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Dear Clare

Optus additional submission on declaration of SMS termination — Public Version

Optus wishes to provide additional comments in response to Telstra's Response to the Submissions of other Interested Parties on the Commission's Discussion Paper on the Review of the declaration of the Domestic Mobile Terminating Access Service (MTAS).

Telstra argues that SMS termination should not be regulated because:

- Retail SMS is provided in a bundle of mobile services;
- Traffic volumes are balanced and there is no off-net differential; and
- Commercial negotiations have not failed, and **[CiC]**.

Optus disagrees with all three reasons:

- First, the argument that wholesale termination services should not be regulated because it is sold in a bundle of retail mobile services has been rejected by the ACCC and Australian Competition Tribunal (ACT) for over a decade.
- Second, the reason for regulation of termination is the existence of above cost rates. Issues of traffic balance and off-net price differential are irrelevant to the question of declaration.
- Third, Telstra is wrong that commercial negotiations have not failed. Optus has been unable to renegotiate the decade long agreement to update SMS rates with any MNO. **[CiC]**

These issues are discussed further below.

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Relevant market is the wholesale termination market

Telstra argues that SMS is provided in a bundle of retail mobile services and as such there are no competition concerns. However, this argument has been rejected as a justification for not declaring MTAS since 2004.[1] Telstra has supported the view that MTAS should continue to be regulated, irrespective of whether retail voice services are supplied in a bundle of mobile products. Telstra stated in 2009 that:

> *As each mobile operator has control over services that terminate on its network, and operators have no control over which networks are called by their end-users, regulation of the MTAS remains critical.*[2]

The Australian Competition Tribunal (ACT) has also rejected such an argument and emphasised that the relevant market is the wholesale termination market:

> *It is correct to identify a wholesale market for the supply of Optus' MTAS. There are no substitutable products and the relevant market transaction is a wholesale transaction provided by one network operator to another. To the extent to which there is substitutability of products or services it is the bundle of services which is substitutable; one of the services is not substitutable for another of the services.*[3]

The exact same logic applies to wholesale SMS termination — under this logic each MNO controls the termination of SMS' on their networks. Each MNO has a 100% market share of the market for SMS termination on their network. The issue of how SMS' are supplied in the retail market does not impact on the finding that each MNO has market power in the wholesale market for termination of SMS' on their network.

Traffic levels and on-net balances are irrelevant

Telstra argues that declaration of the SMS termination service should be dependent on whether traffic is balanced.[4] Telstra is arguing that the regulation of wholesale termination service depends upon the commercial circumstances of the relevant MNO. This view is clearly incorrect, and inconsistent with the regulation of termination services in Australia. Optus also notes that in relation to voice termination, Telstra saw traffic balances as irrelevant to the issue of declaration.[5] It is not clear why traffic balances are irrelevant for voice, yet should be a determining factor whether to declare SMS termination.

Telstra also argues that SMS termination should not be regulated because there are no significant off-net price differentials. Optus notes that there are also no significant retail voice

[1] ACCC, 2004, Mobile Services Review – Mobile Terminating Access Service – Final Decision.
[2] Telstra, 2009, Response to ACCC Discussion Paper on the Re-declaration of the MTAS of December 2008, p.4.
[3] Application by Optus Mobile Pty Limited and Optus Networks Pty Limited [2006] ACompT 8 at para [80].
[4] Telstra, 2011, Response to the Submissions of other Interested Parties on the Commission's Discussion Paper on the Review of the declaration of the Domestic Mobile Terminating Access Service, p.6.
[5] See Telstra, 2011, p.62. Responding to an ACCC question on the extent of imbalance between FTM and MTM traffic, Telstra stated "Telstra does not understand the relevance of this question in the context of determining the appropriate costs for the MTAS".

off-net price differentials in the Australian market — yet Telstra does not use this as evidence to remove the MTAS Declaration.

Both of these issues are largely irrelevant to whether regulation of termination services promotes the LTIE. The key problem with the current SMS termination market is that the SMS termination rate is in excess of the costs of supply. This fact alone has been the key reason why wholesale voice termination was, and continues to be, regulated. It is absolutely clear from all previously statements from the ACCC, the ACT, Telstra and other operators that the LTIE is best promoted by termination rates that reflect efficient cost-based prices.

The ACCC has continuously stated that prices set at the efficient cost of supply best promote the LTIE:

> *Regardless of the network design, the value of that network should reflect an access price which reflects or is tending toward an efficient cost for the supply of the relevant access services using that network (and in the case of MTAS using a TSLRIC+ estimate). There is also recognition that pricing aligned to efficient costs will more likely encourage efficient investment in infrastructure.*[6]

The ACCC has also stated that:

> *The Commission has previously outlined why it preferred to establish access prices such as the MTAS with reference to the TSRLIC. These reasons are summarised below:*
>
> 1. *it encourages competition in telecommunications markets by promoting efficient entry and exit in dependent markets;*
> 2. *it encourages economically efficient investment in infrastructure and provides the appropriate incentives for future investment in decisions by access seekers to 'build' or 'buy';*
> 3. *in the long run TSLRIC based pricing provides for the efficient use of existing infrastructure, promoting allocative efficiency in the use of infrastructure;*
> 4. *it provides incentives for access providers to minimise the costs of providing access by using the most efficient technology commercially available today and best-in-use technology compatible with the existing network design;*
> 5. *by allowing efficient access providers to fully recover the costs of producing the service, it promotes the legitimate business interests of the access provider; and*
> 6. *it protects the interests of persons who have rights to use the declared service.*[7]

The ACT similarly makes it clear that cost-based rates promote the LTIE:

> *Nevertheless, we still consider that in general terms the prices in access undertakings should reflect and not exceed forward looking efficient economic costs.*[8]

[6] ACCC, MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008, p.48.
[7] ACCC, MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008, p.12.

Optus reiterates that these views are uncontroversial. Indeed, Telstra has previously advocated for cost-based MTAS rates:

> *Previously, the Commission and the Australian Competition Tribunal (the Tribunal) have clearly stated that MTAS prices should be set according to the efficient costs of providing the service.*[9]
>
> *Instead of adopting such a vague approach to pricing principles (which undermines the numerous statements made to the industry over the years as to how pricing will be determined) the Commission should revert to determining MTAS prices in accordance with its previously established principle of efficient costs – ie TSLRIC+.*[10]

Telstra strongly criticised the ACCC in 2008 for departing from what, in Telstra's opinion, was the efficient cost of providing MTAS.

> *Indeed, the Commission provides no basis upon which it has determined 9cpm as a starting point for the indicative prices, and in fact the evidence clearly demonstrates that the 9cpm price has no correlation whatsoever to efficient cost -- it is well above the efficient cost of providing the MTAS.*[11]
>
> *The Commission's commentary on the TSLRIC+ approach adopted in the Draft Determination departs markedly from the body of precedent it has established over the years in relation to the pricing of the MTAS, including statements by the Tribunal adopting the TSLRIC+ principle. It seems that suddenly the Commission has taken upon itself to re-write its interpretation of the LTIE criteria under Part XIC, and has given itself the liberty to determine prices for declared services based on a range of unproven factors.*[12]

Telstra has also previously stated that a "*network asset should not be valued on the basis of a network that bears little or no resemblance to the actual efficient costs associated with supplying services*."[13] However, Telstra's position on SMS termination directly counters this argument. The current SMS termination rate is many times higher than the cost of providing the service. At the moment, the SMS termination rate is set at a level that has little or no relationship to the actual efficient cost associated with supplying the service.

Telstra's position appears to be that efficient cost-based rates promote the LTIE for voice termination when Telstra is a net-payer; but efficient cost-based rates do not promote the LTIE if traffic balances are close or where it is a net receiver. In other words, the promotion

[8] Application by Vodafone Network Pty Ltd & Vodafone Australia Limited [2007] ACompT 1 (11 January 2007) at [44].
[9] Telstra, 2008, p.3.
[10] Telstra 2008, p.2.
[11] Telstra, 2008, Response to the ACCC's Draft MTAS Pricing Principles Determination and indicative prices for the period 1 January 2009 to 31 December 2011, 15 December 2008, PUBLIC VERSION, p.21.
[12] Telstra, 2008, p.4.
[13] Telstra, 2011, Response to the Commission Discussion Paper on Domestic Mobile Terminating Access Service (MTAS), p.17.

of the LTIE depends upon the financial impact of the regulation on Telstra. Optus submits that this is not a position that the ACCC can adopt. Either cost-based rates promote the LTIE or they do not. If cost-based rate are efficient for voice termination and every other declared service, then cost-based rates are efficient for SMS termination.

Commercial negotiation has not worked

Telstra's claim that commercial negotiations have not failed is false. Telstra argues that it would be preferable to leave the MNOs to commercially negotiate SMS termination pricing, a process that has worked successfully for the past decade, without the need for regulatory intervention. However, this does not accurately reflect Telstra's current refusal to agree to any reduction in the current rate for the foreseeable future.

[CiC]

The current commercially negotiated SMS termination rate has not changed for over a decade and is significantly above the cost to provide SMS termination. The voice MTAS rate is now a fraction of the SMS termination rate. Given that SMS uses significantly fewer network resources than voice services this is an indication of monopoly pricing.

Optus' experience clearly shows that commercial agreements are no longer working and there are market failures which need to be addressed. This implies that MNOs can and do exercise monopoly power over the termination of SMS' on their networks.

Optus reiterates that:

- Each MNO has 100% market share over the ability to terminate SMS' on their networks;
- MNOs have used this market power to set the rate of SMS termination significantly above the efficient cost of providing; and
- There are now commercial disputes over SMS termination rates which were not previously present.

It is absolutely clear that the inclusion of SMS termination within the MTAS service description promotes the LTIE.

Should you wish to discuss any of these issues in more detail, please contact me on (02) 8082 6454 or by email (luke.vanhooft@optus.com.au).

Regards

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