**22 August 2013**

**Submission in response to the replies of other interested parties in relation to the MTAS declaration inquiry**

VHA refers to the reply submissions made by Telstra on 8 August 2013 and Optus on 15 August 2013.[1] While recognising that neither submission was called for by the ACCC, VHA would like to briefly respond to a couple of the claims made by both parties. In particular, this letter comments on what was said in relation to the lack of pass-through of MTAS price reductions by Telstra and offers a perspective on the need for declaration of short messaging services (**SMS**).

## Lack of pass-through of MTAS price reductions

VHA has long argued for a fact-based assessment of the true extent of the pass through of MTAS price reductions to retail Fixed-To-Mobile (FTM) pricing. We welcome Telstra's preparedness to engage on this issue. We look forward to these discussions in subsequent phases of the ACCC's MTAS assessment; but given Telstra assertion that parties who were concerned about a lack of FTM pass through had made "misleading"[2] claims we feel it appropriate that we respond.

There is minimal consumer benefit from MTAS price reductions if there is no demonstrable reduction in Telstra's retail pricing, particularly its retail FTM pricing. Indeed, without demonstrable pass through all that has happened is unwarranted enrichment of the dominant fixed-line incumbent. This does not benefit consumers or the Australian competitive landscape. Unfortunately over the last decade it is clear that this is what has happened.

Using publicly available information, it is our assessment that since 2004 Telstra has failed to pass through to FTM consumers over $1.4 billion of MTAS price reductions. This has resulted in:

- improved Telstra fixed-line margins (already amongst the highest in the word),
- negative impacts to both VHA and Optus' mobile businesses; and
- consumers are missing out on lower prices and a more robust mobile competitive landscape.

It is for this reason in our recent submission VHA agreed that it was vital that MTAS remains declared so the ACCC could ensure that appropriate outcomes are delivered for consumers and ensure that the dominant market player is not able to extract further super normal rents from the market.

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[1] Telstra Corporation Limited, *Response to the Submissions of other Interested Parties on the Commission's Discussion Paper on the Review of the declaration of the Domestic Mobile Terminating Access Service, Public Version*, 8 August 2013; Optus, *Optus additional submission on declaration of SMS termination – Public Version*, 15 August 2013.

[2] Telstra Corporation Limited, *Response to the Submissions of other Interested Parties on the Commission's Discussion Paper on the Review of the declaration of the Domestic Mobile Terminating Access Service, Public Version*, 8 August 2013, page 9.

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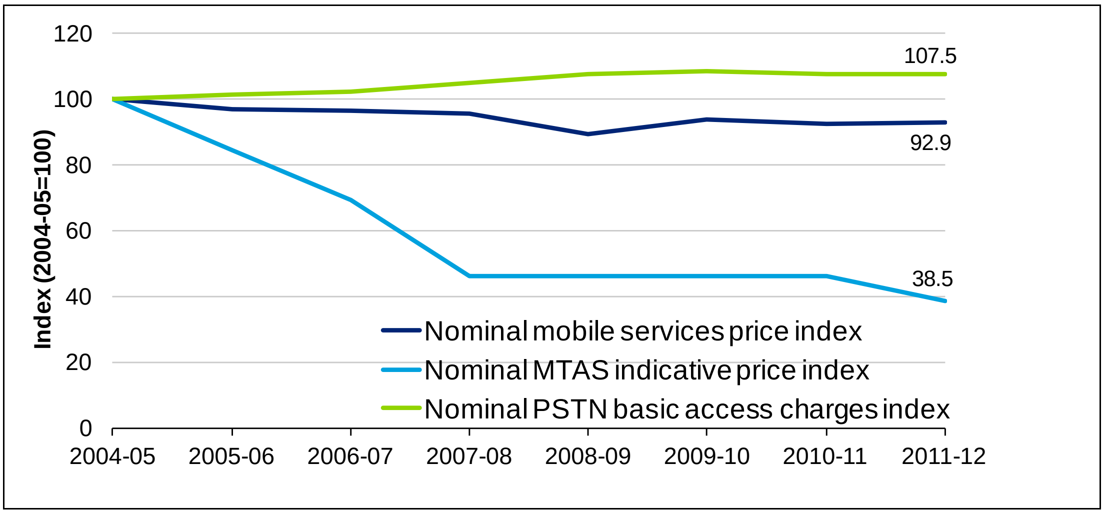
Telstra has responded by saying that they "strongly" believe that they have "more than passed through the reductions in the MTAS to customers."[3] In previous years Telstra has said that while they had not passed through MTAS prices reductions to their users of FTM services they had done so via other price reductions in other parts of their business (presumably in areas where they were facing stiffer competition, which from a competition point of view is quite problematic). We doubt this claim, but we welcome Telstra's preparedness to reassure the ACCC that they have not benefited from inappropriate enrichment. Their initial attempts to do so are not convincing.

For example, Telstra presents information from the ACCC's 2011-12 Annual Telecommunications Report that outlines that price declines in FTM has occurred.[4] However, Telstra neglects to mention that the price reductions cited in that report are in real terms only. Adjusting for inflation it is clear that MTAS reductions are not the reason for the real declines in FTM pricing. The significance of considering price reductions in nominal terms is demonstrated in **Figure 1**.

**Figure 1: Identifying the nominal change in telecommunications prices**




Source: VHA estimate based on ACCC's Annual Telecommunications Reports and the MTAS indicative price.

As **Figure 1** outlines MTAS charges have fallen far more than Telstra's retail FTM charges and FTM price have remained high. For example, on Homeline Plus, one of Telstra's most purchased plans, Telstra charges customers $1.17 for a two minute call from a fixed phone to a mobile (and has done so for some time). This is on top of the $33.95 monthly line rental – a charge that is increasing to $35.95 on 1 October.

Given that inputs such as the MTAS have fallen in both real and nominal terms, while nominal basic access charges have increased (as demonstrated in **Figure 1**) and retail FTM margins have increased (as demonstrated in **Figure 2**), the reference to the ACCC price indices provides no meaningful insight into whether 'super normal' margins continue to be made on FTM calls. If anything it demonstrates the serious structural problems in the market that is not resulting in the

[3] Telstra Corporation Limited, *Response to the Submissions of other Interested Parties on the Commission's Discussion Paper on the Review of the declaration of the Domestic Mobile Terminating Access Service, Public Version*, 8 August 2013, page 4.

[4] Telstra Corporation Limited, *Response to the Submissions of other Interested Parties on the Commission's Discussion Paper on the Review of the declaration of the Domestic Mobile Terminating Access Service, Public Version*, 8 August 2013, page 10.

optimal benefits to consumers. The ACCC should examine whether it is appropriate that Telstra should benefit from such a substantial windfall.

We intend to offer a more comprehensive assessment of this issue in subsequent submissions. To aid the assessment of this issue, VHA requests that the ACCC publish both real and nominal price indices for all telecommunications services included in its Annual Telecommunications Report over the period these indices have been used.

Telstra's submission makes the further claim that they have actually reduced FTM prices by **more** than the MTAS rate reductions[5] but Telstra has used their own internal information to make this claim. This claim is inconsistent with publicly available information. In our view, it is quite disingenuous for Telstra to assert that other interested parties' claims, including VHA's, are misleading[6] when Telstra makes claims based on unsubstantiated internal calculations.

Telstra's supposed demonstration of pass-through of MTAS price reductions through a comparison of its FTM yield and the "effective MTAS rate"[7] is a case in point. The distinction between "effective" and "headline" MTAS rates is not common industry terminology and is not used in a regulatory context, so it is unclear what these terms mean. A footnote in Telstra's letter asserts the "effective MTAS rate is calculated by multiplying the headline rate and the proportion of off-net FTM calls". The economic basis for using this approach is unclear. Moreover, Telstra does not support its assertions regarding its FTM yield or its so-called "effective MTAS rate" with the data necessary to substantiate either figure.

We invite public disclosure by Telstra of its FTM revenue, costs and minutes separated into on-net and off-net call categories so that consumers, industry and the ACCC can assess this issue on its merits. Further, Telstra should also outline which Homeline plans have benefited from price reductions. We are concerned that any FTM price reduction claimed by Telstra has been negated by the higher line rentals Telstra charge these customers and the (minimal) FTM price reductions are concentrated on calls to Telstra mobiles. For example, Homeline Ultimate is $89.95 a month and even though FTM calls to Telstra mobiles are 50c for a two minute call it is still $1.17 for calls to Vodafone and Optus mobiles. Again, it is not clear how the MTAS price reduction has flowed through to consumers, even for Homeline Ultimate consumers.

The data VHA has relied upon as evidence of the lack of pass-through was submitted by Telstra and analysed by the ACCC and is available on the ACCC's website.[8] This data shows that since 2004 the ACCC has reduced the MTAS rate by 77% while the price charged to consumers by Telstra has only reduced by 32%. It also shows that Telstra's own data indicates that the margin on residential FTM calls increased from 31.7% 1Q04 to 61.8% in March 2013. The margin between average unit revenue and costs for aggregated residential and business FTM calls is illustrated in **Figure 2**.

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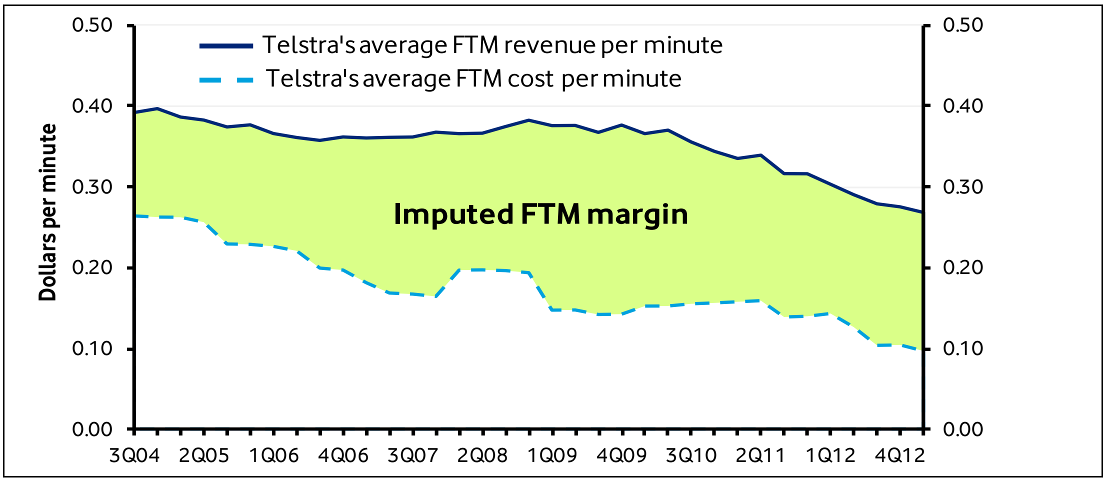
[5] Telstra Corporation Limited, *Response to the Submissions of other Interested Parties on the Commission's Discussion Paper on the Review of the declaration of the Domestic Mobile Terminating Access Service, Public Version*, 8 August 2013, page 9.

[6] Telstra Corporation Limited, *Response to the Submissions of other Interested Parties on the Commission's Discussion Paper on the Review of the declaration of the Domestic Mobile Terminating Access Service, Public Version*, 8 August 2013, page 9.

[7] Telstra Corporation Limited, *Response to the Submissions of other Interested Parties on the Commission's Discussion Paper on the Review of the declaration of the Domestic Mobile Terminating Access Service, Public Version*, 8 August 2013, page 9.

[8] http://transition.accc.gov.au/content/item.phtml?versionId=1118720&nodeId=39cb44bdf8bd8477d15aee13a4137e09&fn=TEM%20Public%20Report%20-%20FY13%20H1.pdf

**Figure 2: Telstra's average FTM revenue and cost per minute**




Source: ACCC's *Imputation testing and non-price terms and conditions reports* (quarterly, June 2004 to March 2013), Current cost data.

While VHA notes that Telstra's revenue from FTM calls is 280% of its network costs, as is clear from Telstra's TEM Report,[9] it would be useful if Telstra could explain how it attributes product, marketing, sales and customer support costs between FTM services and other fixed voice services. Provision of that information will promote transparency so that the ACCC, other stakeholders and consumers can better understand Telstra's performance on this critical consumer issue.

**Declaration of SMS not in the LTIE**

Services should only be declared when it would promote the long term interests of end-users (**LTIE**). In its initial submission, VHA argued that it was unnecessary to declare SMS as the market was functioning effectively without declaration.[10] We remain of the view that expansion of regulation is not needed. Retail prices for SMS are low and decreasing and at the wholesale level given SMS traffic tends to "net out" between mobile network operators (**MNOs**) there does not appear to an anti-competitive detriment occurring. In these circumstances, the existence of a commercial dispute between **MNOs** does not provide a sufficient basis for declaration, particularly where there is no evidence that consumers would benefit as a result. We welcome an ongoing discussion on this issue.

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[9] Telstra Corporation Limited, *Telstra Economic Model (TEM) Public Report – FY13 H1*, available at: http://transition.accc.gov.au/content/item.phtml?versionId=1118720&nodeId=39cb44bdf8bd8477d15aee13a4137e09&fn=TEM%20Public%20Report%20-%20FY13%20H1.pdf

[10] VHA, *Declaration of the Domestic Mobile Terminating Access Service - Response to the Australian Competition and Consumer Commission*, 5 July 2013, page 7.