

Submission in response to ACCC
Discussion Paper

**Review of the declaration of the domestic
mobile terminating access service (MTAS)**

PUBLIC VERSION

July 2013

Contents

Section 1. Introduction	3
The development in competition in downstream markets since 2009	3
SMS should be included in the MTAS Declaration	4
Section 2. Review of market developments	6
State of competition in the retail mobile market	6
State of competition in the retail fixed-to-mobile market	17
Continued declaration of MTAS is in the LTIE	19
Section 3. SMS services should now be regulated	20
The case for regulation of SMS termination in Australia	21
Is SMS still exhibiting significant growth?	22
Operators have been unsuccessful in lowering SMS termination rates	22
Wholesale SMS termination rates are inefficiently high	23
Declaration of wholesale SMS will promote LTIE	24
Section 4. Future services and MTAS	27
What is VoLTE and when is it expected to be deployed?	27
Deployment of VoLTE does not impact on definition of MTAS	28
Interconnection and VoLTE	30
The impact of NBN on MTAS	30
Appendix A. Regulation of SMS in other jurisdictions	33
Jurisdictions where wholesale SMS termination has been regulated	33
Jurisdictions where SMS termination markets have been investigated	36

Section 1. Introduction

- 1.1 The Mobile Terminating Access Service (MTAS) has been a declared service since 1997. The ACCC most recently considered the declaration of the MTAS in 2009 when it decided that declaration was in the long term interest of end users (LTIE). At the time, it also made a number of key findings:
- (a) MTAS continues to be an essential bottleneck;
 - (b) Declaration would promote competition in the downstream retail mobile market and the fixed-to-mobile (FTM) call market; and
 - (c) Declaration, combined with cost-based pricing, would promote any-to-any connectivity and efficient investment in infrastructure.
- 1.2 Optus will show that the reasons for declaration that existed in 2009 still hold in 2013. In fact, the case for regulation of MTAS is stronger now than in 2009 due to the emergence of new trends in the mobile market.
- 1.3 In 2009, the ACCC declined to extend the MTAS declaration to include SMS, as the market was still exhibiting significant growth, was subject to ongoing commercial agreements, and there had been no demonstrable market failure.¹
- 1.4 Optus will demonstrate that the SMS market has developed since 2009 in a manner that has undermined the ACCC's reasons for not including SMS in the MTAS declaration. The SMS market, while having grown significantly since 2009, has flattened since 2011 in the face of increasing competition from messaging services. In response, Optus has attempted to negotiate reductions in the SMS termination rate to help open opportunities for more competitive retail offers. These attempts have been unsuccessful, with the result that SMS interconnection rates remain at levels first set over a decade ago. This has resulted in an SMS termination rate which is significantly more than the MTAS rate. Such an outcome clearly is not consistent with cost-based pricing.

The development in competition in downstream markets since 2009

- 1.5 In this submission, Optus will set out a brief review of the current state of competition in the Australian mobile market. This will show a significant shift in the direction of the mobile industry since the last MTAS declaration Inquiry. Optus finds that:
- (a) Total mobile market growth has stalled as the market has reached saturation;
 - (b) Revenue growth is increasingly driven by data usage, but as data usage grows so too does the need to invest in network upgrades and achieve minimum efficient scale;
 - (c) Telstra has increased its market shares in all the relevant metrics since 2009, reversing the trend seen in the 2009 declaration Inquiry;
 - (d) Telstra has acquired around 70% of all net additions since June 2010, acquiring most of the subscribers that left VHA;

¹ ACCC, *Mobile Terminating Access Service: An ACCC final report on reviewing the declaration of the mobile terminating access service*, May 2009, p.11

- (e) Competition in the market has moved towards network quality and coverage; and
 - (f) Telstra's commanding share of revenue and mobile EBITDA, in combination with its fixed network and \$16.5b of additional revenue due to NBN-related payments, means its market power in the mobile market is likely to continue during the period of the declaration.
- 1.6 Optus finds that the retail mobile market is less competitive today than it was in 2009. Since the last declaration, Telstra's subscriber market share in the retail mobile market has increased by 5 percentage basis points and Telstra now has a 65% market share in mobile EBITDA. Such outcomes indicate that Telstra has significant market power in the retail mobile market.
- 1.7 Telstra's position in the market has been further entrenched by the change in the nature of competition to network coverage and quality. Thus increasing barriers to entry and expansion. This is largely an outcome of the growth of mobile data and consumer demand for latency and download speed. Growth in the presence of network-driven competition necessitates significant capital investments and achieving scale. Both of these facts favour Telstra. First, Telstra has sufficient subscriber numbers to take advantage of minimum efficient scale in its mobile network, enabling it to not only have a dominant share of mobile revenue but also profit. Further, this advantage is magnified by NBN Co payments, where Telstra is expected to receive around \$16.5b from NBN Co during the lifetime of the next MTAS declaration.
- 1.8 For these reasons, it is reasonable to conclude that Telstra will maintain its significant market power in the retail mobile market over the period of the next MTAS declaration. Due to the two-sided nature of mobile markets², the reduction in competition impacts the decision to declare MTAS as it makes it less likely any monopoly rents accrued in the MTAS market are competed away in the retail market.
- 1.9 Optus also finds that there are no changes in the competitive environment in the downstream retail FTM market. Telstra still maintains its dominant market share in fixed line connections.
- 1.10 It is clear therefore, that there have not been sufficient changes in the related downstream retail markets to warrant the ACCC varying its conclusion that declaration of MTAS promotes the LTIE.

SMS should be included in the MTAS Declaration

- 1.11 The ACCC concluded in 2009 that inclusion of SMS within the MTAS declaration would not promote the LTIE because:
- (a) SMS market exhibited significant growth;
 - (b) Ongoing commercial agreements; and
 - (c) There was no demonstrable market failure.
- 1.12 Optus submits that the market has developed since 2009, such that the inclusion of SMS within the MTAS declaration is warranted and would promote the LTIE.

² The two-sided market waterbed argument is that monopoly rents in the wholesale MTAS market do not damage consumer interests because any surplus is competed away in the retail market.

- 1.13 First, while SMS usage has grown significantly since 2009, the rate of this growth has slowed significantly over the last year few years. This slow-down is largely due to greater competition from IP-based over-the-top (OTT) messaging services.
- 1.14 Second, the current commercially negotiated SMS termination rate of [CiC] cents per SMS has not changed for over a decade, and is significantly above the cost to provide SMS termination. The voice MTAS rate is now a fraction of the SMS termination rate. Given that SMS uses significantly fewer network resources than voice services this is an indication of monopoly pricing. [CiC]
- 1.15 Third, in response to increased competition from IP-based over-the-top (OTT) messaging services, Optus has attempted to reduce its SMS termination rate but this has been unsuccessful. Optus' experience clearly shows that the ACCC's findings that commercial agreements work, and there are no known market failures, no longer hold. This implies that MNOs can exercise monopoly power over the termination of SMS' on their networks.
- 1.16 Optus therefore submits that the inclusion of SMS within the MTAS declaration would promote the LTIE. Declaration, combined with cost-based pricing, will promote competition, ensure any-to-any connectivity, and promote economically efficient use and investment in infrastructure.

Section 2. Review of market developments

- 2.1 The ACCC has consistently assessed that the declaration of MTAS promotes the LTIE due to the impact on competition in the related downstream retail mobile and the retail FTM markets. The ACCC found in 2009 that continual declaration of MTAS, combined with appropriate pricing principles, will promote competition in these markets.³
- 2.2 This section looks at whether competition in the relevant markets has developed to such a degree that would justify the removal of the MTAS declaration, and importantly, whether continual declaration is required to promote competition in the future.
- 2.3 Optus finds that competition in the downstream retail mobile market has decreased since 2009. Telstra has consolidated its market share in both subscriber share and revenue/EBITDA. The focus of mobile competition has changed to network competition. This, combined with the integration of Telstra across the retail mobile and retail fixed markets and substantial government payments, indicates that its market position is likely to continue during the period of the next MTAS declaration. Optus finds that should the MTAS declaration be removed, there is a real risk that the dominant player will leverage its monopoly power in the MTAS market to further damage competition in the related retail mobile market.
- 2.4 Optus finds that there has been no material change in the level of competition in the retail FTM market, with Telstra remaining the dominant player. Absent declaration, it is likely Telstra would use its market power in the MTAS market, and its vertical integration, to further consolidate its dominant position in the FTM market.
- 2.5 The ability of Telstra to leverage its market power in the MTAS market has increased due to the decline of competitive pressures in related downstream retail markets. Arguments that competition in two-sided markets limits the ability to exploit monopoly power in the wholesale MTAS market no longer hold.
- 2.6 Optus supports the re-declaration of MTAS for a further five year period.

State of competition in the retail mobile market

- 2.7 The mobile industry is facing a significant period of change and commercial challenges, including rising network costs, market saturation, stagnant revenue growth, and increasing customer care and subscriber acquisition costs.
- 2.8 The ACCC concluded in 2009 that the retail mobile services market had:
 - (a) strong competition, and a general consensus amongst MNOs that the retail mobile services market has become more competitive or is improving in its competitiveness⁴; and
 - (b) that this was in part due to regulation of the MTAS and that without regulation, MNOs are likely to set MTAS prices above their underlying cost of production⁵. The

³ ACCC, *Mobile Terminating Access Service: An ACCC final report on reviewing the declaration of the mobile terminating access service*, May 2009, p.26

⁴ ACCC, *Mobile Terminating Access Service: An ACCC final report on reviewing the declaration of the mobile terminating access service*, May 2009, p.18

⁵ ACCC, *Mobile Terminating Access Service: An ACCC final report on reviewing the declaration of the mobile terminating access service*, May 2009, p.19

ACCC stated that continued declaration of the MTAS will have a positive impact at the retail level because *“it will continue to promote competition in the market for retail mobile services.”*⁶

- 2.9 Optus, on the other hand, submitted in 2009 that the retail mobile market was competitive, and a result, the justification for regulation of MTAS had diminished. Optus noted that *“monopoly profits are increasingly likely to be competed away in the retail mobile services market given the increased level of competition.”*⁷
- 2.10 This section sets out the market developments since the last declaration decision. Irrespective of the level of competition in 2009, the decision to re-declare MTAS should be based on current market facts and trends since 2009. To that end, this section finds that:
- (a) Total mobile market growth has stalled as the market has reached saturation;
 - (b) Revenue growth is increasingly driven by data usage, but as data usage grows so too does the need to invest in network upgrades and achieve minimum efficient scale;
 - (c) Telstra has increased its market shares in all the relevant metrics since 2009, reversing the trend seen in the 2009 declaration Inquiry;
 - (d) Telstra has acquired around 70% of all net additions since June 2010, acquiring most of the subscribers that left VHA;
 - (e) Competition in the market has moved towards network quality and coverage; and
 - (f) Telstra’s commanding share of revenue and mobile EBITDA, in combination with its fixed network and \$16.5b of additional revenue due to NBN-related payments, means its position in the mobile market is likely to continue during the period of the declaration.
- 2.11 An analysis of the current state of competition shows that competition has reduced since 2009, with Telstra extending its market power in the mobile market. Further, Telstra’s market position is likely to continue due to its share of mobile EBITDA and NBN-related payments, which enable Telstra to outspend its competitors on network investments while maintaining profitability.

Mobile market saturation limiting total market growth

- 2.12 The mobile services market in Australia has been characterised by fast growth, with mobile penetration surpassing population and usage surpassing fixed line usage. As highlighted by the ACCC:

*In 2012, there were twice as many mobile phones than fixed line phones, and currently more calls are made on mobile phones than on fixed line.*⁸

- 2.13 This is similarly recognised by the ACMA which notes a continual year-on-year increase in the number of mobile services in operation (SIOs). At June 2012 mobile SIOs were 30.2m, a 25%

⁶ ACCC, *Mobile Terminating Access Service: An ACCC final report on reviewing the declaration of the mobile terminating access service*, May 2009, p.1

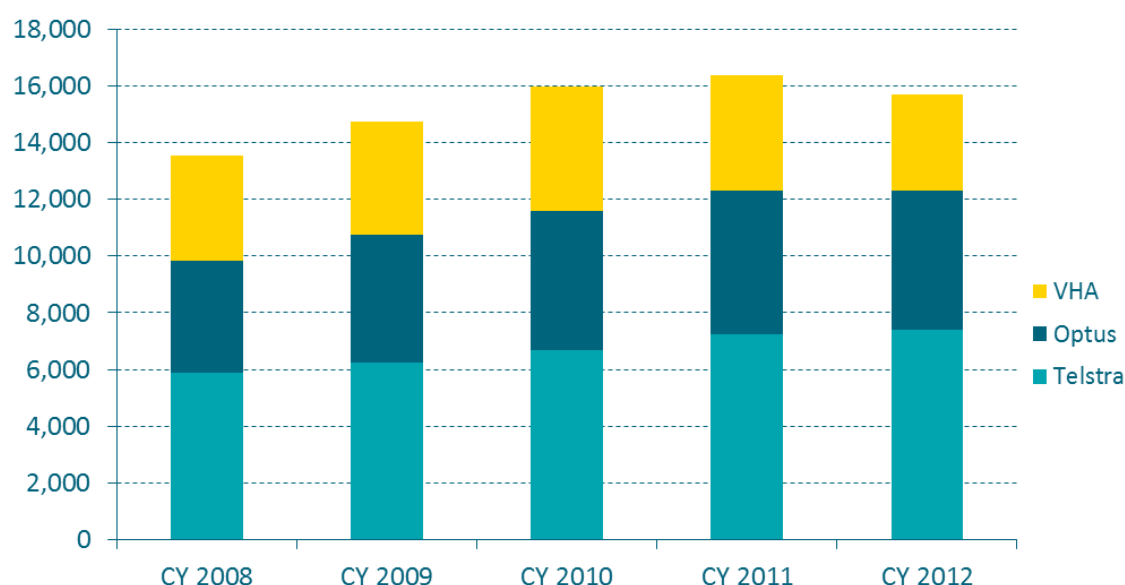
⁸ ACCC, *Mobile Terminating Access Service: An ACCC final report on reviewing the declaration of the mobile terminating access service*, May 2009, p.26

⁸ ACCC, *Review of the declaration of the Domestic Mobile Terminating Access Service*, Discussion Paper, May 2013, p.11

increase from June 2009.⁹ However, the rate of increase has been slowing as the market approaches saturation. During FY2012, mobile SIOs increased by less than 1m, compared to an increase of 3.3m in the preceding financial year. This growth, however, may overstate real growth as end-users typically increase the number of devices they hold (e.g. end-users may have a handset and a tablet) and the growth in new services such as machine-to-machine applications.

- 2.14 The state of the market can also be seen in the growth of industry revenue. Revenue growth is ultimately more important than the number of connections, as MNOs need to grow revenue to cover the increasing cost of deploying and running mobile networks. The figure below shows that mobile industry revenue has stagnated over the last year. As described by many commentators, the mobile industry is now ex-growth.

Figure 1 Mobile Service Revenue



Source: Company reports, Analyst reports.

- 2.15 Total mobile service revenue for CY 2012 is below that seen in CY 2010. Market revenue in 2012 fell by 4% compared to 2011. This is the first decline in service revenue in the history of the market. An analysis of the data shows that in the two years prior to end of 2010¹⁰, Telstra's mobile service revenue grew by \$784m, and Optus and VHA's combined service revenue grew by \$1,640m – indicating that non-dominant operators were still able to acquire sufficient revenue. However, since January 2010, Optus and VHA's combined service revenue fell by \$1,000m. Telstra's revenue grew by \$746m.¹¹

- 2.16 In a market that has reached saturation, competition is now a zero sum game. Growth by one MNO comes at the expense of other MNOs. In a contracting market, the only way non-dominant firms can grow market share is to take it from the dominant player. For the reasons discussed below, this will become more difficult as market growth comes from data and consumers focus on network coverage and capacity.

⁹ ACMA, Communications Report series (various years)

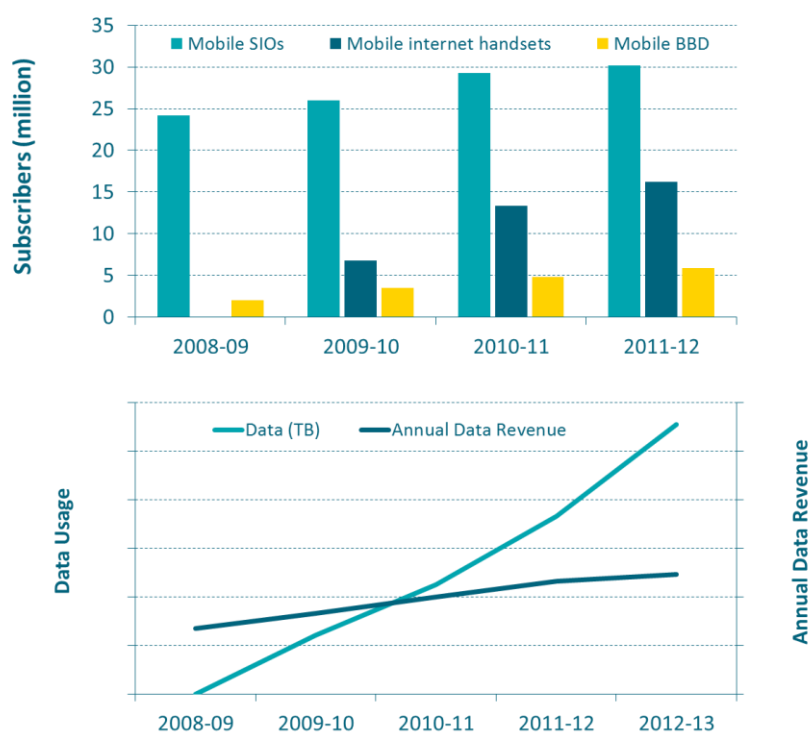
¹⁰ Calendar years 2008, 2009 and 2010

¹¹ Company data; Analyst Reports

Data growth has changed market dynamics

- 2.17 Notwithstanding the stagnation of industry revenue, mobile networks have seen continual growth in the demand for voice services surpassing total voice traffic over fixed networks in the past year. This trend has been recognised by the ACCC.¹²
- 2.18 But this growth has been insignificant compared to the growth in mobile data since 2009, which has been driven by the rollout and accessibility to 3G and 4G networks. For example, mobile handset internet demand has increased by 78.9% (from 3,695TB to 6,610TB) over a 12 month period for the quarter ending June 2012.¹³ This despite only a 21.5% increase in the number of mobile handset internet subscribers over the same period, as illustrated below.¹⁴
- 2.19 The growth in data usage is reflected in revenue growth. Disaggregating total service revenue into data and voice (non-data) shows that while voice and total revenue has declined, data revenue has increased. Optus' data service revenue has grown by 83% since FY 2009, while voice revenue has declined by 14% over the same period.¹⁵
- 2.20 The last five year period has seen a shift in the industry from a voice-driven network to a data-driven network. Both data subscriber and revenue growth has underpinned mobile industry performance, offsetting declining performance of non-data services. As shown in Figure 2, internet-capable mobile devices have grown to represent almost two thirds of total mobile connections in 2011-12.

Figure 2 Growth of Mobile Data



Source: ACMA, Communications Reports (various years); Singtel Ltd, Group Historical Financial Summaries, Q42013.

¹² ACCC, *Telecommunications Report 2011-12, Report 1: Telecommunications competitive safeguards for 2011-12*, 2013, p.13

¹³ ACMA, *Communications Report 2011-12*, p.20

¹⁴ ACMA, *Communications Report 2011-12*, p.33

¹⁵ Singtel Ltd, Group Historical Financial Summaries, Q42013

- 2.21 While data revenue has been positive, there has been a significant disconnect between the investments required to provide data networks and the revenue recovered from consumers. So while mobile data usage grew by around [CiC] during the last three years, mobile data service revenue has grown by just [CiC] (see Figure 2).
- 2.22 The challenge going forward for industry is how to grow revenue and maintain sustainable profitability in a data-centric industry. The historic market behaviour of price-led competition to capture new subscribers in an ever growing market is being replaced with a focus on retaining profitable subscribers, greater cost control, and achieving network efficiency through scale. Continued success in the Australian mobile market will come through; achieving minimum efficient scale in networks; controlling costs; ensuring efficient management of data demand over the network; and attracting and retaining profitable subscribers.
- 2.23 Achieving efficient scale is important in this context. MNOs that can achieve scale will face lower per unit network costs, and as result, will be able to provide network services at lower prices than rivals. Alternatively, an MNO with scale can price at the same level of non-scale MNOs and attain higher profits – enabling it to invest more in network quality and expansion. In 2007, the ACCC calculated that a 2G-only MNO with 44% market share is able to provide services at a cost 8% below that with 31% share, and 15% lower than a MNO with 25% share.¹⁶ The benefit of scale has increased with the deployment of data 3G and 4G networks, which provide for greater network capacity. [CiC]
- 2.24 These scale benefits do not reflect retail level efficiencies, or efficiencies accruing from integration with fixed line networks and ownership of a national backhaul and transit network. These economies of scope magnify the scale advantages accruing to Telstra in the mobile market.
- 2.25 The new competitive paradigm favours large incumbents who can effectively leverage network scale and scope. This can be observed in developments of market shares since 2009.

Development of market shares since 2009

- 2.26 Telstra has increased its market share in the retail mobile market since the 2009 MTAS declaration. As seen in

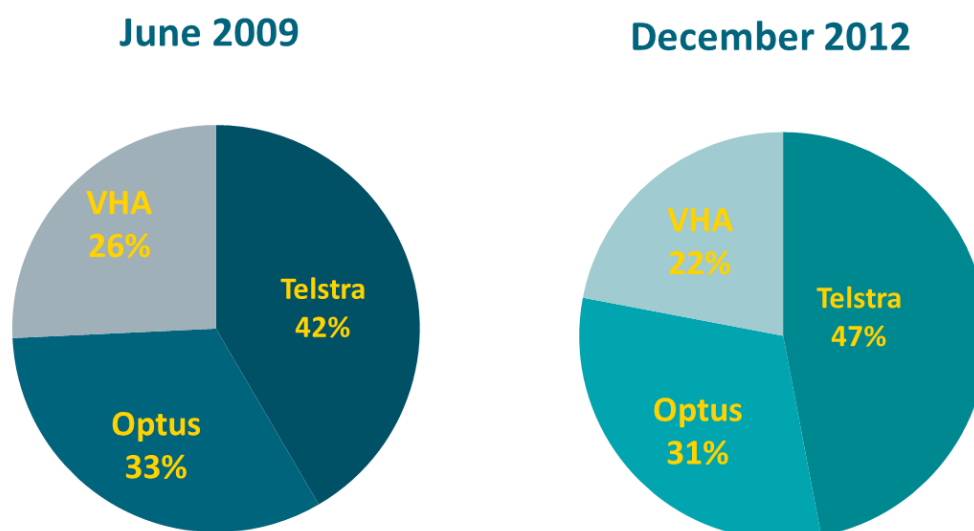
¹⁶ ACCC, *MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008*, Final Report, November 2007, p.66

- 2.27 Figure 3, the market share of Telstra has increased by 5 percentage points to 47% since June 2009. This is partly explained by VHA's network coverage issues that have been experienced by the merger since 2009. The ACCC noted that:

In the mobile voice sector, market leader Telstra continued to strengthen its position Customers moved to Telstra in significant numbers following VHA's network performance problems in 2010.¹⁷

¹⁷ ACCC, ACCC telecommunications reports 2011-12, Report 1: Telecommunications competitive safeguards for 2011-12, 2013, p.6

Figure 3 Subscriber Market Shares

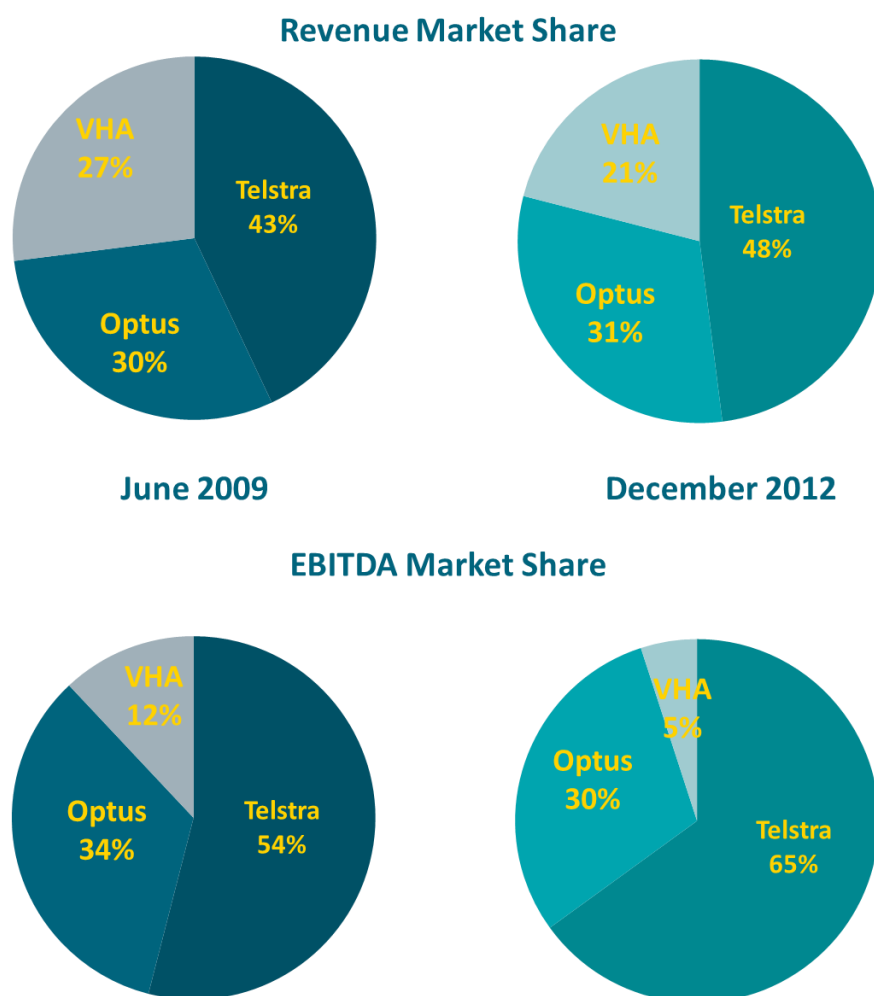


Source: ACCC, *Telecommunications reports* (various years); Analyst Reports. MVNO subscribers are allocated to host networks.

- 2.28 Telstra's dominance since 2009 can also be seen in the share of net additions. Market data show that Telstra has obtained 70% of new subscribers since 2009.¹⁸ Such a share is unprecedented in a competitive market. Telstra has effectively captured most of the subscribers that VHA lost. Optus submits this is yet another sign of the significant market power of Telstra.
- 2.29 Optus submits that the ACCC should take a forward-looking analysis of the likely changes in market shares during the next declaration period. The ACCC should be guided by expert market analysis, as well as its own analysis of the key drivers of market share. Most analysts forecast that Telstra's dominance will continue, with some forecasting that Telstra's market share will grow to 50% in the retail market.
- 2.30 Significant market power would also be maintained through its share of revenue and profitability (EBITDA). In a capital intensive industry like the mobile industry, it is the ability to gain sufficient revenue so as to enable ongoing network replacement and expansion (e.g. increased coverage and capacity) that impacts the ability to compete on a level playing field. Optus notes that revenue and EBITDA share will be particularly important during the next declaration period due to the deployment of national LTE networks and the need for greater capacity due to data usage.
- 2.31 Company and market data show that Telstra's market share of revenue has similarly increased over the period since 2009, growing from 43% to 48% in December 2012. The share of market EBITDA is more concentrated than total service revenue (see Figure 4). It can be seen that Telstra had a market share of 65% at December 2012, growing from a 54% market share in June 2009. That is, during the period of the last declaration, Telstra's share of mobile profits has increased by 9 percentage points, or 20%.

¹⁸ Company data; Analyst Reports

Figure 4 Revenue and EBITDA Market Shares



Source: Company data, Analyst Reports.

- 2.32 Optus notes that Telstra's share of mobile EBITDA is before the significant network economies of scale and scope are taken into account — as a result of its integration with the fixed network, its national backbone and transit network, and the dominant share of mobile traffic. When these network cost advantages are taken into account, the ability of other operators to engage in effective competition is further constrained.

Competition has changed from price to network/service quality

- 2.33 Optus submits that the nature of competition has fundamentally changed since the last MTAS declaration inquiry; and has changed in a manner which increases barriers to entry and expansion.
- 2.34 As acknowledged by the ACCC in the discussion paper, VHA suffered from network issues during 2010. The ACCC stated:

VHA's losses have largely been due to the ongoing effects of network issues it experienced in late 2010. These network problems meant that VHA customers experienced poor network coverage, call drop outs, and delayed SMS and voicemails.¹⁹

2.35 Following this, by December 2012 VHA had lost around 900,000 subscribers, or 13% of its subscriber base as at June 2010. This has had an impact on VHA's service revenue and EBITDA, which has fallen by 26% and 75% respectively since June 2010.²⁰

2.36 This has focused consumer attention back onto network quality and coverage. Competition for subscribers has moved increasingly to network investment. The ACCC has recognised this in the discussion paper:

Telstra has captured many of the subscribers leaving VHA, partly because it has been able to differentiate its services in terms of network quality and coverage.²¹

2.37 Hutchison noted in its annual report that:

To address these needs and its weak brand perception, VHA continued its accelerated investment in building and upgrading the Vodafone network and introducing new customer service initiatives. The focus of the network investment has continued to be voice and data performance, resiliency and coverage.²²

2.38 As a consequence of this, both Optus and VHA have engaged in significant network upgrades and expansions to address the perceived differential with the Telstra network. Optus has invested over \$1.7 billion since FY 2010 on network capital. Similarly, VHA has invested over \$2 billion on capital expenditure to remediate its network since FY 2010.

2.39 Notwithstanding this increase, Telstra's investment in its mobile network is still significant and greater than its competitors. It is estimated by analysts that Telstra spends around \$1 billion each year in mobile-related capex.²³ Where consumer decisions continue to be driven by network quality, Telstra's share of revenue and EBITDA will ensure it is able to reinvest the most, and thus entrench its market position during the next declaration period.

2.40 The network cost burden is magnified by the increase in spectrum costs faced by the industry over the period of the declaration. The industry has faced spectrum bills around \$0.3 billion during previous declaration periods. However, this will jump to over \$5.5 billion during the period of the next MTAS declaration. The combination of increased network investment and higher spectrum costs makes revenue and EBITDA market share more important in determining the level of competition in the market.

¹⁹ ACCC, *Review of the declaration of the Domestic Mobile Terminating Access Service*, Discussion Paper, May 2013, p.14

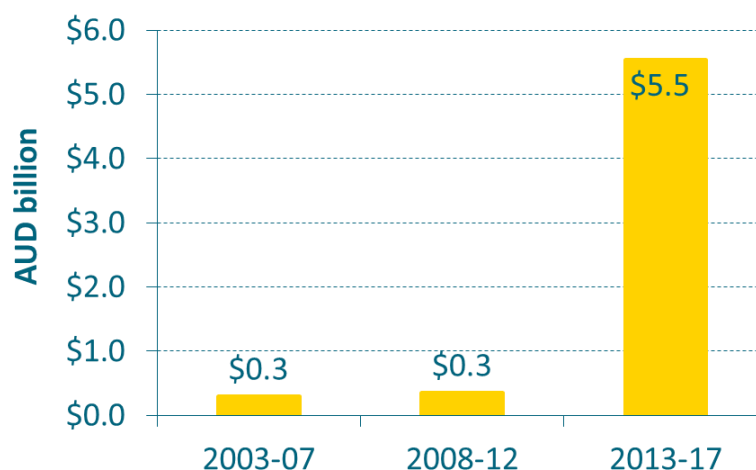
²⁰ Company data; Analyst Reports.

²¹ Company data; Analyst Reports.

²² Hutchison Telecoms, 2013, Preliminary Financial Results, p.4

²³ Consistent with Telstra's stated capex/sales ratio. Telstra has committed to maintaining a ratio of 15% in the future.

Figure 5 Industry Spectrum Costs



Source: Optus estimates, ACMA.

- 2.41 The network cost base of the industry has increased since the last MTAS declaration. Competition is driving greater network investments. As consumers move from voice to data, market success is dependent on the ability to deliver fast mobile broadband with a high quality of service. Increasing network capacity and investing in high speed networks is driving network costs, and this is further magnified by the drastic increase in spectrum costs.
- 2.42 As a result, achieving minimum scale is paramount to ensure sustainable competition. When the dominant network has scale, challenger networks need to invest more (increase costs) and grow market share. But operators that are below efficient scale face a significant cost-disadvantage limiting their ability to compete through price competition. **[CiC]**
- 2.43 This capital investment–efficient scale cycle now present in the Australian market entrenches Telstra’s significant market power, and increases barriers to competition. Telstra is best placed to afford continual high level of capex, and it is the only operator in the market that has minimum efficient scale in the mobile sector. Telstra has the highest revenue market share and the highest EBITDA market share.
- 2.44 There is a significant risk that Telstra’s significant market power will continue during the next MTAS declaration period.

NBN payments will entrench Telstra’s dominance

- 2.45 Finally, the advantages Telstra faces in the mobile market due to its network scale, and its share of subscriber, revenue and EBITDA, is magnified by its ownership of the monopoly fixed line network. While it may be argued that this benefit is likely to reduce over the next declaration period due to the roll out of NBN, this is not the case. The agreement between Telstra and NBN Co will result in significant additional free cash-flow accruing to Telstra. Telstra has two options: increase dividend payments or re-invest the free cash. Given that Telstra is de-commissioning its fixed line network, such investment is likely to shift to its mobile network.
- 2.46 The value of NBN Co payments to Telstra at the time of seeking shareholder approval was described as being worth \$11 billion after-tax, in net present value terms as at June 2010.²⁴ This figure though is somewhat misleading as to the benefit accruing to Telstra from NBN Co

²⁴ Telstra, Explanatory memorandum for the resolution under item 2 at the annual general meeting on 18 October 2011, p.vi

payments. It is the nominal revenue gained from NBN payments that matter. Industry estimates forecast that Telstra will receive around \$8 billion in migration payments; \$7 billion in infrastructure leasing payments; \$1.5 billion in other NBN-related government payments. In total, Telstra is expected to receive around \$16.5 billion over the 10 year period between 2012 and 2021.

- 2.47 The ability of Telstra to re-invest even a fraction of these payments in its mobile network will further distort competition in Telstra's favour during the next declaration period.

How do these factors affect the assessment of competition?

- 2.48 The nature of competition in the related downstream retail mobile market has changed substantially since the last MTAS declaration Inquiry. Optus submits that these developments alter the conclusion that competition is increasing in the market. Competition can be said to be effective when no firm, either acting individually or in coalition with rivals, is able to exert significant market power. When assessing the level of competition a market, the ACCC takes into account the following factors:²⁵

- (a) Industry market shares;
- (b) Barriers to entry;
- (c) Assessment of the competitive conditions in the market;
- (d) Extent of vertical integration;
- (e) Degree of countervailing power; and
- (f) Prices and profit margins.

- 2.49 The evidence shown above demonstrates that:

- (a) Telstra has a dominant market share for subscribers, revenue and EBITDA, and these share have all increased since the last declaration Inquiry;
- (b) Price competition has reduced since 2009, with end-users focusing on network quality and data speeds;
- (c) Network competition greatly increases the barriers to entry and expansion; and
- (d) Telstra's high profit margin, combined with its monopoly position in fixed line market and the expected \$16.5 billion of revenue from NBN payments, means it is in a position to entrench its position over the medium term.

- 2.50 It is clear that the level of competition in the retail mobile market is less than it was during the last MTAS declaration Inquiry. Given these developments, Optus submits that it is likely competition in the retail mobile market during the next declaration period will not be sufficient to offset the monopoly rents accrued in the wholesale MTAS market absent declaration.

- 2.51 Absent re-declaration of the MTAS, it is likely that the long-term interests of end-users will be damaged. Optus submits that declaration of MTAS will promote competition in the related retail mobile market.

²⁵ ACCC, *Merger review process guidelines*, July 2006, Appendix A

State of competition in the retail fixed-to-mobile market

- 2.52 Despite a number of recent trends which *may “suggest a greater degree of fixed to mobile substitution for voice calls today than during previous MTAS declaration inquiries.”*²⁶ Optus contends that FTM continues to be a relevant market for the purposes of this MTAS declaration inquiry.
- 2.53 In the 2009 MTAS declaration, the ACCC concluded that without declaration vertically integrated operators would face FTM termination costs below that which would be charged to non-integrated operators. Declaration would therefore eliminate the ability of integrated operators to raise the costs of their rivals and *“will maintain the conditions conducive to competition in the market within which FTM services are provided.”*²⁷
- 2.54 Optus submits that the FTM market has not sufficiently changed to warrant the ACCC altering its previous assessment of the level of competition and the benefits of MTAS declaration to the FTM market. Moreover, the vertical integration of the dominant FTM provider and dominant mobile provider results in a substantial risk that Telstra would use MTAS to damage competition in the FTM market.
- 2.55 Below Optus will discuss the current state of competition in the Australian fixed to mobile market.

There is still strong demand for FTM minutes

- 2.56 Since the last MTAS declaration Inquiry the level of PSTN demand has fallen. The decrease in demand has also impacted the total level of FTM demand. For example, Telstra has reported a 5% decrease in the number of FTM voice minutes made during 2011-12, however this still translates to 2,953 million minutes (down from 3,122 million minutes the previous year).²⁸ Telstra’s TEM report for the period FY2012 2H also shows a significant volume of FTM voice minutes made over the 6-month period. It reported a total of 1,307 million minutes, of which 69% (or 899.9 million minutes) were off-net.
- 2.57 Nevertheless, while total fixed voice minutes have declined in recent years, the proportion of FTM revenue to total PSTN revenue has increased. In other words, the FTM market has become *relatively* more important within the shrinking PSTN markets.
- 2.58 The ACCC recognises that both basic access and FTM calls accounted for *“much greater proportions of total consumer expenditure in 2011-12 than they did in 1997-98”* as highlighted in the graph below.²⁹

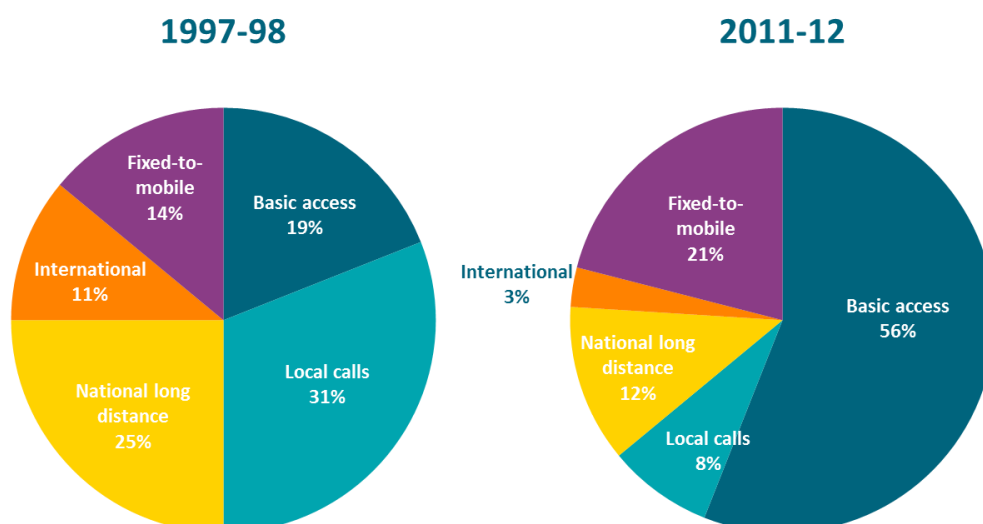
²⁶ ACCC, *Review of the declaration of the Domestic Mobile Terminating Access Service*, Discussion Paper, May 2013, p.12

²⁷ ACCC, *Mobile Terminating Access Service: An ACCC final report on reviewing the declaration of the mobile terminating access service*, May 2009, p.26

²⁸ Telstra annual report 2012

²⁹ ACCC, *Telecommunications reports 2011-12, Report 2: Changes in prices paid for telecommunications services paid in Australia 2011-12*, 2013, p.78

Figure 6 Comparison of share of total customer PSTN expenditure by service component



Source: ACCC, *Telecommunications reports 2011-12, Report 2: Changes in prices paid for telecommunications services paid in Australia 2011-12*, 2013

- 2.59 This suggests that the provision of FTM continues to be a relevant market for the supply of the MTAS. Put simply, setting the price of the MTAS towards the underlying cost of production will promote competition in the relevant market:

*This is because a closer association of the price of the MTAS with its underlying efficient cost will allow equally and more efficient MNOs to compete on their merits in the relevant markets for retail mobile services and within which FTM services are provided.*³⁰

- 2.60 This view was similarly reiterated in the last MTAS FAD. The ACCC in addressing industry FTM pass through concerns considered that:

*This is because such reductions are likely to lessen (or remove) any advantage conferred on horizontally integrated providers of retail fixed line services (that is, providers of such services who also provide retail mobile services), this is because those horizontally integrated providers would not have to pay inefficiently high MTAS charges to themselves for the termination of FTM calls on their own mobile networks.*³¹

- 2.61 Despite this, the issue of lack of FTM pass through continues to persist. Telstra's market power in the highly concentrated fixed line market continues to provide it a substantial degree of control over its retail FTM price. Telstra continues to be the dominant carrier in the fixed line market and non-Telstra players tend to be price takers.

- 2.62 The regulated MTAS price has decreased from 9cpm in 2009 to 6cpm in 2012, dropping further to 4.8cpm in 2013. In contrast, Telstra's publicly reported FTM minutes have only dropped by 13.4 per cent (from 3,410 million minutes in 2009 to 2,953 million minutes in 2012) over the same period.³²

³⁰ ACCC, *Hutchison's undertakings with respect to the supply of its mobile terminating access service (MTAS)*, Final Decision, June 2006, p.52

³¹ ACCC, *Inquiry to make a final access determination for the domestic mobile terminating access service (MTAS)*, Access Determination Explanatory Statement, December 2011, p.15

³² Telstra annual reports (various years)

- 2.63 Optus considers that the reduction in the MTAS has continued to allow Telstra to receive a significant windfall gain. Instead of passing on the reduction to consumers by lowering FTM prices, there is the potential that Telstra has kept most of the benefit.

Continued declaration of MTAS is in the LTIE

- 2.64 Optus has shown that the justification for the removal of MTAS regulation has substantially lessened since the last Inquiry in 2009. By virtue of network ownership, each MNO will continue to have a monopoly over the termination of voice calls on its network. This may result in operators using this market power to damage competition in related downstream markets. Due to the two-sided nature of telecommunications markets, where competition in related downstream markets is strong, any monopoly rents accrued in the wholesale MTAS market will be competed away to the ultimate benefit of end-users. The level of competition in related downstream markets is therefore an important factor when assessing whether declaration of MTAS promotes the LTIE.
- 2.65 In 2009, the ACCC concluded that extending the MTAS declaration for five years was in the LTIE. Notably, that each of the criteria for LTIE was met including:
- *Promotion of competition — the ACCC is satisfied that continuing declaration of this essential bottleneck service would achieve the objective of promoting competition. The ACCC considers that the continued declaration, when coupled with an appropriate pricing principle, generates a closer association of prices with the underlying cost than would exist in the absence of declaration and that this in turn, promotes a greater level of competition in related markets.*
 - *Any-to-any connectivity — the ACCC considers that any-to-any connectivity is promoted by declaration as it prevents any possibility of a carrier, and in particular a new entrant, being refused access to the mobile termination services of other operators.*
 - *Economically efficient investment in infrastructure — the ACCC is satisfied that continuing declaration of an essential bottleneck service such as the MTAS is likely to encourage the economically efficient use and investment in infrastructure. The ACCC is of the view that without regulation, mobile network operators (MNOs) have the ability and incentive to set above cost MTAS prices and that the potential disassociation between price and costs is likely to distort consumption decisions and lead to an inefficient use and investment in telecommunications infrastructure.*³³
- 2.66 Optus submits that the above views are still relevant and continued declaration of the MTAS is in the LTIE. Market evidence shows that the level of competition in related downstream retail markets has reduced since 2009, thereby reducing the countervailing impact of retail competition to prevent exploitation of the monopoly power in the wholesale MTAS market.
- 2.67 Optus submits, therefore, that the MTAS declaration should continue to apply for the next five years. This is in line with the ACCC's recognition "*that a five year term provides a regulatory certainty which facilitates investment decisions.*"³⁴

³³ ACCC, *Mobile Terminating Access Service: An ACCC final report on reviewing the declaration of the mobile terminating access service*, May 2009, p.1

³⁴ ACCC, *Review of the declaration of the Domestic Mobile Terminating Access Service*, Discussion Paper, May 2013, p.16

Section 3. SMS services should now be regulated

3.1 Currently, MTAS is defined as domestic termination of voice calls on a mobile network. This means that the termination of non-voice services falls outside the MTAS description and are not subject to regulation. In particular, the ACCC has listed short message service (SMS) and multimedia message service (MMS) as examples of non-voice services currently not included in the MTAS. Therefore, wholesale termination rates for these other services in Australia are currently negotiated on a commercial basis.

3.2 The ACCC had considered expanding the MTAS description to include SMS, MMS and other data services in its review of the MTAS declaration in 2009. It concluded that:

*...it is not necessary, at this stage, to include SMS, MMS and other data services in the MTAS service description as they are still **exhibiting significant growth**, are subject to **ongoing commercial agreements** and there has been **no demonstrable market failure**.*³⁵
[emphasis added]

3.3 At the time, the majority of parties also did not support an expansion of the service description.³⁶ The ACCC had observed significant declines in revenue per SMS and MMS message sent.³⁷ Therefore there was no *a priori* reason to impose additional costs on industry without any foreseen benefits to end-users.

3.4 Optus submits that the ACCC's conclusion was appropriate at the time it was made, however the market situation has since changed. The inclusion of SMS and MMS services within the MTAS service description should be further explored in this review.

3.5 There are a growing number of jurisdictions in which SMS termination has been investigated, and subsequently regulated in conjunction with the regulation of voice MTAS. Optus also finds that the reasons for the exclusion of SMS no longer hold. The current SMS termination rate is significantly higher than the current voice MTAS rate, and recent attempts to reduce this have been unsuccessful. This exploitation of market power to maintain price significantly above costs results in consumer detriment.

3.6 Optus submits that the inclusion of SMS and MMS services into the MTAS description promotes the LTIE.

The Short Messaging Service (SMS)

3.7 SMS is a short messaging system, generally limited to 160 alphanumeric characters encoded in 7-bit, that can be delivered to a mobile handset. In short,

*SMS enables parties to exchange only relatively short messages (the number of characters in a message is limited) and SMS can be delayed, because, unlike a mobile voice call, an SMS is transferred between networks on a "store and forward" basis.*³⁸

³⁵ ACCC, *Mobile Terminating Access Service: An ACCC final report on reviewing the declaration of the mobile terminating access service*, May 2009, p.11

³⁶ ACCC, *Mobile Terminating Access Service: An ACCC final report on reviewing the declaration of the mobile terminating access service*, May 2009, p.6-9

³⁷ ACCC, *Mobile Terminating Access Service: An ACCC final report on reviewing the declaration of the mobile terminating access service*, May 2009, p.10

³⁸ Ofcom, *Wholesale mobile voice call termination*, Preliminary consultation on future regulation, Consultation, 20 May 2009, p.21

- 3.8 It is generally well accepted that the relevant product market is the market for SMS termination on each individual mobile network. This view is not dissimilar to that concluded by the ACCC in 2009.

*The ACCC has formed the view that the markets within which retail mobile services and FTM calls are provided are the most relevant downstream markets. The **ACCC currently considers SMS and mobile data to be provided in the same market as other retail mobile services** because they are generally sold as part of the same bundle.³⁹ [emphasis added]*

- 3.9 In effect, all MNOs and MVNOs control the origination and termination of SMS that are sent and received on their own network. Therefore, MNOs have a market share of 100% over termination of SMS in their individual mobile network. Moreover, the market is characterised by non-transitory barriers to entry and absence of countervailing buyer power.

The case for regulation of SMS termination in Australia

- 3.10 Since the last MTAS declaration Inquiry several SMS termination markets have investigated and subsequently adopted ex post regulation. These include countries such as France, Denmark, Poland, Israel, Kenya, New Zealand and India.
- 3.11 A number of jurisdictions have also investigated ex post market failure cases, in which MNOs (i.e. designated SMP operators) have exercised abuse of market power in setting wholesale SMS termination rates. The investigations still resulted in the imposition of fines on the offending operators, as the case was in Spain. These cases have also highlighted the presence of competition problems in the wholesale SMS termination markets.
- 3.12 There is a unanimous acceptance that the relevant product market is the market for SMS termination on each individual mobile network demonstrating the presence of an essential bottleneck service. The need for SMS termination regulation depends on the nature of competition in the downstream retail SMS market. As summarised by the BEREC in a recent review on relevant markets in the EU,

***Some NRAs reach the conclusion that, within their national context, SMS termination market meets the three criteria test.** Indeed current Explanatory Memorandum includes a reference to the potential market failures that, depending on national circumstances, these services could face. BEREC considers that these considerations are still valid. SMS services are still a popular messaging channel, even if increase of OTT messaging is forecast. For this reason, BEREC considers that the reference currently included in the Explanatory Memorandum for SMS termination should be maintained in the review of the Recommendation, **allowing every NRA to apply SMP regulation to the SMS termination whenever it finds it necessary and beneficial for competition and users.**⁴⁰ [emphasis added]*

- 3.13 The implication of this bottleneck service on downstream markets (i.e. at the retail level) varies depending on the state of competition in the mobile market.
- 3.14 Optus submits that the nature of competition in the retail mobile SMS market has changed since the last declaration Inquiry. This section will show that:

³⁹ ACCC, *Mobile Terminating Access Service: An ACCC final report on reviewing the declaration of the mobile terminating access service*, May 2009, p.17

⁴⁰ BEREC, *BEREC's response to the European Commission's questionnaire for the public consultation on the revision of the Recommendation on Relevant Markets*, March 2013, p.26

- (a) While SMS has experienced significant growth since the last declaration review, the level of growth has also slowed in recent years. The SMS market is no longer exhibiting significant growth.
- (b) While SMS termination rates are subject to commercial agreements, MNOs have exercised their monopoly power over the termination of SMS' on their networks. The SMS termination rate has remained unchanged for over a decade.
- (c) Wholesale SMS termination rates are far in excess of the cost-based level. The SMS termination rate is now significantly higher than the voice MTAS rate. The disassociation between price and costs is likely to distort consumption decisions and lead to an inefficient use and investment in telecommunications infrastructure

3.15 Each of these factors and their implication in Australia is discussed below.

Is SMS still exhibiting significant growth?

- 3.16 Demand for SMS' has grown considerably since the last declaration Inquiry. The ACMA reported that the total volume of SMS and MMS messages sent during 2010-11 reached 36.1 billion (up 23% from the previous year).⁴¹ Telstra has reported a 21.6% increase in the number of SMS messages sent during 2011-12.⁴² It also noted an increase in mobile interconnection revenue, likely *"driven by SMS volumes and is attributable, in part, to an increase in the number of postpaid handheld plans which include an unlimited SMS bundle."*⁴³
- 3.17 However, the recent trend in SMS growth does not appear to be common amongst all operators. [CiC].

Figure 7 Optus SMS usage per month

[CiC]

- 3.18 Market evidence shows that growth in SMS usage is not uniform across the industry. More importantly, the ACCC can no longer rely upon continual SMS growth as a reason why SMS termination should not be regulated. The SMS retail market is now a mature and saturated market.

Operators have been unsuccessful in lowering SMS termination rates

- 3.19 The decision not to include SMS within the MTAS definition during the 2009 declaration Inquiry was also dependent on a finding that the wholesale SMS rate was subject to commercial agreement and there was no demonstrable market failure.
- 3.20 Optus submits that recent commercial negotiations with regard to wholesale SMS termination rates demonstrate that such a view is no longer correct.
- 3.21 [CiC]
- 3.22 [CiC]
- 3.23 [CiC]

⁴¹ ACMA, *Communications report 2010-11*, p.17

⁴² Telstra annual report 2012

⁴³ Telstra annual report 2012, p.7

3.24 [CiC]

3.25 [CiC]

3.26 [CiC]

3.27 [CiC]

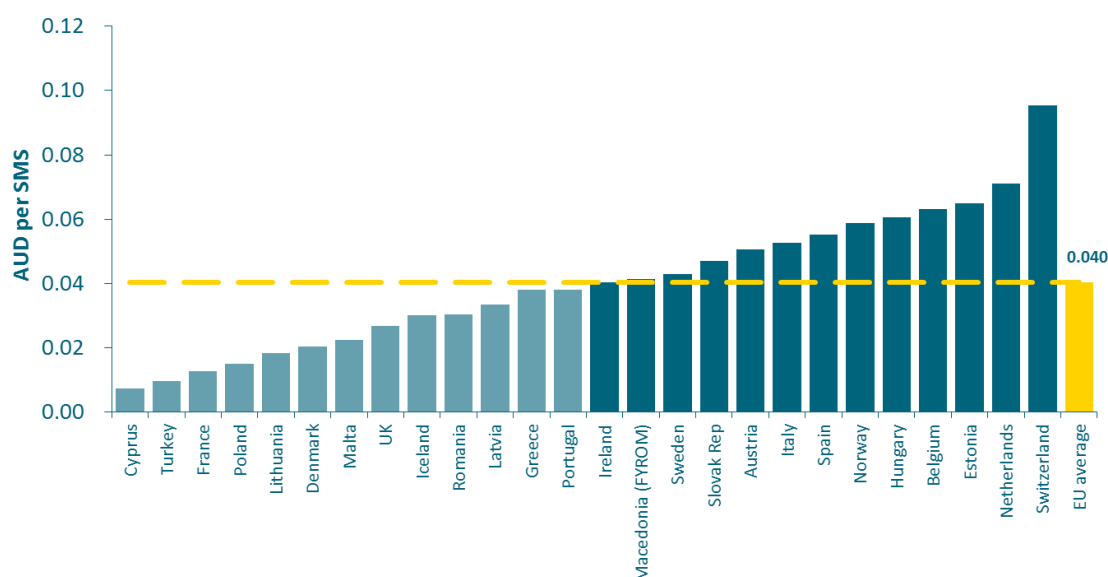
3.28 The behaviour of MNOs demonstrates that they are willing to utilise their market power over the termination of SMS' on their networks. The exploitation of this monopoly power is likely to be damaging competition in the retail SMS mobile market.

Wholesale SMS termination rates are inefficiently high

3.29 To assess the reasonableness of the current market-based SMS termination rate, it is instructive to examine international benchmarks. A larger set of SMS termination decisions is in Appendix A.

3.30 The Body of European Regulators for Electronic Communications (BEREC) publishes a set of SMS termination benchmarks for selected EU countries on a half-yearly basis. The benchmark for the period 1 July 2012 is illustrated below and includes both commercial and regulated rates.⁴⁴ The EU rates above are a mixture of commercial and regulated rates. Optus notes that the EU average of 4 cents is far below the current Australian commercial rate of [CiC] per message.

Figure 8 European SMS termination rates



Source: BEREC EU benchmark as of 1 July 2012, converted to AUD based on RBA exchange rate on 31 December 2012 (1AUD=€0.7868)

3.31 While the methodologies used to set SMS termination rates are varied, SMS termination rates tend to be set below the regulated rate for MTAS (on a TSLRIC+ basis). Optus notes the recent decision to regulate SMS termination rates in New Zealand. The New Zealand Commerce Commission (NZCC) considered that:

⁴⁴ Adapted from BEREC, *Termination rate benchmark snapshot (as of July 2012)*, Integrated report on mobile termination rates and SMS termination rates, September 2012, p.11. In the benchmark, only France, Poland and Denmark have regulated wholesale SMS termination rates.

*One reason for the low cost of SMS termination is that the SMS termination service does not compete for network capacity with real time services such as voice calls. An incoming SMS is always handled when the network has idle capacity and therefore does not require additional dimensioning.*⁴⁵

- 3.32 It was similarly conceded during an industry forum that there was general agreement “*that the costs of SMS termination are low when compared to voice termination.*”⁴⁶
- 3.33 The NZCC set SMS termination rates at NZ 0.06 cents per SMS from May 2011. This compares to a voice MTAS rate at 3.5 cents per minute. The SMS termination rate is less than 2% of the voice termination rate. This is at odds with the Australian market, where SMS termination rates are significantly more than the current voice MTAS rate.
- 3.34 Such a result is not surprising given the relevant network capacity used by a SMS message compared to one voice minute. [CiC]
- 3.35 [CiC]

Declaration of wholesale SMS will promote LTIE

- 3.36 In the 2009 MTAS declaration Inquiry, the ACCC noted that declaration would promote the LTIE because declaration, combined with pricing principles, would ensure that the MTAS rate be cost based. Cost based termination rates promote competition, any-to-any connectivity, and efficient investment.
- 3.37 The ACCC noted that absent declaration operators have the “*ability and incentive to set above cost MTAS prices and that the potential disassociation between price and costs is likely to distort consumption decisions*”⁴⁷ Optus submits that this scenario is precisely what is present in the wholesale SMS market. Absent declaration, MNOs have set the wholesale SMS rate significantly above cost, and have refused to negotiate lower rates. Such refusal is a blatant exercise of monopoly power; the kind of which declaration is aimed to prevent.
- 3.38 The impact of inefficient wholesale SMS rates on downstream retail markets has been assessed by the Danish regulator (DBA):

*In a dynamic market, if an operator unilaterally increases its SMS termination tariffs, other operators have an incentive to respond immediately conducting a similar increase to balance overall financial flows of incoming and outgoing SMS interconnection. Conversely, if an operator decides to unilaterally reduce SMS interconnection charge, other operators have no incentive to reduce them to the extent that their SMS interconnection costs decrease without their incomes are affected. So, **in absence of regulation, network operators do not have any incentive to reduce their SMS termination tariffs.***

Termination rates above wholesale costs generate a net loss to an operator buying more termination than it sells. To avoid such a transfer of margin, operators are encouraged

⁴⁵ 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 service (SMS)*, Decision 724, 5 May 2011, p.98-99

⁴⁶ 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 service (SMS)*, Decision 724, 5 May 2011, p.99

⁴⁷ ACCC, *Mobile Terminating Access Service: An ACCC final report on reviewing the declaration of the mobile terminating access service*, May 2009, p.1

not to market offers that potentially create a negative interconnect balance with their competitors.

Nevertheless, in order to increase their markets shares, small operators have been forced to launch all-net unlimited SMS offers with the short term consequence of decreasing their interconnection balance. However, the short term financial consequences for small operators by engaging in price competition are more serious than the consequences for large operators. The consequences are particularly serious when wholesale termination tariffs set by other operators are high (due to high non-cost based termination fees). Wholesale price regulation is therefore preventing large operators from abusing their monopoly status and is assisting small operators to compete with large operators. In the longer run this competition distortion is diminishing, as other operators will begin to offer similar prices which eventually will rebalance traffic flows.⁴⁸ [emphasis added]

- 3.39 Optus submits that some of the competition concerns noted by the DBA can be observed in the Australian market. This effect is emphasised by Telstra's growing market share and continual dominance in the retail mobile market.
- 3.40 Firstly, there appears to have been no incentive for operators to reduce their SMS termination rates. Optus notes that this commercial rate has remained constant [Cic].
- 3.41 Secondly, Optus notes that while SMS has experienced significant growth since the last declaration review, this level of growth has also slowed in recent quarters. However this does not reflect a decline in the demand for SMS services, rather it may demonstrate a potential shift in consumer behaviour in response to the competitiveness of alternate services. Where retail prices are kept high due to the artificial price floor imposed by wholesale termination rates, it is not surprising that end-users seek alternate services.
- 3.42 Thirdly, similar to the French mobile market at the time SMS was first subject to ex-ante regulation, a number of parallels can be drawn in the Australian context, including:
- (a) The fact that each MNO holds a monopoly over the termination of SMS messages on their network, *"irrespective of the development of competitive pressures, which could weigh on the retail market, between SMS and other modes of communication (Mobile e-mail, MMS, etc)."*⁴⁹
 - (b) This has similarly led to an *"observed lack of competitive pressure on the level of prices charged for terminating SMS communication. This explains why the prices have remained stable for almost six years, only falling (from 5.3 to 4.3 centimes) in November 2005 following intervention by ARCEP."*⁵⁰
 - (c) Finally, *"in the eyes of competition law, the termination of SMS communications by mobile telephony operators could be seen as a charge for access to an essential infrastructure. – which must satisfy certain requirements in terms of transparency,*

⁴⁸ DBA, *Wholesale SMS termination on individual mobile networks – A market susceptible to ex ante regulation*, Paper for the European Commission, April 2013, p.4

⁴⁹ Conseil de la concurrence, "13 March 2006: the wholesale market for SMS call termination on mobile networks", Press Release, 13 March 2006

⁵⁰ Conseil de la concurrence, "13 March 2006: the wholesale market for SMS call termination on mobile networks", Press Release, 13 March 2006

objectivity and non-discrimination, and must allow effective competition on the retail markets, without any price scissoring effects.”⁵¹

- 3.43 Optus submits that there is sufficient evidence to justify including SMS termination within the MTAS declaration. There is a risk that without regulation, the market failure in the wholesale SMS termination rates will persist and will not promote competition in the downstream retail markets for SMS.
- 3.44 Optus finds that inclusion of SMS in the MTAS declaration promotes the LTIE because:
- (a) It will promote competition in related downstream markets. Declaration of the essential bottleneck service combined with appropriate FAD prices will result in retail pricing that has a closer association with the underlying costs and that this in turn, promotes a greater level of competition in related markets.
 - (b) It will promote any-to-any connectivity as it prevents any possibility of a carrier being refused access to the mobile termination services of other operators in the case where a commercial agreement cannot be reached.
 - (c) It will promote economically efficient investment in and use of infrastructure. Without regulation, MNOs have the ability and incentive to set above cost SMS termination rates and that the potential disassociation between price and costs is likely to distort consumption decisions and lead to an inefficient use and investment in telecommunications infrastructure.

⁵¹ Conseil de la concurrence, “13 March 2006: the wholesale market for SMS call termination on mobile networks”, Press Release, 13 March 2006

Section 4. Future services and MTAS

- 4.1 The ACCC seeks comments on how termination on next generation networks, such as long-term evolution (LTE) mobile networks and the NBN, should be dealt with in the MTAS declaration. The ACCC queries:
- (a) whether and when the deployment of 'voice over LTE' (VoLTE) is likely to occur;
 - (b) whether the current MTAS service description would cover calls terminating on LTE networks;
 - (c) whether VoLTE necessitates any changes to the way MTAS is defined within the declaration; and
 - (d) whether the NBN impacts on the definition of MTAS.
- 4.2 This section outlines Optus' views on the likely development and deployment of VoLTE within the next declaration period. Optus submits that the roll-out of VoLTE should have no impact on the declaration of MTAS. There is no justification to treat VoLTE different from other circuit-switched calls terminating on mobile networks. Optus supports the continuation of the technology-neutral approach of the MTAS declaration. Furthermore, the expected timeframe of development and deployment shows that even if VoLTE is deployed it will not have a meaningful impact on the market within the likely declaration period.
- 4.3 This section also outlines Optus' views on the impact that the NBN would have on MTAS. Optus finds that the deployment of a new fixed line network has no impact on issues relating to termination on mobile networks. The MTAS description refers solely to a service between a POI and the B-party end-user. As such, the issues related to origination markets should have no role in the decision to re-declare MTAS.

What is VoLTE and when is it expected to be deployed?

- 4.4 The ACCC specifically asks whether voice services are to be deployed over LTE networks; and if so, when this is likely to occur.
- 4.5 Currently, end-users are able to make voice calls over LTE-enabled handsets through existing 3G and 2G mobile access networks. It is not possible to use the LTE access network to make voice calls. This was the original design of the LTE network. However over recent years there has been a push from some markets to develop a voice solution for LTE. This is known as VoLTE. [CiC].
- 4.6 VoLTE is an add-on to LTE network infrastructure. The provision of VoLTE requires the deployment of specific network hardware, some common with LTE and some specific to VoLTE. In addition, substantial software upgrades need to occur to make the LTE network capable of supplying VoLTE services.
- 4.7 Optus does not expect that the service will be able to be implemented before end of 2015 at the earliest. [CiC]
- 4.8 [CiC]
- 4.9 In summary, the future availability of the technical upgrades necessary for deployment of VoLTE is still unclear at this stage. Further, [CiC].

- 4.10 Given these uncertainties, Optus submits it too early to insert any VoLTE or LTE-specific clauses within the MTAS declaration. Moreover, in the short-term, a technology neutral definition of MTAS (reflecting how voice termination is actually supplied at the core) will be sufficient to cover voice termination to LTE-compliant handsets using VoLTE technology over the RAN.

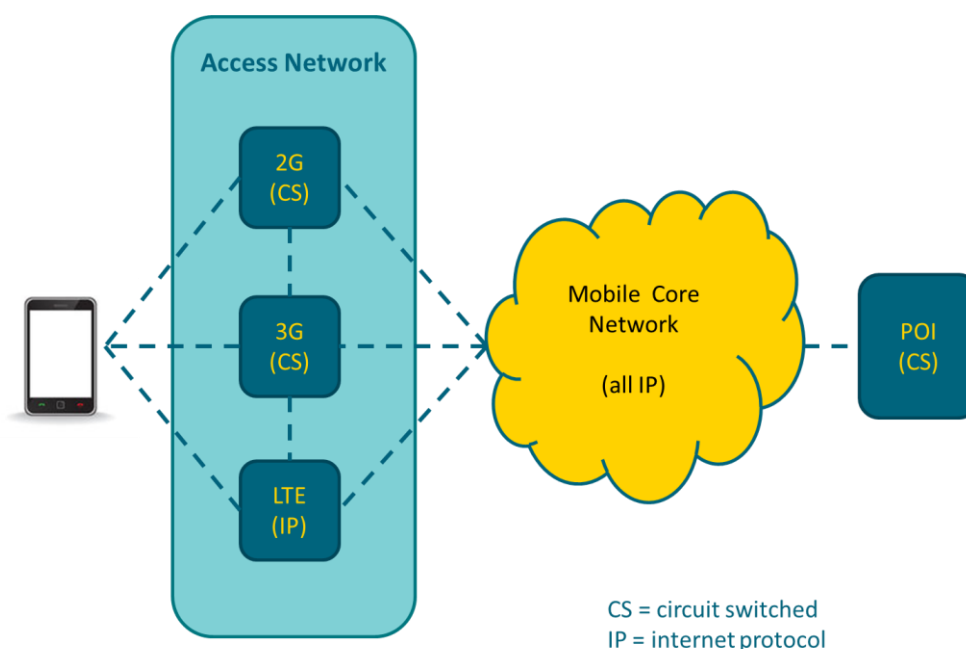
Deployment of VoLTE does not impact on definition of MTAS

- 4.11 The ACCC queries whether the deployment of VoLTE would impact on the definition of MTAS. The current service description states MTAS is an:

... access service for the carriage of voice calls from a point of interconnection, or potential point of interconnection, to a B-Party directly connected to the access provider's digital mobile network.⁵²

- 4.12 Optus submits that the potential deployment of this technology over the *access network* has no impact on the nature of interconnection between different *core* networks. More importantly, the deployment of VoLTE would have no impact on the above definition. Calls made to end-users with a LTE handset (whether using VoLTE or circuit-switched calls) are included within the current definition.
- 4.13 Essentially, VoLTE is another potential future *access* technology that mobile networks may or may not deploy to provide another method through which voice calls are delivered from a MNO's core network to the end-users' device. The three different types of mobile technologies (2G, 3G and LTE) relate only to the access network. Mobile networks have one common core network. Optus notes that it is not accurate to describe mobile networks as being 2G, 3G or LTE as Australian MNOs operate 'hybrid' networks which utilise all three different types of access technologies. This is shown in the diagram below.

Figure 9 Mobile Network Diagram



⁵² ACCC, *Mobile Terminating Access Service: An ACCC final report on reviewing the declaration of the mobile terminating access service*, May 2009, Appendix A.

- 4.14 It is not correct to define MTAS as a service specific to different mobile radio access technologies. This does not reflect the design of modern networks, nor does it reflect how end-user devices switch between different radio access technologies for different calls, and within the same call. That is:
- (a) An end-user with a 2G handset will be able to make calls on the circuit-switched (CS) 2G access network back to the all-IP mobile core network. If the call is an off-net call, the call will be converted back to CS before hand-over. Similarly, an incoming call will be handed to Optus as CS, converted to IP for transmission through the core network, and converted back to CS for delivery over the 2G access network.
 - (b) An end-user with a 3G handset will be able to make calls on the circuit-switched 2G and the 3G circuit-switched access networks back to the all-IP mobile core network. The access over which the call will be made will depend on coverage, capacity and network planning rules. If the call is an off-net call, the call will be converted back to CS before hand-over. Similarly, an incoming call will be handed to Optus as CS, converted to IP for transmission through the core network, and converted back to CS for delivery over the 2G access network.
 - (c) An end-user with an LTE handset will be able to make calls on the 2G or 3G circuit-switched access networks back to the all-IP mobile core network. As noted above, Optus does not plan to introduce VoLTE at this stage. The access over which the call will be made will depend on coverage, capacity and network planning rules. If the call is an off-net call, the call will be converted back to CS before hand-over. Similarly, an incoming call will be handed to Optus as CS, converted to IP for transmission through the core network, and converted back to CS for delivery over the 2G/3G access network.
- 4.15 There is no guarantee that an access network over which a call is made reflects the type of handset that the end-user has. That is, an end-user with a LTE capable handset will use either the 2G or 3G access networks for a call, depending on coverage, cell capacity, and network planning rules. As noted above, the LTE access network cannot handle voice calls at the current time. Further, a voice call may during the actual call utilise any of the access technologies. The VoLTE technology also allows a voice call to handover between VoLTE, 3G and 2G.⁵³
- 4.16 The mixture of technologies may have an impact on the average cost of providing MTAS. Indeed, Optus expects that the average mix of network usage of the various access networks will be an important factor in the estimation of the efficient cost-based price of MTAS. However, Optus does not view that the type of access network utilised to terminate specific calls to specific end-users impacts on the definition of providing termination on the Optus mobile network.
- 4.17 There is no concept of a 2G call termination, 3G call termination, or LTE call termination. Optus therefore strongly supports a technology neutral definition of MTAS. The radio access technology used to terminate the call is best left to end-user demand and network factors. MTAS is, and should be, concerned with the connection of different network cores through POIs.
- 4.18 Optus supports the continuation of the current MTAS description, as outlined in Appendix A of the 2009 MTAS declaration.

⁵³ Through deployment of the SRVCC

Interconnection and VoLTE

- 4.19 At the present time there is no accepted technical solution to provide direct interconnection between different networks for VoLTE calls. To enable direct interconnection between VoLTE services requires that both originating and terminating networks allow for IP-interconnection at the POI. This is in addition to the system that allows circuit-switched interconnection. In essence, a new POI needs to be established.
- 4.20 As discussed above, VoLTE is essentially a value-add service above basic voice connectivity, allowing the delivery of high-definition voice over the LTE network. It is not needed to allow end-users with LTE handsets to make and receive voice calls. VoLTE interconnection is not needed to enable VoLTE enabled end-users to connect with end-users on other networks⁵⁴, but rather it is needed to enable the value-add product to be used to make off-net calls.
- 4.21 Network operators may choose to deploy VoLTE because it has the potential to offer a more technologically efficient way in which to offer HD voice services. In so far as there is a market for HD voice (i.e. end-users are willing to pay to be provided with the service), VoLTE enables the HD service at a lower network cost than using 3G networks. VoLTE provides a higher QoS, but like all higher QoS service (e.g. contention bitstream services) the service will be provided to consumers who are willing to pay for it. The use of HD voice does not impact on any-to-any connectivity.
- 4.22 Optus anticipates that should an IP interconnection protocol be developed, and there is sufficient end-user demand to warrant incurring additional costs, existing interconnection arrangements may be upgraded to allow direct interconnection of VoLTE. Importantly, the lack of direct interconnection does not impact on any-to-any connectivity, and does not limit the ability of end-users to make calls to parties on other networks.
- 4.23 It is unclear how the ACCC could define a service (i.e. IP interconnection) which is not yet defined by industry, nor in service, nor planned to be in service. Optus submits that the ACCC should forebear from interfering in a developing technology. Such a position is consistent with previous ACCC decisions that have refrained from intervening in new and developing markets.
- 4.24 Optus does not see any justification for altering the technology neutral service description currently used in the MTAS declaration.

The impact of NBN on MTAS

- 4.25 The ACCC seeks comments on whether the deployment of the NBN is likely to impact on the MTAS. The ACCC note that the deployment of NBN could impact on MTAS in a similar manner to the shift of mobile networks from circuit switched 3G and 3G to LTE IP technology. The ACCC also seeks comments on how the structural change in the fixed market will likely impact on the mobile market and the definition of MTAS.
- 4.26 First, Optus submits that issues related to the NBN (i.e. fixed line origination) have no impact on issues with termination of calls on mobile networks. The NBN impacts upon the ability of fixed RSPs to originate traffic. It does not impact on the termination of traffic on mobile networks.
- 4.27 Second, the NBN is a wholesale-only access network. As such, it plays no role between the interconnection of retail service providers (RSPs). This conclusion reflects the fact that the

⁵⁴ Without IP interconnection any VoLTE originated call will drop back to circuit switch before being handed over to the other network.

use of ULL or WLR or LSS to provide fixed access has no impact on the interconnections of RSPs.

4.28 Third, the deployment of NBN during the next declaration period is unlikely to have sufficient impact on related downstream retail markets to warrant any change in the declaration of the wholesale MTAS market.

4.29 Fourth, the deployment of NBN should not result in any change to the MTAS description.

NBN is an access network that has no role in interconnection

4.30 The ACCC seeks comments on how voice calls originating from RSPs that utilise the wholesale NBN will interconnect with and terminate on mobile networks. The answer is simple: the originating access network plays no part on how calls are treated by the terminating network. Optus highlights that:

- (a) The ACCC has not made any distinction between traffic from different originating network in previous MTAS declarations, and Optus sees no reason to justify a change to this approach;
- (b) Once the call is handed-over at the POI, the originating network does not influence how the traffic is treated. Indeed, consistent with the finding of monopoly power over MTAS, it is the terminating network that determines how the traffic is handed-over to its network.
- (c) There is no interconnection between NBN and networks at the retail level. The NBN is a wholesale-only access network. Optus notes that there is no interconnection between NBN Co and Optus for retail traffic, for the simple reason that NBN Co is not a service provider and will not originate any traffic. The NBN has no role over how retail service providers (RSPs) interconnect with other RSPs. It is the RSPs whom interconnect with one another to provide connectivity to retail customers.
- (d) The ACCC errs in its assertion that the deployment of NBN has a similar impact on MTAS as the LTE. The access network over which calls originate has no role in the termination of calls to mobile networks, it is therefore not analogous to LTE. More importantly, issues relating to access networks have no role in deciding upon whether MTAS should be declared. While the access network over which the traffic is delivered may impact on the efficient cost-based price of MTAS, it does not impact on the MTAS market definition, the market power over MTAS held by ever operator, and the ability to interconnect at POIs.

4.31 For these reasons, Optus submits that the NBN will have no impact on the issues relevant to deciding whether MTAS should be declared for a further period.

What impact will NBN have on the retail markets

4.32 The ACCC queries how the deployment of NBN will impact downstream retail markets related to the wholesale MTAS market. Specifically, the retail mobile market and the retail FTM markets.

4.33 Optus submits that the NBN will have little or no impact on the retail mobile market. As noted above, Telstra is the dominant mobile operator and its dominance is increasing. NBN Co is not deploying a mobile network, nor will it provide retail mobile services, and therefore will have no impact on competition in the mobile retail market.

- 4.34 Optus also submits that while the deployment of NBN will remove the vertical integration of Telstra in the fixed-line services market, it is likely to have little impact on Telstra's dominance in the retail fixed market — at least during the next declaration period. As discussed above, the Definitive Agreement signed between NBN Co and Telstra provides Telstra with significant monetary payments during the period of the next MTAS declaration. This monetary windfall together with Telstra's dominance in the related mobile and content markets means that Telstra will have market power in the retail market for bundled services (i.e., fixed and mobile bundle; or fixed, mobile and content bundle). The ability to exploit its dominance in related retail markets is likely to entrench Telstra's dominance in the retail FTM market.
- 4.35 Optus submits that the deployment of the NBN during the next declaration period will not have sufficient impact on related downstream retail markets to warrant any change in the declaration of the wholesale MTAS market.

Does NBN impact on MTAS description

- 4.36 The ACCC asks whether the MTAS declaration should be varied to expressly apply to voice calls terminating on FTM calls made on an IP access network. Optus submits that the deployment of NBN does not warrant any change to the MTAS description.
- 4.37 Optus supports the use of a technology-neutral approach to the MTAS service description. Further, issues relating to origination should have no impact on issues relating to termination. It is not clear how the network on which traffic is originated could impact on the definition of MTAS.
- 4.38 Optus also highlights that the service description relates only to the POI to a B-party connected to a digital mobile network. The service description makes no reference of originating network. Optus supports this, and therefore does not expect that NBN would have any impact on MTAS description.

Appendix A. Regulation of SMS in other jurisdictions

- A.1 There have been a number of jurisdictions in which the regulation of SMS has been investigated. A number of these market investigations and inquiries on ex-ante regulation of the wholesale SMS termination service are summarised below.
- A.2 In summary, SMS termination has been regulated in jurisdictions including: France, Denmark, Poland, Israel, Kenya, New Zealand and India.

Jurisdictions where wholesale SMS termination has been regulated

France

- A.3 Following surveys of industry participants in 2003 and 2004 the French regulator, ARCEP, was informed of concern in the market regarding the charging for SMS termination. ARCEP launched its review in July 2004⁵⁵ and proposed in October 2005 to regulate the wholesale price of SMS termination.⁵⁶ Three year price caps came into effect in 2006. France was the first country in Europe to consider and in July 2010 subsequently regulated SMS termination.⁵⁷
- A.4 The regulation was reviewed in 2009 by ARCEP and it proposed a continuance of the caps. This review was then submitted to the French Competition Authority in 2010 as well as the European Commission. Following feedback from both bodies, ARCEP adopted a final decision to continue the regulation as well as extending it to overseas French territories. It was intended that the rate will eventually decrease to one eurocent per SMS terminated.⁵⁸

Denmark

- A.5 In 2010, the Danish regulator, the NITA (now the DBA) notified the European Commission of its proposal to regulate wholesale SMS termination on individual mobile markets. At the time, the NITA had defined a separate market for SMS termination for each of the five MNOs active in the market.
- A.6 The NITA had conducted its market analysis in connection with the Explanatory Note published with the 2007 EC Recommendation on relevant product and service markets which may be subject to ex ante regulation. While the 2007 Recommendation did not identify SMS regulation to be a specific relevant market, it did make comments that assuming similar market problems in the wholesale market for the termination of voice calls, then it may be at the discretion of national regulators to assess whether there is a need to define and notify the presence of an independent market for SMS termination.
- A.7 To this effect, the EC stated:

⁵⁵ ARCEP, "Relevant Market Analysis: ART launches an analysis of wholesale SMS termination services on mobile networks", Press Release, 29 July 2004

⁵⁶ ARCEP, "Relevant Market Analysis: ARCEP proposes regulating the wholesale price of SMS termination in order to revitalise the play of competition for SMS on the retail market and allow the diffusion of SMS beyond the mobile world", Press Release, 24 October 2005

⁵⁷ ARCEP, "L'Autorité adopte sa décision portant sur la régulation de la terminaison d'appel SMS," Press Release, 27 July 2010

⁵⁸ ARCEP, "Market Analysis: ARCEP adopts its decision on regulation governing SMS call termination", Press Release, 27 July 2010

The market identified in this Recommendation is the same as the one identified in the initial Recommendation, i.e. voice call termination on individual mobile networks. To the extent that the exchange and termination of SMS are considered to result in similar market power problems, it is open to NRAs to consider defining and notifying an additional separate market for SMS.⁵⁹

- A.8 It was concluded that the five operators were designated as having significant market power (SMP) on the relevant markets and were subject to the same regulatory obligations of access, transparency, non-discrimination, price control and regulatory cost accounting based on LRAIC method.
- A.9 This remains the view of the DBA today. Notably that it can be argued that the structural barriers on voice termination markets are also present on SMS termination markets.

The conclusion of permanent high and non-cost based termination tariffs is supported by figures which clearly show that there are significant competition problems on wholesale SMS termination markets.

Seen from a European perspective, end users of SMS services experience a significant loss in welfare as a result of not addressing the identified competition problems. In this regard the present lack of harmonized rules where the decision of analysing SMS markets is left to the individual NRA's leads to sub-optimising behaviour among member states. This effectively leads to less welfare for European customers.⁶⁰

Poland

- A.10 In 2010, the Polish regulator, the UKE, similarly reached a position that mobile network operators each have significant market power for wholesale SMS termination, and proposed that regulatory obligations be imposed on the operators as a result. This decision was finalised in December 2010, and a separate market for SMS termination identified with regulatory obligations imposed on the five MNOs.⁶¹
- A.11 The UKE has similarly acknowledged:

The regulation of the SMS termination market would restrict excessive wholesale pricing, thereby having a positive impact on drop in the retail prices and competitive conditions at the wholesale market level. This will ensure that wholesale SMS termination service is always cheaper than the retail price of a text message.⁶²

Israel

- A.12 In Israel, mobile termination prices have been subject to price cap regulation since 2000.⁶³ However, following a review of these rates in 2004 it also commenced the regulation of SMS

⁵⁹ EC, Accompanying document to the Commission Recommendation on Relevant Product and Service Markets within the electronic communications sector susceptible to ex ante regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services, Explanatory Note, Commission Staff Working Paper, SEC(2007) 1483

⁶⁰ DBA, *Response from the Danish Business Authority to: Questionnaire for the public consultation on the revision of the recommendation on relevant markets*, 4 January 2013, p.4

⁶¹ UKE, "Decyzje regulacyjne dla pięciu operatorów na rynku SMS," Press Release, 14 December 2010

⁶² UKE, UKE (Office of Electronic Communications) response to the questionnaire for public consultations on the revision of the recommendation on relevant markets, January 2013, p.5

⁶³ Analysys Mason, *Report for the Israel Minister for Communications and Ministry of Finance: A study of Mobile Termination Charges*, 22 July 2004

termination.⁶⁴ In 2010 the combined Israeli ministries responsible have conducted another review which has led to the adoption of lower rates through a glide path until 2014,⁶⁵ with current SMS termination rates initially dropping to 0.16 agorot (from 1 January 2011) down to 0.13 agorot (by 1 January 2014).⁶⁶

Kenya

A.13 In 2010, the Kenyan regulator, the CKK, issued an addendum to their determination on SMS interconnection termination rates, which required MNOs to implement lower SMS termination rates initially dropping to Ksh. 0.60 (from 1 January 2011) down Ksh. 0.05 by the year 2013.

A.14 In arriving at this decision, the CKK noted that:

the prevailing wholesale termination rates for mobile SMS were way above the incremental costs of providing these services across networks.

... As the industry regulator, CKK is mandated to among other things, promote the development of a competitive telecommunications sector in the country. The Commission's intervention in this respect is intended to provide guidance to the sector and ensure that the Kenyan consumers enjoy more services at reasonable prices.⁶⁷

New Zealand

A.15 In 2007 the New Zealand regulator, the Commerce Commission, observed significant differences in on-net and off-net pricing, as well as some evidence that retail prices were significantly above cost, for both voice and SMS. This prompted a review of the then, unregulated termination service.⁶⁸ Supported further by a new entrant in the mobile market who had voiced significant concerns over termination pricing presenting major barriers to entry in the New Zealand mobile market.⁶⁹ SMS and mobile termination was subsequently regulated in New Zealand in 2011.

A.16 Interestingly, the Commerce Commission also considered implementing a 'bill and keep' arrangement for SMS termination. This was based on the evidence that traffic patterns were relatively balanced between the operators and costs were quite low. However, participants were concerned that a 'zero' termination charge could encourage spam and that transaction costs savings were theoretical. That is, operators would still need to monitor traffic and maintain billing systems. There was a view that with such a low termination price regulated, in time a commercial bill and keep arrangement was possible. It was on this basis that the Commerce Commission therefore set a low SMS termination rate.

India

A.17 In May 2013, the Indian regulator, the TRAI, published a new regulation which prescribed cost-based SMS termination to be Re. 0.02 (2 paise) per SMS effective from 1 June 2013.

⁶⁴ Cellcom Israel Ltd, *Interim Consolidated Financial Statements as at 30 June 2004*

⁶⁵ NERA, *An Examination of Charges for Mobile Network Elements in Israel*, Reply to Consultation Responses, Prepared for the Israeli Ministry of Communications and the Ministry of Finance, 24 August 2010

⁶⁶ Bezeq, "Ministry of Communications decides to reduce mobile termination rates", Press Release, 2 September 2010

⁶⁷ CKK, "CKK issues determination on SMS termination rates," Press Release, 1 January 2011

⁶⁸ Commerce Commission, *Telecommunications Act 2001: Schedule 3 investigation into regulation of mobile termination access service*, Issues Paper, 8 August 2008, p.3

⁶⁹ Commerce Commission, *Telecommunications Act 2001: Schedule 3 investigation into regulation of mobile termination access service*, Issues Paper, 8 August 2008, p.5

A.18 In arriving at this decision,

*The Authority noted that though the policy of forbearance on SMS termination charge has worked satisfactorily in the past when the use of SMS by the subscriber was limited. In the changed circumstances especially due to exponential increase in the number of commercial SMSs, large imbalance in SMS traffic in SMS traffic between the networks of interconnecting service providers, unilateral imposition of SMS termination charge and in case of non agreement, disconnection by some dominant service providers and growing litigations amongst the service providers, the Authority reviewed the policy of forbearance in SMS termination charges and prescribed cost based SMS termination charge.*⁷⁰

A.19 This example further highlight there is a growing shift in the use of SMS. In particular, it also recognises that while previous demand and policies may have worked satisfactorily in the past, current market conditions may have changed and there is now a new case to revisit the relevance of such policies in the changed circumstances.

Jurisdictions where SMS termination markets have been investigated

United Kingdom

A.20 Following France's lead, in 2006 the UK telecommunications regulator, Ofcom published its intention to review the market in which SMS termination is provided.⁷¹ However, no further information has been provided regarding the commencement of the review.

A.21 Despite this, Ofcom has still recognised the bottleneck nature of SMS termination. Namely noting that the presence of *"functional differences that limit the extent to which SMS is a close substitute for calling a mobile... it is the same terminating MNO that controls the SMS termination charge as the voice termination charge."*⁷²

Spain

A.22 In January 2011, the Investigations Division of Spain's antitrust authority, the CNC, initiated infringement proceedings against Telefonica, Vodafone and Orange *"on finding there were indicia of abusive practices... in relation to short text and multimedia messages (SMS and MMS) sent via mobile telephones."*⁷³

A.23 Following a market investigation, the CNC, issued a draft decision in December 2011 which proposed that the three MNOs abused an individual (and collective) dominant position in the provision of wholesale origination of SMS and MMS termination services in setting excessive prices.

A.24 In December 2012 the CNC announced that it would impose fines of EUR 46.490 million, EUR 43.525 million and EUR 29.950 million on Movistar, Vodafone Spain and Orange Espana, respectively. It further reported:

With all three operators cited as having 'a monopoly position in SMS and MMS termination services in their respective networks', the CNC noted that the market for

⁷⁰ TRAI, "TRAI prescribes SMS termination charge and transactional SMS charge", Press Release, 24 May 2013

⁷¹ Ofcom website, *Wholesale SMS termination market review*, published 13 September 2006, <http://stakeholders.ofcom.org.uk/telecoms/policy/mobile-policy/sms-termination-market-review/>

⁷² Ofcom, *Wholesale mobile voice call termination*, Preliminary consultation on future regulation, Consultation, 20 May 2009, p.21

⁷³ CNC, "CNC levies fines of nearly €120 million on Telefonica, Vodafone and Orange for abusing their position in the wholesale telephone short messaging markets," Press Release, 20 December 2012

SMS termination services was unregulated between 2000 and 2009 (the period investigated by the watchdog). As such, the CNC claims, the trio were freely able to price the termination of SMS at very high levels, which in turn allowed them to pass these costs to consumers in the shape of higher retail prices for SMS and MMS services.⁷⁴

- A.25 Despite this outcome there have been no regulatory repercussions as the CNC only considered evidence of overpricing in the period to 2009 and not more recently. Further, it has deferred any future decision to the regulator, CMT, who it considers better placed to design and investigate any ex-ante regulation of these markets.

Italy

- A.26 In 2012, the Italian regulator, AGCOM, issued a questionnaire to operators on the SMS termination market. In February 2013, the AGCOM published a final decision to not regulate the market for wholesale SMS termination on the basis that the second criterion for ex-ante regulation is not met, and presence of characteristics in the SMS termination market (such as a trend for declining wholesale SMS termination rates) that will continue to promote market competitiveness in the absence of regulation.⁷⁵

- A.27 In reaching this conclusion, AGCOM also noted that,

Despite the termination monopoly on each individual mobile network (first criterion met), AGCOM believes that mobile instant messaging services and e-mail applications are substitutes to SMS at retail level. Consequently, wholesale SMS termination rates are indirectly constrained by the existence of alternative services. In other words, AGCOM argues that, if a mobile operator increases its wholesale SMS termination rates, all or part of this price increase would be passed through retail SMS prices, leading end users to switch from SMS to alternative services. This would reduce demand for wholesale SMS termination services making the initial wholesale price increase unprofitable.⁷⁶

⁷⁴ Telegeography, "Spain's competition watchdog fines mobile trio for overpriced SMS," News Article, 21 December 2012, <http://www.telegeography.com/products/commsupdate/articles/2012/12/21/spains-competition-watchdog-fines-mobile-trio-for-overpriced-sms/index.html>

⁷⁵ AGCOM, *Mercato dei servizi di terminazione SMS su singole reti mobili: Definizione del mercato rivelante, identificazione delle imprese aventi significativo potere di mercato ed eventuale imposizione di obblighi regolamentari*, L'autorità, Delibera N.185/13/CONS, 28 February 2013

⁷⁶ AGCOM, Notification form relating to AGCOM's draft decision on the SMS termination market, Executive Summary, 2012, p.2