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Mobile terminating access service

Final access determination discussion paper

August 2014

Submission by Thomson Geer Lawyers on behalf of:

iiNet Limited

Public Version

1. INTRODUCTION

The Australian Competition and Consumer Commission (**ACCC**) is currently undertaking a public inquiry into making a final access determination (**FAD**) for the Mobile Terminating Access Service (**MTAS**). As part of this public inquiry the ACCC has released a discussion paper entitled: *Mobile terminating access service, Final access determination discussion paper* (**the Discussion Paper**).

The Discussion Paper seeks views on the price for MTAS. Issues relating to non price terms are subject to a separate consultation.

iiNet welcomes the opportunity of responding to the Discussion Paper. iiNet's response is set out below.

Please note that this submission contains commercial in confidence information which is marked '[**c-i-c**]' and highlighted in yellow.

2. STRUCTURE OF THIS SUBMISSION

The Discussion Paper raises 20 questions for consideration. iiNet's response to each of those questions is set out in section 5 of this submission. In addition to providing iiNet's response to the questions in the Discussion Paper, this submission also provides the relevant background and context in which to consider iiNet's response (section 3 below) and a summary of iiNet's conclusions as to how the ACCC should approach setting the new price for MTAS (section 4 below).

3. BACKGROUND AND CONTEXT

iiNet notes that:

- The ACCC's approach to pricing MTAS in the past has been conservative. In particular:
    - When the ACCC first set indicative prices for MTAS in 2004, the starting price was the lowest price at which the service was then commercially supplied and the end price was the upper end of the range of reasonable TSLRIC+ estimates.[1]
    - The ACCC's MTAS indicative prices in 2007 were informed by the output of the WIK cost model. However, although that cost model suggested a price in the range of 6.6cpm to 6.1cpm, the ACCC set the price at 9cpm.[2]
    - The ACCC retained the price of 9cpm when it made its indicative prices in 2009 despite developments that saw Mobile Network Operators (**MNOs**) provide MTAS over 3G networks at less cost.[3]
    - When the ACCC made the first MTAS FAD in 2011, the ACCC identified 3.6cpm as the efficient cost of providing MTAS at that time. However, the ACCC adopted a conservative price path and the price of 3.6cpm did not apply until 1 January 2014.[4]
- The ACCC is of the view that:

[1] Trade Practices Act 1974 Determination under section 152AQA - 30 June 2004, annexure 1 - Principles relating to the price of access to the Domestic Mobile Terminating Access Service.
[2] See section 3.4 of ACCC - Domestic Mobile Terminating Access Service Pricing Principles Determination and indicative prices for the period 1 January 2009 to 31 December 2011.
[3] ibid at pp18,19.
[4] Inquiry to make a final access determination for the Domestic Mobile Terminating Access Service (MTAS) Access Determination Explanatory Statement 7 December 2011, at pp13,14.

- o changes in consumer use of mobile services; and
- o investments in technological advances,

mean that the efficient cost of providing MTAS is likely to have fallen since the ACCC last set the price for MTAS in 2011.[5] This means that the current MTAS price of 3.6cpm is likely to allow MNOs to recover more than the efficient cost of providing MTAS.

- When the ACCC made the first MTAS FAD in 2011, the ACCC identified a price approaching zero for providing voice termination on an LTE network.[6]

- Continuing to allow MNOs to recover more than the efficient cost of providing MTAS does not promote the long term interests of end users (**LTIE**).[7]

4. SUMMARY OF IINET'S CONCLUSIONS

The fundamental question is - How much should the MTAS price be reduced by and when?

- As changes in consumer use of mobile services and investments in technological advances mean that the efficient cost of providing MTAS is likely to have fallen since the ACCC last set the price for MTAS in 2011, it appears that the fundamental question at the heart of the MTAS FAD public inquiry is not whether the current price for MTAS should be reduced but how much it should be reduced by and when.

The ACCC should adopt a two stage approach to setting the MTAS price

- iiNet notes that the ACCC has previously found that the cost of providing voice termination on an LTE network is close to zero.[8] Therefore, a move to 4G networks has the potential to drastically reduce the cost of providing MTAS termination. However, there is uncertainty as to when MNOs will use 4G networks to supply voice and SMS services. In iiNet's view, the uncertainty over when 4G networks will be used to provide voice and SMS services requires the ACCC to take a two stage approach to setting the MTAS price.

  - o Stage 1 requires the ACCC to set prices for a shorter regulatory term. This term should be two years. At the end of the first year of this term, the ACCC should review the position with a view to moving to stage 2.

  - o Stage 2 involves the adoption of an MTAS price path with an end point of close to zero (which is the cost of termination on a 4G network).

iiNet favours a pragmatic approach for stage 1 based on bringing the MTAS price into line with the Fixed Terminating Access Service price

- Given that a cost model based on a 3G network is likely to be almost immediately out of date, and the output of a costs model and international benchmarking study may not vary significantly, an approach based on international benchmarking is more appropriate for stage 1 than an approach that involves the development of a new costs model. That said, an attractive pragmatic alternative approach for pricing

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[5] Discussion Paper sections 3.1 and 3.2.

[6] ibid.

[7] ACCC, Telecommunications services - Declaration provisions - a guide to the declaration provisions of Part XIC of the Trade Practices Act July 1999, at p.35. See also: *Telstra Corporation Ltd (No. 3)* [2007] ACompT 3 at [159] and [164].

[8] ACCC - Domestic Mobile Terminating Access Service Pricing Principles Determination and indicative prices for the period 1 January 2009 to 31 December 2011, at pp.18,19.

MTAS during stage 1 is to align the price of MTAS with the price of the Fixed Terminating Access Service (**FTAS**).[9] This would have the following advantages:

- it would deliver a speedier outcome than international benchmarking; and
- aligning the price of MTAS with FTAS is likely to stimulate competition by allowing service providers to develop new bundled pricing options for end users.

iiNet submits that adopting such an approach for stage 1 would not be inconsistent with the legitimate business interests of the MNOs because, given the previous and current over-recovery of efficient costs and the trend towards 4G networks, it is likely that the MNOs have recovered the sunk costs of the 3G networks and so reducing the price to the price of the FTAS will not result in any under recovery of investment.

A LRIC methodology better reflects the efficient costs of MTAS than a TSTRIC+ methodology

- If the ACCC decides to adopt an international benchmarking approach, the ACCC should only consider jurisdictions that use a pure LRIC methodology because, due to the particular characteristics of mobile termination services, a pure LRIC methodology is the methodology that best reflects the efficient costs of providing mobile termination, and accordingly, better promotes the LTIE than an approach that allows MNOs to recover more than the efficient cost of providing MTAS.[10]

SMS pricing should be based on voice pricing

- The ACCC should set the price for SMS termination on the basis of the following formula and consider varying the current FAD to include an initial price for SMS termination based on the current FAD rate for voice termination:

$$A = B/C$$

Where: A = the cost of terminating one SMS message; B = the MTAS charge for terminating a voice call; C = the number of SMS messages that can be sent per minute of voice call.

Other Issues

- Stage 1 pricing should be applied immediately without any transitional arrangements.
- The ACCC should not distinguish between the treatment of FTM and MTM calls.
- Integrated operators (i.e. operators of both mobile and fixed networks) should be subject to a mandated pass-through of MTAS reductions for both retail and wholesale customers.

[9] Formally the PSTNTA.
[10] ibid.

5. RESPONSE TO ACCC QUESTIONS

1. Are there different factors that should be taken into account in determining the pricing approaches for FTM termination and MTM termination?

MTAS is an identical input for both FTM and MTM calls.[11] Therefore, the pricing approach for the termination of FTM and MTM should, as a matter of principle, be identical. Furthermore, beyond the issue of principle, if FTM and MTM calls are treated differently (which is likely to favour MTM calls) there is the risk of artificial competitive distortions being created and/or providers that have fixed and mobile networks engaging in arbitrage by routing FTM calls through their mobile networks.

2. Are there different factors that should be taken into account in determining the pricing approaches for voice termination and SMS termination?

iiNet believes that it is possible to take a pragmatic approach to the setting of prices for SMS termination so that the cost of terminating one SMS message is established by means of the following formula:

$$A = B/C$$

Where: A = the cost of terminating one SMS message; B = the MTAS charge for terminating a voice call; C = the number of SMS messages that can be sent per minute of voice call.

iiNet believes that this approach would be the most efficient way of regulating SMS termination because it allows a reliable estimate of the cost of terminating an SMS message to be obtained on the basis of the assessment of the cost of terminating a voice call (i.e. there is no need for separate modelling or benchmarking of SMS costs).

3. How have developments in the mobile services market impacted on the pricing of the MTAS?

As noted in section 3 above, it is likely that changes in consumer use of mobile services and investments in technological advances mean that the efficient cost of providing MTAS is likely to have fallen since the ACCC last set the price for MTAS in 2011.[12]

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?

iiNet notes that 4G networks are currently being used to provide data services by the MNOs and have been for some time. However, it appears that none of the MNOs currently have any immediate plans to provide IP voice services over their 4G networks.[13]

iiNet notes that the ACCC has previously found that the cost of providing voice termination on an LTE network is close to zero.[14] Therefore, a move to 4G networks has the potential to drastically reduce the cost of providing MTAS termination. In iiNet's view, the uncertainty over when 4G networks will be used to provide voice services requires the ACCC to take a two stage approach to setting the MTAS price.

Stage 1 requires the ACCC to set prices for a shorter regulatory term. This term should be two years. For the reasons given in response to question 15 below, the MTAS price for stage 1 should be determined on the basis of the price of the FTAS. At the end of the first year, the ACCC should review the position with a view to moving to stage 2. Stage 2 involves the adoption of an MTAS price path with an end point of close to zero (which is the cost of termination on a 4G network).

[11] Discussion Paper, at p.5.
[12] Discussion Paper sections 3.1 and 3.2.
[13] Discussion Paper, at p.8.
[14] ACCC - Domestic Mobile Terminating Access Service Pricing Principles Determination and indicative prices for the period 1 January 2009 to 31 December 2011, at pp.18,19.

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.***

In this submission, the terms 'pure LRIC' and 'TSLRIC' and 'TSLRIC+' have the same meanings as in the Discussion Paper. iiNet submits that using the pure LRIC methodology to set the price for MTAS would better promote the LTIE than using a TSLRIC or TSLRIC+ pricing methodology. The reasons for this are best expressed in the context of the following examples:

- **Example 1** - the access provider provides services A, B, C and D. Each service is subject to regulated pricing. If the regulator sets regulated pricing for each service in isolation on the basis of pure LRIC, it is likely that the access provider will not recover the efficient costs of providing the services because it would not be able to recover any organisational level costs (i.e. the 'costs of doing business'). Therefore, in this situation, a pure LRIC approach would not promote the LTIE because it would not reflect the efficient cost of providing the services and it would give insufficient weight to the access provider's legitimate business interests and, in doing so, be likely to discourage investment by the access provider. Therefore, a TSLRIC+ approach would better promote the LTIE in this scenario.

- **Example 2** - the access provider provides services A, B, C and D. These services are subject to competitive constraint and are not regulated. Each service has shared common costs. Due to economies of scale, the organisational level costs are recovered through services A, B and C (with the cost of providing service D being its incremental cost). The access provider wishes to provide a new service E. Service E is not subject to competitive constraints and is subject to regulated pricing. Service E uses the same infrastructure as services A, B, C and D. If the regulator sets the price for service E on the basis of TSLRIC+ then it is likely that the access provider will recover more than its efficient costs of providing service E because it will double recover some of the common costs. Allowing an access provider to recover more than its efficient costs is likely to have a detrimental effect on competition and/or lead to end users paying more for downstream services than would be the case if service E was subject to competitive constraints. Therefore, in this scenario, a pure LRIC approach that allows the access provider to recover no more than the avoidable costs of providing service E would better promote the LTIE than a TSLRIC+ approach.

iiNet submits that given that:

- MNOs would be required to provide termination for their own customers even if the MTAS did not exist; and

- MTAS is the only regulated service provided over the mobile networks,

the provision of MTAS is akin to example 2 rather than example 1. Therefore, adopting a pure LRIC approach rather than a TSLRIC+ approach for MTAS pricing would better promote the LTIE because a TSLRIC+ approach is likely to lead to over-recovery. Given that other services that are provided by MNOs are subject to competitive constraints, iiNet does not believe that a reduction in MTAS prices will lead to a rise in the price for other services.

iiNet notes that adopting a pure LRIC approach would be consistent with the position recommended by the European Commission.[15] However, iiNet notes that the ACCC states that the ACCC does not consider that the UK regulator Ofcom's reasoning in applying the European Commission's recommendation can be found to apply directly to Australia without a detailed assessment of what the impact of pure LRIC and TSLRIC+ pricing approaches would

[15] European Commission, *Recommendation of 7 May 2009 on the Regulatory Treatment of Fixed and Mobile termination Rates in the EU (2009/396/EC),* Official Journal of the European Union, L 124/67, 20 May 2009 (EC Recommendation 2009)

be on competition in the relevant Australian markets.[16] iiNet respectfully submits that making the adoption of a particular cost modelling methodology dependent on an analysis of the likely effects of competition is not the correct approach. This is because the question that the cost modelling seeks to answer is a narrow factual question which is:

> *What is the efficient cost of providing the service?*

An analysis of competition has no relevance to this question. The material related question that arises for consideration here is:

> *Will a pure LRIC or a TSLRIC+ approach better reflect the efficient cost of providing MTAS?*

iiNet's view is that on the basis of the simplified analysis involving examples 1 and 2 above, the characteristics of MTAS mean that a pure LRIC approach is likely to better reflect the efficient cost of providing MTAS. A consideration of the effects on competition only becomes relevant at a later stage, when the following question is asked:

> *Will the statutory criteria be better promoted by allowing the access provider to recover more or less than the efficient cost of supplying the service as determined by the appropriate costing methodology?*

iiNet submits that it is uncontroversial to state that the LTIE criteria are best promoted by restricting the access provider to recovering no more than its efficient costs.[17] Therefore, the only question that is in issue here is whether a pure LRIC or a TSLRIC approach better reflects the efficient costs of providing MTAS. For the reasons given above, iiNet submits that due to the particular characteristics of the MTAS service, a pure LRIC approach will better reflect the efficient cost of supply.

6. ***If a TSLRIC or TSLRIC+ methodology is used to price mobile voice or SMS termination services:***
   a) Which cost allocation method should be used for allocating traffic-related common or costs?
   b) Which cost allocation method should be used for allocating organisational-level costs?

   For the reasons given in response to question 5 above, iiNet believes that a pure LRIC methodology is more appropriate.

7. ***Will the use of a pure LRIC methodology to price mobile voice or SMS termination services promote the LTIE?***

   For the reasons given in response to question 5 above, iiNet believes that a pure LRIC methodology would promote the LTIE.

8. ***If a pure LRIC methodology is adopted, are there risks that the prices of other services offered by MNOs may increase?***

   As explained in response to question 5 above, iiNet believes that any such risk is low due to competitive constraints applying to those other services.

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[16] Discussion Paper, p.16.

[17] ACCC, Telecommunications services - Declaration provisions - a guide to the declaration provisions of Part XIC of the Trade Practices Act July 1999, at p.35. See also: *Telstra Corporation Ltd (No. 3)* [2007] ACompT 3 at [159] and [164].

9. ***If the ACCC adopts a LRIC pricing methodology (i.e. TSLRIC, TSLRIC+ or pure LRIC), should it use an FLBU or actual costs model, or some combination of the two? Please give reasons.***

If the objective is to establish efficient costs then a FLBU should be used because as pointed out in the Discussion Paper, actual costs may not have been efficiently incurred and they therefore provide little incentive for the MNOs to increase efficiency.[18]

10. ***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?***

The ACCC could have regard to actual costs as a 'sanity check'. However, if the objective is to establish efficient costs then FLBU modelling should take precedence.

11. ***How will regulated pricing for voice termination and SMS termination in Australia be assisted by:***
(a) an international benchmarking study of regulated mobile termination prices adopted in other jurisdictions,
(b) an international benchmarking study of mobile termination costs in other jurisdictions?

iiNet believes that international benchmarking is more appropriate than the adoption of a costs model because as observed in the Discussion Paper:[19]

- the difference between the outputs of a cost model and an international benchmark study are likely to be minimal; and
- by the time a cost model based on the current 3G network has been developed it may already have become out of date.

Given that the cost of termination on a 4G network has been assessed as being close to zero,[20] it appears that the price of MTAS can only be moving in one direction and the most material question is what is the best price path to adopt with an end point of close to zero.

As discussed in response to question 4 above, iiNet believes a two stage approach is appropriate.

12. ***What are the important factors that need to be taken into account in developing a robust and effective benchmarking study?***

The obvious problem in any benchmarking study is the need to compare 'apples with apples'. As regards costs, factors that need to be considered include:

- whether actual costs or hypothetical costs have been used,
- the type of network infrastructure and
- the level of demand.

As regards prices, the factors that need to be considered include:

- whether the prices are based on the output of a costs model and, if so, the methodology employed;

[18] Discussion Paper, at p.17.
[19] ibid, pp.18,19.
[20] ACCC - Domestic Mobile Terminating Access Service Pricing Principles Determination and indicative prices for the period 1 January 2009 to 31 December 2011, at pp.18,19.

- whether the price is intended to reflect efficient cost or whether other considerations mean that the price is intended to allow over or under recovery of efficient cost

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?***

iiNet believes that the characteristics of the MTAS service mean that a pure LRIC methodology is the appropriate methodology. Therefore, the benchmark set should be restricted to those jurisdictions that have adopted a pure LRIC methodology.

14. ***Will a BAK arrangement for MTM voice or SMS termination services promote the LTIE?***

Due to the possibility of arbitrage by integrated network operators and the resultant detrimental impact on competition that such arbitrage would have[21], iiNet does not believe a BAK approach for MTM would promote the LTIE unless conditions were right for it to also apply to FTM and MTF calls.

Whether a BAK arrangement for SMS will promote the LTIE depends on whether the volumes of traffic between the networks are balanced enough or the price is close enough to zero not to make any material difference.

15. ***Are there other options for determining the price of mobile voice termination and SMS termination that the ACCC should consider?***

A possible pragmatic alternative to the options canvassed in the Discussion Paper is to align the price of MTAS with the price of the Fixed Terminating Access Service (**FTAS**).[22] This would have the following advantages:

- it would deliver a speedier outcome than international benchmarking; and
- aligning the price of MTAS with FTAS is likely to stimulate competition by allowing service providers to develop new bundled pricing options for end users.

In light of these advantages, this is iiNet's preferred approach. iiNet submits that adopting such an approach would not be inconsistent with the legitimate business interests of the MNOs because, given the trend towards 4G networks, it is likely that the MNOs have recovered the sunk costs of the 3G networks and so reducing the price to the price of the FTAS will not result in any under recovery of investment.

16. ***To what extent have reduced regulated MTAS rates have been passed-through to retail prices for fixed to mobile calls?***

[**c-i-c**]

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?***

iiNet believes that such an approach would be sound in principle. However, pass through should not only be restricted to retail services it should also apply to wholesale services as well. iiNet believes that MNOs being required to pass through reductions in MTAS prices to wholesale customers will promote competition which in turn is likely to act as a further driver of lower prices for consumers. As regards implementation, iiNet acknowledges that this may present difficulties. However, iiNet notes that this issue was considered during the inquiry for the 2011 MTAS FAD and the ACCC received a submission from the Competitive Carriers

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[21] i.e. an integrated operator could deliver FTM traffic through its mobile network for termination.
[22] Formally the PSTN TA.

Coalition (**CCC**) which, in iiNet's view, provides a possible means of implementing pass through on an incentive based approach.[23]

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.

iiNet submits that continuing to allow MNOs to recover more than the efficient cost of providing MTAS does not promote the LTIE because it leads to higher prices for consumers and the inefficient use of infrastructure. As pointed out in response to question 15 above, given the trend towards 4G networks, it is likely that the MNOs have recovered the sunk costs of the 3G networks. Therefore, an immediate reduction in price is unlikely to unreasonably affect the legitimate business interests of the MNOs. Therefore, iiNet believes that MTAS prices should be reduced with immediate effect.

As regards SMS termination, this has only recently been declared. Therefore, there is currently no regulated price for SMS termination. Given that the ACCC's current FAD review may take 12 months or longer to complete, iiNet believes that the ACCC should consider varying the current FAD to include an initial regulated price for SMS termination. As stated in response to question 2 above, it is possible to set an SMS price based on the relative network capacity used by a voice call and an SMS. iiNet notes that the ACCC is currently in possession of information from both Optus and Vodafone as regards the number of SMS messages that can be terminated by the network capacity used to terminate a one minute voice call.[24] Therefore, it appears to iiNet that the ACCC is in a position to set an initial regulated price for SMS before it has completed its inquiry into what the updated cost of voice termination should be. Once the ACCC has completed this inquiry, the initial regulated SMS termination charge could be updated accordingly at the end of the ACCC's current inquiry. Given that the ACCC has found that current commercially negotiated SMS termination prices are well above cost,[25] iiNet submits that effectively leaving SMS termination unregulated for a further year+ clearly does not promote the LTIE.

19. What is an appropriate regulatory period for primary prices relating to mobile voice termination and for SMS termination?

As discussed in response to question 4 above, given the current uncertainty over the use of 4G networks for mobile voice termination, and a potential further drastic decrease in termination costs in the future, iiNet believes that the ACCC should take a two stage approach to setting the MTAS price.

Stage 1 requires the ACCC to set prices for a shorter regulatory term. This term should be two years. MTAS price for stage 1 should be aligned with the price of the FTAS. The next best approach would be to use international benchmarking restricted to jurisdictions that use a pure LRIC methodology. At the end of the second year, the ACCC should review the position with a view to moving to stage 2. Stage 2 involves the adoption of an MTAS price path with an end point of close to zero (which is the cost of termination on a 4G network)

20. Should there be different commencement and expiry dates for mobile voice termination and SMS termination?

Please see the response to question 18 above.

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29 August 2014

[23] CCC submission in response to ACCC Domestic Mobile Terminating Access Service (MTAS) Public Inquiry to make an Access Determination Discussion Paper June 2011.
[24] Domestic Mobile Terminating Access Service Declaration Inquiry Report of the ACCC's Draft Decision 13 December 2013, at section 5.1.
[25] Domestic Mobile Terminating Access Service Declaration Inquiry ACCC's Final Decision June 2014, at p.39.