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**Inquiry to make a final access determination for the  
Domestic Mobile Terminating Access Service**

Dear David,

Macquarie Telecom Pty Limited ("**Macquarie**") appreciates the opportunity to make this submission to the Australian Competition and Consumer Commission ("**ACCC**"). This submission is in response to the ACCC's draft access determination explanatory statement concerning the above.<sup>1</sup>

As set out in the Explanatory Statement, the ACCC's draft final access determination for the MTAS ("**MTAS FAD**") provides for the following:

- a reduction in the MTAS price from 9 cents per minute ("**cpm**") to 6 cpm from 1 January 2012, a further reduction to 4.8 cpm from 1 January 2013 and a further reduction to 3.6 cpm from 1 January 2014; and
- no specific requirement for operators to pass-through MTAS price reductions to end-users.

At the outset, Macquarie wishes to have noted its shock at the failure of the ACCC to lower regulated rates to a level nearing that which would promote competition and enhance consumer outcomes. Despite the ACCC having frozen the MTAS rate for the past 4 and half years at a level the ACCC's own analysis indicates is twice an even "upper bound of cost", and despite the ACCC making clear in past inquiries and findings that it expected to move MTAS to a level aligned with international benchmarks and cost modelling, the draft MTAS FAD merely delivers yet again, on-going monopoly rents to mobile network operators ("**MNOs**"). In fact, despite all the evidence to the contrary, the draft MTAS FAD locks in an unprecedented high MTAS price to be paid, especially by fixed line operators and their customers, through to 2015. When taken in the context of past inaction by the ACCC, this amounts to a significant distortion in the market to the detriment of competition.

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<sup>1</sup> ACCC, Inquiry to make a final access determination for the Domestic Mobile Terminating Access Service (MTAS), Draft Access Determination Explanatory Statement, 23 September 2011, ("**Explanatory Statement**")



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Macquarie notes that the Explanatory Statement is particularly short of detail in that the rationale and logic which the ACCC has used to form its preliminary views are largely not provided. This is in contrast to many other draft decisions resulting from public inquiries which the ACCC has promulgated recently. As such, the task of commenting on the Explanatory Statement is all the more difficult as it is not clear which arguments the ACCC has found to be convincing (or have been rejected) and the weighting that has been given to different arguments. A consequence which flows from this is that Macquarie (and no doubt other respondents) has to make assumptions about the arguments which support the ACCC's preliminary views.

Macquarie also notes that it would appear the ACCC has changed its position on important matters which are relevant to setting the MTAS price. In particular, Macquarie is concerned that the ACCC has changed its position on FTM pass-through. The failure of Telstra to pass-through MTAS price reductions to end-users was understood by Macquarie to have been a barrier to further MTAS price reductions in the ACCC's 2009 Determination on this matter.<sup>2</sup> Now it appears that FTM pass-through no longer matters. In addition, the ACCC is now apparently concerned about "regulatory shock" and uses this to primarily rationalise its failure to propose deeper MTAS price reductions in the draft MTAS FAD. Of further concern to Macquarie is that the ACCC does not provide an explanation in the Explanatory Statement of how it has assessed regulatory shock.

Against this background, Macquarie comments on the following matters arising from the draft MTAS FAD and the Explanatory Statement:

- the quantum of the proposed MTAS price reduction;
- competing in the FTM market;
- the truth about regulatory shock;
- the absence of a FTM pass-through requirement;
- MTAS price – regulatory intervention trade-off; and
- non-price terms and conditions.

### The Quantum of the Proposed MTAS Price Reduction

Macquarie is strongly of the view that the quantum of the proposed MTAS price reduction is not sufficient to achieve the statutory requirement of promoting competition for the benefit of end-users. It is particularly concerning to Macquarie that the ACCC's initial proposed MTAS price of 6 cpm is not aligned with the rationale for its derivation as set out in the Explanatory Statement.

The MTAS price of 6 cpm purports to be rationalised on the basis of the outputs of the 2007 WIK model and international estimates of the efficient cost of the MTAS. The 2007 WIK model produced an output of 5.9 cpm. The Explanatory Statement notes a range of factors which enable an operator to substantially reduce "... *its actual cost of providing the MTAS compared to the outputs of the 2007 WIK model ...*".<sup>3</sup> As such, the cost of the MTAS is in the ACCC's own assessment substantially below 5.9 cpm produced from a model some five years out of date.

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<sup>2</sup> ACCC, Domestic Mobile Terminating Access Service Pricing Principles Determination and indicative prices for the period 1 January 2009 to 31 December 2011, March 2009, ("**MTAS Determination 2009**")

<sup>3</sup> Explanatory Statement, page 8

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With regard to international estimates of the efficient cost of the MTAS, the Explanatory Statement notes three reference points:

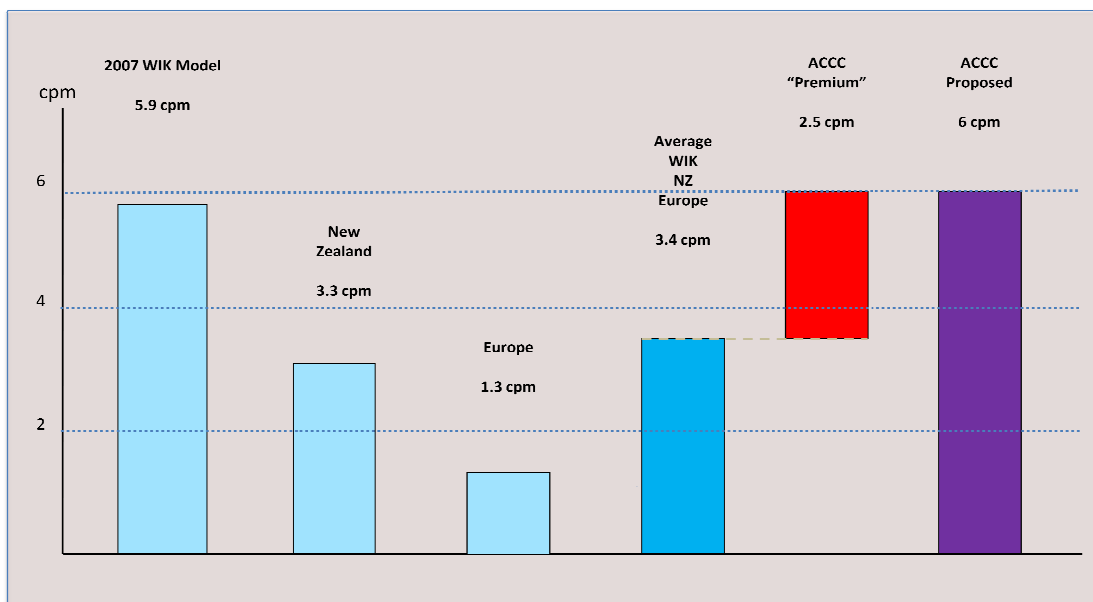
- the New Zealand Commerce Commission which has adopted a price path for mobile termination of “approximately 3.42cpm to 2.84cpm in Australian currency.”<sup>4</sup>;
- European countries including the UK, Belgium and the Netherlands which have mobile termination rates of “... approximately 1.1 cpm to 1.5 cpm in Australian currency.”<sup>5</sup>; and
- the deployment of LTE technology and all IP networks which will mean that “... the cost of providing the MTAS will tend towards 0 cpm.”<sup>6</sup>

Macquarie finds it extraordinary that the ACCC (while believing that the cost of the MTAS will tend towards zero) would propose to adopt a MTAS price which is higher than:

- a cost based modelled outcome which it expects to be substantially lower;
- regulated rates in New Zealand; and
- regulated rates in Europe.

Even if the outcome of the 2007 WIK model of 5.9 cpm is accepted, and the “zero” reference point is overlooked, the average, i.e., arithmetic mean, of the ACCC’s reference points is 3.4 cpm.<sup>7</sup> The ACCC’s proposed MTAS price of 6 cpm is more than 2.5 cpm or 72 *per cent* above this point. The following exhibit illustrates the significant premium that the ACCC has placed on its reference points to derive its proposed MTAS price.

**Exhibit 1: Derivation of ACCC’s MTAS Price**



<sup>4</sup> *ibid*, page 8

<sup>5</sup> *ibid* page 9

<sup>6</sup> *ibid* page 10

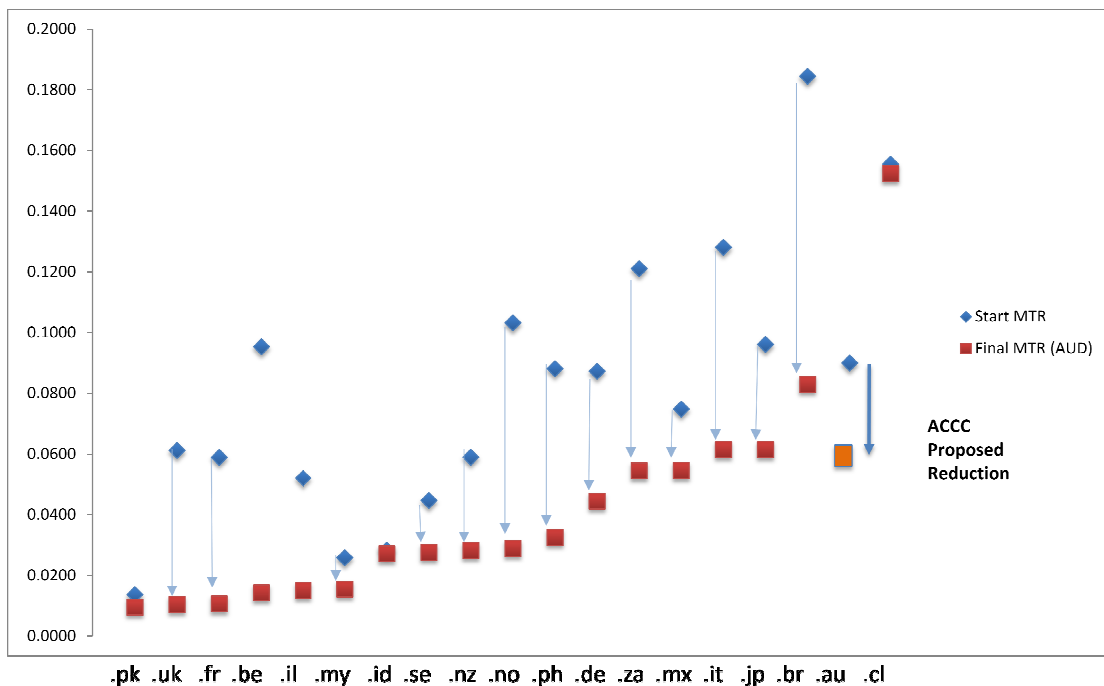
<sup>7</sup> Note that if the “zero” reference point is included, the average of the ACCC’s reference points is 2.6 cpm.

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Based on the ACCC’s analysis, Macquarie contends that the logical outcome for the ACCC’s MTAS price on its most conservative basis should be no more than 3.4 cpm, i.e., the average of three reference points which ignores the “zero” reference point. Of further concern to Macquarie is the absence of any explanation in the Explanatory Statement for the 2.5 cpm “premium” that the ACCC has added to the average of the three reference points. At the very least Macquarie contends that access seekers are entitled to such an explanation.

Macquarie is also of the view that the ACCC’s proposed MTAS price is insufficient compared to a comprehensive range of global benchmarks. The following exhibit shows how the ACCC’s proposed MTAS price reduction from 9 cpm to 3.6 cpm out to 2014 compares against mobile termination rate reductions in other global markets.

**Exhibit 2: ACCC’s MTAS Price Reduction vs. Other Global Markets**



As shown above in Exhibit 2 the ACCC’s proposed MTAS price reduction from 9 cpm to 3.6 cpm is particularly modest compared to the reductions in many other markets. In addition, the proposed 2014 landing point for the MTAS price of 3.6 cpm is already very high compared to prevailing mobile termination rates in other markets. Of particular concern to Macquarie is that the 2014 landing point is relevant and appropriate now – not in three years time. This is because the costs of the MTAS will continue to fall in line with technological developments as set out in the Explanatory Statement. As discussed below, the time delay appears to be a direct result of the failings of the ACCC’s MTAS Determination 2009.

Competing in the FTM Market

Macquarie wishes to draw the ACCC’s attention to the different dynamics of competition in the FTM market which have key implications for the setting of the MTAS price. Macquarie understands that traffic flows between the MNOs is largely balanced such that the value of the MTAS price is essentially immaterial because the amount each MNO pays for MTAS equals the amount that they receive.

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With regard to FTM, the market is characterised by Telstra's very large fixed customer base which results in Telstra being a net payer of MTAS charges to Vodafone Hutchison Australia ("VHA") and to SingTel Optus. As such, the value of the MTAS price is important to Telstra as a cost driver and important to VHA and SingTel Optus as a revenue driver.

For Macquarie, the MTAS price is also important as Macquarie is a net payer of MTAS charges. However, as a retail service provider ("RSP") Macquarie faces two key competitive disadvantages in the FTM market which elevate the importance of the MTAS price.

First, there is a misalignment between the construct of the ACCC's declared services and the construct of the services provided by access providers and sought by access seekers for the provision of FTM services. In particular, Macquarie seeks and is provided a FTM wholesale service. That is, a service which originates on a fixed network and terminates on a mobile network and is priced as a single service. On the other hand, the ACCC has declared a fixed origination service and has provided a price for that service. It has also declared the MTAS and provided a price for that service. This means that Macquarie does not have a regulated price which matches the service that it actually seeks. This also means that Macquarie must negotiate a price for the FTM service. Inevitably, because of the imbalances in bargaining strength, Macquarie pays more for a FTM service than the sum of charges for a fixed originating service and a MTAS. That is, the prevailing ACCC charges for these services are 0.95 cpm and 9 cpm respectively which suggests that the FTM charge should be 9.95 cpm.

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Given these competitive disadvantages, it is essential for competition and the LTIE that RSPs like Macquarie have access to wholesale services including the MTAS at prices which are

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cost based. As such, it is particularly concerning to Macquarie that the ACCC's pricing of the MTAS in the draft MTAS FAD seems to be more concerned with avoiding the impact of "regulatory shock" than with adherence to the principle of economically efficient pricing.

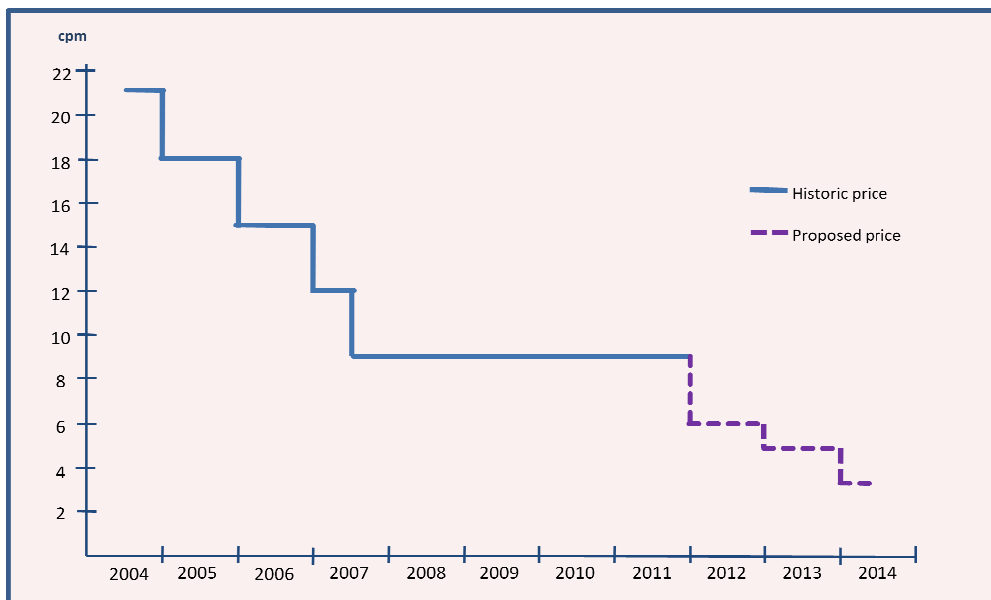
The Truth about Regulatory Shock

Macquarie understands that the ACCC's preliminary view on the reduction of the MTAS price from 9 cpm to 6 cpm is driven by an apparent need to avoid "regulatory shock", i.e., the negative impact on MNOs arising from a sudden and deep reduction in prices. It is, however, noted that this apparent rationale is not discussed in the Explanatory Statement.

Macquarie submits that the ACCC in taking such a view has misunderstood "regulatory shock" from the perspectives of both access seekers and access providers, and as such, any concern that the ACCC has about "regulatory shock" is unfounded and should be dismissed.

The following exhibit shows the MTAS price from 2004 to 2011 as determined by the ACCC and the proposed MTAS price as per the MTAS FAD from 2012 to 2014.

**Exhibit 3: MTAS Price 2004 - 2014**



It is immediately evident from Exhibit 3 that the MTAS price was frozen at 9 cpm for a four and half year period from mid 2007 to the end of 2011. This reflects the outcome of the ACCC's MTAS Determination 2009 which maintained the prevailing MTAS price of 9 cpm for a further three years. This period was preceded by a three year period in which the MTAS price was reduced on four occasions resulting in an overall reduction in the MTAS price from 21 cpm to 9 cpm.

Macquarie submits that in the period from 2004 to 2007 access providers and access seekers alike were conditioned to expect the continuation of MTAS price reductions. What became a "shock" was the failure of the ACCC to reduce the MTAS price in its MTAS Determination 2009. In freezing the MTAS price at 9 cpm at this time, the ACCC ignored the on-going decline in underlying MTAS costs and the global trends in MTAS pricing. The



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ACCC's decision added unnecessary costs to RSPs (like Macquarie Telecom especially in relation to FTM services) and provided a windfall subsidy to SingTel Optus and VHA. Inevitably, this caused detriment to end-users through higher prices and constrained competition.

In the lead up to the ACCC's current MTAS inquiry, Macquarie submits that the industry has been prepared for a deep reduction in the MTAS price. This is because the MTAS 9 cpm price freeze was clearly out of line with the historical trend in the ACCC's MTAS pricing decision and trends in global markets which have seen deep reductions in mobile termination rates. As such, the industry has expected the ACCC to make a correction to the MTAS price in the MTAS FAD in recognition that it made a "bad call" in its MTAS Determination 2009.

Further indicators of the industry's expectations of a deep reduction in the MTAS price in the MTAS FAD which pre-dated the commencement of the ACCC's current inquiry are the following:

- the promulgation of a report commissioned by SingTel Optus in April 2011 warning the ACCC against cutting the MTAS price<sup>8</sup>;
- calls from the managing director of VHA to the federal government in May 2011 to reverse its previous cuts to the MTAS price<sup>9</sup>; and
- comments attributed to a Telstra spokesman that "[m]obile termination rates have been well above cost ... [and] ... there is no reason why they shouldn't be reduced to a level that is more reflective of efficient costs".<sup>10</sup>

In addition to the above, data from Telstra's Annual Reports 2010 and 2011 show that its mobile service revenue per mobile voice minute fell from \$0.56 to \$0.45 or by 18.9 *per cent* for the year ending 30 June 2011. In Macquarie's view this fall in revenue per minute can be interpreted as Telstra recognising that its mobile costs including its costs for mobile call termination are falling and are expected to fall and that it must pass on cost savings to end-users. That is, Telstra has already factored in a substantial reduction in the MTAS price into its retail mobile prices.

Macquarie submits that while the ACCC may wish to be cognisant of avoiding regulatory shock, in the setting of the MTAS price it must consider this from two sides, i.e., an expected loss of revenue to SingTel and VHA and a continuation of an inefficient cost for RSPs like Macquarie. As large operators with a wide range of services, SingTel and VHA are well placed to absorb an anticipated revenue loss arising from a reduction in the MTAS price. This is particularly so given the subsidy that the ACCC provided them with arising from the MTAS Determination 2009. This contrasts with the position of relatively smaller RSPs (like Macquarie) that because the MTAS price is still too high face an increasing inability to offer services to end-users at prices which are profitable. Macquarie contends that the continuation of inefficient costs to RSPs is a far greater regulatory shock with far greater implications for competition than the regulatory shock that arises from the expected loss of a revenue subsidy to SingTel and VHA. Accordingly, Macquarie restates its strong view that a deeper MTAS price reduction than that proposed by the ACCC is warranted.

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<sup>8</sup> Reported in the Australian Financial Review, 11 April 2011

<sup>9</sup> Reported in the Australian Financial Review, 23 May 2011, page 16

<sup>10</sup> *ibid*, page 16



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### The Absence of a Pass-Through Requirement

The Explanatory Statement notes that the ACCC "... has formed the preliminary view that including a FTM pass-through safeguard in the MTAS FAD may not be the most effective way of addressing high FTM retail prices."<sup>11</sup> However, the Explanatory Statement does not provide any explanation of the reasons that support this view. This is surprising given that the ACCC has made it clear that the sticking point for MTAS price reductions was the need to ensure pass-through.

Macquarie lends its qualified support to the ACCC's preliminary view that there is no requirement for a FTM pass-through mechanism. The reason for this view is that competitive pressure has ensured that Macquarie has passed-through previous MTAS price reductions to end-users and that this would continue to be the case for future MTAS price reductions.

Macquarie is, however, concerned that Telstra has been reluctant to pass on previous reductions in MTAS prices for its FTM customers and that there is no basis for believing that Telstra would behave any differently with the ACCC's proposed MTAS price reductions. As such, there is a likelihood that Telstra would be in a position to gain a substantial financial benefit from the ACCC's proposed MTAS price reductions.

Macquarie acknowledges that the ACCC in the Explanatory Statement notes that the Australian Government has "... foreshadowed an extensive review of retail price controls applicable to Telstra ...".<sup>12</sup> Thereby, the ACCC implies that a FTM pass-through mechanism might be addressed in this review. It is noted that this review was finally announced last week. While Macquarie welcomes such a review, it believes that Telstra should be subject to more direct regulation to promote FTM pass-through.

Accordingly, Macquarie re-iterates its views on FTM pass-through expressed in its earlier submission to the ACCC concerning this inquiry.<sup>13</sup> In particular:

- that differential regulation of the MTAS price should apply in the provision of FTM services between integrated operators and all other operators such that integrated operators would be denied any reduction in the MTAS price unless they demonstrate that they have reduced their retail FTM prices; and
- that integrated operators would be subject to a record keeping rule ("RKR") under section 151BU of the *Competition and Consumer Act 2010* which requires them to publicly report their average retail price per minute and average revenue per call of their FTM services.

### MTAS Price – Regulatory Intervention Trade-Off

As discussed above, the ACCC's proposed position on the MTAS as per the draft MTAS FAD is summarised as:

- a modest reduction in the MTAS price; and

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<sup>11</sup> *ibid* page 17

<sup>12</sup> *ibid* page 18. It should be noted that the DBCDE's website reports only the following: "A holistic review of the overall policy and legislative framework for retail price controls will occur during 2011." Moreover, no further details of this review have been publicised.

<sup>13</sup> Macquarie, Submission to the MTAS FAD discussion paper, 27 July, 2011 ("July Submission")



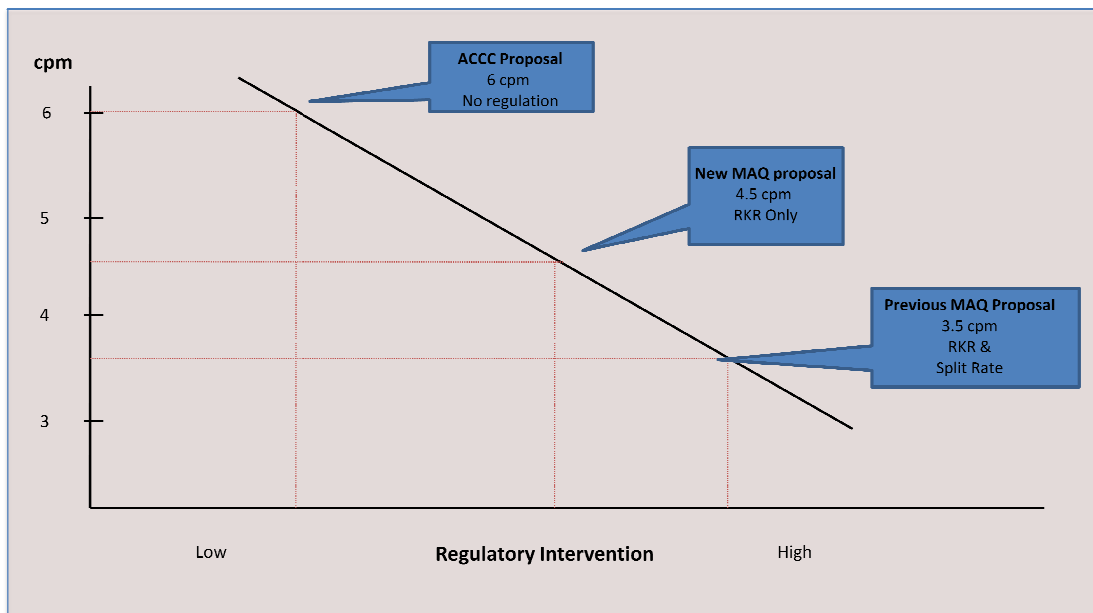
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- no requirement for a pass-through mechanism.

It would appear to Macquarie that there is a direct relationship between these matters. Specifically, the reduction in the MTAS price appears to have been traded-off against the implementation of a FTM pass-through mechanism. That is, the deeper the MTAS reduction, the greater the need for regulatory intervention to ensure that FTM pass-through is achieved. This trade-off framework provides a basis for identifying other options which involve combinations of MTAS prices and regulatory interventions.

The following Exhibit shows the MTAS price – regulatory intervention trade-off framework. Three outcomes are shown, i.e., the ACCC’s position as per its draft MTAS FAD, Macquarie’s preferred position as per its July Submission together with a third outcome.

**Exhibit 4: MTAS Price - Regulatory Intervention Trade-Off**



It would seem that the ACCC has taken the view that the task of implementing a FTM pass-through mechanism can be avoided if the MTAS price is modestly lowered to 6 cpm. This defines one outcome on the trade-off function in Exhibit 4.

In its July Submission, Macquarie proposed that the MTAS price should be immediately lowered to 3.5 cpm and this would be accompanied by:

- a pass-through mechanism whereby integrated operators would be denied any reduction in the MTAS price unless they demonstrate that they have reduced their retail FTM prices; and
- a RKR which requires integrated operators to publicly report their average retail price per minute and average revenue per call of their FTM services.

This defines a second outcome on the trade-off function in Exhibit 4.



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Using the trade-off framework, a further outcome may be identified which falls between the two extremes. Compared to the ACCC's proposal, this outcome involves a lower MTAS price combined with relatively modest regulatory intervention. In particular, the regulatory intervention would consist only of the RKR. This would serve to make the degree of FTM pass-through transparent and provide a basis for monitoring the effectiveness of retail price controls which apply to Telstra. This would be combined with an MTAS price of around 4.5 cpm.

### Non-Price Terms and Conditions

Macquarie notes that the draft MTAS FAD proposes that non-price terms and conditions will be provided in respect of the following topics:

- billing and notification;
- creditworthiness and security;
- general dispute resolution procedures;
- confidentiality provisions; and
- suspension and termination.

This means that non-price terms and conditions in respect of the following topics which exist in the 2008 Model Terms are not provided for in the MTAS FADL:

- communication with end users;
- network modernisation and upgrade provisions; and
- facilities access.

Macquarie considers that such provisions are relevant to the provision of the MTAS and should be included in the final MTAS FAD.

### Closing

Macquarie welcomes the opportunity to make this submission. Setting the MTAS price at an appropriate level is fundamental to encouraging effective competition. As noted herein, Macquarie is strongly of the view that the MTAS price reductions as proposed by the ACCC are simply not sufficient. This is because:

- the ACCC must acknowledge that its failure to reduce the MTAS price in its MTAS Determination 2009 was a mistake and must be corrected; and
- the ACCC's apparent rationale for its modest MTAS price reduction, i.e., to avoid regulatory shock is unfounded as industry has expected a steep MTAS price reduction on the grounds of (i) trends in global markets, (ii) inherent mobile network cost reductions and (iii) prevailing excessive MTAS prices.

The consequences of the ACCC's proposed MTAS prices being above efficient economic costs are detriment to competition and to the LTIE. Moreover, SingTel Optus and VHA will continue to be the beneficiaries of a substantial subsidy.

Macquarie reiterates its view that the MTAS price should be immediately lowered to 3.5 cpm and this should be accompanied by:

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- a pass-through mechanism whereby integrated operators would be denied any reduction in the MTAS price unless they demonstrate that they have reduced their retail FTM prices; and
- a RKR which requires integrated operators to publicly report their average retail price per minute and average revenue per call of their FTM services.

Should the ACCC consider that the implementation of a FTM pass-through mechanism to be problematic, Macquarie considers that as an alternative an MTAS price of 4.5 cpm combined with the RKR rule would be appropriate.

Macquarie would be pleased to discuss with submission with you.

Yours sincerely



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