# DECLARATION OF THE DOMESTIC MOBILE TERMINATING ACCESS SERVICE

## SUBMISSION TO THE AUSTRALIAN COMPETITION AND CONSUMER COMMISSION

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# Contents

# 1. Executive summary

Vodafone Hutchison Australia Pty Limited (**VHA**) welcomes the opportunity to participate in the Australian Competition and Consumer Commission's (**ACCC**) consultation on its draft decision on the review of the declaration of the domestic mobile terminating access service (**MTAS**).

**<u>Pass-through and the LTIE</u>**

VHA agrees that the MTAS should be declared if it promotes the long-term interests of end-users (**LTIE**). Unlike many other declared services, the LTIE test is not straight-forward in the case of the MTAS because:

- carriers are both access providers and access seekers, and
- there is a mix of integrated (fixed and mobile) suppliers and mobile-only suppliers.

The complex interplay between supply of the MTAS, retail fixed-to-mobile pricing, integrated fixed and mobile network operators, and mobile subscriber acquisition requires a detailed assessment of the consumer welfare effects in the supply of several retail and wholesale services through time. Moreover, it requires the ACCC to assess the competitive implications of Telstra benefitting from reductions in the regulated MTAS rate at the expense of its mobile competitors. Any regulatory measures that have the effect of increasing the profitability of Australia's already dominant incumbent, while impairing the ability of its challengers to generate a sustainable rate of return warrant detailed and careful investigation.

For this reason, VHA believes that the pass-through of MTAS pricing to retail Fixed-to-Mobile (**FTM**) services is not merely a pricing issue to be considered in the upcoming Final Access Determination (**FAD**) inquiry. Given end users are meant to be the beneficiary of MTAS declaration an assessment of the extent of pass through of any significant wholesale price reductions is at the centre of the ACCC's declaration considerations. We recommend the ACCC commission a detailed economic analysis of the welfare effects from MTAS declaration prior to finalising its decision on declaration of mobile voice termination services.

Further, to achieve the objectives of declaration, the ACCC must:

- explicitly acknowledge that the lack of retail FTM pass-through is not in the interests of end users and other mobile network operators (an issue that the ACCC has rightly identified as a concern in past declaration enquiries); and
- ensure that this impediment to competition is addressed in the subsequent FAD inquiry (something the ACCC has failed to do in the current FAD).

**<u>Declaration of voice termination services</u>**

Subject to the overriding concerns expressed above, VHA supports the ACCC's decision to re-declare the MTAS for a period of up to 5 years. However, for the past decade the regulation of MTAS has note optimised the LTIE. This is because the link between the LTIE, regulated MTAS rates and competition in the mobile services and fixed voice services markets has not been explicitly recognised in the declaration process.

The ACCC should take a more holistic approach to regulation of the MTAS by considering the extent to which declaration **and** particular pricing constructs promote the LTIE. In particular the ACCC must recognise that the problems with mobile termination relate to the Telstra's significant market power in the fixed line market and it is this market problem that must be resolved to promote the long term interests of end users.

**Declaration of SMS termination services**

VHA was surprised by the ACCC's proposal to declare SMS termination. We find it strange that the ACCC would choose to consider such a heavy-handed approach to regulating SMS interconnection despite the fact that consumers have benefited from substantial reductions in the retail SMS price over the last decade. Unlike mobile voice termination, VHA does not consider there to be any discernible impact on retail pricing or the profitability carriers from SMS termination rates.

Given the size of the revenue that the possible declaration will cover, it is surprising that the Commission has undertaken only a very cursory assessment of the SMS termination service and the market it operates in. The ACCC has not undertaken a formal declaration inquiry and appears to have made its decision based on limited information which has resulted in a number of factual errors (see **Table 1**):

Table 1: Factual inaccuracies in relation to SMS termination in the ACCC's draft decision

| ACCC assertion* | Comment | Recommendation |
|---|---|---|
| Assessment of substitutability of over-the-top messaging applications (pp 33-34) | The ACCC's assessment is characteristics-driven and has ignored empirical data on consumer behaviour from, for instance, markets where messaging applications are rapidly displacing SMS traffic. Further it has not assessed the substantial reduction in the SMS price to respond this new competitive pressure. | ACCC undertake an evidence-based assessment of consumer demand for messaging applications. |
| 49% smartphone penetration (p34) | Reported ACMA figures are around two years of out-of-date and ignored the trend toward rapid adoption of smartphones by consumers. | Use updated ACMA figure of 64% smartphone penetration. By the time declaration would be in effect we would expect that smartphone penetration to be closer to 70%. This significantly changes the substitutability assessment. |
| Imbalance in SMS traffic (p39) | VHA maintains that SMS traffic between service providers is balanced. It appears that the ACCC may be relying on data between carriers that has not been reconciled. | ACCC should define thresholds for "balanced" and, if it believes there are imbalances identify the specific causes for that imbalance. |

* Page references refer to the ACCC's 2013 Draft Decision on the MTAS.

In a climate where 'old world' SMS technology is under threat from 'new world' smartphone messaging applications, the ACCC's draft decision to declare SMS termination services for the next 5 years needs to be reconsidered. VHA does not consider that declaration of SMS termination services is necessary, or that the ACCC has demonstrated an adequate basis for declaration.

Further the ACCC's has appeared not to have assessed alternate more light touch approaches to SMS interconnect regulation. We urge the ACCC consider less interventionist approach to overcome any perceived concerns.

The rapid downward movements in the retail price of SMS services, and the introduction of SMS bundles including many "unlimited" SMS bundles, demonstrate that competition in the retail market and therefore the advancement of the LTIE has not been hindered by the level of SMS termination rates. Should the ACCC ultimately wish to consider declaration of SMS termination services, VHA considers that the ACCC should first conduct a vigorous consideration of the merits of declaration that is separate to the MTAS declaration inquiry.

# 2. Fixed-to-mobile pass-through and the LTIE

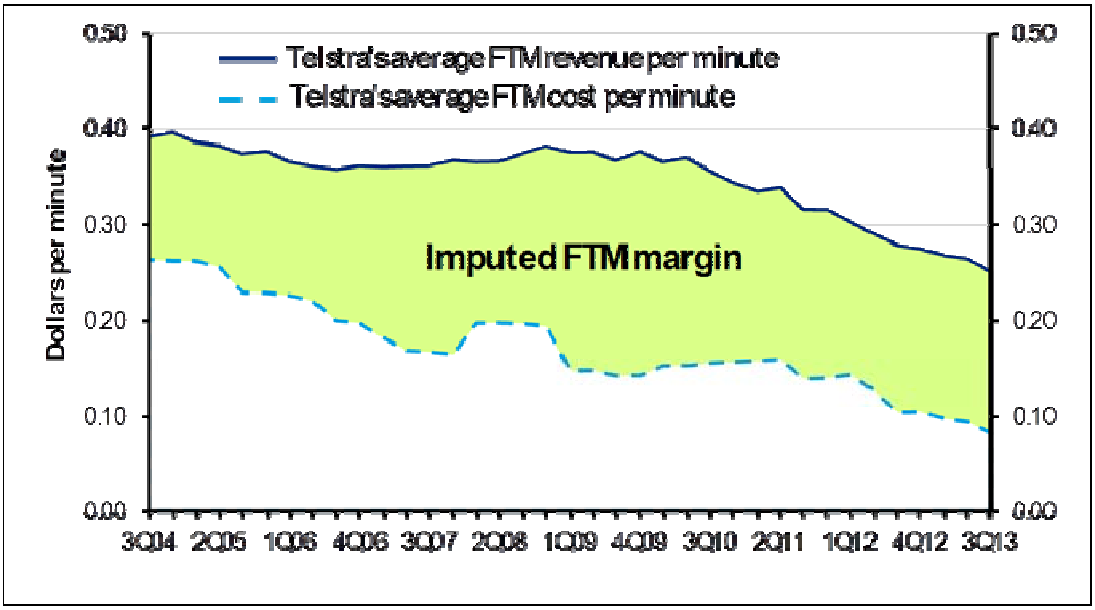
## 2.1 Pass-through and the LTIE

VHA does not agree with the ACCC's assessment that FTM pass-through is merely a pricing issue to be considered in the FAD inquiry, as declaration will not promote the LTIE **unless** the ACCC ensures that MTAS reductions are passed-through to FTM end-users.

Mandated reductions in the MTAS rate over the past decade have not been passed on to end-users of FTM services in any comprehensive way, but have instead been retained by fixed network operators, particularly Telstra, thereby increasing their monopoly rents in the market for fixed voice services. According to the ACCC's own reporting Telstra's FTM margins have increased from 37% at the end of 2004 to 64% in the third quarter of 2013 (see **Figure 1**).[1] We calculate this margin has contributed to Telstra accruing $1.4 billion in unrealised consumer benefits from the lack of pass-through. This is not in the interests of end users and hurts competition.

This issue must be at the centre of any regulatory framework for the management of MTAS. The lack of oversight of the pass through issue has reduced the extent to which declaration of the MTAS has promoted the LTIE. In fact, by effectively strengthening Telstra's fixed-line monopoly, declaration of the MTAS has not promoted the LTIE **at all**. It has not benefited consumers, it has strengthen the dominance of an already powerful incumbent and has held back mobile competition in Australia. The perpetuation of regulatory arrangements that have the effect of increasing the profitability of Telstra, while impairing the ability of challenger MNOs to generate a sustainable rate of return warrants detailed and careful investigation by the ACCC.

**Figure 1: Telstra's average FTM revenue and cost per minute**




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

[1] ACCC, *Imputation testing and non-price terms and conditions report*, various years.

## 2.2 ACCC's lack of engagement on pass-through (despite acknowledging the serious problem)

The issue of the lack of pass-through has been acknowledged by the ACCC in its pricing determination in 2009,[2] where it stated that:

> *"the ACCC is disappointed with respect to reductions in retail FTM prices, as it appears no significant reduction in retail FTM prices has emerged despite earlier expectations."*;

And in the ACCC's public inquiry into making an access determination in 2011:

> *"The ACCC considers that the lack of FTM pass-through demonstrates inherent structural issues in the fixed line services market where integrated operators remain dominant with their full suite of services. Consumers who acquire a variety of services such as voice, data or pay TV tend to select integrated operators so as to obtain bundle discounts and a single bill. The lack of competitive pressure means that integrated operators have little incentive to pass through savings from reductions in the MTAS directly to consumers in the FTM price. Integrated providers also have the ability to use their savings from the regulated reductions in the MTAS rate to subsidise price reductions in services or geographic areas where competition does exist"*.[3]

The ACCC also commissioned the Analysys Mason report on '*Regulatory treatment of fixed-to-mobile pass-through*' (**Analysys Mason Report**) in 2009 to determine whether reductions in the price of the MTAS since 2004 have increased consumer and social welfare and whether the ACCC should mandate FTM pass-through in full. The Analysys Mason Report concluded that:

- the absence of regulation of FTM pass-through in selected international benchmarked countries has led to quite high and increasing retention margins[4] in a number of those countries, with the resulting FTM retail margins being comparable to those seen in Australia;
- regulating FTM pass-through would have a positive impact on overall social surplus;
- regulating MTAS also increases the overall social surplus; and
- while regulating FTM pass-though and MTAS decreases the combined surplus for MNOs, this is more than compensated by the increase in consumer surplus.

In light of the findings in the Analysys Mason Report, VHA commissioned a report from Frontier Economics in 2011 on the '*Welfare analysis of implications of reduced mobile termination rates*', (**Frontier Economics Report**) (see **Attachment 1**). The objective of the Frontier Economics Report was to develop an economic model to analyse the welfare effects of MTAS reductions in the past and extend the welfare analysis undertaken in the Analysys Mason Report. The Frontier Economics Report concluded that:

- FTM pass-through is usually low in markets where competition over the provision of fixed-line services is weak;
- the greatest beneficiaries of past MTAS price reductions have been fixed network operators;

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[2] ACCC, *Domestic Mobile Terminating Access Service Pricing Principles Determination and indicative prices for the period 1 January 2009 to 31 December 2011*, March 2009 at p22.
[3] ACCC (2011), *Domestic mobile terminating access service (MTAS)*, Discussion paper, June, p8.
[4] FTM retention is the difference between retail FTM call rates and wholesale mobile termination rates. It is composed of the fixed operator's own costs (origination and interconnection network costs, retail costs) and its margin.

- the benefit of MTAS reductions to consumers is less than 10% of that enjoyed by the fixed network operators (of which Telstra would be the most significant) due to low levels of FTM pass through; and

- the benefit of MTAS reductions to MNOs, consumers and society as a whole is unclear due to what is called the 'waterbed effect'. The 'waterbed effect' refers to the decrease in a MNOs preparedness to compete for subscribers in their network due to reduced marginal revenues caused by reductions in MTAS rates. Where the mobile market is more competitive than fixed-line markets, the 'waterbed effect' would be strong, that is, MNOs would be closer to operating under a 'zero profit constraint' and any reductions in the price of the MTAS will need to be recovered through increases in retail prices in order for MNOs to remain profitable. Where the 'waterbed effect' is stronger than the level of FTM pass-through, which is observed in Australia, reductions in the price of MTAS will be far less likely to enhance the welfare of consumers.

### 2.3 Lack of pass-through needs to be addressed

Given the significant developments in fixed and mobile telecommunications markets, VHA considers that the ACCC should take a more robust and holistic approach to regulation of the MTAS by:

1. recognising its final decision on the MTAS declaration inquiry that the satisfaction of the statutory declaration criteria is inextricably linked to retail FTM pass-through.

2. commissioning an updated and more comprehensive economic analysis to include the wider welfare effects and a more detailed examination of assumptions underpinning changes in MTAS pricing referred to in the Frontier Economics Report in finalising its declaration decision and preparing for the FAD inquiry.

Only once this economic analysis is done can the ACCC properly assess its options under the FAD and whether any specific and further action is required in relation to the retail price of FTM calls.

## 3. Declaration of voice termination services

### 3.1 MTAS should continue to be declared

Subject to VHA's overriding concerns on the issue of FTM pass-through (discussed in **section 2** above) and pricing (discussed further below), VHA agrees with the ACCC's decision to extend the declaration of MTAS for a period of up to 5 years in so far as it covers the termination of voice calls. VHA considers that, in theory, there is a case for declaration as it will:

- promote competition, as each MNO continues to have a monopoly over termination on its network and there are a lack of substitutes to the MTAS and, unlike SMS termination, there is terminating traffic originating on fixed networks;

- promote any-to-any connectivity; and

- encourage efficient use of, and investment in, telecommunications infrastructure.

### 3.2 A more holistic perspective on MTAS required to assess the impact of declaration on the LTIE

While there is a prima facie case that MTAS declaration can promote the LTIE in the context of a broader program of overcoming areas of market distortion and the competitive playing field. In practice, the impact of MTAS declaration on the LTIE in Australia is not apparent. Declaration in the absence of pass-through and economically sound pricing policies will not only fail to promote the LTIE, it will distort competition in the relevant markets. VHA considers that the ACCC should take a more holistic approach to MTAS regulation and consider both pricing and declaration in the promotion of the LTIE to ensure that the benefits of declaration are realised in practice. It is insufficient for the ACCC to rely on a prima facie case that the LTIE can be promoted in its statutory analysis of declaration without considering whether the LTIE **is actually promoted** in practice.

The evidence on whether past MTAS reductions have promoted the LTIE is questionable. As detailed in **section 2** above, MTAS price reductions have primarily benefited fixed network operators, in particular Telstra, and have not been passed-through to consumers. Telstra's imputed margin for FTM calls has increased and there is no evidence that lower MTAS prices have reduced nominal prices for bundled fixed-line calls or price reductions in the mobile services market. On the contrary, lower MTAS prices have been associated with increased concentration in the mobile services market due to market distortions created by aggressive reductions in MTAS rates which have lessened the ability of some MNOs to compete. This increased concentration in the mobile services market means that changes to the MTAS rate will have a more pronounced effect than previously, further impacting on smaller MNOs' ability to compete. VHA considers that the ACCC should take into account industry dynamics when considering its approach to pricing, as lower MTAS rates do not necessary result in the promotion of the LTIE.

VHA considers that the ACCC should acknowledge the significance of these issues, which are outlined in more detail below, in its final decision and address them adequately in the FAD in order to meet the statutory objectives of declaration.

3.2.1 Promoting Competition

Despite declaration and MTAS price reductions, the level of competition in the relevant downstream markets remains low and has deteriorated since the MTAS FAD inquiry in 2011.

In relation to the fixed voice services market, Telstra's market share of public switched telephone network (**PSTN**) services exceeds 65% and has remained virtually unchanged since 2004.[5] There has also been significant industry consolidation over the past few years, indicating that smaller fixed network operators feel the competitive pressure to merge in order to viably compete against Telstra. Further, despite MTAS price reductions, non-MTAS barriers to entry to the market are significant, resulting in a lack of threat of new entry and an absence of pressure on Telstra to competitively price services.

In relation to the mobile services market, lower MTAS prices have:

- [c-i-c]
- led to increased concentration (as measured by profitability, revenue and subscriber rates).
- distorted competition in the mobile services market as MNOs have experienced reduced marginal revenue which lessens the ability and the preparedness of some MNOs to compete.

Additionally, barriers to entry in the mobile industry remain significant and will likely increase with the transition to mobile data.

[5] ACCC, *Telecommunications competitive safeguards*, various years.

The structural characteristics of the relevant markets indicate that MTAS declaration is necessary. However, the current lack of competitiveness observed in these markets suggests that declaration has not promoted competition due to the lack of FTM pass-through and the distortion of competition due to regulated price reductions which have an asymmetric impact on smaller MNOs. VHA considers that the ACCC should comprehensively and urgently address these issues in order to promote competition and prevent further distortion.

### 3.2.2 Any-to-any connectivity

VHA acknowledges that, in principle, declaration of the MTAS is likely to promote any-to-any connectivity in the sense that it prevents the hypothetical possibility of an MNO refusing to terminate calls on its network. However, the extent of actual interconnection between MNOs indicates that, in practical terms, the impact is likely to be minimal.

### 3.2.3 Encouraging efficient use of, and investment in, infrastructure

While declaration is required to encourage efficient use of, and investment in, infrastructure, it is doubtful whether declaration has done so in the relevant markets to date.

In the fixed services market, the lack of anything like full FTM pass-through means that consumers are not receiving the full benefits of MTAS reductions. As a consequence, the consumption of FTM calls is less than what is economically efficient due to higher imputed retail FTM prices. Further, the ability of an MNO to efficiently invest in infrastructure is informed by a MNOs ability to generate revenue to fund investment. At present, the ACCC's MTAS pricing decisions have been based on an assumption that competitive industry participants will achieve a "target" rate of return of 15%, which is significantly higher than that achieved by VHA, the third largest market participant (see **Figure 4** below). This has resulted in, aggressively reducing MTAS rates to a point at which smaller MNOs are hindered from efficiently recovering capital costs that are commensurate with risks of the industry. This reduced ability to generate a sustainable rate of return undoubtedly dampens incentives for investment in infrastructure.

**Figure 4:**

[c-i-c]

In the mobile services market, declaration and MTAS price reductions can promote efficient use of infrastructure provided that there are no corresponding changes to retail prices. This, however, is unrealistic. As outlined in the Frontier Economics Report, where the mobile services market is more competitive than the fixed-line markets, as is undoubtedly the case in Australia, the 'waterbed effect' would be strong and reductions MTAS will be followed by increases in subscription charges in order for MNOs to remain profitable. Therefore, the perceived efficiency is lost. Further, similar to the fixed voice services market, an increase in subscription charges may also lead to less economically efficient use of infrastructure by end users.

VHA considers it necessary for the ACCC to undertake a detailed assessment of current market dynamics, including a balanced consideration of the nature of downstream retail competition, the method in which industry players should recover their costs and the level of investment that is optimal in the market.

# 4. Declaration of SMS termination services

## 4.1 Declaration of SMS termination services is unnecessary

VHA does not consider declaration of SMS termination services to be necessary, or that the ACCC has demonstrated an adequate basis for declaration. It appears from the ACCC's draft decision that its primary concerns are based on concerns raised by Optus and Macquarie Telecom in relation to Telstra. VHA considers that these issues, which relate to the conduct of individual market participants rather than the structure of the market, can and should be resolved between these MNOs and should not be dealt with in the context of a declaration inquiry. VHA is comfortable with the ACCC setting a timetable for these commercial negotiations. Only if problems persist should the ACCC consider declaration.

Further, any declaration should be based on careful and rigorous economic analysis. The Draft Decision was not based on a Declaration Inquiry, rather a limited set of information requests. The ACCC has not undertaken a formal declaration inquiry and appears to have made its decision based on limited information which has resulted in a number of factual errors (see **Table 1**):

Table 1: Factual inaccuracies in relation to SMS termination in the ACCC's draft decision

| ACCC assertion* | Comment | Recommendation |
|---|---|---|
| Assessment of substitutability of over-the-top messaging applications (pp 33-34) | The ACCC's assessment is characteristics-driven and has ignored empirical data on consumer behaviour from, for instance, markets where messaging applications are rapidly displacing SMS traffic. Further it has not assessed the substantial reduction in the SMS price to respond this new competitive pressure. | ACCC undertake an evidence-based assessment of consumer demand for messaging applications. |
| 49% smartphone penetration (p34) | Reported ACMA figures are around two years of out-of-date and ignored the trend toward rapid adoption of smartphones by consumers. | Use updated ACMA figure of 64% smartphone penetration. By the time declaration would be in effect we would expect that smartphone penetration would be closer to 70%. This significantly changes the substitutability assessment. |
| Imbalance in SMS traffic (p39) | VHA maintains that SMS traffic between service providers is balanced. It appears that the ACCC may be relying on data between carriers that has not been reconciled. | ACCC should define thresholds for "balanced" and, if it believes there are imbalances identify the specific causes for that imbalance. |

* Page references refer to the ACCC's 2013 Draft Decision on the MTAS.

Should the ACCC wish to contemplate declaration of SMS termination services, it should conduct a more comprehensive inquiry that is separate to the current MTAS declaration inquiry. That inquiry should, at a minimum, address the following key issues.

## 4.2 Service description

The ACCC defines SMS in Appendix A of its draft decision as:

> *"the provision of messages up to 160 characters of text using spare capacity in the voice signalling channel of a mobile network".*

This description is very specific, referring to "spare capacity", and does not appear to be technology neutral, contrary to the ACCC's stated approach to the regulation of telecommunications services.

### 4.3 Promoting competition

#### 4.3.1 Substitute Services

VHA does not agree with the ACCC's finding that new messaging technologies are not a substitute for SMS. This seems factually incorrect in light of available evidence outlined below.

The ACCC references the ACMA's report, *Communications Report 2011-2012; Report 3 – Smartphone and tablets take up and use in Australia* (**ACMA Report**), stating that:

> *"The ACMA reports that 92 per cent of Australians used a mobile phone as at May 2012, whereas 49 per cent of adults were using smartphones."*

First, VHA notes that the ACMA Report dates the statistics as at May 2012, not May 2013 as stated by the ACCC. The ACMA's updated smartphone take up of 64% of the adult population as at May 2013 is a significant trend that the ACCC must not ignore.[6] By June 2014 we expect smartphone penetration to be over 70%.

Secondly, VHA does not agree with the ACCC's assessment that this information as an indication that smartphone messaging technologies are not a substitute for SMS messaging. VHA acknowledges that smartphone messaging applications require both the sender and receiver to use the same application. However, the most popular of these smartphone applications (including Whatsapp, Viber, Kik and Facebook Messenger, as well as other applications which allow for pictures and text to be sent including Snapchat and Instagram) are readily available as they usually free to download and are available on both Android and iPhone operating systems – the two largest operating systems (OS) as at September 2013.[7] Moreover, consumers can download and use multiple messaging applications on their mobile OS. It is difficult to conceive of these services as anything other than a direct substitute for SMS and, in some markets (for example, the Netherlands), messaging applications have displaced large volumes of mobile SMS traffic.

#### 4.3.2 State of competition in relevant markets

The ACCC states that the current wholesale and retail markets for SMS are not competitive. One factor cited by the ACCC in support of its finding is that SMS usage has increased since 2003 while SMS termination rates have remained constant during this time. A more relevant measure are the retail prices of SMS, which have fallen significantly and where large SMS inclusions are now regularly offered as part of a bundle (see **Tables 1** and **2**). As such, this rationale for regulation is tenuous.

[6] ACMA (2013), *Communications report 2012-13*, p25.
[7] IDC (2013), 'Android Pushes Past 80% Market Share While Windows Phone Shipments Leap 156.0% Year Over Year in the Third Quarter', Press release, November, http://www.idc.com/getdoc.jsp?containerId=prUS24442013.

Table 1: Vodafone postpaid options for heavy domestic SMS usage at various price points

| Monthly spend | $30 | $40 | $50 | $60 | $65 | $80 | $100 |
|---|---|---|---|---|---|---|---|
| Flexible value | $200 | $250 | $500 | $700 | N/A | N/A | N/A |
| Rate/inclusion | $0.30/TXT | Infinite | Infinite | Infinite | Infinite | Infinite | Infinite |
| Max. SMS using flexible value | 666 | Infinite | Infinite | Infinite | Infinite | Infinite | Infinite |

Table 2 Vodafone prepaid options for heavy domestic SMS usage at various price points

| Recharge options | $10 | $30 | $40 | $50 | $70 |
|---|---|---|---|---|---|
| Flexible value | $100 | $450 | $750 | $1,000 | $1,500 |
| Rate/inclusion | $0.30/TXT | Infinite | Infinite | Infinite | Infinite |
| Max. SMS using flexible value | 333 | Infinite | Infinite | Infinite | Infinite |
| Expiry period | 30 days | 28 days | 28 days | 28 days | 28 days |

VHA submits that the retail SMS market is already competitive. This is further supported by the ACMA Report which states that:

> *"Mobile network operators earn significant revenue from users sending SMS messages and making phone calls carried over a mobile network...While consumers may be currently making more use of these services, this increase has not necessarily been reflected in revenue increases for providers. Increased competition has forced them to lower prices and include more in service offerings to entice consumers...*
>
> *Mobile network operators are also at risk of losing SMS revenue as consumers switch to alternative methods of sending text-based messages"*

It follows that declaration is unlikely to further promote competition.

## 4.4 Any-to-any connectivity

VHA considers that declaration of SMS services would not promote any-to-any connectivity. The ACCC has not provided evidence that any-to-any connectivity is not being achieved in the absence of declaration.

## 4.5 Encouraging efficient use of, and investment in, infrastructure

The current treatment of SMS termination has not been an impediment to investment in associated infrastructure. Network demand from SMS is insignificant compared to voice and data services and does not significantly affect the need for investments in new infrastructure. Indeed, the ACCC's draft definition of SMS as text messaging using "spare capacity" of a mobile network.

Further, declaration would not encourage efficient use of infrastructure as the provision of SMS services uses spare network capacity, indicating that MNOs are already making use of their infrastructure, including spare capacity. Further, end-users often purchase mobile services that include unlimited SMS. Reductions in SMS termination rates will not impact on these end-users' use of SMS as they are not charged for individual SMS.

### 4.6 International approaches to regulation of SMS termination rates

Despite regulatory intervention across a range of mobile services, including MTAS and international roaming, SMS termination services are not generally regulated in other jurisdictions. For instance, Italy, which recently investigated whether to regulate SMS termination rates, concluded that "the market for SMS termination on individual mobile networks is not susceptible to ex-ante regulation, because the market tends toward effective competition".[8] More generally, the European Commission has not sought to intervene on SMS termination rates and, while a handful of European Union countries have regulated SMS termination (for example, Denmark, France and Poland), most European regulatory authorities submit that SMS termination rates do not meet the criteria for ex-ante regulation.

# 5. Conclusion

**MTAS**

VHA considers that there is still a clear basis for MTAS declaration as the fundamental policy underpinnings for declaration remain. However, it is doubtful whether the impact of declaration has promoted the LTIE in practice and we recommend the ACCC undertake economic analysis to assess this issue. Australia has perhaps the most distorted fixed line market in the OECD. This is evidenced by the $1.4 billion in unrealised consumer benefits that have accrued to Telstra due to past MTAS reductions. It is not sufficient for the ACCC to adopt a sequential approach to its regulatory decision making and assess declaration and pricing in separate analytical frameworks. VHA considers it is imperative that the ACCC's final decision adequately recognises and appreciates the observed negative impact of pass-through and pricing on competition and efficiency, which in turn inhibits the ability of declaration to promote the LTIE. These issues then need to be addressed in the ACCC's subsequent FAD inquiry. A failure to adequately identify and resolve these issues will result in the statutory objective of declaration not being met.

**SMS**

VHA considers that declaration of SMS termination services is unnecessary. VHA considers that commercial issues can and should be resolved commercially between Telstra, Optus and Macquarie Telecom rather than through declaration. Further there are alternate regulatory oversight options that will more efficiently overcome any perceived concerns about commercial arrangements.

A less draconian approach would allow the ACCC to undertake a more accurate market assessment than the review that has been undertaken to date. We are confident that this will show smartphone messaging applications are a significant substitute to traditional SMS services and the existing retail market is already competitive. Should the ACCC ultimately wish to consider declaration, it should conduct a more comprehensive inquiry and economic analysis of the impact of declaration on the LTIE that is separate to the MTAS declaration inquiry, so that it can ensure it is taking a robust approach to data assessment and regulation.

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[8] IDC (2013), 'Android Pushes Past 80% Market Share While Windows Phone Shipments Leap 156.0% Year Over Year in the Third Quarter', Press release, November, http://www.idc.com/getdoc.jsp?containerId=prUS24442013.

# Attachment 1: Frontier Economics report