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**Submission to the  
Australian Competition and Consumer Commission**

**Access Undertakings  
domestic digital mobile terminating access service**

**Hutchison Telecommunications (Australia) Limited and  
Hutchison 3G Australia Pty Limited**

**October 2005**

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## Introduction

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On 7 October 2005, Hutchison Telecommunications (Australia) Limited (**HTAL**) and Hutchison 3G Australia Pty Limited (**H3GA**)(together **Hutchison**) submitted access undertakings (the **Undertakings**) to the Commission under the *Trade Practices Act 1974* (Cth)(the **Act**) in relation to the domestic digital mobile terminating access service (**MTAS**).

Hutchison provides this submission in support of the Undertakings.

## Structure of submission

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This submission is structured as follows:

1. The Undertakings: structure and interrelationship:
  - An overview of the Undertakings.
  - The principal concepts contained in the Undertakings.
  - How the Undertakings interrelate.
2. The Undertakings: terms and conditions:
  - Price related terms and conditions.
    - The proposed price of the MTAS in respect of PMTS calls.
    - The proposed price of the MTAS in respect of Non-PMTS calls.
  - Non-price related terms and conditions.
    - The 'existing agreement' option.
    - The model terms and conditions.
3. Analysis of the statutory criteria:
  - The 'reasonableness' test.
  - The decision of the Australian Competition Tribunal in FOXTEL.
  - Consistency of the Undertakings with the statutory factors.

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## 1. The Undertakings: structure and interrelationship

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### 1.1 Overview

Hutchison maintains the view that 12 cpm represents an appropriate price for the MTAS.<sup>1</sup>

Hutchison has previously submitted that a regulated reduction in MTAS prices would promote competition in the mobile services market, and that the delayed transition to 12 cpm is restricting the development of effective competition in that market.<sup>2</sup> However, lower MTAS charges are unlikely to promote competition in the fixed-to-mobile market unless they are coupled with commensurately lower fixed-to-mobile prices. Lower fixed-to-mobile call prices are unlikely to be achieved through reductions in MTAS charges alone given the uncompetitive state of the fixed-to-mobile market.<sup>3</sup> Rather, such reductions create a windfall for providers of fixed-line services.

The Undertakings aim to strike an appropriate balance between the benefits that a reciprocal price of 12 cpm would bring to the mobile-to-mobile market and the limited role that reduced MTAS prices are likely to play in improving competition in the fixed-to-mobile market in the absence of an effective pass-through mechanism.

Hutchison has submitted six Undertakings: three on behalf of H3GA and three of behalf of HTAL. The Undertakings set out the terms and conditions on which HTAL and H3GA will supply the MTAS to access seekers in respect of different types of voice calls: public mobile telecommunications service calls (**PMTS Calls**) and other telecommunications service calls (**Non-PMTS Calls**).

### 1.2 Principal concepts employed in the Undertakings

#### **PMTS Undertakings**

'PMTS Call' is defined in the Undertakings as 'a voice call originating from a Mobile Service Number on a Mobile Network in Australia and terminating on a Mobile Service Number on a Mobile Network in Australia'. The Undertakings which relate to PMTS Calls apply exclusively to domestic mobile-to-mobile traffic.

HTAL and H3GA have each submitted two alternative undertakings regarding the supply of MTAS in respect of PMTS Calls:

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<sup>1</sup> Hutchison, *Submissions by Hutchison in response to the Commission's discussion papers on Vodafone MTAS Undertaking and Optus MTAS Undertaking*, 2005 and ACCC, *Mobile Services Review, Final Decision on whether or not the Commission should extend, vary or revoke its existing declaration of the mobile terminating access service*, June 2004 (the **MTAS Final Decision**).

<sup>2</sup> Hutchison, *Submission by Hutchison to the Mobile Services Review*, June 2003.

<sup>3</sup> Productivity Commission, *Telecommunications Competition Regulation*, 21 September 2001 at page 133; Professor Allan Fels, *Regulatory competition in converging markets; telecommunications and broadcasting*, 30 April 2003 at page 4; Professor Allan Fels, *Competition in Telecommunications*, 6 March 2003 at page 40.

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- an undertaking which provides for two optional usage charges for the MTAS – one reciprocal, the other non-reciprocal (the **PMTS Dual Rate Undertaking**);<sup>4</sup> and
  - an undertaking which provides for a single, reciprocal usage charge for the MTAS (the **PMTS Single Rate Undertaking**).<sup>5</sup>

#### **Non-PMTS Undertaking**

'Non-PMTS Call' is defined in the Undertakings as 'a voice call other than a PMTS Call'. The Undertakings which relate to Non-PMTS Calls apply to all traffic which is excluded from the PMTS Calls Undertakings, namely, domestic fixed-to-mobile traffic and traffic originating on overseas networks.

H3GA and HTAL have each submitted an undertaking to the Commission regarding the supply of the MTAS in respect of Non-PMTS Calls (the **Non-PMTS Undertaking**).<sup>6</sup>

### **1.3 How the Undertakings interrelate**

The PMTS Dual Rate Undertaking and PMTS Single Rate Undertaking are submitted by Hutchison as alternatives.

Hutchison submits that the LTIE is best served by the Commission accepting the PMTS Dual Rate Undertaking coupled with the Non-PMTS Undertaking.

Hutchison submits that the LTIE would also be served by the Commission accepting the PMTS Single Rate Undertaking coupled with the Non-PMTS Undertaking. This approach, however, would not be as beneficial to the LTIE as the former approach.

Notwithstanding the views expressed above, Hutchison submits that each individual Undertaking promotes the LTIE. Acceptance of one or more of the Undertakings submitted by each of HTAL and H3GA would therefore be in the LTIE.

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<sup>4</sup> In this submission, a reference to 'PMTS Dual Rate Undertaking' singular includes the PMTS Dual Rate Undertakings submitted by H3GA and HTAL.

<sup>5</sup> In this submission, a reference to 'PMTS Single Rate Undertaking' singular includes the PMTS Single Rate Undertakings submitted by H3GA and HTAL.

<sup>6</sup> In this submission, a reference to 'Non-PMTS Undertaking' singular includes the undertakings submitted by H3GA and HTAL in respect of Non-PMTS Calls.

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## 2. The Undertakings: terms and conditions

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### 2.1 Price related terms and conditions

H3GA and HTAL have each submitted three undertakings to the Commission: one in respect of Non-PMTS Calls and two alternative undertakings in respect of PMTS Calls.

The Non-PMTS Undertaking proposes that Hutchison will supply the MTAS at 18 cpm, Both the PMTS Dual Rate and Single Rate Undertakings contain an offer by Hutchison to supply the MTAS at the rate of 12 cpm on a reciprocal basis.

The different rates proposed by the Non-PMTS Undertaking (18 cpm) and the PMTS Undertakings (12 cpm) reflect the different competition issues that arise in the relevant markets in which the MTAS is supplied.

The PMTS Dual Rate Undertaking also includes an optional rate of 21 cpm as a fall back for those access seekers who choose not to accept the reciprocal 12 cpm offer. This is the only respect in which the two PMTS Undertakings differ.

The Single Rate Undertaking was submitted in addition to its Dual Rate counterpart to accommodate the possibility that the Commission may regard the optional rate of 21 cpm as a departure from its MTAS pricing principle which affects the reasonableness of the PMTS Dual Rate Undertaking.

In assessing the reasonableness of the price related terms and conditions, particularly the 21 cpm proposed by the PMTS Dual Rate Undertaking, Hutchison submits that the Commission should have regard to:

- the interplay between all of the price related terms and conditions contained in the Undertakings; and
- the different markets in which those terms and conditions apply.

For example, 18 cpm represents a reasonable reduction in MTAS charges in the fixed-to-mobile market given the absence of an effective pass through mechanism and the delayed emergence of competition in that market. Meanwhile 12 cpm is an appropriate price for the MTAS in the mobile-to-mobile context, being at the higher end of the range of best estimates of the cost of supplying the MTAS. While Hutchison does not intend to suggest that the rate of 21 cpm is in any way reflective of the underlying cost of providing the MTAS, this optional rate is appropriate when coupled with the offer of the lower, reciprocal rate of 12 cpm.

The rate of 21 cpm contained in the PMTS Dual Rate Undertaking should not be viewed in isolation. A review of all of the price related terms and conditions *in context* reveals a broader consistency with the principles expressed by the Commission in its MTAS Final Decision and the LTIE. Hutchison submits that, when considered together, the PMTS Dual Rate Undertaking and the Non-PMTS Undertaking provide a rate structure that addresses the different issues arising in the relevant markets, promotes competition in those markets and ensures a closer association of the price of the MTAS with its underlying cost in such a way as to promote the LTIE.

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### ***PMTS Undertakings: Dual Rate and Single Rate***

The PMTS Dual Rate Undertaking and PMTS Single Rate Undertaking provide that Hutchison will charge a rate of 12 cpm for its supply of the MTAS to access seekers who agree to charge Hutchison, or are otherwise required to charge Hutchison, an equal rate for their supply of the MTAS to Hutchison.<sup>7</sup> This conditional offer reflects the principle of reciprocity which generally informs commercial negotiations regarding the supply of the MTAS.

The PMTS Dual Rate Undertaking differs from the PMTS Single Rate Undertaking in one respect: the PMTS Dual Rate Undertaking provides that Hutchison will supply the MTAS at the 'fall back' rate of 21 cpm to access seekers who do not accept Hutchison's 12 cpm reciprocal offer. The purpose of the PMTS Dual Rate Undertaking is twofold: it allows access seekers to benefit from a 12 cpm reciprocal rate, a rational price for an efficient mobile operator, while providing certainty of pricing for those access seekers that do not choose the 12 cpm reciprocal offer.

The PMTS Dual Rate Undertaking provides access seekers with a choice: a reciprocal, forward-looking efficient cost-based price, or 21 cpm. The rate of 21 cpm is the most recent commercially negotiated rate, and Hutchison submits that there is no basis for offering a lower rate to an access seeker who does not accept the 12 cpm rate on a reciprocal basis. The key concept in this alternative pricing approach is choice for the access seeker.

Hutchison has lodged the PMTS Single Rate Undertaking as an alternative to the PMTS Dual Rate Undertaking in the event that the Commission is minded not to accept the latter due to the optional rate of 21 cpm, such rate being above the target rate determined by the Commission in the MTAS pricing principle. If the Commission is minded to reject the PMTS Dual Rate Undertaking, Hutchison submits that the PMTS Single Rate Undertaking should be accepted. However, this undertaking will not be nearly as effective as its Dual Rate counterpart in ensuring faster, more widespread implementation of the target price of 12 cpm.

As noted above, Hutchison believes that 12 cpm is an appropriate price having regard to the fair and reasonable costs of providing the MTAS and that acceptance of the reciprocal offer would be the rational choice of any efficient mobile operator. The Mobile Services Review, which led to the Commission's Final Decision on whether or not to extend, vary or revoke the declaration of the MTAS and the MTAS pricing principle, was a comprehensive review into the appropriate price for the MTAS.<sup>8</sup> It took over a year to complete and many submissions were received from a large number of interested parties. As part of this review the Commission also reviewed in detail the international position.

The Commission concluded that the best cost measures of the MTAS indicate a range of between 5 and 12 cpm. This estimate was supported by the Commission's analysis of Telstra's RAF External Wholesale account for GSM termination and origination, which

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<sup>7</sup> See H3GA and HTAL PMTS Dual Rate and Single Rate MTAS Undertakings, Attachment A, clause 2.3.

<sup>8</sup> ACCC, MTAS Final Decision, June 2004.

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indicated a per minute cost well within the Commission's estimated range of 6 to 12 cpm.<sup>9</sup> Accordingly, the Commission adopted a target price of 12 cpm for the MTAS pricing principle.

As to the Commission's adjustment path, its underlying rationale was to minimise the disruption to the pricing and business strategies of mobile network operators which the Commission believed could flow from a substantial reduction in the price of the MTAS.<sup>10</sup>

Hutchison maintains the view that the Commission's adjustment path is unnecessary, and that the impact of a reciprocal price of 12 cpm upon mobile network operators would not be so adverse as to outweigh the benefits that such a price would have for the LTIE. Given the substantial period of time that has passed since the Commission first proposed the adjustment path,<sup>11</sup> Hutchison considers that any disruption for mobile network operators caused by a 12 cpm reciprocal MTAS charge will be minimal. This view is consistent with the submissions of consumer groups and other industry participants which note that "three years have already been lost in terms of generating a closer association of prices and costs for the MTAS".<sup>12</sup>

Hutchison does not believe that a more rapid transition to the target price would result in disruption to pricing and business strategies. Regulated reductions in MTAS charges have been anticipated in the industry for some time for the following reasons:

- since 2001, the Commission has regulated MTAS through retail benchmarking with the objective of achieving a reduction in MTAS charges;<sup>13</sup>
- the reduction has taken place in the context of the following international developments:<sup>14</sup>
  - the UK regulator (OfTel) imposing a price cap for MTAS of RPI-9% on Vodafone and BT in 1999;
  - the UK regulator (OfTel) imposing a price cap for MTAS of RPI-12% on Vodafone, BT, T-Mobile and Orange in 2000-01;
  - the French regulator (ART) imposing an obligatory 40% reduction in MTAS prices on Orange and SFP in November 2001, such reduction to be achieved by 1 January 2004;
  - in March 2003, the Italian regulator mandated a maximum charge for MTAS for Telecom Italia and Vodafone to apply with 30 days of the decision;

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<sup>9</sup> ACCC, MTAS Final Decision, June 2004, p237.

<sup>10</sup> ACCC, MTAS Final Decision, June 2004, p 216.

<sup>11</sup> See ACCC, Draft MTAS Final Decision, March 2004.

<sup>12</sup> AAPT, *Submission by AAPT Limited in Response to the ACCC's Draft Decision on the Mobile Service Review: Mobile Terminating Access Service*, 30 April 2004, pp. 7-8 cited in MTAS Final Decision, June 2004, p217.

<sup>13</sup> ACCC, *Discussion Paper, Mobile Services Review*, April 2003 at page 49.

<sup>14</sup> ACCC, *Discussion Paper, Mobile Services Review*, April 2003 at page 35.



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- the Dutch regulator (OPTA) released rules in March 2002 requiring MTAS charges to be reduced in line with EU best practice by April 2003; and
  - in Portugal, the regulator (Anacom) announced indicative MTAS price reductions in May 2002 for MTAS and required operators to reach interconnection agreements within 10 days based on the indicative price.
  - Access seekers have had at least 2 years to reconsider their pricing and business strategies in response to any of the developments referred to above. There is nothing to be gained by further delaying the transition to the target price and it is not appropriate that reductions to MTAS charges be unnecessarily delayed to suit the pricing plans of individual carriers.
  - Incumbent mobile carriers are in a financial position to accommodate a reduction in the MTAS charge to 12 cpm within a tighter timeframe. As the Commission has acknowledged, some mobile operators are enjoying high levels of economic profit overall.<sup>15</sup>

To the extent that the Undertakings represent a departure from the adjustment path, Hutchison submits that the target price of 12 cpm for the MTAS is a conservative estimate of its underlying cost and strikes an appropriate balance between the legitimate interests of access seekers and the LTIE:

...by choosing a target price that is at the top-end of the best estimates currently available, the Commission believes it is taking a conservative approach to setting a target price for this service. Whilst this may mean the Commission chooses a target price above existing TSLRIC+ levels (and possibly even further above what TSLRIC+ will be in 3 years time), the Commission believes such an element to its pricing principle is consistent with section 152AH(1), as it has regard to the legitimate business interests of access providers. As the Commission is not specifically modelling TSLRIC+ in Australia for the purposes of determining this pricing principle, it is therefore introducing some risk into its assessment of an appropriate target price for this service. The Commission believes this risk is balanced over the period of this pricing principle, by choosing a conservative target price for this service. Were the Commission to reduce the price of the MTAS beyond its current target price in the future, it would seek to more accurately determine the TSLRIC+ of the MTAS in Australia.

Overall, therefore, the Commission continues to believe that the best cost measures of the MTAS indicate a range of between 5 and 12 cpm. Accordingly, the Commission continues to believe a target price of 12 cpm is appropriate for this pricing principle.<sup>16</sup>

Reciprocal pricing for the MTAS has long been the industry standard. The rationale for reciprocal pricing can be summarised as follows:

- Reciprocal pricing is inherent to a TSLRIC approach which is based on the 'efficient operator' concept rather than the actual costs of mobile operators.

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<sup>15</sup> ACCC, Draft MTAS Final Decision, March 2004, p82.

<sup>16</sup> ACCC, MTAS Final Decision, June 2004, p 215.

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- Reciprocal pricing enhances consumer welfare. As Gans & King have noted, the lack of transparency in the pricing of mobile tariffs (whereby consumers are ignorant of the amount paid by the B-party) is a significant contributing factor to the maintenance of artificially high MTAS prices, which is adverse to the LTIE.<sup>17</sup> Asymmetrical pricing would exacerbate the problem identified by Gans & King.
  - Asymmetrical pricing necessarily involves efficient operators subsidising less efficient operators.

A review of the positions adopted by European regulators in relation to reciprocal pricing reveals that a number of countries have introduced delayed reciprocity. This approach enables new entrants to charge a higher termination rate as compensation for market entry disadvantages caused by smaller market share. This is seen as an interim measure; reciprocity being the goal once entrants have achieved adequate economies of scale and scope.

In Hutchison's view, the notion of an industry-wide price for the MTAS based on the estimated costs of an efficient, forward-looking operator is fundamental to the TSLRIC approach adopted by the Commission in the MTAS pricing principle. Accordingly, Hutchison offers access seekers a reciprocal price of 12 cpm for the MTAS on the terms and conditions set out in the PMTS Undertakings.

Hutchison regards the 21 cpm rate contained in the PMTS Dual Rate Undertaking as a fall back for access seekers who, for whatever reason, choose not to accept the reasonable, reciprocal rate of 12 cpm. Hutchison acknowledges that its supply of the MTAS at the non-reciprocal rate of 21 cpm to access seekers who choose this rate may benefit Hutchison commercially.

Since H3GA launched its '3' brand, it has often been a market leader in respect of both price and innovation. Hutchison submits that any benefits that may accrue to it by reason of access seekers choosing the 21 cpm option are likely to be used by Hutchison to drive further product innovation and reductions in retail prices. Hutchison submits that the Dual Rate Undertaking is therefore consistent with the LTIE.

#### ***Non-PMTS Undertaking***

As noted above, the Non-PMTS Undertaking relates to voice calls other than PMTS Calls. The Non-PMTS Undertaking provides that Hutchison will supply the MTAS to access seekers in respect of Non-PMTS Calls, ie predominantly domestic fixed-to-mobile calls, at the rate of 18 cpm.

The fixed-to-mobile market is not effectively competitive.<sup>18</sup> Existing market structures provide vertically-integrated fixed and mobile network operators with considerable scope and incentive to use their control over access to the MTAS to engage in anti-competitive

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<sup>17</sup> J Gans and S King, *Termination Charges for Mobile Phone Networks – Competitive Analysis and Regulatory Options*, 22 December 1999.

<sup>18</sup> ACCC, Draft MTAS Final Decision, March 2004, p 93.

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price-squeeze behaviour.<sup>19</sup> Given the lack of competition in the fixed-to-mobile market, Hutchison considers it very unlikely that lower MTAS charges will be reflected in lower fixed-to-mobile prices in the absence of more effective regulation of those retail prices. Without a mechanism to require pass through, competition in the fixed-to-mobile market from the end users' perspective will not be promoted. Further, without pass through, significant reductions in access prices may adversely affect price competition in the mobile services market. With pass through, the lower fixed-to-mobile call prices may lead to increased fixed-to-mobile call traffic enhancing competition in both the mobile services and fixed-to-mobile markets.

Hutchison submits that the rate of 12 cpm would not promote the LTIE in the fixed-to-mobile market at this time. Rather, a price of 18 cpm is an appropriate short term price for the MTAS supplied in respect of Non-PMTS Calls. This reflects a 14% reduction on the last commercially negotiated price that Hutchison has offered and paid for the MTAS and is referable to the adjustment path contained in the MTAS pricing principle. In view of Hutchison's concerns about fixed-to-mobile pass through and competition in the mobile services market, Hutchison considers 18 cpm to be a significant reduction in the price of the MTAS supplied in respect of Non-PMTS Calls.

In its previous submissions to the Commission, Hutchison advocated the need for a pass through mechanism to ensure a reduction in fixed-to-mobile retail prices. However, pass through mechanisms, including the FTM safeguard proposed by Vodafone in its MTAS undertaking, have been strongly rejected by fixed-line operators such as Optus and Telstra.<sup>20</sup> In the light of this opposition, Hutchison considers that a reduction in MTAS charges to 18 cpm for Non-PMTS Calls is a practical means of testing whether or not an appropriate degree of pass through will occur in the absence of a specific pass through mechanism.<sup>21</sup>

The Non-PMTS Undertaking expires on 30 June 2006, at which time Hutchison will review the retail price of fixed-to-mobile calls by reference to both the declining price of the MTAS and the effectiveness of the revised retail price control scheme.<sup>22</sup>

The other component of traffic covered by the Non-PMTS Undertaking is traffic originating from overseas networks. The issues raised above in relation to the lack of an effective pass through mechanism in the fixed-to-mobile market also arise in this context. Accordingly, Hutchison submits that a reduction in MTAS charges to 18 cpm for Non-PMTS Calls, including calls originating overseas, is reasonable.

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<sup>19</sup> Hutchison, *Submission by Hutchison in response to the draft MTAS Final Decision*, April 2004, p 3.

<sup>20</sup> See Optus, *Optus Submission to the ACCC on Vodafone's revised mobile terminating access service undertaking lodged 23 March 2005*, August 2005, p6.

<sup>21</sup> The Commission acknowledges that "pass-through may take time to emerge in full": ACCC, *MTAS Final Decision*, p 125.

<sup>22</sup> See *Telstra Carrier Charges – Price Control Arrangements, Notifications and Disallowance Determination No. 1 of 2002*. Senator the Hon. Helen Coonan, Minister for Communications, Information Technology and the Arts, *Senate Hansard*, 22 June 2005, p 50.

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## 2.2 Non-price related terms and conditions

The Undertakings provide two alternative sources of non-price related terms and conditions on which Hutchison will supply the MTAS:

- the access seeker's existing agreement with Hutchison for the supply of the MTAS, SMS, MMS or any other service (the **existing agreement option**); or
- the non-price terms and conditions contained in Attachment B to the Undertakings.

The existing agreement option applies to access seekers who have a commercial agreement directly with Hutchison as at the date the Undertakings come into force. In this scenario, the non-price terms and conditions contained in the existing agreement will govern Hutchison's supply of the MTAS. The interests of access seekers are accommodated by the existing agreements as their terms and conditions were arrived at through commercial negotiation.

Attachment B to the Undertakings applies to access seekers who do not have an existing agreement with Hutchison as at the date the Undertakings come into force. Attachment B is closely based on the model terms and conditions at Annexure A of the *Telecommunications Access Code 1998*. Hutchison believes that the terms and conditions contained in Attachment B protect the interests of access seekers and create certainty regarding Hutchison's supply of the MTAS.

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### 3. Statutory Criteria

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#### 3.1 The 'reasonableness' test

The Commission can only accept the Undertakings as proposed by Hutchison if the Commission is satisfied that the Undertakings are reasonable.<sup>23</sup>

In considering the issue of reasonableness, the Commission is required to have regard to a number of statutory factors which in turn require the Commission to have regard to further factors. Annexure A is a diagram which sets out these factors. Those factors that are relevant to the task before the Commission, including those introduced by the *Telecommunications Legislation Amendment (Competition and Consumer) Act 2005*, are highlighted. Only those factors relevant to the task before the Commission are specifically addressed in this submission.

The terms and conditions contained in the Undertakings and their combined effect satisfy the relevant statutory factors. The Undertakings are therefore reasonable and should be accepted by the Commission in the manner proposed by Hutchison.

#### 3.2 Analysis of statutory criteria for assessing reasonableness

In determining whether the Undertakings are reasonable the Commission is required to have regard to:

- whether the terms and conditions promote the long-term interests of end users (the *LTIE*) of carriage services or services supplied by means of carriage services;
- 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 interests of persons who have rights to use the declared service concerned;
- the direct costs of providing access to the declared service concerned;
- the operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility; and
- the economically efficient operation of a carriage service, a telecommunications network or a facility.<sup>24</sup>

This list is not exhaustive and the Commission may have regard to any other relevant matter.<sup>25</sup>

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<sup>23</sup> s152BV(2)(d).

<sup>24</sup> s152AH(1).

<sup>25</sup> s152AH(2).

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### ***The LTIE criterion***

In considering whether a thing promotes the LTIE, the Commission is required to have regard to:

- the objective of promoting competition in markets for listed services;
- the objective of achieving any-to-any connectivity in relation to carriage services that involve communications between end users; and
- the objective of encouraging the economically efficient use of, and the economically efficient investment in:
  - (i) the infrastructure by which listed services are supplied; and
  - (ii) any other infrastructure by which listed services are, or are likely to become, capable of being supplied.<sup>26</sup>

This list is exhaustive and the Commission may not have regard to any other matters.<sup>27</sup>

### ***The promotion of competition criterion***

In considering whether a thing is likely to promote competition, the Commission is required to have regard to the extent to which the thing will remove obstacles to end users of listed services gaining access to listed services.

This is not exhaustive and the Commission may have regard to any other relevant matter.<sup>28</sup>

### ***The efficient investment criterion***

In determining the extent to which a particular thing is likely to encourage the economically efficient use of, and the economically efficient investment in infrastructure, the Commission must have regard to the following matters:

- whether it is technically feasible for the services to be supplied;
- the legitimate commercial interests of the supplier including the ability of the supplier to exploit economics of scale and scope;
- the incentives for investment in:
  - (i) the infrastructure by which the services are supplied; and
  - (ii) any other infrastructure by which the services are, or are likely to become, capable of being supplied.<sup>29</sup>

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<sup>26</sup> s152AB(2). The *Telecommunications Legislation Amendment (Competition and Consumer) Act 2005* was passed by Parliament on 15 September 2005 and received the Royal Assent on 23 September 2005. Schedule 9 of the Act amends the factors that should be considered in determining the LTIE. Schedule 9 commenced on 24 September 2005 (the day after receiving the Royal Assent). It inserted s152AB(2)(ii) into the Act.

<sup>27</sup> s152AB(3).

<sup>28</sup> s152AH(5).

<sup>29</sup> s152AB(6)(a)-(c). See footnote 26. The *Telecommunications Legislation Amendment (Competition and Consumer) Act 2005* inserted s152AB(6)(c)(ii) into the Act.

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- for the purposes of determining the incentives for investment, regard must be had to the risks involved in making the investment.<sup>30</sup>

This list is not exhaustive and the Commission may have regard to any other relevant matter.<sup>31</sup>

### 3.3 The decision of the Australian Competition Tribunal in FOXTEL

The Australian Competition Tribunal (the *Tribunal*) has recently considered the meaning of the phrase 'long-term interests of end-users' in *Seven Network (No. 4)* (the **FOXTEL decision**).<sup>32</sup>

In the FOXTEL decision, the Tribunal stated that the appropriate way to test if a particular thing was in the LTIE was to use the 'future with and without' test. In that case, the test required a comparison of the future situation with the exemption orders, and the future situation without the exemption orders and a consideration of which of those situations was in the LTIE.<sup>33</sup> The Tribunal found that this assessment requires:

...the forecasting of future market behaviour, competitive activity and market conduct in a particular area or region and the development of an investment.<sup>34</sup>

The Tribunal formulated the 'key principles' by which the Commission should assess whether a thing is in the LTIE<sup>35</sup> and in doing so concluded that generally TSLRIC is the appropriate cost measure to employ. Specifically the Tribunal determined that:

- the price of a service should not exceed the minimum costs that an efficient firm would incur in the long-run in providing that service;
- the costs are the forward-looking costs, including a normal return on efficient investment, taking account of 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, by using more costly out-of-date technology;
- The cost of providing the service should be the cost that would be avoided in the long-run by not having to provide it; and
- Modelling should be undertaken using a TSLRIC approach based on the forward-looking costs of providing the service.<sup>36</sup>

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<sup>30</sup> s152AB(7A). See footnote 26. The *Telecommunications Legislation Amendment (Competition and Consumer) Act 2005* inserted s152AB(7A) into the Act.

<sup>31</sup> s152AB(7).

<sup>32</sup> *Seven Network Limited (No. 4)* [2004] ACompT 11.

<sup>33</sup> *Seven Network Limited (No. 4)* [2004] ACompT 11 at [119].

<sup>34</sup> *Seven Network Limited (No. 4)* [2004] A CompT 11 at [119].

<sup>35</sup> *Seven Network Limited (No. 4)* [2004] ACompT 11 at [135].

<sup>36</sup> *Seven Network Limited (No. 4)* [2004] ACompT 11 at [135-136].

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The Tribunal emphasised that in applying the LTIE, it needed to consider what would encourage 'efficient investment'.<sup>37</sup> That consideration involved arriving at an appropriate access price. As the Tribunal stated, 'The right signals means prices that will allow sound investors to make a reasonable, but not excessive return'.<sup>38</sup>

### 3.4 The Undertakings are consistent with the statutory factors

#### *The LTIE*

The terms and conditions contained in the Undertakings promote the LTIE. This can be demonstrated by applying the Tribunal's approach in the FOXTEL decision.

- **End users:** 'end users' are users of mobile services and fixed-to-mobile services and include existing and future subscribers.
- **Interests:** the interests of end users are three-fold: lower prices, improved quality of service and innovative product offerings.
- **Long-term:** while it is difficult to be prescriptive, the long-term will exceed the period specified in each of the Undertakings. That said, the Commission's acceptance of the Undertakings will:
  - signal to current and future market participants (including an acquirer of an existing network and not merely new entrants) the Commission's likely approach to outdated and costly technology; and
  - create the conditions or environment for improving long term competition in the relevant markets from what it would be otherwise.<sup>39</sup>

Hutchison applies the Tribunal's 'future with and without' test in demonstrating that the price related terms contained in the Undertakings are in the LTIE. This test requires an assessment of which of the following scenarios better serves the LTIE:

- acceptance of the Undertakings, which will govern the price of the MTAS supplied by Hutchison to other carriers; or
- rejection of the Undertakings, in which case the price of the MTAS will be determined by reference to the MTAS pricing principle, commercial negotiations or access arbitrations (the results of which may or may not reflect the MTAS pricing principle).

Hutchison submits that the former scenario, that is, the future with the Undertakings, is more likely to promote the LTIE. The prices proposed by the PMTS and Non-PMTS Undertakings will ensure faster, more widespread implementation of a lower price for the MTAS than the adjustment path established by the MTAS pricing principle, thereby creating benefits for a greater number of end users.

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<sup>37</sup> *Seven Network Limited (No. 4)* [2004] A CompT 11 at [129] and [130].

<sup>38</sup> *Seven Network Limited (No. 4)* [2004] A CompT 11 at [132].

<sup>39</sup> *Sydney International Airport* [2000] ACompT 1 at [106].



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Hutchison has demonstrated its commitment to innovation in the mobile services market. In this context, any benefit accrued by Hutchison as a result of access seekers opting for the non-reciprocal price of 21 cpm will be applied to continued innovation which promotes the LTIE.

Hutchison now considers each element of the LTIE test.<sup>40</sup>

### **Promoting Competition**

In determining whether a thing promotes the LTIE regard must be had to whether the thing is likely to promote competition in markets for listed services.<sup>41</sup> This requires a 'general view' as to market definition.<sup>42</sup>

The Undertakings will promote competition and create the necessary pre-conditions to achieve greater competition in markets for listed services.<sup>43</sup>

Hutchison submits that there are two relevant markets by which the LTIE should be assessed, namely:

- the national market for mobile services; and
- the national market for retail fixed-to-mobile services.

Further, Hutchison submits that:

- the mobile services market is not effectively competitive; and
- the fixed-to-mobile market is less competitive than the mobile services market.

Hutchison's rationale in submitting separate undertakings in respect of PMTS and Non-PMTS traffic flows from the above market analysis. A general reduction in MTAS charges to 12 cpm would be a windfall for fixed-line providers and would hinder competition in the mobile services market and the fixed-to-mobile market. However, a reduced MTAS charge of 12 cpm in respect of PMTS traffic only will foster competition in the mobile services market while addressing pass-through concerns in the fixed-to-mobile market. A price of 12 cpm would also enable efficient mobile operators to place competitive pressure on integrated carriers to increase efficiency.

As noted above, Hutchison submits that a price of 18 cpm for its supply of the MTAS in respect of Non-PMTS Calls:

- constitutes a significant reduction in MTAS charges;
- is referable to the Commission's adjustment path; and
- is appropriate given the time period for which the Non-PMTS Undertaking will operate.

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<sup>40</sup> s152AB(2).

<sup>41</sup> s152AB(2)(c).

<sup>42</sup> *Seven Network Limited (No. 4)* [2004] A CompT 11 at [126].

<sup>43</sup> s152AB(2)(c).

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Hutchison has previously submitted that to reduce MTAS charges without ensuring a commensurate reduction in fixed-to-mobile retail prices would be detrimental to competition.<sup>44</sup> Reductions in MTAS charges alone would result in an unjustified windfall for fixed-line operators, leading to greater market distortions and no tangible consumer benefit. Given the likely effect of a universal reduction in the price of the MTAS on competition, Hutchison believes that the Undertakings, which propose rates of 12 cpm and 18 cpm in the mobile services market and the fixed-to-mobile market respectively, will ultimately assist in promoting competition in each of the relevant markets.

### **Encouraging economically efficient use and investment in infrastructure**

Hutchison submits that the PMTS Undertakings will encourage the economically efficient use and investment in infrastructure as they provide a price for the MTAS which reflects the costs that an efficient, forward-looking operator would incur in providing the service. Given the short time period for which the Non-PMTS Undertaking will operate, Hutchison submits that it will most likely have a neutral effect on the economically efficient use and investment in infrastructure, and will certainly not discourage the economically efficient use and investment in infrastructure.

The Commission has stated that assessing the economically efficient use of and investment in infrastructure refers to the concept of economic efficiency, comprising:<sup>45</sup>

- dynamic efficiency;
- allocative efficiency; and
- productive efficiency.<sup>46</sup>

(a) Dynamic efficiency

Dynamic efficiency reflects the need for industries to make timely changes to technology and products in response to changes in consumer tastes and productive opportunities.

3G technology allows Hutchison to supply termination services at a lower cost than GSM technology. The acceptance of the Undertakings will therefore promote the expansion of 3G networks by:

- increasing the incentive for carriers to roll out their own 3G networks, as carriers will no longer be able to protect the profitability of their GSM networks; and
- increasing the incentive for carriers, once they have rolled out 3G networks, to migrate their customers onto that new network.

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<sup>44</sup> Hutchison, *Submission by Hutchison to the Mobile Services Review*, June 2003, p3.

<sup>45</sup> ACCC, *Access Pricing Principles – Telecommunications – a guide*, 1997.

<sup>46</sup> This summary is taken from *A report on the assessment of Telstra's Undertaking for the Domestic PSTN Originating and Terminating Access services* (July 2000), p20.

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(b) Allocative efficiency

Allocative efficiency is achieved where the prices of resources reflect their underlying costs so that the benefit of the final unit consumed of the good equals the cost of producing that unit. This ensures that resources are allocated to their highest value uses.

Acceptance of the Undertakings would promote allocative efficiency in that it would ensure a closer association of the price of the MTAS and the underlying cost of providing the MTAS.

(c) Productive efficiency

Productive efficiency is achieved where individual firms produce the goods and services they offer at least cost.

By terminating calls on its 3G network, Hutchison provides termination services at minimum cost. This is consistent with productive efficiency. The price of 12 cpm offered in the PMTS Undertakings is reflective of the cost an efficient operator using forward-looking technology would incur in providing the same service. The price of 18 cpm offered in the Non-PMTS Undertaking will achieve a closer association of price and cost while avoiding a windfall for fixed-line operators adverse to the LTIE.

***Hutchison's legitimate business interests***

In considering whether the Undertakings are reasonable, the Commission is required to consider Hutchison's legitimate business interests.<sup>47</sup> The Commission has stated that a carrier has a legitimate business interest in earning a normal commercial return on its investment.<sup>48</sup> It does not extend to compensating operators for a loss of 'monopoly' profits due to effective competition.

In the case of an incumbent operator, there is a tacit tension between this factor and those relevant to the LTIE test. This is demonstrated by the two most recent access undertakings lodged by Vodafone and Optus which sought to justify MTAS prices which were substantially above cost on the basis that such measures were required to protect their legitimate business interests, among other things.

The interests of Hutchison, as a new entrant and an efficient forward-looking operator, are wholly consistent with the statutory factors which make up the LTIE test, namely promoting competition and the economically efficient use of, and investment in, infrastructure. The acceptance of the Undertakings will promote Hutchison's legitimate business interests not at the expense, but rather in furtherance of, the LTIE.

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<sup>47</sup> s152AH(1)(b).

<sup>48</sup> See, for example, *Seven Network Limited (No. 4)* [2004] A CompT 11 or *A report on the assessment of Telstra's undertaking for the domestic PSTN originating terminating access services* (July 2000), p19.

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***The interests of persons who have rights to use the declared service***

This statutory factor requires the Commission to have regard to the interests of access seekers. Hutchison submits that the interests of access seekers will be served by the certainty which the Undertakings provide, particularly in relation to price.

In addition, Hutchison submits that the PMTS Undertakings promote the interests of access seekers given the reciprocity that they provide.

Hutchison submits that the Non-PMTS Undertaking strikes an appropriate balance between the interests of fixed-line/integrated operators and mobile only operators. It proposes a reduction in the price of the MTAS for fixed-to-mobile calls which does not create an undue windfall in favour of fixed-line operators, but ensures a closer association of price and underlying cost.

For the reasons outlined above, the price related terms contained in both the PMTS and Non-PMTS Undertakings will promote competition in the markets to which they apply; an outcome which serves the legitimate interests of all access seekers.

***The direct costs of providing access to the declared service***

In determining reasonableness the Commission must consider Hutchison's direct costs of providing the MTAS. For the purposes of this submission, Hutchison assumes that direct costs means the actual subjective costs of access providers.<sup>49</sup>

The Commission considered the direct costs of providing access to the MTAS as part of the Mobile Services Review and determined that the target price of 12 cpm reflects the underlying TSLRIC of providing the MTAS.<sup>50</sup> In its MTAS Final Decision, the Commission noted that a "TSLRIC pricing principle.. has been found to be consistent with the LTIE...for a number of declared telecommunications services in the past...because it reflects the direct cost of supplying the service".<sup>51</sup>

Given that:

- the Commission has already considered the direct costs of providing the MTAS in determining the MTAS pricing principle; and
- the terms and conditions proposed by the Undertakings are consistent with this pricing principle,

Hutchison submits that the Undertakings are reasonable.

Hutchison notes that both Optus and Vodafone have recently submitted undertakings accompanied by further evidence of their direct costs. Hutchison submits that the Commission should accord little weight to this evidence for the reasons outlined in Hutchison's submissions in response to the Commission's discussion papers on the Optus and Vodafone undertakings. In particular, Hutchison submits that the Commission should take into account Hutchison's supplementary submission in response to the Commission's

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<sup>49</sup> As stated in the Explanatory Memorandum to the *Trade Practices Amendment (Telecommunications) Act 1996*, p44.

<sup>50</sup> ACCC, MTAS Final Decision, June 2004, p 204.

<sup>51</sup> ACCC, MTAS Final Decision, June 2004, p 205 (emphasis added).

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discussion paper on the Vodafone undertaking, which provides further support for the Commission's estimate of the direct costs of providing the MTAS.<sup>52</sup>

***The economically efficient operation of a carriage service, a telecommunications network or a facility***

Hutchison repeats its discussion above in relation to encouraging economically efficient use and investment in infrastructure.

**DATED 13 OCTOBER 2005**

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<sup>52</sup> Hutchison, *Supplementary submission by Hutchison in response to the Commission's discussion paper on the Vodafone MTAS Undertaking*, September 2005.