



Submission in response to ACCC
Draft Decision

**Mobile Terminating Access Service
Final Access Determination**

PUBLIC VERSION

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Section 1. Executive Summary

- 1.1 Optus welcomes the approach proposed in the Draft Final Access Determination (FAD) for the provision of the domestic mobile terminating access services (MTAS). Optus has supported the use of international benchmarking method as the most appropriate and cost effective method to estimate the efficient cost of providing MTAS in Australia.
- 1.2 In saying that, however, the Draft FAD has not adequately assessed whether the proposed MTAS rates promote the long term interest of end-users. Specifically, the Draft FAD has:
 - (a) failed to assess the impact of lower MTAS voice and SMS rate on end-users;
 - (b) failed to demonstrate that one-off declines in MTAS rates better promote the LTIE than a glidepath; and
 - (c) failed to adopt a cost of capital for the mobile industry.
- 1.3 In addition, Optus has identified errors in the benchmarking approach adopted by WIK-Consult. WIK-Consult has erred in making arbitrary adjustments rather than making direct adjustments in the benchmarked models.
- 1.4 In summary, the ACCC has not demonstrated to a reasonable standard that the proposed MTAS rates reflect the cost of a hypothetical efficient new entrant in the Australian mobile market; and has failed to reasonably enquire into whether the proposed decline promotes the long term interest of end-users.
- 1.5 Further, the ACCC's approach of implementing a substantial once-off price reduction is inconsistent with its approach in pricing fixed line services; where it is proposing to preserve price stability through adopting a four year price. This inconsistency benefits Telstra at the expense of its major competitors Optus and VHA.

Draft Decision presents no evidence lower MTAS benefits consumers

- 1.6 The Draft FAD alleges that *“decreasing mobile voice termination rate will continue to benefit end-users of mobile services and fixed-line voice services in the form of lower retail prices and more generous inclusions of calls in included-value plans”*.¹ This is consistent with the statement in the MTAS Declaration Final Report that reductions in termination rates could benefit plans that are *“less expensive and are likely to appeal to vulnerable and price sensitive consumers.”*²
- 1.7 Such a broad statement, however, is not consistent with the way in which MTAS rates affect end-users. It fails to recognise that the flow through of lower MTAS rates to retail plans is determined by the impact on the customer lifetime value of end-users. End-users who make more calls than they receive benefit from lower MTAS rates; whereas end-users that receive more calls/messages than they make do not benefit from lower MTAS rates. This analysis has been accepted in the United Kingdom, and used several times by the regulator and courts when assessing effects on consumers. It is reasonable to expect that the ACCC would make similar enquiries about the Australian mobile market prior to making conclusions as to how reductions in the MTAS rates impact end-users. The Draft FAD does not make such enquiries.

¹ ACCC, 2015, MTAS FAD Draft Decision, p.25

² ACCC, 2014, MTAS Declaration Inquiry, Final Report, June, p.57

- 1.8 There is no evidence before the ACCC that lowering MTAS rates benefits all end-users equally, or the proposed reductions provide a net benefit on average. Moreover, there is no evidence before the ACCC that lower MTAS rates benefits “vulnerable and price sensitive consumers” whom are more likely to purchase low value mobile plans – rather available evidence suggests these consumers would be worse off with low MTAS rates.
- 1.9 Optus recommends that the ACCC conduct an analysis of the customer lifetime value of customer types before it concludes that the LTIE is promoted by lowering MTAS voice and SMS rates.

Adoption of a glidepath better promotes the LTIE

- 1.10 The Draft FAD proposes a one-off 55% reduction of the voice MTAS and a 99% reduction for the SMS MTAS. The level of these one-off reductions is unprecedented and inconsistent with regulatory certainty and the ACCC’s objective of avoiding “*regulatory shock in implementing reduced MTAS prices*”. The average MTAS glidepath imposed since 2004 has been around 22% for each step. Optus recommends a similar glidepath be adopted in this FAD Inquiry.
- 1.11 The Draft FAD does not analyse whether the immediate reduction in MTAS rates promotes the long term interest of end-users more than the adoption of a multi-year glidepath. Optus does not believe immediate reductions in MTAS rates would lead to benefits sufficient to outweigh the detriment to MNO businesses.
- 1.12 Optus submits that the benefits of an immediate reduction are limited due to:
- (a) The use of unlimited voice and SMS allowances in high use retail mobile plans limiting the extent to which lower MTAS rates can lower retail prices.
 - (b) The plans that have limited voice and SMS usage are those used primarily by end-users that receive more calls/messages than they make. It is not clear that MTAS reductions are beneficial to these customer types.
- 1.13 On the other hand, the costs on business of a one-off substantial reduction during a financial year without warning are significant. The proposed one-off reduction is problematic because the:
- (a) Magnitude of the decline is unprecedented, and hence, not predictable by business; and
 - (b) Decline occurs mid-way through the financial years of MNOs, and as a result disrupts financial planning cycles and internal business planning processes.
- 1.14 **[CiC]**
- 1.15 There would be little, if any, change in end-user outcomes if the ACCC moved away from a one-off reduction and adopted a glidepath over the three years of the FAD. But there would be material industry benefit from regulatory certainty and reducing the regulatory shock in implementing such a large decline.
- 1.16 At the minimum, MTAS declines should not occur midway through the same financial year in which the decision was made. This does not give business any reasonable opportunity to adjust to revenue short falls.
- 1.17 Optus strongly recommends that the ACCC adopt a multi-year glidepath with reductions in line with historic steps.

- 1.18 Further, the proposed decline in MTAS is inconsistent with the approach to regulated access pricing for fixed line – where the ACCC has proposed to average prices over a four year period to maintain price stability limiting the ability of access seekers to benefit from lower prices.
- 1.19 It is not clear why price stability is given a prominent focus in fixed regulation but not mobile regulation given ACCC’s position that considerations of regulatory certainty and consistency will be important when setting the terms and conditions of the FADs.³ Further, it is not clear why the ACCC accepts above-cost access price for fixed line services to promote the business interests of Telstra – which has 95% of fixed line access lines – but advocates for more aggressive reductions in cost-based pricing for mobile services – the only communications sector where infrastructure-based competition has been a success.

WIK-Consult benchmarking should be rejected

- 1.20 Optus supports the use of international benchmarking to provide guidance on the range for the efficient cost of providing MTAS in the Australian market. However, the advice provided by WIK-Consult fails to implement such benchmarking approach in a reasonable manner. Optus finds that WIK-Consult’s advice:
- (a) Makes errors in relevant Australian input values;
 - (b) Assumes elasticity values that have no evidentiary basis and are inconsistent with the benchmarked models; and
 - (c) Fails to make proposed adjustments directly in the identified public cost models.
- 1.21 As such, the proposed benchmark rate does not represent a reasonable estimate of the efficient cost of providing MTAS in Australia. The proposed rate of 1.61cpm is at the same level of the MTAS rates in the European Union using the pure LRIC cost standard. The ACCC has specifically rejected this standard because it *undermines the legitimate business interests of the MNOs and is likely to discourage the efficient investment in mobile infrastructure*. Setting a rate at the same level will have the same effect.
- 1.22 The ACCC cannot reject a cost method because it does not promote the long term interest of end-user and then propose a rate consistent with the rejected method. The proposed rate of 1.61cpm does not pass the common-sense test.
- 1.23 An analysis of the WIK-Consult report indicates that the errors in the model are so numerous and sufficiently material that the benchmarking approach should start afresh, with input from industry. Many of the errors in the report could have been avoided if the report was conducted in consultation with industry.
- 1.24 Adjusting for errors (where possible) results in a corrected benchmark value of at least 2.29cpm for voice MTAS – 42% higher than the draft FAD.

Use of fixed line WACC is not appropriate

- 1.25 The Draft FAD proposes to use the cost of capital estimated for Telstra in the fixed line services FAD Inquiry. This would be the first time since MTAS was regulated in 2004 that the rate uses the cost of capital for the fixed line sector.
- 1.26 The proposed approach to WACC is inconsistent with the hypothetical efficient new entrant cost standard. The ACCC cannot propose to benchmark LRIC+ models based on this standard

³ ACCC, 2011, MTAS Draft FAD, A.5.9

and then adopt a cost of capital which rejects the same cost standard. The ACCC cannot adopt LRIC+ cost standard because it is consistent with previous decisions, and promotes regulatory certainty,⁴ while at the same time changing its position on cost of capital.

- 1.27 The Draft MTAS FAD does not provide evidence supporting the change in the ACCC's long standing positions. The ACCC has not made reasonable enquiries nor provided adequate reasons for changing views. The extent of the analysis put in the Draft FAD is contained in three paragraphs – this does not provide adequate reasons to overturn almost a decade of well-established regulatory and legal precedents. Deviating from such a long-standing position does not appear to be consistent with the ACCC's statement that considerations of regulatory certainty and consistency are important when setting the terms and conditions of the FADs.⁵
- 1.28 Further, the Draft FAD is counter to the specific decision of the Australian Competition Tribunal that the mobile WACC should represent a stand-alone mobile operator, not an integrated fixed and mobile operator.
- 1.29 Optus is concerned that the position put in the Draft FAD errs in both the estimation of parameters and interpretation of key issues that have long been settled through many regulatory and judicial decisions.

⁴ ACCC, 2011, MTAS Draft FAD, p.16

⁵ ACCC, 2011, MTAS Draft FAD, A.5.9

Section 2. Proposed reduction does not promote LTIE

- 2.1 The Draft Decision proposes a one-off reduction in the MTAS voice rate from 3.6cpm to 1.61cpm and MTAS SMS rate from **[CiC]** c/SMS to 0.03 c/SMS. This represents a 55% decline in voice and a 99% decline in SMS.
- 2.2 This would be the first MTAS pricing decision which did not include a glidepath from existing rates to the target rate.
- 2.3 Previous MTAS pricing decisions has been cognisant of “**avoiding regulatory shock in implementing reduced MTAS prices**”.⁶ The proposed one-off decline would impose serious regulatory shock on the industry and would impose unnecessary business harm without any offsetting consumer benefits.
- 2.4 **[CiC]**
- 2.5 Optus recommends that the ACCC adopt a glidepath reduction down to the target MTAS rates over the period of the FAD. The percentage reductions should be in line with those in previous decisions.
- 2.6 Importantly, the Draft Decision has presented no evidence on how the reduction in MTAS rates are expected to flow through to end-users given the presence of unlimited voice and SMS plans in the market. Further, no analysis has been undertaken on the impact on mobile businesses of an unprecedented and unannounced reduction part way through a financial year.
- 2.7 This section outlines Optus’ position on the adoption of glidepath for future reductions in voice and SMS MTAS rates. This section shows that:
- (a) There are limited benefits to end-users from reduction in the MTAS rates;
 - (b) MTAS reductions impact different customer groups differently;
 - (c) There are real negative impacts on business arising from an unexpected reduction announced part way through a financial year.

Limited benefits to end-users from reduced MTAS rates

- 2.8 End-users have the option of mobile plans (prepaid and postpaid) that provide for unlimited voice and SMS. Given the current pricing of voice and SMS retail services in Australian mobile plans, there would be limited benefit to consumers of lower MTAS rates – all of Optus’ monthly plans contain unlimited voice and unlimited SMS. There will therefore be no benefit to end-users from reductions in the SMS termination rate.
- 2.9 Optus only provides one prepaid plan without unlimited voice, for recharges less than \$30 a month. However, for end-users likely to purchase these low value recharges, lower MTAS rates may have detrimental impact due to their outbound-inbound traffic balance.⁷

⁶ ACCC, 2011, MTAS – Draft final access determination, September, p.6

⁷ See Ofcom and the UK Competition Commission

Outline of Optus' mobile plans

- 2.10 Optus' current mobile plans are explained below.
- 2.11 Optus has four My Plan Plus postpaid options, for \$40, \$60, \$80 and \$100 a month. Optus also has three My Plan Plus SIM only plans for \$30, \$45 and \$60 per month. All these postpaid plans contain unlimited voice and unlimited SMS traffic per month. Reductions in MTAS rates will not result in lower voice and SMS retail rates in the way expected by the ACCC.
- 2.12 Optus has three types of prepaid mobile plans:
- (a) My prepaid monthly;
 - (b) My prepaid daily; and
 - (c) My prepaid daily plus.
- 2.13 The only prepaid monthly recharge vouchers that contain limited voice propositions are the \$30 monthly recharge option, and the \$10 and \$20 weekly and fortnightly recharge options. These plans contain 'included minutes' and for minutes above the include value, calls are charged at 10c per minute.⁸ These plans also contain unlimited voice usage during weekends. These prepaid plans are designed for low volume users.
- 2.14 My prepaid daily plans offer a \$1 a day option which provides up to 30 mins of voice calls a day and a \$1.50 a day option which for \$1.50 a day provides unlimited voice. Importantly, the daily charge upgrades automatically to \$1.50 if the end-user uses their included allowance. In effect this 'daily plan' offer provides for unlimited voice and SMS.⁹ End-users are only charged the daily fee upon the first outbound call minute, SMS or data usage.
- 2.15 The 'my prepaid daily plus' offer provides unlimited voice and SMS usage for \$2 a day.
- 2.16 The current plans in the market clearly show that for end-users who anticipate using more than low volumes of either voice, SMS or data, the plans options all contain unlimited voice and SMS. The specific plan adopted is more likely to be driven by the data needs of the end-user rather than voice or SMS usage. It is only low volume end-users (those who require a mobile phone to keep in contact and enable others to call them) that are likely to have plans which contain limited voice volumes.

Impact of voice MTAS on different customer groups

- 2.17 It is not immediately clear, however, that plans designed for low volume customers actually benefit from reduction in the MTAS rates. The latest regulatory views on the impact of reducing MTAS rates¹⁰ seek to understand the impact on two spearte groups of end-users:
- (a) high use end-users (those that send more outbound minutes than inbound) and
 - (b) low use end-users (those that receive more inbound than outbound).
- 2.18 Optus strongly recommends that the ACCC adopt this framework when analysing the likely impact on end-users of reductions in MTAS rates. To assist the ACCC in this process, we

⁸ http://smb.optus.com.au/opfiles/Shop/All/cis/Cis%20Documents/1400883_CIS_New_My_Prepaid_Monthly.pdf

⁹ http://smb.optus.com.au/opfiles/Shop/All/cis/Cis%20Documents/1400881_CIS_My_Prepaid_Daily.pdf

¹⁰ See for instance, Ofcom 2015, MCT Review; and Competition Appeals Tribunal, 2011, British Telecommunications PLC v Office of Communications (Mobile Call Termination); Available at: <http://www.catribunal.org.uk/237-7143/1180-3-3-11-British-Telecommunications-PLC.html>

outline the approach below as accepted by the UK regulator Ofcom, the UK Competition Commission¹¹ and the Competition Appeals Tribunal.¹²

- 2.19 MTAS rates impact the relative attractiveness of different customer groups. Generally, higher MTAS rates increase the customer lifetime value (CLV) of users who receive more calls than they make and reduce the CLV of those that make more calls than receive.¹³ The most important factor is the outbound-inbound call ratio for different groups of consumers.
- 2.20 It has been established in previous MTAS decisions that decreasing MTAS rates:
- (a) Increases the CLV of users who make more calls than receive;
 - (b) Decreases the CLV of users that receive more calls than they make;
 - (c) The effects of this would be larger for smaller MNOs than larger MNOs, who tend to have a higher proportion of off-net calls (both outgoing and incoming);
 - (d) Would put smaller MNOs at a disadvantage when competing for users that make more calls than they receive, and such customers tend to be post-paid and include the high-value users of data and voice.¹⁴
- 2.21 Optus agrees that generally any changes to retail prices as a result of lower MTAS rates would be seen through a price rise for pre-pay customers as a whole, while prices for high-usage post-pay customers would tend to fall.¹⁵
- 2.22 The clear implication of this is that pre-paid users (as a group) will become less profitable as a result of MTR cuts, while the profitability of post-paid users (as a group) will be unchanged or slightly enhanced. And MNOs would offer more favourable terms to users that have become more valuable and less favourable terms to users that have become less valuable.¹⁶
- 2.23 For example the UKCC concluded that:
- ... prices will rise for pre-pay customers as a whole (especially low-usage customers) and for low-usage post-pay customers, while prices for high-usage post-pay customers will tend to fall.*¹⁷
- 2.24 It is reasonable to anticipate the same broad effects in the Australian market. As a result, MNOs are likely to do one of two things:
- (a) Reduce acquisition expenditure (including handset subsidies) to reflect the lower CLV of new pre-pay users; and
 - (b) Increase prices to increase the CLV of new and existing pre-pay users. Any price rise is unlikely to be seen through basic pricing but rather through two-part tariff elements (such as bolt-ons or bonus credits). This can also be achieved by altering expiry time of unused credit.

¹¹ UK Competition Commission, 2012, Determination British Telecommunications plc v Office of Communications, February. Available at: http://www.catribunal.org.uk/files/1.1180-83_MCT_Determination_Excised_090212.pdf

¹² Competition Appeals Tribunal, 2011, British Telecommunications PLC v Office of Communications (Mobile Call Termination), Available at: <http://www.catribunal.org.uk/237-7143/1180-3-3-11-British-Telecommunications-PLC.html>

¹³ UKCC 2012, [2.76]

¹⁴ UKCC 2012, [2.362]

¹⁵ UKCC 2012, [2.634]

¹⁶ UKCC 2012, [2.626]

¹⁷ UKCC 2012, [2.634]

- 2.25 Ultimately, the question is how these price changes are likely to impact on mobile ownership and subscription. The UKCC commented that it considered that certain groups will be at risk of giving up mobile subscriptions and that those will generally be low users. Whereas high users could scale back their usage to compensate for price increase, low users would not be less able to do so; and as a result are more likely to become inactive or forego mobile subscriptions altogether.¹⁸
- 2.26 This is an empirical question for the Australian market. We have shown above that all Optus postpaid plans have unlimited voice and SMS calls. Given the call balance of high-use end-users, it would be expected that MTAS reductions flow through to lower call charges. But with the current price structure, retail prices are unlikely to be further reduced. There would in practice be little or no price benefit to post-paid end-users.
- 2.27 Prepaid end-users may be affected by MTAS reductions. As above, high-use prepaid end-users will not be affected as they already receive unlimited call volumes. Low-use prepaid end-users may face higher call charges or reduced inclusions as per the reasoning outlined above.
- 2.28 Finally, it must be noted that the main benefit often quoted of reducing MTAs rates is that it promotes competition and economic efficiency by lowering barriers to competition in the high-use/high-value segment of the market – in other words, allowing smaller MNOs to attract high-profit end-users.¹⁹ But as noted above these end-users already have access to unlimited voice and SMS plans. Reductions in the cost of off-net calling will have no impact on the retail voice prices experienced. Further, it is unclear how this assumption would apply to the Australian market.
- 2.29 In conclusion, the pricing of Australian mobile plans, together with how MTAS reductions impact different segments of mobile end-users, shows that there would be little, if any, change in end-user outcomes from adopting a 55% one-off reduction.
- 2.30 Optus strongly recommends that the ACCC conduct an analysis of the CLV of customer types before it concludes that the LTIE is promoted by lowering MTAS voice and SMS rates. There is no evidence before the ACCC that lowering MTAS rates benefits all end-users equally, or provides for a net benefit. Moreover, there is no evidence before the ACCC that lower MTAS rates benefits “vulnerable and price sensitive consumers” whom are more likely to purchase low value mobile plans.

Optus customer analysis

- 2.31 Optus undertook analysis in July 2014 for the MTAS Declaration Inquiry showing the SMS traffic balance of plans that have unlimited SMS inclusions. The same dataset can be used to show the different calling patterns of Optus’ prepaid and postpaid customers.
- 2.32 [CiC]
- 2.33 [CiC]
- 2.34 This data supports the analysis conducted in the UK, and utilised by Ofcom, the Competition Commission and the Competition Appeals Tribunal. Namely, the majority of end-users that received more calls than they make are prepaid end-users. And for both postpaid and prepaid end-users, the end-users that receive more than they make, make and receive substantially fewer call minutes than end-users that are net senders.

¹⁸ UKCC 2012, [2.736]

¹⁹ Ofcom, 2014, Mobile call termination market review 2015-18, p.102

- 2.35 Therefore, the beneficiaries of lower MTAS voice rates are high-usage end-users that are more likely going to be postpaid than prepaid.
- 2.36 Actual Optus data does not support the claim that lower MTAS rates benefits “vulnerable and price sensitive consumers” whom are more likely to purchase low value mobile plans. Users of low value mobile plans are likely to be net receivers of voice minutes, and as such, lower MTAS voice rates will lower their CLV to MNOs. And are therefore, more likely to face price increases to increase the CLV of new and existing prepaid users.

Impact of SMS MTAS on different customer groups

- 2.37 The mechanism through which MTAS reductions flow through to retail price plans is explained above. The same process applies to both voice and SMS termination rates and voice and SMS retail rates. In summary, reductions in the MTAS SMS rate will not result in reductions in the retail SMS rate, or inclusion of more SMS’ in bundles – as all Optus plans include unlimited SMS messages.
- 2.38 The ACCC commented that regulation of SMS termination rates could benefit plans that are “*less expensive and are likely to appeal to vulnerable and price sensitive consumers.*”²⁰ The MTAS Declaration Final Decision showed that across the whole industry, the vast number of limited SMS plans occurred for low-spend prepaid plans.²¹ The analysis above shows that the flow through of termination reductions to retail plans is unlikely to incur in the manner described by the ACCC. The retail beneficiaries of lower termination rates are high use and high value plans (where the outgoing volume is greater than incoming volume). Low value plans aimed at price sensitive consumers typically receive more incoming volumes than outgoing, and as such, are negatively impacted by reductions in termination rates. Should the ACCC wish to argue that low value plans will benefit from lower MTAS rates, it should replicate the analysis undertaken in the UK by Ofcom, the Competition Commission and accepted by the Competition Appeals Tribunal. The ACCC should demonstrate that low use end-users send more SMS messages than they receive.
- 2.39 Further, Optus notes that all Optus retail plans include unlimited SMS volumes. It is not possible for any retail plan to offer more SMS inclusions. It may be that not all MNOs have unlimited SMS for all plans, but should end-users value the benefit of unlimited SMS, end-users are able to move to Optus – we note that prepaid customers face no barriers to changing MNOs.
- 2.40 The relevant consideration for the timing of SMS MTAS rates is whether an immediate 99% reduction in the rate promotes the LTIE more than a glidepath reduction.

Optus customer analysis

- 2.41 Optus undertook analysis in July 2014 for the MTAS Declaration Inquiry showing the SMS traffic balance of plans that have unlimited SMS inclusions. The same dataset can be used to show the different calling patterns of Optus’ prepaid and postpaid customers.
- 2.42 [CiC]
- 2.43 [CiC]
- 2.44 This data supports the analysis conducted in the UK, and utilised by Ofcom, the Competition Commission and the Competition Appeals Tribunal. Namely, the majority of end-users that

²⁰ ACCC, 2014, MTAS Declaration Inquiry, Final Report, June, p.57

²¹ ACCC, 2014, MTAS Declaration Inquiry, Final Report, June, p.44.

received more texts than they sent are prepaid end-users. The end-users that receive more traffic than they sent have substantially lower overall traffic volumes. Therefore, the beneficiaries of lower MTAS SMS rates are high-usage end-users and are more likely going to be postpaid than prepaid.

- 2.45 Actual Optus data does not support the claim by that lower MTAS rates benefits “vulnerable and price sensitive consumers” whom are more likely to purchase low value mobile plans. Users of low value mobile plans are likely to be net receivers of text messages, and as such, lower MTAS SMS rates will lower their CLV to MNOs. And are therefore, more likely to face price increases to increase the CLV of new and existing prepaid users.

But there are real impacts on business

- 2.46 It has been shown above, with regards to the characteristics of the Australian mobile market and the manner through which MTAS reductions flow through to end-user outcomes, that there are likely to be little or no positive impact on retail prices – end-users who would experience declining retail rates already have unlimited voice and SMS plans. Moreover, an analysis of Optus’ actual consumer data shows that termination rate declines are detrimental to the CLV of end-users that use plans that are “less expensive and are likely to appeal to vulnerable and price sensitive consumers.”²²
- 2.47 But a mid-year 55% reduction in the voice MTAS rate and a 99% reduction in the SMS MTAS rate will have significant impact on MNOs. The large percentage decline in the rates are exacerbated by the fact the reductions are significantly larger than any reduction imposed in previous decisions – and this was not reasonably forecasted by MNOs. [CiC]
- 2.48 Optus suggests two changes to limit the detriment to business:
- (a) Align reductions to financial years; and
 - (b) Adopt a multi-year glidepath.

Alignment to financial years

- 2.49 The Draft FAD proposes to implement the new rates in January 2015. It is stated that a draft decision to have effect in January 2016, which is issued in May 2015, is reasonable because the ACCC “considers it is appropriate to provide a short period of transition for industry to adjust their commercial arrangements to reflect this change”.²³
- 2.50 However, while a short period of transition may be reasonable to change the relevant wholesale commercial agreements between the three MNOs, a change midway through the same financial year does not provide commercial entities with a reasonable opportunity to alter committed business plans. At a minimum, changes to MTAS rates should occur at the beginning of financial years.
- 2.51 The impact of the timing of the proposed change is magnified by the unannounced and unprecedented proposed decline. For example, the 2011 Draft FAD, issued in September proposed voice MTAS to drop from 9cpm to 6cpm in January 2012. But this 3cpm decline was consistent with the rate of decline in previous MTAS decisions, and came after a four and a half year period of 9cpm. In other words, the decline was predictable and anticipated by business.
- 2.52 [CiC]

²² ACCC, 2014, MTAS Declaration Inquiry, Final Report, June, p.57

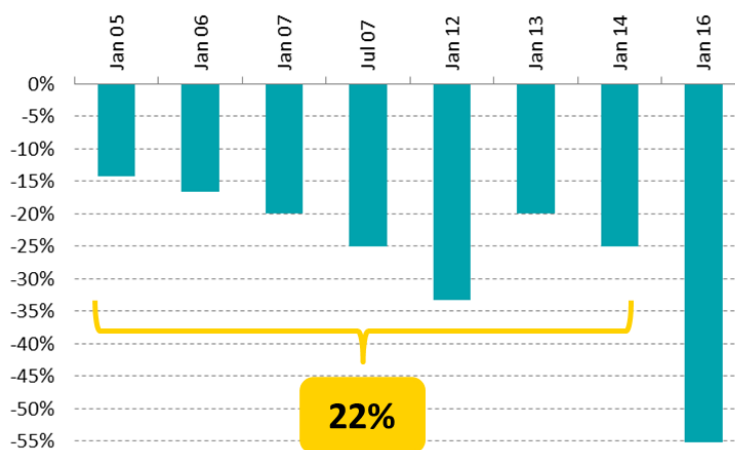
²³ ACCC, 2015, MTAS FAD Draft Decision, p.30

- 2.53 This represents a **regulatory shock in implementing reduced MTAS prices**, counter to claims that the ACCC is cognisant of unpredictability. Optus further notes the prominent role the principles of regulatory certainty and predictability play in the ACCC’s fixed line pricing decisions,²⁴ and statements that under s.152BCA(3), the ACCC believes considerations of regulatory certainty and consistency will be important when setting the terms and conditions of the FADs.²⁵
- 2.54 It is not immediately clear why certainty and consistency does not play a central role in setting mobile access prices.

Multi-year glidepath should be adopted

- 2.55 The 2004 MTAS pricing decision reduced the rate from 21cpm to 12cpm in three 3cpm steps over the period July 2007 to July 2011. The 2007 MTAS pricing decision reduced the rate from 12cpm to 9cpm, consistent with the previous glidepath reduction. The ACCC held MTAS rate at 9cpm until December 2011.
- 2.56 The 2011 MTAS FAD adopted a glidepath reduction of 3cpm to 6cpm in January 2012, and adopted a slowly reduction path of 1.2cpm drops in January 2013 and 2014.
- 2.57 The percentage reduction in the MTAS rate over time is shown in figure 1. The average percentage decline for each step-down has been 22% over the period 2004 to 2016. The proposed step-down in January 2016 represents a 55% decline in the rate – 2.5 times the average over the previous 12 years.
- 2.58 Such a decline is without precedent. It would also appear to be counter to the principles of regulatory certainty and predictability, which the ACCC accept promote efficient investment and competition in the markets for carriage services.²⁶ Providing regulatory certainty and consistency is an important factor in ACCC pricing decisions for declared services.²⁷

Figure 1 MTAS Glidepath Reductions



Source: ACCC

- 2.59 The Draft FAD proposed a one-off drop to the new ‘efficient’ price of 1.61cpm for voice and a drop to 0.03 c/SMS for SMS MTAS. This is unprecedented. No previous MTAS pricing decision has dropped immediately to the target rate. The proposed drop results in a dramatic

²⁴ ACCC, 2015, FAS FAD – Primary price terms draft decision, p.8

²⁵ ACCC, 2011, MTAS Draft FAD, A.5.9

²⁶ ACCC, 2015, FAS FAD – Primary price terms draft decision, p.137; ACCC, 2011, Fixed line services FAD final report, p.133.

²⁷ ACCC, 2011, MTAS Draft FAD, A.5.9

percentage decline of 55% for voice and 99% for SMS. This is almost double the previous largest percentage decline seen in the market.

2.60 The ACCC has previously commented on the benefits of adopting a glidepath. For instance, the 2011 FAD Draft Decision stated:

*The glide-path in the draft FAD is a measured approach when considered against industry developments regarding WIK model parameters and recent international efficient cost regulation of the MTAS. **The ACCC is also cognisant of avoiding regulatory shock in implementing reduced MTAS prices.***²⁸ [emphasis added]

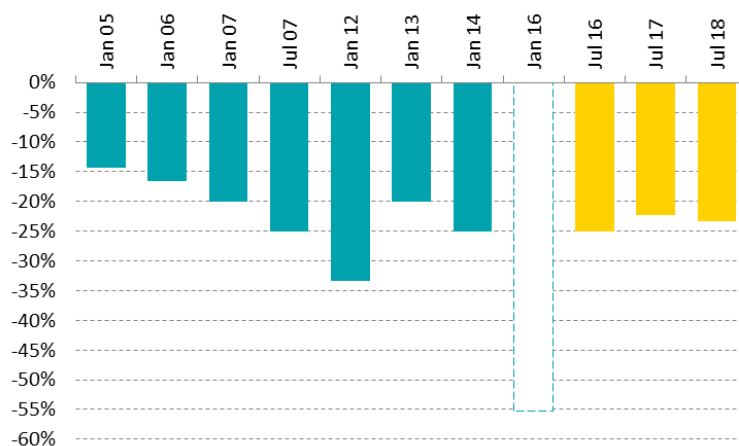
2.61 The 2011 FAD decision adopted an initial 3cpm reduction, consistent with previous reductions but then adopted a slower reduction for the following two step-downs – representing declines of 20% and 25% respectively. The ACCC states that the reductions in 2013 and 2014 represented a “conservative price path to the ACCC’s estimate of the efficient cost of provide the MTAS of 3.6cpm.”²⁹

2.62 It is not clear how a drastic departure from previous decisions is consistent with regulatory certainty and consistency. The ACCC should undertake further analysis to identify the additional net benefits that arise from a one-off drop compared to a glidepath. As noted above, there would appear to be limited end-user retail price benefits from adopted drastic one-off reductions. This is especially the case for SMS MTAS, where end-users are able to choose retail pricing plans with unlimited SMS volumes.

2.63 Optus suggests that a multi-year glidepath be adopted consistent with percentage declines observed in previous MTAS decisions (figure 2). Optus proposes three declines:

- (a) 25% decline in July 2016;
- (b) 22% decline in July 2017; and
- (c) 23% decline in July 2018.

Figure 2 Proposed MTAS Glidepath Reductions



Source: ACCC, Optus

2.64 This would result in MTAS rates of 2.7cpm in July 2016; 2.1cpm in July 2017 and 1.61cpm in July 2018 – assuming no change from the Draft FAD, which Optus does not agree with.

²⁸ ACCC, 2011, MTAS Draft FAD, p.6

²⁹ ACCC, 2011, MTAS FAD Explanatory Statement, p.14.

- 2.65 In relation to SMS MTAS, three drops of roughly equal magnitude would be consistent with the ACCC's long held position on the use of glidepaths; and its stated position of adopting MTAS rates that limit regulatory shock and promote predictability and certainty. Optus proposes three declines to:
- (a) 5 cents/SMS in July 2016;
 - (b) 2.5 cents/SMS in July 2017; and
 - (c) 0.03 cents/SMS in July 2018.
- 2.66 The above rates assume no change from the Draft FAD, which Optus does not agree with.
- 2.67 The proposed glidepath addresses concerns over mid financial year changes and drastic declines at a rate inconsistent with previous regulatory decisions.

Inconsistent with approach adopted in fixed line FAD

- 2.68 The ACCC states that that considerations of regulatory certainty and consistency will be important when setting the terms and conditions of the FADs.³⁰ Optus notes that such certainty and consistency should apply not only to individual FADs, but across FADs such as fixed line and MTAS. This is particularly important where the fixed line FAD sets prices for fixed line termination, which is the reciprocal service for MTAS. Both FADs impact on the same downstream market, and hence should take a consistent approach.
- 2.69 However, the fixed line FAD and the MTAS FAD take diametrically different positions on setting future rates and the need for price stability and regulatory certainty.
- 2.70 The fixed line FAD is proposing to set an average price for four years for the purpose of promoting price stability. This results in significantly above-cost access prices for the first three years, and below cost prices for the outer years as demand falls. In effect, the desire to maintain price stability limits the ability of access seekers to benefit from lower prices. The ACCC observe that:
- This price stability is achieved in large part by adopting a four year regulatory period. The ACCC considers that a regulatory period of four years, and the relative price stability that results, will promote the efficient use of, and investment in, the infrastructure used to provide the declared fixed line services.³¹*
- 2.71 No such concerns with price stability appear in the MTAS FAD. Optus notes that the term 'price stability' does not appear in the MTAS FAD Draft Decision. Indeed, it is hard to reconcile concerns about 'price stability' and a 99% one-off decline in SMS MTAS; and a 55% on-off decline in voice MTAS.

³⁰ ACCC, 2011, MTAS Draft FAD, A.5.9

³¹ ACCC, 2015, FSR FAD – Primary price terms draft decision, p.158

Section 3. Benchmarking MTAS

- 3.1 In this section, Optus discusses the proposed approach to setting the price terms for the mobile terminating access service (MTAS). In particular,
- (a) The ACCC maintains that TSLRIC+ remains the most appropriate pricing framework for the MTAS during the next FAD period. This ensures that MNOs are adequately compensated for the provision of the MTAS.
 - (b) The ACCC recognises the most direct way to implement TSLRIC+ would be to develop a cost model, however given the expected delays associated with the process: *“the benefits of obtaining a more accurate estimate using such cost model are outweighed by the detriment that will result from the delay in setting new MTAS prices.”*³²
 - (c) The ACCC therefore considered an international benchmarking study capable of producing an estimate of mobile voice termination in Australia. A study has been conducted by WIK-Consult and used in setting the price terms for the draft FAD.
- 3.2 Optus agrees with this broad approach. However, we have concerns over its implementation. Specifically, the adjustments applied by WIK-Consult to the benchmark set appear arbitrary, with limited justification. Further, we note that many ‘Australian’ values used by WIK-Consult appear to be incorrect.
- 3.3 Optus does not believe that the WIK-Consult report contains sufficient evidence on which to support its conclusion that the efficient cost of MTAS is 1.61cpm. There is no evidence on which to support the approach adopted by WIK-Consult, or the actual elasticity values used. In summary, the errors in the WIK-Consult report are numerous and sufficiently material that the report should be set aside and the benchmarking process should be re-run.
- 3.4 Optus outlines below two types of errors present in the benchmarking approach:
- (a) Errors in Australia-specific values; and
 - (b) Failure to make adjustments directly in cost models.

Price terms for mobile voice termination

- 3.5 The draft FAD sets out MTAS rates at 1.61cpm. This rate is based on the central value within WIK-Consult’s estimated cost range of 1.37cpm to 1.85cpm.³³
- 3.6 WIK-Consult bases its view on an adjusted benchmark of comparable LRIC+ cost models. Interestingly, WIK-Consult’s benchmarking approach shows a varied range of estimates for both the adjusted and unadjusted estimates across each of the benchmark countries. The 1.61cpm result is observed to be the average cost estimate for the adjusted estimates with extremes removed (i.e. Portugal and Romania). However, if this same approach was applied to the unadjusted estimates, the central average would be 3.11cpm (with the extremes removed for Portugal and Denmark).
- 3.7 Optus notes that a fundamental issue when assessing the reasonableness of the 1.61cpm estimate is the manner in which the adjustments are made. Optus agrees that 3.11cpm is a

³² ACCC, 2015, Mobile Terminating Access Service – Final access determination, Draft Decision, May, 3.1.2

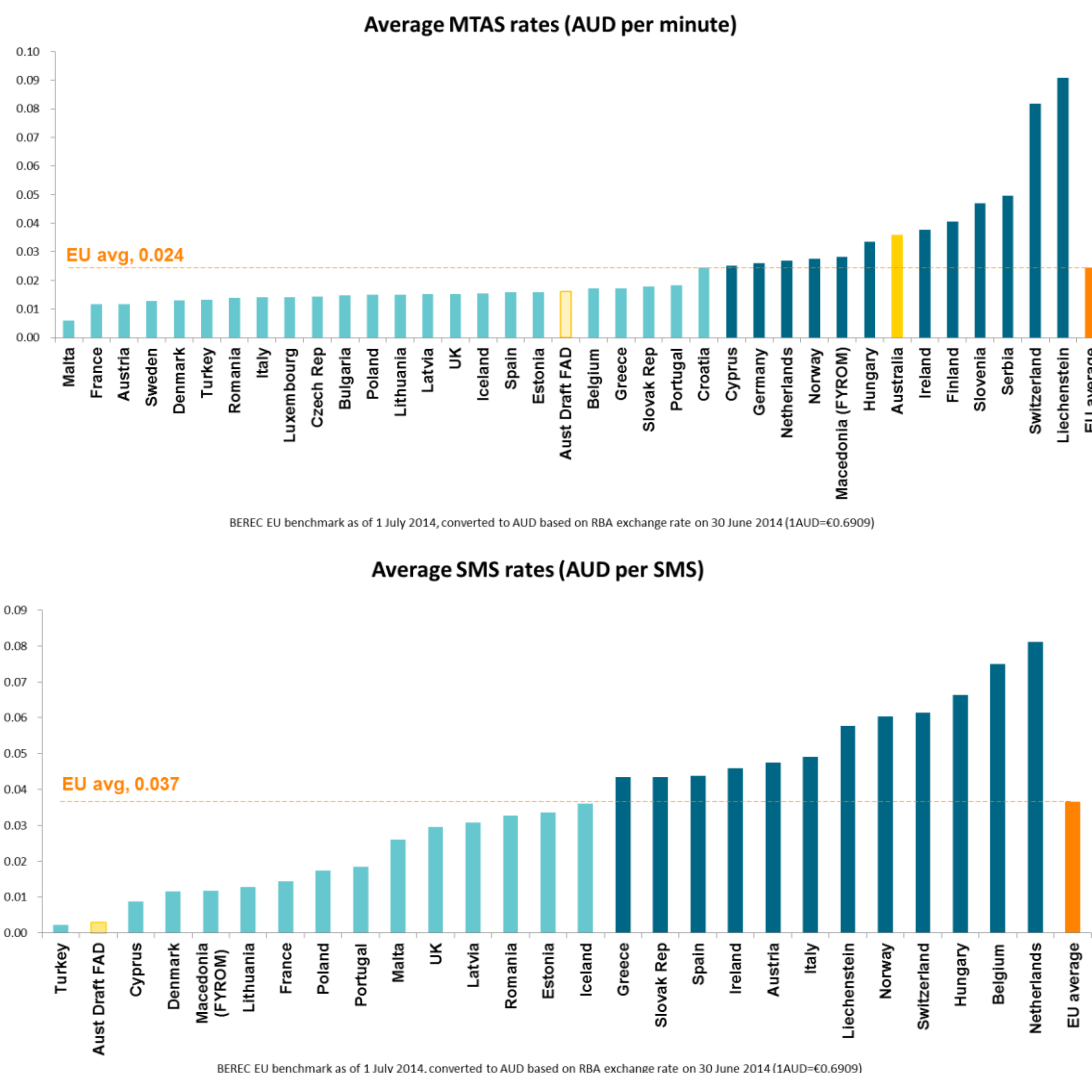
³³ WIK-Consult, 2015, Benchmarks for the Cost of the Mobile Termination Access Service in Australia, Final Report, 15 April, p.51

reasonable benchmark of comparable countries. However, the adjustments proposed by WIK-Consult are troubling due to (a) including incorrect variables; and (b) making arbitrary adjustments outside the cost modelling framework.

- 3.8 A simple test to assess whether the 1.61cpm is reasonable is to compare it against MTAS rates in other jurisdictions. When compared with international benchmarking of MTAS rates in the EU, the draft FAD is well below the average EU rate as at July 2014.
- 3.9 On the face of it, this would not appear to be problematic. But it is problematic given that the EU markets below the Australian benchmark utilise the EU LRIC cost methodology – a methodology specifically rejected by the ACCC as it excludes fixed and common costs and does not promote the LTIE. The ACCC observed that:
- ... pure LRIC creates a risk of cost under-recovery for MNOs. This undermines the legitimate business interests of the MNOs and is likely to discourage the efficient investment in mobile infrastructure.³⁴*
- 3.10 Optus recommends that the ACCC conduct a simple common-sense test on the proposed adjusted rate of 1.61cpm. If the benchmarked LRIC+ rate is equal to the European pure LRIC rates then it should be assumed to be problematic. There are two possible reasons for this. First Australia is one of the lowest cost markets in the world to deploy mobile network infrastructure; or two, the arbitrary adjustments proposed by WIK-Consult are incorrect.
- 3.11 As noted above, it would appear that the error is not in the use of a benchmark method or the selection of comparable cost models; but rather lies in the unjustified and arbitrary adjustments proposed by WIK-Consult.
- 3.12 It is not reasonable for the ACCC to reject the LRIC method yet adopt a price estimate of MTAS which is consistent with the rejected method.

³⁴ ACCC, 2015, MTAS FAD Draft decision, p.16

Figure 3 EU MTAS Benchmarks as at July 2014



Source: BEREC

3.13 Optus recommends that the WIK-Consult benchmarking be viewed in context of the selection criteria instructed by the ACCC, and the adjustments that have been applied to take into account Australian conditions. It cannot be reasonable that adjustments to a LRIC+ cost estimate results in LRIC outcomes

3.14 Optus' views on these adjustments are set out below.

Errors in the benchmarking study

3.15 The Terms of Reference for the benchmarking study set out the selection criteria and adjustment process. Notably,

The benchmark set should include TSLRIC+ rates calculated or published by international regulators even if they have adopted a pure LRIC methodology to determine the regulated termination rates... [And] ... should benchmark against the costs of providing termination services in international jurisdiction, rather than the regulated termination rates ultimately adopted in regulatory decisions.³⁵

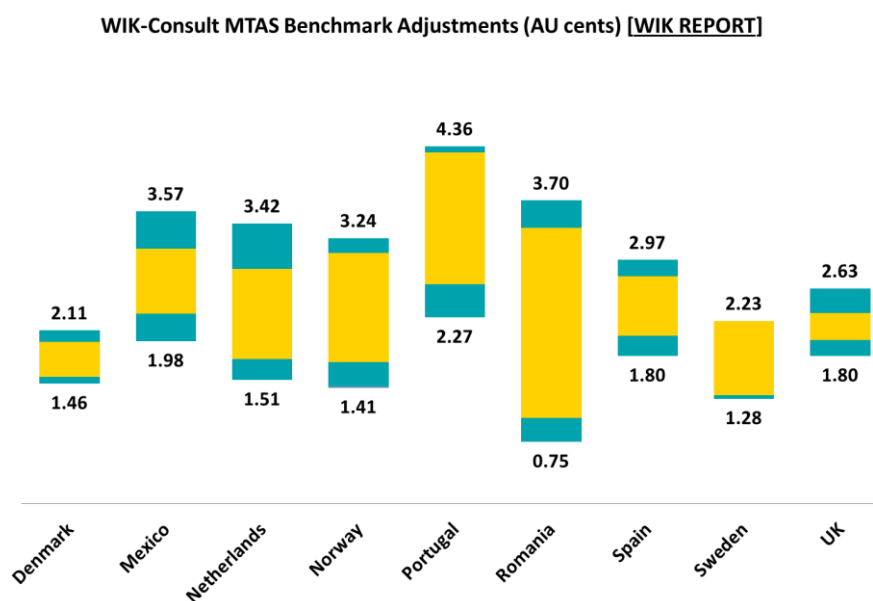
³⁵ WIK, 2015, Benchmarks for the Cost of the Mobile Termination Access Service in Australia, Final Report, 15 April, p.7

- 3.16 Based on this selection criteria, WIK-Consult selected nine benchmark countries which have published cost models able to be utilised for the purposes of the benchmarking study. In summary, it has taken into account the following selection criteria:
- (a) Jurisdictions of OECD countries where the ‘calling party pays’ principle is applied and which include *“the countries the most likely to be similar to Australia in terms of economic development, types of networks and level and structure of demand”*³⁶;
 - (b) For EU (and other) countries outside the OECD, jurisdictions were considered where it was known that regulators utilised costs models and it was publicly available. Caribbean countries were also excluded *“on the basis that the networks of these small island countries are too dissimilar to those in Australia”*³⁷;
 - (c) The resulting selection was then based on the requirement that the models are able to calculate costs using a TSLRIC or comparable standard; is of recent vintage (i.e. less than three year since date of publication); and all contain estimates for the year 2015. All remaining models were excluded where it did not meet the aforementioned criteria.
- 3.17 The Australia-specific adjustments, where applied, have been based on the difference between the estimate for an ‘efficient Australian operator’ and that applied in each respective cost model. Optus is concerned that this approach lacks robustness, and fails to address any inherent interactions within the individual cost models for the affected model input assumption when compared to the Australian input estimate.
- 3.18 This is illustrated in figure 4 below showing each of the individual adjustment impacts for each of the benchmark countries. Of particular note is the impact of the blended adjustment for 2G and 3G costs (shown in yellow) which contributes the most significant change on the benchmark values. Optus’ analysis shows that WIK-Consult’s assumed elasticities differ significantly from those in the actual models. This undermines the proposed approach, and as such, little confidence should be placed in the cost estimates in the report.

³⁶ WIK, 2015, Benchmarks for the Cost of the Mobile Termination Access Service in Australia, Final Report, 15 April, p.19

³⁷ WIK, 2015, Benchmarks for the Cost of the Mobile Termination Access Service in Australia, Final Report, 15 April, p.19

Figure 4 Impact of the WIK adjustments on benchmark values



Source: WIK-Consult

- 3.19 The remainder of this section discusses Optus’ concerns on the robustness of WIK-Consult’s model adjustment approach. In particular, Optus questions the arbitrary adjustment for Australia-specific adjustments outside the use of the benchmark models. There is also a lack of sensitivity analysis provided to support the use of the Australia-specific assumptions applied, and which can be shown to significantly impact the adjustment being applied to the benchmark values.
- 3.20 As noted above, it cannot be reasonable for a benchmark of LRIC+ cost rates to recommend a MTAS rate consistent with LRIC modelling. It would result in a significant risk of *undermining the legitimate business interests of the MNOs and is likely to discourage the efficient investment in mobile infrastructure.*

2G-3G traffic adjustment

- 3.21 The majority of the adjustment proposed by WIK-Consult is explained by the assumed differences in the mix of 2G and 3G traffic. WIK-Consult adjusts the calculated MTAS rates by assuming an elasticity for 2G and 3G costs, and applying that to the percentage change in the distribution of traffic.
- 3.22 Optus agrees that WIK-Consult’s approach may have merit in principle, that the per minute cost of traffic increases as volumes decrease. This is because the relevant cost method is LRIC+, includes common and fixed costs – as traffic falls the cost per minute increases due to fixed and common costs.
- 3.23 WIK-Consult’s assumption that there is an “elasticity” of -0.5 for 2G traffic and -0.3 for 3G traffic, however, appears to be made without any supporting evidence. Optus notes that these assumptions have little connection to the way traffic volume changes impact MTAS cost estimates in LRIC+ models. The actual calculated elasticities vary significantly – in some markets the signs are different than assumed by WIK-Consult.

- 3.24 For example, the shared of 2G traffic can be directly altered within the Netherlands cost model.³⁸ Altering the share to reflect the Australian traffic distribution (6% 2G; 94% 3G) results in the cost of 2G MTAS increasing from 2.52 €cpm to 6.65 €cpm; and the cost of 3G MTAS falling from 1.10 €cpm to 0.88 €cpm.³⁹ The WIK-Consult approach would result in the 2G MTAS rates increasing from 2.52 €cpm to 3.64 €cpm and 3G MTAS falling from 1.10 €cpm to 0.77 €cpm.⁴⁰
- 3.25 There is clearly a significant difference between WIK-Consult’s assumed approach and the actual Dutch model adjustments, which imply an elasticity of -1.85 for 2G voice and -0.20 for 3G voice.
- 3.26 Applying these elasticities to the analysis in Tables 4-5 and 4-6 of the WIK-Consult report results in the 2G benchmark price to increase by 5.67 AUcpm to 9.12 AUcpm; and the 3G price to decrease by 0.41 AUcpm to 1.78 AUcpm. The blended rate⁴¹ is then 2.22 AUcpm – 26% higher than the prediction in Table 4-7 of 1.765 AUcpm.
- 3.27 Optus reiterates that there is no evidence to support WIK-Consult’s elasticity based adjustment. Actual evidence from cost models demonstrate WIK-Consult has significantly underestimated the impact of fixed and common costs on the increase of 2G costs as traffic falls, and has overestimated the impact on the decrease of 3G costs as traffic increases.

Estimating elasticities through actual cost model

- 3.28 As indicated above, there may be significant variance between the unjustified assumed elasticities of -0.5 for 2G traffic and -0.3 for 3G traffic; and the actual elasticities calculated in the benchmark models.
- 3.29 Figure 5 below compares the elasticities assumed in the WIK-Report and the elasticities calculated in selected benchmarked cost models.⁴² This shows there is no relationship between WIK-Consult’s ‘assumed’ values and the actual values. The actual average of the elasticity values results in the 2G elasticity being 156% greater than ‘assumed’; and the 3G elasticity 13% than ‘assumed’.
- 3.30 It is not clear to Optus why the below analysis was not conducted by WIK-Consult prior to the finalisation of its report.

Figure 5 Traffic elasticity estimates

Country	2G		3G	
	WIK Table 4-5	Cost Model Actual	WIK Table 4-6	Cost Model Actual
Denmark	-0.5	-1.38	-0.3	-0.30
Netherlands	-0.5	-1.85	-0.3	-0.20
Norway	-0.5	-1.32	-0.3	0.10

³⁸ “loading.voice.migration”

³⁹ Nominal 2015 values.

⁴⁰ The adjustment uses the € figure for ease of comparison. The adjustments used the percentage fall and elasticity in Tables 4-5 and 4-6. This results in the 2G cost would increasing by 0.445; and 3G falling by 0.297.

⁴¹ Assuming 6% 2G and 94% 3G.

⁴² Given timeframes, it was not feasible to do the analysis for all benchmark models.

Country	2G		3G	
	WIK Table 4-5	Cost Model Actual	WIK Table 4-6	Cost Model Actual
Portugal	-0.5	-2.30	-0.3	-0.02
Romania	-0.5	-0.73	-0.3	0.11
Sweden	-0.5	-0.07	-0.3	0.09
Average	-0.5	-1.28	-0.3	-0.04

Source: Optus analysis using WIK-Consult's methodology

- 3.31 The failure to adopt the actual elasticities seen in the benchmark models means that the outputs of the report should not be used by the ACCC when setting Australian MTAS rates. It is not reasonable to rely upon a report which contains materially incorrect outputs.

Other adjustments

- 3.32 The 2G-3G traffic adjustment factor has the largest impact on the benchmark. The other adjustments also contain significant errors and omissions. This section looks at the following adjustments:
- (a) Currency conversion;
 - (b) WACC adjustment;
 - (c) Population density and network usage;
 - (d) Geographic terrain; and
 - (e) Spectrum fees.

Currency conversion

- 3.33 The unadjusted benchmark outputs from the overseas cost models have been selected based on the equivalent 2015 nominal MTAS estimate in local currencies. This is then converted to Australian dollar based on an average of the 10 year market exchange rate and the exchange rate adjusted for purchasing power parity. The currency conversion approach applied is set out in WIK Table 4-2 and presumed to be the same conversion factor applied in the subsequent spectrum cost adjustments.
- 3.34 Optus however questions the upfront application of this adjustment. Given that WIK-Consult's adjustment approach is sequential in nature. It is unclear why the adjustment would occur upfront and not towards the latter end of the selected adjustments (i.e. before the adjustment for spectrum fees – step 2).

WACC

- 3.35 The WACC adjustment has been taken into account *"to ensure that the difference in the cost of financing capital expenditure in Australia is taken into account."*⁴³ However the nominal WACC that has been provided is that currently applied in the fixed line services draft FAD, which reflects a fixed line operator and not a mobile network operator that is the subject to this regulatory decision. It can be observed in most regulatory decisions, including within the benchmark set, that the WACC that applies for a mobile operator is generally higher than that for a fixed operator.

⁴³ ACCC, 2015, Mobile Terminating Access Service – Final access determination, Draft Decision, May, 3.2.2

- 3.36 A simple test of this can be illustrated using the Swedish benchmark model. The default model results in a benchmark value of 12.226 cents in local currency (in nominal 2015 terms) based on a real WACC input of 5.7% (or derived nominal WACC of 7.92%). Adjusting the real WACC to equal the AU nominal WACC of 5.43% (real WACC equals 3.26% assuming no change to the Sweden inflation rate assumption for 2015) the benchmark value becomes 11.788 cents (or -3.6% lower than the default benchmark) – this represents a much smaller adjustment to the Swedish benchmark due to WACC when compared with the -5.7% percentage change adjustment applied by WIK-Consult. Again, this demonstrates there is little evidence to support the ‘assumed’ elasticity values used by WIK-Consult.
- 3.37 It has also been long accepted that WACC in fixed and mobile networks do differ. As noted by the BEREC (formerly known as the ERG):

Generally speaking it can be observed that NRAs use a different WACC value for regulated companies in the fixed and mobile markets and that the WACC value for regulated companies in the latter is usually higher than the one used for the former.⁴⁴

- 3.38 This can similarly be observed in recent regulatory decisions made in the benchmark countries. For example, in Mexico the IFT has calculated the following WACCs (in 2013 real terms): fixed WACC of 7.00% and mobile WACC of 9.74%.⁴⁵ For more detail see Section 4.
- 3.39 The following table sets out the resulting percentage change in benchmark resulting from different AU nominal WACC assumptions. For simplicity, WIK-Consult’s methodology including elasticity assumption has been adopted for comparative purposes.

Figure 6 Comparison of benchmark adjustments due to variance in nominal AU WACC assumption

Country	AU nominal WACC			
	WACC in Cost Model (WIK Table 4-8)	5.43%	7%	9%
Denmark	6.29%	-2.7%	2.3%	8.6%
Mexico	12.95%	-11.6%	-9.2%	-6.1%
Netherlands	6.60%	-3.5%	1.2%	7.3%
Norway	11.28%	-10.4%	-7.6%	-4.0%
Portugal	11.05%	-10.2%	-7.3%	-3.7%
Romania	11.10%	-10.2%	-7.4%	-3.8%
Spain	10.87%	-10.0%	-7.1%	-3.4%
Sweden	7.61%	-5.7%	-1.6%	3.7%
UK	9.04%	-8.0%	-4.5%	-0.1%
	Average	-8.0%	-4.6%	-0.2%

Source: Optus analysis using WIK-Consult’s methodology

- 3.40 Optus therefore considers the ACCC should reconsider the use of its fixed line WACC in setting the efficient cost for mobile voice termination in Australia. It is not reasonable – given the large impact WACC has on values – for the ACCC not to calculate a mobile industry WACC.

⁴⁴ ERG, 2008, Regulatory Accounting in Practice 2008, ERG Report, September, p.26 [See: ERG (08) 47 final RA in Practice 081016]

⁴⁵ WACC provided in 2013 real terms. Analysys Mason, 2015, Cálculo de la WACC, Informe para el Instituto Federal de Telecomunicaciones (IFT), p.2

Population density and network usage

- 3.41 Both population density and network usage have been considered by WIK-Consult as factors which affect the cost of mobile voice termination in Australia. While there is a general presumption that lower population density is associated with higher average cost per unit of traffic, it was concluded that given the ‘extremely high network usage per site’ in Australia, relative to the other benchmark countries, the ACCC therefore considered it was appropriate to only adjust for network usage (per mobile cell site) rather than population density as a significant driver on the cost of mobile voice termination under a TSLRIC+ framework.
- 3.42 Optus finds that these conclusions are based on errors in the WIK-Consult report. Optus recommends the ACCC reconsider their view based on the corrected values.
- 3.43 The following tables set out a comparison of the population density and network usage set out in the benchmark models. In general, this alone is unable to provide any meaningful information regarding the distribution of population and/or network coverage. Optus also finds significant variation between the users/site in WIK-Consult’s analysis for Australia and that used in the latest regulatory mobile model produced by Analysys Mason for the ACMA. Using actual market evidence, the user/site for the efficient operator is **[CiC]** which is more in line with the Scandinavian markets.

Figure 7 Population density and Network usage (GB) per mobile cell site – 2015

Country	Total Pop - 2015	Land area (sq.km)	Derived Pop Density	Derived users/site ⁴⁶	Users/site (WIK Table 2-1)	Delta
Denmark	5,658,057	43,098	131.28	635	636	-0.2%
Mexico	118,854,225	2,033,175	59.97	2,681	2,663	-0.1%
Netherlands	16,830,931	34,978	481.19	1,444	1,444	-
Norway	5,250,772	471,409	11.14	427	430	-0.8%
Portugal	10,751,700	92,024	116.84	1,392	1,392	-
Romania	21,456,933	238,390	709.86	1,223	729	+67.7%
Spain	-	504,549	-	1,461	1,013	+44.2%
Sweden	-	410,278	-	468	434	+7.9%
UK	64,328,008	237,941	271.38	915	877	+4.3%
Australia	23,906,349	7,687,809	3.11	[CiC]	1,344	[CiC]

Country	Total sites - 2015	Derived 2G share in model ⁴⁷	Derived usage (GB/site) ⁴⁸	Network usage (WIK Table 2-1)	Delta	Derived usage if 4G removed (GB/site) ⁴⁹
Denmark	2,877	32%	3,456	3,596	-3.9%	n/a
Mexico	6,659	38%	4,720	5,104	-7.5%	n/a
Netherlands	4,718	53%	1,617	1,838	-12.0%	n/a

⁴⁶ Derived values are calculated based on the total mobile voice and data subscribers for the generic operator divided by the number of physical site locations observed in the model.

⁴⁷ Derived values indicate 2G share as proportion of 2G/3G volumes for voice traffic only. In some benchmark models, 4G voice traffic is also taken into account, where this is the case the 2G share inclusive of 4G traffic is denoted in brackets.

⁴⁸ Derived values are calculated based on the sum of total data volumes divided by the number of physical site located observed in the benchmark models. In some benchmark models 4G traffic is also taken into account, where this is the case the 4G share of the total data traffic is denoted in brackets.

⁴⁹ Calculated based on total data traffic attributable to 2G and 3G devices and revised number of total physical sites (i.e. excludes all 4G-only sites) observed in the models.

Country	Total sites - 2015	Derived 2G share in model ⁴⁷	Derived usage (GB/site) ⁴⁸	Network usage (WIK Table 2-1)	Delta	Derived usage if 4G removed (GB/site) ⁴⁹
Norway	4,924	40% (39%)	3,301 (34%)	3,429	-3.7%	2,183
Portugal	4,992	61%	3,593	3,759	-4.4%	n/a
Romania	4,941	69%	1,696	1,323	+28.2%	n/a
Spain	12,949	42%	5,770	6,016	-4.1%	n/a
Sweden	8,207	45%	8,682 (40%)	8,864	-2.1%	5,282
UK	21,193	29%	6,540	6,440	+1.5%	n/a
Australia ⁵⁰	[CiC]	[CiC]	[CiC]	15,569	[CiC]	[CiC]

Source: Benchmark Models; WIK-Consult

- 3.44 The WIK-Consult report states that the network usage per site in Australia (benchmark operator) is 15,569, almost three times the average in the benchmark models. Optus suggests that this significant variation should have resulted in WIK-Consult conducting further enquiries as to the reasons for such variation. Optus has conducted further investigation and the large variation is due to the inclusion of 4G data traffic, which the other models do not include. This is a fundamental error in the WIK-Consult report.
- 3.45 Using the data available in the Analysys Mason ACMA model, 4G data traffic makes up [CiC] of the derived usage/site. Only two other models include 4G traffic – Norway and Sweden. In order to make a like-for-like analysis, 4G data traffic should be removed. This results in the Australian usage figure reducing to [CiC] per site, which is consistent with that observed in the other non-4G models.
- 3.46 Optus finds that there is little evidence to support the ACCC’s conclusion that Australia has ‘extremely high network usage per site’ relative to the other benchmark countries.
- 3.47 Moreover, the calculation of the efficient operator usage per site fails to take into account differences across markets of the market share of the efficient operator. A summary of the generic operator traits in each of the benchmark models is also clearly varied but not adequately addressed by WIK-Consult. For example, the market share assumptions as applied in the various models also vary in their application (i.e. differential market share by technology or voice/data splits). This needs to be corrected before conclusions can be made about relative usage.
- 3.48 The following table sets out the resulting percentage change in benchmark resulting from different nominal AU network usage assumptions. For simplicity, WIK-Consult’s methodology including elasticity assumption has been adopted for comparative purposes.

Figure 8 Comparison of adjustments for variance in AU network usage assumption

Country	AU network usage		15,569	[CiC]
	WACC in Cost Model (WIK Table 4-8)	% change in benchmark		
Denmark	6.29%	-6.7%		-0.8%
Mexico	12.95%	-4.1%		0.1%
Netherlands	6.60%	-14.9%		-3.4%
Norway	11.28%	-7.1%		-0.9%

⁵⁰ Data derived for Australia has been based on the Analysys Mason mobile network model being developed for the ACMA. The output is based on the average number of sites and network usage in the market (equivalent to the hypothetical efficient operator).

AU network usage		15,569	[CiC]
Country	WACC in Cost Model (WIK Table 4-8)	% change in benchmark	% change in benchmark
Portugal	11.05%	-6.3%	-0.6%
Romania	11.10%	-21.5%	-5.5%
Spain	10.87%	-3.2%	0.4%
Sweden	7.61%	-1.5%	0.9%
UK	9.04%	-2.8%	0.5%
Average		-7.6%	-1.0%

Source: Optus analysis using WIK-Consult's methodology

- 3.49 Optus therefore notes that applying a consistent treatment regarding 4G traffic would result in quite a different adjustment outcome. Further information on the underlying assumption being applied to the Australian specific metric should be provided.

Geographic terrain

- 3.50 The adjustment for geographic terrain has been applied as a proxy to capture “the effect of mountainous and hilly regions in a country which obstructs the propagation of radio waves.”⁵¹ This adjustment factor is without any basis in engineering or geographical facts.
- 3.51 Put simply, it appears that WIK-Consult's adjustment simply applies a standard uplift (if geography considered more mountainous than Australia) or equivalent decrease (if geography less mountainous). Notably, the justification used by WIK-Consult for determining the terrain adjustment is not robust. As a starting point, WIK-Consult has acknowledged:

*There do not appear to exist statistics that measure the degree of mountainousness [sic] of a country. One would have to rely on verbal descriptions of the geographical features of a country or own visual inspection of maps showing the topographical profiles of the countries... [Therefore] Lacking better sources, we relied on visual inspection of the countries' maps showing their topographical profiles. On the basis of their comparison, we were able to operationalise the terrain features of the benchmark countries by classifying them either as more or as less mountainous than Australia.*⁵²

- 3.52 The following table sets out a comparison of the geotypes and number of sites each benchmark country includes in their respective mobile cost models. In some cases, the geotypes in the cost models disaggregate further, however for purposes of network design/deployment they usually aggregate back into the 3 or 4 geotypes set out below.

Figure 9 Geographic terrain in benchmark countries

Country	Geotypes in Mobile Cost Models	Geographic terrain in Mobile Cost Model (WIK Table 4-11)
Denmark	4 – Dense urban; Urban; Suburban; and Rural	3%
Mexico	3 – Urbano; Suburbano; and Rural	0%
Netherlands	3 – Urban; Suburban; and Rural	3%
Norway	14 – Regions/Fylke	-3%
Portugal	4 – Dense urban; Urban; Suburban; and Rural	0%
Romania	4 – Dense urban; Urban; Suburban; and Rural	0%

⁵¹ ACCC, 2015, Mobile Terminating Access Service – Final access determination, Draft Decision, May, 3.2.2

⁵² WIK, 2015, Benchmarks for the Cost of the Mobile Termination Access Service in Australia, Final Report, 15 April, pp.36-37

Country	Geotypes in Mobile Cost Models	Geographic terrain in Mobile Cost Model (WIK Table 4-11)
Spain	3 – Urban; Suburban; and Rural	0%
Sweden	3 – Urbana; Förorts; and Landsbygden	3%
UK	3 – Urban; Suburban; and Rural	0%

Source: Benchmark Models; WIK-Consult

- 3.53 Optus notes that this terrain classification approach clearly neglects use of the CIA World Factbook terrain descriptions as set out in WIK Table 4-10. It also does not take into account the geotype information set out in the models. For example, WIK has identified Denmark, Netherlands and Sweden to be more hilly/mountainous than Australia, while only Norway is considered less hilly/mountainous than Australia.
- 3.54 There is no reasonable evidence or basis on which to propose the geographic terrain adjustment suggested in the WIK-Consult report. Should the ACCC wish to make an adjustment for differing geotypes across the cost models, they should be made directly into the models.

Spectrum fees

- 3.55 The benchmark report applies two spectrum fee adjustments to account for the differences in the cost of spectrum that MNOs have to incur to provide mobile services in Australia. The first adjustment involved setting the cost components for spectrum to zero in each of the benchmark models. The second adjustment was to apply an Australia-specific mark-up to account for the spectrum fees incurred for the provision of mobile services.
- 3.56 First, it is not clear why adjusting for different spectrum costs should be undertaken, when no other cost adjustment is performed. Clearly the amount of spectrum utilised across the markets influences the cost of mobile networks, but the cost to acquire spectrum is just one cost element of a mobile network. There is no principled reason why the capital costs incurred to acquire spectrum should be treated differently than those incurred to build base stations or provide backhaul. Indeed, variations in the cost to deploy base stations are likely to have a more significant impact than the cost of spectrum.
- 3.57 Optus recommends that the ACCC either make adjustments for all major capital cost differences, or it makes no adjustments. There is no a priori reason why spectrum costs should be singled out ahead of other mobile capital costs.
- 3.58 In saying that, however, we provide comments below on the accuracy of the spectrum adjustments proposed.

Spectrum adjustment 1: removal of spectrum costs in benchmark models

- 3.59 Figure 10 compares the impact of this first adjustment as applied by WIK-Consult. It highlights that the removal of spectrum costs effectively reduces the respective benchmark values in all cases.

Figure 10 Spectrum cost adjustment in benchmark countries

Country	WIK Table 4-2	WIK Table 4-3	WIK Table 4-4	WIK Table 4-4
	Unadjusted Benchmarks (AU cents)	Benchmarks with Spectrum Fees eliminated (AU cents)	Benchmarks with Spectrum Fees eliminated for 2G (AU cents)	Benchmarks with Spectrum Fees eliminated for 3G (AU cents)
Denmark	2.113	1.973	2.825	1.573
Mexico	3.569	3.112	4.150	2.474
Netherlands	3.420	2.865	3.448	2.216
Norway	3.241	3.058	5.308	1.619
Portugal	4.362	4.289	4.353	4.190
Romania	3.699	3.364	4.135	1.728
Spain	2.973	2.777	3.420	2.303
Sweden	2.230	2.229	3.223	1.412
UK	2.627	2.328	2.405	2.278
Average	3.137	2.888	3.696	2.199

Source: Benchmark Models; WIK-Consult

3.60 Optus observes that there appears to be an inconsistent approach in the removal of spectrum fees from the benchmark models. For example, in some cases, both one-off licence fees and annual spectrum management fees are removed, while in other cases only one or the other spectrum fee category is removed. The removal of spectrum fees (either spectrum capex and/or spectrum opex) will have varying cost implications on the resulting benchmark value.

Spectrum adjustment 2: mark-up to account for Australia-specific spectrum costs

3.61 The final adjustment WIK-Consult applies includes the Australia specific mark-up for spectrum costs. This is effectively calculated based on the total cost of spectrum for the hypothetical efficient operator and the forecast share of voice traffic. All things equal, assuming a change in WACC as discussed elsewhere in this submission would also have implications on the mark-up to be applied in this adjustment.

3.62 The following table sets out the resulting percentage change in benchmark resulting from different AU nominal WACC assumptions. For simplicity, WIK-Consult’s methodology as set out in WIK Tables 4-12, 4-13 and 4-14 has been adopted for comparative purposes.

Figure 11 Comparison of spectrum cost mark-up due to variance in nominal AU WACC assumption

AU nominal WACC	5.43%	6.7%	9%
Spectrum fee mark-up (AU cpm)	0.016	0.017	0.020

Source: Optus analysis using WIK-Consult’s methodology

3.63 This example also highlights the interactions between some of the adjustments being considered. As such, correcting the AU nominal WACC input will result in a subsequent upward adjustment of the final benchmark value.

3.64 Applying further adjustments to traffic volumes for Australia also results in a range of different mark-ups when 3G and 4G traffic forecasts are taken into account. This is highlighted in the table below. For simplicity, WIK-Consult’s methodology as set out in WIK

Tables 4-13 and 4-14 has been adopted for comparative purposes; however this has been updated to reflect different traffic forecasts for Australia.⁵³

Figure 12 Comparison of spectrum cost mark-up from correction in AU forecast voice and data traffic

AU voice traffic, 2015	[CiC]	million mins	
AU data traffic – 3G, 2015	[CiC]	million MB	
AU data traffic – 4G, 2015	[CiC]	million MB	
AU nominal WACC			
	5.43%		
Data traffic considered	3G data only	4G data only	Both 3G/4G data
Share assigned to voice	3.14%	1.91%	1.20%
Spectrum fee mark-up (AU cpm)	0.036	0.022	0.014
Spectrum fee mark-up (AU cpm) Digital dividend \$ removed	0.021		

Source: Optus analysis using WIK-Consult's methodology

- 3.65 Optus therefore considers that adjusted for a AU nominal WACC of 6.7%, the Australia-specific mark-up for spectrum costs becomes 0.039 AU cents (which is a significant uplift from the 0.016 AU cents calculated by WIK); and excluding digital dividend revenue (to be consistent with removal of 4G from the cost models) results in a mark-up of 0.023 AU cents.
- 3.66 The corrections above do not contain necessary corrections for the Australian spectrum payments. The WIK-Consult report appears to contain several errors in the values used:
- (a) The value of 1800MHz spectrum does not appear to reflect the renewals value paid in 2014;
 - (b) It is not clear whether historic values have been adjusted to 2015 current nominal values;
 - (c) No justification or evidence is put for the 2% and 10% cost mark-ups. No evidence is put whether these mark-ups are consistent with mark-ups in benchmarked cost models.
- 3.67 In summary, there appears to be little evidence on which to base a conclusion that the spectrum value adjustment is reasonable or reflects actual Australian values. Again, Optus recommends that the benchmarking adjustments be re-run in consultation with Australian MNOs.

Correcting for AU-specific comparators for application in WIK adjustments

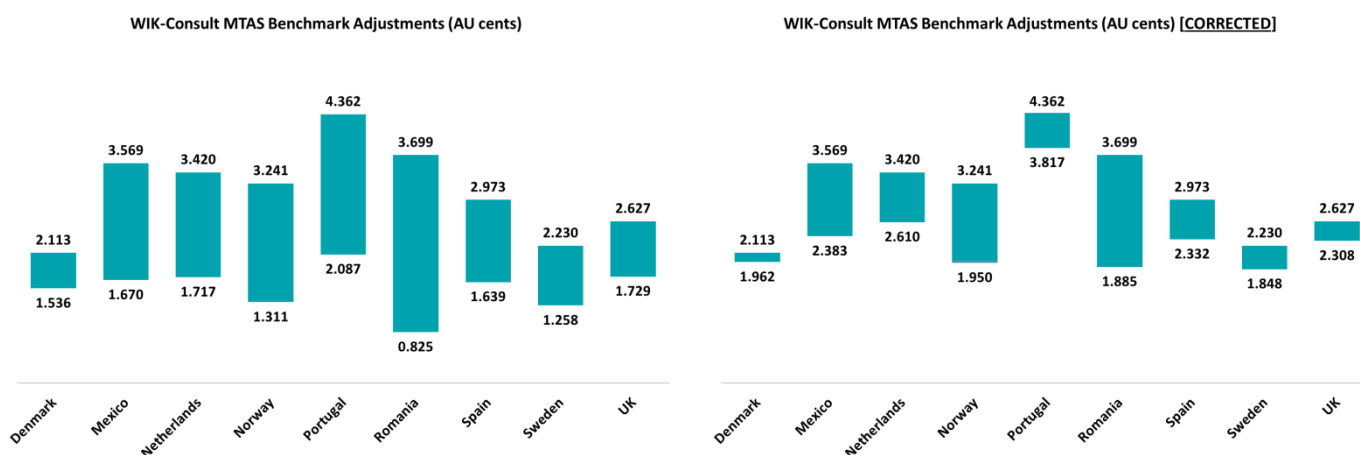
- 3.68 As discussed above, Optus has identified a number of errors in the Australia-specific adjustments, specifically:
- (a) Elasticity value for impact of 2G/3G traffic mix; and
 - (b) Inclusion of 4G traffic in cost models.
- 3.69 Correcting for these adjustments, and for simplicity applying the same methodology used by WIK-Consult, alters the final benchmark values (see figure 13).

⁵³ [CiC]

3.70 Optus also corrects for the incorrect elasticity assumptions for 2G/3G traffic adjustments in figure 13. Ideally, one should review all of WIK-Consult’s assumed elasticities given the number of errors identified. Optus recommends the ACCC to review all the assumptions in the WIK-Consult report to ensure that the ‘assumed’ values are accurate.

3.71 The default output assumes no change to the WIK benchmark values and adjustments, as calculated in a separate excel workbook replicating the WIK adjustments. To this end, Optus acknowledges there may be some rounding issues in its replication of the adjustment results. Optus therefore refers to percentage differentials for interpretation against the final benchmark values as set out in the WIK-Consult benchmarking report.

Figure 13 MTAS benchmark adjustments – WIK default & corrected



Source: Optus analysis using WIK-Consult’s methodology

3.72 In summary, the key Australia specific adjustments that have been applied are:

- (a) AU nominal WACC increased from 5.43% to 6.7%;
- (b) Exclusion of 4G traffic, resulting in:
 - (i) 2G share of traffic increases to [CiC]
 - (ii) AU network usage (GB/site) reduced from 15,569 to [CiC] and
- (c) Part correction for AU specific spectrum mark-up. The revised mark-up value similarly reflects the removal of 4G data volumes and a different voice traffic volume, and excludes value of digital dividend auction.

3.73 The resulting MTAS benchmark values results in a 42.09% differential from the WIK default inputs. Applying this mark-up to the MTAS draft FAD rate of 1.61 cpm results in a corrected benchmark value of 2.29 cpm for voice MTAS.

It is not reasonable to reject actual cost of SMS equipment

3.74 The Draft FAD proposes to set the SMS MTAS rate as the sum of two elements:

- (a) The conveyance cost of SMS, determined relative to the cost of voice MTAS; and
- (b) SMS-specific cost based on the investment costs for SMSCs.

- 3.75 Optus agrees with this broad approach. However, Optus disagrees with the way it has been implemented in the Draft FAD.
- 3.76 The Draft FAD rejects the use of actual Australian data on the cost of building a SMS system capable of providing capacity sufficient for an efficient new entrant with market share of 33%. The reason for this approach was because the costs provided by MNOs differed.⁵⁴
- 3.77 During January 2015, the ACCC requested information regarding the cost of providing SMS functionality in Optus' mobile network. Optus provided actual cost information to replace its SMS equipment required to provide the functionality currently provided over the network.
- 3.78 In response to the request in January 2015, Optus provided the following information on the replacement cost for its SMS messaging system. The costs that would be incurred included the following elements:
- (a) **SMS Platforms:** hardware costs, SMS licences, Optus labour, vendor professional services, IT costs, reporting system and reports costs, alarming costs, SW costs.
 - (b) **SMS Gateway Platforms:** hardware costs, SMS licences, Optus labour, vendor professional services, IT costs, reporting system and reports costs, alarming costs, SW costs.
 - (c) **SMS Billing integration:** IT costs, SW costs, Optus labour, vendor professional services, alarming costs, reporting costs
 - (d) **International SMS integration:** Optus labour, vendor professional services, licences, reporting costs
- 3.79 Optus informed the ACCC that these are the cost categories that would be incurred to provide the level of SMS functionality currently seen on the network. It would not be possible, for example, to have a functioning SMS system without; (a) SMS gateway platform, as Optus could not send SMS messages to another carrier; (b) without the SMS billing integration, as Optus could not bill for messages sent; or (c) without the international SMS integration, Optus could not send or receive messages internationally (including roaming).
- 3.80 Optus acknowledges that these network elements may fall outside the scope of what WIK-Consult or the ACCC consider to be the SMSC – but their limited scope is not correct. The approach outlined in the Draft FAD claims to represent an estimate of the *“cost of an SMS due to the acquisition and operation of SMS-specific elements of the network”*.⁵⁵ SMS-specific elements of the network comprise more than the SMSC.
- 3.81 The relevant benchmark is the costs that would be incurred by a new entrant to build a SMS system that provides sufficient capacity and features to serve a customer base with 33% market share. Optus current market share (31%) is close to the relevant benchmark level. The information provided to the ACCC in response to its January 2015 data request represented actual replacement cost of Optus' system. Optus has recently completed a project for this very purpose. There is no reason to suggest that the costs supplied do not represent the best available estimate of Australian costs.
- 3.82 It is not clear on what basis WIK-Consult and the ACCC rejected this evidence – other than it differed from other estimates provided.

⁵⁴ ACCC, 2015, MTAS FAD Draft Decision, p.29

⁵⁵ ACCC, 2015, MTAS FAD Draft Decision, p.29

Section 4. Cost of Capital

- 4.1 The Draft MTAS FAD proposes to adopt the same WACC as used in the Fixed Line Services FAD. This position differs from previous MTAS and fixed line pricing decisions which have adopted WACC parameters reflecting the different nature of the two industries.
- 4.2 The proposed WACC is inconsistent with the hypothetical efficient new entrant cost standard. The ACCC cannot propose to benchmark LRIC+ models based on this standard and then adopt a cost of capital which is inconsistent.
- 4.3 The Draft MTAS FAD does not provide evidence supporting the change in the ACCC's long standing positions. The ACCC has not made reasonable enquiries nor provided adequate reasons for changing its position. The extent of the analysis put in the Draft FAD is contained in three paragraphs – this does not provide adequate reasons to overturn almost a decade of well-established regulatory and legal precedents. Further, Optus believes that the Draft FAD is counter to specific decisions of the Australian Competition Tribunal.
- 4.4 It is inconsistent with the position of the ACCC that the mobile and fixed line operators face different market characteristics and risk profiles that lead to different WACC values. The reason used since 2007 justifying different fixed and mobile WACC values, is now used in the Draft MTAS FAD to support the same WACC value. Such a position is not reasonable.
- 4.5 Optus further queries why the principles of regulatory certainty and predictability, which play a large role in the ACCC's decision in the fixed line WACC, do not seem to apply when setting the mobile WACC.⁵⁶
- 4.6 Optus is concerned that the position put in the Draft FAD errs in both the estimation of parameters and interpretation of key issues which have long been settled through many judicial decisions.

WACC inconsistent with the hypothetical new entrant

- 4.7 The proposed use of Telstra's fixed line WACC in the Draft MTAS FAD fails to recognise the difference between the modelling approaches used in fixed services and MTAS FADs. The proposed WACC is inconsistent with the hypothetical new entrant and LRIC+ cost standard.
- 4.8 The fixed line services FAD utilises the Building Block Model approach, using Telstra's actual historic costs. There are no efficiency adjustments; there is no recognition of incremental costs. Costs are fully allocated to these services on a cost causal basis. The modelled operator is Telstra and the costs incurred are Telstra's costs. The legitimate business interests promoted under the LTIE test are those of Telstra as an operator of a monopoly fixed line network. As a result, the WACC adopted for the fixed line FAD reflect the cost of capital incurred by Telstra, or similar fixed line operators. As noted in the Draft Fixed Line FAD; *"the FLSM is intended to estimate the cost of supplying the fixed line services over Telstra's fixed line network and Telstra is the only supplier of these services."*⁵⁷
- 4.9 The cost standard for MTAS, however, is the hypothetical efficient new entrant. MTAS is provided over all three mobile networks in Australia. The objective is to replicate, as far as possible, the environment of a competitive market. It is desirable to use as a benchmark criteria which would exist in a competitive market – including determining the costs of an

⁵⁶ ACCC, 2015, FAS FAD – primary price terms draft decision, p.100

⁵⁷ ACCC, 2015, Fixed Line FAD Draft Decision, p.97

operator operating in that market.⁵⁸ This requires that the ACCC consider the cost of a stand-alone mobile operator.⁵⁹

- 4.10 Concerns raised by the ACCC that this approach would allow integrated operators to recover more than the costs actually incurred have been rejected by the Tribunal.⁶⁰ The Tribunal determined that a stand-alone carrier best promoted the legislative objectives by:
- (a) Likely resulting in the promotion of competition for listed services under s152Ab2(c);
 - (b) Likely resulting in a price that encourages the economically efficient use of, and investment in, infrastructure under s152AB(2)(e); and
 - (c) Having appropriate regard to Optus' legitimate commercial interests under s152AB(6)(b).⁶¹
- 4.11 The Draft MTAS FAD, however, appears to take a fundamentally different position on the hypothetical new entrant. The Draft FAD seems to adopt the position that the hypothetical new entrant would be an integrated fixed and mobile operator as Optus and Telstra are integrated.⁶² This is a surprising and puzzling position. No evidence or reasoning is put to explain the reversal of a long standing position – especially given that both Telstra and Optus were integrated during previous MTAS decisions. It is also inconsistent with the LRIC models included in the benchmark analysis – all LRIC models estimate the cost of a stand-alone operator.
- 4.12 For example, in the 2007 Pricing Principles Final Report, the ACCC noted that in the context of a TSLRIC model it was not required to estimate the WACC of any one specific operator – unlike in an undertaking or access dispute.⁶³ In previous decisions, the ACCC has accepted that the:
- (a) Efficient operator could encompass scenarios that are achievable by all MNOs such as an achievable minimum efficient scale;⁶⁴
 - (b) 2007 WIK-Consult cost model estimated the efficient cost of a stand-alone MNO because it represents the likely characteristics of a new market entrant.⁶⁵
- 4.13 Optus notes that the use of an integrated hypothetical network was considered in 2007 and was rejected by WIK-Consult and the ACCC. It was rejected in the 2009 and 2011 MTAS pricing decisions which relied upon the outputs of the WIK-Consult cost model. It is also seemingly inconsistent with the 2015 WIK-Consult benchmarking report, which uses average values of the three Australian MNOs to represent the hypothetical efficient operator, with a market share of 33%.⁶⁶

⁵⁸ Australian Competition Tribunal, *Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8, paragraph 122

⁵⁹ Australian Competition Tribunal, *Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8, paragraph 123

⁶⁰ Australian Competition Tribunal, *Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8, paragraph 124

⁶¹ Australian Competition Tribunal, *Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8, paragraph 123.

⁶² ACCC, 2015, MTAD Draft FAD, p.21

⁶³ ACCC, 2007, MTAS pricing principles determination report, section A.5.7

⁶⁴ ACCC, 2007, Draft MTAS Pricing Principles Determination report, pp.39-41

⁶⁵ ACCC, 2007, Draft MTAS Pricing Principles Determination report, p.40

⁶⁶ WIK-Consult, 2015, MTAS benchmark study, April, p.1

- 4.14 The proposed approach overturns a decade of established precedents. Such change appears inconsistent with the ACCC stated view on regulatory certainty when assessing the LTIE, namely:
- (a) ACCC is of the view that considerations of regulatory certainty and consistency will be important when setting the terms and conditions of the FADs; and
 - (b) ACCC also considers that it should have regard to its previous decisions in relation to the MTAS.⁶⁷
- 4.15 The decision to adopt Telstra’s fixed line WACC for MTAS is not consistent with either of these considerations.

Mobile WACC is not the same as Fixed Line Services WACC

- 4.16 The ACCC errs in its view that the WACC proposed in the Fixed Line Services FAD should be used in the MTAS FAD. Optus notes that:
- (a) First, all previous MTAS decisions have adopted different WACC than in FLS FADs;
 - (b) Second, FLS FAD regulates one dominant company using a Building Block Method and as a result should be based on Telstra’s actuals. Whereas, MTAS regulates the hypothetical new entrant on a LRIC basis.
 - (c) Third, key inputs used in the estimating WACC are different for mobile industry than fixed industry.
- 4.17 This section discusses the differences between mobile and fixed market WACC.
- 4.18 It is necessary to highlight that the Draft Fixed Line FAD states that the systematic risk faced with fixed line service would likely be significantly less than other business lines like mobile.⁶⁸ This is consistent with the view accepted by the ACCC in its ‘only’ determination of mobile WACC for the 2007 Pricing Principles. The ACCC noted that:
- ... the equity and asset betas used in its fixed-line decisions may not be an appropriate reference point for equity betas for mobile services such as the MTAS, due to the nature of the service and the relative systematic risk of the entity under assessment.*⁶⁹
- 4.19 In 2007, WIK-Consult also observed that it is not possible to directly observe relevant equity and asset betas for the Australian mobile market as Telstra and Optus are integrated fixed and mobile operators, “for which the beta values might be expected to be different than for a stand-alone mobile operator”.⁷⁰ Further, the stand-alone operators are wholly owned foreign subsidiaries and not observable on Australian markets. WIK-Consult used international benchmarks to determine an appropriate range of the equity and asset beta. WIK-Consult used a list of international mobile operators and global regulatory MTAS decisions.
- 4.20 It is also instructive to note, for example, that the updated international benchmark for equity and asset beta used in the Fixed Line Draft FAD contains one stand-alone mobile operator – Spark NZ. While its inclusion is arguably an error (the fixed benchmark should

⁶⁷ See comments in relation to s.152BCA(3), Section A.5.9, MTAS FAD Draft decision.

⁶⁸ ACCC, 2015, Fixed Line FAD Draft Decision, p.89

⁶⁹ ACCC, 2007, Draft MTAS Pricing Principles Determination report, p.102

⁷⁰ WIK-Consult, 2007, Report on Mobile Termination Cost Model, p.32

include the wholesale fixed line operator Chorus), it is notable that the asset beta is three to four times higher than the fixed average.⁷¹

- 4.21 The cost of debt used in the Fixed Line Draft FAD is the cost faced by Telstra.⁷² The Draft decision noted that again, while this is appropriate for the WACC for Telstra's fixed line network, it is not appropriate for the cost of debt likely to be faced by a hypothetical new entrant deploying a stand-alone mobile network in Australia, with 33% market share.
- 4.22 In 2007, the ACCC accepted the following key variables:
- (a) Market risk premium of around 6 per cent;
 - (b) An equity beta in the range of 1.10 and 1.32; and
 - (c) A gearing ratio of 40%.⁷³
- 4.23 The ACCC adopted a pre-tax WACC of 13% for the final decision.
- 4.24 This can be compared to the fixed line FAD which proposed the following key variables:
- (a) Market risk premium of around 6 per cent;
 - (b) An equity beta of 0.7; and
 - (c) A gearing ratio of 40%.⁷⁴
- 4.25 It is instructive to update the benchmark of key variables undertaken in 2007. Benchmarking comparable regulator decisions worldwide shows that fixed and mobile WACC variables differ.

WACC variables differ compared to fixed

- 4.26 The draft fixed line FAD proposes to use an equity beta of 0.7. This is based on an analysis of equity beta from a panel of fixed or integrated operators. Telstra's actual equity beta is 0.34-0.45. This is based on an average asset beta between 0.35-0.40, and Telstra's asset beta of 0.26-0.35.
- 4.27 These values differ significantly from the estimates in other MTAS decisions worldwide. For example:
- (a) A Brattle Group report for Ofcom published in January 2015, estimates an equity beta of Deutsche Telekom of 0.97, 1.17 for Orange, 1.04 for Telefonica and 1.33 for Vodafone.⁷⁵
 - (b) The same Brattle Group report estimates the average asset beta of
 - (i) UK MNOs to be between 0.52 to 0.61
 - (ii) US Wireless to be between 0.58 to 0.61 (compared to 0.42 for US fixed)

⁷¹ ACCC, 2015, Fixed Line FAD Draft Decision, p.91

⁷² ACCC, 2015, Fixed Line FAD Draft Decision, p.96

⁷³ ACCC, 2007, MTAS pricing principles determination report, section A.5.7

⁷⁴ ACCC, 2007, MTAS pricing principles determination report, section A.5.7

⁷⁵ Brattle Group, 2015, Estimates of Equity and Asset Betas for UK Mobile Owners, Annex 13 in Ofcom MTC Statement 2015.

- (iii) EU Wireless to be between 0.56 to 0.62
 - (c) Ofcom uses an asset beta of 0.6 in its 2015 MCT Statement.⁷⁶
 - (d) The Swedish regulator (PTS) in 2014 provided the following asset beta estimates for European mobile operators:⁷⁷
 - (i) Bouygues Group – 0.83
 - (ii) Elisa – 0.60
 - (iii) Iliad – 0.60
 - (iv) Telenor – 0.72
 - (v) Tele2 – 0.74
 - (vi) Vivendi – 0.62
 - (vii) Vodafone – 0.46
 - (e) Europe Economics for the Irish Regulator ComReg estimated mobile asset beta to be in the range of 0.4 to 0.6.
- 4.28 In conclusion, global evidence shows that the average asset beta for mobile operators (and used in MTAS decisions) is around 0.5 to 0.6. This is greater than the asset beta used in the fixed line FAD WACC of 0.35 to 0.4. This equates to an equity beta of between 0.83 and 1.⁷⁸
- 4.29 Optus further notes that the standard debt premium used in MTAS decisions in Europe average around 1.5% rather than the 0.9% proposed in the fixed line FAD.⁷⁹ Ofcom’s analysis in its 2015 MCT Consultation indicates a range of 1.1% to 1.6%.⁸⁰
- 4.30 A brief benchmarking analysis of mobile MTAS decisions globally shows that the proposed approach in the Draft Decision is not correct. The MTAS FAD Draft Decision does not contain sufficient evidence from which to make a conclusion about values of WACC that best promote the LTIE.
- 4.31 Updating the WACC in the fixed line FAD to reflect equity beta (1.0) and debt premium (1.5%) to reflect mobile industry data, results in a real vanilla WACC of 4.2% and a nominal WACC of 6.73%, some 1.3ppts larger than the corresponding fixed WACC.
- 4.32 Optus recommends the ACCC conduct further consultation on the appropriate WACC values.

⁷⁶ Ofcom, 2015, MCT Review 2015-18, p.84

⁷⁷ PTS, 2014, Consultation on return rates for mobile networks - an update (PTS-ER-2014:17)

⁷⁸ Using Monkhouse formula.

⁷⁹ Europe Economics, 2014 Cost of capital for mobile, fixed line and broadcasting price controls – report for ComReg, April

⁸⁰ Ofcom, 2015, MCT Review 2015-18, Annexure 10