



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

**Final Decision  
November 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  
WACC

Unconditioned Local Loop Service  
Vodafone Australia Pty Ltd  
Voice over Internet Protocol  
Weighted Average Cost of Capital

## **1. Commission's 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.

The ACCC's 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. Optus provided a commercial-in-confidence submission to support the undertaking on 13 March 2006. Optus provided a public version of its submission on 16 March 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 Service<sup>1</sup>; and
- a schedule outlining Optus's proposed charges for the Optus DGTAS<sup>2</sup> - 12 cents per minute (cpm).

On 21 June 2007 the Commission released its draft decision to reject the Optus 2007 Undertaking. The Commission sought submissions on its draft decision by 6 August 2007. Optus did not provide a submission prior to the deadline. Optus provided a submission on 15 August 2007.

On 29 August 2007, the Commission notified Optus that the Commission was extending the six month statutory period for assessment of the undertaking by three months until 13 December 2007.

### **Price-related terms and conditions**

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<sup>1</sup> Optus, *Optus 2007 Undertaking*, Schedule 1, p. 5.

<sup>2</sup> *ibid.*, Schedule 2, p. 6.

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.<sup>3</sup>

## **2.1. 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.<sup>4</sup>

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. The Commission has, therefore, decided to reject the Optus 2007 Undertaking.

### **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;

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<sup>3</sup> *ibid.*

<sup>4</sup> Optus, *Optus 2007 Undertaking*, clause 2.2, p. 2.

- 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.

### **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.<sup>5</sup> 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*,<sup>6</sup> 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.<sup>7</sup>

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

- the MTAS provided on each individual mobile network is defined to be provided in its own individual product market<sup>8</sup>; and
- termination services of individual MNOs are not substitutable for each other.<sup>9</sup>

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.<sup>10</sup>

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

<sup>6</sup> 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.

<sup>7</sup> *ibid.*, p. 205.

<sup>8</sup> *ibid.*, p. 67.

<sup>9</sup> *ibid.*, p. v.



## 4.2. Use of the with and without test

The Commission notes Telstra's submissions that the 'with and without test' has little or no application in the assessment of an ordinary access undertaking.<sup>11</sup>

The Commission has not used this tool or test to make its decision in the Optus 2007 Undertaking.

## 4.3. 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.<sup>12</sup> The Commission outlines its reasons below in terms of the overall reasonableness of the price terms and conditions and then with reference to the relevant statutory criteria.

### 4.3.1. Overall reasonableness of the price terms and conditions

Optus is seeking to apply a price of 12 cpm for the period 1 July 2007 to 31 December 2007.

Optus submits 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 model is in a draft stage of development.

The Commission notes Telstra's submissions in relation to the reasonableness test and the lack of support provided by Optus to show that a price of 12 cpm is reasonable for the supply of the DGTAS by Optus in Australia, including among other issues that 12 cpm represents an efficient cost of supply.<sup>13</sup>

The Commission is not satisfied that the proposed price of 12 cpm is reasonable. Optus has not provided evidence to establish that 12 cpm is a reasonable price for the supply of the MTAS. It has sought to rely on international benchmarking analyses, but has not provided detailed information about the data sources for the information it is seeking to rely on, including whether the benchmarks are price or cost benchmarks. The Commission is unsure whether the benchmarks are based on regulated prices or benchmarks based on costs derived from models or accounts. Telstra in its response to the draft decision submits that it agrees with the Commission's conclusions on Optus's use of international benchmarking of cent per minute costs.<sup>14</sup>

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<sup>10</sup> *ibid.*, pp. 67-70.

<sup>11</sup> Telstra, *Submission in Response to the ACCC's Draft Decision on Optus' 2007 Undertaking in Relation to the Domestic Mobile Terminating Access Service* (Telstra Submission in Response), August 2007, pp. 8-9.

<sup>12</sup> 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).

<sup>13</sup> Telstra, *Telstra Submission in Response*, pp.4-5.

<sup>14</sup> Telstra, *Telstra Submission in Response*, p. 2.

The Commission notes that in its response to the draft decision, Optus seeks to update the European benchmarking analysis and support its position stating that ‘the Commission’s proposed 9 cpm termination rate is significantly lower than all but one of the countries of the European Union...and 12 cpm is not an unusually high rate.’<sup>15</sup>. The Commission considers that Optus does not demonstrate the reasonableness of 12 cpm in relation to the efficient cost estimate for the supply of the DGTAS.

The following outlines the limitations of the Optus international benchmarking analysis to support that 12 cpm is reasonable:

1. The Commission notes that the information provided by Optus is not complete and countries such as the United Kingdom are omitted from the Optus analysis but are contained in the European Regulators Group (ERG) *Updated snapshot on mobile termination rates (June 2007)*.<sup>16</sup> Optus has not provided any reason as to why this country is excluded from its analysis.
2. There is no indication from these average termination rates data provided by Optus as to whether the data are peak termination, off-peak termination or total termination rates (all these rates are labelled average mobile termination rates in the ERG ‘snapshot’ document).
3. Optus has not provided as part of its analysis the exchange rate used to convert the European rates used by the ERG to an Australian dollar rate. The Commission has not been able to verify if the Australian cent per minute rates are accurately converted.
4. In addition, the ERG termination rates referred to by Optus are as of 1 January 2007, and the United Kingdom (excluded from the Optus analysis) has had a reduction in regulated termination rates since that time, below the rates reported. In addition, termination rates in Sweden have also reduced since 1 January 2007 which was not reflected in the data. An updated snapshot of mobile termination rates as of 1 July 2007 was released by the ERG on 23 October 2007<sup>17</sup> which reflects the reduction in rates.
5. The Commission considers that the termination prices in three countries (United Kingdom, Netherlands and Sweden), contained in the ERG ‘snapshot’ may not be entirely comparable to an Australian regulatory context as an efficient cost estimate for the supply of the MTAS. This is outlined in Appendix 3. The analysis of those countries demonstrates the limitations of the Optus international benchmarking exercise.
6. Optus also seemingly contradicts the basis of its own supporting submission for the Optus 2007 Undertaking in relation to international benchmarking analysis by submitting that: ‘Optus considers that the Commission’s international benchmarks are of limited use since efficient costs are influenced by many factors, which vary between one country and another. The Tribunal has recognised this point and accordingly has placed limited weight on

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<sup>15</sup> Optus, *Optus submission to Australian Competition and Consumer Commission on Draft Decision on Optus 2007 MTAS Undertaking*, 15 August 2007, p. 33.

<sup>16</sup> ERG (07) 27 *Updated snapshot on mobile termination rates*, Accessed on 21 August 2007, [http://erg.eu.int/doc/whatsnew/erg\\_07\\_27\\_mtr\\_update\\_snapshot\\_for\\_publication.pdf](http://erg.eu.int/doc/whatsnew/erg_07_27_mtr_update_snapshot_for_publication.pdf)

<sup>17</sup> ERG (07) 61 *Updated snapshot on mobile termination rates*, Accessed on 8 November 2007, [http://erg.eu.int/doc/publications/erg\\_07\\_61\\_mtr\\_update\\_snapshot\\_for\\_publ.pdf](http://erg.eu.int/doc/publications/erg_07_61_mtr_update_snapshot_for_publ.pdf)

international benchmarks'.<sup>18</sup> The Tribunal was not dismissive of international benchmarks per se, as the following shows, but it stated that it could not rely on the international benchmarking analysis provided by Optus to support its undertaking submitted in 2004:

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...<sup>19</sup>

The Commission considers that the Tribunal's comments support the Commission's view that the benchmarking analysis proffered by Optus to support the Optus 2007 Undertaking cannot be relied upon to provide support for the reasonableness 12 cpm for the supply of Optus's DGTAS.

Telstra submits that other sources (the expired Pricing Principles determination which listed 12 cents per minute as a conservative estimate, comparable international benchmarks endorsed by the Commission, the CRA cost model and the WIK Mobile and Network Cost Model) demonstrate that 12 cents per minute is likely to significantly overstate Optus's costs of supplying the MTAS (and/or DGTAS).<sup>20</sup>

The Commission notes that 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 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.

Since 2004, more reliable and robust information about the efficient costs of the supply of the MTAS in an Australian context has also become available to suggest that 12 cpm is not reasonable, including:

- 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.<sup>21</sup> 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

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<sup>18</sup> Optus, *Optus submission to Australian Competition and Consumer Commission on Draft Decision on Optus 2007 MTAS Undertaking*, 15 August 2007, p. 34.

<sup>19</sup> *Application by Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8 (22 November 2006) at [296-297].

<sup>20</sup> Telstra, *Telstra Submission in Response.*, p. 3.

<sup>21</sup> 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.

the CRA Model. At that 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.<sup>22</sup> 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 rises in costs, the cost estimate for the DGTAS would be below 12 cpm in an Australian context (refer to Appendix 2 for details). The Commission notes that Optus has not provided an updated model.

- the development of comparable international cost models that can be used as benchmarks to corroborate the TSLRIC+ estimated range of 5 cpm to 12 cpm. (refer to Appendix 3 for details) and
- the development of the WIK Model which indicates at this stage, and without further refinement of the WIK Model for submissions received from interested parties on the WIK Model Version 1.1, that an efficient cost estimate for the supply of the MTAS in an Australian context is below 12 cpm (refer to Appendix 5). In respect of this issue rather than use international benchmarking analysis to support that 12 cpm is reasonable, Optus attempts to demonstrate that the Commission's proposed indicative price for the period 1 July 2007 to 31 December 2008 of 9 cpm is not reasonable. The Commission considers that the substantial submissions made by Optus in respect of the WIK Model and the application to the MTAS Pricing Principles Determination for the period 1 July 2007 to 31 December 2008 are misplaced for the purposes of demonstrating the reasonableness of 12 cpm as a price for the supply of the MTAS by Optus.

Optus's submissions on the WIK Model Version 1.1 are summarised in part in Appendix 5 but the Commission has not addressed these submissions in the context of assessing the Optus 2007 Undertaking, particularly given the lack of information provided by Optus to support the reasonableness of its position. The onus is on Optus to provide information to support that 12 cpm is a reasonable price for the supply of the DGTAS, which it has not done.

The Commission considers that there is insufficient information before it to show that a price of 12 cpm for the supply of the MTAS as outlined in the Optus 2007 Undertaking is reasonable for the period 1 July 2007 to 31 December 2007. The Commission notes the Tribunal's position that:

there is still a need for the Commission (and, on review the Tribunal), to be satisfied, having regard to the matters set out in s152AH and the objectives in s 152AB of the Act, that the firm's costs are efficiently incurred. In general terms, an operator in a competitive market should have more of an opportunity to establish the efficiency of its recently incurred costs by reference to its actual costs than a monopolist or dominant operator such as Telstra in *Telstra Corporation Limited* [2004] AcompT4.<sup>23</sup>

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<sup>22</sup> *ibid.*, p. xii.

<sup>23</sup> Application by Optus Mobile Pty Limited & Optus Networks Pty Limited [2006] ACompT 8, 22 November 2006, at [116-118].

Optus has not provided information that the undertaking price of 12cpm reflects Optus' costs or demonstrated that its costs are efficiently incurred. The Tribunal's decision was available to Optus prior to the lodgment of its undertaking, but Optus appears to have not taken into account the Tribunal's views in its undertaking proposal.

#### **4.3.2. Relevant Statutory Criteria**

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 in sections 4.3.3 to 4.3.8.

#### **4.3.3. The long term interests of end-users**

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.<sup>24</sup>

#### **Promoting competition in the relevant markets**

##### *Optus's initial submission*

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.<sup>25</sup>

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.<sup>26</sup>

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;

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<sup>24</sup> *Trade Practices Act 1974*, section 152AB(2).

<sup>25</sup> Optus, *Submission to ACCC in Support of the Optus 2007 Undertaking* - Public version (Optus Submission in Support), 16 March 2007, p. 10.

<sup>26</sup> *ibid.*, p. 15.

- 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.<sup>27</sup>

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

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<sup>28</sup>.

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 cost models.

### **Optus's submission on the Draft Decision**

Optus submits that even if the regulated price of the MTAS is to be closely aligned with the efficient cost of provision of the MTAS, the Commission should not be informed by the WIK Model as it does not provide an estimate of the efficient cost of the MTAS.<sup>29</sup>

Optus submits that it considers that the Commission's conclusion that 12 cents per minute is in excess of the efficient cost of supply of the MTAS is not properly supported by either the outputs of the WIK Model or by the other corroborating evidence. It therefore submits that the Commission's findings on the legislative criteria formed in reliance on this conclusion, and its rejection of Optus's undertaking on this basis, are invalid.<sup>30</sup>

### ***Submissions on the Discussion Paper***

#### **AAPT**

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<sup>27</sup> *ibid.*, p. 16.

<sup>28</sup> *Ibid.*, p. 26

<sup>29</sup> Optus, *Submission to ACCC on Draft Decision on Optus 2007 MTAS Undertaking* - Public version (Optus Submission on Draft Decision), August 2007, p. 4.

<sup>30</sup> *ibid.*

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.<sup>31</sup>

#### 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.<sup>32</sup>

#### 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.<sup>33</sup>

#### 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.<sup>34</sup>

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.<sup>35</sup>

#### **Submission on the Draft Decision**

#### Telstra

Telstra submits that it broadly agrees with the Commission's conclusion that the Optus Undertaking:

- (a) is unlikely to promote competition in the markets for carriage services and services supplied by users of carriage services;
- (b) will not adversely impact on the any-to-any connectivity between end-users; and
- (c) is unlikely to encourage the economically efficient use of and investment in infrastructure.<sup>36</sup>

#### ***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

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<sup>31</sup> AAPT, *Assessment of Optus's Undertaking in Relation to Declared Service – Mobile Terminating Access Service* (AAPT Submission), 5 April 2007, p. 1.

<sup>32</sup> Competitive Carriers Coalition, *Submission to Optus Domestic Mobile Terminating Service Undertaking* (CCC Submission), 5 April 2007, p. 4.

<sup>33</sup> H3GA, *Hutchison's Response: Optus's 2007 Undertaking in Relation to the Domestic Mobile Terminating Access Service* (H3GA Submission), 11 April 2007, p. 1.

<sup>34</sup> 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 on Discussion Paper), April 2007, p. 8.

<sup>35</sup> *ibid.*, p. 10.

<sup>36</sup> Telstra, *Telstra Submission in Response*, August 2007, p. 8.

terms and conditions will remove obstacles to end-users of gaining access to listed services.<sup>37</sup>

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.<sup>38</sup>

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.'<sup>39</sup>

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.<sup>40</sup>

In the *MTAS Final Report* the ACCC identified three markets as relevant for the purpose of assessing competition under the LTIE criterion, namely:<sup>41</sup>

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

In response to the draft decision Optus has also provided its analysis of the promotion of competition in the market in which FTM services are provided and the extent of

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<sup>37</sup> *Application by Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8 (22 November 2006) at [12].

<sup>38</sup> *ibid.*, at [13].

<sup>39</sup> *Sydney International Airport* [2000] ACompT 1 (1 March 2000) at [106]-[107].

<sup>40</sup> *Telstra Corporation Ltd (No 3)* [2007] ACompT 3 (17 May 2007) at [96].

<sup>41</sup> 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).



pass-through of lower MTAS prices to lower retail prices that has occurred. These submissions and the Commission's view are discussed in the following section about the market in which FTM services are provided.

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 initial submission***

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.<sup>42</sup>

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.<sup>43</sup>

Optus does not consider that the mobile services market is a *retail* market.<sup>44</sup>

Optus submits that the relevant products and services in the mobile services 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.<sup>45</sup>

Optus submits that a small significant non-transitory increase in price (SSNIP) analysis<sup>46</sup> 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 subscribers. Optus submits that the price of subscription and origination services would adjust to attract subscribers and higher termination revenue would be competed

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<sup>42</sup> Optus, *Optus Submission in Support*, p. 11.

<sup>43</sup> *ibid.*, p. 12.

<sup>44</sup> *ibid.*

<sup>45</sup> *ibid.*

<sup>46</sup> 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.

away. Optus submits that the SSNIP would be unsuccessful indicating a wider market definition, incorporating all the services is appropriate.<sup>47</sup>

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.<sup>48</sup>

### ***Submission on the Discussion Paper***

#### **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 market<sup>49</sup>

### ***Submission on the Draft Decision***

Telstra submits that it maintains the view that market definition is not relevant to the present inquiry and in any event, the majority of Optus' arguments in relation to the "two-sided nature" of the mobile services market and the "waterbed effect" has already been rejected by the Australian Competition Tribunal and do not provide any support for the reasonableness of the Optus Undertaking. (Page 7)

### ***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.<sup>50</sup>

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

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<sup>47</sup> Optus, *Optus Submission in Support*, p. 13.

<sup>48</sup> *ibid.*, p. 11.

<sup>49</sup> Telstra, *Telstra Submission on Discussion Paper*, p. 11.

<sup>50</sup> 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.

provision of the wholesale MTAS. Accordingly, the Commission considers that the state of competition in each of the wholesale MTAS markets is not competitive.<sup>51</sup>

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 at attracting additional subscribers. This argument appears to be referring to the 'waterbed' effect.

The Commission outlines its views on the existence of the 'waterbed' effect and the issue of the two-sided market in Appendix 4.

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.<sup>52</sup>

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 initial submission***

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.<sup>53</sup>

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.<sup>54</sup>

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<sup>51</sup> *ibid.*, p. 70.

<sup>52</sup> *Application by Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8 (22 November 2006) at [85].

<sup>53</sup> Optus, *Optus Submission in Support*, p. 13.

<sup>54</sup> *ibid.*

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.<sup>55</sup>

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 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.<sup>56</sup>

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.’<sup>57</sup>

### **Optus’s submission on the Draft Decision**

Optus submits that Telstra has not completely ‘passed-through’ decreases in the MTAS to its retail pricing for fixed-to-mobile (FTM) calls.<sup>58</sup>

Optus submits that the incomplete nature of the pass-through means that Telstra is able to obtain a windfall gain in the fixed-line market. Optus submits that this additional margin has negative implications for competition in wider markets.<sup>59</sup>

Optus submits that the Commission’s inference (that lower FTM prices prove increased competition in the FTM market) is not justified. There are other potential explanations. Even a monopolist with 100 per cent market share will pass on a proportion of a cost decrease to consumers.<sup>60</sup>

Optus considers that the Commission has demonstrated neither that its MTAS price reductions have created ‘the conditions or environment for improving competition’ nor that they have resulted in ‘displacement of inefficient suppliers by efficient suppliers of services’.<sup>61</sup>

#### *FTM pass-through*

Optus submits that Telstra has not completely ‘passed-through’ decreases in the MTAS to its pricing for FTM calls. Optus has analysed Telstra’s public financial

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<sup>55</sup> *ibid.*

<sup>56</sup> *ibid.*

<sup>57</sup> *ibid.*

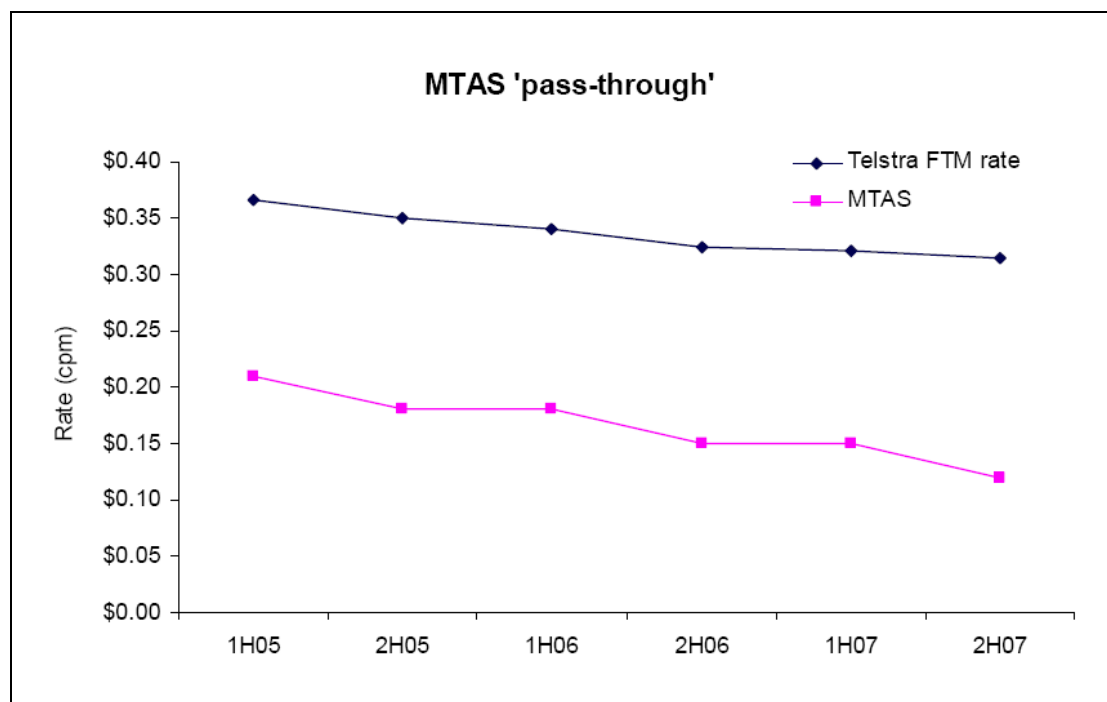
<sup>58</sup> Optus, *Optus Submission on Draft Decision*, p. 38.

<sup>59</sup> *ibid.* p. 39.

<sup>60</sup> *ibid.* p. 39.

<sup>61</sup> *ibid.*

reports to investigate the relationship between the price of FTM calls and the MTAS. In the period January 2005 until end June 2007, the MTAS has decreased by 43 per cent. Over the same period, FTM prices have been reduced by only 14 per cent. Optus submits that although FTM prices have fallen to a limited extent as a result of a reduced MTAS, this is clear evidence that pass-through has not been complete.<sup>62</sup>



**Source:** Optus, *Optus submission to Australian Competition and Consumer Commission on Draft Decision on Optus 2007 MTAS Undertaking*, 15 August 2007, p. 38

Optus submits that the graph above highlights that in recent years the difference between the prices (i.e. Telstra's margin) has in fact increased. Optus contends that although Telstra's costs may have decreased over this period, the margin is still unjustifiably excessive.<sup>63</sup>

### ***Submissions on the Discussion Paper***

#### 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.<sup>64</sup>

#### Telstra

<sup>62</sup> *ibid.* p.38

<sup>63</sup> *ibid.* p.39.

<sup>64</sup> CCC, *CCC Submission*, p. 3.

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.<sup>65</sup>

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).<sup>66</sup> These constraints include:

- an increase in quasi-facilities based competition using the Unconditioned Local Loop Service (ULLS);<sup>67</sup>
- regulatory constraints such as price caps under the retail price control arrangements;<sup>68</sup>
- substitution between fixed and mobile services;<sup>69</sup> and
- substitution between fixed services and services using alternative delivery such as VOIP technology.<sup>70</sup>

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. Telstra submits that pass-through may occur by way of improved quality of service.<sup>71</sup>

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.<sup>72</sup>

### 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

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<sup>65</sup> Telstra, *Telstra Submission on Discussion Paper*, p. 24.

<sup>66</sup> *ibid.*, pp. 32-33.

<sup>67</sup> *ibid.*, p. 25.

<sup>68</sup> *ibid.*, p. 13.

<sup>69</sup> *ibid.*, pp. 28-32.

<sup>70</sup> *ibid.*, pp. 31-32.

<sup>71</sup> *ibid.*, pp. 38-39.

<sup>72</sup> *ibid.*, p. 39.

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.<sup>73</sup>

### ***Submission on the Draft Decision***

#### *Telstra*

Telstra submits that it has already provided detailed submissions on the issue of competition in fixed-line services in the First Telstra Submission which Telstra continues to rely on. Telstra does not intend to provide any further detailed submissions on the level of competition in the fixed line market in this submission but notes four observations.

- 1) The information referred to by Optus in support is dated market share information. Leaving aside the continued relevance of that information, Telstra submits that it is well established that market share alone is a poor indicator of the state of competition.
- 2) The Commission's analysis of the benefits that might be available in the relevant downstream market, the Draft Decision appears to overlook the fact that competitive improvements could be realised across a basket of fixed line services.
- 3) The submissions Telstra has provided in support of its application for exemption from the standard access obligations in respect of the Local Carriage Service and Wholesale Line Rental are also relevant to an assessment of this issue.
- 4) The Commission's analysis in section 2.7 of its Draft Pricing Principles - while not necessarily endorsed by Telstra in its entirety - is generally consistent with many of Telstra's submissions in relation to matters concerning pass-through and related issues.<sup>74</sup>

#### ***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.<sup>75</sup>

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.

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<sup>73</sup> H3GA, *H3GA Submission*, p. 1.

<sup>74</sup> Telstra, *Telstra Submission in Response*, pp. 7-8.

<sup>75</sup> ACCC, *MTAS Final Report*, p. xi.

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.<sup>76</sup>

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 market within which FTM services are provided, help to ensure the level of FTM pass-through increases.<sup>77</sup>

To demonstrate these improvements using publicly available data,<sup>78</sup> the Commission notes that Telstra's revenue from FTM services has fallen in recent years, while FTM call volumes have 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 full year ended 30 June 2007, Telstra reported FTM revenues of \$1,487 million from total FTM minutes of 4,687 million. This reflects a FTM yield of 31.7 cpm for the full year ended 30 June 2007 compared with a much higher FTM yield that prevailed at 30 June 2004 of 37.8 cpm (based on figures of \$1,597 million from total FTM minutes of 4,226). This represents a fall in FTM yields of 16.1 per cent over that time as outlined in the table below.<sup>79</sup>

	As at 30 June 2004	As at 30 June 2007	Change between 30 June 2004 and 2007 (%)
FTM Revenue (\$millions)	1,597	1,487	- 6.9
FTM minutes (millions)	4,226	4,687	10.9
Yield (cpm)	37.8	31.7	-16.1

The Commission, notes Optus's submission on pass-through of lower MTAS rates to the price of FTM calls. The Commission considers that the Tribunal quote provided by Optus in the recent ULLS decision<sup>80</sup>, supports the Commission's view on this issue where it states that:

That is, the Act aims to promote competition because of the benefits that result from the *process* of competition, such as lower prices for consumers and the displacement of

<sup>76</sup> By reducing the ability of incumbent mobile network owners to frustrate new entrants into the market. ACCC, *MTAS Final Report*, Chapters 5 and 6.

<sup>77</sup> *ibid.*, p. xii.

<sup>78</sup> There is no publicly available information about FTM prices or yields for Optus, to undertake this analysis.

<sup>79</sup> Telstra Corporation Limited and Controlled Entities, *Financial Results for the Year Ended 30 June 2007*, p. 13. Telstra Corporation Limited and Controlled Entities, *Financial Results for the Year Ended 30 June 2004*, p. 79.

<sup>80</sup> Optus, *Optus Submission on Draft Decision*, p. 38.



inefficient suppliers by efficient suppliers of services. As the Tribunal observed in *Sydney International Airport* (supra) at par [108].<sup>81</sup>

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.<sup>82</sup> However, material to support or disprove such improvements has not been provided by any party in the context of this undertaking process.

As a result, the Commission considers that the proposed MTAS price of 12 cpm in the Optus Undertaking is not aligned to the TSLRIC+ estimate of the supply of the MTAS and would not be likely to result in the achievement of the objective of promoting competition in the market within which FTM services for the period 1 July 2007 to 30 June 2007.

### **LTIE: Any-to-any connectivity**

#### ***Optus's initial submission***

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.<sup>83</sup>

#### ***Submissions on the Discussion Paper***

##### **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.<sup>84</sup>

##### ***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.<sup>85</sup>

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**

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<sup>81</sup> *ibid.*, p. 39.

<sup>82</sup> ACCC, *MTAS Final Report*, p. 223.

<sup>83</sup> Optus, *Optus Submission in Support*, p. 15.

<sup>84</sup> Telstra, *Telstra Submission on Discussion Paper*, p. 39.

<sup>85</sup> ACCC, *MTAS Final Report*, pp. xiv-xv.

### ***Optus's initial submission***

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.

### ***Optus's submission on the Draft Decision***

Optus concludes that it is not reasonable for the Commission to use the WIK Model or its other corroborating evidence in order to inform itself for the purpose of forming a conclusion on whether an MTAS price may or may not encourage economically efficient use of, and investment in infrastructure, and that the Commission's conclusions expressed in the draft decision on the economically efficient use of, and investment in infrastructure are not valid.<sup>86</sup>

### ***Submissions on the Discussion Paper***

#### **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.<sup>87</sup>

#### ***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.<sup>88</sup>

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

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<sup>86</sup> Optus, *Optus Submission on Draft Decision*, p. 39.

<sup>87</sup> Telstra, *Telstra Submission on Discussion Paper*, pp. 14-19.

<sup>88</sup> ACCC, *MTAS Final Report*, p. xv.

the TSLRIC+ of supply of the MTAS provides for an environment that will increase demand and expand the economically efficient use of, and investment in, infrastructure. To this end, the Commission notes 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.<sup>89</sup>

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 services.

The Commission notes that Optus states in its submission on the Draft Decision that it is not reasonable for the Commission to use the WIK Model or its other corroborating evidence in order to inform itself for the purpose of forming a conclusion.<sup>90</sup> However, Optus has not provided sufficient information to demonstrate that 12 cpm is a will achieve the objective of encouraging the 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 an estimate of the TSLRIC+ relevant for the period 1 July 2007 to 31 December 2007. Optus has not demonstrated that 12cpm has a relationship to costs or provided evidence that the costs are efficient in relation to the LTIE

#### **4.3.4. 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 initial submission***

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.<sup>91</sup>

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<sup>89</sup> 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.

<sup>90</sup> Optus, *Optus Submission on Draft Decision*, p. 39.

<sup>91</sup> Optus, *Cover Letter to Optus 2007 Undertaking*, 16 February 2007, p. 1.

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.<sup>92</sup>

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.<sup>93</sup>

#### ***Optus's submission on the Draft Decision***

Optus concludes that it is not reasonable for the Commission to use the WIK Model or its other corroborating evidence in order to inform itself for the purpose of forming a conclusion on whether a given MTAS price is or is not in Optus' legitimate business interests, and that the Commission's conclusions on the legitimate business interests of Optus are not valid.<sup>94</sup> Optus's submissions on the WIK Model are outlined in Appendix 5.

#### ***Submissions on the Discussion Paper***

##### 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 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.<sup>95</sup>

##### 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.<sup>96</sup>

##### 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

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<sup>92</sup> Optus, *Optus Submission in Support*, p. 28.

<sup>93</sup> *ibid.*

<sup>94</sup> Optus, *Optus Submission on Draft Decision*, p. 41.

<sup>95</sup> AAPT, *AAPT Submission*, p. 1.

<sup>96</sup> CCC, *CCC Submission*, p. 3.

to MTAS prices and suggests that pass-through of reduced MTAS rates to retail prices has been sufficient.<sup>97</sup>

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.<sup>98</sup>

### ***Submission on the Draft Decision***

#### Telstra

Telstra submits that it does not intend to repeat the matters raised in the First Telstra Submission about this issue. However, it notes that the Commission's analysis in section 5.3.2 of the Draft Pricing Principles also tends to support the position maintained by Telstra.<sup>99</sup>

#### ***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.<sup>100</sup>

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.'<sup>101</sup>

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

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<sup>97</sup> Telstra, *Telstra Submission on Discussion Paper*, pp. 40-42.

<sup>98</sup> *ibid.*, p. 43.

<sup>99</sup> Telstra, *Telstra Submission in Response*, p. 8.

<sup>100</sup> 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.

<sup>101</sup> *ibid.*, p. 51.

with the growth in mobiles EBITDA of 17.5 per cent over the same period. Revenue for the June Quarter 2007, shows a 3 per cent increase year-on-year from June Quarter 2006 and EBITDA margin remains high at 34 per cent<sup>102</sup> ; 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.

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

Source: SingTel financial reports<sup>103</sup>

Following the release of Optus's 2007 full year financial results, Optus has released half-yearly financial figures.<sup>104</sup> These figures report Optus, as having recorded an operating revenue of \$3831 million and operational EBITDA of \$959 million over the

<sup>102</sup> SingTel, *Singapore Telecommunications Limited and Subsidiary Companies, Management Discussion and Analysis of Unaudited Financial Condition, Results of Operations and Cash Flows for the First Quarter Ended 30 June 2007*, August 2007, p.41

<sup>103</sup> 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.

<sup>104</sup> SingTel, *Singapore Telecommunications Limited and Subsidiary Companies Management Discussion and Analysis of Unaudited Financial Condition, Results of Operations and Cash Flows for the second quarter and half year ended 30 September 2007*.

six month period. Optus state that this represents a reduction in their operational EBITDA by 0.5% for the half year.<sup>105</sup>

Despite this reduction in EBITDA, Optus reported that operating revenue increased by 3.6% which is also reflected in an increased underlying net profit of \$245 million.

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.<sup>106</sup>

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.<sup>107</sup>

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.

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,<sup>108</sup> 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.<sup>109</sup> As demonstrated by Optus's financial performance since 2004, its mobiles revenue has increased at a time when MTAS

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<sup>105</sup> SingTel, Singapore Telecommunications Limited and Subsidiary Companies Management Discussion and Analysis of Unaudited Financial Condition, Results of Operations and Cash Flows for the second quarter and half year ended 30 September 2007, p.35.

<sup>106</sup> ACCC, *Access Undertakings – A Guide to Part IIIA of the Trade Practices Act*, 30 September 1999, pp. 4-5.

<sup>107</sup> 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.

<sup>108</sup> *ibid.*

<sup>109</sup> Optus, *Optus Submission in Support*, p. 16.

prices have fallen. Even with prices lower than 12 cpm for the MTAS, it is likely based on the experience to date 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 that in the recent Telstra ULLS undertaking decision,<sup>110</sup> the 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.

Optus has also provided in its submission on the draft decision, statements that the WIK Model is not appropriate to account for prudent investments of MNOs. It does not however present a robust case as to how 12 cpm reflects its legitimate business interests.

The Commission also notes Optus's submission that the Tribunal 'interpreted legitimate business interests as a reference to the interest of a carrier in recovering the costs of its infrastructure and its operating costs and obtaining a normal return on its capital'<sup>111</sup>. Optus again does not present information to support how 12 cpm is a reasonable price that reflects the recovery of the costs of its infrastructure and its operating costs so that it obtains a normal return on its capital.

Having regard to, the FL-LRIC+ estimate for the supply of MTAS by Optus, comparable international TSLRIC+ benchmarks and price benchmarks derived from hybrid (top-down and bottom-up models), the Commission cannot be satisfied that the undertaking price of 12 cpm is reasonable and rejecting the Optus 2007 Undertaking will not adversely impact Optus's legitimate business interests.

#### **4.3.5. The interests of persons who have the right to use the declared service**

##### ***Optus's initial submission***

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.

##### ***Optus's submission on the Draft Decision***

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<sup>110</sup> *Telstra Corporation Ltd (No 3)* [2007] ACompT 3 (17 May 2007) at [261].

<sup>111</sup> Optus, *Optus submission to Australian Competition and Consumer Commission on Draft Decision on Optus 2007 MTAS Undertaking*, 15 August 2007, p. 33.



Optus concludes that it is not reasonable for the Commission to use the WIK Model or its other corroborating evidence in order to inform itself for the purpose of forming a conclusion on whether an MTAS price may or may not be in the interests of access seekers, and that the Commission's conclusions on the interests of access seekers are not valid.<sup>112</sup>

### ***Submissions on the Discussion Paper***

#### 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.<sup>113</sup>

#### 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
- (ii) the Undertaking may be withdrawn by Optus before 31 December 2007.<sup>114</sup>

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.<sup>115</sup>

#### 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

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<sup>112</sup> Optus, *Optus Submission on Draft Decision*, p. 41.

<sup>113</sup> CCC, *CCC Submission*, p. 2.

<sup>114</sup> AAPT, *AAPT Submission*, p. 2.

<sup>115</sup> *ibid.*

that cost-based pricing of the DGTAS would impede the interests of access seekers, and accordingly, 12 cpm cannot be reasonable.<sup>116</sup>

### *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 toward 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 would be in the interests of persons who have the rights to use the declared service. The Commission considers this is the case partly because the FL-LRIC estimate of the DGTAS from Optus's 2004 undertaking and international cost benchmarking indicate a TSLRIC+ estimate of the supply of the MTAS is lower than 12 cpm.

#### **4.3.6. The direct costs of providing access to the declared service**

##### *Optus's initial submission*

Optus submits that the Optus 2007 Undertaking price is consistent with the direct costs of providing the DGTAS, though they remain uncertain.<sup>117</sup>

##### *Submissions on the Discussion Paper*

##### 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.<sup>118</sup>

##### Telstra

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<sup>116</sup> Telstra, *Telstra Submission on Discussion Paper*, pp. 43-44.

<sup>117</sup> Optus, *Optus Submission in Support*, p. 29.

<sup>118</sup> AAPT, *AAPT Submission*, p. 2.

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.<sup>119</sup>

### ***Submission on the Draft Decision***

#### **Telstra**

Telstra submits that it notes Optus's own admission that it is uncertain about whether 12 cents per minute is above or below cost.<sup>120</sup>

Telstra submits that irrespective of the merits of the WIK Model, that the relevant question is whether there is anything to support Optus's claim that 12 cents per minute represents the efficient costs of supplying the MTAS. Further, that Optus has not submitted any other evidence to contradict Telstra's and the Commission's findings.<sup>121</sup>

#### ***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) as a result of the provision of access.<sup>122</sup>

The Commission's view concurs with the Tribunal's view, where the Tribunal 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) because without the existence of the assets in respect of which the FCCs are incurred, the relevant access could not be provided;<sup>123</sup> and

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<sup>119</sup> Telstra, *Telstra Submission on Discussion Paper*, p. 44.

<sup>120</sup> *ibid.*

<sup>121</sup> *ibid.*, p. 6.

<sup>122</sup> ACCC, *Access Pricing Principles Guidelines*, p. 10.

<sup>123</sup> *Application by Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8 (22 November 2006) at [137].

- 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.<sup>124</sup>

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 do not consider that a fully allocated cost model, as distinct from a TSLRIC+ model is, of itself, unreasonable having regard to the matters specified in s 152AH and the objectives set out in s 152AB. We accept that in *Re Seven Network* (No 4) (2004) 187 FLR 373 at 410, the Tribunal expressed the view that it would generally not be in the long-term interests of end-users to depart from TSLRIC pricing where access is regulated. However, we would repeat the observation of the Tribunal in *Telstra Corporation Limited* (supra) at par [63]:

In this area of analysis there is no one correct or appropriate figure in determining reasonable costs or a reasonable charge. Matters and issues of judgement and degree are involved at various levels of analysis.

Nevertheless, we still consider that in general terms the prices in access undertakings should reflect and not exceed forward looking efficient economic costs: *Telstra Corporation Limited* (supra) at par [46].

The Tribunal affirms this position that alternative model approaches may also be appropriate if it can be established that the actual costs incurred by an MNO are efficient.<sup>125</sup>

...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.<sup>126</sup>

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.

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.<sup>127</sup>

In the absence of any information provided by Optus to demonstrate that 12 cpm reflects the direct costs of supply of the MTAS for Optus for the period beyond 30

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<sup>124</sup> *ibid.*, at [138].

<sup>125</sup> *Application by Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8, 22 November 2006, at [116-118].

<sup>126</sup> *Telstra Corporation Limited (ACN 051 775 556)* [2006] ACompT 4 (2 June 2006) at [46].

<sup>127</sup> *Telstra Corporation Limited (ACN 051 775 556)* [2006] ACompT 4 (2 June 2006) at [46].

June 2007, the Commission considers that with reference to information as outlined in section 4.2, that it cannot be satisfied that the proposed price in the Optus 2007 Undertaking is consistent with the direct costs of providing the service.

#### **4.3.7. Safe and reliable operation of the carriage service/telecommunications network/facility**

##### *Optus's initial submission*

Optus contends that the Optus 2007 Undertaking offers an operationally and technically feasible service.<sup>128</sup>

##### *Submissions on the Discussion Paper*

###### 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 submits that the ACCC cannot be satisfied that the Optus 2007 Undertaking price is necessary for this purpose.<sup>129</sup>

###### 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.<sup>130</sup>

##### *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.

#### **4.3.8. The economically efficient operation of a carriage service/telecommunications network/facility**

##### *Optus's initial submission*

Optus submits that it has relied upon a number of data sources<sup>131</sup> to devise its Optus 2007 Undertaking prices. Optus has not undertaken a bottom-up cost modelling

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<sup>128</sup> Optus, *Optus Submission in Support*, p. 29.

<sup>129</sup> AAPT, *AAPT Submission*, p. 2.

<sup>130</sup> Telstra, *Telstra Submission in Response*, p. 44.

<sup>131</sup> 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;

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.<sup>132</sup>

### *Submissions on the Discussion Paper*

#### 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.<sup>133</sup>

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.<sup>134</sup>

#### 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.<sup>135</sup>

#### *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. Optus has not provided sufficient information to demonstrate that a price of 12 cpm is likely to promote the economically efficient operation of a

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- 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.

<sup>132</sup> *ibid.*, p. 30.

<sup>133</sup> AAPT, *AAPT Submission*, p. 4.

<sup>134</sup> *ibid.*

<sup>135</sup> Telstra, *Telstra Submission on Discussion Paper*, p. 43.

carriage service, a telecommunications network or a facility for the period beyond 30 June 2007.

#### **4.3.9. 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).

### **4.4. Price terms and conditions found not to be reasonable**

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 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**

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.

### *Optus's initial submission*

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.<sup>136</sup>

### *Submissions on the Discussion Paper*

#### 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.<sup>137</sup>

### *Submission on the Draft Decision*

#### Telstra

Telstra submits that it agrees with the Commission's conclusion that the non-price terms and conditions of the Optus Undertaking are consistent with the statutory criteria.<sup>138</sup>

### *Commission's view*

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

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**

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.

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<sup>136</sup> Optus, *Optus Submission in Support*, p. 30.

<sup>137</sup> Telstra, *Telstra Submission on Discussion Paper*, p. 7.

<sup>138</sup> Telstra, *Telstra Submission in Response*, p. 3.



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 initial submission***

Optus submits that the Optus 2007 Undertaking explicitly states that Optus will comply with the SAOs. Therefore the undertaking is consistent with the SAOs.<sup>139</sup>

### ***Submissions on the Discussion Paper***

#### **AAPT**

AAPT submits that the Optus 2007 Undertaking is not inconsistent with Optus's standard access obligations to provide the MTAS.<sup>140</sup>

#### **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 the applicable SAOs, Telstra acknowledges that the Commission can be satisfied that these statements in the Undertaking are consistent with the SAOs.<sup>141</sup>

### ***Submission on the Draft Decision***

#### **Telstra**

Telstra submits that it agrees with the Commission's view that the Optus Undertaking is consistent with the applicable Standard Access Obligations as the DGTAS would be provided on a non-discriminatory basis (in accordance with schedule 3 of the Optus Undertaking).<sup>142</sup>

### ***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

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<sup>139</sup> Optus, *Optus Submission in Support*, p. 9.

<sup>140</sup> AAPT, *AAPT Submission*, p. 1.

<sup>141</sup> Telstra, *Telstra Submission on Discussion Paper*, p. 7.

<sup>142</sup> Telstra, *Telstra Submission in Response*, p. 4.

each of the applicable SAOs. The Commission is of the view that the non-price terms are consistent with the 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. An access provider must supply an active declared service to an access seeker in order that an access seeker can provide carriage and/or content services, if requested by an access seeker.

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

The Commission is satisfied that non-price terms in 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. This provision states 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 the service supplied to itself.

The Commission is satisfied that non-price terms in the undertaking are consistent with the applicable SAO.

### **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. Under this provision 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.

The Commission is satisfied that non-price terms in the undertaking are consistent with the applicable SAO.

### **6.1.4. Interconnection**

The nature of the Optus 2007 Undertaking and the service concerned suggests that section 152AR(5) is an applicable SAO for the purposes of supplying the declared service.

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.<sup>143</sup>

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 is not satisfied considers that the Optus 2007 Undertaking contains price terms and conditions are reasonable for the period 1 July 2007 to 31 December 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.

The Commission has decided to reject the Optus 2007 Undertaking.

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<sup>143</sup> 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 seeking interested parties' views.

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.

On 21 June 2007 the Commission released its draft decision to reject the Optus 2007 Undertaking. The Commission sought submissions on its draft decision by 6 August 2007. Submissions received in response to the draft decision are identified below:

- Telstra, *Submission in response to the ACCC's Draft Decision on Optus' 2007 Undertaking in relation to the Domestic Mobile Terminating Access Service*, 6 August 2007.
- Optus, *Submission in response to the ACCC's Draft Decision on Optus' 2007 Undertaking*, 15 August 2007.

The Commission provided written notice to Optus on 29 August 2007 to extend the decision marking period on the Optus 2007 Undertaking for a further period of 3 months until 14 December 2007. A copy of the statement explaining why the Commission has been unable to make a decision on the Undertaking within the 6 month period is available on the Commission website.

### **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 applicable to the SAOs.<sup>144</sup>

### **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 Optus, and its investment in facilities used to supply the declared service;

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<sup>144</sup> Under section 152CH of the Act, 'price-related terms and conditions' means terms and conditions relating to price or a method of ascertaining price.

- 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.<sup>145</sup>

### ***Application of the reasonableness test***

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.

### ***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.<sup>146</sup> 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.<sup>147</sup> To consider the likely impact of particular terms and conditions, the Act requires that the Commission needs to have regard to whether the terms and conditions are likely to:

- promote competition in markets for carriage services and services supplied by means of carriage services;
- achieve any-to-any connectivity; and
- encourage 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.<sup>148</sup>

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

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<sup>145</sup> 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.

<sup>146</sup> ACCC, *Telecommunications services — Declaration Provisions: A Guide to the Declaration Provisions of Part XIC of the Trade Practices Act*, July 1999.

<sup>147</sup> *ibid.*, pp. 32-33.

<sup>148</sup> *Trade Practices Act 1974*, Section 152AB(2).

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.<sup>149</sup>

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 Principles* and the Commission’s use of a TSLRIC framework for cost-based access pricing. In the decision, the Tribunal stated that 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 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.<sup>150</sup>

The Tribunal also 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.’<sup>151</sup>

In considering whether the 12 cpm proposed in the Optus 2007 Undertaking is 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 relevant in considering the declaration of the MTAS:

- the individual markets for the MTAS on each MNO’s network;

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<sup>149</sup> *Seven Network Limited (No 4)* [2004] ACompT,11 (23 December 2004) at [120].

<sup>150</sup> *ibid.*, at [135].

<sup>151</sup> *ibid.*, at [136].

- 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 these markets are relevant for the assessment of the Optus 2007 Undertaking.

The Commission notes that the Tribunal agreed with the Commission's interpretation of an appropriate market definition:

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.<sup>152</sup>

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 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.<sup>153</sup> 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

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<sup>152</sup> *Application by Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8 (22 November 2006) at [80].

<sup>153</sup> Explanatory Memorandum to Telecommunications Legislation Amendment (Competition and Consumer Issues) Bill 2005, pp. 4 and 8.



investment, are given due consideration in assessing whether the particular thing promotes the efficient use of, and efficient investment in, 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 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.<sup>154</sup>

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.<sup>155</sup>

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.<sup>156</sup>

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

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<sup>154</sup> Explanatory Memorandum for the Trade Practices Amendment (Telecommunications) Bill 1996, p. 44.

<sup>155</sup> ACCC, *Access Undertakings – A Guide to Part IIIA of the Trade Practices Act*, 30 September 1999, pp. 4-5.

<sup>156</sup> *ibid.*, p. 6.

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.<sup>157</sup>

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. 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.<sup>158</sup>

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. The Efficient Component Pricing Rule (ECPR) may also 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:

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<sup>157</sup> ACCC, *Access Pricing Principles Guidelines*, p. 18.

<sup>158</sup> Explanatory Memorandum for the Trade Practices Amendment (Telecommunications) Bill 1996, p. 44.

... costs an access provider will incur in producing a service assuming the access provider produced no other services.<sup>159</sup>

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 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 existence of the assets in respect of which the FCCs are incurred, the relevant access could not be provided;<sup>160</sup> 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.<sup>161</sup>

### ***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.<sup>162</sup>

### ***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 terms and conditions.

## **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

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<sup>159</sup> ACCC, *Access Pricing Principles Guidelines*, p. 10.

<sup>160</sup> *Application by Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8 (22 November 2006) at [137].

<sup>161</sup> *ibid.*, at [138].

<sup>162</sup> 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.

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.<sup>163</sup>

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 29 August 2007, the Commission wrote to Optus and provided Optus a written notice to extend the six-month decision making period for a further period of 3 months until 14 December 2007 in accordance with section 152BU(7) of the *Trade Practices Act 1974*. A statement explaining why the Commission has been unable to make a decision on the Undertaking within the six-month period can be found on the Commission website in accordance with section 152BU(8) of the Act.

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<sup>163</sup> 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 may refuse to consider the undertaking until the carrier or provider gives the Commission the information.’

## Appendix 2 – Confidential

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

The Commission notes that Optus has not relied on or updated the information previously supplied in support of its MTAS Undertaking in 2004. In support of its MTAS Undertaking to the Commission in 2004, Optus engaged CRA to develop a model using a FL-LRIC framework.

The Commission considered that the FL-LRIC and TSLRIC concepts were broadly consistent underlying cost concepts. Optus allocated common costs using Ramsey-Boiteux principles and included a second '+' factor: a 'network externality surcharge.' The Commission concluded that these mark-ups did not reflect the efficient costs of providing the MTAS service. The Commission's decision was affirmed by the Tribunal.<sup>164</sup>

At the time of assessment of the reasonableness of Optus's 2004 Undertaking, the Commission noted conceptual and methodological problems with inputs used in the CRA Model. It also noted that many of the assumptions employed to calculate the CRA model inputs would tend to over estimate the FL-LRIC of the DGTAS relative to its 'efficient' level.<sup>165</sup>

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.<sup>166</sup> 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.

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<sup>164</sup> *Application by Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8 (22 November 2006).

<sup>165</sup> *ibid.*, section 5.2.4.

<sup>166</sup> 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 were 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.<sup>167</sup>

*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.<sup>168</sup>

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 the TSLRIC+) based on the CRA model inputs may represent an upper-bound estimate of the costs of supplying the MTAS in Australia for Optus.<sup>169</sup>

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<sup>167</sup> *Application by Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8 (22 November 2006) at [287-291].

<sup>168</sup> *ibid.*, at [242].

<sup>169</sup> ACCC, *Optus Undertaking Final Decision* Chapter 5.

### 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.<sup>170</sup>

Optus refers to several European mobile termination rates in its benchmarking analysis.<sup>171</sup> 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...<sup>172</sup>

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 provided by Optus to support its Undertaking that these concerns remain valid.

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<sup>170</sup> ACCC, *MTAS Final Report*, p. 211.

<sup>171</sup> Optus, *Optus Submission in Support*, pp. 24-25.

<sup>172</sup> *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 it can address at this time.

### ***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 cpm<sup>173</sup>) for four of the mobile carriers and 5.9 ppm (14.0 cpm<sup>174</sup>) for one of the mobile carriers operating in the United Kingdom for the period from 1 April 2010.<sup>175</sup>

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 0.72<sup>176</sup> cpm), which is not considered relevant in an Australian context.<sup>177</sup>
- 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.<sup>178</sup>
- The EU 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 cpm to 4.5 cpm to the MTAS price.<sup>179</sup>
- The model is a hybrid 'top-down' and 'bottom-up' cost model and has been parameterised with MNOs' accounting data<sup>180</sup> with limitations including a robust and consistent set of detailed accounting information for all MNOs.<sup>181</sup>

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 currency.<sup>182</sup>

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

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<sup>173</sup> Using an exchange rate of 0.42 GBP to 1 Australian dollar.

<sup>174</sup> Using an exchange rate of 0.42 GBP to 1 Australian dollar.

<sup>175</sup> Ofcom, *Mobile Call Termination Report Statement*, March 2007, p. 2.

<sup>176</sup> ACCC, *Draft 2007 MTAS Pricing Principles Determination 1 July 2007 – 31 December 2008 Report*, p. 48.

<sup>177</sup> *ibid.*, p. 49

<sup>178</sup> *ibid.*

<sup>179</sup> *ibid.*

<sup>180</sup> *ibid.*

<sup>181</sup> *ibid.*

<sup>182</sup> *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’.<sup>183</sup> The Commission notes that the target rates 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.<sup>184</sup> 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 for the supply of the MTAS in an Australian context.

### *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.<sup>185</sup> 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.<sup>186</sup>

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 the supply of the MTAS for lower than this price.

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<sup>183</sup> *ibid.*

<sup>184</sup> *ibid.*, p. 50.

<sup>185</sup> See: ACCC, *Optus Undertaking Final Decision*, p. 123.

<sup>186</sup> ACCC, *MTAS Final Report*, p. 211.

## Appendix 4 - 'Waterbed' effect and Two-sided market

### (a) 'Waterbed' effect

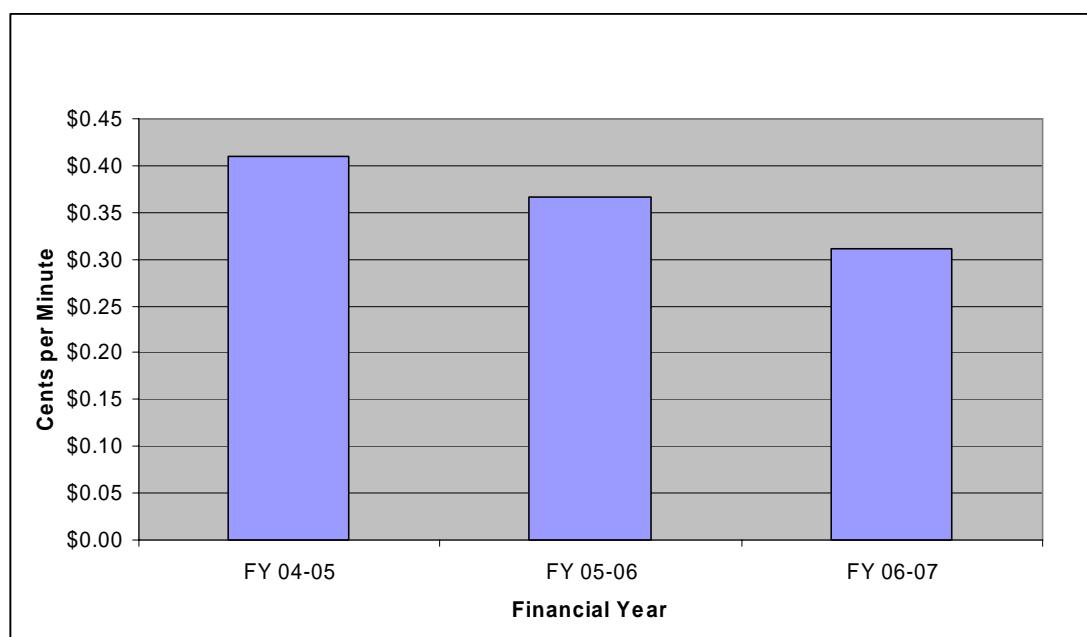
The 'waterbed' effect refers to the extent to which regulated reductions in access prices such as the MTAS results in increases in retail prices, which includes the price of outgoing mobile calls and subscription or fixed contract and handset prices. For further discussion on the 'waterbed' effect see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

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.

#### *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/Minute<sup>187</sup>**



<sup>187</sup> Average cent per minute charges calculated using: Telstra Corporation Limited and Controlled Entities, Financial Results for the Year Ended 30 June 2007, pp. 23-24. Telstra Corporation Limited and Controlled Entities, Financial Results for the Year Ended 30 June 2005, pp. 15-16..

Telstra's average (nominal) call rates have fallen from 41.0 cpm for the full year ended 30 June 2005 to 31.0 cpm<sup>188</sup> for the full year ended 30 June 2007, coinciding with a fall in the MTAS from 21 cpm to 12 cpm.

Similarly, Optus's 30 June 2007 quarter results indicate that total revenue increased by 8 per cent from 31 March 2006.<sup>189</sup> There is no information to suggest that this increase in revenue is 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 3.8 per cent between June 2006 and June 2007.<sup>190</sup>

Optus's 30 June 2007 quarter 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, continuing the trend from the 30 June 2007 quarter compared to previous quarters and the previous year ended 30 June 2007.<sup>191</sup> This is also indicative of lower, not higher, retail mobile rates.

## **ii. Real price reductions in mobile services**

The ACCC has noted a number of broad trends in post-paid and prepaid plans examined in the Division 12 report examining the financial year ended 30 June 2006.

The average (real) price paid for mobile services has fallen, as reflected by the price indexes for mobile services.<sup>192</sup>

Average real prices for mobile services also decreased a further 6.5 per cent in 2005-06.<sup>193</sup> The lower real prices for mobile services reflects a fall of 6.7 per cent fall in GSM services, and a 10.2 per cent fall in post-paid services.<sup>194</sup>

Since 2003-04 the decline in the overall prices for reported mobile services has fallen by 18.6 per cent, reflecting a fall of 18.8 per cent in GSM prices. This reflects a large fall in prices for GSM post-paid contracts of around 24 per cent, and a fall of 6.4 per cent for GSM pre-paid contracts.<sup>195</sup>

## **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

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<sup>188</sup> ACCC, *2007 MTAS Pricing Principles Determination Report*, p. 25.

<sup>189</sup> SingTel, *Management Discussion and Analysis of Financial Condition, Results of Operations and Cash Flows for the First Quarter Ended 30 June 2007*, p. 6.

<sup>190</sup> *ibid.*, p. 41. 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.

<sup>191</sup> *ibid.*

<sup>192</sup> ACCC, *Changes In the Prices Paid for Telecommunication Services in Australia 2005-06 – Report to the Minister for Communications, Information Technology and the Arts*, May 2007., p. 99.

<sup>193</sup> *ibid.*, p. 99.

<sup>194</sup> *ibid.*, pp. 3-4.

<sup>195</sup> *ibid.*, p. 107..

the take up of handsets on subsidised plans as well as higher average subsidies offered.<sup>196</sup>

*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 do not allow the acceptance of a ‘waterbed’ effect.

**(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.<sup>197</sup> While the Commission is of the view:

...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.<sup>198</sup>

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.<sup>199</sup>

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

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<sup>196</sup> Telstra Corporation Limited and Controlled Entities, Financial Results for the Year Ended 30 June 2007, p. 39.

<sup>197</sup> ACCC, *MTAS Final Report*, p. 46.

<sup>198</sup> *ibid.*

<sup>199</sup> *ibid.*, pp. 29-56.

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.<sup>200</sup>

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.

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<sup>200</sup> *Application by Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8 (22 November 2006) at [80].

## Appendix 5 - WIK Model

### *WIK MODEL DEVELOPMENT*

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 benchmarking exercise making adjustments for all factors that drive the TSLRIC+ of providing the MTAS in different countries for Australia-specific factors.<sup>201</sup>

WIK-Consult (WIK) has been engaged to develop a bottom-up cost model to assist the Commission to determine an estimated efficient cost of supply of the MTAS in Australia using a total service long-run incremental cost (TSLRIC) conceptual framework.

Further material relating to the development of the WIK model is available from the Commission's website.

### **Optus's submission on the draft decision**

#### *Use of the WIK Model to inform decision*

Optus submits that even if the regulated price of the MTAS is to be closely aligned with the efficient cost of provision of the MTAS, the Commission should not be informed by the WIK Model as it does not provide an estimate of the efficient cost of the MTAS.<sup>202</sup>

Optus submits that it considers that the hypothetical MTAS cost that results from its method is not practically achievable by any real world operator, either an existing operator or a new entrant.<sup>203</sup>

Optus submits that the WIK Model is not capable of estimating the forward looking efficient cost of supply of the MTAS (rather, it is likely to underestimate it) since the model designs a physical network that is incapable of providing a mobile service of the quality and service delivery standard provided by mobile network operators in Australia.<sup>204</sup>

Optus submits that the WIK Model ignores the costs existing mobile network operators face as the result of past prudent investments and holds them to a standard

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<sup>201</sup> ACCC, *MTAS Final Report*, p. 211.

<sup>202</sup> Optus, *Submission to ACCC on Draft Decision on Optus 2007 MTAS Undertaking* - Public version (Optus Submission on Draft Decision), August 2007, p. 4.

<sup>203</sup> *ibid.*

<sup>204</sup> *ibid.*

of operational and cost efficiency they cannot achieve.<sup>205</sup>

Optus submits that the WIK Model uses a number of assumptions that are not feasible for an efficient entrant even if it adopts efficient network structures and operations, and which substantially underestimate the cost to a hypothetical mobile network operator in providing the MTAS service which means that it cannot be relied upon as an estimate of the efficient cost of the supply of the MTAS. (Page 4 or 7 – Same comment)<sup>206</sup>

Optus submits that the use of the WIK Model by the Commission as a means of estimating the efficient cost of supply of the MTAS in Australia is inconsistent with the observations of the Tribunal that the task of assessing the forward looking costs of a new entrant must involve some balancing of opposing considerations and must take account of the actual markets in which the relevant services are provided.<sup>207</sup>

Optus submits that the WIK Model is an irrelevant consideration for the purpose of setting MTAS prices.<sup>208</sup>

Optus submits that the WIK Model adopts an unrealistic and infeasible network design and adopts assumptions that are not consistent with the network options and costs faced by a new entrant.<sup>209</sup>

Optus submits that by adopting a scorched earth approach the Commission has ignored a relevant consideration being the cost incurred by existing mobile network operators (if they can be shown to be efficient). It submits that this is a relevant consideration because it takes into account the legitimate business interests of the mobile network operator – that the business can receive a reasonable return on invested capital.<sup>210</sup>

#### *WIK Model - scorched-node issues*

Optus submits that the Commission has not been informed by either approach (scorched-earth approach with calibration or scorched-node) and that this is inconsistent with the observations of the Tribunal that the task of assessing the forward looking costs of a new entrant must take account of the actual markets in which the relevant services are provided.<sup>211</sup>

Optus submits that the Commission’s dismissal of the scorched-node approach has no basis; the identified ‘issue’ is an important practical consideration, but not, however, a fatal flaw in the approach (and if the Commission believes that it this a fatal flaw it has certainly not explained how and why this may be so). The ‘issue’ has also been addressed by regulators in most other jurisdictions in which MTAS prices are

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<sup>205</sup> *ibid.*

<sup>206</sup> *ibid.*

<sup>207</sup> *ibid.*, p. 8.

<sup>208</sup> *ibid.*

<sup>209</sup> *ibid.*

<sup>210</sup> *ibid.*

<sup>211</sup> *ibid.*



regulated. It submits that it considers that the Commission has not adequately addressed Optus's submissions on the disadvantages of a scorched-earth approach.<sup>212</sup>

Optus submits that a bottom up scorched-earth model is not practically achievable by an existing mobile network operator which has been operating efficiently for a significant length of time for two main reasons.

- 1) Existing operators built their networks some time ago. Due to the dynamic nature of demand, the design of these legacy networks is no longer likely to be optimal. As it noted in its March submission on the WIK Model, the design of a mobile network is heavily influenced by inter-temporal factors and as such the optimal or efficient configuration of the mobile network will vary depending upon the build date and constraints at the time. Optus therefore submits that it may not be reasonable to impose scorched-earth pricing on existing operators since such efficiencies are not achievable by existing mobile network operators.<sup>213</sup>

Optus submits that a scorched-node design would apply an historic costing approach to certain network elements (consistent with the legitimate business interests of the access provider and the direct cost of providing the service), and a forward looking costing approach would be applied to the remaining elements, encouraging the network owner to make efficient investment decisions and adopt least cost technologies where they are feasible.<sup>214</sup>

- 2) The modern equivalent asset (MEA) prices used in the WIK Model understate the capital investment of a mobile network operator in Australia today, since equipment prices have fallen in recent years. In this circumstance the existing mobile network operators are unlikely to have received appropriate compensation for past network investments because the falling price trends were not used historically to front load the return of capital invested.<sup>215</sup>

#### *WIK Model - new entrants and inconsistency*

Optus submits that outcome the WIK Model produces is not the MTAS cost of a hypothetical efficient mobile network designed by a bottom up scorched-earth model as it is not practically achievable by a new entrant mobile network operator in Australia for three main reasons.

- 1) The model does not demonstrate that the network could provide the service quality assumed nor does it demonstrate that the network could provide the declared service provided by a mobile network operator competing in the Australian market.
- 2) The model assumes a network design algorithm that can be demonstrated to fail in providing the service quality assumed if it were to be rolled out.

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<sup>212</sup> *ibid.*, p10.

<sup>213</sup> *ibid.*, pp. 9-10.

<sup>214</sup> *ibid.*, p.10.

<sup>215</sup> *ibid.*, p. 11.

- 3) The model fails to take into account all the practical considerations that a new entrant would face in actually building a network. These are relevant considerations because they represent the forward looking efficient costs a new entrant would incur – being the costs that set the benchmark (or contestable) price in a competitive market that the Commission is seeking to mimic.<sup>216</sup>

Optus submits that the WIK Model takes the option that is cheaper in both cases: it assumes optimised network design and MEA equipment prices and assumes away practical difficulties in obtaining sites for its mobile network base stations. It submits that this is logically inconsistent and more fundamentally, the cost level it results in is effectively meaningless, since it is not practically achievable by any real world operator (either existing or new entrant).<sup>217</sup>

#### *WIK Model - assumptions*

Optus submits that an efficient mobile network operator that wished to deliver the standards of service required of a mobile network in Australia would be compelled to deploy a considerably more extensive and more costly network than the WIK Model deploys.<sup>218</sup>

#### *WIK Model – 2G/3G considerations*

Optus submits that given the rising demand for 3G services, the WIK Model's assumption that a new entrant would supply only 2G services is not realistic, and as a result of this assumption, the WIK Model will underestimate the cost of provision of the MTAS.<sup>219</sup>

Optus submits that despite the sharing of spectrum, a 3G network still has significantly increased capital and O&M costs compared to the 2G service, particularly in the early years of operation while the transition from 2G to 3G is still taking place. Further to move from the 2G to 3G sphere, mobile network operators must still alter and upgrade their equipment. It also submits higher 3G subscriber acquisition costs are expected to negatively impact mobile margins in 2007 and beyond.<sup>220</sup>

Optus submits that it observes that no mobile network operator has launched a new 2G mobile network in the Australian market since March 2000.<sup>221</sup>

#### *WIK Model - Market share*

Optus submits that having due regard to the directions given by the Australian Competition Tribunal (the Tribunal), as well as the landscape of the Australian mobile market it is not realistic for the WIK Model to use a 25 per cent market share (or a 31 per cent market share) as a standard reference case. It disagrees that the Tribunal has

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<sup>216</sup> *ibid.*, p.12.

<sup>217</sup> *ibid.*, pp. 12-13.

<sup>218</sup> *ibid.*, p. 13.

<sup>219</sup> *ibid.*, p. 15.

<sup>220</sup> *ibid.*

<sup>221</sup> *ibid.*, p.16.

given any indication that the relevant benchmark may be greater than 25 per cent. The Tribunal considered a number of ‘potential’ outcomes.<sup>222</sup>

Optus submits that the likely defensive action of the current mobile network operators, an entrant would likely find it extremely difficult to attract market share as high as 25 per cent.<sup>223</sup>

Optus submits that a more reasonable estimate of an achievable market share would be based on the market share of the most recent entrants into the Australian mobile market (Vodafone and Hutchison).<sup>224</sup>

#### *WIK Model - BTS deployment*

Optus submits that a new entrant operator would provide coverage to highways without being subsidised, and that the Commission’s assumption that a hypothetical mobile network operator would not provide coverage to highways is unrealistic.<sup>225</sup>

Optus notes that it submitted that WIK’s Model does not appear to take sufficient account of the impact on base station siting decisions of terrain features such as deep valleys and bay-side suburbs, which can often cause quality problems which can best be managed by siting additional base stations (and TRXs).<sup>226</sup>

Optus notes the Commission’s use of the term ‘specific operational strategies’. This appears to be code for saying ‘if the carrier chooses to supply a higher level of quality MTAS to itself and to access seekers than is assumed in the WIK Model, such a choice is that carrier’s operational strategy and it should not be reflected in cost’. Optus submits that if the Commission is defining a particular strategy that a new entrant would follow, then it is the Commission that is adopting ‘specific operational strategies’ that are inconsistent with market reality and do not appear to be consistent with reasonableness.<sup>227</sup>

Optus submits that all of these are factors that would be taken into account by an efficient new entrant in designing its network. To assume a new entrant would neglect factors like quality and reliability is an unrealistic assumption. If it did neglect these factors then its ability to attract customers would be compromised. It therefore submits that since the WIK Model estimates the cost of a service provided in fewer areas or at lower quality than the service provided by mobile network operators, it underestimates the efficient cost of supplying the MTAS.<sup>228</sup>

#### *WIK Model - Aggregation network*

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<sup>222</sup> *ibid.*, p.17.

<sup>223</sup> *ibid.*

<sup>224</sup> *ibid.*

<sup>225</sup> *ibid.*, p.18.

<sup>226</sup> *ibid.*

<sup>227</sup> *ibid.* p.19.

<sup>228</sup> *ibid.* p.21.

Optus submits that it is not technically feasible for a mobile network to use microwave links only in the BTS – BSC aggregation network. The reason for this is that radio links have a limited throughput capacity and accordingly cannot aggregate traffic from all upstream sites.<sup>229</sup>

#### *WIK Model - Backhaul network*

Optus submits that, as a mobile carrier and service provider, it maintains at all times ‘Carrier class’ annual network availability of 99.95 per cent for backhaul transmission, and this standard of availability is typical of Australian mobile carriers and service providers. To achieve such availability, it is standard practise to employ path protection with equipment interface protection on every backhaul segment in the transmission network, which provides full geographical diversity for backhaul transmission. It appears that the WIK Model does not incorporate such service protection mechanisms for its backhaul network (since discussion of any such mechanisms has not been presented) and consequently Optus considers that its concerns about the resilience of the design of WIK Model’s backhaul network remain. Optus submits that as a result, the WIK Model does not appear to be capable of designing a mobile network capable of meeting typical Australian availability standards.<sup>230</sup>

#### *WIK Model – Traffic and demand issues*

Optus submits that it considers that the Commission’s view on the usage of an average milli-Erlang demand per consumer is incorrect, and that application of it in the WIK Model to estimate busy-hour traffic is not reasonable for three main reasons:

- 1) It is not necessarily true that the actual milli-Erlang demand per consumer in rural areas is likely to be below the average milli-Erlang demand per consumer (or that in suburban and urban areas the milli-Erlang demand per consumer is expected to be above the average milli-Erlang demand per consumer).
- 2) A-bis transmission has a minimum fixed size (one E1 or 2 Mbps) regardless of carried traffic, and this is not impacted by the milli-Erlang demand per customer at that site. The assumption that as BTS units located in rural areas are further away from BSC locations than suburban or urban areas, using an average milli-Erlang demand per consumer results in an over-estimation of the capacity required for transmission, in general, is incorrect.
- 3) The cost of microwave links has little dependency on the transmission path length, so the assumption that the impact from overestimating milli-Erlang demand in rural areas has a greater impact on cost than the underestimation in suburban and urban areas due to the longer transmission links required in rural areas is not generally correct.<sup>231</sup>

Optus submits that that the WIK Model does not address variation in busy hours across cell sites through use of the assumption of a morning and afternoon busy hour, since the size of the BTS to BSC transmission pipe (A-bis) is generally fixed at one 2

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<sup>229</sup> *ibid.*, p.22.

<sup>230</sup> *ibid.* pp. 22-23.

<sup>231</sup> *ibid.*, p. 24.

Mbps link. Diurnal variations in traffic between base stations and across the network provide no A-bis efficiency benefit to the network operator whatsoever. Any "unused" A-bis capacity on a specific site is inaccessible to other traffic.<sup>232</sup>

*WIK Model - Asset prices*

Optus submits that the fact that three out of four mobile network operators are subsidiaries within international telecommunications group and their relative bargaining power will therefore be irrelevant to the equipment prices mobile network operators paid.<sup>233</sup>

Optus submits that it notes the Commission's speculation that the analysis for land values could be used to support the relative value of construction and labour costs. Optus submits that it does not consider the Commission has adequately demonstrated that land values are the dominant factor behind international variation in site acquisition and construction costs.<sup>234</sup>

*WIK Model - Risk-free rate*

Optus submits that in calculating the risk-free rate, the Commission should average Government bond rates for the at least 10 days leading up to the start of the regulatory periods. The Commission has used this methodology for many years and Optus believes it is suitably robust to address any potential concerns regarding day-to-day market volatility.<sup>235</sup>

*WIK Model - Cost trends*

Optus submits that the Commission has not specifically responded to the issue of cost trends over time it raised in its previous submissions and Optus continues to believe local factors should be taken into account.<sup>236</sup>

*WIK Model - Site sharing*

Optus submits that it disagrees with the statement that Optus is silent on the site sharing assumptions made about microcell sites as it explicitly stated that 'microcell sites are generally not shared with other carriers...they are typically positioned at busy street intersections...street lightning poles, or shop awning. Neither Optus nor Telstra own or otherwise use these structures.' It submits that it never implicitly agrees with the WIK's site sharing assumption of microcell and in fact submitted that the rate of microcell site sharing is zero.<sup>237</sup>

Optus submits that with respect to the site sharing assumptions for macrocells, it observes the WIK figure is high when comparing the percentage to its own network.<sup>238</sup>

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<sup>232</sup> *ibid.*, p. 25.

<sup>233</sup> *ibid.*, p. 27.

<sup>234</sup> *ibid.*

<sup>235</sup> *ibid.*, p. 28.

<sup>236</sup> *ibid.*, p. 29.

<sup>237</sup> *ibid.*

<sup>238</sup> *ibid.*

Optus submits that contrary to the Commission's apparent belief that shelter costs are negligible compared to overall site costs, shelter costs are in fact a substantial proportion of overall site costs.<sup>239</sup>

*WIK Model - Working capital*

Optus submits that it believes that it is unrealistic to say an efficient operator would not face demand for working capital. Such a scenario could only exist in a text book. The demise of Onetel indicates the difficulties faced by new entrants in the mobile market in organising their cash flow. The market is constantly changing and unpredictable outgoings are expected from time to time. Mobile network operators incur substantial up-front costs for infrastructure and labour before receiving payments and unexpected turbulences occur from time to time. An example would be the > \$1 million damage caused by an armoured personnel carrier at our western Sydney mobile base stations in July 2007.<sup>240</sup>

*WIK Model - Carrier licence fees*

Optus submits that it continues to hold the view that the entire carrier licence fee should be allocated to network services. According to the Australian Communications and Media Authority (ACMA), there are two types of organisations that can provide telecommunication services to the public – carriers and carriage service providers (CSP). Carriers are required to hold a carrier licence but CSPs are not. Like other carriers in Australia, CSP provides retail services to the public but do not own a telecommunication network unit. Accordingly, the licence fee is not related to the entire mobile business of a CSP and Optus therefore submits licence fee should not be treated in the same way as common organisational-level costs.<sup>241</sup>

*WIK Model - Spectrum*

Optus submits that the allocation of spectrum costs is incorrect, and that 100 per cent of spectrum costs should be allocated to networks, since possession of spectrum is required for a network operator, but not for a retailer. In any case, even if 100 per cent of spectrum costs were allocated to the network, a proportion would de facto be allocated to retail services, since all mobile services other than termination are sold at retail.<sup>242</sup>

Optus submits that a more reasonable approach would be for the model to amortise spectrum costs according to a straight line method or with a front loaded tilt to reflect the technology obsolescence risk in 2G (from 3G). This would be necessary to maintain efficient investment in 2G consistent with a competitive market. (Page 32)<sup>243</sup>

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<sup>239</sup> *ibid.*, p. 30.

<sup>240</sup> *ibid.*

<sup>241</sup> *ibid.*, p. 31.

<sup>242</sup> *ibid.*, pp. 31-32.

<sup>243</sup> *ibid.*

### *Telstra*

Telstra submits that it maintains its concerns in relation to the development and implementation of the WIK Model. It does not intend to repeat here what it has stated (and will state) in its submissions on the WIK Model in the associated consultation process. Telstra also acknowledges that the WIK Model may still undergo further modifications and transformations before it is finalised.<sup>244</sup>

Telstra submits that it continues to believe that the outputs of the WIK Model as they now stand appear to be consistent with the view that 12 cpm overstates the efficient costs of supplying the MTAS. In stating this, it submits that it needs to be understood that Telstra is not endorsing the WIK Model itself.<sup>245</sup>

Telstra submits that it expects that even if the ACCC were to modify the WIK Model to address all of Telstra's concerns with it, the modified model would still produce a cost estimate below 12cpm. This is consistent with, and corroborated by, numerous other sources (including a critical assessment of Optus' own cost model offered in support of its previous undertaking). On the balance of all the information available to Telstra, the efficient costs of supplying the MTAS are likely to be significantly below 12 cpm.<sup>246</sup>

### **Commission's view**

The Commission considers that Optus's detailed submissions and critique of the WIK Model do not contribute to the information set required to demonstrate that 12cpm is related to Optus' efficient costs of producing MTAS.

Optus's submissions on the WIK Model are relevant to the Commission's consideration and use of the WIK Model as corroborating support for the MTAS Pricing Principles Determination for the period 1 July 2007 to 31 December 2008. The Commission has not had regard to the WIK model for the purpose of assessing the Optus undertaking.

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<sup>244</sup> Telstra, *Telstra Submission in Response.*, p. 6.

<sup>245</sup> *ibid.*

<sup>246</sup> *ibid.*, pp. 6-7.

## Appendix 6 – List of documents the Commission examined in reaching its final decision

<b>OPTUS MOBILE TERMINATING ACCESS SERVICE UNDERTAKING SECTION 152CGA STATEMENT</b>
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DOC NO	DATE	TYPE	TITLE	FROM	TO
1	February 2007	Undertaking	Optus 2007 Undertaking	Optus	
2	1997	Guidelines	<i>Access Pricing Principles – Telecommunications, A Guide, 1997 (Access Pricing Principles Guidelines)</i>	ACCC	
3	June 2004	Report	<i>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)</i>	ACCC	
4	1974	Act	<i>Trade Practices Act 1974</i>		
5	July 2007	Report	<i>MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008 Report (2007 MTAS Pricing Principles Determination Report)</i>	ACCC	
6	February 2006	Report	<i>Optus's Undertaking with Respect to the Supply of its Domestic GSM Terminating Access Service (DGTAS): Final Decision Public Version (Optus Undertaking Final Decision)</i>	ACCC	
7	March 2007	Submission	<i>Submission to ACCC in Support of the Optus 2007 Undertaking - Public version (Optus Submission in Support)</i>	Optus	ACCC
8	April 2007	Submission	<i>Assessment of Optus's Undertaking in Relation to Declared Service – Mobile Terminating Access</i>	AAPT	ACCC



			<i>Service Submission</i> (AAPT Submission)		
9	April 2007	Submission	<i>Submission to Optus Domestic Terminating Undertaking Submission</i> (CCC Submission)	Competitive Carriers' Coalition	ACCC
10	April 2007	Submission	<i>Hutchison's Response: Optus's 2007 Undertaking in Relation to the Domestic Mobile Terminating Access Service</i> (H3GA Submission)	Hutchison 3G Australia	ACCC
11	April 2007	Submission	<i>Submission in Response to the ACCC's Discussion Paper on Optus' 2007 Undertaking in Relation to the Domestic Mobile Terminating Access Service</i> (Telstra Submission in Response to Discussion Paper)	Telstra Corporation Limited	ACCC
12	November 2006	ACT Decision	<i>Application by Optus Mobile Pty Limited &amp; Optus Networks Pty Limited</i> [2006] ACompT 8	ACT	
13	March 2000	ACT Decision	<i>Sydney International Airport</i> [2000] ACompT 1	ACT	
14	May 2007	ACT Decision	<i>Telstra Corporation Ltd (No 3)</i> [2007] ACompT 3	ACT	
15	January 2007	Annual Report	<i>Results and Operations Review Half Year Ended 31 December 2006</i>	Telstra Corporation Limited	
16	January 2004	Annual Report	<i>Results and Operations Review Half Year Ended 31 December 2003</i>	Telstra Corporation Limited	
17	July 2006	Annual Report	<i>Annual Report for the Year Ended 30 June 2006</i>	Telstra Corporation Limited	
18	July 2005	Annual Report	<i>Annual Report for the Year Ended 30 June 2005</i>	Telstra Corporation Limited	
19	May 2007	Annual Report	<i>Singapore Telecommunications Limited and Subsidiary Companies, Management Discussion and Analysis of Unaudited Financial Condition, Results of Operations and Cash</i>	Singapore Telecommunications Limited and Subsidiary Companies	

			<i>Flows for the Fourth Quarter and Financial Year Ended 31 March 2007</i>		
20	February 2007	Letter	<i>Cover Letter to Optus 2007 Undertaking</i>	Optus	ACCC
21	May 2005	Annual Report	<i>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</i>	Singapore Telecommunications Limited and Subsidiary Companies	
22	June 2006	ACT Decision	<i>Telstra Corporation Limited (ACN 051 775 556) [2006] ACompT 4</i>	ACT	
23	December 2004	ACT Decision	<i>Seven Network Limited (No 4) [2004] ACompT,11</i>	ACT	
24			<i>Explanatory Memorandum to Telecommunications Legislation Amendment (Competition and Consumer Issues) Bill 2005</i>		
25			<i>Explanatory Memorandum for the Trade Practices Amendment (Telecommunications) Bill 1996</i>		
26	March 2007	Report	<i>Mobile Call Termination Report Statement</i>	OfCom (UK)	
27	October 2005	Report	<i>Review of the Mobile Terminating Access Service Cost Model submitted by Optus – Revised final report for the ACCC</i>	Anaylsys Consulting	
28	January 2004	Annual Report	<i>Results and Operations Review Half Year Ended 31 December 2003</i>	Telstra Corporation Limited	
29	August 2007	Submission	<i>Telstra Submission in response to the ACCC's draft decision on Optus 2007 Undertaking in relation to the Domestic Mobile Terminating Access</i>	Telstra Corporation Limited	ACCC

			<i>Service</i>		
30	August 2007	Submission	<i>Optus submission to the ACCC on Draft Decision on Optus 2007 MTAS Undertaking</i>	Optus	ACCC
31	June 2007	Document	<i>ERG updated snapshot of Mobile Termination rates, 1 January 2007</i>	ERG	
32	October 2007	Document	<i>ERG snapshot of Mobile Termination, 1 July 2007</i>	ERG	
33	1999	Guide	<i>Access Undertakings – A Guide to Part IIIA of the Trade Practices Act, 30 September 1999,</i>	ACCC	