TELSTRA CORPORATION LIMITED

Response to the Commission's Domestic Mobile Terminating Access Service Declaration Inquiry – Report of the ACCC's Draft Decision

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01 EXECUTIVE SUMMARY

1. Telstra welcomes the opportunity to provide this submission to the Australian Competition and Consumer Commission's (**Commission**) Domestic Mobile Terminating Access Service Declaration Inquiry – Report of the ACCC's Draft Decision, 13 December 2013 (**Draft Decision**) relating to the declaration of the domestic mobile terminating access service (**MTAS**).

2. The Draft Decision set out the Commission's preliminary view that the declaration of MTAS should be extended for five years. Based on the information provided to the Commission through the inquiry process, the Draft Decision also set out the Commission's preliminary view that the MTAS service description should be varied to include short message service (**SMS**) termination services. Telstra supports the Commission's preliminary view to continue the declaration of mobile voice termination services. Telstra does not, however, support the Commission's preliminary view that the service description should be varied to incorporate SMS termination services.

3. Consumers in Australia are benefiting from a thriving and dynamic mobiles market with high levels of investment and improvements in the customer experience. Growth in the mobiles market continues through, for example, demand for smartphones and tablets. Telstra is committed to providing high quality, 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 network to provide high quality coverage, service reliability and data capacity. In just the last 6 months Telstra has invested a further $650 million and having achieved 85% coverage of Australia with LTE, remains committed to continue to invest in its mobile network. In the second half of the year Telstra is committed to further deepening LTE coverage, investing in additional capacity and a number of other innovative trials and preparations for the digital dividend spectrum which will become available in 2015.

4. The mobiles sector in Australia has evolved to meet the changing preferences of consumers. Research shows that a growing number of consumers now use their phone to browse the internet, send emails, download applications and send instant messages. Australian consumers are also now more willing and able to switch between mobile service providers. This is reflected in the high number of subscribers who have switched providers in the last three years along with the trend away from long-term contracts. The changing environment means that mobile service providers must compete more vigorously, and on different grounds, to win and retain customers. The mobiles sector in Australia is clearly competitive and working in the best and long-term interests of consumers. There is no evidence of market failure in the provision of SMS termination services. Mobile service providers are offering a large number of retail plans incorporating different options for SMS as well as competitive SMS pricing and/or bundling.

5. Telstra maintains that SMS traffic between service providers is balanced[1]. This has not changed in recent years, despite shifts in the market shares of mobile service providers, and is unlikely to change in the future. From a mobile network operator perspective, balanced traffic, combined with consumer demand for any-to-any connectivity means that there is no incentive to block access or impose unreasonable terms and conditions to SMS termination services. It also means that suppliers of SMS termination face countervailing buyer power when negotiating terms of access. The larger degree of symmetry between mobile network operators means that unlike voice termination, which includes mobile-to-mobile and fixed-to-mobile, bargaining positions in relation to SMS termination are more balanced.

6. Significantly the bottleneck characteristics evident in the voice market are not present for SMS. This is primarily due to the existence of effective substitutes for SMS, assisted by the rapid

[1] Telstra understands that Vodafone Hutchison Australia (**VHA**) is of the same view.

emergence and popularity of smartphones which have enabled the decoupling of messaging services from the underlying carrier network.

7. In its Draft Decision the Commission did not consider that there were effective substitutes for SMS services at that point in time due to:

    a. Over the top (**OTT**) messaging applications requiring a smartphone and data connection;
    b. only 49 per cent of adults using smartphones; and
    c. OTT messaging services requiring the sender and receiver to use the same application.

8. Significant recent developments, coupled with the inherently dynamic nature of the mobiles market in Australia suggest these concerns are unfounded. Smartphone penetration increased from the 49 per cent reported in May 2012 (used in the Draft Decision) to 64 per cent in May 2013. Telstra's Smartphone Index indicated smartphone penetration of 72 per cent in October 2013. Further, forecasts predict that over ***C-i-C*** [redacted] ***C-i-C*** per cent of mobile users will be using smart phones by 2016. This means that more consumers are able to access the OTT messaging applications that are effective substitutes to SMS. Developments in OTT applications are also removing the requirement for the sender and receiver to use the same application.

9. The widespread offering of unlimited SMS for consumers on both prepaid and postpaid mobile service plans has been a result of strong competition between service providers across the range of mobile services and functionality (including the competitive impact of OTT applications). ***C-i-C*** [redacted] ***C-i-C***. This is clear evidence of the substitutability between SMS and OTT messaging applications.

10. The growing use and prevalence of OTT messaging applications has also been recognised by the Australian Communications and Media Authority (**ACMA**) who consider that the number of people using OTT communications is challenging traditional fixed and mobile voice revenues. Other jurisdictional regulators have made similar observations, including the European Commission who recently recommended that any regulatory authority considering defining a SMS termination market should only do so if justified on a forward-looking basis and taking into account substitutability from alternative services.

11. At present, SMS termination rates are negotiated on a commercial basis. This arrangement has worked well for over a decade and has not constrained the development and growth of the mobiles market in Australia. Rather the evidence suggests that the mobiles market is flourishing. Access seekers, including MVNOS, have not been disadvantaged by the current arrangements. Rather the evidence indicates that they are competitive in the retail market. Wholesalers of MVNO services have the opportunity to set SMS prices for MVNOs that take into account the net costs of supplying 'end to end' SMS services (recognising that the flow of SMS both 'on-net' and between networks means the net costs of supply are relatively low and do not significantly affect retail or resale prices). This is illustrated by the fact that all mobile service providers currently offer competitively priced SMS services across a number of price points, including unlimited.

12. In Telstra's view, the declaration of SMS termination services would not be in the long term interests of end-users (**LTIE**). Consumers continue to benefit from strong competition in the mobiles market, including competitive SMS pricing and retail mobile service plans that reflect the changing preferences of consumers towards data-centric services such as internet, email and OTT messaging applications. Any-to-any connectivity is already well established as mobile network operators have interconnected for over a decade and have no incentive to deny access to new entrants or to impose unreasonable terms and conditions of access. There is also no evidence to suggest that SMS termination rates have led, or will lead, to inefficient use of mobile infrastructure. Significant and ongoing investment by mobile network operators reflects the continued growth of the sector and an acute awareness of the change in services demanded by consumers.

13. The Draft Decision also included the Commission's view that the MTAS service description should not be varied to include MMS termination. Telstra supports this view on the basis that, as with SMS, MMS termination services have been subject to effective commercial arrangements, the retail market is competitive and there are effective substitutes in the form of smartphone OTT applications and email. Telstra also agrees that the relatively small consumer take-up of MMS services means that declaration is unlikely to have a significant impact on the relevant downstream markets.

14. Consistent with the Commission's reasoning for the exclusion of MMS termination, should the Commission maintain its draft position to declare SMS termination services, Telstra proposes that the MTAS service description should be amended to specifically exclude Application-to-Person (**A2P**) SMS services. These services are distinct from traditional SMSs exchanged between mobile handset users and are similar to MMS in that they are currently small, nascent products with the potential for strong growth in the future. Failure to exclude A2P SMS services will increase the risk of facilitating a pricing environment that will lead to high growth in the volume of bulk SPAM, including sales and marketing, SMS.

02 INTRODUCTION

15.This submission is structured as follows:

a. Section 3 sets out Telstra's views on the Commission's preliminary view on mobile voice termination services

b. Section 4 sets out Telstra's view on the Commission's preliminary view relating to SMS termination services , including

   i. Evidence relating to the absence of market failure in the provision of SMS termination services;

   ii. Why the bottleneck characteristics evident in the voice market are not present for SMS;

   iii. Telstra's position that the commercial arrangements for SMS termination rates have worked well in the past and continue to work well;

   iv. Telstra's position on the current arrangements relating to MVNO SMS charges and the associated impact on the downstream market;

   v. Evidence that consumers continue to benefit from competition and ongoing investment in mobile services; and

   vi. Why declaration of SMS termination services would not be in the LTIE.

c. Section 5 sets out Telstra's view on the Commission's preliminary view relating to MMS termination services.

d. Section 6 provides Telstra's comments in support of excluding A2P SMS services from the proposed Service Description.

03 MOBILE VOICE TERMINATION SERVICES

16.Telstra is supportive of the Commission's decision to extend the declaration of mobile voice termination services for five years. Telstra reiterates its view made in previous submissions that the mobile voice termination services declaration is in the LTIE. As currently declared, mobile voice termination services are a bottleneck. This is unlikely to change. At the same time, Telstra's view is that consumers in Australia are benefiting from a thriving and dynamic mobiles market with continuing high levels of investment and improvements in the customer experience.

17.The mobiles market in Australia continues to grow and evolve in line with changing consumer preferences. Mobile voice services, convergence between fixed and mobile services and the increased prevalence of alternatives such as VoIP are playing an increasingly effective role in driving competition and providing benefits for consumers in terms of innovation, choice, service offerings and competitive constraints. This thriving and dynamic mobiles markets has emerged against a background of a relatively light handed approach to mobile regulation over the last ten years.

18.Accordingly, Telstra maintains that the Commission's downstream market definition remains too narrow – Telstra believes that the downstream market should be considered as simply a 'voice market' rather than two distinct markets of fixed-to-mobile services and retail mobile services. As stated in previous submissions this is because:

a. Fixed-to-mobile services continue to be provided as part of a basket of fixed voice services and, as such, cannot be considered a separate downstream market; and

b. Increased convergence between fixed and mobile services and the availability of alternatives such as VoIP and OTT messaging mean it is no longer appropriate for the Commission to attempt to define separate markets on the basis of the type of technology used to make a particular call.

19. The Commission's Draft Decision did not accept that there is a single downstream voice retail market. Rather, the Commission considered that:

a. There should be separate markets due to perceived differences between the services – specifically that mobile services allow customers to use their phone in nearly any location, while fixed services only allow a customer to use services in a fixed location;

b. Mobile services are not currently substitutes for fixed voice services – the Commission considered that the number of end-users who have adopted mobile voice services at the expense of fixed voice services is relatively low (3.3 million mobile only users in 2012); many end-users rely on a fixed-line connection (medical alarms etc); the replacement of fixed services by mobile services tends to occur in only a segment of the market rather than the entire market; and business end-users are less likely than residential to make a complete substitution; and

c. For the majority of end-users mobile services are a complement rather than a substitute to fixed voice services.

However, market developments continue to support fixed-mobile substitution from a number of perspectives:

a. Continued growth in mobile only consumers and steady decline in fixed-line services and revenue; and

b. Changing patterns in communications preferences including the availability and use of alternatives such as VoIP and OTT messaging.

20. The most recent Australian Communications and Media Authority (ACMA) Communications Report[2] noted the steady decline in the number of fixed-line services in operation. In June 2013 there were 10.32 million fixed-line services compared to 10.44 million at June 2012, a net decline of around one per cent for the second year in a row. Although the decline is small, it is indicative of a broader trend where fixed-line use is declining overall – although services may be technically in operation, they are no longer high use. This is reflected in the decline in fixed-line services revenue. Telstra has experienced an ongoing reduction in PSTN product revenue – for example, decreases of $538 million in 2011-12 and $460 million in 2012-13.

21. The ACMA considered that the decrease in fixed-line services in operation and related revenue reflects the changing patterns of communications use in Australia, which have been driven by a number of key trends:

a. Continued growth in the number of mobile phone users without a fixed-line voice service in the home;

[2] Australian Communications and Media Authority, Communications report 2012-13, November 2013 p.18

b. Diversification in communications services used and a related decline in consumers identifying fixed-line voice as their most used communications service; and

c. Growth in the use of OTT communications services such as mobile VoIP.

22.These trends are consistent with Telstra's position that the downstream market definition used by the Commission is too narrow and that there should be a single 'voice market' rather than separate fixed-to-mobile and retail mobile services markets.

23.As noted by the ACMA, the number of mobile phone users without a fixed-line voice service in the home continues to grow. In the Draft Decision, the Commission considered the proportion of users to be relatively low based on mobile-only users as at June 2012. However, this number has since increased – from 3.3 million in June 2012 to 3.68 million in June 2013, an increase of 18 per cent[3] – and continues to grow. The number of mobile phone users without a home fixed-line telephone service is not the only indicator of fixed-mobile substitution. As indicated above, many end-users have fixed-line services but the use of these services has steadily declined. In the six months to May 2013, 53 per cent of people identified mobile phones as their most used communication service, compared to 16 per cent for a home fixed-line telephone. Further, the ACMA has reported that the communications services identified by adults as their most used communications service are[4]:

Communications service	*Percentage of adults identifying this as their most used communications service*	*Change from May 2012*
Mobile voice calls	29%	Up from 26%
Texting	24%	Up from 22%
Email	20%	No change
Fixed-line telephone calls	16%	Down from 22%
Social media	9%	Up from 7%
Other services such as instant messaging and OTT VoIP	2%	No change

24.This equates to over 80 per cent of users who consider services other than fixed-line telephones to be their most used communications service.

25.Changing patterns in communication preferences are also reflected in the increased use of online services as the expense of traditional forms of communication. In the six months to May 2013, 5.33 million Australians went online to make video calls. Over the same time period, 10.40 million when online for social networking purposes, a 10 per cent increase over the 9.42 million doing so in the six months to May 2012.[5]

26.Between May 2012 and May 2013, users of VoIP services in Australia increased by six per cent to 4.59 million people with the majority of growth in VoIP related to the use of OTT services such as those offered by Skype.[6] The number of people using VoIP services via mobile phones increased by 73 per cent to reach 1.06 million. The ACMA considered this rapid growth paralleled the rapid

[3] ACMA, p.4
[4] ACMA, p.21
[5] ACMA, p.124
[6] ACMA, p.4

uptake of smartphones and the increased availability of mobile applications designed to facilitate the use of internet-based services via mobiles.[7] This is discussed in more detail in subsequent sections of this submission.

27. In light of these developments, all of which support the increased convergence between fixed and mobile services as well as the increased use of alternative forms of communication, Telstra maintains that it is no longer appropriate for the Commission to attempt to define separate markets based on the types of technology used to make a particular call.

04 SMS TERMINATION SERVICES

28. The Draft Decision included the Commission's preliminary view that the MTAS service description should be amended to cover SMS termination so that these services are also declared. Telstra does not support this view.

29. It is Telstra's view that there is no need to declare SMS termination in Australia. This is because:

   a. There is no evidence of market failure in the provision of SMS termination services. The Australian mobile industry continues to grow and change rapidly, as does consumer use of mobile phone services. Further, the retail market for mobiles is competitive and not characterised by the types of structural problems that have led to the declaration of SMS termination services in other jurisdictions.

   b. The bottleneck characteristics evident in the voice market are not present for SMS. From a consumer perspective, there are a number of effective substitutes for SMS services. The pervasiveness of these services has shaped current retail offers reflecting the competitive constraints faced by network service providers.

   c. Commercial arrangements currently in place for SMS termination services have worked well and, in Telstra's view, continue to work well to deliver a robust and reliable technical and operational platform for the exchange of SMSs between mobile carriers. Despite an isolated instance where this appears not to be the case in terms of negotiations around price with one carrier, Telstra remains committed to good faith commercial negotiations. The retail market in Australia has not been adversely impacted or constrained by the existence of commercially agreed SMS interconnection rates.

   d. Consumers continue to benefit from competition and ongoing investment in mobile services. There is no evidence of consumer harm in the provision of SMS interconnection services. Service providers continue to make significant investments which reflect changes in the use of mobile services. There is no evidence to suggest that commercially negotiated SMS termination rates have led, or will lead, to inefficient use of mobile infrastructure.

30. Accordingly, Telstra's view is that declaration of SMS termination services would not be in the LTIE.

4.1. No evidence of market failure in the provision of SMS termination services

31. As discussed in previous submissions, Telstra considers that there is no cause to declare or include the SMS termination service in the MTAS service description as there is no market failure in the provision of SMS services in either the upstream or downstream markets. Rather:

[7] ACMA, p.22

a. The mobiles market continues to grow and is evolving rapidly;

b. There are a number of effective substitutes for SMS services;

c. Evidence indicates that the mobile retail market specifically related to SMS is effectively competitive; and

d. The Australian SMS market does not display any of the structural problems that have led to regulation in other jurisdictions.

32. Each of these is discussed in more detail below.

4.1.1. A thriving mobiles environment

33. In previous submissions, Telstra provided evidence showing that the Australian mobile industry has continued to grow and change rapidly. This continues. Reported developments since the release of the Commission's Draft Decision support Telstra's position.

34. All the available evidence shows that competition in the mobile sector in Australia continues to thrive. In June 2013 there were an estimated 31.09 million mobile voice and data services in operation. This reflected an annual growth rate of three per cent, the same as the previous year but less than the 13 per cent growth experienced in 2010-11[8]. The slowing down of growth rates in the number of services in operation does not, however, suggest that the mobiles market in and of itself is not growing. Rather it suggests, as noted by the ACMA[9], that the number of services in operation is reaching saturation point which is inevitable in a maturing market. Instead growth in the mobiles market is being derived from other sources – for example, the growing demand for smartphones and tablets; and investment in networks to provide high quality coverage, service reliability and data capacity.

35. Retail prices for mobile services have continued to fall. This has been acknowledged in other submissions to the Commission (such as that made by Macquarie). Other submissions, such as that made by ACCAN, claimed that the level of price competition has declined with the average price for mobile services decreasing only one per cent during 2011-12. Telstra considers that a slowing down in the rate of price decreases is inevitable in a maturing market. Instead, consumers are deriving value from other sources.

36. Mobile service providers are competing vigorously for market share in response to the changing demands and preferences of consumers – away from traditional voice and SMS (although these continue to grow) towards data. This has been acknowledged by the Commission in the Draft Decision where it noted that mobile network operators "...*are increasingly competing on factors other than prices, such as network quality and coverage*".[10] Optus made a similar observation, specifically that competition is now based on service quality and revenue growth is based on data usage rather than voice services. In Telstra's view this does not suggest that the market is in a state of transition or is less competitive, but rather that it has evolved to meet the changing preferences of consumers.

37. Telstra has previously submitted that:

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[8] ACMA, p.4
[9] ACMA, p.22.
[10] ACCC, Draft Decision, p.25

> "*Growing consumer demand for data hungry smart devices (smartphones and tablets) and a changing preference for the use of mobile services for services and applications other than traditional voice and SMS, has seen the demand for bandwidth over mobile networks grow quickly.*"[11]

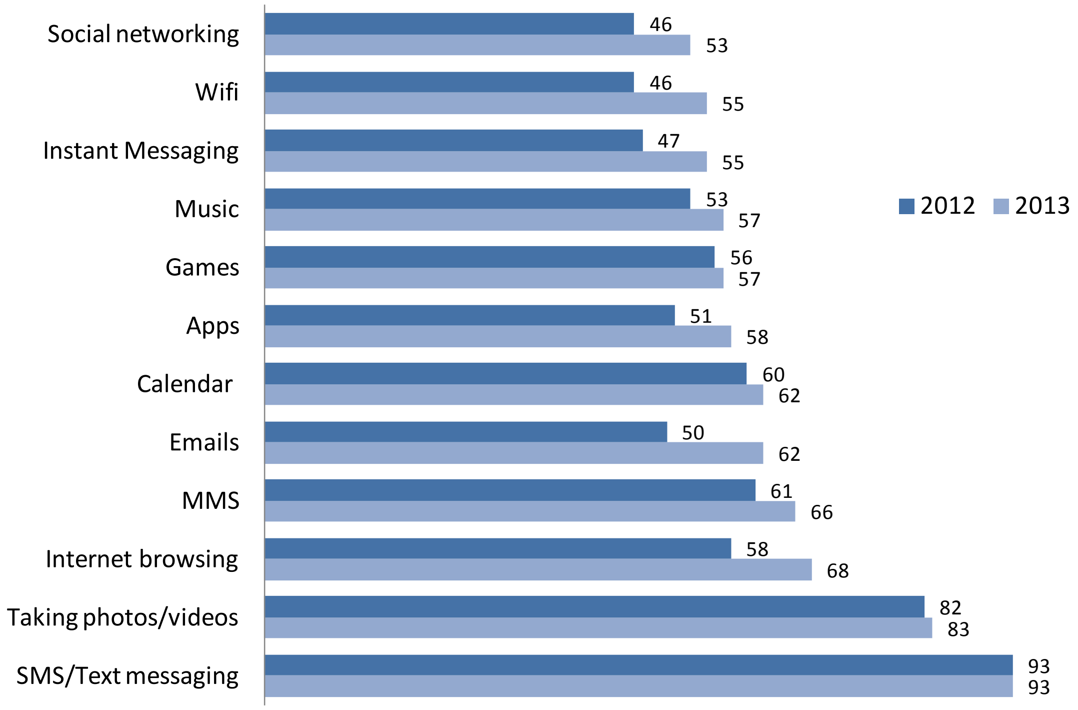
38. Smartphone use in Australia continues to develop at a significant pace. In the Draft Decision, the Commission noted that only 49 per cent of adults were using smartphones.[12] More recent data shows that in May 2013 this has grown to 64 per cent of adults, an increase of 29 per cent, and Telstra's Smartphone Index showed smartphone penetration of 72 per cent in October 2013. Recent statistics show that Australia has the sixth highest smartphone penetration in the world.[13] This is indicative of the rapid growth and evolution of the Australian mobiles sector.

39. The use of smartphones is making it easier for data centric consumers to fulfil their preference for access services over mobile networks. There has been steady growth in the number of consumers who use mobile phone handsets to connect to the internet – from 16.19 million in June 2012 to 19.65 million in June 2013, an increase of 21 per cent.[14] Although this growth is concentrated in the 18-44 age group, all age groups have exhibited significant growth. This is reflected in the increase in the volume of data downloaded on mobile handsets – from 9,943TB in the quarter ending June 2012 to 19,636TB in the quarter ending June 2013, an increase of 97 per cent[15].

40. Consumers are increasingly using their mobile phones for purposes other than traditional voice and SMS services. For example, ACMA research shows that 62 per cent of adults used the internet via their mobile handset during the six months to May 2013 compared to 52 per cent the previous year.[16] This is an increase of over 500 per cent since June 2008.[17] Further, 52 per cent of mobile phone users downloaded an application during June 2013 compared to 50 per cent during June 2012.

41. The chart below shows the top 12 mobile features used in Australia in 2012 and 2013, demonstrating the strong shift towards communications (email and social) and internet usage.[18]

[11] Telstra Corporation Limited's Response to the Commission's Discussion Paper on the Review of the declaration of the Mobile Terminating Access Service, 5 July 2013.
[12] ACCC, p.34
[13] Zoe Fox, The 15 Countries with the Highest Smartphone Penetration, 27 August 2013. http://mashable.com/2013/08/27/global-smartphone-penetration/
[14] ACMA, p.8
[15] ACMA, p.11
[16] ACMA, p.24
[17] ACMA, p.109
[18] TNS, Mobile Life 2013 – Australia, 2013



42.In addition to demanding different types of mobile services, the new type of consumer is also increasingly willing and able to switch between mobile service providers. Previous Telstra submissions[19] outlined research of key consumer traits including:

a. ***Greater consumer switching*** – between March 2011 and March 2013 on average 12 per cent of consumers had switched between mobile service provider, an average 2 percentage points higher than for the period March 2009 to March 2011.

b. ***Demand for lower prices and higher quality*** – the two primary reasons cited for switching were 'lower mobile rates' and 'better network coverage'.

c. ***Growing threat of switching*** – consumers continue to show a willingness to switch mobile service providers, with 13 per cent stating a 'likelihood' to switch in the next 12 months.

43.A recent study by Telsyte provides further evidence on the shift in consumer behaviour. For example, the study found that 46% of Australian mobile subscribers had switched providers in the past three years and a similar number were considering changing providers this year.[20] The study also highlighted the trend away from long-term contracts with less than half of new phones sold on a contract in 2013, the lowest number ever recorded.[21] Rather than buying handsets as part of a mobile phone contract, Australian consumers are instead buying phones outright or using second-hand handsets providing them with more flexibility to switch between mobile service providers. According to Telsyte MVNOs in particular have benefited from this with "nearly half" of those who have switched providers either switching to, or between, MVNOs.[22]

[19] Telstra Corporation Limited, Response to the Commission's Discussion Paper on the Review of the declaration of the Domestic Mobile Terminating Access Service, 5 July 2013
[20] Communications Day, Issue 4604, 4 February 2014
[21] Sydney Morning Herald, 3 February 2014.
[22] Communications Day, Issue 4604, 4 February 2014

44. The above key traits, as well as increased use of data by mobile users, have significantly changed the scope of the retail mobile sector as well as the nature of competition within the sector. Mobile service providers must compete more vigorously, and on different grounds, to win and retain customers. Accordingly, the evolving demands of the consumer have led to changes in the retail mobile service plans offered by all mobile service providers. In such a competitive market, any supranormal behaviours with respect to SMS termination would be defeated by customers switching to alternative providers.

4.1.2. The retail market for SMS is competitive

45. As described above, in the Draft Decision the Commission considered that competition in the retail market as a whole is more moderate than it has been in previous years and that price competition is more subdued. Further the Commission indicated that it had some concerns about the competitiveness of SMS offers in the retail market. Telstra does not consider that there are grounds for any concerns of this nature. Rather there is compelling evidence that competition in the market in relation to SMS is fiercely competitive and this is in particular illustrated by:

   a. The large number of retail plans incorporating different options for SMS that are available to consumers; and

   b. Competitive SMS pricing and/or bundling between service providers.

Large number of retail plans

46. In the Draft Decision, the Commission undertook a preliminary analysis of retail mobile plans which showed that while many retail plans do offer consumers unlimited SMS for a monthly fee, there are also many plans where the costs of sending an SMS appear high to the Commission. The analysis encompassed 115 retail mobile service plans which included low, medium and high spend plans, prepaid and postpaid products, and plans from all three mobile network operators as well as a selection of resellers such as Amaysim, Boost, Go Talk, TPG and TransACT.

47. In Telstra's view, the Commission's analysis demonstrates the wide selection of retail plans available to consumers. The plans offered by Telstra alone include a variety of options for SMS ranging from unlimited SMS, price per text and the option to buy 'text plus' packs in addition to what is already available in retail plans. SMS options vary according to, for example, how much a consumer wants to spend per month; whether the consumer wants to be 'locked in' to a contract or not; and the value placed by consumers on other elements of a retail mobile bundle (such as a preference for data versus voice calls and SMS). Similar options are provided by other mobile service providers.

48. The retail mobile service plans that are available include voice, data and SMS as 'bundles' which are designed to enable customers to self-select based on individual preferences. On the whole, mobile service providers have adapted these bundles in recent years to meet the changing requirements of customers, as described in previous sections. That is, the plans recognise that consumers are now more interested in data than voice and SMS. Accordingly, plans are structured around data allowances, while including varying levels of voice minutes and – generally – unlimited SMS. Where unlimited SMS is not provided, this is typically because customers choose to have a prepaid contract or select a bundle that more accurately reflects their usage patterns and preferences.

Competitive pricing

49. As well as offering a wide variety of plans with different options for the provision of SMS, mobile service providers offer these across several price points. At the bundle level, as noted by the Commission, plans tend to cover low, medium and high spend (Telstra offers small, medium, large

and extra large plans) which tend to vary more in terms of data allowances than voice and SMS (although these may also vary to a lesser degree).

50.In terms of SMS, this is provided on a number of different bases and price levels depending on the plan chosen, and whether a customer is prepaid or postpaid. For example, Telstra offers all postpaid customers on bundle plans unlimited SMS, while prepaid customers can select options from 1 cent per text to 12 cents per text.

51.Similar SMS plans are offered by mobile service providers such as Amaysim who provide an 'as you go' option including 12 cents per text, 'flexi' including 9 cents per SMS and 'unlimited' including unlimited SMS. Optus offers similar plans to Telstra with unlimited SMS for postpaid customers, some unlimited SMS plans for prepaid customers, and other prepaid plans with SMS rates ranging from 10 cents per text to 29 cents per text.

52.A Telstra-conducted survey of over 30 mobile service providers and associated prepaid and postpaid plans indicated similar outcomes. All mobile service plans typically include an allowance for usage (for example voice, SMS and MMS) with standard rates charged if the allowance is exceeded. SMS rates ranged from unlimited to 30 cents per standard national text with a number of price points in-between.[23]

53.The above illustrates that the wide variety of retail mobile service plans also include different options for SMS across a number of price points per text. While it is difficult to 'unpick' bundles to demonstrate that SMS pricing is competitive, the fact the consumers have broad choice across mobile service providers, such that they can select a bundle that meets both their preferences for mobile (and SMS) services and budget indicates a highly competitive market.

54.The Commission also expressed concern in the Draft Decision that:

a. The revenue outcomes of uneven SMS traffic flows have the potential to be passed on to downstream retail markets; and

b. High SMS termination prices are impacting mobile retail plans available to consumers.

55.Telstra maintains that SMS traffic between service providers is balanced.[24] It also maintains that one effect of this is that SMS termination rates have no impact on the downstream retail market. This is discussed in more detail in Section 4.1.3 below. Nevertheless, even where it is considered that there are small imbalances in SMS traffic from time to time, these net traffic flow differentials are unlikely to be to the extent that the resulting costs are passed on to consumers in the form of higher retail prices or foregone investments in service innovations. Telstra is not aware of any evidence that any imbalance in revenue outcomes has been passed on to consumers in terms of higher prices or reduced availability of services.

56.There is also no evidence in the context of relatively low net traffic imbalances between the mobile carriers to suggest that current SMS termination rates are impacting mobile retail plans nor that termination rates materially affect the price of other services in bundles of mobile services. In the Draft Decision, the Commission noted that all three MNOs reduced the amount of voice calls and data in their retail mobile services plans in 2012 and considered that, where unlimited SMS services are offered, the prices for other elements in the bundle will be unlikely to decrease, and where SMS are charged per message, these prices will remain above cost.

[23] Standard national SMS rates included 10 cents, 12 cents, 14 cents, 15 cents, 18 cents, 20 cents, 25 cents, , 25.3 cents, 28 cents and 29 cents per text.

[24] Telstra understands that Vodafone Hutchison Australia (**VHA**) is of the same view.

57. The changes in retail mobile service plans noted by the Commission have not occurred in response to the level of SMS termination rates. The retail mobile service plans provided by Telstra are now largely focused on data allowances which reflect the changing preferences of Telstra's mobile customers. The pricing of mobile service plans typically varies according to the size of the data allowance selected by a customer with less variation based on the inclusion of voice and SMS.[25]

58. Further, the changes made in Telstra's retail mobile service plans have provided more value to Telstra customers in terms of inclusions. For example, the replacement of Telstra's 'Freedom' plans by the current 'Everyday' plans included a general increase in the dollar value included in the bundle (i.e. value of included calls) and a number of plans added free nights and/or weekends. Although this was accompanied by a decrease in data allowances, this reflects the costs incurred by Telstra due to the increase in data consumption on the existing network (and the significant investments being made by Telstra to increase network capacity to cope with the demand for data).

59. There have been no changes made to the provision of unlimited SMS since this was introduced in May 2011 as part of the move from Telstra's 'Next G' plans to 'Freedom' plans. Critically, the introduction of unlimited SMS occurred partly in response to the growing threat of OTT messaging apps. As described in Section 4.2, the provision of unlimited SMS has a notable impact on the use of OTT messaging apps.

60. Prepaid plans are where SMS is generally charged per message rather than provided on an unlimited basis (although these are some exceptions to this). As noted elsewhere in this submission, prepaid plans provided by mobile service providers include a variety of options for the inclusion of SMS at different price points. The plans are structured in this way to provide the greatest value to consumers who can select a plan that best suits their usage patterns and preferences.

61. Despite the Commission's concerns as set out in the Draft Decision, Telstra does not believe that there is any evidence to suggest that SMS termination rates have impacted on the downstream retail mobiles market in terms of the prices, plans or services available to consumers. On the contrary, as described elsewhere in this submission, SMS pricing is competitive; the average price per SMS for postpaid customers has declined; retail bundles have changed in response to changes in consumers preferences; and investment in mobile networks is significant and ongoing (as discussed in section 4.5).

4.1.3. The Australia SMS market does not display any of the structural problems that have lead to regulation in other jurisdictions

62. Telstra has set out in previous submissions that the Australian SMS market does not display any of the economic issues of concern raised by other jurisdictional regulators that have led to the decision in a small number of countries to regulate SMS termination. The main economic issues of concern include:

   a. Traffic imbalances;

   b. Retail pricing differentials particularly between "on-net" and "off-net" traffic[26]; and

   c. Commercial negotiations consistently failed.

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[25] That is, voice and SMS allowances tend to be included in an allowance (which varies according to the price of the plan) or provided uniformly across plans (such as unlimited SMS) rather than on a cost per call or SMS basis.

[26] In the context of SMS, on-net refers to a SMS message sent from an end-user to another end-user on the same mobile network while off-net refer to a SMS message sent from an end-user to another end-user on a different mobile network.

Traffic imbalances

63. The Draft Decision sets out the Commission's view that confidential SMS traffic data received from mobile service providers showed that traffic between operators is not even and that mobile network operators do not send the same number of SMS as they receive from other networks. As a result the Commission concluded that there is an imbalance in SMS traffic which results in profits and losses for different mobile network operators and provides an incentive to keep SMS termination charges high. The Commission also considered that the imbalance in SMS traffic is similar to imbalances in mobile-to-mobile traffic.

64. Traffic imbalances – specifically, the "...*large imbalance in SMS traffic between the networks of interconnecting service providers...*"[27] contributed to the decision of the Indian regulator, the TRAI, to regulate SMS termination rates in India. However, traffic imbalances were only part of the identified problems in India. Other issues identified by the TRAI included:

   a. Exponential increase in the number of commercial SMSs;

   b. Unilateral imposition of SMS termination charge; and

   c. In the case of non agreement, disconnection of some dominant service providers and increasing instances of litigation amongst the service providers.

   That is, the combined impact of these factors – which do not apply to the Australian context - led to the decision to regulate rather than traffic imbalances alone.[28]

65. Telstra maintains that SMS traffic between service providers is balanced to the extent that it provides no incentive to keep SMS termination rates high. From Telstra's perspective, the difference between SMS volumes sent and received, and the resulting revenue outcome, means that any changes to SMS termination rates will have a neutral outcome. Even as Telstra's market share has increased in recent years, the consequent increase in SMS traffic has not significantly changed the differential (as a percentage of total volume). This is illustrated in C-i-C XX

66. *C-i-C* below.

C-i-C [redacted]

[27] TRAI, "TRAI prescribes SMS termination charge and transactional SMS charge", Press Release, 24 May 2013.
[28] TRAI, The Short Message Services (SMS) Termination Charges Regulations 2013 (No.7 of 2013), 24 May 2013, p. 6.

C-i-C

67. Similarly, although Telstra has moved to a net outpayer position, the total difference between revenue received and outpayments made has been relatively stable. This is illustrated in C-i-C XX

68. *C-i-C* below.

C-i-C [redacted]

C-i-C

69. From a volume percentage perspective, the Commission is correct that the imbalance appears to be reasonably similar between SMS traffic and mobile-to-mobile voice traffic. On average, the volume difference for SMS between 2009-10 and 2012-13 was ***C-i-C*** [redacted] ***C-i-C*** per cent. For mobile-to-mobile voice, the volume difference was ***C-i-C*** [redacted] ***C-i-C*** per cent.

70. Although these numbers appear comparable and relatively small, the difference has a significant impact in terms of revenue outcomes. As a result, Telstra considers that the small imbalance in SMS traffic is significantly different from the relative imbalance in mobile-to-mobile voice traffic. It is therefore incorrect to conclude that SMS termination rates should be regulated on the basis that mobile voice termination rates are regulated. Telstra maintains that the small imbalance between SMS traffic and the resulting revenue or loss means that the outcome of regulating SMS termination rates at the retail end will be minimal and disproportionate to the cost of regulation. As discussed elsewhere in this submission there are also other factors (such as the disconnect between wholesale SMS termination rates and retail/resale prices) which contribute to the limited impact of a potential SMS declaration on downstream markets.

71. Telstra also notes that, in any event, the mobile voice termination context is quite different to SMS as significantly it includes large traffic asymmetries between fixed voice networks and mobile voice

networks. In the context of SMS termination only traffic exchanged between mobile network operators is applicable and, as indicated above, is balanced between the operators.

"On-net" and "off-net" pricing

72. The decision to regulate SMS termination rates in New Zealand arose after the New Zealand Commerce Commission observed significant differences in on-net and off-net pricing, which had downstream impacts in terms of presenting major barriers to entry in the New Zealand mobile market. At the time of the decision to regulate, pricing practices in New Zealand meant that over 90 per cent of SMS traffic was carried on-net.[29] This is clearly not the case in Australia.

73. A submission made by Telstra on 8 August 2013 included the results of a desktop survey of advertised pre-paid and post-paid mobile plans for consumer and business customers that are currently available in the retail market. Overall the survey found that the majority of advertised mobile plans have no SMS pricing differentials between:

    a. On-net versus off-net; or

    b. Pre-paid versus post-paid.

74. As noted above, the survey found that, not only are pricing differentials rare, but that the value per unit of consumption for SMS has substantially increased in recent years. This is primarily due to the availability of 'unlimited' SMS for post-paid mobile customers, which means that the notional average retail price per SMS decreases with each SMS sent.

75. This clearly contrasts with the market in New Zealand where the differential between on-net and off-net pricing (and the relative high proportion of on-net versus off-net traffic of the two major mobile network operators) was contributing to structural problems in the retail mobiles market to the extent that a decision to regulate SMS termination rates was made.

Failure of commercial negotiations

76. In the Draft Decision the Commission noted that to date commercial negotiations have been unsuccessful in lowering SMS termination rates.

77. Telstra acknowledges that commercially negotiated SMS termination rates have not changed in recent times. However, despite claims to the contrary with respect to one instance, the bilateral commercial negotiations on termination rates that have succeeded in securing constructive outcomes for all parties and industry for over a decade are continuing in good faith.

78. There is no suggestion that the mobile network operators in Australia have leveraged any perceived market power in order to impose high termination rates which have in turn been passed on to consumers. To the contrary, mobile prices have consistently decreased; and the competitiveness of the retail SMS market is such that the majority of mobile service plans now include unlimited SMS to standard Australian fixed and mobile numbers to the extent that the average price per SMS for postpaid customers has declined. As discussed in Section 4.1.2, this reflects the changing demands of consumers for data allowances and the competitive efforts of mobile service providers to entice consumers to use SMS in the face of growing preference for OTT apps.

[29] Commerce Commission, Reconsideration Report on whether the mobile terminating access services. (incorporating mobile-to-mobile voice termination, fixed-to-mobile voice termination and short-message-service termination) should become designated or specified services, 16 June 2010, p.16

79.Given the preceding analysis and examples, Telstra considers that the Australian SMS market does not display any of the economic issues raised by global regulators as a justification for regulation of SMS termination.

4.2. Bottleneck characteristics evident in the voice market are not present for SMS

80.The Draft Decision considered that SMS termination has the same bottleneck characteristics as mobile-to-mobile services and that declaration of SMS termination will therefore promote any-to-any connectivity. Specifically, the Commission considered that SMS termination is an essential bottleneck service for which there are no substitutes.

81.Telstra does not believe that the bottleneck characteristics evident in the mobile-to-mobile market are also evident for SMS. ***C-i-C*** [redacted]

C-i-C.[30] The submission noted that:

"Ex-ante access regulation is only likely to be in the long term interests of end users where there is an enduring bottleneck. A facility or service is only a bottleneck if it is a necessary natural monopoly input into the production process of a firm to compete in a downstream market. Strictly, a bottleneck service exists only if it passes two economic tests:

1. *Is used to manufacture a specific good or service and there must be no alternative input or process which enables a competitor to produce an equivalent final good or service at a comparable cost; and*
2. *There must be no alternative, substitutable final good or service that can be manufactured and sold at a comparable price without using that input.*

If both tests pass, then an economic problem that may justify regulation exists. If one or both tests do not pass, then no structural impediment to competition and no economic basis for regulation exist."[31]

82.Although it seems that terminating services would meet the above tests for an enduring bottleneck, in the case of mobile networks the rapid emergence and popularity of smartphones has enabled the decoupling of messaging services from the underlying carrier network. In May 2013, smartphone penetration had reached 64 per cent of Australian adults. This number has undoubtedly increased since then, with Telstra's Smartphone Index showing penetration of 72 per cent in October 2013.[32] Telstra also forecasts smartphone penetration to reach ***C-i-C*** [redacted] ***C-i-C*** per cent of all mobile users by 2016.[33]

83.The rapid growth of smartphone penetration means that the majority of mobile phone users in Australia have the ability to install third-party messaging services (or OTT apps) that can bypass the SMS services provided by mobile network operators. Telstra research indicates that ***C-i-C*** [redacted]
C-i-C[34].

84.In terms of the economic tests outlined above, the quality and pervasiveness of substitutes to SMS available to end users with smartphone devices means that network service providers face effective competition in the market for SMS services. While there are no alternative substitute

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[30] Telstra, The Economics of Bottlenecks for Voice, Short Message Services and Multi-media Message Service Termination, 24 September 2013.
[31] Ibid.
[32] http://www.telstra.com.au/abouttelstra/media-centre/announcements/shopaholics-get-smartphone-savvy.xml
[33] Telstra internal forecasts.
[34] Telstra internal research

inputs in the wholesale SMS market (as per the first economic test), there are many applications which have an equivalent or enhanced end-user experience to traditional SMS and so are strong substitutes in the retail market (as per the second economic test).

There are a number of effective substitutes for SMS

85. In the Draft Decision the Commission considered that, at this point in time, there are no effective substitutes for SMS services. The Commission believes that SMS services and smartphone messaging services differ in ways that mean they are not effective substitutes:

    a. Smartphone messaging applications require a smartphone and data connection;

    b. Only 49 per cent of adults were currently using smartphones so a significant proportion of mobile users were not able to use OTT apps and would instead rely on SMS; and

    c. Smartphone messaging services require the sender and receiver to use the same application.

86. However, the market has developed from the point of the Commission's decision. In 2012-13 growth in the mobile services market was largely driven by the replacement of existing mobile handsets with smartphones. As noted above, as at May 2013, 64 per cent of adults were using smartphones – a 29 per cent increase since the May 2012 reference point used by the Commission in the Draft Decision where it considered that low smartphone penetration meant that a significant proportion of mobile users were not able to use OTT apps and would instead rely on SMS.[35] The ongoing and rapid development of the mobile sector suggests that this is not the case.

87. The ACMA included "...*a jump in the number of people using OTT communications, such as Skype, via tablets and mobile phones – challenging traditional fixed-line telephone and mobile voice revenues*" as a key highlight of Australia's digital economy in its most recent communications report.[36] The ACMA further acknowledged the specific threat to mobile service provider's revenue from mobile phone plans as a result of OTT apps which substitute for SMS.[37]

88. The use of OTT apps is widespread and growing rapidly. In December 2013, WhatsApp announced that they had "...*reached a milestone that no other mobile messaging service has achieved: 400 million monthly active users, with 100 million users added in the last four months alone.*"[38] The instant messaging app allows users to send free photos, messages, videos and audio messages to people on their mobile contact list and can be used across multiple mobile platforms. In August 2013 WhatsApp penetration in Australia was estimated at 22 per cent of monthly active users, with Facebook Messenger at 19 per cent.[39]

89. The presence of unlimited SMS has contributed to the continued growth in SMS volumes in Australia. However, this growth does not mean that there are no effective substitutes to SMS. Rather unlimited SMS clearly demonstrates the competitive constraint placed on SMS by OTT messaging apps. Where SMS is charged on a per text basis, there is a consistent trend in consumers substituting OTT messaging apps. Telstra research into the use of OTT apps by mobile users clearly shows this substitutability between SMS and OTT apps. Specifically, where

[35] ACMA, p.4
[36] ACMA, p.3
[37] ACMA, Mobile apps: putting the 'smart' in smartphones, Snapshot 4, p.9
[38] WhatsApp, 400 million stories, http://blog.whatsapp.com/index.php/2013/12/400-million-stories/
[39] The Wall Street Journal, The Quiet Mobile Giant: With 300M Active Users, WhatsApp Adds Voice Messaging', August 6 2013

unlimited SMS is not included in retail mobile service plans, OTT messaging apps are the preferred method for communicating with friends and family on the basis that they are free and/or cheaper than traditional SMS services. Further, ***C-i-C*** [redacted] ***C-i-C***[40].

90.The OTT app market continues to innovate and provide alternatives to SMS messaging services. In addition to OTT services which require users to subscribe to the same app, there are a number of apps (such as imo) which enable users to sync multiple accounts and send messages across different apps. Facebook Messenger is an instant messaging service which can be used as a replacement to SMS services. Significantly, it enables users to message contacts who do not have a Facebook account or use Facebook Messenger. Other apps (such as textPlus) provide users with an additional phone number from which they can send text messages whilst bypassing the traditional SMS service provided by their mobile network. Other established apps, such as Instagram, are introducing separate messaging services to complement their existing functionality.

91.The growing use and prevalence of OTT apps as alternatives to SMS has been recognised by other jurisdictional regulators.

92.In the UK, the number of outgoing SMS messages fell through much of 2012. Ofcom considered that this is likely to be the result of the increased availability of alternatives to SMS noting that:

"*There are now many ways consumers can send electronic messages to each other, including instant messaging, other 'over-the-top' applications such as What'sApp and Viber, and messaging capabilities built into frequently-used web tools such as Facebook and Skype*."[41]

93.According to Ofcom, the slowing growth in the use of traditional mobile messaging services is related to increasing smartphone take-up, which enables consumers to access a number of alternatives to SMS messaging while on the move. The Communications Report 2013 included data that showed the total volume of mobile instant messages sent in the UK increased from 37 billion in 2011 to 57 billion in 2012, equivalent to an increase from 49 to 75 messages per person per month.[42] Ofcom research also found that, while the use of traditional mobile messaging services remained unchanged between Q1 2011 and Q1 2013, email, social networking sites and instant messaging services all increased.[43]

94.In 2013 the Italian regulator, Agcom decided not to regulate the market for wholesale SMS termination on the basis that, amongst other things, "...*mobile instant messaging services and email applications are substitutes to SMS at (the) retail level. Consequently, wholesale SMS termination rates are indirectly constrained by the existence of alternative services*."[44] AGCOM considered that mobile instant messaging services, email applications and SMS belong to the same market for a number of reasons, including:

a. Mobile instant messaging, email and SMS are sufficiently interchangeable because they are used by consumers for the same purposes.

b. Downloading and using instant messaging applications is free of charge.

c. More than 40 per cent of mobile devices were smartphones.

[40] Telstra internal research
[41] Ofcom, The Communications Market 2013, p.342
[42] Ofcom, p.376
[43] Ofcom, p.358
[44] AGCOM, Notification form relating to AGCOM's draft decision on the SMS termination market, Executive Summary, 2012, p.2

d. The number of users using their mobile devices to connect to the Internet more than doubled over a three year period and generated 20 per cent of total IP traffic.

e. IP traffic for instant messaging services and email increased by 50 per cent between 2010 and 2011.

f. A general increase in the total volume of SMS was attributed to the growth of SMS sent through flat offers.

All of the market characteristics and trends reflected in the above points apply to the Australian context – in some instances to a greater extent. For example, smartphone penetration in Australia exceeded 60 per cent in May 2013 and the number of users using their mobile devices to connect to the internet almost doubled over a two year period (June 2011 to June 2013)[45].

95.A report prepared for the European Commission for its review of future electronic communications markets subject to ex ante regulation noted that "*instant messaging services can substitute for SMS in many circumstances*".[46] While the report also considered that there are many circumstances where instant messaging is not an acceptable substitute, supported by current traffic projections, it formed a view that "...*the possible substitutability by instant messaging services suggests that, at some point, the second criterion may no longer be satisfied*."[47] It its draft revised recommendation on relevant markets; the European Commission does not propose defining a separate market for SMS termination.[48] It does, however, leave it open for a regulatory authority to define such a market on the basis that it would be justified on a forward-looking basis. In doing so, the European Commission recommends that the authority should "...in particular, consider the implications on the substitutability of the traditional and the push SMS with emails and instant messaging which are more and more available due to an increase in smartphones and broadband penetration, including (free) hotspots."[49]

96.Mobile operators in other jurisdictions have experienced the effect of OTT apps in terms of the direct negative impact on revenue. In the Netherlands, the incumbent telecommunications operator KPN has been pushed into profit warning following the erosion of its SMS revenue due to consumer take-up of Whatsapp[50]. Similarly, operator revenues in South Korea have been affected by consumer use of the messaging app KakaoTalk[51].

97.The developments and scenarios described above suggest that the reasons given by the Commission in the Draft Decision for concluding that there are no effective substitutes for SMS are no longer applicable. Rather, changes in the mobile sector (in particular the rapid growth in smartphone penetration) and the way in which consumers use their mobile phones increasingly mean that OTT apps and SMS are entirely substitutable.

98.This is in contrast to the mobile voice termination market, where there are no alternative substitute inputs in the wholesale market nor are there alternative final goods or services in the retail market.

[45] ACMA, Communications Report Series – mobile phone handset internet subscribers in June 2011 – 13.32m, June 2012 – 16.19m and June 2013 – 19.65m – an increase of 47.5 per cent. At www.acma.gov.au

[46] Ecorys, Future electronic communications markets subject to ex ante regulation: Final report, Rotterdam 18 September 2013,p.156

[47] Ibid, P.157

[48] European Commission, Draft recommendation on relevant markets, 24 January 2014 at http://ec.europa.eu/digital-agenda/en/news/draft-revised-recommendation-relevant-markets

[49] European Commission, Draft explanatory note on relevant markets, 24 January 2014 at http://ec.europa.eu/digital-agenda/en/news/draft-revised-recommendation-relevant-markets

[50] The Economist, Over-the-top phone services: Joyn them or join them, 11 August 2012 at http://www.economist.com/node/21560298]

[51] Ibid.

As discussed in previous submissions, there are some OTT voice services but these are at present weak substitutes due to differences in the end-user experience (particularly in terms of quality) which mean they are not comparable to traditional voice services at this time.

99. Telstra also notes the requirement for any bottleneck to be *enduring* to justify ex ante access regulation. Should the Commission believe that the substitutes for SMS are not presently effective, despite the evidence that is presented in preceding sections and the significant changes (in terms of, for example, smartphone use and prevalence of OTT apps) that have occurred since the Commission's Draft Decision, it should take into account whether the evolving nature of the mobile sector means that this is likely to change in the near future. That is, the rapidly evolving nature of both the mobiles sector and OTT apps would strongly suggest that the Commission's view is unlikely to be one that holds for any meaningful period of time – certainly not to the extent that ex ante regulation would be justified in terms of the LTIE.

100. It is Telstra's view that SMS termination does not have the same bottleneck characteristics as mobile voice termination services. Specifically no bottleneck exists for SMS due to the existence of very strong substitutes in the downstream market which can and are used to by-pass any perceived limitations to effective participation in the upstream market. The effectiveness of OTT messaging apps as substitutes for traditional SMS has become even more apparent since the Draft Decision due to the rapid uptake of smartphones in Australia and the ongoing development of OTT messaging apps. There is therefore no structural impediment to competition in the SMS market and no justifiable economic basis for the regulation of SMS services.

4.2.1. No incentive to deny access to SMS termination services

101. In the Draft Decision the Commission concluded that declaration of SMS termination services would ensure that service providers are able to gain access to the bottleneck service on reasonable terms and conditions and that prices for the service are not inefficiently high.

102. From a mobile network operator perspective, the nature of the market for SMS services in Australia means that there is no incentive to block access to SMS termination services or impose unreasonable terms and conditions. Specifically:

a. SMS traffic between mobile service providers is balanced – this has not changed in recent years despite shifts in the market shares of mobile service providers. Should there be any increase in the disparity of market shares the reciprocal nature of SMS means that this will not result in some MNOs having greater bargaining power in SMS termination negotiations.

   Section 4.1.3 of this submission considered SMS traffic from a whole of industry perspective. In relation to the commercial negotiation of SMS terminate rates and terms and conditions of access, bilateral SMS traffic is the relevant indicator. From Telstra's perspective, traffic between Telstra and Vodafone and Telstra and Optus is also balanced. The difference between SMS sent and received over the past four years has ranged from ***C-i-C*** [redacted] ***C-i-C*** % to ***C-i-C*** [redacted] ***C-i-C*** % for Optus and from ***C-i-C*** [redacted] ***C-i-C*** % to ***C-i-C*** [redacted] ***C-i-C*** % for Vodafone. ***C-i-C*** [redacted] ***C-i-C***.

b. As noted above, SMS is a reciprocal form of communication and to a much greater extent than voice. That is, SMS messages are exchanged more frequently between users or groups of users compared to voice calls, which tend to be one way or exchanged infrequently or after longer time period. As a result suppliers of SMS termination face countervailing buyer power when negotiating the terms of access.

c. The nature of the SMS market also means that there is little incentive to block access – this is because consumers would switch to alternative substitute services (as happened in the Netherlands and South Korea) and there is also a 'network effect' which means consumers demand any-to-any connectivity from mobile service providers. To block this would be detrimental to mobile service providers in light of a customer base that is now more willing to switch service providers or to substitute services to meet its changing needs.

d. Unlike voice, the larger degree of symmetry between operators means that bargaining positions are more balanced. No mobile service provider has a majority market share. Although the largest mobile network operator in terms of customer base, this actually places Telstra at a disadvantage as illustrated through the fact that Telstra is a net outpayer of SMS termination rates. The level of outpayments made by Telstra has actually increased in line with market share gain.

103. Telstra is not aware of any instance where a mobile network operator has attempted to block access to SMS termination services to a third party nor impose unreasonable terms and conditions. As discussed in the following section, the arrangements for the commercial negotiation of SMS termination rates have worked well in the past and continue to work well.

104. As a result, the nature of the SMS termination services market in Australia means that service providers are currently able to gain access to the service on reasonable terms and conditions. As discussed elsewhere in this submission, Telstra also does not believe that SMS termination is a bottleneck service nor does it agree with the Commission that prices for the service are inefficiently high.

4.3. Commercial arrangements have worked well and continue to work well

105. The Commission has expressed its concern that commercial negotiations have not been successful in lowering SMS termination rates. Specifically, the Draft Decision considered that there were indications that SMS termination rates had not changed for many years, commercial negotiations had been unsuccessful in lowering these rates, and that SMS termination rates were inefficiently high.

106. As noted elsewhere in this submission, Telstra considers that commercial arrangements with respect to SMS termination rates have worked well for over a decade and continue to work well to deliver a robust and reliable technical and operational platform for the exchange of SMSs between mobile carriers. Despite an isolated instance where negotiations with one carrier have proven difficult, Telstra remains committed to pursuing a mutually beneficial outcome in good faith. The retail market in Australia has not been adversely impacted or constrained by the existence of commercial agreed SMS interconnection rates.

107. Telstra maintains that it would be preferable to leave the mobile network operators to commercially negotiate SMS termination pricing, a process that has worked successfully for the past decade. The success of the current approach to commercially negotiating SMS termination rates, as well the absence of any market failure or bottleneck in the provision of SMS termination services, strongly suggests that regulatory intervention is not required.

4.4. MVNO market

108. In the Draft Decision the Commission also considered that the rates MVNOs pay to acquire services from mobile network operators to resell in the retail market may limit MVNO's ability to provide competitive retail services. For example, a mobile network operator that pays SMS termination on behalf of an MVNO will pass on this cost to the MVNO in the price the MVNO pays for the SMS it resells. The Commission stated that confidential information showed that mobile network operators may charge MVNOs wholesale SMS rates that are similar to the network operators own SMS termination rates. This therefore limits an MVNO's ability to provide retail prices below termination rates and places pressure on an MVNO's retail margin.

109. As noted elsewhere in this submission, the mobiles market is highly competitive. All mobile service providers compete vigorously for market share and the dynamic nature of the market is reflected in recent developments showing the movement away from fixed-term contracts and the increasing propensity of end-users to switch between providers. MVNOs in particular have benefited from these behavioural changes. MVNO or resale arrangements are offered on a commercial basis and negotiated accordingly.

110. MVNOs are not specifically charged SMS termination rates by mobile network operators. Rather they are charged an 'end-to-end' SMS rate of which termination is a component. In theory, the wholesale SMS charge passed on to MVNOs would then be taken into account by the MVNO in setting the MVNO's retail SMS charge. However, balanced SMS traffic (as discussed elsewhere in this submission) effectively means that there is a disconnect between gross termination charges between operators and retail and resale (MVNO) SMS charges. Wholesalers of MVNO services have the opportunity to set SMS prices for MVNOs that take into account, amongst other things, their net costs of supplying 'end-to-end' SMS services (recognising that, as with the retail market segment, the flow of SMS both 'on-net' and between networks means that the net costs of the supply of SMS are low and do not significantly affect overall prices). This is illustrated by the fact that all mobile service providers currently offer competitively priced SMS services across a number of price points, including on an unlimited basis.

111. Telstra's view is that MVNOs are not disadvantaged by the current arrangements in relation to the commercial negotiation of SMS termination services. Rather there is abundant evidence that MVNOs are active and profitable in the retail mobile market. For example, ***C-i-C*** [redacted]

C-i-C.[52] ***C-i-C*** [redacted]

C-i-C.[53] All MVNOs offer a wide variety of mobile service plans to customers which include, amongst other things, unlimited SMS and data packages at rates competitive with those offered by mobile network operators. This suggests that MVNOs are not limited in their ability to provide competitive retail services, nor are these services provided on a loss making basis.

4.5. Consumers continue to benefit from competition and ongoing investment in mobile services

112. As presented throughout this submission, consumers continue to benefit from competition in the mobiles market. There is no evidence of consumer harm in terms of the impact on retail pricing or the provision of retail bundles and services to justify the regulation of SMS termination services in Australia. As discussed in preceding sections of this submission SMS pricing is competitive; the average price per SMS for postpaid customers has declined; and retail bundles have changed in response to changes in consumers preferences.

113. There is also no evidence to suggest that SMS termination prices have led, or will lead, to inefficient use of mobile infrastructure – rather the mobile industry is characterised by high levels of investment and innovation that are forecast to continue.

114. All MNOs continue to invest in mobile networks to compete effectively on coverage and quality, most evident in the ongoing rollout of 4G networks. As at June 2013 Telstra's 4G network covered 66% of the population while Optus had coverage in the major metropolitan cities as well as Byron Bay, Coffs Harbour and the Gold Coast. Significantly, Optus has indicated that it plans to continue to improve its competitive position by significantly building out its coverage in regional

[52] Internal Telstra Research.
[53] Internal Telstra Research.

areas – spending $1 billion to improve its networks.[54] Vodafone also launched its 4G network in June 2013 and opened the service to new customers on 10 July 2013.

115. The continued investment by MNOs is evidence of the continued growth of the mobile sector and an acute awareness of the change in service demanded by mobile phone users. Telstra and Optus have both conducted trials of technology intended to facilitate faster mobile speeds in order to address increased demand for mobile data and the use of OTT apps. Optus has publicly noted that the intended move to faster mobile speeds would make it cheaper to provide greater data allowances to subscribers reflecting the steady rise in the amount of data downloaded over 4G networks.[55]

116. Competition in the mobiles market is now data focused, reflecting the strong preferences of consumers and changes in the way mobile phones are used. The significant investments made by mobile network operators reflect the changing mobiles environment and the continued intensity of competition for market share.

4.6. Declaration of SMS termination services would not be in the LTIE

117. Telstra strongly considers that the declaration of SMS termination services would not be in the LTIE. Specifically, although Telstra considers that the LTIE is enhanced by the continued declaration of mobile voice termination services, the inclusion of SMS termination services will have no impact on competition, any-to-any connectivity or investment and use of infrastructure. Telstra also considers that there is a strong risk of regulatory error should SMS termination rates be declared given the neutral impact that regulation of these rates would have on the mobile services offered to consumers.

Promoting competition in markets for listed services

118. In considering whether competition is likely to be promoted the Commission considers whether declaration will remove obstacles to end users gaining access to services. It is Telstra's view that there are currently no obstacles to end users gaining access to SMS termination services and that, as a result, declaration will have no impact on promoting competition in the market for SMS termination services (including the relevant downstream market). This is because:

a. The retail market is currently competitive – current SMS termination rates and the commercial negotiation process for determining these rates have had no impact on ability of MNOs and MVNOs to compete in the retail mobile services market. End-users continue to benefit from the ongoing intensity of competition in the mobiles market which has evolved to meet the changing preferences of consumers, away from pure price-based competition to network coverage, quality and data allowances. Nevertheless, prices have fallen overall and consumers have experienced significant increases in value from the changes in retail price bundles, including different options for the provision of SMS across different price points.

b. There is no evidence to suggest there is any consumer detriment in the absence of declaration – as noted above, consumers have benefited from ongoing competition in the mobiles market. SMS termination rates have not impacted on the ability of downstream providers to compete with mobile network operators in terms of SMS prices and services offered to end-users. Consumers have the ability to access SMS services in a number of forms and across a range of price points based on individual preferences.

[54] Australian Financial Review, Optus targets network, data to fight Telstra, 19 December 2013 p.20
[55] AFR, ibid.

c. SMS termination does not exhibit the same bottleneck characteristics as mobile-to-mobile voice termination. Specifically no bottleneck exists for SMS due to the presence of effective substitutes in the downstream market which are used to bypass the apparent bottleneck in the upstream market. The effectiveness of OTT messaging apps as substitutes has been strengthened since the Draft Decision with the increased penetration of smartphones and development of those apps such that they provide consumers with an equivalent, if not enhanced, end-user experience.

d. Mobile network operators have no ability or incentive to deny access to SMS termination services or set unreasonable terms and conditions of access to new entrants or MVNOs. Balanced SMS traffic means that mobile network operators face countervailing buyer power when negotiating terms of access. The balance of SMS traffic is also reflected in the current competitive pricing of SMS services by mobile network operators and MVNOs.

119. Telstra maintains that the declaration of SMS termination services will have no impact on competition in the downstream retail market for mobile services.

Achieving any-to-any connectivity

120. The declaration of SMS termination services should ensure that SMS termination enables each end-user to communicate with each other end-user, whether or not they are on the same network. Telstra does not consider that the declaration of SMS services will impact on achieving any-to-any connectivity as this is already in place with no prospect of change. This is because:

a. As noted above and throughout this submission, mobile network operators have no ability or incentive to deny access to new entrants or MVNOs or to impose unreasonable terms and conditions of access.

b. Although SMS termination rates have not changed in recent years, balanced traffic point means that this has not affected the ability of mobile service providers to compete effectively at the retail level. The overall neutral impact of SMS charging (not just at the termination level but also in terms of the end-to-end charge faced by MVNOs) means that SMS pricing is effectively external to the revenue outcomes. All mobile service providers therefore essentially have the ability to provide SMS across a number of price points independently of SMS termination rates.

c. Any increase in the disparity of market shares in the mobiles market will not result in greater bargaining power. This is clearly illustrated by the fact that, as Telstra's market share has increased it has become a net outpayer (albeit at a relatively small level given the balance of SMS traffic). Again, balanced SMS traffic prevents any leverage of real or perceived market power in the mobiles market.

121. For these reasons, Telstra does not believe that the declaration of SMS termination will promote the achievement of any-to-any connectivity. The commercial negotiation process for SMS termination rates has worked effectively in the past and continues to work well. There is no evidence or prospect of a carrier being refused access to the mobile termination services of other operators in the case where a commercial agreement cannot be reached as this would not be in the interest of any service provider given the demands of mobile customers who are increasingly willing to switch providers.

Encouraging the economically efficient use of, and the economically efficient investment in, the infrastructure by which telecommunications services are supplied

122. Paragraph 152AB(2)(e) of the CCA requires the Commission to have regard to the extent to which declaration is likely to encourage the economically efficient use of, and the economically

efficient investment in, infrastructure. Telstra considers that there is already economically efficient use of, and economically efficient investment in, mobile infrastructure and that the declaration of SMS termination services will have no impact on this. As set out in this submission:

a. There is strong evidence of high investment in mobile services, particularly to facilitate data – the investment in, for example, 4G networks to enhance network coverage and data capacity. These investments are aimed at enabling mobile network operators to provide end-users with quality improvements and to facilitate the development of new products and services. The mobiles sector has evolved significantly to provide new products and services as demanded by end-users. Critically current SMS termination rates and the process of commercially negotiating these rates have not impacted on levels of investment and innovation in the mobiles sector, suggesting that regulation of SMS termination rates is unlikely to result in any dynamic efficiency gains.

b. The competitiveness of the mobiles sector also ensures that resources are allocated to their most efficient use, reflected in the above-mentioned investments in network improvements and data capacity. SMS termination rates have not impacted on the ability of the mobiles sector to ensure that consumers are able to access SMS services. Indeed, changes in the mobiles sector have ensured that customers have the ability to access SMS services across a variety of price points and in a number of forms. Most significantly, the introduction of unlimited SMS has ensured that consumers are able to access SMS services while being able to select retail mobile service plans based on personal preference and where they derive the highest value.

123. Telstra considers that the declaration of SMS termination service is unlikely to produce efficiency gains in an already competitive and evolving mobiles market characterised by high levels of investment and innovation. SMS termination rates and the commercial negotiation process for determining these rates has not impacted on the economically efficient use of, or investment in, the infrastructure used to provide mobile services in Australia. Rather significant investments continue to be made that reflect the demands and preferences of mobile end-users.

Risk of regulatory error

124. Should the Commission determine that the MTAS service description should be varied to incorporate SMS termination services, it is Telstra's view that there is a high risk of regulatory error given the likelihood that regulating SMS termination rates will have no impact on downstream retail markets and in particular will not enhance or materially affect competition. That is, it is highly likely that the costs of regulating SMS termination rates will significantly outweigh the perceived benefits of doing so.

125. For the reasons set out in the preceding sections, it is Telstra's view that the Commission's preliminary view to incorporate SMS termination into the MTAS service is not in the LTIE. The mobile services market is competitive and the current commercial approach to negotiating SMS termination rates is working well and will continue to work well. Consumers continue to benefit from a thriving mobiles environment characterised by significant investment and the competitive provision of retail mobile service plans including SMS. Telstra considers that the Commission should therefore forebear from declaring SMS termination services.

05 MMS TERMINATION SERVICES

126. The Draft Decision included the Commission's preliminary view that the MTAS service description should not be varied to cover MMS termination at this time. Telstra supports this view.

127. Telstra agrees with the Commission that the declaration of MMS termination services is not necessary. As stated in previous submissions, as with SMS termination services, MMS termination services have been subject to effective commercial arrangements, the retail market is competitive

and there are effective substitutes for MMS services in the form of smartphone OTT applications such as Facebook, Instagram and Photostream.

128. Telstra also agrees with the Commission that the relatively small consumer take-up of MMS services suggests that declaration is unlikely to have a significant impact on the relevant downstream markets. That said, Telstra does not believe that the high take-up of SMS services warrants declaration given that relatively balanced SMS traffic between mobile service providers also means that declaration is unlikely to have a significant impact on the relevant downstream markets.

06 SERVICE DESCRIPTION

129. Should the Commission maintain its preliminary position to declare SMS termination services, despite the vast amount of evidence that indicates this would not be in the LTIE, the service description proposed should be amended to specifically exclude application-to-person (**A2P**) SMS services.

130. A2P SMS services include machine-to-machine and machine-to-person SMS. At present in Australia A2P SMS is generally used for various commercial purposes, such as those SMS messages sent by retail banks to confirm new payment details or billing reminders from a variety of organisations. Sales and marketing SMS messages are not as common and the small amount of SPAM SMS messages received by Australian consumers typically originate from overseas. Telstra estimates that A2P SMS currently comprises approximately 2.3 per cent of total Telstra SMS traffic.

131. Telstra proposes that A2P SMS termination services should be excluded from any potential declaration for the following reasons:

a. A2P SMS services are distinct SMS services and, like MMS, are currently nascent products with the potential for strong growth in the future. The Commission's position in relation to MMS should therefore apply to A2P SMS. That is, similar to MMS, the level of A2P SMS traffic is low compared to traditional SMS. Traffic flows and the nature of the commercial arrangements involved in the A2P SMS segment also differ significantly from the traditional SMS segment where messages are exchanged between end-users rather than messages being delivered in bulk from an application or machine. Further no concerns have been raised about A2P SMS services in terms of the level of pricing or that mobile network operators are acting in any way to restrict or stifle access to A2P SMS termination services.

b. Failure to exclude A2P SMS services would significantly increase the risk of SPAM or sales and marketing SMS messages to consumers. The inclusion of A2P SMS termination in any potential declaration would lower the cost of these services and potentially increase the number of unwanted and nuisance SMS messages received by consumers.

c. A2P SMS services do not appear to be explicitly considered in the draft declaration of SMS termination proposed by the Commission which has thus far focused on traditional SMS messages. The distinct nature of A2P SMS services (particularly the potential impact on downstream markets and consumers) means that they should be subject to specific consideration if there is any intention to include such services in the SMS service description.

d. There is international precedent for the exclusion of such services. Specifically, in New Zealand, the SMS service description excludes SMS messages that originate on the internet, machine-to-man and machine-to-machine. The exclusion of A2P SMS in New Zealand followed concerns that inclusion of such services could significantly increase the risk of SPAM SMS messages and that they had not been considered by the New Zealand Commerce Commission as part of its inquiry into mobile termination services.[56]

132. In addition to the above points, it is possible that failure to exclude A2P SMS messages may significantly increase the cost of regulation due to the increased risk of SPAM SMS messages and resulting complaints from consumers. At present there are no facilities in place for SMS like the 'Do Not Call' register which provides consumer protection against unwanted sales and marketing calls. Although the SPAM Act 2003 prohibits the sending of unsolicited commercial electronic messages (including in the form of SMS) in some circumstances, there are a range of exceptions and qualifications to the prohibition the impact of which (in terms of diluting the law's effectiveness) could be significantly magnified if regulatory changes facilitated an environment in which bulk SMS became a more attractive marketing option from a cost perspective. It is likely that a significant increase in unwanted and nuisance SMS messages will warrant a response by authorities to ensure that SMS is afforded the same approach to consumer protection, particularly given the importance of SMS to mobile end-users in Australia. The practicalities of implementing this approach are also likely to increase costs to industry.

133. As a result, Telstra proposes that, in the event the Commission disagrees with Telstra's primary submission that declaring SMS termination is not in the LTIE, the service description should, in any event, be amended to exclude A2P SMS services. Telstra's suggested amendments to the Commission's proposed service description are set out in the Appendix to this submission. It is based on the Commission's proposed changes to the MTAS service description which was included in the Draft Decision, amended to incorporate the core elements used by the New Zealand Commerce Commission in carving out A2P SMS from the service description.

[56] See, for example, New Zealand Commerce Commission, Standard Terms Determination for the designated services of the mobile termination access services (MTAS) fixed-to-mobile voice (FTM), mobile-to-mobile voice (MTM) and short messaging services (SMS), Decision 724 5 May 2011 at http://www.comcom.govt.nz/regulated-industries/telecommunications/standard-terms-determinations/mobile-termination-access-services-mtas-std/

APPENDIX: PROPOSED SERVICE DESCRIPTION

Suggested amendments are shown in <u>underlined</u> text.

MTAS Declaration service description - 2009

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

Definitions

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

Other definitions

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

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

<u>**Multi-media message** means an asynchronous message, comprising graphics, animation, pictures, photos, images, audio, video or an alphanumeric sequence of text, or comprising any combination of these, which generally conforms to 3GPP Specification TS 23.140 (as amended from time to time), but does not include, for the avoidance of doubt, any voice call or SMS;</u>

<u>**Other message** means any SMS or other message where that message is made, or is to be made, to an access provider mobile number that has been allocated to a mobile service on the access provider's digital mobile network, including (without limitation):</u>

(a) <u>any message utilising push-to-talk messaging services;</u>
(b) <u>any message sent by the access seeker that uses a WAP–push or similar system to indirectly transmit a multi-media message;</u>
(c) <u>any message that utilises enhanced message service functionality;</u>
(d) <u>any message that utilises instant messaging functionality; and</u>
(e) <u>any message that utilises machine-to-machine (or machine-to-man) service functionality such that the message is sent without any human intervention (other than initial establishment of the service) by the customer of the access seeker, but does not include a multi-media message, SMS, read receipt or delivery receipt;</u>

Point of interconnection is a location which:

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

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

Short message service message (SMS) means a message of up to 160 characters of text, which:

(a) is transmitted using the CCITT No. 7 MAP protocol and generally conforms to GSM Technical Specifications GSM 23.040, GSM 24.011 and GSM 29.002 (as amended from time to time); and
(b) originates in, or is transited by a digital mobile network operated by the access seeker; or
(c) is sent:
   (i) using the customer's mobile phone service provided to that customer by the access seeker or, in the case of transited calls, a third party with whom the access seeker has a transiting arrangement; and
   (ii) using the SMS functionality of the customer's mobile phone or handset, a web-to-text system accessed on the customer's mobile phone or handset and associated with an MTAS reply path; and
(d) is made to a mobile number that has been allocated to a mobile service on a digital mobile network operated by the access provider, but does not include:
(e) a voice call;
(f) a multi-media message; or
(g) an other message.