these benefits.

Promote the legitimate interests of an efficient access provider

60. By including a return on efficiently invested capital (i.e. through the Weighted Average Cost of Capital (**WACC**)), a return of efficiently invested capital (i.e. through depreciation), and a return of efficiently incurred common costs, TSLRIC+ pricing also promotes the legitimate commercial interests of an efficient access provider and recovers the direct costs of the MTAS attributable to that service.
61. In contrast other methodologies are contrary to the legitimate business interests of a carrier or carriage service provider, including the recovery of investment in facilities used to supply the MTAS. Whilst Telstra recognise that the short term effects of below cost pricing (driven by the adoption of other methodologies such as TSLRIC or Pure LRIC) could result in new entrants (by MVNO's), it would not incentivise any innovation and certainly not result in expansion of infrastructure based competition to an economically efficient level. On this basis, Telstra's position is that TSLRIC+ continues to be the most appropriate methodology for pricing the MTAS in Australia.

Provide for regulatory certainty for all industry participants

62. In the presence of strong market outcomes currently being observed in the mobile market, there does not appear to be any rationale to depart from the well established TSLRIC+ methodology for pricing the MTAS in Australia.
63. In addition, Telstra considers that despite best efforts, setting prices for MTAS in such a dynamic and fast changing environment is challenging and there may be considerable scope for regulatory error in this process. As such Telstra is of the view that the continued use of TSLRIC+ methodology will minimise this risk. The other methodologies set out in the Discussion Paper, which more narrowly define the relevant cost increment, have not been used internationally to the extent that TSLRIC+ has, and therefore the body of knowledge and experience is less and could be subject to much greater variability and error.²⁶ TSLRIC+ is an established methodology, well understood by industry participants and has been proven to assist in delivering a thriving mobile market in Australia.

²⁶ Telstra note that there has been a move to Pure LRIC particularly in the European jurisdiction since the 2009 European Commission's Direction. However, in many countries this transition is still occurring and thus, the body of literature on effects (particularly longer term) is limited.

4.2.1. Cost allocation

Traffic Related Common Costs and Organisational Level Common Costs

64. The Commission notes in the Discussion Paper that, if it adopts a TSLRIC or TSLRIC+ approach, it will need to determine how common costs are to be allocated to the MTAS. In the past, this has been done via the WIK model which allocates traffic-related common costs based on a proportional approach; and organisational-level costs based on the equi-proportional mark-up (EPMU) approach.

65. Telstra supports the continued use of the approach previously taken by the Commission for allocating traffic-related and organisational-level common costs. Specifically, Telstra supports the use of an EPMU approach for allocating organisational-level common costs. As noted by WIK when preparing the original 2007 Mobile Cost Termination model:

“Under this approach business overheads are allocated in proportion to the incremental costs of each business activity or service. The TSLRIC of a particular service is then increased by a certain percentage mark-up to cover business overheads.”²⁷

66. The EPMU approach is widely endorsed in the economic literature as the most pragmatic and suitable method for allocating common costs.²⁸ It is also consistent with the Fully Allocated Cost Framework that the Commission is required (through the FAD Fixed Principles) to apply in the context of setting Fixed Line Services access prices.

4.2.2. Pure LRIC

67. Telstra considers that the use of a pure LRIC approach to set prices for mobile voice or SMS termination will not promote the LTIE or any other statutory criteria as it would result in a price that is below full cost recovery. The Commission reflects on the deficiencies of a pure LRIC approach in its Discussion Paper,

“As pure LRIC does not take into account traffic-related common costs or organisational-level costs, MNOs would not (be) able to achieve full cost recovery if all of its services were priced using a pure LRIC approach.”²⁹

“The use of pure LIRC approach to price the MTAS would also mean that an MNO’s cost of terminating its own traffic(which would include traffic-related common costs and organisational level cost) would be higher than the price it could charge access seekers for providing termination services”³⁰

68. Pure LRIC provides an estimate that is closer to the LRMC of supplying a service. While it provides for a return on, and of, capital (i.e. long run costs), this is only provided on capital that is relevant to supplying the regulated increment of the service. This implies that it excludes recovery of any corporate overhead common costs (similar to TSLRIC), but also does not make a contribution to joint network costs (i.e. recovery of the costs associated with infrastructure that is used to jointly supply other network services).

²⁷ Wik-Consult, Mobile Termination Cost Model for Australia, 2007, available at <http://www.accc.gov.au/system/files/Mobile%20termination%20cost%20model%20for%20Australia%20-%20WIK%20report.pdf>

²⁸ See Janusz A. Ordover, *Recovering Fixed and Common Costs for Mobile Networks in Europe*, August 2008, compass lexcon for a fulsome discussion of this

²⁹ ACCC, *Mobile Terminating Access Service, Final Access Determination Discussion Paper*, August 2014, pg.15

³⁰ ACCC, *Mobile Terminating Access Service, Final Access Determination Discussion Paper*, August 2014, pg.15

69. A Pure LRIC approach is not in the LTIE, as it will result in an inefficient use of infrastructure and investment, will distort competitive outcomes (rather than promote competition) and does not support the legitimate business interests of an Access Provider as it does not allow for full cost recovery. Finally, there are distinguishing factors between the Australian market place and overseas jurisdictions (in particular, UK) which have employed a Pure LRIC methodology which render it inappropriate.

A Pure LRIC methodology will not result in efficient use of and investment in infrastructure

70. Employing a pure LRIC methodology would not result in allocative and dynamic efficiency being achieved. As such, a pure LRIC methodology does not support the LTIE.

71. A Pure LRIC approach will result in the inefficient use of and investment in infrastructure, as it fails to account for the considerable shared and common cost component of mobile network costs.

72. Businesses incur a range of costs in supplying services, including overhead and joint costs, which must be recouped. By failing to account for common costs in the price setting for the MTAS, MNO's will not be given the opportunity to adequately recover all the relevant costs incurred in supplying termination services. In making investment decisions, efficient firms in a competitive market seek to recover their costs (including overheads and joint costs) and earn a normal return. Denying an access seeker this opportunity will result in firms shifting their investment efforts/resources to other opportunities.

73. In addition, application of a Pure LRIC methodology could lead to an expectation of significantly below normal returns across all services supplied by the access provider. Therefore, MNO's will not be incentivised to make investments in new technologies nor will they evolve their product offering in response to changes in consumer tastes, leading to inefficient market outcomes (i.e. no dynamic efficiency). Even Ofcom, whilst adopting a Pure LRIC approach recognise that dynamic efficiency is best achieved under a TSLRIC+ approach.

*"We conclude that in terms of the impact on dynamic efficiency, the potential difference between pure LRIC and LRIC+ is small, but may marginally favour LRIC+."*³¹

74. The imposition of pure LRIC pricing in some jurisdictions has created uncertainty regarding the continued roll out of Next Generation Services. Such a situation has been contemplated in Italy where the reduced revenue stream available from a pure LRIC methodology has led to significant risk regarding the roll out of Next Generation Services.³² Given the importance and benefits 4G technology is having and is predicted to have on end consumers, such an outcome must necessarily be avoided. Such an outcome is clearly not in the LTIE.

75. Lastly, whilst ongoing investment is required to drive innovation in new services, the use of a Pure LRIC methodology for pricing the MTAS could also ultimately lead to deterioration in the performance of telecommunications networks as providers are no longer incentivised to continue investment (as Pure LRIC does not allow for full cost recovery) unless full recovery could be achieved elsewhere. Such a distortion is clearly not in the LTIE. The Commission also note such a risk in their 1997 Access Pricing Principles, which states

*"A price that is artificially low may also result in the running down of infrastructure, which in the long term may not in the interests of end users."*³³

³¹ Ofcom, *Wholesale Mobile Voice Call Termination*, 15 March 2011 http://stakeholders.ofcom.org.uk/binaries/consultations/mtr/statement/MCT_Statement_Annex_3.pdf, pg. 24

³² Ovum, *Italy's late adoption of pure LRIC forces a dramatic cut in MTRs*, 2 December 2011

³³ ACCC, *Access Pricing Principles, Guide*, 1997, pg. 7

Pure LRIC will not promote greater competition

76. Regulatory bodies that have adopted Pure LRIC often cite that a key benefit is that competition will be further promoted (through falling retail prices in both mobile and fixed offers).³⁴ However, the resulting market outcomes are not uniformly supportive of these conclusions.

77. If the ACCC adopts a pure LRIC methodology, Telstra believe that there are significant risks that prices of other services offered by MNO's may increase. As the Commission point out,

*"While a pure LRIC approach will lead to lower MTAS rates compared to TSLRIC or TSLRIC+, it could result in higher prices for other services offered by MNOs if service providers seek to recover traffic-related common costs or organisational costs through the prices of other services"*³⁵

78. Under pure LRIC, common costs directly attributable to the supply of MTAS are subsidised by other services, such as the data service or the mobile voice origination service. However, economic theory dictates that a MNO must in the long run, recoup all costs associated with the supply of the service. Consequently, MNO's may seek to recover these joint/common costs in other ways such as rebalancing of tariffs across a product bundle. This could result in higher prices than would otherwise exist under a TSLRIC+ approach in both the Wholesale and Retail markets depending on where costs are recovered. Such an effect would clearly be disruptive and distort the strong competitive outcomes that are currently being observed in the Australian market. As previously stated, Australian customers face some of the lowest prices in the world for mobile services.³⁶ Further, these distortionary impacts will not necessarily be confined to the mobile market and may be spread across other markets such as fixed services. Lastly, the impacts of any price rebalancing exercise are very difficult to predict and raise the risk of regulatory error. Such decisions are company and service-specific and therefore very difficult to predict the effect on the wider market.

Pure LRIC methodology does not support the other legislative criteria

79. A pure LRIC methodology will not be in the legitimate business interests of access seekers as it does not allow an MNO to recover all of its costs nor earn a normal commercial return on investment having regard to the risks involved.

80. A pure LRIC model is a significant departure from the Commission's approach to date on regulating MTAS. There is high risk that proceeding to a pure LRIC methodology will require lengthy consultation and submissions by stakeholders leading to protracted time frames for the setting of the FAD. This delay, coupled with a likely expected shock of a price decline when compared with current MTAS rates will create uncertainty for the industry. Given the significance of the upcoming NBN transition, it is in the LTIE that such a situation be avoided.

A Pure LRIC methodology is not appropriate in the Australian context

81. The move towards Pure LRIC has also been driven in large part by the European Commission's Recommendation on termination rates.³⁷ Specifically, the European Commission sought to address a number of problems which are not present in the Australian context. The European Commission's Recommendation promotes Pure LRIC as an appropriate methodology to,

³⁴ See 2009 Commission of the European Communities Direction on the *Regulatory Treatment of Fixed and Mobile Termination Rates in the EU*, Brussels, 7.5.2009 ,C(2009) 3359 and Ofcom decision cited above as examples of this

³⁵ ACCC, *Mobile Terminating Access Service, Final Access Determination Discussion Paper*, August 2014, pg.15

³⁶ Canadian Radio-television and Communications Commission, *Communications Monitoring Report 2013*

³⁷ 2009 Commission of the European Communities Direction on the *Regulatory Treatment of Fixed and Mobile Termination Rates in the EU*, Brussels, 7.5.2009 ,C(2009) 3359

amongst other things, address issues of high termination pricing, high retail pricing, asymmetric market shares and investment impediments resulting in limited new entry. These impediments are not present in an Australian context. A recent survey undertaken by Ovum showed Australia's average termination rates are low in relative terms, ranking below the sample average.³⁸ As previously highlighted, Australia has some of the lowest retail voice and data prices across all user categories when benchmarked internationally which clearly evidence a strong and thriving mobile market in Australia.³⁹ Lastly, network deployment in Australia is well established and new (network) entry is not expected. Given that, any competition-enhancing effects of a move to pure LRIC would be much smaller than in other countries and the impact on an LTIE assessment for the Australian market would be very different than in many countries that chose to adopt pure LRIC.

82. In addition, one of the major concerns the European Commission held was that mobile and fixed termination rates should be set on the same basis, with the costs of coverage excluded from both. The European Commission instead required that termination rates include only traffic-sensitive costs. As recognised by a number of countries that have low population densities, pure LRIC may be less appropriate for jurisdictions that are sparsely populated because:
- a. implementation of pure LRIC has a larger impact on termination rates seeing as a relatively smaller percentage of costs are traffic-sensitive; and
 - b. moving to pure LRIC rates could have a more material dampening effect on incentives to invest in increased coverage than existing TSLRIC rates do.

83. Therefore, the risks of price increases for other services, or alternatively a negative impact on investment in coverage expansion, is higher in Australia than in more densely populated countries. More generally, a difficulty with the European Commission's approach is that, while for the fixed network coverage costs are effectively covered by a monthly access rental (or at the wholesale level through the ULL or resale price), mobile markets do not have the same pricing structure, therefore further amplifying distortionary effects.

4.2.3. Options for implementing a LRIC methodology

A forward-looking bottom-up (FLBU) model is the best practice approach

84. Ideally Telstra considers that the Commission should use a FLBU modelling approach to inform its TSLRIC+ pricing. Such an approach is consistent with the cost information that was used in developing the now-outdated WIK model and in many other jurisdictions worldwide.
85. Telstra considers that an actual costs model should not be used to set the MTAS price. This is because actual cost information is able to be manipulated through the discretion that an MNO has when determining how to allocate costs across the various services on its network. This discretion will inevitably lead to varying results across MNOs and difficulties in reconciling and developing an appropriate model.
86. Telstra reaffirms its previous views relating to actual costs.⁴⁰ Specifically, if the Commission were to use actual costs then they must be highly prescriptive in the identification and definition of costs and create specific rules as to how these costs are to be allocated across the various services carried on the mobile networks (both voice and data), to ensure consistent application of the rules by the various MNOs.

³⁸ Ovum, Interconnect Benchmarks 2Q2014

³⁹ Canadian Radio-television and Communications Commission, *Communications Monitoring Report 2013*

⁴⁰ Telstra, Response to the Commission Discussion Paper on Domestic Mobile Terminating Access Service (MTAS), July 2011

Actual costs should not be used in the development of a price model.

87. Telstra also does not support the use of actual costs to be used to cross check the outputs from a FLBU cost model, again due to high degree of variability that may result between MNO's due to cost allocation across the various services on the network. Whilst it is up to each MNO to allocate costs as it sees necessary, this discretion would introduce complexity and doubt into the Commission's process and decision making as there is likely to be no 'apples with apples' comparison between carriers.
88. As noted above, ideally the Commission would develop a new TSLRIC+ model for the MTAS. However, there are practical limitations to achieving this given the timeframes set out in the Discussion Paper. The development of a new cost model will require significant consultation with industry on, for example, the appropriate form and inputs. This is likely to take a significant amount of time and effort on the behalf of the Commission and industry stakeholders. Accordingly, Telstra considers that a more pragmatic approach would be international benchmarking, with appropriate adjustments made to account for the Australian context. The use of international benchmarking, although not Telstra's preferred approach, represents the most appropriate option given the need for timely regulatory decision-making in this case. Telstra's position on international benchmarking is set out in more detail in the following section of this submission.

4.3. International benchmarking

89. Telstra has set out its preference for a TSLRIC+ based price for the MTAS in section 4.2 of this submission. Previously, the cost of the voice MTAS has been derived from the WIK model, which is based on a 2G network. In the Discussion Paper, the Commission notes that this model is no longer appropriate to price the MTAS and that, if the Commission were to adopt FLBU modelling of MTAS prices, a new model would be needed. Telstra agrees with the Commission that the WIK model is no longer fit-for-purpose and should therefore not be used to estimate the costs of providing mobile termination services.
90. As set out in section 4.2, ideally the Commission would develop a new TSLRIC+ FLBU model for the MTAS. However, there are practical limitations to achieving this given the timeframes set out in the Discussion Paper. The development of a new cost model will require consultation with the industry on, for example, the appropriate form and inputs. This is likely to take a significant amount of time and effort on behalf of the Commission and industry stakeholders. The process also has implications for regulatory certainty at a time when the telecommunications industry requires relative stability.
91. The Commission notes that where an appropriate cost model is not available, some jurisdictions have adopted an international benchmarking approach for regulated pricing of mobile termination. Further a benchmark based on prices in other jurisdictions that have adopted a cost-based methodology may provide an approximation of cost-based prices for mobile termination service in Australia.
92. Telstra maintains its view that a TSLRIC+ cost model is the best approach to estimate MTAS pricing however Telstra considers that international benchmarking may be a more pragmatic approach at this time given the limitations around developing a new model.
93. The Commission has set out its view that a benchmark of the costs of providing mobile termination in other jurisdictions, as opposed to a benchmark of actual mobile termination prices, is likely to be more useful for approximating cost-based prices for mobile termination services in Australia. Telstra agrees with this view as well as that "*[t]he effectiveness of an international benchmarking methodology depends on developing an appropriate set of benchmark jurisdictions,*

*taking into account a range of technological, economic and regulatory factors.*⁴¹ Telstra's position is that care and a conservative manner must be taken when considering international benchmark data in the context of setting a regulated price for the MTAS in Australia.

Benchmarking mobile termination costs is more appropriate than prices

94. The Discussion Paper sets out the Commission's preliminary view that:

"...the actual regulated termination prices adopted in other jurisdictions will reflect country-specific policy, regulatory and other considerations that may not reflect the cost of providing the service. As a result, it may not be appropriate to benchmark against these rates to determine efficient prices for the MTAS in Australia."

Telstra agrees with the Commission's view. The prices set in other jurisdictions typically reflect a regulator's response to the specific market failure that it is seeking to address via regulated pricing of mobile termination. Simply benchmarking prices will therefore fail to capture the broader market and regulatory environment.

95. There are also a number of other reasons why published regulated MTAS prices are not appropriate for benchmark purposes. These include:

- a. A number of jurisdictions include glide paths to transition to a final cost-based price. As a result the rate that applies to operators at any one time may not reflect the efficient cost-based price but instead be based on, for example, a process of regulatory negotiation or decision-making that reflects jurisdictional market structure or commercial operations.
- b. Some jurisdictions apply asymmetric pricing – not only between services but also between operators (for example, incumbent versus new entrants). The adjustments made for such asymmetric pricing may not necessarily be transparent such that the 'correct' rate can be simply chosen for benchmark purposes.
- c. Regulated rates in some jurisdictions reflect a regulatory decision on an appropriate rate rather than the calculated efficient cost. For example, regulators may estimate a range of efficient regulated prices and select one that they consider reasonable given the particular regulatory and market circumstances in that jurisdiction.
- d. Underlying cost drivers can vary significantly from jurisdiction to jurisdiction. This will make some jurisdictions unsuitable for inclusion in the benchmark sample without substantive adjustments which may expose the benchmarking process to regulatory error.
- e. Regulated rates in some jurisdictions are not based on a comparable pricing principle. This may include different underlying policy objectives and/or statutory objectives, as noted by the Commission in the Discussion Paper with respect to Ofcom.

96. Benchmarking international jurisdiction costs for mobile termination rather than prices will also more readily enable the adjustment of those costs to suit the Australian context, as discussed in more detail below.

Appropriate adjustments need to be made to suit the Australian context

97. As noted above, Telstra's position is that the Commission must apply care and a conservative manner when considering international benchmark data in the context of setting a regulated price for the MTAS in Australia. The Commission acknowledges this in the Discussion Paper where it considers that there are a number of factors that influence the cost of providing termination services which may differ between Australia and other jurisdictions. As a result *"...the ACCC will need to take these factors into account in selecting the appropriate jurisdictions for the*

⁴¹ ACCC, Discussion Paper, p.18.

benchmarking exercise and/or in making appropriate adjustments to the cost estimates in other jurisdictions.”

98. Telstra considers that the use of international benchmarking as an appropriate pricing methodology for the MTAS in Australia relies on:
- a. Appropriate selection of benchmark sample countries; and
 - b. Appropriate adjustments to MTAS cost estimates of those sample countries.
99. The Commission notes that one factor that will be important in determining which jurisdictions to include in a benchmark sample is the pricing approach used in the potential jurisdiction. For example, the Commission queries whether it will be appropriate to include jurisdictions that use a TSLRIC+ (or equivalent) cost model if a TSLRIC+ approach is chosen as the appropriate pricing methodology for the MTAS.
100. The NZCC included in its benchmark sample only jurisdictions which set cost-based prices based on TSLRIC methodology. Further, jurisdictions must have prepared rates using bottom-up cost modelling, based on forward-looking costs which could be substantiated or validated using publicly available information.⁴² In some instances, jurisdictions were included in the benchmark that based regulated MTAS rates on a Pure LRIC methodology but also published or calculated TSLRIC rates.
101. Telstra's position is that the approach taken by the NZCC in terms of the selection of the initial benchmark sample is appropriate. That is, jurisdictions should only be included in the benchmark sample if they use a TSLRIC+ (or equivalent) cost model. This may include jurisdictions that apply a Pure LRIC methodology where they also publish a TSLRIC+ (or equivalent) cost estimate.
102. Once the initial benchmark sample is chosen, this should be further refined to ensure that the jurisdictions included are comparable. As per the NZCC, comparability takes into account variations in conditions or factors that are likely to influence the cost of supplying the service across jurisdictions. The aim of selecting a comparable jurisdiction will be to ensure that a benchmarked price reflects the conditions under which the MTAS is supplied in Australia.
103. In the context of the jurisdictions included in the benchmark sample, comparability may include factors such as:
- a. Urbanisation rates – specifically the inclusion of jurisdictions with urbanisation rates that would likely result in similar underlying cost estimates to Australia.
 - b. Cost modelling of similar services - whether the jurisdiction has developed cost models for a similar service to that considered appropriate for the provision of the MTAS in Australia (for example, a 3G only network or mixed network).
 - c. Population density – despite Australia's relatively high level of urbanisation, low population density and low urban population density means that there will be higher MTAS costs relative to other jurisdictions.
104. Where these factors significantly limit the benchmark sample, it may be more appropriate to make adjustments to the benchmark cost estimates in order to retain an appropriately sized benchmark sample.
105. Once the benchmark sample has been refined, the cost estimates for each of the jurisdictions will need to be appropriately adjusted to reflect any differentials in the efficient cost of providing the MTAS between a benchmark jurisdiction and Australia. The Commission notes this in the

⁴² NZCC Draft Determination, p.19

Discussion Paper citing network usage and population density as factors likely to impact on the costs of providing termination services.

106. Telstra considers that the scope of adjustments that would need to be made to the benchmark costs would be broader and may include (but are not limited to):
- a. Mobile traffic density – the volume of mobile calls (or SMS) will directly affect MTAS rates in a jurisdiction with, generally, more calls resulting in a lower MTAS rate.
 - b. Mix of voice and data traffic – depending on the service being costed, cost allocations between voice and data will affect MTAS rates.
 - c. Cost of telecommunications equipment – particularly when comparisons are made across different time series (i.e. jurisdictional rates that were calculated several years ago).
 - d. Spectrum auction outcomes – the inclusion (or otherwise) of spectrum costs may lead to inconsistency and incomparability between some international MTAS rates.
 - e. Mobile communication frequency range – the frequency range adopted by MNOs in a jurisdiction will directly affect the costs of providing the MTAS. For example, higher frequency towers typically cost more to operate.
107. Telstra also considers that the Commission should give further consideration to how they address currency conversion. In the Discussion Paper, the Commission set out some indicative mobile voice and SMS termination rates in other jurisdictions compared to Australia using market exchange rates. Telstra's position is that it would be more appropriate to use Purchasing Power Parity (PPP) rates for currency conversion of mobile termination rates. Compared to market exchange rates, PPP rates more appropriately adjust for average cost differences between countries as they are not subject to volatile capital movements. More simply, PPP rates address inter-country price differences while market exchange rates do not. The use of PPP rates will adjust for different currencies, while at the same time taking into account differences in wage levels, equipments prices and varying capital charges all of which are relevant to the provision of the MTAS. The use of PPP rates may therefore also address some of the adjustment factors highlighted above.
108. If the Commission proposes to adopt an international benchmark approach to price the MTAS in Australia, Telstra will submit a more detailed response on appropriate selection of benchmark jurisdictions and adjustments to international cost estimates post that decision being made. The above suggestions are indicative only, with specific suggestions dependent on the detail of any proposal made by the Commission.

4.4. Bill and Keep

109. The Commission invites views on whether a Bill and Keep (BAK) arrangement for MTM voice or SMS termination services would promote the LTIE. Under BAK arrangements, MNOs would not pay each other for the exchange of mobile traffic and payments for termination services would effectively be waived. BAK for MTM termination was considered by the Commission during the 2011 MTAS FAD Inquiry. The proposal was ultimately dismissed by the Commission, primarily due to concerns raised by stakeholders about the risk of arbitrage if the FTM termination rate was higher than the MTM termination rate. Telstra's general position in relation to asymmetric pricing of FTM and MTM termination rates is set out in section 2.1 of this submission. This section considers the appropriateness of a BAK regime in more detail.

BAK is efficient in limited circumstances

110. Generally, BAK is likely to be an efficient mechanism when:
- a. Calling externalities are significant

-
- b. There are low costs associated with supplying the MTAS, as well as minimal transaction costs

Telstra does not consider that either of these factors is present in Australia – for either voice or SMS termination. This is discussed in more detail below.

No evidence of un-internalised calling externalities

111. BAK pricing will only be efficient if there is some un-internalised calling externality in the market. A calling externality arises where the benefits of a call are enjoyed not only by the party making (and paying for) the call, but also by the recipient of the call. While it is highly likely that such calling externalities exist, the significance of these is unknown (and difficult to measure). Further, such externalities are likely to be internalised due to the reciprocal nature of voice calls and SMS.
112. The New Zealand Commerce Commission (NZCC) considered the introduction of a BAK pricing arrangement for MTM and SMS termination as part of its 2011 Standard Terms Determination. In arriving at its ultimate decision to reject BAK as a pricing option, amongst other things the NZCC was not satisfied that there were sufficient un-internalised calling externalities in the context of the New Zealand market. For SMS termination specifically, the NZCC ultimately concluded that calling externalities were not present to the extent that they justified a departure from a forward-looking cost methodology.⁴³
113. Ofcom also considered the introduction of a BAK regime for wholesale mobile termination as part of its 2010 market review.⁴⁴ Similar to the NZCC, Ofcom rejected BAK on the basis that assessing the size of call externalities or the degree of possible internalisation is difficult; and that mandating BAK would mean a departure from prices that reflect the underlying costs of termination.
114. For BAK to be an efficient pricing mechanism in Australia, the Commission must be satisfied that un-internalised calling externalities exist. Otherwise, in the absence of lower transactions costs (discussed below), BAK will decrease the efficient operation of the mobile and fixed line telecommunications market. Telstra is unaware of any evidence of un-internalised calling externalities in the Australian market that would justify the use of BAK pricing.
115. Further in the absence of the Commission being satisfied that un-internalised calling externalities exist, a BAK regime will decrease allocative efficiency. This is discussed in more detail below. As a result, Telstra maintains that BAK cannot be considered in the LTIE.

There are non-trivial costs associated with the supply of the MTAS which need to be recovered

116. The Commission notes in the Discussion Paper that, in general, BAK arrangements are considered appropriate where traffic between networks is relatively balanced, resulting in net payments between MNOs close to zero. Further, the Commission indicated that even where traffic is not relatively balanced, there may be merit in a BAK arrangement where the actual costs of providing the MTAS are close to zero as a BAK arrangement would simply reflect the low costs of providing termination services.
117. BAK involves charging a zero price for the interconnection of traffic between two networks. That is, each network agrees to terminate traffic (voice or SMS) at no charge. As noted previously, the payment for termination services would effectively be waived. This charging regime implies that any costs associated with terminating traffic are not recovered from

⁴³ NZCC, p.104

⁴⁴ Ofcom, Wholesale mobile voice termination Market Review Volume 2 – Main Consultation, 1 April 2010, pp. 81-82

termination. This includes the recovery of joint network or common costs incurred by an efficient multi-product provider.

118. Telstra notes that an allowance for the recovery of common costs is legitimate, as it is aligned with efficient cost allocation rules and regulatory principles around cost allocation. It ensures that efficient regulated MNOs have the opportunity to earn a normal return. Any failure to take common costs into account is contrary to the legitimate business interests of the access provider, is not in the LTIE and is goes against the Commission's stated preference for a cost-based approach to pricing the MTAS.
119. The Commission acknowledges this in the Discussion Paper noting that termination rates should reflect the perceived marginal cost to an MNO of providing off-net mobile calls and SMS to its retail customers. A termination rate of zero, as implied by a BAK regime, would mean that the perceived marginal cost to the MNO would be lower than the actual cost of providing the termination services.
120. Any approach that effectively results in below cost pricing necessarily has an adverse impact on long-term investment, and hence on long-term competition. Pricing that does not recover costs acts as an economic deterrent to infrastructure investment and use, both in the short-term and the long-term. This is clearly not in the LTIE, the interests of access providers or of access seekers. Telstra recognises that mobile networks are increasingly carrying more data, with other service (voice and SMS) now accounting for a smaller fraction of overall network capacity. However, as discussed in section 03 of this submission, it does not follow that the unit cost of providing those services is significantly lower or approaching zero nor that there should be no recovery of costs associated with providing those services.
121. In addition to the legitimate costs of providing the MTAS, it is also the case that BAK will not generate savings in transaction costs through the avoidance of measurement and billing systems. Telstra considers that a move to BAK for MTM and/or SMS termination services would not reduce transaction costs and, in fact, would likely increase those costs. Telstra's system for recording it wholesale fixed and mobile interconnecting traffic is a fixed costs and would exist with or without charges for the MTAS.
122. For example, if BAK was introduced for MTM calls only, Telstra's network would still need to generate call records for all calls, mediate those calls and price them in Telstra's wholesale system. It is only at the point of pricing the call that is can clearly and unambiguously be identified as a MTM call as distinct from another call. Simply pricing the MTM call at zero will not remove the need to undertake this work.
123. As the pricing for MTAS traffic does not currently distinguish between FTM and MTM calls, Telstra does not have to validate whether the call originated from a fixed or mobile network. A move to BAK for MTM, while retaining a charge for FTM, would introduce the need to differentiate between mobile and fixed originated traffic for charging purposes. This additional step would increase system complexity and cost, not reduce it.
124. A similar situation applies in the case of SMS termination. Telstra's system for recording SMS termination applies to multiple interconnect products. As with voice, the network generates records for interconnect products which flow through to the billing system which performs multiple processing functions such as identifying product type, reporting, rates and billing. The introduction of a BAK arrangement for SMS would not remove the requirement for this billing process to occur. That is, if there was a zero SMS interconnect charge between MNOs, there would still be a billing system cost associated with each SMS event.

BAK may lead to unintended outcomes including arbitrage

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125. As set out above, Telstra does not consider that BAK is an efficient pricing mechanism for the MTAS due to the absence of calling externalities, no transaction cost savings and the fact that it does not provide for the recovery of efficiently incurred costs in the supply of the MTAS. Further, Telstra considers that BAK is likely to result in unintended outcomes that will not be in the LTIE. Specifically BAK will create inappropriate incentives for arbitrage, resulting in allocative inefficiencies.
126. Telstra believes that as the voice MTAS is a homogenous service that needs to be priced the same way regardless of whether a call originates from a fixed or mobile network, the existence of asymmetric prices and the use of BAK will create inappropriate incentives for arbitrage. This is acknowledged by the Commission in the Discussion Paper where it notes that stakeholders expressed concerns about the risk of arbitrage during the MTAS FAD 2011 Inquiry. Specifically, that arbitrage arises when Fixed Network Operators (FNOs) direct FTM calls through a mobile network in order to avoid the MTAS charge and take advantage of the BAK arrangement for MTM terminations. This concern was a contributing factor to the Commission electing not to pursue a BAK approach.
127. Telstra maintains that the risk of arbitrage remains unchanged in the context of the present FAD inquiry. Telstra has previously undertaken analysis that suggested that there is nothing preventing arrangements to route FTM calls through mobile gateways to avoid FTM MTAS charges being set up in Australia if the Commission were to introduce BAK pricing for MTM MTAS while setting a positive FTM MTAS price.⁴⁵ There is no evidence to suggest that this is no longer the case.
128. Having different MTAS prices depending on the originating network (that is, fixed or mobile) create incentives for firms to take advantage of, and exploit, arbitrage opportunities. This in turn promotes:
- a. Non-commercial use of the network assets despite increased usage of the network;
 - b. Distorted and inefficient investments that would not otherwise be taken in non-productive and non-network related activities such as SIM boxes or GSM gateways;
 - c. The potential for extra traffic without investment to manage this, resulting in network congestion; and
 - d. Inefficient acceleration of substitution of traffic from fixed line to mobile markets.
129. Telstra has previously submitted analysis on the potential inefficient outcome of BAK where there is no calling externality.⁴⁶ In summary, the analysis illustrated that such an access pricing regime will result in:
- a. Below-cost pricing for retail MTM calling, which creates allocatively inefficient over-consumption of MTM calls; and
 - b. A lower price for MTM calling relative to fixed line voice calling, which generates allocatively inefficient FTM substitution.
130. These outcomes are in addition to potential productive inefficiencies generated through investment in unproductive arbitrage activities and dynamic inefficiencies from the failure to recover investment costs on the termination service.

⁴⁵ Telstra, Response to the Commission discussion paper on domestic mobile terminating access service (MTAS), July 2011

⁴⁶ Telstra, *Ibid.*, Appendix D

05 FIXED-TO-MOBILE PASS-THROUGH

5.1. Integrated operators should not be subject to a mandated pass-through of MTAS reductions

131. The Discussion Paper acknowledges the Commission's decision in the 2011 MTAS FAD Inquiry not to mandate a pass-through requirement of MTAS reductions. In deciding not to introduce a mandatory pass-through requirement, the Commission agreed with the Australian Competition Tribunal's views on flexibility in determining the form in which price reductions are passed on (as detailed above) and also noted that it is possible for parties to circumvent a mandated pass-through obligation by having access agreements with terms and conditions that depart from the terms of a FAD. Telstra considers that there is no reason for the Commission to depart from this view for the current FAD.
132. As set out in previous submissions, Telstra also considers that a mandatory FTM pass-through mechanism would distort competition and could result in the Commission acting outside its jurisdiction. Telstra does not consider that this would be in the LTIE.
133. Telstra considers that a mandated pass-through mechanism would distort competition because it would force parties to pass through MTAS price reductions to the FTM price and thus prevent the reductions from being passed through to other components of the fixed services bundle. FTM services are not sold in isolation – fixed services bundles include an access line, local, STD, International and FTM calls, as well as value added services such as Messagebank. The inability to pass on changes in the underlying costs for one service across the bundle of services would be detrimental to consumers, since consumers are likely to benefit more from MTAS cost reductions being passed through to prices of other components of the bundle rather than solely on the FTM component.⁴⁷ This is also contrary to the view of the Australian Competition Tribunal (as noted above) with which the Commission has agreed.
134. Previous analysis undertaken by Telstra and submitted to the Commission has also show that the benefit to customers of any price reductions from a reduction in MTAS prices will be greater the more that those reductions are passed through on calling services other than FTM calls.⁴⁸ That is, passing through savings solely to FTM calls will not be allocatively efficient as consumers value pass-through relatively more on the other calling products (i.e. local, STD and International calls). Imposing a pass-through requirement on integrated operators would harm the ability to meet customer needs, which would not be in the LTIE.
135. Telstra also believes that the application of any mandated FTM pass-through mechanism may be outside the Commission's jurisdiction. Section 152BC(1) of the CCA provides that the Commission may make a written determination relating to access to a declared service. The remaining provisions of section 152BC, which detail the Commission's power to make access determinations, are all concerned with the principle objective contained in section 152BC(1); that is, the provisions empower the Commission to set terms and conditions governing access to the relevant declared service.
136. Any mandated pass-through mechanism would appear to go beyond the scope of regulating access to the MTAS, and instead could be considered an attempt to regulate prices in the downstream retail market over which the Commission has no regulatory jurisdiction. It is of

⁴⁷ See Telstra, Submission in response to the Australian Competition & Consumer Commission's Review of Telstra Price Control Arrangements, 12 February 2010.

⁴⁸ See Telstra, Supplementary submission in response to the Commission Discussion Paper on Domestic Mobile Terminating Access Service (MTAS), 19 September 2011

course the case that the Commission must have regard to the factors in section 152BCA in making a FAD (and in particular the LTIE). However, these factors apply in the context of the Commission regulating access to the MTAS. They do not have the effect of extending the power in section 152BC beyond the scope of access to the relevant declared service and into the area of the supply of downstream services.

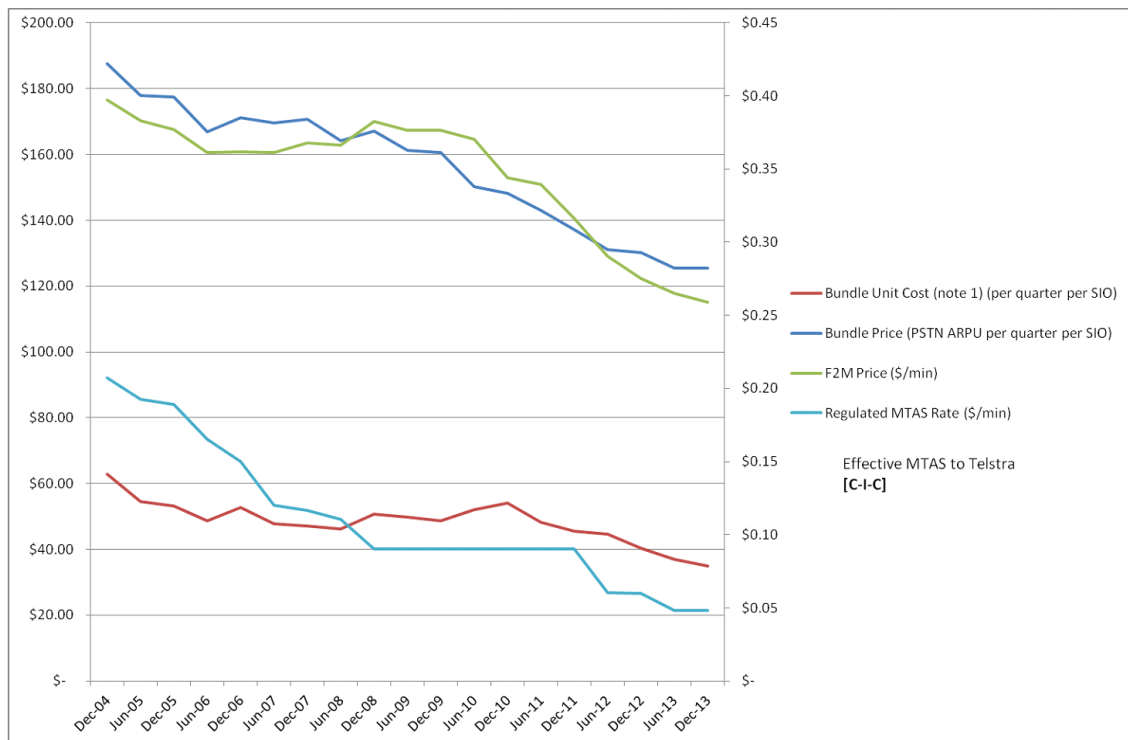
137. Telstra does not support any proposal for integrated operators to be subject to a mandated pass-through of MTAS reductions for these reasons. At the same time, Telstra considers that any such mechanism is unnecessary given that previous reductions in MTAS prices have, in fact, been passed through in the prices for the bundle of fixed services. There is no reason to believe that future MTAS reductions will not be similarly passed through.

5.2. Reductions in MTAS rates have been more than passed through to customers

138. The Discussion Paper sets out stakeholder concerns that retail prices for FTM calls have remained high despite reductions in regulated MTAS rates. These concerns were raised during the 2011 MTAS FAD Inquiry and again during the 2014 MTAS Declaration Inquiry. Stakeholders have argued that Telstra has benefited from the alleged failure to pass through reductions in the MTAS to the detriment of consumers and other MNOs.

139. Telstra's position is that claims by stakeholders that Telstra has had a windfall gain from the reduction in the MTAS by not passing through that reduction to the price of FTM calls are erroneous and misleading. Previous submissions made by Telstra have presented analysis showing that Telstra has more than passed through the reductions in the MTAS rates to FTM pricing. For the purposes of this submission, Telstra has updated this analysis which is replicated in the graph below.

Figure 1: Average price of supplying voice bundled services 2004-2013⁴⁹



⁴⁹ Note 1: Cost assumed all F2M calls are off-net

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140. Telstra's analysis clearly shows that the FTM price reductions have continued. The above graph illustrates the steady decline of the FTM rate in supplying voice bundled services. From December 2004 to December 2013, Telstra's FTM yield has fallen by 11.3 cents per minute while the effective MTAS rate paid by Telstra has reduced by only 7.6 cents per minute.⁵⁰
141. Analysis of industry trends also provide evidence that MTAS rate reductions have been passed through to retail prices for fixed to mobile calls. In the 2012/2013 Annual Telecommunications Report, the Commission concluded that prices for FTM calls fell by 11.2% year on year. This represented the largest decline since the Commission began reporting on prices in this manner. The decline in retail FTM rates is consistent with the trend over the last three years which shows falls in excess of 10 per cent year on year.⁵¹
142. Telstra also notes the analysis presented by the Commission in the Final Declaration Decision which showed that:
- a. There have been consistent reductions in Telstra's FTM call rate (with the exception of 2007-08 and 2008-09) although the reductions in the call rate have been lower than the reductions in the MTAS over the period analysed.
 - b. Adjusting for off-net calls, the accumulated reductions in FTM call revenue from 2005-06 to 2012-13 is larger than the accumulated reductions in the MTAS rate.
143. The Commission's analysis reflects the reality that customers purchase fixed voice services as a basket of PSTN services (i.e. access, local, national long distance, FTM and international) rather than as individual component services. Changes in the underlying costs for one service may therefore be passed on across the bundle of services. It is therefore inappropriate to base an assessment of pass-through only on revenues and margins attached to individual products.
144. The Commission acknowledges this in the Discussion Paper, recognising that Telstra may have passed through reductions in the MTAS rate in other ways. Specifically noting that as FTM services are purchased in a bundle with other fixed services, the reductions in the MTAS rate could be reflected in the prices of other elements of these bundles. The Commission also states that it agrees with the Australian Competition Tribunal that access seekers should have the flexibility to determine the form in which cost reductions are passed on to the retail fixed services market. Telstra supports this view and considers that this results in outcomes which are in the LTIE as it provides the ability to pass on savings where most valued by customers.

⁵⁰ Figure 1 was updated based on data supplied under the Telstra Accounting Separation RKR. This RKR was repealed by the ACCC on 28 March 2014. Therefore no further update based on this data source is available. However, using the TEM SSU public report, Telstra conclude that for the period between June 2013 and June 2014, analysis shows that the average FTM price fell by 2c whilst the regulate MTAS rate fell by 1.2c over the same period.

⁵¹ ACCC, Telecommunications Report 2012-13, p.100
https://www.accc.gov.au/system/files/814_ACCC%20Telecommunications%20reports%202012%20C2%AD13%20Div%2011%20and%20Div%2012.pdf

06 TRANSITIONAL ARRANGEMENTS

145. The Discussion Paper sets out the Commission's view that, based on cost information currently available to it, future regulated prices for mobile voice termination and SMS termination are likely to be lower than current regulated and commercial terms. The Commission therefore considers that, in line with previous approaches, there may be merit in considering the circumstances that might warrant any transitional arrangements for the introduction of new mobile voice and SMS termination rates and the form that such arrangements might take.
146. Telstra considers the view formed by the Commission on future regulated prices for mobile voice termination and SMS termination to be premature given the absence of detailed cost information and/or analysis. It is Telstra's position that any views on the requirement for transitional arrangements would best be formed once the nature of any price change is known. This is because different transitional arrangements are appropriate in different circumstances.
147. For example, where a price change is particularly steep, a relatively long glide path approach will:
- a. Ensure that operators have adequate time to adjust retail prices where a sudden or rapid drop may generate significant and potentially harmful disruption to the operations and planning of telecommunications carriers; and
 - b. Reduce the impact on certain customer segments. For example, the NZCC considered that a reduction in MTAS prices may lead to a change in relative balance between wholesale revenues, monthly subscription prices and handset prices and lead operators to increase subscription prices or reduce handset subsidies. The steeper the change in the MTAS price, the more pronounced these effects may be.
148. On the other hand, smaller price changes may not require any transitional arrangements. It is also possible that, if the Commission is minded to set regulated prices for SMS termination; different arrangements may be required for voice and SMS termination. This is because, as detailed elsewhere in this submission, SMS traffic is relatively balanced and the majority of customers are on unlimited SMS retail mobile plans. As such Telstra expects that changes to the SMS termination rate will have a minimal impact on downstream retail markets. This may mean that it will be more efficient – from both a regulatory and MNO perspective – to forego any transitional arrangements and make a one-off adjustment at the start of the regulatory period.

07 DURATION OF REGULATED TERMS AND CONDITIONS

149. The Commission invites views on the appropriate regulatory period for the MTAS FAD, including appropriate commencement and expiry dates for mobile voice termination and SMS termination. The current MTAS declaration expires on 30 June 2019 which suggests that a new MTAS FAD should also apply until that time.
150. Under the CCA, the Commission must include an expiry date in an access determination for a declared service. Further, unless there are circumstances that warrant a different expiry date, this should align with the expiry of the associated determination. In the Discussion Paper, the Commission questions whether the transitional state of the mobile industry, in particular the potential deployment of 4G services for mobile voice termination and SMS termination, warrant a different expiry date for a new MTAS FAD.
151. As set out in section 03 of this submission, Telstra does not believe that it is appropriate to take any potential deployment of 4G services for mobile voice termination and SMS termination into account at this point in time. There is still a significant amount of uncertainty associated with the deployment of 4G services for termination services. Telstra is considering its technical and commercial options in this regard and industry standards are still to be developed. As a result, even if deployment does occur, the use of 4G for mobile voice and SMS termination is unlikely to be widespread over the next five years.
152. Telstra does not consider that the potential deployment of 4G for mobile voice and SMS termination represents a circumstance that would warrant different expiry dates for the MTAS declaration and FAD as required under the CCA. Telstra is also not aware of any other circumstances that would warrant different expiry dates. A new MTAS FAD should therefore align with the MTAS declaration and apply until 30 June 2019.

08 NON-PRICE TERMS AND CONDITIONS FOR THE MTAS FAD

153. The Commission is undertaking a separate consultation on the non-price terms and conditions and supplementary prices for all the declared services, including the MTAS. Telstra has made a number of submissions to the Commission in response to the Position Paper published in May 2014. All Telstra's views in relation to non-price terms and conditions and supplementary prices are contained within those submissions. Notwithstanding that, Telstra notes its overall position that any supplementary prices should be dealt with in conjunction with the primary prices for each declared service.

APPENDIX: ANSWERS TO DISCUSSION PAPER QUESTIONS

	Commission Question	Telstra Response
1	Are there different factors that should be taken into account in determining the pricing approaches for FTM termination and MTM termination? Please give details and supporting evidence.	No – the approach to determining the price for FTM and MTM termination should be the same. Mobile voice termination services are homogenous services that should be priced the same regardless of whether a call originates from a fixed or mobile network. See Section 02.
2	Are there different factors that should be taken into account in determining the pricing approaches for voice termination and SMS termination? Please give details and supporting evidence.	Yes- Telstra's view is that it would be appropriate to take a different regulatory approach to the pricing of voice and SMS termination at this point in time. Specifically, Telstra does not believe that it is necessary to set price terms for SMS. See Section 02.
3	How have developments in the mobile services market impacted on the efficient cost of providing the MTAS? Please give details and supporting evidence.	Telstra considers that the per unit cost of providing the MTAS has likely remained relatively constant since the MTAS FAD Inquiry in 2011. See Section 03.
4	When will voice and SMS termination services be offered over 4G networks? How should the ACCC take this into account for the purposes of the MTAS FAD?	Telstra is still considering its technical and commercial options regarding the deployment of mobile termination services over its 4G network. Telstra's view is that the new FAD should be based on current network deployment only. Further, Telstra considers that the Commission should not make any adjustments to the duration of provisions in the FAD based on speculative timing of 4G deployment. See Section 03.
5	Will the use of a TSLRIC or TSLRIC+ methodology to price mobile voice or SMS termination services promote the LTIE? Please explain your answer.	Telstra considers that a TSLRIC+ methodology to price the MTAS will best promote the LTIE as it provides an access seeker with an expectation of a return on efficiently invested capital and the recovery of efficiently incurred common costs. See Section 04.
6	If a TSLRIC or TSLRIC+ methodology is used to price mobile voice or SMS termination services:	Telstra supports the continued use of the approach previously taken by the Commission for allocating traffic-related common costs and organisational-level

	<p>(a) Which cost allocation method should be used for allocating traffic-related common costs?</p> <p>(b) Which cost allocation method should be used for allocating organisational-level costs?</p>	<p>common costs. See Section 0.</p>
7	<p>Will the use of a pure LRIC methodology to price mobile voice or SMS termination services promote the LTIE? Please give reasons.</p>	<p>Telstra considers that a pure LRIC methodology to price the MTAS will not promote the LTIE or any other statutory criteria. See Section 4.2.2.</p>
8	<p>If a pure LRIC methodology is adopted, are there risks that prices of other services offered by MNOs may increase? If so, how significant are these risks? Please give reasons and any supporting evidence.</p>	<p>Yes – if the Commission adopts a pure LRIC methodology, Telstra believes that there is a significant risk that prices of other services offered by MNOs will increase. This is because in the long run MNOs must recoup all costs associated with a service, which a pure LRIC approach does not allow for. See Section 4.2.2.</p>
9	<p>If the ACCC adopts a LRIC pricing methodology (i.e. TSLRIC, TSLRIC+ or pure LRIC), should it use a FLBU or actual costs model? Please give reasons.</p>	<p>Ideally Telstra considers that the Commission should use a FLBU modelling approach to inform TSLRIC+ pricing for the MTAS. However, Telstra recognises that there are practical limitations to achieving this and suggests a more pragmatic approach is to use international benchmarking. See Section 4.2.3.</p>
10	<p>If the ACCC uses a FLBU model, should actual costs be used to cross check the outputs from the model? If so, how would any discrepancies be resolved in determining the costs to be used in setting prices?</p>	<p>No – Telstra does not support the use of actual costs to be used to cross check the outputs from a FLBU cost model due to the high degree of variability that may results from different approaches to cost allocation between MNOs. See Section 4.2.3.</p>
11	<p>Would regulated pricing for voice termination and SMS termination in Australia be assisted by:</p> <p>(a) an international benchmarking study of regulated mobile termination prices adopted in other jurisdictions</p> <p>(b) an international benchmarking study of mobile termination costs in other jurisdictions?</p> <p>Please give reasons.</p>	<p>Telstra maintains its view that a TSLRIC+ cost model is the best approach to estimate MTAS pricing. However, Telstra further considers that international benchmarking may be a more pragmatic approach at this time given the limitations around developing a new model.</p> <p>Telstra agrees with the Commission that a benchmark of the costs of providing mobile termination in other jurisdictions, as opposed to a benchmark of actual mobile termination prices is likely to be more useful for approximating cost-based prices for mobile termination services in Australia. See Section 4.3.</p>
12	<p>What are the important factors that need to be taken into account in developing a robust and effective benchmarking study?</p>	<p>Telstra considers that care and a conservative manner must be applied with considering international benchmark data in the context of setting a regulated price for the MTAS in Australia.</p>

		The use of international benchmarking as an appropriate pricing methodology relies on (a) appropriate selection of benchmark sample countries; and (b) appropriate adjustments to MTAS cost estimates of those sample countries. See Section 4.3.
13	Is it appropriate to restrict the benchmark set to jurisdictions that have adopted a particular pricing methodology, and if so, which methodology would be appropriate? Please give reasons.	Telstra's position is that the approach taken by the New Zealand Commerce Commission (NZCC) in terms of the selection of the initial benchmark sample is appropriate. That is, jurisdictions should only be included in the benchmark sample if they use a TSLRIC+ (or equivalent) cost model. This may include jurisdictions that apply a pure LRIC methodology where they also publish a TSLRIC+ (or equivalent) cost estimate. See Section 4.3.
14	Will a BAK arrangement for MTM voice or SMS termination services promote the LTIE? Please give reasons.	Telstra does not consider that a BAK arrangement for termination services will promote the LTIE. This is because (a) the conditions for BAK to be an efficient mechanism are not present in Australia and (b) BAK may lead to unintended outcomes. See Section 4.4.
15	Are there other options for determining the price of mobile voice termination and SMS termination that the ACCC should consider? If so, please explain why.	Telstra has not proposed any alternate options for determining the price of the MTAS.
16	To what extent have reduced regulated MTAS rates have been passed-through to retail prices for fixed to mobile calls? Please provide evidence.	Telstra has more than passed through reductions in regulated MTAS rates to retail prices for customers. This is supported by Telstra and the Commission's own analysis. See Section 5.2.
17	Should integrated operators (i.e. operators of both mobile and fixed networks) be subject to a mandated pass-through of MTAS reductions? If so, how would this be implemented? Please provide reasons for your answer, including by reference to the LTIE.	No – a mandated pass-through of MTAS reductions would not be in the LTIE. Telstra considers that a pass-through mechanism would distort competition and may result in the Commission acting outside its jurisdiction. See Section 5.1.
18	What, if any, transitional arrangements should apply to potentially lower voice termination and SMS termination rates? Should there be different implementation times for potential reductions in regulated voice termination and SMS termination? Please give reasons, including by reference to the LTIE.	Telstra considers that decisions regarding potential transitional arrangements are best left until the nature and scale of changes in MTAS prices are known. See Section 06.
19	What is an appropriate regulatory period for primary prices relating to mobile voice termination and for SMS termination?	Telstra's position is that a new MTAS FAD should align with the MTAS declaration and apply until 30 June 2019.



		See Section 07.
20	Should there be different commencement and expiry dates for mobile voice termination and SMS termination?	Yes – Telstra does not consider that it is necessary to apply price terms to the declaration of SMS termination at this point in time. See Section 07.