



**The Optus 2007 Undertaking in
relation to the Domestic Mobile
Terminating Access Service
Public Version**

**Draft Decision
June 2007**

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Abbreviations

Act	<i>Trade Practices Act 1974</i>
ACCC	Australian Competition and Consumer Commission
ARPU	Average Revenue Per User
CAN	Customer Access Network
CCC	Competitive Carriers Coalition
CDMA	Code Division Multiple Access
Commission	Refers to the decision-making body, comprising the Commissioners, as constituted and appointed under section 7 of the Act
cpm	Cents per minute
CRA	Charles River Associates
CSP	Carriage Service Provider
DCITA	Department of Communication, Information Technology and the Arts
DGTAS	Optus's domestic GSM terminating access service
EBITDA	Earnings before interest, taxation, depreciation and amortisation
ECPR	Efficient Component Pricing Rule
EPMU	Equi-Proportionate Mark-Up
FCC	Fixed and common costs
FL-LRIC	Forward-looking long-run incremental cost
FL-LRIC++	Forward-looking long run incremental cost plus two mark-ups; one to account for the recovery of common costs based on Ramsey-Boiteux principles, and the other to reflect a 'network externality surcharge'
FTF	Fixed-to-fixed
FTM	Fixed-to-mobile
GBV	Gross Book Value
GSM	Global System for Mobiles
GST	Goods and Services Tax
H3GA	Hutchison 3G Australia Pty Limited
HSDPA	High-Speed Downlink Packet Access
LRIC	Long run incremental cost
LPMC	Long run marginal cost
LTIE	Long term interests of end users
MNO	Mobile Network Operator
MSR	Mobile Services Review
MTAS	Mobile Terminating Access Service
MTF	Mobile-to-fixed
MTM	Mobile-to-mobile
Optus	Optus Mobile Pty Limited and Optus Networks Pty Limited
Optus 2007	Undertaking lodged by Optus with the ACCC on 16 February 2007
Undertaking	for the supply price of the MTAS
POI	Point of interconnection
MTAS PPD 2007	The new MTAS pricing principles determination to be made to apply for the period from 1 July 2007 to 30 June 2009
PSTN	Public Switched Telephone Network
RAF	Regulatory Accounting Framework
SAOs	Standard Access Obligations
SIO	Services in operation
SSNIP	Small but significant non-transitory increase in price
Telstra	Telstra Corporation Limited
TSLRIC	Total service long-run incremental cost
TSLRIC+	Total service long-run incremental cost plus a mark-up to account for a proportion of organisational-level common costs based on an EPMU approach

ULLS
Vodafone
VoIP

Unconditioned Local Loop Service
Vodafone Australia Pty Ltd
Voice over Internet Protocol

1. Draft Decision

Pursuant to section 152BV(2)(a)(i) and (ii) of the Act, the ACCC has published the Optus 2007 Undertaking, invited submissions and has considered the submissions received, in forming its views on the Optus 2007 Undertaking.

Pursuant to section 152BV(2)(b) of the Act, the Commission is satisfied that the Optus 2007 Undertaking is consistent with the Standard Access Obligations (SAOs) that are applicable to Optus.

Pursuant to Section 152BV(2)(c) of the Act, as the Minister has not made a pricing determination in relation to the Mobile Termination Access Service (MTAS), the Commission is satisfied that this provision is not relevant to its assessment of the Optus 2007 Undertaking.

Pursuant to section 152BV(2)(d) of the Act, the Commission is not satisfied that the terms and conditions specified in the Optus 2007 Undertaking are reasonable for the reasons outlined in this report.

Therefore the ACCC's draft decision is to reject the Optus 2007 Undertaking.

2. Background on the Optus 2007 Undertaking

Optus lodged an ordinary access undertaking with the Commission in relation to what it terms the domestic GSM terminating access service (DGTAS) on 16 February 2007.

The Optus 2007 Undertaking specifies certain terms and conditions under which Optus undertakes to supply the DGTAS.

Specifically, the Optus 2007 Undertaking includes:

- a schedule describing the relevant service – Optus Domestic GSM Terminating Access Service¹; and
- a schedule outlining Optus's proposed charges for the Optus DGTAS² - 12cents per minute (cpm).

2.1. Price-related terms and conditions

Optus offers to supply the DGTAS at a rate of 12 cpm for the term of the Optus 2007 Undertaking, being from the later of 1 July 2007 or the date of acceptance by the ACCC to 31 December 2007.

A full description of the means by which Optus proposes to charge access seekers for a particular billing period can be found in Schedule 2 to the Optus 2007 Undertaking.³

¹ Optus, *Optus 2007 Undertaking*, Schedule 1, p. 5.

² *ibid.*, Schedule 2, p. 6.

³ *ibid.*

2.2. Non-price terms and conditions

The Optus 2007 Undertaking does not apply to any agreements with an access seeker which:

- are effective on the date the Optus 2007 Undertaking is accepted; and
- incorporate an express price for the supply of the Optus DGTAS.⁴

Other than the primacy of existing agreements, the Optus 2007 Undertaking does not expressly deal with any other non-price terms and conditions.

3. Summary of Reasons

The Commission is not satisfied that the price terms and conditions in the Optus 2007 Undertaking are reasonable. Therefore the Commission's draft decision is that the Optus 2007 Undertaking be rejected.

3.1. Reasonableness of the Optus 2007 Undertaking

Appendix 1 outlines in detail the statutory criteria the Commission must have regard to in assessing whether to accept an undertaking.

Having had regard to the criteria in section 152AH(1) of the Act the Commission concluded that the Optus 2007 Undertaking:

- would not compromise Optus's legitimate business interests or impact Optus's investment in facilities used to supply the MTAS; or
- would not lead to arrangements between access providers and access seekers that encourage the unsafe or unreliable operation of a carriage service, telecommunications network or facility; or
- would not impact on any-to-any connectivity relevant for the long term interests of end-users (LTIE) criterion.

However, the Commission also concluded that the Optus 2007 Undertaking:

- would not promote the LTIE because it would not be likely to:
 - promote competition in relevant markets; nor
 - encourage the economically efficient use of, and investment in infrastructure;
- would adversely impact the interests of persons who have a right to use the MTAS; and
- would not be likely to promote the economically efficient operation of a carriage service/telecommunications network facility.

Accordingly, the Commission is not satisfied that the price terms and conditions contained in the Optus 2007 Undertaking are reasonable.

⁴ Optus, *Optus 2007 Undertaking*, clause 2.2, p. 2.

3.2. Standard Access Obligations

The Optus 2007 Undertaking does not specify all the terms and conditions on which Optus will comply with the applicable SAOs. It states that additional terms and conditions must be negotiated and agreed between Optus and an Access Seeker or failing agreement, determined in accordance with section 152CP or 152CPA of the Act. In relation to the terms and conditions that are specified in the Optus 2007 Undertaking, the Commission is satisfied that the undertaking is consistent with the SAOs.

4. Conclusions on the reasonableness of the price terms and conditions

This section outlines in more detail the Commission's analysis and conclusions on the reasonableness of the price terms and conditions of the Optus 2007 Undertaking.

4.1. Commission's approach to the pricing of the MTAS

The Commission's preferred approach to the pricing of declared services is to use a total service long-run incremental cost (TSLRIC) framework to promote the LTIE and the other objectives of the statutory criteria.⁵ Conceptually, the TSLRIC only includes those costs that can be attributed to the production of the service. Costs common to more than one service cannot be attributed to a particular service and therefore do not form part of a 'pure' TSLRIC. However, in practice, the Commission accepts that network common costs may form part of the measure of efficient costs. Additionally, a contribution to organisational-level costs is accounted for in a mark-up or '+' added to the TSLRIC to form a 'TSLRIC+' measure of costs.

In the *MTAS Final Report*,⁶ the Commission found a price more closely aligned with the TSLRIC+ is appropriate for the supply of the MTAS because it better:

- reflects the direct cost of supplying the service;
- ensures equally-efficient access seekers in related markets are able to compete on an equal footing with integrated access providers as both will face similar input costs for the declared service;
- takes account of the interests of both access providers and access seekers; and
- encourages the economically efficient use of, and economically efficient investment in, the infrastructure used to provide telecommunications services.⁷

The Commission considers that each network operator has an effective monopoly over the provision of the MTAS on its own network because:

⁵ ACCC, *Access Pricing Principles – Telecommunications, A Guide*, 1997 (*Access Pricing Principles Guidelines*), p. 28.

⁶ ACCC, *Mobile Services Review Mobile Terminating Access Service- Final Decision on Whether or not the ACCC Should Extend, Vary or Revoke its Existing Declaration of the Mobile Terminating Access Service, (MTAS Final Report)*, June 2004.

⁷ *ibid.*, p. 205.

- the MTAS provided on each individual mobile network is defined to be provided in its own individual product market⁸; and
- termination services of individual MNOs are not really substitutable for each other.⁹

MNOs are therefore not constrained in their pricing decisions for the MTAS, and have both the ability and incentive to raise the price of this service above its underlying efficient cost of production.¹⁰

4.2. Assessment of the price terms and conditions

The Commission cannot accept an undertaking unless it is satisfied that the terms and conditions are ‘reasonable’ based on the criteria set out in section 152AH(1) of the Act.¹¹ The Commission outlines its reasons below.

Optus is seeking to apply a price of 12 cpm for the period 1 July 2007 to 31 December 2007, which is beyond the time period in which the Commission’s current indicative prices for the MTAS to apply.

The Commission notes Optus’s submission that it relies on the current *MTAS Pricing Principles Determination* to support 12 cpm as a reasonable estimate of efficient cost. Optus submits that it is appropriate for the Commission to continue to rely on the *MTAS Pricing Principles Determination* in setting access prices for the period 1 July 2007 to 31 December 2007 while the WIK modelling is in a draft stage of development.

Optus’s proposed rate of 12 cpm for the full calendar year 2007 reflects what the Commission considers is the conservative upper-bound estimate of the TSLRIC+ of the supply of the MTAS for the period 1 July 2004 to 30 June 2007, and is in line with the Commission’s indicative prices for the MTAS for the period 1 January 2007 to 30 June 2007. These indicative prices were informed by a range of TSLRIC+ estimates between 5 cpm to 12 cpm from international cost benchmarking and regulatory accounting framework (RAF) data analyses.

In the *MTAS Final Report*, the Commission stated that before it would reduce the price of the MTAS below 12 cpm, or the upper-end of the range of best estimates available to it of the TSLRIC+ of providing the MTAS, it would develop a more detailed estimate of the TSLRIC+ of providing the MTAS in Australia.

In June 2004, the Commission stated this could be via developing a model to estimate the TSLRIC+ of providing the MTAS in Australia, or via a detailed international

⁸ *ibid.*, p. 67.

⁹ *ibid.*, p. v.

¹⁰ *ibid.*, pp. 67-70.

¹¹ It is also noted that the ACCC is not limited by the matters to which regard may be had, as set out in *Trade Practices Act 1974*, section 152AH(2).

benchmarking exercise making adjustments for all factors that drive the TSLRIC+ of providing the MTAS in different countries for Australia-specific factors.¹²

Since 2004, more reliable and robust information about the efficient costs of the supply of the MTAS in an Australian context has become available, including:

- the development of the WIK Model which indicates that the efficient cost estimate is below 12 cpm (refer to Appendix 2);
- the development of comparable international cost models that can be used as benchmarks to corroborate the TSLRIC+ estimate range of 5 cpm to 12 cpm. For example, evidence from jurisdictions such as South Korea and Israel provide for efficient cost estimates of 4.49 cpm and 5.45 cpm respectively (refer to Appendix 3 for details);¹³ and
- the FL-LRIC+ estimate for the supply of the MTAS by Optus in Australia derived from the Charles River Associates (CRA) Model to support Optus's 2004 Undertaking.¹⁴ In assessing Optus's earlier undertaking, Analysys Consulting Pty Ltd (Analysys) provided advice to the Commission about the FL-LRIC+ estimates for the supply of the MTAS by Optus in Australia from the CRA Model. At the time, the Commission raised concerns that many assumptions employed to calculate the CRA Model inputs would tend to over estimate the FL-LRIC of the DGTAS.¹⁵ The cost estimate for the supply of the MTAS was below 12 cpm in 2004 and confirms that, even without adjustment for higher traffic volumes since that time which are likely to offset any rise in costs, the cost estimate would be below 12 cpm in an Australian context (refer to Appendix 4 for details).

Interested parties will note that the Commission is in the process of establishing pricing principles for the period beyond 30 June 2007, and even though this process is not yet complete, the information above provides a reasonable basis to conclude that a price below 12 cpm is appropriate for the supply of the MTAS for the period 1 July 2007 to 31 December 2007.

The Commission considers that there is sufficient information to show that a price of 12 cpm for the supply of the MTAS as outlined in Optus 2007 Undertaking is not reasonable for the period 1 July 2007 to 31 December 2007.

The Commission's assessment of the price terms and conditions contained in the Optus 2007 Undertaking against the statutory criteria set out in section 152AH(1) of the Act is outlined below.

¹² ACCC, *MTAS Final Report*, p. 211.

¹³ ACCC, *MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008 Report (2007 MTAS Pricing Principles Determination Report)*, p. 47.

¹⁴ ACCC, *Optus's Undertaking with Respect to the Supply of its Domestic GSM Terminating Access Service (DGTAS): Final Decision Public Version (Optus Undertaking Final Decision)*, February 2006.

¹⁵ *ibid.*, p. xii.

4.2.1. The LTIE

In considering whether particular terms and conditions will promote the LTIE, the Commission is required to have regard to whether the terms and conditions are likely to result in:

1. promoting competition in markets for carriage services and services supplied by means of carriage services;
2. achieving any-to-any connectivity; and
3. encouraging the economically efficient use of, and economically efficient investment in infrastructure.¹⁶

Promoting competition in the relevant markets

Optus's view

Optus submits that the LTIE assessment firstly requires identification of the relevant markets in relation to the Optus 2007 Undertaking. This is in order to determine whether the above three criteria are satisfied for each of those markets.¹⁷

Optus submits that the notion of promoting competition can be summarised as creating the conditions or environment for improving competition from what it would otherwise be. In order to achieve this, Optus submits that the Optus 2007 Undertaking would have to put in place better conditions for competition to occur than the current case.¹⁸

Optus submits that it relies on a number of sources in order to support 12 cpm as a price that will promote competition:

- The Australian Competition Tribunal's (**Tribunal**) judgement that consideration must be given to Optus's overall revenue in setting DGTAS prices;
- Optus financial reports that indicate the effect on Optus of rate reductions resulting from the Commission's pricing principles;
- Telstra's financial reports indicating that it is likely to benefit most from immediate further reductions in MTAS rates and evidence that it will strengthen its dominant position in the fixed-to-mobile market; and
- Evidence that competition in the mobile services market has increased since 2004 when the Commission released the pricing principles.¹⁹

Optus submits that the 12 cpm rate offered in the Optus 2007 Undertaking is a reasonable estimate of efficient cost. Optus submits that:

¹⁶ *Trade Practices Act 1974*, section 152AB(2).

¹⁷ Optus, *Submission to ACCC in Support of the Optus 2007 Undertaking* - Public version (Optus Submission in Support), 16 March 2007, p. 10.

¹⁸ *ibid.*, p. 15.

¹⁹ *ibid.*, p. 16.

it reflects the best information available to the Commission at this time and that it provides commercial certainty for access seekers for the six months from July 2006[sic] to December 2007.

Optus also submits that there is considerable uncertainty as to efficient costs. Optus submits that the Tribunal has determined that prices above cost for the Optus DGTAS may promote competition, which may allow some leeway for the Commission in making a decision where costs are uncertain.

Optus submits that it relies on a number of sources of information in order to support 12 cpm as a reasonable estimate of efficient cost including:

- the Commission pricing principles established in June 2004; and
- International benchmarking of mobile terminating access prices including overseas costs models.

Submitters' views

AAPT

AAPT submits that it does not understand how an Optus 2007 Undertaking with a maximum effective period of only 6 months is in the LTIE.²⁰

Competitive Carriers Coalition (CCC)

The CCC submits that a delay in the implementation of a further reduction in MTAS pricing will not promote the LTIE and may actually harm the LTIE. The CCC submits that the ACCC should reject the Optus 2007 Undertaking as it would lock the industry into costs that are double the cost calculated by the ACCC's own modelling advisor.²¹

H3GA

H3GA submits that it would be inconsistent with the ACCC's LTIE test to accept the Optus Undertaking when the ACCC is in the process of determining new indicative prices.²²

Telstra

Telstra submits that before an undertaking can be accepted as reasonable or meeting the LTIE objectives, it is necessary for the access provider to make a reasonable effort to establish that its costs are efficient costs.²³

Telstra submits that the Tribunal has recognised that it is efficient pricing that promotes competition for the purposes of the LTIE criterion irrespective of the precise definition of the markets in which the service is supplied.²⁴

²⁰ AAPT, *Assessment of Optus's Undertaking in Relation to Declared Service – Mobile Terminating Access Service* (AAPT Submission), 5 April 2007, p. 1.

²¹ Competitive Carriers Coalition, *Submission to Optus Domestic Mobile Terminating Service Undertaking* (CCC Submission), 5 April 2007, p. 4.

²² H3GA, *Hutchison's Response: Optus's 2007 Undertaking in Relation to the Domestic Mobile Terminating Access Service* (H3GA Submission), 11 April 2007, p. 1.

²³ Telstra, *Submission in Response to the ACCC's Discussion Paper on Optus' 2007 Undertaking in Relation to the Domestic Mobile Terminating Access Service* (Telstra Submission in Response), April 2007, p. 8.

Commission's view

In determining the extent to which terms and conditions are likely to result in the objective of promoting competition, regard must be given to the extent to which the terms and conditions will remove obstacles to end-users of gaining access to listed services.²⁵

In determining the extent to which terms and conditions are likely to result in the achievement of the objective of encouraging the economically efficient use of and investment in infrastructure, regard must be had to technical feasibility, the legitimate commercial interests of the supplier, and the incentives for investment.²⁶

The Tribunal's interpretation of the notion of promoting competition is that it 'involves the idea of creating the conditions or environment for improving competition.' The Tribunal distinguishes this from any requirement to demonstrate, 'that there would be an advance in competition in the sense that competition would be increased.'²⁷

The Tribunal has recently discussed this notion in the context of Part XIC, where it noted the differences in language between Part IIIA (before its amendment) and Part XIC. In particular, the Tribunal noted that when section 152AB(2)(c) directs the Commission (and the Tribunal on review) to have regard to 'the extent to which' a term or condition is likely to result in the achievement of the objective of promoting competition,:

..the Commission (the Tribunal on review) must consider the extent of the competitive impact...and the likelihood of that extent, not only the improvement of the environment for competition.²⁸

In the *MTAS Final Report* the ACCC identified three markets as relevant for the purpose of assessing competition under the LTIE criterion, namely:²⁹

- individual markets for termination on each MNO's network;
- market within which fixed-to-mobile (FTM) services are offered; and
- market for retail mobile services.

The promotion of competition in each market is considered in turn below.

The Commission notes Optus's submission that Optus relies on the following sources of information to support its submission that 12 cpm will promote competition:

- (i) The Tribunal's judgement that consideration must be given to Optus's overall revenue in setting DGTAS prices; and

²⁴ *ibid.*, p. 10.

²⁵ *Application by Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8 (22 November 2006) at [12].

²⁶ *ibid.*, at [13].

²⁷ *Sydney International Airport* [2000] ACompT 1 (1 March 2000) at [106]-[107].

²⁸ *Telstra Corporation Ltd (No 3)* [2007] ACompT 3 (17 May 2007) at [96].

²⁹ For a detailed discussion on the Commission's approach to market definition see: ACCC, *MTAS Final Report*, section 4.2 (particularly pp. 31-32 and 45-55).

- (ii) Optus's financial reports, which show the effect of rate reductions resulting from the Commission's pricing principles.

The Commission considers these submissions are more appropriately dealt with in the legitimate business interest criterion (section 4.2.2) rather than the under the LTIE criterion.

The Commission also notes Optus's reliance on international benchmarking analysis. The Commission's views on this analysis are contained in Appendix 3.

LTIE: Promotion of competition in individual markets for MTAS on each MNO's network

Optus's view

Optus submits that there are two markets that will be affected by the Optus 2007 Undertaking, the mobile services market and the fixed to mobile services (FTM) market. Optus submits that a separate market for the Optus DGTAS does not exist and should therefore not be considered as part of the LTIE analysis.³⁰

Optus submits that it sells the DGTAS into a market for mobile services. Optus submits that this market has different 'functional' levels in the sense that origination services are purchased directly by retail customers, but termination services are purchased indirectly by fixed to mobile operators who provide services to their retail customers.³¹

Optus does not consider that the mobile services market is a *retail* market.³²

Optus submits that the relevant products and services in this market are origination services; termination services (including the Optus DGTAS itself); and subscription services. Optus submits that it sells these services as a cluster given the strong economies of scope between the services. Optus submits that this market definition overtly takes into account the two sides of the market including the origination/subscription services sold to retail mobile users and termination services to those mobile users sold at wholesale.³³

Optus submits that a small significant non-transitory increase in price (SSNIP) analysis³⁴ demonstrates that the services (termination, origination and subscription) are all part of the same market. Optus states that if an individual operator raised the price of terminating services to its subscribers, this increases the profitability of attracting additional subscribers and as a direct result increases competition for those

³⁰ Optus, *Optus Submission in Support*, p. 11.

³¹ *ibid.*, p. 12.

³² *ibid.*

³³ *ibid.*

³⁴ The small but significant and non-transitory increase in price (SSNIP) test is a market definition tool that measures the substitutability between goods and services by considering how the market would likely react to a SSNIP of product A. If buyers would switch in such large numbers to purchasing or producing product B such that the price increase in product A would be unprofitable, then products A and B are in the same market.

subscribers. Optus submits that the price of subscription and origination services would adjust to attract subscribers and higher termination revenue would be competed away. Optus submits that the SSNIP would be unsuccessful indicating a wider market definition, incorporating all the services is appropriate.³⁵

Optus submits that the Optus 2007 Undertaking needs to be assessed according to the LTIE criteria, having regard to the two-sided character of the mobile services market.³⁶

Submitters' views

Telstra

Telstra submits that both the ACCC and the Tribunal have already rejected Optus's submissions on the two-sided nature of the market in which the DGTAS is provided. Optus has not provided any new evidence or raised additional matters to support its continued advocacy of a two-sided MTAS market³⁷

Commission's view

The Commission concluded in the *MTAS Final Report* that there is a separate single market for the MTAS on each MNO's network where the presence of weak substitutes for the service means MNOs are not constrained in their pricing decisions for the MTAS and have the ability and incentive to raise the price of the MTAS above its underlying cost of production.³⁸

While the mere existence of a monopoly does not automatically imply that prices will be set at a level inconsistent with that expected in competitive markets, the Commission considers that both the structural and behavioural characteristics evident in the wholesale MTAS markets indicate that MNOs are using their market power in their individual markets to extract monopoly rents and earn economic profits from the provision of the wholesale MTAS. Accordingly, the Commission considers that the state of competition in each of the wholesale MTAS markets is not competitive.³⁹

The Commission notes Optus's submission on the two-sided nature of the DGTAS market, which would result in higher termination revenue being competed away by adjustments in the price of subscription and origination services aimed as attracting additional subscribers. This argument appears to be referring to the 'waterbed' effect.

³⁵ Optus, *Optus Submission in Support*, p. 13.

³⁶ *ibid.*, p. 11.

³⁷ Telstra, *Telstra Submission in Response*, p. 11.

³⁸ In the *MTAS Final Report*, the ACCC found that the termination services of individual MNOs are not substitutable for each other, irrespective of the size of individual operators or the network technology they employ. Further, the ACCC concluded that alternative forms of communication, such as fixed-line network services, SMS messages, email and calls using voice over Internet protocol technology (VoIP), are not sufficiently substitutable means of contacting a mobile subscriber to constrain providers of a MTAS. ACCC, *MTAS Final Report*, pp. 29-61.

³⁹ *ibid.*, p. 70.

The Commission has provided its views about the existence of the ‘waterbed’ effect and further addresses the issue of the two-sided market in Appendix 5.

The Commission maintains its view expressed above that the lack of substitutes for the MTAS means that MNOs are not constrained in their pricing decisions for the MTAS and the MNOs have both the ability and incentive to raise the price of this service above its underlying cost of production. The Commission notes that the Tribunal agreed with the Commission’s interpretation of the Optus DGTAS market:

We do not consider that the DGTAS is provided in the retail mobile services market. Even if the retail mobile services market were effectively competitive we do not consider that Optus would be strongly constrained in setting its DGTAS price by competition in the retail market. The mobile operators could set their termination charges on a reciprocal basis at above cost while still competing vigorously in the retail market. Indeed, it was accepted that that is what they do.⁴⁰

The Commission considers that competition will be unaffected in this market by the price proposed in the Optus 2007 Undertaking as each MNO effectively has monopoly power in the individual markets for termination on its network.

LTIE: Promotion of competition in the market within which FTM services are provided

Optus’s view

Optus submits that in defining a FTM service market it is necessary to consider the demand side substitutability of potential substitutes. Optus submits that these include fixed-to-fixed (FTF) services and mobile-to-mobile (MTM) services. For the proportion of time a mobile user is away from their fixed line(s), FTF services are functionally not a substitute for FTM services and could not be considered in the same market.⁴¹

Optus submits that MTM services are increasingly becoming a substitute for FTM services. At the margin these services may provide a competitive constraint on the pricing of fixed-to-mobile services.⁴²

Optus submits that while FTM services are preselected by customers in a bundle of long distance and international services, Optus contends that FTM services are supplied in a separate market to long distance and international. Even though there are complementarities in the demand for the bundle of services, it may be that operators can compete on single services, such as by offering calling cards and override codes.⁴³

Optus submits that notwithstanding this, the effect of the Optus 2007 Undertaking on the FTM services market may be impacted by the pricing of any of those bundled

⁴⁰ *Application by Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8 (22 November 2006) at [85].

⁴¹ Optus, *Optus Submission in Support*, p. 13.

⁴² *ibid.*

⁴³ *ibid.*

services. For example, changes in the price of the Optus DGTAS may be passed on in the bundle of preselect services via a change in the price of long distance services rather than FTM services.⁴⁴

Optus submits that further reductions in MTAS prices for the period of the Optus 2007 Undertaking are ‘unlikely to promote competition in the market(s) for fixed telephony services.’⁴⁵

Submitters’ views

CCC

The CCC submits that while there has been a degree of retail ‘pass-through,’ the maintenance of the above cost MTAS as offered in the Optus 2007 Undertaking allows Optus to discriminate in its retail pricing to adversely impact on fixed-only competitors.⁴⁶

Telstra

In response to Optus’s submission that further reductions in MTAS prices for the period of the Optus 2007 Undertaking are ‘unlikely to promote competition in the market(s) for fixed telephony services,’ Telstra submits that it is cost based pricing of the MTAS that puts in place the necessary conditions for improving competition and this may occur across a basket of fixed-line services or in forms other than price.⁴⁷

In response to Optus’s submission that competition in the fixed line market will not be promoted in a downstream market due to Telstra’s control of the local loop, Telstra submits that there are competitive forces which clearly constrain the prices which can be charged for fixed-line services (including for FTM calls).⁴⁸ These constraints include:

- an increase in quasi-facilities based competition using the Unconditioned Local Loop Service (ULLS);⁴⁹
- regulatory constraints such as price caps under the retail price control arrangements;⁵⁰
- substitution between fixed and mobile services;⁵¹ and
- substitution between fixed services and services using alternative delivery such as VOIP technology.⁵²

⁴⁴ *ibid.*

⁴⁵ *ibid.*

⁴⁶ CCC, *CCC Submission*, p. 3.

⁴⁷ Telstra, *Telstra Submission in Response*, p. 24.

⁴⁸ *ibid.*, pp. 32-33.

⁴⁹ *ibid.*, p. 25.

⁵⁰ *ibid.*, p. 13.

⁵¹ *ibid.*, pp. 28-32.

⁵² *ibid.*, pp. 31-32.

Contrary to Optus's submission that Telstra 'has not passed on the full benefits of MTAS price reduction enforced by the Commission since 2004,' Telstra submits that there is no requirement that pass-through be solely in the form of retail price reductions and there are many other ways in which pass-through can occur. Telstra submits that empirical data suggests that to date, sufficient pass through has occurred. Telstra also submits that it is incorrect to consider the benefits of reduced MTAS rates solely by reference to reductions in FTM call prices. That is, the benefits of reduced MTAS rates can be realised in a number of ways. For example, pass-through may occur by way of improved quality of service.⁵³

Telstra submits that given 12 cpm is likely to be significantly above the efficient costs of supply, it cannot be accepted that the price terms and conditions specified in the Optus 2007 Undertaking will encourage the objective of the promotion of competition in relevant markets and hence that the Optus 2007 Undertaking will not promote the LTIE.⁵⁴

H3GA

H3GA submits that evidence from the ACCC suggests that integrated carriers have used the opportunity to price discriminate to retain their business customers with business customers enjoying average FTM reductions of 21.2 per cent while residential customers have only experienced a reduction of 1.8 per cent in retail FTM prices for the period 2004-05. H3GA argues that the average consumer has not benefited from the MTAS glide path reductions.⁵⁵

Commission's view

In the *MTAS Final Report*, the Commission indicated that it expected that the greatest competitive benefit from regulation of the MTAS was likely to occur in the market within which FTM services are provided.⁵⁶

In general, the Commission considers that the ability to raise the price of the MTAS above its underlying cost of production (in the absence of regulation of this service), enables MNOs to make above normal economic profits when providing this service. While some integrated MNOs and mobile-only MNOs can benefit somewhat from a higher MTAS price, the consequence for fixed-only operators is higher input costs than should prevail. That is, higher MTAS prices increase the cost to providers of FTM calls above the underlying efficient cost of the service and which in turn may result in higher prices for FTM calls.⁵⁷

The Commission considers that linking the price of the MTAS to its underlying efficient cost of production should, by improving the state of competition in the

⁵³ *ibid.*, pp. 38-39.

⁵⁴ *ibid.*, p. 39.

⁵⁵ H3GA, *H3GA Submission*, p. 1.

⁵⁶ ACCC, *MTAS Final Report*, p. xi.

⁵⁷ By reducing the ability of incumbent mobile network owners to frustrate new entrants into the market. ACCC, *MTAS Final Report*, Chapters 5 and 6.

market within which FTM services are provided, help to ensure the level of FTM pass-through increases.⁵⁸

To demonstrate these improvements using publicly available data,⁵⁹ the Commission notes that Telstra’s revenue from FTM services has fallen in recent years, while FTM call volumes has increased. This is indicative of lower FTM pricing, in the same period in which MTAS prices have fallen from above 21 cpm to 12 cpm. For example, in its results for the half year ended 31 December 2006, Telstra reported FTM revenues of \$749 million from total FTM minutes of 2339 million. This reflects a FTM yield of 32.0 cpm for the half year ended 31 December 2006 compared with a much higher FTM yield that prevailed at 31 December 2003 of 38.5 cpm. This represents a fall in FTM yields of 16.8 per cent over that time.⁶⁰

The Commission notes that, despite Optus’s submission about Telstra’s structural advantages, it considers that both Optus and Telstra, as integrated operators, are in the best position of all carriers and carriage service providers to effect a longer and more complete pass-through of lower MTAS rates in both the markets in which fixed services are offered as well as retail services markets.

The Commission also notes that the extent of pass-through is not the only measure of the extent to which a lower price for the MTAS promotes competition in that market or the LTIE more generally. Improvements in the quality of services provided or reductions in the price of other services provided in the bundle of pre-selected fixed line services can also promote the LTIE.⁶¹ However, material to support these improvements has not been provided by any party.

As a result, the Commission considers that an MTAS price more closely aligned to the TSLRIC+ estimate of the supply of the MTAS and below 12 cpm would be likely to promote competition in the market within which FTM services are provided.

⁵⁸ *ibid.*, p. xii.

⁵⁹ There is no publicly available information about FTM prices or yields for Optus.

⁶⁰

	As at 31 December 2003	As at 31 December 2006	Change between 31 December 2003 and 2006 (%)
FTM Revenue (\$millions)	808	749	-7.3
FTM minutes (millions)	2,099	2,339	11.4
Yield (cpm)	38.5	32.0	-16.8

Source: Telstra Corporation Limited and Controlled Entities, *Results and Operations Review Half Year Ended 31 December 2006*, p. 13. Telstra Corporation Limited and Controlled Entities, *Results and Operations Review Half Year Ended 31 December 2003*, p. 12. Telstra Corporation Limited and Controlled Entities, *Annual Report for the Year Ended 30 June 2006*, pp. 8-9. Telstra Corporation Limited and Controlled Entities, *Annual Report for the Year Ended 30 June 2005*, p. 82.

⁶¹ ACCC, *MTAS Final Report*, p. 223.

Accordingly, the Commission is of the view that Optus's proposed price of 12 cpm would not be likely to result in the achievement of the objective of promoting competition in the market within which FTM services are provided beyond 30 June 2007.

LTIE: Promotion of competition in the retail mobile services market

Optus's view

Any submissions made by Optus in relation to the retail mobile services market are considered in the other relevant markets or the LTIE criterion as a whole.

Submitters' views

Any submissions made by interested parties in relation to the retail mobile services market are considered in the other relevant markets or the LTIE criterion as a whole.

Commission's view

The Commission noted in the *MTAS Final Report* that while the retail mobile services market was exhibiting more encouraging market outcomes than the markets for fixed-line telecommunications services that it was unlikely to be effectively competitive.

The reasons for this, which remain relevant today, included:

- the high level of concentration at the carrier network level;
- barriers to effective entry into the market (associated with national coverage and sunk costs) remain high; and
- established MNOs making profits well in excess of those the Commission would expect in competitive markets for these services.⁶²

These trends of improvement have continued with lower retail prices. For example, Telstra's average call rates have fallen from 41.19 cpm in the second half of 2004 to 33.16 cpm⁶³ in the second half of 2006, coinciding with a fall in the MTAS from 21 cpm to 15 cpm. Similarly, Optus's 31 March 2007 year-end results indicate that total revenue increased by 3.5 per cent from 31 March 2006.⁶⁴ Optus's March year end 2007 results also illustrate that minutes of use per user per month grew at a faster rate than average revenue per user per month, implying decreasing revenue per minute in the March year end 2007 compared to previous quarters and the previous financial year.⁶⁵ This is also indicative of lower, not higher, retail mobile rates.⁶⁶

⁶² *ibid.*, pp. 70-75.

⁶³ ACCC, *2007 MTAS Pricing Principles Determination Report*, p. 25.

⁶⁴ *ibid.*

⁶⁵ Minutes of use per subscriber per month for pre-paid services grew by 10 per cent between 2005-06 and 2006-07, while Average Revenue Per User (ARPU) per month grew by 9 per cent over the same period; and for post-paid services minutes of use per subscriber per month grew by 5 per cent, while ARPU per month fell by 1 per cent. From: Singapore Telecommunications Limited and Subsidiary Companies (SingTel), *Singapore Telecommunications Limited and Subsidiary Companies, Management Discussion and Analysis of Unaudited Financial Condition, Results of*

However, despite the continued presence of price capping schemes at the retail level and lower retail prices, the Commission continues to believe that structural features of the mobile industry indicate that the retail mobile services market is still not effectively competitive. In particular, the market is still highly concentrated, the barriers to entry remain high as evidenced by the nature of 3G deployment mainly in the form of infrastructure sharing agreements and no new entrants since June 2004, as well as the continued high profits for three of the four MNOs and improved performance for all MNOs, in the context of lower wholesale revenues arising from lower MTAS prices.

The Commission considers that prices more closely aligned to a more robust and reliable estimate of TSLRIC+ of the supply of the MTAS in an Australian context below 12 cpm would be likely to promote competition in the retail mobile services market. Therefore, the Commission considers that Optus's proposed price of 12 cpm would not be likely to result in the achievement of the objective of promoting competition in the retail mobile services market beyond 30 June 2007.

LTIE: Any-to-any connectivity

Optus's view

Optus submits that the offering of access to the Optus DGTAS in the Optus 2007 Undertaking will allow any-to-any connectivity. Optus also submits that as the prices offered are consistent with existing rates and consistent with efficient costs, that they will encourage any-to-any connectivity.⁶⁷

Submitters' views

Telstra

Telstra submits that it accepts that the Optus 2007 Undertaking is consistent with the objective of achieving any-to-any connectivity under the LTIE criterion.⁶⁸

Commission's view

In the *MTAS Final Report*, the Commission concluded that any-to-any connectivity can be promoted through the declaration of the MTAS by impacting on the ability of established MNOs to frustrate a new entrant's ability to offer a full end-to-end service to its subscribers by hampering supply of the MTAS on reasonable terms and conditions.⁶⁹

The Commission believes that any-to-any connectivity is unaffected by the acceptance or rejection of the Optus 2007 Undertaking.

LTIE: Efficient use of, and investment in, infrastructure

Operations and Cash Flows for the Fourth Quarter and Financial Year Ended 31 March 2007, p. 44.

⁶⁶ ACCC, *2007 MTAS Pricing Principles Determination Report*, p. 26.

⁶⁷ Optus, *Optus Submission in Support*, p. 15.

⁶⁸ Telstra, *Telstra Submission in Response*, p. 39.

⁶⁹ ACCC, *MTAS Final Report*, pp. xiv-xv.

Optus's view

Optus submits that an assessment of whether the Optus 2007 Undertaking encourages the efficient use of infrastructure is closely linked to the promotion of competition. Optus submits that this is because factors affecting competition, such as the terms and conditions of access to infrastructure, will determine the extent to which the infrastructure is utilised efficiently.

In relation to encouraging investment in infrastructure, Optus submits that it is important that consideration not only be given to the extent to which the Optus 2007 Undertaking will encourage investment in new infrastructure but also the extent to which continued investment in existing infrastructure will be encouraged.

Submitters' views

Telstra's view

Telstra submits that that 12 cpm is likely to substantially overstate the efficient costs of supplying the MTAS (and/or the DGTAS). Telstra submits that the current pricing principles do not support Optus' contention that 12 cpm reflects its efficient costs of supplying the DGTAS during the period in which the Optus 2007 Undertaking will operate. Telstra submits that Optus's benchmarking analysis needs to be considered with caution because the Tribunal found that the benchmarking analysis of other countries reveal little about the reasonableness of prices charged in the Australian regulatory environment.⁷⁰

Commission's view

The Commission considers that a price that reflects the TSLRIC+ of supply of the MTAS is likely to promote efficient use of, and investment in, infrastructure by which telecommunications services are provided.⁷¹

The Commission considers that a lower MTAS price, a key wholesale input for network and service providers, is more likely in the long run to encourage, rather than discourage, investment and reduce associated risks for any potential and/or existing infrastructure owners. In general, the Commission considers that pricing tending to the TSLRIC+ of supply of the MTAS provides for an environment that will increase demand and expand the economically efficient use of, and economically efficient investment in, infrastructure. To this end, earlier this year Optus announced plans to expand its 3G network to cover 96 per cent of the population (to replicate the coverage of its existing 2G mobile network) and further on 30 March 2007, Optus announced plans to upgrade its mobile network with High-Speed Downlink Packet Access (HSDPA) technology. It is expected that this upgrade will provide 55 per cent of the Australian population with high-speed wireless broadband services.⁷²

To the extent that the lower input prices are passed-through as lower retail prices for mobile services, efficiency would be improved in the retail market for mobile

⁷⁰ Telstra, *Telstra Submission in Response*, pp. 14-19.

⁷¹ ACCC, *MTAS Final Report*, p. xv.

⁷² SingTel, *Singapore Telecommunications Limited and Subsidiary Companies Management Discussion and Analysis of Unaudited Financial Condition, Results of Operations and Cash Flows for the Fourth Quarter and Financial Year Ended 31 March 2007*, May 2007, p. 46.

services. As already outlined, the proposed price of 12 cpm in the Optus 2007 Undertaking, has been considered the conservative upper-bound estimate of supply of the MTAS. However, with more reliable and robust information about the efficient cost of supply of the MTAS in an Australian context, the Commission considers that the estimated TSLRIC+ of the MTAS is likely to be lower than 12 cpm after 30 June 2007. The Commission is of the view that an MTAS price more closely aligned with such an estimate would be likely to result in the achievement of the objective of economically efficient use of, and investment in, infrastructure.

Overall conclusion on the Optus 2007 Undertaking and the LTIE

The Commission is not satisfied that accepting the Optus 2007 Undertaking will be likely to promote the LTIE. This is because the Optus 2007 Undertaking would establish a price structure for the MTAS in excess of the TSLRIC+ relevant for the period 1 July 2007 to 31 December 2007.

4.2.2. The legitimate business interests of the carrier or carriage service provider

The reasonableness criterion in section 152AH of the Act requires the Commission to take into account the legitimate business interests of Optus, and its investment in facilities used to supply the MTAS when assessing the Optus 2007 Undertaking.

Optus's view

Optus submits that the 12 cpm price of supplying the MTAS under the Optus 2007 Undertaking reflects its legitimate business interests to have regulatory certainty over its costs and for regulated price reductions to be consistent with previous determinations.⁷³

In setting the Optus 2007 Undertaking price, Optus submits that it has had regard to the significant adjustment in subscription and origination prices needed to implement a price lower than that offered in the Optus 2007 Undertaking. Optus submits that the impact on Optus from reduced MTAS rates is significant. Optus states that mobile termination rate reductions have had a significant effect on Optus's net revenues and hence ability to adjust prices.⁷⁴

Optus argues that its legitimate business interests require that it is able to set a price that will allow it to recover the lost termination revenue. Optus submits that application of 12 cents per minute for an additional 6 months, as contemplated by the Optus 2007 Undertaking, is consistent with those legitimate business interests.⁷⁵

Submitters' views

AAPT

AAPT submits that Optus's submission in support of the Optus 2007 Undertaking provides no real explanation as to how the undertaking protects its legitimate business

⁷³ Optus, *Cover Letter to Optus 2007 Undertaking*, 16 February 2007, p. 1.

⁷⁴ Optus, *Optus Submission in Support*, p. 28.

⁷⁵ *ibid.*

interests. AAPT submits that it is not a legitimate business interest of an access provider to continue to extract rents well in excess of service costs.⁷⁶

CCC

The CCC submits that the impacts observed during the period of the price glide path suggest no evidence to support negatives that mobile operators claimed would result from the price falls. The CCC submits that retail outgoing mobile prices have fallen and handset subsidies have increased. The CCC submits that the opposite would be expected if the claims by some MNOs about the 'waterbed effect' were valid.⁷⁷

Telstra

Telstra submits that Optus appears to have exaggerated the impact of reduced MTAS rates on its business. Optus's operating revenues actually increased by 1.1 per cent despite decreased MTAS rates and the evidence suggests that reductions in MTAS rates are being virtually cancelled out by increased call volumes. In addition, evidence provided by Access Economics confirms the absence of the waterbed effect in relation to MTAS prices and suggests that pass-through of reduced MTAS rates to retail prices has been sufficient.⁷⁸

Telstra submits that since 12 cpm is already likely to be above the efficient costs of supply of the MTAS, there is no basis for artificially maintaining that price for another six months as suggested by Optus when there is evidence of sufficient pass-through and no evidence that a lower DGTAS rate will cause harmful disruption to the operations of mobile operators.⁷⁹

Commission's view

The Commission notes Optus's submission that a price of 12 cpm reflects its legitimate business interests to have regulatory certainty over its costs and for regulated price reductions to be consistent with previous determinations.

The Commission considers that Optus's recent financial performance clearly demonstrates that Optus's mobiles division is robust, in an environment of falling MTAS prices: it remains profitable, revenue and minute volumes are increasing, and it has recently committed to an investment in mobile infrastructure for the period to 2010.⁸⁰

Optus's most recent full year results to 31 March 2007 show that its mobile division continues to contribute an increasingly high proportion of Optus's total EBITDA. In reporting these results, Optus states that its 'traffic expenses fell by 1.5 per cent due to lower mobile termination rates, partly offset by an increase in mobile traffic'.⁸¹

⁷⁶ AAPT, *AAPT Submission*, p. 1.

⁷⁷ CCC, *CCC Submission*, p. 3.

⁷⁸ Telstra, *Telstra Submission in Response*, pp. 40-42.

⁷⁹ *ibid.*, p. 43.

⁸⁰ SingTel, *Singapore Telecommunications Limited and Subsidiary Companies Management Discussion and Analysis of Unaudited Financial Condition, Results of Operations and Cash Flows for the Fourth Quarter and Financial Year Ended 31 March 2007*, May 2007, p. 46.

⁸¹ *ibid.*, p. 51.

Optus's performance since 2004, when MTAS prices have fallen from above 21 cpm, is illustrated below.

In summary the table shows that:

- Optus's mobile segment EBITDA contributed 77 per cent of the Optus Group's EBITDA for the financial year ended 31 March 2007;
- revenue growth for the mobiles segment increased 3.4 per cent in the financial year ended 31 March 2007 compared to the financial year ended 31 March 2006; and over the longer-term total mobiles revenue growth has increased 21 per cent in the financial years 2004 to 2007, compared with the growth in mobiles EBITDA of 17.5 per cent over the same period; and
- the proportion of total operating revenue attributable to mobiles also increased between the financial year to 31 March 2004 and 31 March 2007 from 52 per cent to 56 per cent.

OPTUS	2004 full year data to 31 March 2004	2005 full year data to 31 March 2005	2006 full year data to 31 March 2006	2007 full year data to 31 March 2007
<i>Optus Group</i>				
Operating Revenue (\$m)	6,609	6,920	7,192	7,475
Operational EBITDA (\$m)	1,892	2,155	2,038	1,988
<i>Optus's Mobile Division</i>				
Operating Revenue (\$m)	3,445	3,817	4,036	4,177
Operational EBITDA (\$m)	1,298	1,515	1,528	1,531
Mobile Market Share (%)	35	33	33	33
Mobile Revenue to Total Group Revenue (%)	52	55	56	56
Mobile EBITDA to Total Group EBITDA (%)	69	70	75	77

Source: SingTel financial reports⁸²

The Commission notes that the legitimate business criterion is not concerned with the maintenance of revenues or monopoly profits where these are inflated by prices that return a higher than normal return on investment.⁸³

⁸² SingTel, *Singapore Telecommunications Limited and Subsidiary Companies, Management Discussion and Analysis of Unaudited Financial Condition, Results of Operations and Cash Flows for the Fourth Quarter and Year Ended 31 March 2005*, May 2005, pp. 42-43;

SingTel, *Singapore Telecommunications Limited and Subsidiary Companies, Management Discussion and Analysis of Unaudited Financial Condition, Results of Operations and Cash Flows for the Fourth Quarter and Year Ended 31 March 2007*, May 2007, pp. 43-44.

⁸³ ACCC, *Access Undertakings – A Guide to Part IIIA of the Trade Practices Act*, 30 September 1999, pp. 4-5.

In respect of Optus's submission about regulatory certainty, the Commission notes that in the *MTAS Final Report*, it stated that any reduction in pricing below 12 cpm could be supported among other things by the development of its own bottom-up cost model.⁸⁴

The Commission considers that over three years notice has been provided to Optus and other access seekers that 12 cpm reflects the conservative upper-bound estimate of the supply of the MTAS and that a rate below this may prevail if more robust and reliable information referable to an Australian context was forthcoming.

In addition, there is no evidence of the predicted disruptions to business plans or possible harm as a result of the fall in MTAS prices,⁸⁵ but rather the contrary has been experienced with consolidation and improvement of financial performance for all MNOs since 2004.

The Commission notes Optus's reliance on 'the Tribunal's judgement that consideration must be given to Optus's overall revenue in setting DGTAS prices' and the impact of the MTAS reductions.⁸⁶ As demonstrated by Optus's financial performance since 2004, its mobiles revenue has increased at a time when MTAS prices have fallen. Even with prices lower than 12 cpm for the MTAS, it is likely based on this experience that Optus's mobiles revenue would increase and not decrease, also demonstrating the benefits of a higher volume of minutes arising from lower input prices and retail prices.

The Commission notes notwithstanding Optus's submission, the Tribunal has also maintained that in:

consideration of a price term by comparing it with costs, it would be necessary, in order to satisfy the statutory framework, that the access provider establish that its costs are efficient costs.⁸⁷

The Commission notes that in the recent Telstra ULLS undertaking decision,⁸⁸ the

⁸⁴ ACCC, *MTAS Final Report*, p. 211.:

Given it (the Commission) has:

- not developed a specific model to estimate TSLRIC+ in Australia at this time, and
- concerns regarding the possible harm that might be caused by disrupting the business plans of MNOs if the Commission were to immediately reduce the price of the MTAS to TSLRIC+.

The Commission believes a pricing principle that generates a gradual reduction in the price of the MTAS so that it reduces to a level that represents a closer association of price and the best measures the Commission has available to it of the TSLRIC+ of providing the service within Australia would be most appropriate under the Act at this time. The principles by which this price path should be determined are as outlined above.

Over the longer term, however, the Commission wishes to stress that before it would reduce the price of the MTAS below the upper end of the range of best estimates available to it of the TSLRIC+ of providing the MTAS, the Commission would develop a more detailed estimate of the TSLRIC+ of providing the MTAS in Australia. This could be via developing a model to specifically model the TSLRIC+ of providing the MTAS in Australia, or via a detailed international cost benchmarking exercise that sought to make adjustments for all factors that drive the TSLRIC of providing the MTAS in different countries for Australia-specific factors.

⁸⁵ *ibid.*

⁸⁶ Optus, *Optus Submission in Support*, p. 16.

⁸⁷ *Telstra Corporation Limited (ACN 051 775 556) [2006] ACompT 4 (2 June 2006) at [46].*

Tribunal, in considering the reasonableness of Telstra's proposed averaged ULLS charge under the legitimate business interest criterion, stated:

We do not know whether that charge does no more than recover Telstra's costs of its infrastructure used to supply the ULLS, its operating costs and obtain a normal return on its capital. In order to be satisfied that this is the case, we need to be satisfied that an application of the PIE II model accurately estimates Telstra's forward-looking efficient costs of the network, the CAN [Customer Access Network], used to supply the ULLS. For the reasons set out later, we are not satisfied that it does produce such an estimate of the efficient forward-looking costs of the CAN.

The Commission concurs with the Tribunal's view that in order to be satisfied that a price term does not go beyond an MNO's legitimate business interests by allowing over-recovery of the costs of supplying a declared service, the Commission must be satisfied that the application of the MNO's pricing approach accurately estimates the forward-looking efficient costs of supplying that declared service.

Accordingly, the Commission concludes that rejection of the Optus 2007 Undertaking will not adversely impact Optus's legitimate business interests. Moreover, the Commission is of the view that, if the Optus 2007 Undertaking were accepted, it would provide for a price for the supply of the MTAS that is greater than is needed to maintain Optus's legitimate business interests for the period 1 July 2007 to 31 December 2007.

4.2.3. The interests of persons who have the right to use the declared service

Optus's view

Optus submits that the Optus 2007 Undertaking price promotes the interests of access seekers because it is consistent with rates that Optus would expect to arrive at through commercial negotiations which are capped by existing pricing principles that had three cent decrements in price on a calendar year basis.

Submitters' views

CCC

The CCC submits that evidence of the past three years supports the view that access seekers have been seriously disadvantaged, to the detriment of competition and end users, by the approach that a rapid move to toward cost-based prices would cause 'regulatory shock' for access providers. Access seekers still confront prices for retail fixed to mobile calls that are well below the wholesale price of termination, even with prices today having fallen to 12 cpm for those who have been to arbitration.⁸⁹

AAPT

AAPT submits that the terms and conditions of the Undertaking are not conducive to providing any real certainty to 'the market' in circumstances where:

- (i) the Optus 2007 Undertaking only applies to a limited set of access seekers; namely those that do not have a contract for the supply of the MTAS for the period covered by the Undertaking; and

⁸⁸ *Telstra Corporation Ltd (No 3)* [2007] ACompT 3 (17 May 2007) at [261].

⁸⁹ CCC, *CCC Submission*, p. 2.

(ii) the Undertaking may be withdrawn by Optus before 31 December 2007.⁹⁰

AAPT also notes that since June 2004, the market has been on notice of the ACCC's view that the TSLIRC+ cost of supplying the MTAS is in the lower end of the 5-12 cpm range. In these circumstances, AAPT questions any belief held by Optus that access seekers would expect commercial negotiations for the supply of the MTAS beyond 1 July 2007 to result in a price of 12 cpm.⁹¹

Telstra

Telstra submits that access seekers have a legitimate interest in acquiring the MTAS (and/or the DGTAS). Telstra submits that available evidence tends to indicate that a price of 12 cpm is well above the efficient costs of providing that service. Mobile carriers have been on notice since June 2004 that the price of the MTAS could fall below 12 cpm after the expiration of the current *MTAS Pricing Principles Determination*. It is therefore incorrect to assume that access seekers would have 'expected' 12 cpm for another six months when all evidence points to the implementation of a lower price. Optus has not offered any evidence which suggests that cost-based pricing of the DGTAS would impede the interests of access seekers, and accordingly, 12 cpm cannot be reasonable.⁹²

Commission's view

Consideration of the interests of persons who have rights to use the MTAS includes consideration of the ability for access seekers to compete for the custom of end-users on the basis of their relative merits. Terms and conditions favouring one competitor, or class of competitors, over another may distort the competitive process and harm the interests of persons who have rights to use the MTAS.

The Commission considers a price for the MTAS tending down toward a more referable estimate of the TSLRIC+ of providing the service in an Australian context would be likely to be in the interests of persons that have a right to use the declared service. This is because a closer association of the price of the MTAS with its underlying efficient cost of supply will allow equally and more efficient MNOs to compete on their merits in the markets for FTM and retail mobile services.

The Commission considers that the price of 12 cpm proposed in the Optus 2007 Undertaking is above a referable TSLRIC+ estimate of the supply of the MTAS for the period 1 July 2007 to 31 December 2007, and as a result the Commission does not consider that Optus's proposed price would be in the interests of persons who have rights to use the declared service.

4.2.4. The direct costs of providing access to the declared service

Optus's view

⁹⁰ AAPT, *AAPT Submission*, p. 2.

⁹¹ *ibid.*

⁹² Telstra, *Telstra Submission in Response*, pp. 43-44.

Optus submits that the Optus 2007 Undertaking price is consistent with the direct costs of providing the DGTAS, though they remain uncertain.⁹³

Submitters' views

AAPT

AAPT submits that Optus's submission in relation to this criterion is 'nonsensical.' AAPT questions how Optus can argue that the Optus 2007 Undertaking price is consistent with the direct costs of providing the MTAS in circumstances where those costs remain uncertain to Optus.⁹⁴

Telstra

Telstra submits that pricing on a TSLRIC+ basis would enable Optus to recover its direct costs of supplying the DGTAS because the latest estimates of the TSLRIC+ price of the MTAS are substantially lower than 12 cpm.⁹⁵

Commission's view

The direct costs of providing access to a declared service are those incurred (or caused) by the provision of access. In this context, the phrase 'direct costs' is interpreted to mean that an access price should cover the direct long-run incremental costs incurred in providing access. However, it does not extend to receiving compensation for loss of any 'monopoly profits' that occurs as a result of increased competition.

In its Access Pricing Principles, Telecommunications guide (*Access Pricing Principles Guidelines*), the Commission stated:

Direct costs are those costs necessarily incurred (caused by) the provision of access. As stated in the explanatory memorandum ... 'direct' costs of providing access are intended to preclude arguments that the provider should be reimbursed by the third party seeking access for consequential costs which the provider may incur as a result of increased competition in an upstream or downstream market. (Trade Practices Amendment (Telecommunications) Bill 1996 Explanatory Memorandum p. 44)

This requires that an access price should not be inflated to recover any profits the access provider (or any other party) may lose in a dependent market as a result of the provision of access.⁹⁶

The Tribunal's view concurs with the Commission's view when it states that direct costs:

- mean the total costs of providing access to the relevant declared service which ordinarily include an appropriate allocation of fixed and common costs (FCCs)

⁹³ Optus, *Optus Submission in Support*, p. 29.

⁹⁴ AAPT, *AAPT Submission*, p. 2.

⁹⁵ Telstra, *Telstra Submission in Response*, p. 44.

⁹⁶ ACCC, *Access Pricing Principles Guidelines*, p. 10.

because without the existence of the assets in respect of which the FCCs are incurred, the relevant access could not be provided;⁹⁷ and

- are intended to exclude the consequential costs which the access provider might incur as a result of increased competition as a result of access in any relevant market.⁹⁸

The Commission notes that when asked to consider whether estimates of efficient costs should be based on the costs incurred by an access provider in providing its service or some other costs, the Tribunal responded as follows:

...we would point out that whenever an access provider seeks approval of an access undertaking from the Commission which involves a consideration of a price term by comparing it with costs, it would be necessary, in order to satisfy the statutory framework, that the access provider establish that its costs are efficient costs. An access provider should also recognise that if the Commission decides against accepting the access undertaking and rejects it and the provider wishes to seek review of the Commission's decision before the Tribunal, it would be necessary to establish before the Tribunal that its costs are efficient.⁹⁹

In this respect the Commission considers that the direct costs of providing the service are not inconsistent with underlying efficient costs of providing the MTAS.

In this way, as outlined previously, the Commission has before it more reliable and robust information that the referable efficient cost of the supply of the MTAS in an Australian context is below 12 cpm. This view is supported by international cost and price benchmarking, the estimated efficient costs derived from the WIK Model and the FL-LRIC+ estimate for the supply of the DGTAS by Optus derived from the CRA Model.

In the absence of more reliable information, the Commission considers that 12 cpm is a price above the direct costs of supply of the MTAS for Optus for the period beyond 30 June 2007.

4.2.5. Safe and reliable operation of the carriage service/telecommunications network/facility

Optus's view

Optus contends that the Optus 2007 Undertaking offers an operationally and technically feasible service.¹⁰⁰

Submitters' views

AAPT

AAPT submits that Optus's submission in support of the Optus 2007 Undertaking provides no justification for its assertion that the Optus 2007 Undertaking price of 12cpm is necessary for the safe and reliable operation of its mobile network. AAPT

⁹⁷ *Application by Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8 (22 November 2006) at [137].

⁹⁸ *ibid.*, at [138].

⁹⁹ *Telstra Corporation Limited (ACN 051 775 556)* [2006] ACompT 4 (2 June 2006) at [46].

¹⁰⁰ *Optus, Optus Submission in Support*, p. 29.

submits that the ACCC cannot be satisfied that the Optus 2007 Undertaking price is necessary for this purpose.¹⁰¹

Telstra

Telstra submits that it accepts that this criterion is not relevant to the ACCC's assessment of the Optus 2007 Undertaking or, in the alternative, that the undertaking is consistent with this criterion.¹⁰²

Commission's view

The Commission does not consider that there is any risk that the price-related terms and conditions of the Optus 2007 Undertaking (whether accepted or rejected) would lead to unsafe or unreliable operation of a carriage service, telecommunications network or facility.

4.2.6. The economically efficient operation of a carriage service/telecommunications network/facility

Optus's view

Optus submits that it has relied upon a number of data sources¹⁰³ to devise its Optus 2007 Undertaking prices. Optus has not undertaken a bottom-up cost modelling exercise, as it believes that given its operation in a competitive mobile services market (with four infrastructure competitors) and the age of the assets, its approach is reasonable.¹⁰⁴

Submitter's views

AAPT

AAPT submits that Optus's submission in support of its Optus 2007 Undertaking contains no substantive analysis, or any modelling, to support a conclusion that the Optus 2007 Undertaking price reflects the economically efficient cost of providing the MTAS. AAPT submits that Optus is unable to provide such information to the ACCC, having not finalised a view as to the TSLIRC of providing the MTAS. Therefore, AAPT submits that the ACCC must reject the Optus 2007 Undertaking.¹⁰⁵

¹⁰¹ AAPT, *AAPT Submission*, p. 2.

¹⁰² Telstra, *Telstra Submission in Response*, p. 44.

¹⁰³ Optus, *Optus Submission in Support*, p. 16. The information listed includes:

- the Australian Competition Tribunal's judgement that consideration must be given to Optus's overall revenue in setting DGTAS prices;
- Optus's financial reports that indicate the effect on Optus of rate reductions resulting from the Commission's pricing principles.
- Telstra's financial reports indicating that it is likely to benefit most from immediate further reductions in MTAS rates and evidence that it will strengthen its dominant position in the fixed to mobile market; and
- evidence that competition in the mobile services market has increased since 2004 when the Commission released its pricing principles.

¹⁰⁴ *ibid.*, p. 30.

¹⁰⁵ AAPT, *AAPT Submission*, p. 4.

AAPT also submits that it does not understand Optus's claims that the Optus 2007 Undertaking price is consistent with the ACCC's current MTAS pricing principles when the ACCC's current pricing principles are expressed to apply only in relation to the period up to 30 June 2007.¹⁰⁶

Telstra

Telstra submits that the Optus 2007 Undertaking is inconsistent with the economically efficient operation of a carriage service and a telecommunications network or facility because the price of 12 cpm for the period 1 July 2007 to 31 December 2007 is likely to have substantially overstated the efficient costs of supply of the DGTAS.¹⁰⁷

Commission's view

Similar to the test described under the 'efficient use of, and investment in, infrastructure' LTIE criterion, this criterion also relates to the productive and allocative efficiency impacts of the Optus 2007 Undertaking.

For the reasons outlined above under the 'efficient use of, and investment in, infrastructure' LTIE criterion, the Commission considers that the economically efficient operation of a carriage service/telecommunications facility would be likely to be promoted by MTAS pricing that is aligned with estimated efficient costs of supplying the MTAS. As set out above, the Commission is not satisfied that Optus's proposed price of 12 cpm reflects estimated efficient costs of supplying the MTAS. Therefore, in the Commission's view, Optus's 2007 Undertaking is not likely to promote the economically efficient operation of a carriage service, a telecommunications network or a facility for the period beyond 30 June 2007.

4.2.7. Other matters

The Commission did not have regard to any other matters in determining whether the price terms and conditions are reasonable as permitted by section 152AH(2).

4.3. Price terms and conditions found to be unreasonable

Based on the considerations detailed above, the Commission is not satisfied that the price terms and conditions in the Optus 2007 Undertaking are reasonable for the period 1 July 2007 to 31 December 2007.

5. Conclusion on the reasonableness of the non-price terms and conditions

This section contains the Commission's analysis and findings on the reasonableness of the non-price terms and conditions that form part of the Optus 2007 Undertaking.

The Optus 2007 Undertaking does not apply to any agreements with access seekers that are effective on the date that the undertaking is accepted and which incorporate an express price for the supply of the Optus DGTAS. The non-price terms and

¹⁰⁶ *ibid.*

¹⁰⁷ Telstra, *Telstra Submission in Response*, p. 43.

conditions are contained within clauses 2 and 3 of the Optus 2007 Undertaking and schedules 1 and 3.

The relevant provisions of the Optus 2007 Undertaking are as follows:

2.2 For the avoidance of doubt, this Undertaking (including, without limitation, any prices in this Undertaking) has no effect in respect of the supply of the Optus DGTA Service by Optus to an Access Seeker under an agreement that is effective on the date which the Undertaking is accepted by the ACCC and which incorporates an express price for the Optus DGTA Service, for as long as that agreement continues to be effective and applies an express price for the Optus DGTA service.

...

3.2 For clarification, this Undertaking:

(a) does not specify all the terms and conditions on which Optus will comply with the Applicable Standard Access Obligations and additional terms and conditions must be negotiated and agreed between Optus and an Access Seeker or failing agreement, determined in accordance with section 152CP or 152CPA of the TPA;

5.1. Assessment of the non-price terms and conditions

Optus's view

Optus submits that the non-price terms and conditions in the Optus 2007 Undertaking are reasonable, satisfy the statutory criteria and should therefore be accepted by the ACCC. Optus submits that they are consistent with the regulatory requirements for the acceptance of the Optus 2007 Undertaking; they are commercially reasonable and are accepted good industry practice; and Optus agrees to comply with the SAOs.¹⁰⁸

Submitters' views

Telstra

Telstra submits that the non-price terms in the Optus 2007 Undertaking do not give rise to any particular concerns in respect of the reasonableness criteria. Telstra also submits that as schedule 3 confirms that the DGTAS will be provided on a non-discriminatory basis in accordance with the applicable SAOs, Telstra acknowledges that the ACCC can be satisfied that the statements in the Optus 2007 Undertaking are consistent with those obligations.¹⁰⁹

Commission's view

The Commission considers that the limited non-price terms and conditions are clear and unambiguous as to their scope and effect.

As noted previously, determining whether to accept the terms and conditions of the Optus 2007 Undertaking are reasonable must include an assessment of both the price and non-price terms and conditions. This section considers the reasonableness of the non-price terms and conditions.

¹⁰⁸ Optus, *Optus Submission in Support*, p. 30.

¹⁰⁹ Telstra, *Telstra Submission in Response*, p. 7.

The Commission did not receive any submissions that the non-price terms and conditions are unreasonable.

5.2. Conclusion on the non-price terms and conditions found to be reasonable

Based on the considerations detailed above, the Commission is satisfied that the limited number of non-price terms and conditions contained in the Optus 2007 Undertaking are reasonable.

6. Consistency with the SAOs

Under section 152BV(2)(b) of the Act, the Commission must not accept an undertaking unless it is satisfied that it is consistent with the SAOs that are applicable to a carrier or carriage service provider. The SAOs become applicable when an access provider supplies a declared service to itself or others.

This chapter assesses whether the Optus 2007 Undertaking are consistent with the SAOs applicable to Optus through its proposed supply of the MTAS. Appendix 1 outlines the Commission's approach to assessing consistency with the SAOs, while this section contains the actual assessment.

Under Schedule 3 of the Optus 2007 Undertaking, Optus states:

- 3.2 Optus will:
- (a) supply the Optus DGTA Service to the Access Seeker in order that the Access seeker can provide Carriage Services; and
 - (b) take all reasonable steps to ensure the technical and operational quality of the Optus DGTA Service or that part of the Optus DGTA Service, is equivalent to that which Optus provides to itself; and
 - (c) take all reasonable steps to ensure that the Access Seeker receives, in relation to the Optus DGTA Service or that part of the Optus DGTA Service, fault detection, handling and rectification of a technical or operational quality and timing that is equivalent to that which Optus provides to itself.

Optus's view

Optus submits that the Optus 2007 Undertaking explicitly states that Optus will comply with the SAOs and will accept terms and conditions that are not set out in the undertaking when supplying the DGTAS. Therefore the undertaking is consistent with the SAOs.¹¹⁰

Submitters' views

AAPT

AAPT submits that the Optus 2007 Undertaking is not inconsistent with Optus's standard access obligations to provide the MTAS.¹¹¹

Telstra

Telstra submits that given that schedule 3 of the Optus 2007 Undertaking confirms that the DGTAS will be provided on a non-discriminatory basis in accordance with

¹¹⁰ Optus, *Optus Submission in Support*, p. 9.

¹¹¹ AAPT, *AAPT Submission*, p. 1.

the applicable SAOs, Telstra acknowledges that the Commission can be satisfied that these statements in the Undertaking are consistent with the SAOs.¹¹²

Commission's view

In conducting its assessment, the Commission has considered whether the *non*-price terms and conditions specified in the Optus 2007 Undertaking are consistent with each of the applicable SAOs. The Commission considers that the price terms and conditions contained in the Optus 2007 Undertaking are more relevant to an assessment of reasonableness rather than assessment of consistency with the applicable SAOs.

6.1. The applicable SAOs

The Act requires that there be consistency between the proposed Optus 2007 Undertaking and the applicable SAOs.

6.1.1. Service to be supplied

The applicable SAO in respect of the supply of a declared service is set out in section 152AR(3)(a) of the Act. It provides that, if requested to do so by an access seeker, an access provider must supply an active declared service to the access seeker in order that the access seeker can provide carriage and/or content services.

The MTAS Declaration applies to all voice services terminating on all digital mobile telephony networks.

To the extent that Optus gives the Optus 2007 Undertaking for the supply of a declared service, the Commission is satisfied that these parts of the undertaking are consistent with the applicable SAO.

6.1.2. Technical and operational quality of the service to be supplied

The applicable SAO in respect of the technical and operational quality of the service to be supplied is set out in section 152AR(3)(b) of the Act, which provides that an access provider must take all reasonable steps to ensure that the technical and operational quality of the service supplied to the access seeker is equivalent to that which the access provider provides to itself.

6.1.3. Fault detection, handling, rectification and timing of the service to be supplied

The applicable SAO in respect of fault detection, handling, rectification and timing of the service to be supplied is set out in section 152AR(3)(c) of the Act. This provides that an access provider must take all reasonable steps to ensure that the access seeker receives, in relation to the supplied service, fault detection, handling and rectification of a technical and operational quality and timing that is equivalent to that which the access provider provides to itself.

¹¹² Telstra, *Telstra Submission in Response*, p. 7.

6.1.4. Interconnection

The Commission notes that the Optus 2007 Undertaking would appear to be in relation to the provision of a service that require the interconnection of facilities.

The nature of the Optus 2007 Undertaking and the service concerned suggests to the Commission that section 152AR(5) is an applicable SAO for the purposes of supplying the declared service. Optus has also acknowledged this.¹¹³

The Commission is satisfied that the Optus 2007 Undertaking is consistent with the applicable SAO outlined above.

7. Consistency with Ministerial Pricing Determination

Division 6 of Part XIC of the Act provides that the Minister may make a written determination setting out the principles dealing with price-related terms and conditions relating to the SAOs.¹¹⁴

A Ministerial Pricing Determination has not been made in relation to the MTAS. Accordingly, the Commission is not required to assess the Optus 2007 Undertaking against this criterion.

8. Overall Assessment of the Optus 2007 Undertaking

The Commission considers that the Optus 2007 Undertaking:

- is consistent with the SAOs that are applicable to Optus; and
- is not inconsistent with any relevant ministerial pricing determination; and
- contains non-price terms and conditions that are reasonable.

However, the Commission considers that the Optus 2007 Undertaking contains price terms and conditions that are not reasonable for the period beyond 30 June 2007. The reasons why the Commission holds these view are outlined in this decision.

As a result, the Commission is **not** satisfied that the Optus 2007 Undertaking is reasonable.

Accordingly the Commission has decided not to accept the Optus 2007 Undertaking.

¹¹³ Optus, *Optus Submission in Support*, p. 7.

¹¹⁴ Under *Trade Practices Act 1974*, section 152CH 'price-related terms and conditions' means terms and conditions relating to price or a method of ascertaining price.

Appendix 1 - Statutory Criteria for assessing an undertaking

Section 152BV(2) of the Act sets out the matters which need to be satisfied before the Commission can accept an undertaking. This section applies where an access undertaking is given to the Commission that *does not* adopt a set of model terms and conditions set out in the telecommunications access code as relevant to the Optus 2007 Undertaking.

Section 152BV(2) of the Act specifies that:

- (2) The Commission must not accept the undertaking unless:
- (a) the Commission has:
 - (i) published the undertaking and invited people to make submissions to the Commission on the undertaking; and
 - (ii) considered any submissions that were received within the time limit specified by the Commission when it published the undertaking; and
 - (b) the Commission is satisfied that the undertaking is consistent with the standard access obligations that are applicable to the carrier or provider; and
 - (c) if the undertaking deals with a price or a method of ascertaining a price – the Commission is satisfied that the undertaking is consistent with any Ministerial pricing determination; and
 - (d) the Commission is satisfied that the terms and conditions specified in the undertaking are reasonable; and
 - (e) the expiry time of the undertaking occurs within 3 years after the date on which the undertaking comes into operation.

The approach of the Commission to assessing each of these matters is considered in turn below.

Public submission process

Optus lodged the Optus 2007 Undertaking on 16 February 2007.

On 7 March 2007, the ACCC published the Optus 2007 Undertaking and released a Discussion Paper in relation to the undertaking and sought interested parties' views on the undertaking.

On 13 March 2007, Optus lodged a confidential version of its submission in support of the Optus 2007 Undertaking.

On 16 March 2007, Optus lodged a public version of its submission in support.

Submissions received in response to the discussion paper are identified below:

- AAPT, *Assessment of Optus's Undertaking in Relation to Declared Service – Mobile Terminating Access Service (MTAS)*, 5 April 2007.
- Competitive Carriers Colation, *Submission to Optus Domestic Mobile Terminating Service Undertaking*, 5 April 2007.
- Telstra, *Submission in Response to the ACCC's Discussion Paper on Optus's 2007 Undertaking in Relation to the Domestic Mobile Terminating Access Service*, 5 April 2007.

- H3GA, *Hutchison's Response: Optus's 2007 Undertaking in Relation to the Domestic Mobile Terminating Access Service*, 11 April 2007.

Consistency with the SAOs

The Act does not specify any particular approach for assessing whether an undertaking is consistent with the SAOs applicable to an access provider. Notwithstanding this, the Commission finds it useful to adopt the following approach:

- identify those SAOs that are applicable to a particular access provider; and
- assess whether the proposed undertaking is consistent with the applicable SAOs.

This assessment may involve consideration of whether the terms and conditions raise any inconsistencies with the applicable SAOs. If the terms and conditions are not found to be inconsistent with the SAOs, the Commission is likely to regard the undertaking as being consistent with the applicable SAOs.

Consistency with Ministerial Pricing Determination

Division 6 of Part XIC of the Act provides that the Minister may make a written determination setting out the principles dealing with price-related terms and conditions relating to the SAOs.¹¹⁵

Whether the terms and conditions are reasonable

In determining 'reasonableness' in this context, the Commission must have regard to the range of matters set out in section 152AH(1) of the Act:

- whether the terms and conditions promote the long-term interests of end-users (LTIE) of carriage services or of services supplied by means of carriage services;
- the legitimate business interests of Hutchison, and its investment in facilities used to supply the declared service;
- the interests of all persons who have rights to use the declared service;
- the direct costs of providing access to the declared service;
- the operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or facility; and
- the economically efficient operation of a carriage service, a telecommunications network or a facility.

In addition, the Commission may consider any other relevant matter.¹¹⁶

Application of the reasonableness test

¹¹⁵ Under section 152CH of the Act, 'price-related terms and conditions' means terms and conditions relating to price or a method of ascertaining price.

¹¹⁶ Section 152AH of the Act does not use the expression 'any other relevant matter.' Rather, section 152AH(2) of the Act states that the matters listed in section 152AH(1) of the Act do not limit the matters to which the Commission may have regard. Thus, the Commission interprets this to mean that it may consider any other relevant matter.

The reasonableness of the *price* and *non-price* terms and conditions in the Optus 2007 Undertaking is considered in Chapters 4 and 5 respectively. Set out below is a summary of the key phrases and words used in assessing the above matters. It should be noted that only some of the criteria have been judicially considered, and in other contexts. Accordingly, in taking these matters into account, it is necessary for the Commission to form its own view as to their meaning.

LTIE

The Commission has published a guideline explaining what it understands by the phrase ‘long-term interests of end-users’ in the context of its declaration responsibilities.¹¹⁷ The Commission considers that a similar interpretation would seem to be appropriate in the context of assessing an access undertaking.

In the Commission’s view, particular terms and conditions promote the interests of end-users if they are likely to contribute towards the provision of goods and services at lower prices, higher quality, or towards the provision of greater diversity of goods and services.¹¹⁸ To consider the likely impact of particular terms and conditions, the Act requires the Commission to have regard to whether the terms and conditions are likely to result in:

- promoting competition in markets for carriage services and services supplied by means of carriage services;
- achieving any-to-any connectivity; and
- encouraging the economically efficient use of, and economically efficient investment in:
 - the infrastructure by which listed carriage services are supplied; and
 - any other infrastructure by which listed services are, or are likely to become, capable of being supplied.¹¹⁹

In considering whether Optus’s proposed prices contained in Optus 2007 Undertaking are likely to promote competition, it is first useful to identify the relevant markets in which competition may be affected. In the *MTAS Final Report*, the Commission identified the following markets as being relevant to the question of whether it should declare the MTAS and, if so, the pricing principles it should specify for this service:

- the individual markets for the MTAS on each MNO’s network;
- the national market within which FTM services are provided; and
- the national market for retail mobile services.

The Commission continues to believe that these are the most appropriate markets to consider for the purposes of the Optus 2007 Undertaking.

The Commission notes that the Tribunal agreed with the Commission’s interpretation of the Optus MTAS market:

¹¹⁷ ACCC, *Telecommunications services — Declaration Provisions: A Guide to the Declaration Provisions of Part XIC of the Trade Practices Act*, July 1999.

¹¹⁸ *ibid.*, pp. 32-33.

¹¹⁹ *Trade Practices Act 1974*, Section 152AB(2).

Accordingly, we lean towards the Commission's view of the appropriate market definitions. It is correct to identify a wholesale market for the supply of Optus' MTAS. There are no substitutable products and the relevant market transaction is a wholesale transaction provided by one network operator to another. To the extent to which there is substitutability of products or services it is the bundle of services which is substitutable; one of the services is not substitutable for another of the services. However, it would be somewhat artificial to use this wholesale market for the purpose of identifying and analysing Optus' conduct and that of its competitors, and the effect of Optus' pricing of its DGTAS on its customers and its competitors, both mobile network and fixed-line operators, independently of the national market for retail mobile services. Nor, indeed, did the Commission suggest such an approach. Such conduct and effect is only meaningfully analysed and understood in the context of the wider markets identified by Optus and the Commission: see *Power New Zealand Ltd v Mercury Energy Limited and Commerce Commission* [1996] 1 NZLR 686 at 705.¹²⁰

The Tribunal, in its decision on access to subscription television services, noted in relation to the terms that make up the LTIE that:

Having regard to the legislation, as well as the guidance provided by the Explanatory Memorandum, it is necessary, in our view, to take the following matters into account when applying the touchstone – the long-term interests of end-users:

End-users: in this matter, 'end-users' include actual and potential subscribers to subscription television services and other viewers in their households. The term is also likely to include businesses, such as hotels and other places where people congregate, that subscribe or may potentially subscribe to subscription television services;

Interests: the interests of end-users lie in obtaining lower prices (than would otherwise be the case), increased quality of service and increased diversity and scope in product offerings. In our view, this would include access to innovations such as interactivity in a quicker timeframe than would otherwise be the case; and

Long-term: the long-term will be the period over which the full effects of the Tribunal's decision will be felt. This means some years, being sufficient time for all players (being existing and potential competitors at the various functional stages of the subscription television industry) to adjust to the outcome, make investment decisions and implement growth – as well as entry and/or exit – strategies.¹²¹

The Commission also notes that in *Seven Network Limited (No 4)*, the Tribunal expressed its general agreement with the Commission's approach to applying the LTIE test established by the Commission's publication, *Access Pricing Principle* and the Commission's use of a TSLRIC framework for cost-based access pricing. In the decision, the Tribunal relevantly stated that, in its view, the key pricing principles in applying the LTIE include:

- The price of a service should not exceed the minimum costs that an efficient firm will incur in the long-run in providing the service.
- The costs are the forward-looking costs, including a normal return on efficient investment (which takes into account the risk involved).
- Forward-looking means prospective costs using best-in-use technology. The access provider should only be compensated for the costs it would incur if it were using this technology, not what it actually incurs, for example in using out-of-date technology which is more costly. Of course, a firm may be using older technology because it was the best available at the time the investment was made and replacing it cannot be justified commercially. In a competitive market, however, that firm would only be able to charge on the basis of using the most

¹²⁰ *Application by Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8 (22 November 2006) at [80].

¹²¹ *Seven Network Limited (No 4)* [2004] ACompT,11 (23 December 2004) at [120].

up-to-date technology because, if it did not (in this hypothetical competitive market) access seekers would simply take the service from an alternative service provider.

- The cost of providing the service should be the cost that would be avoided in the long-run by not having to provide it. Thus, it is the additional or incremental costs necessarily incurred, assuming other production activities remain unchanged.¹²²

Further, the Tribunal noted that ‘in the general case where access prices need to be regulated, unless pricing is on a TSLRIC basis, efficient investment is unlikely to be encouraged.’¹²³

In the Commission’s view, the phrase ‘economically efficient use of, and economically efficient investment in, infrastructure’ refers to the concept of economic efficiency. This concept consists of three components:

- *Productive efficiency* – This is achieved where individual firms produce the goods and services that they offer at least cost;
- *Allocative efficiency* – This is achieved where the prices of resources reflect their underlying costs so that resources are then allocated to their highest valued uses (i.e. those that provided the greatest benefit relative to costs); and
- *Dynamic efficiency* – This reflects the need for industries to make timely changes to technology and products in response to changes in consumer tastes and in productive opportunities.

The Commission notes that the Tribunal decision makes it clear that the incentives for investment in new and existing infrastructure and the risks of making such an investment are given due consideration in assessing whether the particular thing promotes the efficient use of and efficient investment limb of the LTIE test. As acknowledged by the Tribunal decision, and cited above, cost-based access pricing includes a normal return on efficient investment (which takes into account the risk involved).

The Commission also notes that section 152AB clarifies, *inter alia*, that in considering whether a particular thing promotes the efficient use of and efficient investment in infrastructure, the Commission must consider the incentives for, and the risks involved in, investment in new and existing infrastructure.¹²⁴ The Commission notes that the purpose of the amendment was to make it clear that the incentives for investment in new and existing infrastructure, and the risks of making such an investment, are given due consideration in assessing whether the particular thing promotes the efficient use of and efficient investment limb of the LTIE test.

The legitimate business interests of the carrier or carriage service provider concerned and the carrier’s or provider’s investment in facilities used to supply the declared service concerned

The Commission is of the view that the concept of legitimate business interests should be interpreted in a manner consistent with the phrase ‘legitimate commercial interests’ used elsewhere in Part XIC of the Act. Accordingly, it would cover the carrier’s or

¹²² *ibid.*, at [135].

¹²³ *ibid.*, at [136].

¹²⁴ Explanatory Memorandum to Telecommunications Legislation Amendment (Competition and Consumer Issues) Bill 2005, pp. 4 and 8.

carriage service provider's interest in earning a normal commercial return on its investment. This does not, however, extend to receiving compensation for the loss of any 'above-normal' economic profits that occur as a result of increased competition. In this regard, the Explanatory Memorandum for the Trade Practices Amendment (Telecommunications) Bill 1996 states:

... the references here to the 'legitimate' business interests of the carrier or carriage service provider and to the 'direct' costs of providing access are intended to preclude arguments that the provider should be reimbursed by the third party seeking access for consequential costs which the provider may incur as a result of increased competition in an upstream or downstream market.¹²⁵

When considering the legitimate business interests of the carrier or carriage service provider in question, the Commission may consider what is necessary to maintain those interests. This can provide a basis for assessing whether particular terms and conditions in the undertaking are necessary (or sufficient) to maintain those interests.

The Commission's *Access Undertakings – A Guide to Part IIIA of the Trade Practices Act* (the Access Undertakings Guideline) states that:

The Commission's analysis of legitimate business interests of the service provider will focus on commercial considerations of the service provider. The Commission will take into account the provider's obligations to shareholders and other stakeholders, including the need to earn a commercial return on the facility. It will also aim to ensure that any undertaking provides appropriate incentives for the provider to maintain, improve and invest in the efficient provision of the service.¹²⁶

The *Access Undertakings Guideline* also states that:

The Commission will take an interest in the extent to which competition arising from access to a service generates real benefits to intermediate and final consumers and the community in general. It will not assess business interests as legitimate if they have the purpose or effect of preventing the objectives of the Trade Practices Act being realised, in particular the objective of enhancing the welfare of Australians through the promotion of competition and efficiency. In addition, and in line with the stated intentions of the access regime, the Commission will not allow for reimbursements of forgone monopoly profits which the provider may incur as a result of increased competition in an upstream or downstream market, except insofar as they affect the ability of the firm to discharge CSOs.¹²⁷

In this regard, the Commission noted in the *Access Pricing Principles Guidelines* that:

As an access price consistent with these principles allows efficient access providers to recover their costs of production it will not violate their legitimate business interests.¹²⁸

In relation to the non-price terms and conditions, the Commission considers that this criterion requires an assessment of the broader commercial interests of the access provider in conducting its own business affairs. An access provider, as an owner or controller of particular facilities, should not, simply because it is under an obligation to provide access to its service, be unduly compromised in the conduct of its own legitimate business interests. For instance, an access provider must have the right to make reasonable decisions about modifications and upgrades to its network or the right to set reasonable requirements for billing and the payment of accounts.

¹²⁵ Explanatory Memorandum for the Trade Practices Amendment (Telecommunications) Bill 1996, p. 44.

¹²⁶ ACCC, *Access Undertakings – A Guide to Part IIIA of the Trade Practices Act*, 30 September 1999, pp. 4-5.

¹²⁷ *ibid.*, p. 6.

¹²⁸ ACCC, *Access Pricing Principles Guidelines*, p. 18.

Generally speaking, an access provider is entitled to have some legitimate control over its relationship with an access seeker to the extent reasonably required to protect its business concerns.

Interests of persons who have rights to use the declared service

Persons who have rights to use a declared service will, in general, use that service as an input to supply carriage services, or a service supplied by means of carriage services, to end-users. In the Commission's view, these persons have an interest in being able to compete for the custom of end-users on the basis of their relative merits. Terms and conditions that favour one or more service providers over others and thereby distort the competitive process may prevent this from occurring and consequently harm those interests.

While section 152AH(1)(c) of the Act directs the Commission's attention to those persons who already have rights to use the declared service in question, section 152AH enables the Commission to also consider the interests of persons who may wish to use that service.

Direct costs

The Commission's considers that the 'direct costs' of providing the service are those costs necessarily incurred in the provision of access. At a minimum, in this context, the phrase 'direct costs' is interpreted to mean that an access price should cover the direct incremental costs incurred in providing access. It does not, however, extend to receiving compensation for loss of any 'monopoly profits' that occurs as a result of increased competition. As stated in the Explanatory Memorandum:

... 'direct' costs of providing access are intended to preclude arguments that the provider should be reimbursed by the third party seeking access for consequential costs which the provider may incur as a result of increased competition in an upstream or downstream market.¹²⁹

This requires that the access price should not be inflated to recover any profits the access provider (or any other party) may lose in a dependent market as a result of the provision of access. In particular the Efficient Component Pricing Rule (ECPR) may be inconsistent with this criterion.

At a minimum, an access price should cover the direct incremental costs incurred in providing access and should not exceed the 'stand-alone costs of providing the service', where this is defined to mean:

... costs an access provider will incur in producing a service assuming the access provider produced no other services.¹³⁰

The Commission considers that the TSLRIC+ of providing the MTAS reflects the direct incremental cost of providing access. In addition, the TSLRIC+ does not provide any compensation for foregone monopoly profits.

The Tribunal's has interpreted direct costs to:

- mean the total costs of providing access to the relevant declared service which ordinarily include an appropriate allocation of FCCs because without the

¹²⁹ Explanatory Memorandum for the Trade Practices Amendment (Telecommunications) Bill 1996, p. 44.

¹³⁰ ACCC, *Access Pricing Principles Guidelines*, p. 10.

existence of the assets in respect of which the FCCs are incurred, the relevant access could not be provided;¹³¹ and

- exclude the consequential costs which the access provider might incur as a result of increased competition as a result of access in any relevant market.¹³²

Economically efficient operation of, and investment in, a carriage service

In the Commission's view, the phrase 'economically efficient operation' embodies the concept of economic efficiency set out above. It would not appear to be limited to the operation of carriage services, networks and facilities by the carrier or CSP supplying the declared service, but would seem to include those operated by others (e.g. service providers using the declared service).

To consider this matter in the context of assessing an undertaking, the Commission may consider whether particular terms and conditions enable a carriage service, telecommunications network or facility to be operated in an efficient manner. This may involve, for example, examining whether they allow for the carrier or carriage service provider supplying the declared service to recover the efficient costs of operating and maintaining the infrastructure used to supply the declared service under consideration.

In general, there is likely to be considerable overlap between the matters that the Commission takes into account in considering the LTIE as it relates to the efficient use and investment of infrastructure and its consideration of this matter.¹³³

Other relevant matters

The Commission is not limited in its assessment of reasonableness to these criteria but may consider other matters relevant to the reasonableness of the non-price terms and conditions.

The Commission considers there are some common themes or indicia arising from these statutory criteria that serve as a useful guide to the Commission's assessment of the non-price terms and conditions. They are as follows.

A non-price issue may arise in relation to timeliness. That is, the time it takes for an access seeker to obtain access or any other matter related to access. This will include an assessment of the process an access seeker must negotiate to obtain access.

Intertwined with this concept is the issue of delay or potential for delay in providing access. Unreasonable delay is tantamount to no access. In relation to the above issues, the Commission will look at conditions that specify timeframes and preconditions that may attach to timeframes in the context of what potential obstacles to access may exist.

¹³¹ *Application by Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8 (22 November 2006) at [137].

¹³² *ibid.*, at [138].

¹³³ Relevantly, and as noted above, in considering whether particular terms and conditions will promote the LTIE, the Commission must have regard to their likely impact on the economically efficient use of, and the economically efficient investment in, the infrastructure by which listed carriage services are supplied and any other infrastructure by which listed services are, or are likely to, become capable of being supplied.

As the Optus 2007 Undertaking will govern the terms and conditions of access and form the basis on which Optus will satisfy the applicable SAOs, there should be certainty in the terms of the agreement. This certainty should be reflected in the technical and non-technical aspects of the agreement. Silence or lack of clarity in an agreement may deprive an agreement of certainty. The undertakings have to provide certainty on the face of the proposed agreement. That is, it should not require the Commission to make inquiries to seek clarification as to the intended terms and operation of an agreement.

The Commission is generally concerned to see that undertakings (if they deal with dispute resolution) have clear and decisive mechanisms for resolving disputes in a timely manner, especially since an access seeker will not be able to avail itself of the arbitration route once an undertaking is accepted.

Encompassing all of the above matters are the concepts of fairness and balance. As noted above, the criteria require the Commission to have regard to the interests of both the access provider and seeker. Accordingly, undertakings should reflect the balanced rights of these parties. In this regard, terms and conditions that tend to unfairly treat an access seeker, in comparison to the rights of an access provider, might be regarded as unreasonable.

In deciding whether particular non-price terms and conditions are reasonable, the Commission will to some extent also be guided by any applicable Communications Alliance Codes relevant to the matters under consideration, as well as having regard to current industry norms and practices. The reasonableness of the non-price terms and conditions are assessed on this basis.

Statutory decision making period

The Commission has a six-month statutory time frame in which to make a decision to either accept or reject an access undertaking. If the Commission does not make a decision within this six-month statutory timeframe, section 152BU(5) of the Act stipulates that:

... the Commission is taken to have made, at the end of that 6-month period, a decision under subsection (2) to accept the undertaking.

For the purpose of calculating the six-month time frame, certain periods of time are disregarded. Specifically, section 152BU(6) of the Act states that in calculating the six-month timeframe, the Commission should disregard:

- (a) if the Commission has published the undertaking under paragraph 152BV(2)(a) – a day in the period:
 - (i) beginning on the date of publication; and
 - (ii) ending at the end of the time limit specified by the Commission when it published the undertaking; and
- (b) if the Commission has requested further information under section 152BT of the Act in relation to the undertaking – a day during any part of which the request, or any part of the request, remains unfulfilled.¹³⁴

¹³⁴ In relation to information requests about the undertaking, *Trade Practices Act 1974*, section 152BT(2) states that ‘the Commission may request the carrier or provider to give the Commission further information about the undertaking; while section 152BU(3) states that ‘the Commission

Notwithstanding the six-month time limit, and those days which are to be disregarded as outlined above, the Commission notes that section 152BU(7) of the Act states that:

The Commission may, by written notice given to the carrier or provider, extend or further extend the 6-month period referred to in subsection (5), so long as:

- (a) the extension or further extension is for a period of not more than 3 months; and
- (b) the notice includes a statement explaining why the Commission has been unable to make a decision on the undertaking within that 6-month period or that 6-month period as previously extended, as the case may be.

The decision-making period in relation to the Optus 2007 Undertaking is discussed below.

Calculating the decision-making period for the Undertakings

Public consultation process

On 7 March 2007, the ACCC published a Discussion Paper and called for submissions on the Optus 2007 Undertaking. In this Discussion Paper, the ACCC indicated that the period of time for interested parties to make submissions was by no later than 5 April 2007.

On 21 June 2007, the Commission released the draft decision and called for submissions on the draft decision by no later than AEST 9am on Monday 6 August 2007.

At this point, the Commission does not consider that it will need to extend decision making period and anticipates that a final decision will be issued within the six-month statutory time frame.

may refuse to consider the undertaking until the carrier or provider gives the Commission the information.’

Appendix 2 - WIK Model

WIK MODEL STRUCTURE

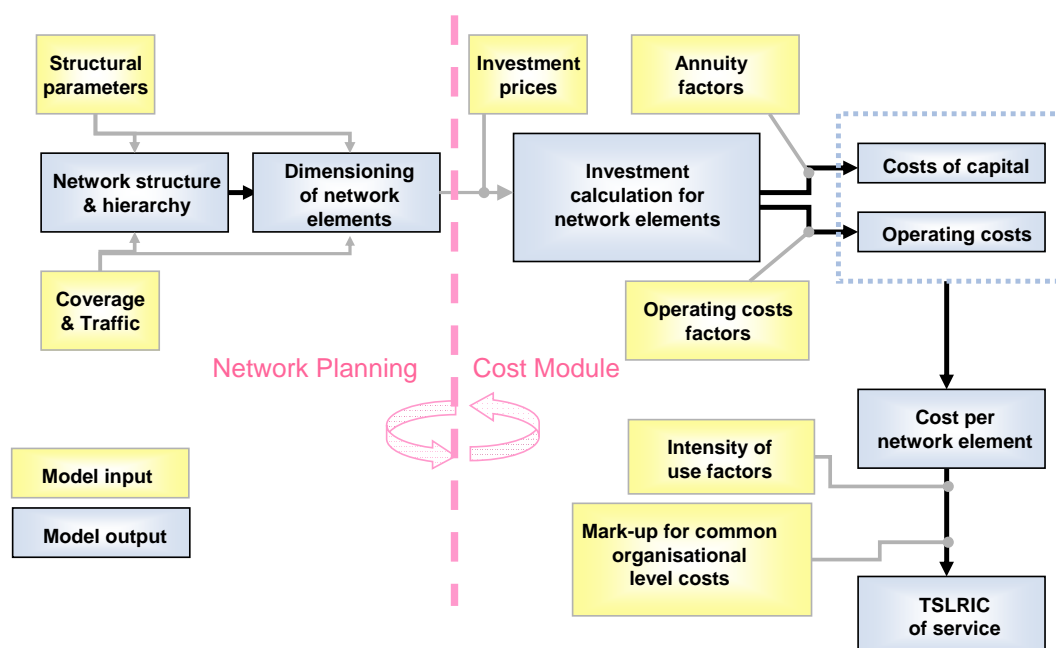
The WIK Mobile Network and Cost Model functionality and description

The WIK Model consists of two main modules (as illustrated in the schema below):

- Mobile network design and dimensioning carried out by the Strategic Network Planning Tool; and
- Calculating the costs of the various network elements carried out by the Cost Module.

Each of these parts are discussed below.

Schematic diagram of the WIK Mobile Network and Cost Model



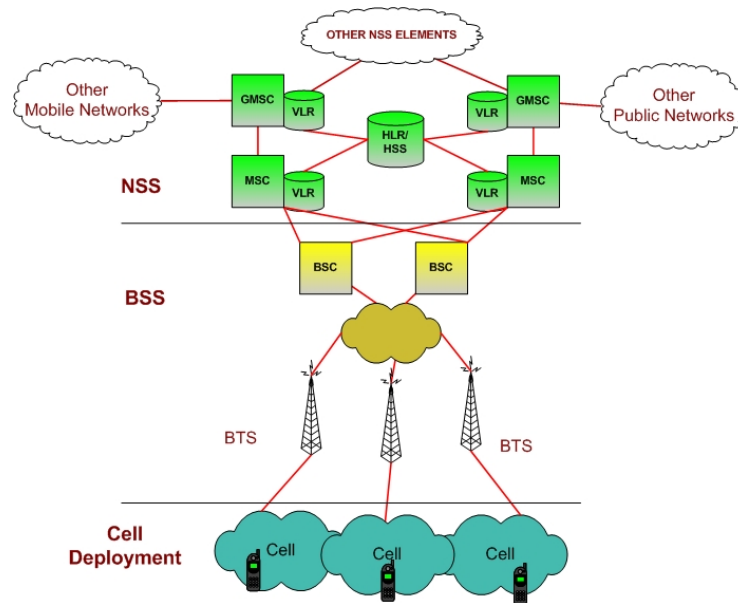
Mobile network design and dimensioning

The network design and dimensioning requires identification of the areas to be covered. This is of particular importance in the Australian context, given its population distribution and topography. The network design and dimensioning part of the model carries out the following tasks:

- Optimal cell radius calculation and cell deployment for each relevant area (based upon coverage and capacity requirements);
- Determination of the network hierarchy; and
- Determination of the capacity requirements of the link structure.

A schematic representation of the resulting architecture of the network is shown in the following picture.

Architecture for a GSM mobile network



BSS:	Base station subsystem
NSS:	Network Switching Subsystem
BTS:	Base transceiver station
BSC:	Base station controller
MSC:	Mobile switching centre
GMSC:	Mobile switching centre with gate to another network
VLR:	Visiting location register
HLR/HSS:	Home location register
A line:	A transmission link

Each of the network elements illustrated above is determined on the basis of optimising algorithms. The values for the following parameters are required:

- (1) Information about topography and population;
- (2) Demand parameters for the different services, geographic coverage requirements, total mobile penetration, market share of modelled operator, average demand per subscriber;
- (3) Technical data, equipment prices, operating and maintenance cost of network elements as a share of value of network elements; and
- (4) Network design configuration data.

Determining the cost of network services (Cost Module)

Once the network structure and all network elements have been determined as described above, the costs of providing services with this network can be determined. Total costs using a TSLRIC framework essentially consist of the annual capital cost of

all equipment items that are owned and the cost of operations and maintenance including any amortised cost of leased facilities.

The annual value of capital expenditure items or capex is derived using a tilted annuity formula for the derivation of economic depreciation. Operating expenditure in the WIK Mobile Network and Cost Model is expressed as a percentage mark-up on the value of the network elements.

The total costs comprises the total annual cost of running the network and providing all the services on the network, which, through information about routing factors and number of minutes delivered, can isolate the operating and capital cost of a particular service. Common organisational-level costs are added as an equi-proportionate mark-up on the total network element costs (direct, indirect and operating expenditure).

Determining the cost of MTAS

In the schema below, a simplified view of the network model is presented. For a call being delivered from another network and being terminated on the modelled network, there are essentially two possibilities.

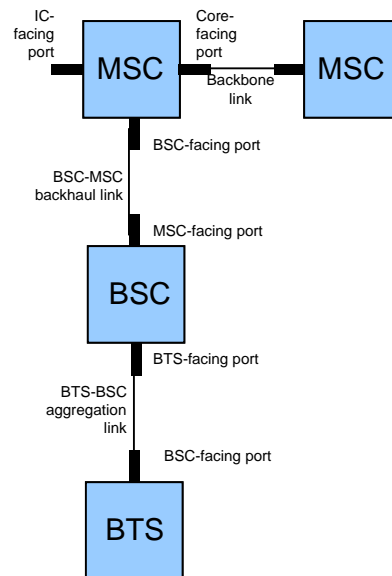
Calls can be delivered at the level of the mobile switching centre (MSC) to which the BTS belongs that serves the user receiving the call. These calls use each of the network elements on the way to this user once: MSC, home location register (HLR), link between MSC and base station receiver (BSC), the BSC itself, the link between BSC and BTS, and the BTS itself.¹³⁵ For each of these network elements the per-minute cost of using it is determined in the Cost Module so that the total cost of delivering the call is arrived at by simply adding up the per-unit costs for each of the six network elements listed.

Calls can also be delivered at the level of another MSC not serving the BTS of the receiving user. The per-minute cost of this second MSC needs to be added to the cost determined for the first case as well as to the cost of the link between this MSC and the MSC that serves the BTS in question.

For the purposes of a single cost figure for termination, the costs of both of these types of calls, is derived by using a weighted average.

¹³⁵ In some cases BTS hubs may be used between the BTS and the BSC for calls delivered to remote areas.

Schematic view of network model



Model functionality

The WIK Model is parameter-driven and various scenarios can be modelled based on these parameters. Key parameters include:

1. Threshold in terms of minimum population per basic geographical area to determine the degree of coverage;
2. Market share achieved by the modelled operator in the area covered by its network;
3. Shares of various services (voice on-net, voice off-net outgoing, voice off-net incoming, SMS, high-speed data, etc.) in the total network load; and/or
4. Prices of equipment and facilities.

The interface of the user with the model software is structured in a way so that parameter values can be modified by:

- Changing the value of a single parameter, by entering the value in a corresponding cell of the mask building the interface; and/or
- Changing the values of a number of parameters, by entering the new data into a data file that the model algorithms refer to when carrying out the calculations.

WIK MODEL VERSION 1.1 SPECIFICATIONS AND OUTPUT

Relevant population coverage assumption

A 96 per cent population coverage assumption is a realistic and relevant coverage assumption for the period after 30 June 2007, as it reflects the current population coverage of two of the three existing GSM networks.

The population coverage assumption of 96 per cent that applies to most 2G networks and that is used in the WIK Model would tend to produce a conservative upper-bound (higher) cost estimate for the MTAS than if the actual population coverage for 3G networks.

Relevant market penetration assumption

The market penetration assumption of 96 per cent reflects current services in operation and is considered relevant for the regulatory period for which the TSLRIC+ estimates derived from the WIK Model (that rely on this assumption) will apply.

Derivation of the WIK Model TSLRIC+ estimate

The WIK Model Version 1.1 has been modified to account for:

- a minimum of 2 SMSCs from 1 SMSC;
- reclassification of POAs encompassing airport precincts and other adjustments to classifications of industrial areas and military bases;
- unbilled minutes;
- more appropriate routing factors for the HLR; and
- removal of the redundant terrain parameter

In addition, the Commission considers additional adjustments can be made to further contextualise the WIK Model for Australian conditions, which provide for an even more conservative approach to parameterisation than already present in the WIK Model:

- an increase in the number of MSC switching machines from five to nine achieved by reducing the number of ports per MSC;
- an increase in the number of voice equivalent minutes to reflect a more realistic level of voice equivalent minutes (voice and data) for 2006-07. This is achieved by increasing milli-Erlang demand from 8.3 to 13.1 and holding all other annual traffic variables constant;
- elimination of the traffic reduction factor between Eastern and Western Australia by setting it to zero;
- imposing restrictions to better reflect the influence of dual band and single band radio frequencies of actual MNO networks; and
- an increase in weighted average cost of capital (WACC) to 13 per cent, notwithstanding that the change in WACC parameters in light of interested party submissions would result in a much lower WACC of between 10.7 per cent and 11.8 per cent.

Resulting TSLRIC+ estimate

The relevant reference points for TSLRIC+ estimates for the supply of the MTAS for consideration are summarised in the following table:

Table A-1: TSLRIC+ estimates of MTAS supply

Population coverage: 96 per cent Penetration rate: 96 per cent	TSLRIC+ estimate of supply (cpm)
Reference Case 1 (25 per cent)	5.6
Reference Case 2 (31 per cent)	5.2

The results in this table indicate that an efficient cost estimate for the supply of the MTAS is in the range of 5.2 cpm to 5.6 cpm, for relevant efficient operator scenarios instead of the range of estimates released in the WIK Model version released on 16 February 2007 of 5.3 per cent and 5.9 per cent prior to recalibration and inclusion of relevant considerations in an Australian context.

Appendix 3 - International Cost Benchmarking

The Commission notes that the current *MTAS Pricing Principles Determination* is informed by international cost benchmarking and RAF data analyses, which identified a range of TSLRIC + estimates for the supply of the MTAS of 5 cpm to 12 cpm. The Commission outlined in the *MTAS Final Report* that before it would reduce the price of the MTAS below 12 cpm with reference to international cost benchmarking any such exercise would need to make adjustments for all factors that influence the TSLRIC of providing the MTAS in different countries for Australia-specific factors. For the purposes of this current process, the Commission has not undertaken this detailed benchmarking exercise, so the information provided below in relation to cost and price benchmarking processes is used as corroborating information.¹³⁶

Optus refers to several European mobile termination rates in its benchmarking analysis.¹³⁷ In particular, Optus refers to the cost models that have been developed (or are in development) in the United Kingdom, the Netherlands and Sweden which the Commission considers below.

The Commission considers it is difficult to comprehensively assess the robustness of Optus's international benchmarking analysis without detailed referencing of the sources of these data.

Since the release of the *MTAS Pricing Principles Determination* in June 2004, international benchmarking analyses have further featured in regulatory processes and, in particular, Optus has sought to rely on such analysis to support its position in: (i) the ordinary access undertaking lodged with the ACCC on 23 December 2004 (**2004 Optus Undertaking**) in support of a price of 17 cpm; and (ii) the Optus 2007 Undertaking to support its proposed price of 12 cpm.

The Commission notes that these international benchmarking analyses have not always related to cost benchmarks and have more recently focused on rate or price benchmarks. It was for this reason that the Tribunal concluded in its decision regarding the 2004 Optus Undertaking:

We do not consider that the international benchmarking analysis proffered by Optus is of any assistance to us in determining the issue as to the reasonableness of Optus' price... In order to place any reliance on the international benchmarking analysis it would be necessary to know much more about the regulatory environment within which they were determined...¹³⁸

These previous analyses have sought to confound price and cost analyses thereby attempting to represent the Commission's cost estimates and range as significantly lower than in other jurisdictions. Further, these analyses have also misrepresented the model framework and approach used in other jurisdictions. The Commission considers without detailed referencing of the benchmarking analyses by Optus that these concerns remain valid.

¹³⁶ ACCC, *MTAS Final Report*, p. 211.

¹³⁷ Optus, *Optus Submission in Support*, pp 24-25.

¹³⁸ *Application by Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8 (22 November 2006) at [296-297].

That said, the Commission notes that since the international cost benchmarking analysis was performed, there have been several developments relevant to the benchmarks from European jurisdictions submitted by Optus that require addressing.

European Cost Models

United Kingdom Cost Model: On 27 March 2007, Ofcom released its final statement on mobile call termination. In this statement, Ofcom proposes an average price of 5.1 pence per minute (ppm) (12.1 cpm¹³⁹) for four of the mobile carriers and 5.9 ppm (14.0 cpm¹⁴⁰) for one of the mobile carriers operating in the United Kingdom for the period from 1 April 2010.¹⁴¹

There are several features of this model, which may reduce the comparability of its outputs in an Australian regulatory context:

- The prices set included a network externality charge to the value of 0.3 ppm (or 0.72¹⁴²) cpm), which is not considered relevant in an Australian context.¹⁴³
- Ofcom's approach to spectrum costs is peculiar to the United Kingdom regulatory context reflecting the significant costs incurred for the purchase of spectrum in the United Kingdom and further is inconsistent with a European Union (EU) directive on how spectrum costs should be treated.¹⁴⁴
- The EU¹⁴⁵ has estimated that the impact of the 3G spectrum costs added on average between 1.2 ppm to 1.9 ppm or the equivalent of 2.9 cpm¹⁴⁶ to 4.5 cpm to the MTAS price.¹⁴⁷
- The model is a hybrid 'top-down' and 'bottom-up' cost model and has been parameterised with MNOs' accounting data¹⁴⁸ with limitations including a robust and consistent set of detailed accounting information for all MNOs.¹⁴⁹

Together the impacts of the NES and spectrum costs would reduce the target price to be implemented in the United Kingdom for 1 April 2010 by 3.6 cpm and 5.2 cpm resulting in target prices less than 9 cpm, when converted to Australian currency¹⁵⁰.

The Ofcom Model provides a conservative upper-bound estimate of the supply of the MTAS in an Australian context.

The Netherlands Cost Model: The Netherlands national regulatory authority, Onafhankelijke Post en Telecommunicatie Autoriteit (OPTA) has developed a

¹³⁹ Using an exchange rate of 0.42 GBP to 1 Australian dollar.

¹⁴⁰ Using an exchange rate of 0.42 GBP to 1 Australian dollar.

¹⁴¹ Ofcom, *Mobile Call Termination Report Statement*, March 2007, p.2.

¹⁴² ACCC, *2007 MTAS Pricing Principles Determination Report*, p. 48.

¹⁴³ *ibid.*, p. 49

¹⁴⁴ *ibid.*

¹⁴⁵ *ibid.*

¹⁴⁶ *ibid.*

¹⁴⁷ *ibid.*

¹⁴⁸ *ibid.*

¹⁴⁹ *ibid.*,

¹⁵⁰ *ibid.*,

Bottom-Up Forward Looking Long Run Incremental Cost (BULRIC) Model, informing it of ‘cost-orientated’ MTAS rate from 1 July 2006. The OPTA Model framework, notwithstanding its title, is also a hybrid, ‘top-down’ model as ‘the unit costs used to populate the model have been derived by averaging across operator-provided data’.¹⁵¹ The Commission notes that the target rates relevant required to be implemented by July 2008 are less than 12 cpm.

The Swedish Cost Model: also adopts a hybrid of ‘bottom-up’ (LRIC + EPMU) and ‘top-down’ (historic costs) approach to parameterising the model.¹⁵² This feature would tend to suggest that the outcomes in this cost model reflects a conservative upper-bound TSLRIC+ estimate for the supply of the MTAS. The Swedish Model also provides for a target price for 2007 below 12 cpm.

The cost parameterisation approaches adopted in the United Kingdom, the Netherlands and Sweden ‘hybrid’ models are not considered to be true ‘bottom-up’ cost models that necessarily reflect efficient cost estimates and will provide at best an upper-bound efficient cost estimate.

Other Cost Models

The Commission notes that there have been developments of comparable ‘bottom-up’ cost models informing cost benchmarks that can be used as corroborative support for the TSLRIC+ estimate range of 5 cpm to 12 cpm. The models from jurisdictions such as South Korea and Israel provide for cost estimates of 4.49 cpm and 5.45 cpm respectively.¹⁵³ However, as already noted the Commission has stated in the *MTAS Final Report* that before it would reduce the price of the MTAS below 12 cpm with reference to benchmarking any detailed benchmarking exercise would need to make adjustments for all factors that drive the TSLRIC of providing the MTAS in different countries for Australia-specific factors.¹⁵⁴

In these circumstances the Commission is concerned about relying on Optus’s international benchmarking analysis as the sole basis for supporting a sustained price of 12 cpm from 1 July 2007. This is particularly in light of the fact that in 2004, 12 cpm was recognised as a conservative upper-bound estimate of supply of the MTAS for the period 1 July 2004 to 30 June 2007 and comparable cost benchmarks suggest a TSLRIC+ estimate of supply lower than this price.

¹⁵¹ *ibid.*

¹⁵² *ibid.*, p. 50.

¹⁵³ See: ACCC, *Optus Undertaking Final Decision*, p.123.

¹⁵⁴ ACCC, *MTAS Final Report*, p. 211.

Appendix 4 – Confidential

FL-LRIC+ estimate of the supply of the MTAS by Optus

The Commission notes that Optus has not relied on the information previously supplied in support of its MTAS Undertaking in 2004. However, it is instructive to review this material for the current undertaking process.

When Optus submitted its MTAS Undertaking to the Commission in 2004, it employed a FL-LRIC framework through a model prepared by CRA.

At the time the Commission noted conceptual and methodological problems with inputs used in the CRA Model. At the time the Commission noted that many of the assumptions employed to calculate the CRA model inputs would tend to over estimate the FL-LRIC of the DGTAS from its ‘efficient’ level.¹⁵⁵

While the Commission considers that the FL-LRIC and TSLRIC concepts are broadly consistent underlying cost concepts, there are significant differences in the approach to the mark-ups (or ‘+’s) that apply under each concept as applied by Optus. As distinct from the Commission’s TSLRIC+ principle, Optus proposed a different method of allocating common costs (Ramsey-Boiteux principles) and it includes a second ‘+’ factor: a ‘network externality surcharge.’ The Commission believes that these mark-ups did not reflect the efficient costs of providing the MTAS service and is above the reasonable price for recovering investment costs. The Tribunal agreed with the Commission’s position that these mark-ups do not reflect the efficient costs of providing the MTAS service. The Commission’s decision was affirmed by the Tribunal.¹⁵⁶

The Commission retained Analysys Consulting Pty Ltd (Analysys) to provide advice on the CRA Model. Analysys provided its final report to the Commission in October 2005.¹⁵⁷ The work performed by Analysys informed the Commission of the FL-LRIC+ estimates for the supply of the MTAS by Optus in Australia. Consultancy work undertaken by WIK also assisted the Commission to inform its views on the appropriateness of CRA’s estimates of the mark-ups for allocating common costs and the ‘network externality surcharge’. The analysis provided by both consultants has informed the illustrations below.

¹⁵⁵ *ibid.*, section 5.2.4.

¹⁵⁶ *Application by Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8 (22 November 2006).

¹⁵⁷ *Analysys, Review of the Mobile Terminating Access Service Cost Model submitted by Optus – Revised final report for the ACCC*, 14 October 2005.

Figure 1: Analysys's estimate of Optus's MTAS prices

C-i-C

Figure 2: Optus's proposed MTAS prices Optus Undertaking 2004

C-i-C

Note: The Fixed and Common costs in Figure 1 are allocated by Analysys according to an EPMU approach.

As illustrated in the diagrams above a key difference in the Optus conceptual framework is the nature and quantum of mark-ups (or '+'s) that apply.

Network externality surcharge

The Tribunal concluded that if externalities are to be considered in pricing services, they need to be surveyed with some degree of thoroughness and that in the absence of evidence it was difficult to be conclusive. It considered that it is not sufficient to include some externalities in the analysis and ignore others purely on an *a priori* basis that they matter less. Further, while the Tribunal does not rule out the possibility that taking into account externalities may be a valid part of coming to a reasonable price, it

indicated that there are difficulties in the approaches put before it. Namely, the degree of empirical accuracy required about likely behaviour, and which was absent, for it to have confidence that a particular approach adopted leads to a well-based outcome.¹⁵⁸

Ramsey-Boiteux

The Tribunal has made several comments about the use of an EPMU including: that regulators prefer the EPMU approach and that it is incorrect to say that applying an EPMU is an over-cautious reaction to uncertainty regarding elasticities and has concluded:

The body of expert economic material is persuasive of the proposition that consistent with accepted economic theory and principles, it is not appropriate to use the R-B pricing principles to determine the allocation of FCCs to an MTAS.¹⁵⁹

The Commission is of the view that the TSLRIC+ estimate of Optus supplying its DGTAS (i.e. FL-LRIC of c-i-c cpm to which an EPMU mark-up of c-i-c cpm is added to estimate TSLRIC+) based on the CRA model inputs may represent an upper-bound estimate of the costs of supplying the MTAS in Australia for Optus.¹⁶⁰

¹⁵⁸ *Application by Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8 (22 November 2006) at [287-291].

¹⁵⁹ *ibid.*, at [242].

¹⁶⁰ ACCC, *Optus Undertaking Final Decision* Chapter 5.

Appendix 5 - 'Waterbed' effect and Two-sided market

(a) 'Waterbed' effect

The converse of the 'waterbed' effect

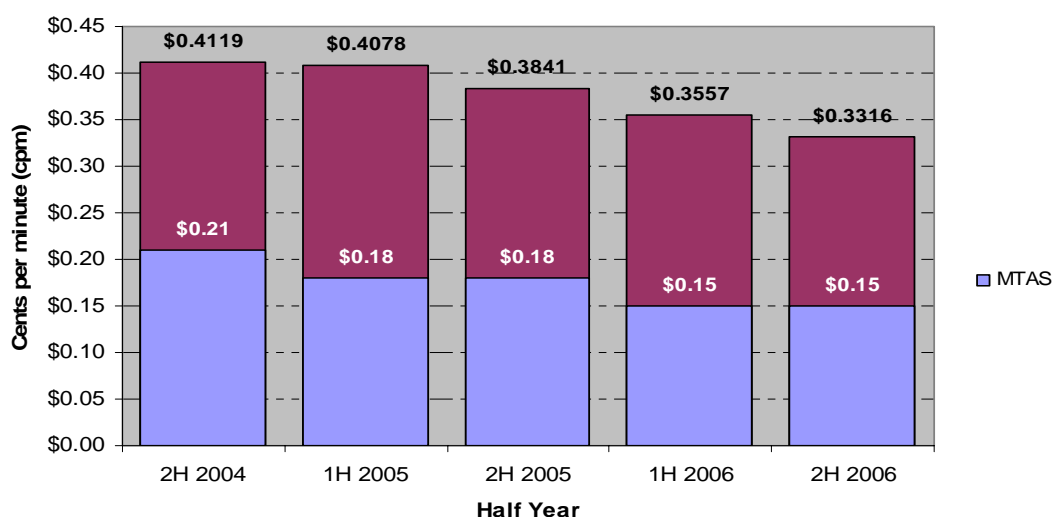
The 'waterbed' effect refers to the extent to which regulated reductions in access prices such as the MTAS results in increases in retail prices, which includes the price of outgoing mobile calls and subscription or fixed contract and handset prices. For further discussion on the 'waterbed' effect see ACCC, *Optus Undertaking with respect to its Domestic GSM Terminating Access Service (DGTAS) Final Decision*, February 2006, Appendix 5.

There has been no empirical evidence of the so-called 'waterbed' effect. Instead of retail mobile prices increasing and handset or subscription subsidies being eliminated due to a fall in the MTAS rates, there has been a decrease in retail prices for mobile outbound calls and an increase in the level of handset subsidies accompanying the fall in the MTAS rates. This suggests that the opposite than the 'waterbed' effect has been occurring.

i. Average retail price reductions are occurring without pass-through mechanisms:

Figure 1 illustrates that Telstra's average access fee and call charge revenue per minute does not provide evidence of the 'waterbed' effect:

Telstra Average Access and Call Charge Revenue/Minute¹⁶¹



¹⁶¹ Source: ACCC, 2007 MTAS Pricing Principles Determination Report, p. 25.

Telstra's indicative FTM pricing Half 1 2004 to Half 1 2007

	2003 Half 2 Dec-03	change from previous period (%)	2004 Half 1 June-04	change from previous period (%)	2004 Half 2 Dec-04	change from previous period (%)	2005 Half 1 June-05	change from previous period (%)
FTM Revenue (\$millions)	808	NA	789	-2.4	806	2.1	760	-5.7
FTM minutes (millions)	2,099	NA	2,127	1.3	2,206	3.7	2,169	-1.7
Yield (cpm)	38.5	NA	37.1	-3.6	36.5	-1.6	35.0	-4.1
	2005 Half 2 Dec-05	change from previous period (%)	2006 Half 1 June-06	change from previous period (%)	2006 Half 2 Dec-06	change from previous period (%)	Dec-03 to Dec-06 change (%)	
FTM Revenue (\$millions)	761	0.1	729	-4.2	749	2.6	-7.3	
FTM minutes (millions)	2,234	3.0	2,257	0.6	2,339	3.6	11.4	
Yield (cpm)	34.1	-2.9	32.3	5.3	32.0	0.9	-16.9	

Source: Telstra Corporation Limited Financial Results for the Half Year ended 31 December 2006, p. 13. and Telstra Corporation Limited Annual Report (for the Full Year ended 30 June 2006) pp. 15-16. and Telstra Corporation Limited Financial Results for the Half Year ended 31 December 2005, p. 11. and Telstra Corporation Limited Annual Report (for the Full Year ended 30 June 2005) p. 82 and Telstra Corporation Limited Financial Results for the Half Year ended 31 December 2004 p. 7.

Telstra's average call rates have fallen from 41.19 cpm in the second half of 2004 to 33.16 cpm¹⁶² in the second half of 2006, coinciding with a fall in the MTAS from 21 cpm to 15 cpm.

Similarly, Optus's 31 March 2007 year-end results indicate that total revenue increased by 3.5 per cent from 31 March 2006.¹⁶³ There is no information to suggest that this increase in revenue is as a result of increasing retail mobile rates bought about by the 'waterbed' effect, but rather this increase in revenue is mainly attributable to an increase in subscribers which grew by 3.9 per cent between March 2006 and March 2007.¹⁶⁴

Optus's March year end 2007 results also illustrate that minutes of use per user per month grew at a faster rate than average revenue per user per month, implying decreasing revenue per minute in the March year end 2007 compared to previous

¹⁶² ACCC, *2007 MTAS Pricing Principles Determination Report*, p. 25.

¹⁶³ *ibid.*

¹⁶⁴ *ibid.*, p. 26. It is unclear from the information that the Commission has available to it publicly as to the extent of this increase is attributed if at all to Virgin Mobile subscribers.

quarters and the previous financial year.¹⁶⁵ This is also indicative of lower, not higher, retail mobile rates.

ii. *FTM retail pass-through occurring without mandated pass-through mechanisms*

In demonstrating the lack of substantiation for operation of the ‘waterbed’ effect in Australia, it is clear FTM retail prices are lower compared with a period prior to the adjustment path for indicative prices for the MTAS as outlined above.

Only Telstra publicly reports data on FTM revenue and minutes. These data are presented in the LTIE discussion about promoting competition in the market in which FTM services are provided and show that yields have fallen from 38.5 cpm as at 31 December 2003 to 32 cpm as at 31 December 2006.¹⁶⁶

Evident from the analysis of Telstra’s falling FTM yields is that FTM volumes have consistently increased. The impact of falling MTAS prices on call volumes is a point that is often ignored in almost all of the analyses of the ‘waterbed’ effect, but at the same time these analyses put forward the improbable argument that profit can be sustained or increased from an increase in retail mobile prices to offset lost termination revenues.¹⁶⁷

iii. *Handset subsidies are increasing not decreasing*

Again only Telstra reports financial information on the value of handset subsidies.

Handset subsidies for Telstra have not declined since 2004, notwithstanding changes to accounting treatment over time, which Telstra explains as ‘attributable to a rise in the take up of handsets on subsidised plans as well as higher average subsidies offered.’¹⁶⁸

iv. *Conclusion on the empirical substantiation of the ‘waterbed’ effect*

The Commission considers that these trends of lower average retail prices (including lower FTM prices) and the increase in handset subsidies demonstrate that the converse of the ‘waterbed’ effect has been in operation.

(b) Two-sided market

In the *MTAS Final Report* the Commission stated that it does not consider the MTAS to be part of a retail bundle (or cluster) of mobile services. Rather it considered that MTAS is provided as an individual wholesale service sold to other network operators.¹⁶⁹ While the Commission is of the view:

¹⁶⁵ ACCC, *2007 MTAS Pricing Principles Determination Report*, p. 26.

¹⁶⁶ Telstra Corporation Limited and Controlled Entities, *Results and Operations Review Half Year Ended 31 December 2006*, p. 13.

Telstra Corporation Limited and Controlled Entities, *Results and Operations Review Half Year Ended 31 December 2003*, p. 12.

¹⁶⁷ ACCC, *2007 MTAS Pricing Principles Determination Report*, p. 26

¹⁶⁸ *ibid.*

¹⁶⁹ ACCC, *MTAS Final Report*, p. 46.

...the MTAS is 'two-sided' in nature, in that it provides benefits to both mobile subscribers and those individuals that chose to make calls to them. However, just because the service is two-sided in nature doesn't mean that it should be defined to be provided in the same bundle (or cluster) as retail mobile services. Further, it should not imply that MNOs are constrained by mobile subscribers when setting the price of the MTAS, or that the provision of retail mobile services provides a constraint on pricing of this service.¹⁷⁰

In this regard the Commission maintains its view expressed in the *MTAS Final Report* that:

MNOs have control over access to termination of calls to subscribers on their network. As a result of this, the Commission does not believe that MTASs provided on different mobile networks are substitutable for each other – calls to a consumer connected to one mobile carrier's network cannot be terminated on another carrier's network. Further, there are no adequate demand- or supply-side substitutes that will constrain mobile network operators in their pricing decisions for the mobile termination service. These factors, combined with a lack of consumer awareness (on the part of both the A- and B-party consumers) and the incentives that arise from the CPP [calling party pays] principle that governs calls to mobile networks, fails to mitigate the control over access mobile operators have with regard to calls terminating on their networks.

The Commission further concluded that alternative forms of communication, such as fixed-line network services, SMS messages, email and calls using voice over Internet protocol (VoIP) technology, are not sufficiently substitutable means of contacting a mobile subscriber to constrain providers of a MTAS from monopoly pricing.¹⁷¹

The Commission notes that the Tribunal agrees with the Commission's interpretation of the Optus MTAS market:

Accordingly, we lean towards the Commission's view of the appropriate market definitions. It is correct to identify a wholesale market for the supply of Optus' MTAS. There are no substitutable products and the relevant market transaction is a wholesale transaction provided by one network operator to another. To the extent to which there is substitutability of products or services it is the bundle of services which is substitutable; one of the services is not substitutable for another of the services. However, it would be somewhat artificial to use this wholesale market for the purpose of identifying and analysing Optus' conduct and that of its competitors, and the effect of Optus' pricing of its DGTAS on its customers and its competitors, both mobile network and fixed-line operators, independently of the national market for retail mobile services. Nor, indeed, did the Commission suggest such an approach. Such conduct and effect is only meaningfully analysed and understood in the context of the wider markets identified by Optus and the Commission: see *Power New Zealand Ltd v Mercury Energy Limited and Commerce Commission* [1996] 1 NZLR 686 at 705.¹⁷²

The Commission maintains its view expressed in the *MTAS Final Report* that MNOs are not constrained in their pricing decisions for the MTAS, and have both the ability and incentive to raise the price of this service above its underlying cost of production. The Commission's view is based on the lack of alternative substitutes for the service and that the MTAS is effectively a monopoly market for each MNO.

¹⁷⁰ *ibid.*

¹⁷¹ *ibid.*, pp. 29-56.

¹⁷² *Application by Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8 (22 November 2006) at [80].