



Optus Submission

in response to the ACCC Discussion Paper

Public Inquiry to make an Access Determination for the  
Mobile Terminating Access Service

July 2011

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## Section 1. Executive Summary

- 1.1 Optus welcomes the opportunity to participate in the Australian Competition and Consumer Commission (ACCC)'s consultation on the future regulation of the Mobile Terminating Access Service (MTAS). Optus' responses to the issues set out in the ACCC's discussion paper are presented in this submission.
- 1.2 The ACCC's main task in making a final access determination (FAD) is to set a regulated price for supply of the MTAS. Much of the discussion paper is devoted to evaluating the merits of alternative pricing and costing methods. Optus submits that this focus is misplaced. Before considering the fine details of mobile network costing methodologies, the ACCC should address the prior issue of whether any change to the regulated rate is required. The current MTAS rate, 9 cents per minute (cpm), was set by the ACCC in its Pricing Principles Determination for 2009 to 2011. The primary question in the current consultation is whether 9 cpm continues to be an appropriate MTAS rate, or whether there are grounds for change.
- 1.3 In this submission, Optus will argue that the MTAS rate should be held steady at 9 cpm. The years 2007 – 2011, during which the MTAS rate has remained at 9 cpm, have seen strong growth in mobile network investment (Optus alone invested **CiC**), in particular the extensive deployment of 3G infrastructure, and flourishing competition in the mobile market. Optus will submit in this paper that maintaining a stable MTAS rate at 9 cpm would continue to encourage much-needed investment in critical mobile network infrastructure including the introduction of LTE technology, and thereby promote the long term interests of all mobile consumers.
- 1.4 In this context, some of the ideas floated in the discussion paper are extreme and clearly inconsistent with the legislative criteria. These should be rejected out of hand. The "pure LRIC" costing method, for example, would prevent mobile operators from recovering common network costs which are critical to provision of the MTAS, as would a "bill and keep" approach to pricing (an MTAS rate of zero). Both of these methods would fail to allow for network operators' legitimate business interest in recovering their network investment costs and discourage network investment, and must be rejected. Further, any proposal to set different rates for mobile-to-mobile (MTM) and fixed-to-mobile (FTM) calls would create significant practical problems around arbitrage which would be difficult if not impossible to prevent.
- 1.5 Even putting these proposals aside, however, Optus has significant concerns with the approach the ACCC appears to be taking to the current consultation. In the discussion paper the ACCC has proposed a number of alternative options for setting a new MTAS rate, all of which, it says, would likely "produce a new MTAS rate that departs significantly from the current rate." This observation is concerning, since it suggests the ACCC has already made up its mind to cut the rate, without first undertaking a thorough investigation of the effects of such a reduction.
- 1.6 In setting the MTAS rate, the ACCC is required to take into account the objectives set out in the legislation; in particular, its determination must promote the long term interests of end users and take into account network operators' legitimate business interests. In Optus' view, there is a strong likelihood that *any* proposed reduction in the MTAS rate would fail this legislative test.
- 1.7 In this submission Optus will argue that a rate cut would reduce operators' revenue at a time when they face increasing cost pressures associated with capacity demands, customer service needs and important technological changes. **CiC** That is, in current circumstances, the marginal

cost of providing mobile termination is particularly high. In this submission, Optus will argue that this fact should be reflected in the MTAS charge.

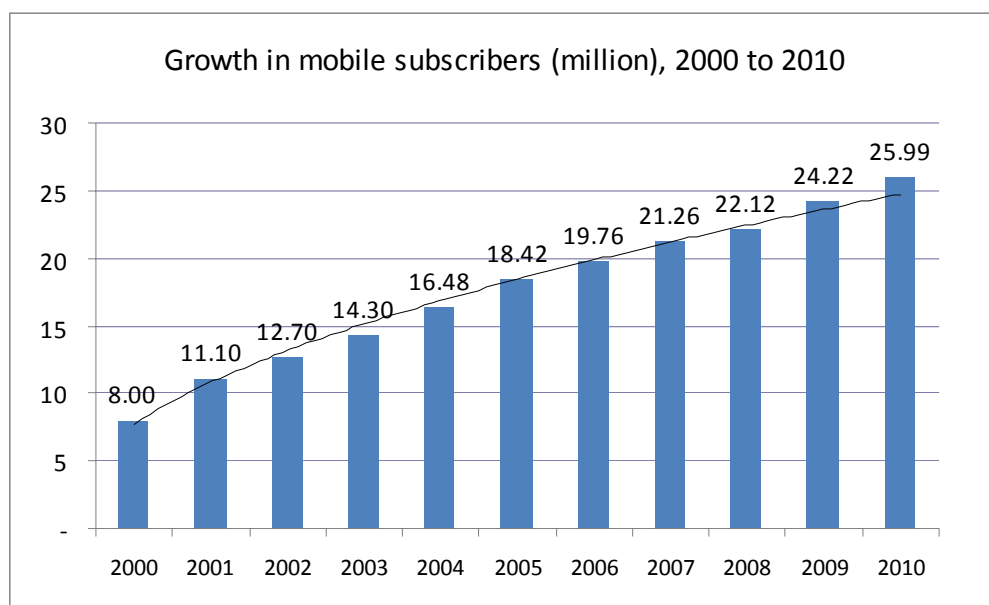
- 1.8 However, the role of increasing traffic on mobile network cost should not be overstated. A key assumption underlying the ACCC's approach to determining MTAS costs is the view that network cost is driven predominantly by traffic. This assumption is erroneous – and the error has serious implications. It risks leading the ACCC to conclude that MTAS costs are low and that data is responsible for the bulk of network costs. If this were true, data would be unprofitable and no operator would invest in mobile broadband or offer a 3G or 4G service on its network. In this submission, Optus will argue that the ACCC must make a fundamental change to the way it views mobile network costs, in order to reflect network engineering and commercial reality. Whilst traffic does cause significant costs at the margin in some constrained areas of the network, in fact the vast majority of mobile network costs are driven by the need to provide coverage – primarily for voice services. Data is simply an overlay on the voice network and does not drive a substantial proportion of total network costs. Optus submits that it would be wrong for the ACCC to conclude that the cost of providing the MTAS is below 9 cpm on the basis of a flawed and uncommercial approach to cost allocation.
- 1.9 In these circumstances a reduction in the MTAS rate could be justified only by unambiguous evidence that consumers would benefit in the long term; however, as Optus will show in this paper, the opposite case is more likely. Reducing the MTAS rate is likely to disadvantage low usage mobile consumers, because mobile plans designed for these customers are more reliant on MTAS revenue to be profitable. Nor will a rate cut benefit high usage mobile consumers, who in many cases face very low calling costs already.
- 1.10 Fixed line consumers will not benefit from a rate reduction because the dominant fixed line operator will not reduce the fixed to mobile (FTM) prices paid by its retail customers – as demonstrated by Telstra's failure to do so in response to previous MTAS rate cuts. Further, the ACCC's proposed measure to ensure pass-through would be ineffective, since Telstra could circumvent any required reduction in retail FTM prices by making offsetting adjustments to other elements of the fixed line bundle. The interests of fixed line consumers can best be promoted through structural reforms in the fixed line market. The necessary reforms, including structural separation and the construction of an open access National Broadband Network (NBN), are already being implemented; however, time will be required before their impact is felt. For now, any MTAS rate cut will be pocketed by Telstra.
- 1.11 On the whole, a cut in the MTAS rate can only make consumers worse off. Optus urges the ACCC to think twice before taking such a step.

## Section 2. Mobile Operators' Margins are under Pressure

- 2.1 The mobile industry is facing a significant period of change and commercial challenges, including rising network costs, market saturation, stagnant revenue growth and increasing customer care and subscriber acquisition costs. Whilst demand for data services is growing, revenue from data and mobile broadband services is unlikely to be sufficient for MNOs to offset growing costs, contrary to the ACCC's assumption.<sup>1</sup>
- 2.2 A cut in the MTAS rate would significantly reduce operators' revenue at a time when they face increasing cost pressures associated with capacity demands, customer service needs and important technological changes. Network operators have a legitimate business interest in recovering a reasonable proportion of their increasing network costs through MTAS revenue. By facilitating this cost recovery, maintaining MTAS at 9cpm will provide incentives for mobile operators to make further efficient investments in the future.

### Current trends in the mobile market

- 2.3 There has been a significant take-up of mobile subscriptions in Australia from 8 million<sup>2</sup> subscribers in 2000 to 25.99 million<sup>3</sup> mobile subscribers in June 2010, as illustrated in the graph below. Furthermore, mobile penetration surpassed 100 per cent in 2007.<sup>4</sup>



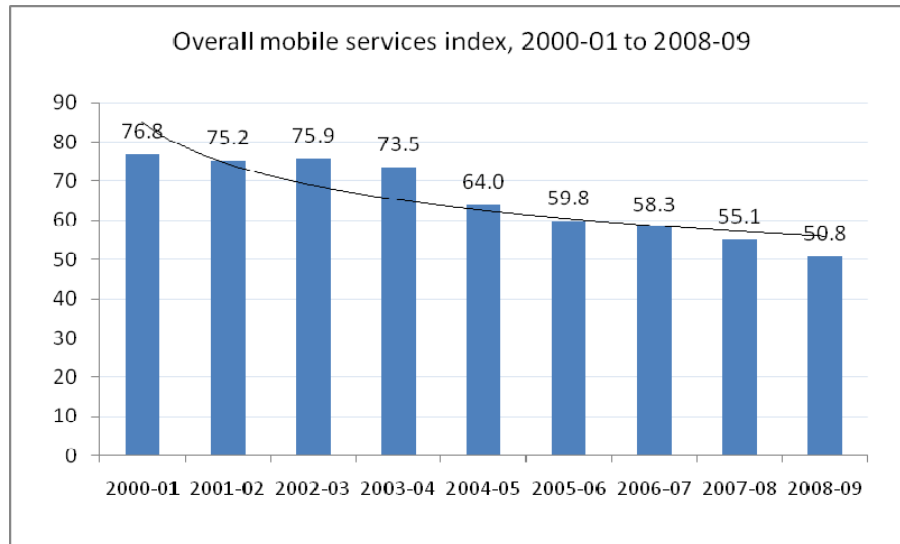
<sup>1</sup> ACCC, Domestic Mobile Terminating Access Service (MTAS) – Public inquiry to make an access determination, Discussion Paper, June 2011, p.11

<sup>2</sup> ACMA, Telecommunications Performance Report 2004-05, November 2005, p.70

<sup>3</sup> The reported total of 25.99 million is inclusive of both wholesale and retail services and wireless broadband services provided via data cards and dongles. In comparison, the ACMA also notes that as at June 2010 there were 3,455,000 mobile wireless subscribers which is inclusive of data cards and dongles but excludes mobile handset. ACMA, Communications report 2009-10, November 2010, p.34 and 38

<sup>4</sup> The estimated resident population in Australia in 2007 was 21,263,300. ABS, 3101.0 – Australia Demographic Statistics, December 2010, Table 1

2.4 As the number of mobile connections continues to grow, this will in turn lead to increasing mobile traffic volumes across both voice and non-voice services. However this expansion is not necessarily indicative of increases in mobile profitability, for example the Australian overall mobile services index shows that there has been a significant decline in mobile prices since 2000, as illustrated in the graph below.<sup>5</sup>



2.5 The ACCC has acknowledged these price declines:

*The ACCC notes that the market for retail services in which MTM calls are supplied has experienced material price declines exhibited through the increasing value and variety of bundles and lower priced calls that are offered by MNOs, MVNOs and other resellers.<sup>6</sup>*

2.6 **ciC**

<sup>5</sup> Extrapolated from ACCC, Changes in prices paid for telecommunications services in Australia, 2008-09, in ACCC telecommunications reports 2008-09 – Report 2, June 2010, p.126

<sup>6</sup> ACCC, Domestic Mobile Terminating Access Service (MTAS) – Public inquiry to make an access determination, Discussion Paper, June 2011, p.5

## **Operators' costs are rising**

### **2.7 CiC**

2.8 Operator costs will continue to rise in the short term for a number of reasons, including:

- (a) Operators will participate in upcoming spectrum auctions – which will result in significant upfront costs of acquisition in a number of mobile spectrum bands;
- (b) The costs of customer acquisition is incrementally greater than the cost of retaining an existing customer;
- (c) Australia is experiencing wage and labour supply pressure due to the NBN; and
- (d) Continued investment in 3G (and 4G) networks is required to expand coverage.

### Spectrum acquisition

2.9 Mobile operators in Australia currently operate mobile networks on the 850MHz, 900MHz, 1800MHz and 2100MHz spectrum frequencies, and with the exception of the 900MHz, these spectrum rights are allocated in the form of 15 year spectrum licences. In contrast, the 900MHz spectrum rights are allocated in the form of five year apparatus licences.

2.10 Optus currently owns mobile spectrum in the 900MHz, 1800MHz and 2100MHz bands, which are used to provide mobile handset and wireless broadband services. The latter of these licences are due to expire in 2013 and 2017 respectively. **CiC**

### Costs of customer acquisition

2.11 The high and rising costs of customer acquisition are well recognised; for example:

*Across mature wireless markets, mobile operators have long appreciated that the cost of acquiring a new customer is incrementally greater than the cost of retaining an existing one. Today this has never been truer.<sup>7</sup>*

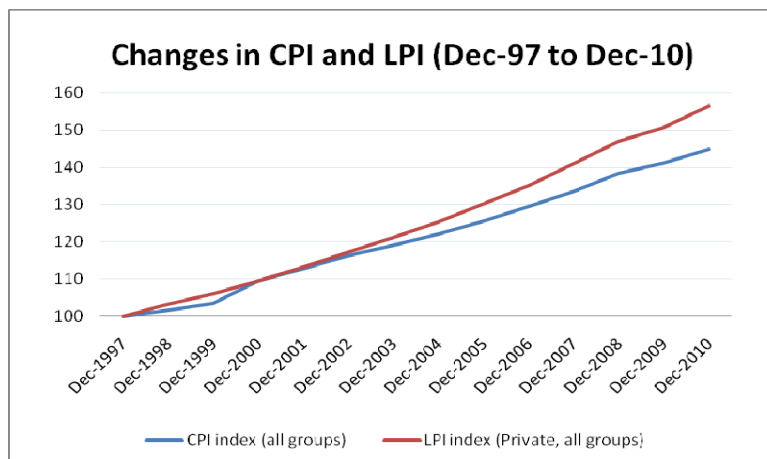
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<sup>7</sup> WDS, Mobile churn – The impact of churn on mobile subscriber profitability, Industry Briefing, p.3



### Labour costs and wage growth pressures

- 2.12 In recent years, the labour price index in Australia has grown at a faster rate than the consumer price index, as illustrated in the graph below. In the period December 1997 to December 2010, the LPI increased by 56.6 per cent<sup>8</sup> relative to the CPI, which only increased by 45.0 per cent.<sup>9</sup>



- 2.13 Coupled with labour demand required for the roll out of the NBN, labour costs and wage growth pressures in the telecommunications sector will likely only increase, adding further pressure on operator costs.

### Continued expansion of 3G (and future rollout of 4G) networks

- 2.14 The coverage footprint of 3G networks is expanding and the continued expansion of 3G networks by mobile operators is costly. For example as the ACMA notes

*Telstra's 3G network is claimed to provide coverage to 99 per cent of the Australian population. Optus' 3G network is claimed to provide coverage to 97 per cent of the Australian population, with plans to extend to 98 per cent. VHA is claimed to provide coverage to between 92 and 95 per cent of the Australian population.*<sup>10</sup>

- 2.15 Following this, mobile network investments are also required for the future rollout of LTE networks. Optus is currently planning to make capital investments in its mobile network in the order of **CiC** over the 5 year period FY2010 – FY2014 (April 2009 – March 2014).

<sup>8</sup> This percentage change has been calculated based on the difference over the period December 1997 and December 2010 for the category titled 'Quarterly Index; Total hourly rates of pay excluding bonuses; Australia; Private; All industries.' ABS, 6345.0 Labour Price Index, Australia, March 2011

<sup>9</sup> This percentage change has been calculated based on the difference over the period December 1997 and December 2010 for the category titled 'Index Numbers; All groups; Australia.' ABS, 6401.0 Consumer Price Index, Australia, June 2011

<sup>10</sup> ACMA, Mobile network broadband, December 2010, p.7

## Mobile revenues are unlikely to keep pace

2.16 Given the increasing pressures on operator costs discussed above, mobile revenues are unlikely to keep pace with these steeply rising costs. This will have several implications for cost recovery and mobile profitability:

- (a) Consumption of data services is not increasing as rapidly as 3G subscription.
- (b) Consumers are unwilling to face higher prices for data services
- (c) Reducing MNO revenue is likely to impact margins (and so cause reduced investment)
- (d) Loss of international revenue inflow due to reducing MTAS rates is a net loss to all Australian carriers and a net loss to national welfare and therefore Australian consumers.

2.17 Each of these will be discussed in turn.

### Consumption of data services is not increasing as rapidly as 3G subscription

2.18 Over the period 2006 to 2009, the growth of 3G mobile subscribers increased from 4.3 per cent of total SIOs in 2006 to 50.7 per cent in 2009.<sup>11</sup> However, usage of 3G services has *not* grown at the same rate as take-up in 3G services. For example,

*Of the available features, customers use the phone most frequently for voice calls (used greater than 50 per cent of the time) and SMS. Interestingly, 3G features accounted for just six per cent of the overall phone use.*<sup>12</sup>

2.19 In addition, the ACMA also acknowledges that even across all three customer segments surveyed who have taken up 3G phone plans only 40% of 3G bill-payers reported using 3G features on their phones.<sup>13</sup> Importantly, this highlights that even though the end-user may have access to a 3G-compatible handset and access plan, this does not necessarily translate to a significant take-up and use of 3G services.

### Consumers are unwilling to face higher prices for data services

2.20 Operators struggle to adequately recover costs through data service revenue because consumers have a status quo bias regarding the existing charging structure. Currently consumers pay for access to a voice network and are primarily paying to utilise their mobile phone to make and receive calls (see section 3). Consumers generally understand the charging units (minutes and connection) and are able to control their bills for voice, in contrast to new mechanisms to charge data ('bits') and the unclear relationship between use and charge units for bill control.

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<sup>11</sup> ACMA, Communications Report series (various years)

<sup>12</sup> ACMA, 3G mobile bill-payers' understanding of billing charging arrangements, Quantitative research report, June 2011, p.14

<sup>13</sup> ACMA, 3G mobile bill-payers' understanding of billing charging arrangements, Quantitative research report, June 2011, p.15

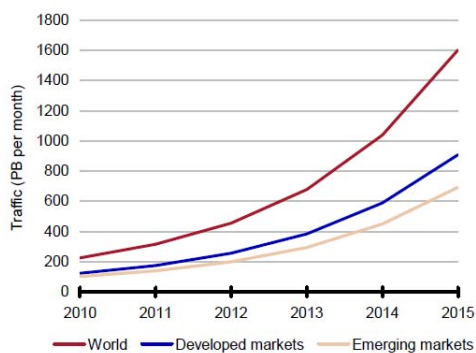
- 2.21 Data charges are currently very low compared to voice because it is considered a new product, and low pricing is used to encourage the take-up of new services and technology. However, this can create a status quo bias against paying more for data from the consumers' point of view. This has been described in the literature as "*status quo inertia is the presence of uncertainty in the decision-making setting*".<sup>14</sup> That is, currently consumers pay for voice and are happy and comfortable paying for it, as mobile networks have been in place for over a decade. However, data is still a new product; so if charges were high consumers may simply choose not to 'try it'. In turn, operators have created an expectation that data is 'cheap', which erodes the willingness to pay more in the short term.
- 2.22 As a result, it is difficult, if not effectively impossible to re-balance prices in the market between data and voice services in the near term, hence in order to be consistent with an operator's legitimate business interests, it is necessary that the operator recovers some of the data-related network costs through the existing 9cpm MTAS rate.

Reducing MNO revenue is likely to impact margins

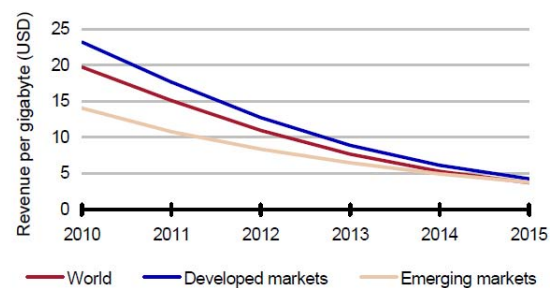
- 2.23 There is an increasing disconnect between traffic volumes and revenue, which is placing increasing pressure on mobile network operators, while concurrently making the current pricing structure for mobile services unsustainable. An example of this relationship is illustrated below.<sup>15</sup>

**Wireless traffic will grow at a 48% CAGR from 2010 to 2015**

Traffic from mobile connections, worldwide, 2010–2015 [Source: Analysys Mason, 2010]



Revenue per gigabyte of mobile broadband traffic, worldwide, 2010–2015 [Source: Analysys Mason, 2010]



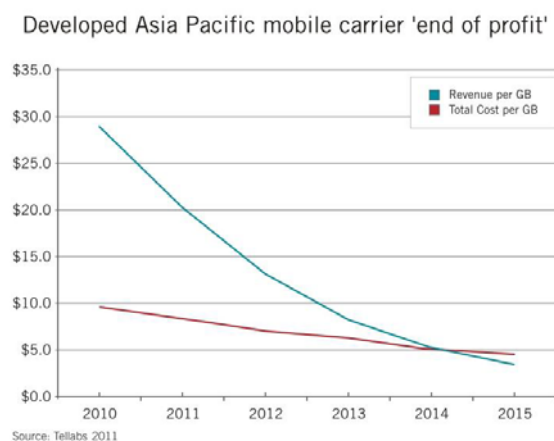
- 2.24 These trends are in line with the recent Tellabs study and Analysys Mason presentation on the future profitability of mobile services. For example,

<sup>14</sup> Samuelson, William and Richard Zeckhauser (1988), "Status Quo Bias in Decision Making", Journal of Risk and Uncertainty, 1: 7-59.

<sup>15</sup> Lavender, T., Data traffic explosion: A turnaround opportunity – or a margin threat? How operators can monetize broadband services, Presentation to the Nokia Siemens Network WSE Efficiency Forum, Paris, October 2010

*The [Tellabs] study puts timescales on an issue that has concerned operators since users began embracing the mobile Internet. Traditional ways of handling dramatic traffic growth are expensive. Meanwhile competition has increased pressure on revenues.*<sup>16</sup>

- 2.25 In particular, the Tellabs study shows that mobile carriers risk an ‘end of profit’ sometime before mid 2015 as illustrated in the chart below.<sup>17</sup>



- 2.26 Tellabs further notes:

*... it is clear that carriers are facing significant challenges in balancing cost and revenue. Existing network architectures are ill equipped to cope with the dual challenge of sustained data demand and falling revenues. To avoid an end of profit, carriers must fundamentally rethink the design and capabilities of their networks.*<sup>18</sup>

- 2.27 Analysys Mason supports this observation, noting that the combination of rapidly rising network traffic and slowly growing revenue is responsible for increasing pressure on infrastructure and mobile operator profit margins – a phenomenon often referred to as the ‘scissor effect’. This is illustrated in the graph below.<sup>19</sup>

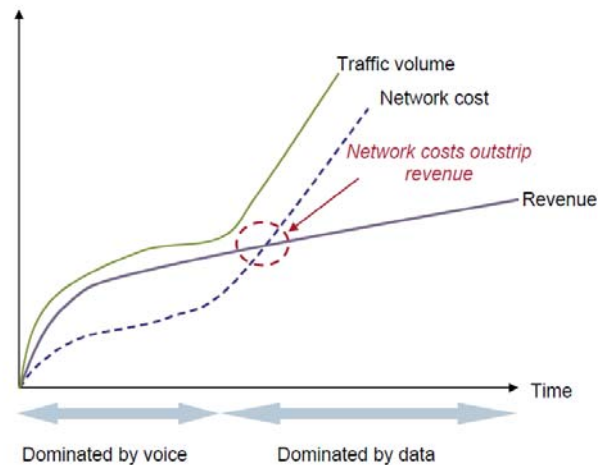
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<sup>16</sup> Tellabs, “Mobile operators profitability challenged within three years, says study,” Press Release, 3 February 2011, <http://www.tellabs.com/news/2011/index.cfm/nr/142.cfm>

<sup>17</sup> Tellabs, Tellabs “End of Profit” study, Executive Summary, February 2011, p.5

<sup>18</sup> Tellabs, Tellabs “End of Profit” study, Executive Summary, February 2011, p.7

<sup>19</sup> Lavender, T., Data traffic explosion: A turnaround opportunity – or a margin threat? How operators can monetize broadband services, Presentation to the Nokia Siemens Network WSE Efficiency Forum, Paris, October 2010



2.28 Optus submits in the increasingly challenging environment for mobile network operators described above, a reduction in the MTAS rate would be very difficult to absorb and would have a detrimental financial impact on operators' financial position. For example, the New Zealand Commerce Commission's recent decision to reduce MTRs has been cited by Vodafone PLC in the UK as affecting growth in the business. The impact of the decision has resulted in Vodafone losing customers to lower margin providers, including MVNOs – who do not receive termination revenue, and do not incur network costs.<sup>20</sup> A reduction in the MTAS rate would necessarily impact on operators' investment plans, which will impact on consumers. By contrast, maintaining MTAS at 9cpm will provide incentives to make efficient investment in future and is conducive to regulatory stability (which is further discussed in Section 7).

**CIC**

2.29 **CiC**

2.30 **CiC**

2.31 **CiC**

<sup>20</sup> Bennett, Bill, "MTR regulation already hitting Vodafone figures", Communications Day, 26 July 2011

## Section 3. The High Cost of Providing the MTAS

- 3.1 The ACCC's approach to setting a price for the MTAS appears to be driven by the view that the cost of service provision is low and in decline. The ACCC has asserted that:

*Rapid technological advancements and the growth of mobile data services will continue to drive down the cost of voice termination.*<sup>21</sup>

- 3.2 Optus submits that the ACCC's views are misplaced. Whilst the mobile industry is dynamic and technological advancements and data services are increasing, it is not the case that these developments are driving down the cost of providing voice termination. In fact the current cost of providing the MTAS is substantial – and is not in decline – for two main reasons:
- (a) As mobile networks approach capacity the cost of providing voice termination in the near term increases because it imposes a significant cost at the margin in terms of infrastructure requirements; and
  - (b) Notwithstanding the capacity costs noted above, the majority of mobile network costs are driven primarily by the need to provide coverage for voice services including the MTAS (as opposed to data services).
- 3.3 Accordingly, in this section Optus will argue that the ACCC must make a fundamental change to the way it allocates mobile network costs, in order to reflect network engineering practises and commercial reality.

### Capacity constraints increase the marginal cost of providing the MTAS

#### Measuring capacity constraints

- 3.4 As the number of subscribers on a mobile network increases, or the pattern of use changes, network capacity becomes increasingly scarce. When the network becomes close to fully utilised additional capacity can be added by building more base stations or acquiring bandwidth (spectrum). Whilst the majority of mobile network costs are attributable to the provision of voice coverage (that is, they relate to increasing the “reach” of the network), as discussed in the next section, adding capacity to a network also comes at a significant cost.
- 3.5 Capacity utilisation is not uniform. Some base stations may be heavily used, as subscribers in that area make frequent calls (eg CBD), and some used less intensely, such as a remote base station in a low population centre (eg a holiday town). The extent of capacity constraint in a network may be measured by reference to the number of base stations that are currently experiencing constraints.
- 3.6 One measure of network utilisation is the number of sites that are built to their maximum configuration. That is, the number of sites that are using the maximum allotment of spectrum capacity. Optus currently has four channels of 2100MHz spectrum in metro areas which it uses to provide 3G services. **CiC**

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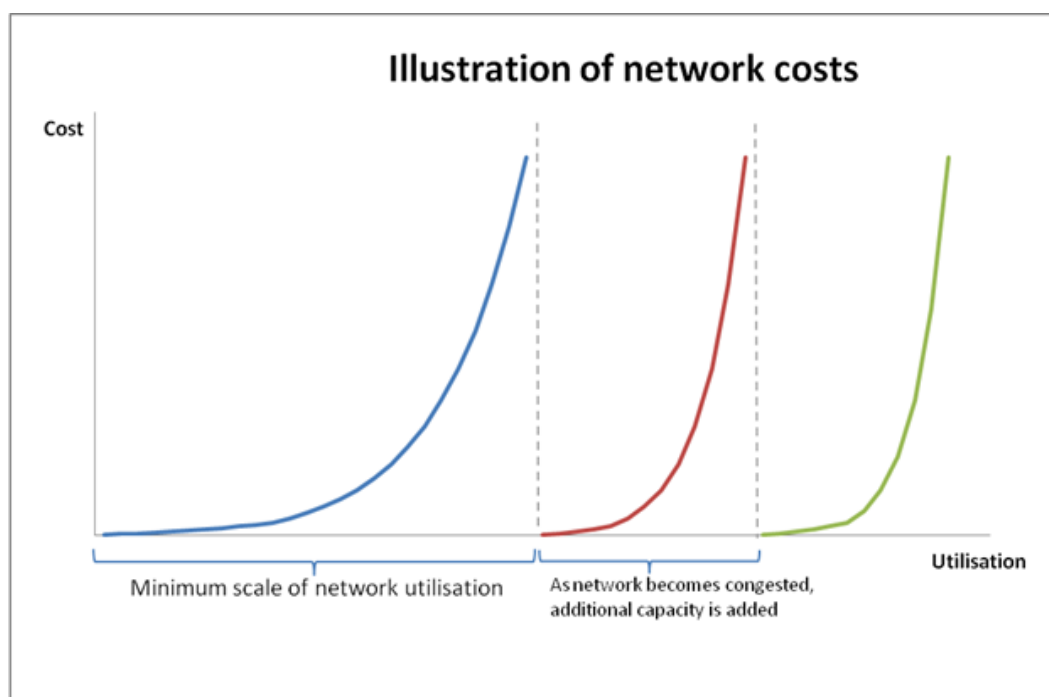
<sup>21</sup> ACCC, *Domestic Mobile Terminating Access Service (MTAS): Public Inquiry to make an Access Determination*, Discussion Paper, June 2011, p.19

3.7 **ciC**

3.8 **ciC**

### Implications for marginal cost of constraints

- 3.9 As the number of sites utilising the maximum configuration of spectrum increases, the short run marginal cost (SRMC) of meeting network demand increases, as capacity needs to be added in terms of additional spectrum or base stations. This has the implication of significantly increasing the cost of providing voice termination services as capacity available to be allocated to voice has become more scarce, and hence, more costly. The chart below illustrates the relationship between available capacity (or utilisation) and SRMC.



- 3.10 Given that the network is approaching capacity in many places, and principally more expensive locations for capacity provision (CBD and inner suburban areas), *any* marginal traffic including incoming/terminating voice traffic will impose a very high marginal cost. That is, at the current point in time provision of a terminating access service is particularly costly. Whilst voice coverage still drives most costs, as discussed in the next section, the incremental capacity required to terminate voice calls also imposes a significant cost.
- 3.11 In the academic literature, SRMC is considered the most efficient pricing methodology. This is because SRMC captures the immediate resource cost of utilising the good or service. It is therefore considered a 'first best' pricing outcome since the SRMC appropriately signals the opportunity cost of consuming the good or service.<sup>22</sup>
- 3.12 Ordinarily it is unadvisable to price utilities at SRMC because of the significant sunk costs present. Where there is excess capacity on a network, SRMC is low and sunk costs could not be recovered through SRMC pricing. For this reason long run marginal cost (LRMC) or variants such as TSLRIC are generally employed by regulators to set access prices.<sup>23</sup> However, given the current (and forecast) capacity constraints present on mobile networks it is likely that SRMC is above LRMC. Consequently, in current circumstances, it would be not only efficient to price at SRMC but also to do so would achieve cost recovery.

<sup>22</sup> Kahn, Alfred (1988). *The Economics of Regulation: Principles and Institutions*. Boston: MIT Press

<sup>23</sup> Kahn, Alfred (1988). *The Economics of Regulation: Principles and Institutions*. Boston: MIT Press



- 3.13 Optus submits that the MTAS should be priced at a level which will properly reflect the very high SRMC imposed on the network by *any* marginal traffic including incoming/terminating voice traffic. It follows that the MTAS rate should not be reduced at a time when capacity constraints are becoming increasingly severe.

### **Mobile network costs are driven by voice coverage**

- 3.14 The rapid growth of data and the resulting capacity-related costs as discussed above may lead some to argue that it is responsible for the bulk of traffic and for that reason should bear the bulk of allocated common network costs. The ACCC's current view appears to be that traffic or capacity usage is the main cost driver for mobile costs.
- 3.15 Contrary to that point of view, Optus submits that notwithstanding the fact that capacity constraints cause a significant amount of cost in constrained areas of the network, in fact the bulk of overall network costs are driven by the requirements of coverage, not traffic. It follows that most common network costs should be allocated to voice, not data.

### *Demand for voice coverage*

- 3.16 In the last decade the use of mobile phones has become pervasive - so much so that not having a mobile phone is considered an anomaly for an adult living in Australia. Given the widespread use of mobile phones, and the increasing reliance on them for the conduct of personal, business and emergency communication, mobiles have come to be viewed as a necessity. This has contributed to consumers' increasing demand for ubiquitous coverage and high quality of service.
- 3.17 Recent market research conducted by the AMCA captures this effect as the most common reason for a mobile user to be dissatisfied with their mobile service was 'bad/no mobile reception/coverage'.<sup>24</sup> Yet, consumers are increasingly expecting high quality of service for very low prices, as the second most common response was that their service was 'too expensive'.<sup>25</sup> This is despite a nearly 50 per cent decline in retail mobile prices since 1997/98<sup>26</sup> and conspicuous improvements in service and coverage.
- 3.18 Coverage requirements are principally determined by the number (and location) of subscribers. As the penetration of mobile phones have reached saturation, it becomes necessary for coverage to be offered increasingly everywhere that subscribers live, work and travel in order to market access to a truly 'mobile' network. And it is access to voice services that is driving these consumer demands.
- 3.19 The advent of 3G mobile phones has expanded the services available, however it remains the case that consumers take-up (and are willing to pay for) services for the purpose of access to voice. This is illustrated by recent evidence published by the ACMA that found:

*Of the available features, customers use the phone most frequently for voice calls (used greater than 50 per cent of the time) and SMS. Interestingly, 3G features accounted for just six per cent of the overall phone use.<sup>27</sup> [emphasis added]*

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<sup>24</sup> ACMA, *Mobile capped plans: Consumer attitudes and behaviours*, May 2010, p.17

<sup>25</sup> ACMA, *Mobile capped plans: Consumer attitudes and behaviours*, May 2010, p.17

<sup>26</sup> ACCC, *Changes in the prices paid for telecommunications services in Australia, 2008-09*, 1 June 2010, p.124

<sup>27</sup> ACMA, *3G mobile bill-payers' understanding of billing charging arrangements*, Quantitative research report, June 2011, p.14

3.20 In addition, the ACMA also acknowledges that even across all three customer segments surveyed who have taken up 3G phone plans only 40% of 3G bill-payers reported using 3G features on their phones.<sup>28</sup> Importantly, this highlights that even though the end-user may have access to a 3G-compatible handset and access plan, this does not necessarily translate to a significant take-up and use of 3G services.

### 3.21 CiC

3.22 It is therefore of paramount importance to recognise that these new services are considered incidental to the principal purpose of building and using a mobile network. That is, the majority of the costs incurred, and which are likely to occur in the near future, relate to subscriber growth - building the network's coverage. The incremental cost of providing 3G services (as opposed to traditional voice) relates primarily to the provisioning of additional capacity on an existing network.

#### Cost of providing mobile voice coverage

3.23 The demand for coverage has important consequences for the structure of costs, both in terms of capital invested and ongoing operational costs. This is because the footprint or 'spread' of the network is the principal determinant for the number of base stations required. In turn, the number (and geographic spread) of base stations determines:

- (a) The number and location of properties required to install towers and equipment; and
- (b) The amount of transmission (backhaul) required to connect base stations and exchanges with each other and the 'core' network.

3.24 The demand for voice coverage is also related to the requirement to be 'on the move' whilst maintaining continuous access to a high quality voice service. The 'mobility' factor also has implications for the network costs in terms of installed equipment, network management and capacity allocated to voice services.

3.25 Given that Australia is one of the world's largest countries by landmass and has a relatively small population, the cost to provide ubiquitous coverage is very high. The Optus Open Network currently covers up to 97 per cent of the Australian population.<sup>29</sup> Since Optus launched its 2G business in 1993 the total investment in sites has totalled **CiC** 3G services launched in 2005, with the initial 55 per cent coverage having a capital cost of **CiC** The cost of expanding coverage was **CiC** up to the 2009 financial year (FY09). **CiC** Data service provision requires some incremental transmission bandwidth and equipment in addition to the basic voice infrastructure, but this does not represent a very large proportion of the total cost. Whilst the incremental capacity required to terminate voice calls does impose a significant cost on operators (particularly in capacity constrained areas), as discussed in the previous section, the requirement to provide voice coverage nevertheless drives most network costs.

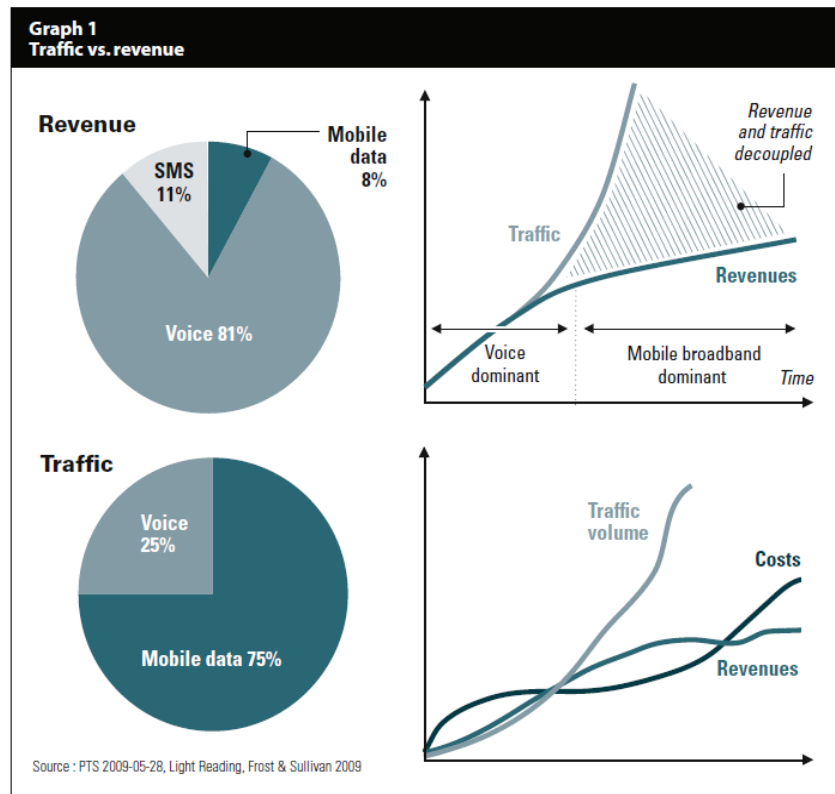
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<sup>28</sup> ACMA, *3G mobile bill-payers' understanding of billing charging arrangements*, Quantitative research report, June 2011, p.15

<sup>29</sup> <http://www.optusopennetwork.com.au/>

- 3.26 The breadth of the network also has significant ramifications for operating costs. **CiC** Operating costs are driven by the physical size of the network (sites and spread) since:
- (a) property rentals increase with the number of sites;
  - (b) operation and maintenance increase with the number of sites and their relative distance, as the number of personnel, travel time and risk of faults increase; and
  - (c) access to backhaul increases with site number and location.
- 3.27 For Optus, coverage costs are a substantial component of ongoing operational costs. In FY12 Optus will spend approximately **CiC** in mobile operating expenditure, of which over **CiC** relates to property costs alone. These ongoing property costs directly relate to the rental of land or building space on which Optus erects its towers and equipment to operate the mobile network.
- 3.28 **CiC**
- 3.29 Moreover, for voice services the quality of service (QoS) requirements are very high. This is because voice services need to be provided in 'real-time', whereas for any data service a certain level of delay is acceptable. Voice services are therefore considered priority and require capacity to be set aside to ensure the quality of service, ie capacity allocated to voice. Because of this, the allocated capacity to voice displaces other services such as data.
- 3.30 This is evidenced by the fact that as the number of sites utilising all frequencies increases, the priority of voice to ensure QoS has required a reallocation of capacity. **CiC**

- 3.31 Therefore, as demand for data (and to a lesser extent voice) services increase, the capacity available for voice allocation decreases, such that prioritising voice (and MTAS) has a higher cost to Optus as it displaces the capacity available for other services, such as data.
- 3.32 Despite these significant drivers for voice, the ACCC's current view appears to be that traffic or capacity usage is the main cost driver. For example, the WIK model allocates network costs between services based on the relative usage of each network element's capacity by each service.<sup>30</sup>
- 3.33 Allocating costs between product areas using a model based on traffic load worked well when the difference in the services' traffic was limited, that is, prior to the introduction of HSPA technologies and the predominant usage of mobile networks was for voice and SMS services. However, the introduction of mobile broadband services has increasingly led to a significant 'gap' between traffic and revenue and cost, revealing a disconnect in the assumptions made about traffic relative to cost. A paper by Greger Blennerud, Director of Business Developments at Ericsson Networks, has highlighted this issue, as illustrated in the graph below,<sup>31</sup> which shows a decoupling of the relationship between the traffic and revenue behaviour of subscribers – and also a decoupling of traffic volume from network cost.<sup>32</sup>



- 3.34 Blennerud notes that a significant part of the disconnect in cost assumptions between traditional mobile services and mobile broadband is likely to arise from a technical oversight:

*In the current software release for HSPA, there is a difference in capacity (spectrum efficiency) of roughly 1 to 12 times when comparing the voice and HSPA bearer on a 5*

<sup>30</sup> Wik Consult, *Mobile Termination Cost Model for Australia*, January 2007, section 4.

<sup>31</sup> Blennerud, G., *The recipe for mobile broadband profitability*, Ericsson Business Review #3 2009, p.47

<sup>32</sup> Blennerud, G., *Mobile broadband – busting the myth of the scissor effect*, Ericsson Business Review #2 2010, p.50

MHz carrier. This means a voice byte is about 12 times more costly than a mobile broadband byte.

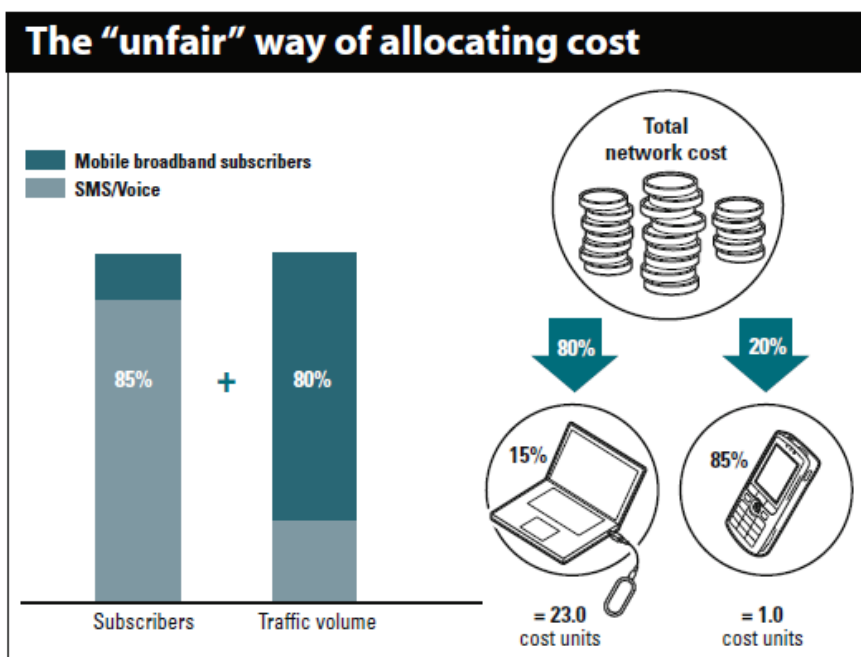
... If this cost uneven relation is not taken into account – and in most current studies it is not; the cost allocation is done on an equal basis – mobile broadband will be overloaded with cost by a factor of at least 10 times.<sup>33</sup>

3.35 This suggests that, as a technical matter, the cost models used to estimate mobile network costs are very likely to be significantly under-estimating the network capacity required to provide voice services, relative to data services (and thus under-estimating the MTAS cost).

3.36 Blennerud also highlights the fact that, with the introduction of mobile broadband, the allocation of cost based on capacity increasingly does not accord with commercial reality (such an allocation would make data services unprofitable). He describes the problem as follows:

... the internal cost structure was such that the transport unit was internally charging product owners (voice, mobile broadband, SMS, etc.) on a per MB basis. Shortly after launching mobile broadband, some operators noted two trends; broadband looked to be unprofitable, and the unit responsible for transport was rapidly growing and drastically improving margins.<sup>34</sup>

3.37 But the conclusion that broadband is unprofitable depends entirely on an allocation method based on traffic, which is “not entirely fair, at least in a case in which the 3G network already exists...”<sup>35</sup>



3.38 Blennerud explains that there are plausible alternative methods for allocating common costs, as illustrated in the figure below.<sup>36</sup> The number of subscribers, for example, is a reasonable

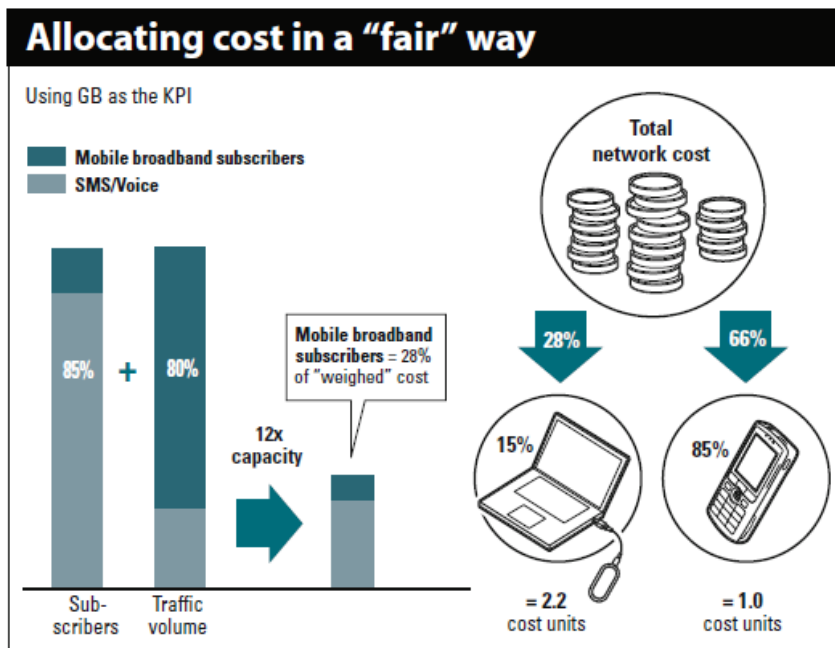
<sup>33</sup> Blennerud, G., *The recipe for mobile broadband profitability*, Ericsson Business Review #3 2009, p.46

<sup>34</sup> Blennerud, G., *The recipe for mobile broadband profitability*, Ericsson Business Review #3 2009, p.46

<sup>35</sup> Blennerud, G., *The recipe for mobile broadband profitability*, Ericsson Business Review #3 2009, p.47

<sup>36</sup> Blennerud, G., *The recipe for mobile broadband profitability*, Ericsson Business Review #3 2009, p.49

candidate to be a cost driver: “Using averages from a group of operators, mobile broadband accounts for close to 80 percent of mobile network traffic, but only 15 percent of the subscriber base. The cost per subscriber differs significantly depending on the allocation method”.<sup>37</sup>



3.39 Blennerud concludes:

*There is no single way of allocating costs, but it is important to strive for fairness between services, and minimize the risk of promoting unprofitable services or penalizing profitable ones.*<sup>38</sup>

3.40 Businesses could not allocate costs as the traditional TSLRIC cost models do and still make money, since data revenue would be insufficient to cover costs. If operators genuinely believed that costs were driven by traffic (as per the ACCC’s approach), they would not offer mobile broadband (since it would be unprofitable) and the investments Optus and other operators are planning in order to provide LTE services would not be made.

3.41 Optus submits that the ACCC needs to fundamentally change its approach to cost allocation. The predominant drivers of costs are not related to traffic – they are related to providing coverage, primarily for voice services; hence common network costs should be included in the MTAS price. It would be wrong for the ACCC to conclude that the cost of providing the MTAS is below 9 cpm, on the basis of a flawed and uncommercial approach to cost allocation.

<sup>37</sup> Blennerud, G., *The recipe for mobile broadband profitability*, Ericsson Business Review #3 2009, p.46

<sup>38</sup> Blennerud, G., *The recipe for mobile broadband profitability*, Ericsson Business Review #3 2009, p.47

## Section 4. Consumers Will Not Benefit from a Rate Cut

- 4.1 The ACCC has indicated that a FAD “will likely produce a new MTAS rate that departs significantly from the current rate”.<sup>39</sup> Optus considers that reducing the MTAS rate will not have the desired effect of lowering prices to consumers. In fact, it is likely that mobile consumers will face *higher* prices on balance. This leaves Telstra as the biggest benefactor of any rate cut, at the expense of mobile network investment and to the ultimate detriment of consumers.
- 4.2 The ACCC has not examined how any change in the MTAS will affect mobile consumers and has assumed that a reduction of the MTAS, combined with a pass-through safeguard, will ensure that fixed customers benefit. However, Optus will argue that a reduction in the MTAS will not necessarily benefit either customer group, and in particular that as a result of any rate cut:
- (a) Low usage consumers will be worse off;
  - (b) High usage consumers are unlikely to be better off; and
  - (c) Fixed-users will not benefit because Telstra will not pass-through savings.
- 4.3 As a result, the combined effect will be detrimental to consumers and accordingly, not in the long term interests of end users. Each of these arguments will be discussed in detail below.

### Low usage consumers will not benefit

- 4.4 A lower MTAS in Australia will have a disproportionate effect on low usage consumers. This is because the business model to serve these customers primarily relates to the receipt of termination payments for calls the customer receives. Low usage consumers are of particular concern since these consumers are more likely to be on lower incomes.
- 4.5 Consumers that are considered low-usage generally value a mobile phone service for emergencies and use it primarily to receive calls. Prepay is therefore generally appealing to low-usage users, or users on lower incomes, since they can control how much money is spent by limiting calls and paying on a month to month basis, rather than committing to spend a certain amount each month over a 12 to 24 month period.<sup>40</sup>
- 4.6 For this reason the ACMA has found that prepay is popular amongst younger and older age groups. It found that 73 per cent of those surveyed aged 15 to 17 and 59 per cent of those aged 75 year and over have adopted a prepaid plan.<sup>41</sup> Specifically, the ACMA stated that:

*This is likely to reflect the lower incomes commonly associated with those under the age of 18 (often financially dependent on parents), and those aged 75 and over who are more likely to be retired or low users of their mobile phones. The characteristics of pre-paid plans are clearly attractive to these age groups. Given pre-paid users pay for calls*

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<sup>39</sup> ACCC, Domestic Mobile terminating Access Service (MTAS): Public inquiry to make an Access Determination, Discussion Paper, June 2011, p.20

<sup>40</sup> In contrast to postpaid plans, for which a customer signs a contract and receives a bill after they have used the service, prepay offers use of the mobile network only after payment has been made.

<sup>41</sup> ACMA, Mobile capped plans: consumer attitudes and behaviours, May 2010, p.7

*in advance, large unexpected bills are avoided and the absence of contracts for any length of time avoids ongoing fees and allows users to easily switch providers without having to pay cancellation fees.*<sup>42</sup>

4.7 **CiC**

4.8 Given the low usage profile of prepaid users, a significant proportion of the costs to serve these customers are recovered from the termination payments received from incoming calls.

**CiC**

4.9 Therefore, a reduction in the MTAS rate will reduce the profitability of these customers. Accordingly, mobile operators will have less incentive to market to this customer group and offer discounted prepay plans. Covec described this effect in their report (Attachment 1 to this submission) as follows:

*To some extent, this revenue loss will be offset by higher prices in the retail mobile market. This is not because mobile operators try to 'recover' the lost revenue, but rather because their incentive to compete for mobile customers are changed when the MTR changes. The end result is a partial offset of the welfare losses experienced by mobile operators, and additional welfare losses for mobile consumers.*<sup>43</sup>

4.10 The MTAS is a revenue item to mobile operators, as well as an expense. For many mobile operators, the net effect is positive revenue. Indeed, as CEG stated in its report to Optus (Attachment 2 to this submission):

*It is generally accepted in the literature and by international regulators such as Ofcom and the New Zealand Commerce Commission that reducing the amount of costs that operators can recover in termination charges will force more of those costs to be recovered in mobile retail prices.*<sup>44</sup>

4.11 The IDEI has noted that high termination rates intensify competition for subscribers and result in lower net subscription prices and enhanced participation:

*The reasoning is simple. Incoming termination revenue accrues to the operator once the receiver has subscribed, independently of the amount of calls placed by this subscriber; it thus constitutes a fixed revenue per subscriber, which reduces the net fixed cost (the opportunity cost) of servicing a customer. A rational operator then reacts to the reduction in fixed costs per subscriber by lowering subscription prices (or, given subscribers' inertia and the possibility of mid-term contracts, by rising advertising spending or offering handset subsidies). That is, increasing termination rates and revenues results in lower acquisition costs (or even transforms them into net acquisition revenues). But it also intensifies competition for subscribers and results in lower net subscription prices and enhanced participation.*<sup>45</sup>

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<sup>42</sup> ACMA, Mobile capped plans: consumer attitudes and behaviours, May 2010, p.7

<sup>43</sup> Covec, Mobile Termination Welfare Analysis, 30 March 2011, pp.6-7

<sup>44</sup> CEG, Domestic mobile terminating access service (MTAS), A report for Optus, July 2011

<sup>45</sup> Jullien, B. and Rey, P., Notes on the economics of termination charges, IDEI Report #6, Telecommunications, July 2008, p.6



- 4.12 Conversely, reductions in termination rates are likely to weaken competition for subscribers and result in higher net subscription prices and poorer participation. As a result of MTAS rate reductions by the ACCC, the availability and price structure of prepay plans may change.
- 4.13 In countries that have very low MTRs (or none), the primary mechanism to recover costs (especially in a 'minutes-of-use' traditional prepay context) has been to charge for all call minutes. That is, by implementing 'receiving party pays' (RPP). This way, the cost of an outgoing minute could decline, and potentially the effective fixed components (eg recharge amount and expiry) need not change since all minutes could be charged, effectively increasing the cost of use.
- 4.14 However, RPP is not a likely outcome in Australia or other CPP jurisdictions such as the UK as there are strong consumer preferences for not paying for incoming calls. It would therefore be very difficult to implement RPP in a CPP environment. Ofcom's consumer research indicated that the introduction of RPP plans would be very unpopular and so an unlikely response as competitive pressure on providers to resist RPP would be strong.<sup>46</sup>
- 4.15 As a result, it is clear that consumers continuing to utilise prepay plans will be worse off as the effective prices paid for services increases. The limited availability of and prices of prepay has also been referred to as a reason for the slower take-up of mobile services in North America, especially among lower income groups, as consumers face effectively higher prices and greater commitment in the form of contracts (which require credit checks). Indeed, CEG noted that in the USA a third of low income earners do not have mobile phones.<sup>47</sup>
- 4.16 As the use of mobile phones becomes widespread, the risk that some consumers may not be able to afford, or only use at high unit costs, has implications for the social inclusion of these consumer groups.
- 4.17 The historical lack of prepay offers and higher prices in the USA is an indication of how consumers may fare in a lower MTR environment in Australia. The FCC noted an analyst's comments as:

*The prepaid market used to be fairly homogeneous, with customers... in general far overpaying for handsets and minutes relative to postpaid customers.*<sup>48</sup>

- 4.18 The FCC has observed a more recent increase in the number of prepaid offerings in the USA. These offers appear to resemble 'higher value' postpaid plans in the form of 'unlimited' offers. These are prepaid plans which mimic the unlimited or 'bucket' style flat rate pricing of postpaid plans in a prepaid, no contract, service environment. In addition to these services requiring higher ongoing fees from the traditional prepaid offers, they tend to be targeting consumers that otherwise would have postpaid but for the slide in credit conditions in the USA. The FCC described this as:

*In the United States, most mobile wireless subscribers pay their phone bills after they have incurred charges, which requires service providers to extend credit to their customers...More recently, however, the pool of unsubscribed customers [that] qualified*

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<sup>46</sup> Ofcom, Wholesale mobile voice termination: Market review, Volume 3 - Supporting Annexes, 1 April 2010, p.183

<sup>47</sup> CEG, Domestic mobile terminating access service (MTAS), A report for Optus, July 2011

<sup>48</sup> FCC, Fifteenth Report, FCC 11-103, 27 June 2011, p.67

*for postpaid plans declined to the point where prepaid offerings, which do not require credit checks, have become more attractive to more service providers.<sup>49</sup>*

4.19 This has led the FCC to characterise the change in the prepaid market as:

*...analysts stress that the market segment for prepaid service is “bifurcating” into a low-end segment and a high-end segment. The low-end segment comprises traditional pay-as-you-go prepaid service, while the high-end segment encompasses unlimited (“all-you-can-eat”) prepaid offerings.<sup>50</sup>*

4.20 Despite this positive development in the USA, it still remains the case that prices are relatively high when compared to Australia. CEG noted the OECD evidence that low MTR countries such as Canada and the USA have the highest mobile retail prices in the OECD and Australia was among the lowest.<sup>51</sup>

4.21 **CiC**

4.22 Recently, the New Zealand Commerce Commission’s decision to reduce MTRs has been cited by Vodafone PLC in the UK as affecting growth in the business. Tellingly, the customers Vodafone is losing (or not competing for) are prepaid. Communications Day reported:

*The numbers are not as bad as they look at first sight because many of the lost customers are low value prepaid accounts.<sup>52</sup>*

### **High usage consumers will not benefit**

4.23 A reduction in the MTAS may also change the way that mobile operators structure their service offers for high usage customers in order to respond to lower termination revenues. This may have the effect of reducing off-net (or all) call usage prices and/or reducing handset subsidies. Each of these potential effects will be discussed below.

### Changing the structure of pricing plans

4.24 The relationship between usage and the MTR has been described in the academic literature as the tendency for mobile operators to price services according to *perceived* marginal costs. That is, that the MTR acts to set a minimum retail price for off-net calls.

4.25 This means that although a mobile operator may break even or be a net receiver of MTAS revenue from other mobile operators, the prices it charges for outbound calls reflects the termination payment it is required to make regardless of the net position of the operator. That is, an operator is unsure of the resulting traffic profile at the end of a period and so tries to

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<sup>49</sup> FCC, Fifteenth Report, FCC 11-103, 27 June 2011, pp.66-67

<sup>50</sup> FCC, Fifteenth Report, FCC 11-103, 27 June 2011, p.67

<sup>51</sup> CEG, Domestic mobile terminating access service (MTAS), A report for Optus, July 2011

<sup>52</sup> Bennett, Bill, “MTR regulation already hitting Vodafone figures”, Communications Day, 26 July 2011

implement prices such that it would not be losing if traffic should move in an unfavourable direction.

4.26 Conventional thought has therefore associated lower regulated MTRs with lower usage charges, which would lead to increased consumption of mobile minutes of use. Comparisons are often made between countries which implement MTRs and those that do not (that is, they have 'bill and keep' or 'sender keeps all' interconnection regimes) to prove this relationship. There are very few countries that do not have interconnection regimes similar to Australia; the most studied are: USA; Canada; Singapore; and Hong Kong.

4.27 For example, a quantitative study by Growitsch et al found that a lower MTR was associated with higher usage and lower, on average, retail prices. Yet the authors state two qualifications:

*First, for consumer retail prices to be lower on average with lower MTRs does not exclude the possibility that **some customers (e.g. those with lower disposable income) might be worse off**. Second, for consumer retail prices to be lower on average does not necessarily mean that all components of the retail price are lower; **with a two part tariff, it is probably that monthly fees (for instance) would be higher while per minute fees were lower.***<sup>53</sup> [emphasis added]

4.28 Given these conclusions, should a lower MTR in fact result in lower usage charges, it is highly unlikely that this would lead to an increase in mobile usage. This is because most consumers are already on 'capped' plans, which have a certain amount of usage included (value). Recent research conducted by the ACMA suggests these consumers could be in the order of 39 per cent of the market.<sup>54</sup> Furthermore, the prepaid market is becoming increasingly dominated by cap-type plans, for example Optus' prepaid offer "2 dollar days" operates similarly to a post-paid plan by charging a daily access fee and including unlimited access to a number of services.<sup>55</sup>

4.29 Arguably, these consumers already face zero (or very low) marginal costs because they are essentially on flat rate pricing plans. Customers on flat rate pricing plans or 'bucket plans' face zero marginal costs because the plans include a certain number of minutes of use or value of combined types of minutes, texting and data. Therefore, the cost a customer faces for each call or minute of a call on these plans is zero since the monthly (or daily) charge is paid regardless of whether the minutes or value is used or not.

4.30 This means that should fixed prices increase consumers would be unlikely to benefit from higher offsetting use. Therefore, they would simply face higher overall prices without any offsetting benefits.

4.31 Nevertheless, it should be noted that these types of studies suffer from a number of shortcomings related to the quality of the dataset. These were noted in the report by CEG, and

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<sup>53</sup> Growitsch, Christian, J. Scott Marcus, and Christian Wernick, "The effects of lower Mobile Termination Rates (MTRs) on Retail Price and Demand", Communications and Strategies, No.80, 8 April 2010, p.21

<sup>54</sup> ACMA, Mobile capped plans: consumer attitudes and behaviours, May 2010, p.8

<sup>55</sup> Optus website,  
[http://personal.optus.com.au/web/ocaportal.portal?\\_nfpb=true&\\_pageLabel=Template\\_woRHS&FP=/personal/mobile/prepaidmobile/callingoffersandrates/DollarDays&site=personal](http://personal.optus.com.au/web/ocaportal.portal?_nfpb=true&_pageLabel=Template_woRHS&FP=/personal/mobile/prepaidmobile/callingoffersandrates/DollarDays&site=personal)

further work undertaken by CEG for Ofcom found no robust statistical evidence on the relationship between the charging regime and usage.<sup>56</sup>

### Handset subsidies may be reduced

- 4.32 A lower MTAS rate may also reduce the ability of mobile operators to offer subsidies on handsets. Mobile operators incur significant capital outlays in order to provide handset subsidies. This outlay is paid off over time through the receipt of both subscription charges and termination revenue. A reduction in termination revenue requires that either subscription charges increase or subsidies reduce or a combination of both effects.
- 4.33 Handset subsidies are currently offered on a wide range of handsets, which allow consumers access to the latest technology for limited or no upfront cost. A reduction in subsidies could be implemented by reducing the variety of handsets available on subsidised plans or reducing the subsidy available by introducing/increasing upfront costs. This could potentially have the following effects:
- (a) Lower consumer welfare, as consumers are less willing to pay upfront costs for handsets;
  - (b) Lower handset sales with flow-on effects in the market for handset manufacture and software development; and
  - (c) Reduced ongoing revenues which could affect investment in new technology.
- 4.34 Firstly, a reduction in subsidies would be detrimental to consumer welfare as consumers are less willing to pay upfront costs for handsets.

### **CiC**

- 4.35 Secondly, since consumers are less willing to pay high upfront costs for a new mobile phone, without subsidies fewer units are sold, and there is a wider impact in the market. Dedrick et al state that:

*...because lower sales volume makes it harder for the handset maker to cover its fixed development costs and to extract price reductions from its suppliers over time. In short, the absence of subsidies would have meant lower total profits for all the firms along the supply chain: carriers, handset makers and component suppliers.<sup>57</sup>*

- 4.36 The authors also note the negative effects on market entry and the associated software developer market:

*Smartphones that run independently developed software applications, like those from the iPhone's "App Store," benefit from network effects; the more people that are using smartphones that run on a given platform, the greater the incentive for independent software vendors to write applications for that platform. If the end of subsidies lead to*

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<sup>56</sup> CEG, Domestic mobile terminating access service (MTAS), A report for Optus, July 2011

<sup>57</sup> Dedrick, Jason, Kenneth L. Kraemer, and Greg Linden, "The Distribution of Value in the Mobile Phone Supply Chain", Personal Computing Industry Center, October 2010, p.21

*the slower uptake of a new smartphone platform, then it's harder for a novel platform such as the iPhone to reach a self-sustaining critical mass of users.*<sup>58</sup>

4.37 This reasoning was noted as behind one study's support for allowing subsidies in Finland (where subsidies were prohibited) in the years following the introduction of 3G handsets.<sup>59</sup> Optus notes that the rapid penetration of smartphones in Australia has led to a booming 'app' developer market. This has led Optus to recently launch Partner Connect, a mobile application developer portal.<sup>60</sup>

4.38 Thirdly, a reduction in subsidies will reduce ongoing revenues which may affect investment. **CiC** The quantitative work undertaken in the Dedrick et al study led the authors to conclude that mobile carriers capture significant value in offering subsidies:

*However the carriers must also shoulder the burden of network installation, maintenance, and upgrades, which absorbs a lot of the gross value from their subscription fees.*<sup>61</sup>

4.39 **CiC**

#### **Fixed line consumers will not benefit**

4.40 A reduction in the MTAS rate will not benefit fixed end-users. Whilst some providers may pass-through savings, as evidenced from past behaviour, the provider to the majority of end-users, Telstra, will not pass through the reduction into lower FTM call prices, and will instead 'pocket' the savings. This is amply demonstrated by Telstra's failure to reduce fixed to mobile (FTM) prices paid by its retail customers in response to previous MTAS rate cuts, which the ACCC has acknowledged. Optus estimates that Telstra has received a windfall of \$1 billion since 2004 as a result of not passing through reductions in MTAS rates to its retail customers (see Appendix B).

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<sup>58</sup> Dedrick, Jason, Kenneth L. Kraemer, and Greg Linden, "The Distribution of Value in the Mobile Phone Supply Chain", Personal Computing Industry Center, October 2010, p.22

<sup>59</sup> Dedrick, Jason, Kenneth L. Kraemer, and Greg Linden, "The Distribution of Value in the Mobile Phone Supply Chain", Personal Computing Industry Center, October 2010, p.22

<sup>60</sup> Optus, "Optus launches Australia's first mobile operator application developer portal", Media Release, 24 May 2010

<sup>61</sup> Dedrick, Jason, Kenneth L. Kraemer, and Greg Linden, "The Distribution of Value in the Mobile Phone Supply Chain", Personal Computing Industry Center, October 2010, p.25

- 4.41 The ACCC has recognised that historic reductions in the MTAS rate have not been fully passed through into FTM call prices. However, as evidenced in Appendix B, it is Telstra that has not fully passed on reductions in the MTAS rate. Since Telstra remains the dominant supplier in the fixed-line market, it is unlikely that any changes in the MTAS will result in a material increase in consumer welfare unless Telstra passes through savings.
- 4.42 For this reason, the ACCC has proposed a pass-through safeguard to enforce reductions in the MTAS are passed-through to FTM call prices in order to benefit consumers. However, Optus submits that such a measure will fail to benefit consumers since any mandated price reduction for FTM call prices will encourage price increases for other Telstra fixed-line services. This is because, as the ACCC has recognised, there are “*inherent structural issues in the fixed line market*” and Telstra continues to possess significant market power so will be able to increase prices without losing material market share.
- 4.43 That is, the ACCC’s proposed measure to ensure pass-through would be ineffective, since Telstra could defeat any required reduction in retail FTM prices by making offsetting adjustments to other elements of the fixed line bundle whilst still remaining within its price cap. Indeed, Telstra itself has stated that:

*The imposition of a regulated price reduction in the FTM rate below the efficient level may generate a ‘next best’ price increase in another price element or elements. Such arbitrary price signals tend to prevent, rather than support efficient pricing.*<sup>62</sup>

- 4.44 That is, the ACCC’s proposed pass-through safeguard will be ineffective.
- 4.45 Optus submits that the most effective way to address the 'inherent structural issues' in the fixed line market is to address these problems at their source, by confronting and resolving the lack of effective competition in the fixed line market. Many significant reforms are currently underway to address longstanding concerns in the fixed line wholesale market (discussed at section 5) which are expected to improve the competitive landscape in the near future. Accordingly, imposing additional costs in the form of unnecessary and inefficient regulation is premature.

### **Overall welfare will decrease**

- 4.46 Optus submits that overall consumer welfare will decrease as a result of the combined above effects; this is supported by:
- (a) welfare modelling undertaken by Covec;
  - (b) international and empirical evidence; and
  - (c) a consideration of the legislative criteria.

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<sup>62</sup> Telstra, Submission in response to the Australian Competition & Consumer Commission’s Review of Telstra Price Control Arrangements, 12 February 2010, p.19

### Welfare modelling

- 4.47 Covec has modelled the effects of a lower MTAS rate which resulted in an overall detrimental effect, or 'welfare loss' of \$291 million.<sup>63</sup> The total loss is a result of the combined effects on consumers and operators in the fixed and mobile markets.
- 4.48 The estimated effect of a lower MTAS rate in Australia on consumers was estimated by Covec as:
- (a) A gain to fixed consumers of \$141 million as a result of limited pass-through of savings; and
  - (b) A loss to mobile consumers of \$608 million as a result of price increases.<sup>64</sup>
- 4.49 Although fixed consumers might gain from a reduction in the MTAS, it is important to note that fixed customers are highly likely to also be mobile customers. This is because the number of 'fixed only' households has been in decline, as only 6 per cent of households rely only on a fixed-line telephone for voice communication.<sup>65</sup> In fact, increasingly households are becoming 'mobile only'. The ACMA reported that in June 2010 14 per cent of Australian households were 'mobile only', an increase of 4 per cent over the previous year.<sup>66</sup> Given the relatively small gain in the fixed market relative to the mobile market, and the small number of 'fixed only' households, it is likely that on balance consumers will be worse off.
- 4.50 The conclusions of the Ofcom distributional analysis are therefore telling - it identified the most significant effects of lower MTRs as:
- (a) Some people who would have multiple subscriptions will face incentives to have fewer subscriptions;
  - (b) *Consumers who used fixed (and not mobile) services will be better off; and*
  - (c) *Consumers who use mobile (and not fixed) services may be worse off depending on how sensitive they are to changes in the prices for subscriptions and calls.*<sup>67</sup>
- 4.51 In addition, Covec estimated the effect of a lower MTAS rate in Australia on operators as:
- (a) A gain to fixed operators of \$706 million as a result of limiting the pass-through of savings in the MTAS rate; and
  - (b) A loss to mobile operators of \$531 million as a result of unrecovered termination revenue.<sup>68</sup>

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<sup>63</sup> Covec, Mobile Termination Welfare Analysis, 30 March 2011 (Attachment 1 to this submission)

<sup>64</sup> Covec, Mobile Termination Welfare Analysis, 30 March 2011.

<sup>65</sup> ACMA, *Communications Report 2009-10 series*, Report 2 – Take-up and use of voice services by Australian Consumers, 18 November 2010, p.20

<sup>66</sup> ACMA, *Communications Report 2009-10 series*, Report 2 – Take-up and use of voice services by Australian Consumers, 18 November 2010, p.21

<sup>67</sup> Ofcom, Wholesale mobile voice termination: Market review, Volume 3 - Supporting Annexes, 1 April 2010, p.183

- 4.52 The loss to mobile operators is a result of termination revenues lost that are not recovered through increased retail prices. Therefore, a reduction in the MTAS rate may have a disproportionate overall effect on mobile operators due to traffic imbalances and the extent of fixed service business activities. As a result, investment in the mobile market may be affected, at least in the short to medium term as a loss of that size (\$531 million) is significant in a capital intensive industry. **CiC**

#### International evidence of consumer impact

- 4.53 CEG has undertaken a review of the available empirical evidence measuring the effects of changes in MTRs and the impact of the interconnection charging regime. It raised a number of concerns with the data utilised to calculate average revenue per minute to proxy retail price, namely that the service mix can oft lead to double counting of minutes in some countries. This is then used to make conclusions on the interconnection charging regime and level of MTR across countries, namely that CPP countries have higher retail prices.
- 4.54 A more direct method to compare retail prices (and hence charging regimes) across countries was noted by CEG to have been established by the OECD. This utilises a standard basket of mobile services to calculate average retail prices across countries. CEG stated that:

*The OECD comparisons show that the low MTR countries of Canada and the US have amongst the **highest mobile retail prices in the OECD**, while Australian and a number of European countries are below or around the average.<sup>69</sup> [emphasis added]*

- 4.55 CEG also noted that the incidence of on-net/off-net price discrimination appears to be pervasive in the USA, which has low termination charges. This is in contrast to concerns given by regulators in CPP countries regarding such pricing.
- 4.56 In conclusion CEG state that:

*...international evidence suggests that cutting termination charges would increase mobile retail prices, harm mobile subscription numbers, while potentially having little impact on the presence of on-net/off-net price differentials.<sup>70</sup>*

#### Not consistent with the long term interests of end-users

- 4.57 The ACCC has stated that particular terms and conditions promote the long term interests of end-users if they are likely to contribute towards the provision of:
- (a) Goods and services at lower prices;
  - (b) Goods and services of a high quality; and/or
  - (c) A greater diversity of goods and services.<sup>71</sup>

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<sup>68</sup> Covec, Mobile Termination Welfare Analysis, 30 March 2011.

<sup>69</sup> CEG, Domestic mobile terminating access service (MTAS), A report for Optus, July 2011

<sup>70</sup> CEG, Domestic mobile terminating access service (MTAS), A report for Optus, July 2011



- 4.58 From the above discussion, it is apparent that a reduction in the MTAS will do neither of the above because:
- (a) The price of mobile services are likely to increase, given the proportion of costs which are currently recovered in the MTAS will need to be recovered from end-users;
  - (b) To the extent that margins decline from a reduction in the MTAS, investment may suffer which in turn will not promote a high quality of service; and
  - (c) A reduced MTAS is likely to affect the incentives to market products to particular consumer segments, for example low usage prepaid customers, and so will reduce the diversity of mobile services available.
- 4.59 Further, a reduction in the MTAS will also impact on the promotion of competition in markets for carriage services.<sup>72</sup> A number of studies cited by CEG note the link between higher termination charges and more intense competition, as a higher market share reduces the average marginal cost of producing calls. In fact, CEG conclude that “higher termination charges may better promote competition” compared to BAK regimes or very low (‘pure LRIC’) termination charges.<sup>73</sup> It is therefore likely that a reduction, particularly a ‘substantial’ one, will promote competition, as it would harm the profitability of providing mobile services in current market conditions.

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<sup>71</sup> ACCC, Domestic Mobile Terminating Access Services (MTAS): Public Inquiry to make an Access Determination, Discussion Paper, June 2011, p.28

<sup>72</sup> ACCC, Domestic Mobile Terminating Access Services (MTAS): Public Inquiry to make an Access Determination, Discussion Paper, June 2011, p.29

<sup>73</sup> CEG, Domestic mobile terminating access service (MTAS), A report for Optus, July 2011

## Section 5. Differential Regulatory Approaches are Inappropriate

- 5.1 The ACCC has indicated that there is potential for differential regulatory approaches to the MTAS. In particular, that there is “opportunity for the three MNOs to adopt a ‘no payment exchanged’ bill-and-keep (BAK) arrangement” which would apply to MTM calls and a cost based approach to apply for FTM calls.
- 5.2 Optus has considerable reservations with this proposed approach for the following reasons:
- (a) Any differential in the approaches for MTM and FTM will create costly arbitrage problems;
  - (b) Bill and keep is inappropriate for MTM;
  - (c) Additional retail regulation (that is, a pass-through safeguard) is an inappropriate response to competition concerns in the fixed market; and in any case there are serious questions as to whether the ACCC can impose a pass-through safeguard under Part XIC of the Act.

### Differential MTAS rates will create costly arbitrage problems

- 5.3 The ACCC has stated that a differential rate for MTM compared to FTM:

*may create an incentive for fixed line and third-party operators to route their traffic through mobile networks before terminating on a mobile network so as to bypass the higher FTM termination charges.*<sup>74</sup> [emphasis added]

- 5.4 However, the ACCC has also stated that MNOs:

*may be able to prevent serious arbitrage activities by appropriately structuring their access agreements to prohibit re-routing.*<sup>75</sup> [emphasis added]

- 5.5 Optus submits that *any* material differential in the termination rate *will* create an incentive to route traffic in such a way as to maximise receipts or minimise payments. Furthermore, that it is *not possible* to prevent arbitrage from the structure of access arrangements. Arbitrage can only be prevented by removing the underlying incentive or gain to be made from engaging in the behaviour.

- 5.6 Below Optus will therefore argue that:

- (a) Arbitrage is an inevitable outcome where an incentive and opportunity exists;
- (b) The only way to prevent arbitrage is to remove the incentive or opportunity (ie have no differential); and
- (c) Detecting and rectifying arbitrage has material costs.

<sup>74</sup> ACCC, Domestic Mobile Terminating Access Service (MTAS): Public inquiry to make an Access Determination, Discussion Paper, June 2011, p.8

<sup>75</sup> ACCC, Domestic Mobile Terminating Access Service (MTAS): Public inquiry to make an Access Determination, Discussion Paper, June 2011, p.8

Arbitrage will occur where the opportunity exists

5.7 The ACCC appears to have presented a view that arbitrage is a possible outcome of differential MTAS rates. Optus submits that an incentive to exploit an arbitrage opportunity will exist and therefore parties will find a way to capitalise on that opportunity. This is because where there are differences in market prices there are incentives for market participants to capitalise on these differences – it is the nature of competitive market forces.

5.8 This essential assumption was recognised by the European Commission:

*Setting the price of any service at zero may cause distortionary behaviour, bring arbitrage opportunities, lead to inefficient traffic routing and inefficient network utilisation. For instance, a potentially problematic issue might be inefficient routing of traffic from operators not participating in the Bill and Keep scheme.<sup>76</sup>*

5.9 In particular, the Commerce Commission has recognised that where a different pricing principle applies to FTM and MTM termination, this difference could generate arbitrage opportunities.<sup>77</sup> Specifically, the Commission referred to arbitrage opportunities as a reason not to introduce a BAK (or element of BAK) for the MTAS.<sup>78</sup>

5.10 Indeed the French case is an instructive case study of differential regulatory regimes. Between 1995 and 2004 commercial BAK was in place for MTM calls and a regulated cost-based price for FTM calls.

5.11 An arbitrage opportunity arose because integrated operators were able to offer attractive FTM prices to their own networks whereas fixed only operators could not match these because of the higher termination price. In order to compete with the integrated operators they exploited the arbitrage opportunity by implementing mobile gateways to convert their fixed-to-mobile traffic into mobile-to-mobile traffic.

5.12 By 2004 between 20 and 30 per cent of total mobile incoming traffic was routed through these mobile gateways.<sup>79</sup> The consultancy Tera stated that the differential regulatory approach:

*Led to significantly different prices at the retail level, which in turn gave rise to arbitrage opportunities on fixed-to-mobile traffic, resulting eventually in a significant loss in*

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<sup>76</sup> Commerce Commission, Standard Terms Determination for the designated services of the mobile terminating access service (MTAS) fixed-to-mobile voice (FTM), mobile-to-mobile voice (MTM) and short message services (SMS)), Decision 724, 5 May 2011, p.40

<sup>77</sup> Commerce Commission, Standard Terms Determination for the designated services of the mobile terminating access service (MTAS) fixed-to-mobile voice (FTM), mobile-to-mobile voice (MTM) and short message services (SMS)), Decision 724, 5 May 2011, p.88

<sup>78</sup> Commerce Commission, Standard Terms Determination for the designated services of the mobile terminating access service (MTAS) fixed-to-mobile voice (FTM), mobile-to-mobile voice (MTM) and short message services (SMS)), Decision 724, 5 May 2011, p.89

<sup>79</sup> Tera Consultants, Study on the Future of Interconnection Charging Methods, Final Study Report, 23 November 2010, pp.162-163

*interconnection revenues for mobile operators as well as in an inefficient use of radio frequencies.<sup>80</sup>*

5.13 The scheme ended when one operator withdrew from the voluntary agreement in the second half of 2004. The regulator then decided to impose the end of BAK for 1 January 2005.

5.14 **CiC**

*The only way to prevent arbitrage is to remove the opportunity*

5.15 The ACCC dismisses the likelihood of significant arbitrage behaviour and the resulting negative effects. However, as Optus has stated above, it is inevitable that where an opportunity for arbitrage exists, arbitrageurs will exploit it.

5.16 Despite the ACCC's reluctance to view arbitrage as an inevitable consequence of differential MTAS rates, it proposes to "*work with industry to ensure that these concerns are adequately addressed*" and suggests:

*MNOs may be able to prevent serious arbitrage activities by appropriately structuring their access agreements to prohibit re-routing.<sup>81</sup>*

5.17 Optus submits that whilst prohibiting specific behaviour may deter some 'serious arbitrage activities', it cannot prevent *all* methods to exploit the arbitrage opportunity (many of which are likely to be unforeseeable in practice, either by the ACCC or by legitimate operators). Nor can it prevent parties from conducting illegal activities or otherwise failing to comply with a prohibition on particular activity.

5.18 **CiC**

5.19 It is therefore inadequate to rely on legal processes such as licence conditions and access agreements to address behaviour that would arise out of a regulatory process that can be prevented. This has been recognised previously by regulators when considering differential regulatory regimes.

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<sup>80</sup> Tera Consultants, Study on the Future of Interconnection Charging Methods, Final Study Report, 23 November 2010, pp.162-163

<sup>81</sup> ACCC, Domestic Mobile Terminating Access Service (MTAS): Public Inquiry to make an Access Determination, Discussion Paper, June 2011, p.8

- 5.20 The New Zealand Commerce Commission recently considered a bill and keep regime as a replacement for the mobile termination rate. However, it recognised the potential for such a scheme to present arbitrage opportunities that could potentially outweigh the benefits of a bill and keep regime (principally the avoided regulatory costs of setting MTRs).<sup>82</sup>
- 5.21 In the French case, the integrated operators had tried to prevent the installation of mobile gateways but ultimately failed and pulled out of the BAK arrangement. Clearly, in their view, the only way to stop was to remove the opportunity.

*Detecting and rectifying arbitrage problems has material costs*

5.22 It is expensive to monitor and ensure compliance. There are a number of systems that need to be in place and teams dedicated to identifying and compiling evidence. However, it is also the case that not all arbitrage is easily detectable and so there are costs in developing methods.

5.23 Indeed the Commerce Commission noted that its standard terms determination prohibits the use of SIM boxes that could re-route traffic. Yet, they note:

*There may be practical difficulties in identifying the use of SIM boxes and compliance costs associated with ongoing monitoring of traffic.*<sup>83</sup>

5.24 Furthermore, there are network costs, as identified in the French case, from traffic re-routed onto mobile networks from fixed. **CiC** The case of Vodafone's network disruptions was a result of an explosion of unexpected network demand, which was then compounded by technical faults. In a press release Vodafone stated that:

*From mid-2010, explosive growth in the popularity of smartphones and mobile broadband led to a sharp increase in data use in some areas, which could have been better supported by earlier coverage and capacity upgrades. At the same time specific technical faults complicated the network improvements planned.*<sup>84</sup>

5.25 Vodafone has thus brought forward network upgrade plans, however recent media coverage is reporting that service is yet to be completely rectified, which is nearly a year following the recognition of increased demand.<sup>85</sup>

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<sup>82</sup> Commerce Commission, Standard terms determination for the designated services of the mobile termination access service (MTAS) fixed-to-mobile voice (FTM), mobile-to-mobile voice (MTM) and short messaging service (SMS)), Decision 724, 5 May 2011, p.40

<sup>83</sup> Commerce Commission, Standard terms determination for the designated services of the mobile termination access service (MTAS) fixed-to-mobile voice (FTM), mobile-to-mobile voice (MTM) and short messaging service (SMS)), Decision 724, 5 May 2011, p.88

<sup>84</sup> Vodafone, Vodafone's Network and Service Update: Plans accelerated to improve network performance and customer service, Media Release, 22 February 2011.

<sup>85</sup> Grubb, Ben, "'Better, faster, stronger' Vodafone not so hot for some", Sydney Morning Herald, 20 July 2011.

5.26 Accordingly, if there is money to be made re-routing traffic through mobile networks it is likely that such a situation could occur again on another (or the same) network to the detriment to consumers. Further, it would be costly to monitor and rectify in the near term.

### **Bill and Keep is inappropriate for MTM**

5.27 The ACCC has postulated that the characteristics of the mobile market suggest that regulated MTAS pricing may have become less relevant for MTM termination. This is based on a number of assertions and assumptions which Optus will show are invalid. Particularly, Optus will show that contrary to the ACCC's statements:

- (a) Traffic is not balanced between the mobile operators and so termination costs remain a valid expense to levy on access seekers;
- (b) Called parties remain unwilling to pay for some of the costs of a call;
- (c) There are no frictional cost savings to be made with BAK; and
- (d) There are potential unintended consequences for network efficiency and quality of services.

### *Traffic is not balanced between the mobile operators*

5.28 One of the primary assumptions underpinning the ACCC's proposal for a BAK regime between MNOs appears to be based on the view that traffic is balanced between the operators. Specifically, the ACCC has postulated that the three MNOs have 'similarity of scale' and quote recent market shares of Telstra (42 per cent), Optus (32 per cent) and VHA (27 per cent). This apparently leads the ACCC to the view that "voice traffic flows between any pair of the three operators with similar scale are likely to be broadly symmetrical."<sup>86</sup>

5.29 Regardless of the market shares of the three operators, experience indicates that the assumption of symmetrical traffic flows is unlikely to hold true for a number of reasons, including the implications of subscriber behaviour. For example, there is a variety of mobile plans available in the market which target different segments of the subscriber market with various mobile usage behaviours.

5.30 Optus submits that traffic is not and will not be balanced between any pair of the three operators. **CiC**

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<sup>86</sup> ACCC, Domestic Mobile Terminating Access Service (MTAS): Public Inquiry to make an Access Determination, Discussion Paper, June 2011, pp.4-5

5.31 **CIC**

5.32 **CiC**

5.33 Traffic imbalances have implications for the costs of the network operator receiving more traffic than it is originating. An imbalance implies that one network needs to provision more capacity than the other network and thereby incur greater costs. **CiC**

5.34 In the context of an access determination, this is a critical consideration for the ACCC. Section 152BCA(1)(d) of the Act requires the ACCC, in making an access determination, to take into account the direct costs of providing access to the declared service. This means the ACCC must treat the consideration of these costs as a fundamental consideration in making its decision.<sup>87</sup> It has not been suggested that the direct costs of providing access to MTAS for any carrier is zero. Rather, the ACCC's proposal is based on the assumption that MTAS traffic and revenue between Telstra, Optus and VHA is symmetrical. If this assumption holds, the value of the MTAS access provided by a carrier is assumed to equate to the value of the MTAS access it receives. However, in a case where MTAS traffic and revenue is not symmetrical (as demonstrated above), a bill and keep arrangement will leave Optus in a position where it cannot recover its direct costs of providing access to the MTAS, as the value of the MTAS access it receives will be outweighed by the value of the MTAS access it provides. If the proper weight is given to this consideration, the ACCC cannot, in Optus' submission, impose a bill and keep arrangement between Optus, Telstra and VHA by means of an access determination.

5.35 Moreover, as Optus has discussed elsewhere in this submission (section 3), network capacity is becoming increasingly scarce as the demand for data services increases. As discussed, this means that the available capacity to terminate voice traffic is declining, which is contributing to an *increase* in the short-run marginal cost of terminating a call.

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<sup>87</sup> Telstra Corporation v ACCC [2008] FCA 1758.



- 5.36 Traffic (and revenue) balance should also have regard for the international balance. As noted in Section 2, any reduction in the termination rate reduces revenues from international carriers which will lead to a reduction in national (Australian) welfare that is not offset by reduced costs.
- 5.37 Moreover, traffic is not balanced between the fixed and mobile networks. **CiC**
- 5.38 Optus submits that should BAK be implemented for MTM it should also apply for MTF, that is, that if a termination rate were to be set at zero, it would be appropriate to do so *only* if a zero rate applies uniformly across platforms, fixed and mobile alike.

*Called parties are unwilling to pay for any benefits received*

- 5.39 The interconnection regime in Australia operates on a ‘calling-party’s-network-pays’ (CPNP) basis. This means that the network of the customer making the call to another network (the ‘off-net’ call) is responsible for the payment to the network of the called party to compensate for the costs incurred in terminating the call.
- 5.40 Accordingly, retail plans in Australia have historically offered what is known as ‘calling-party-pays’ (CPP). When a customer initiates a call, it is charged for each minute of use. This charge would therefore incorporate the termination payment for an ‘off-net’ call, as well as their own network’s costs. Therefore, network costs (including termination payments) are borne by customers making calls.
- 5.41 In contrast, in countries which have utilised BAK (or some variation), network operators must recover all (or most) of their network costs from their own customers. Therefore, historically retail plans in these countries (for example the USA) have operated on a receiving-party-pays (RPP) basis. This means that all minutes of use are charged, such that the network operators’ costs are covered for outgoing calls as well as incoming calls. Since both parties are paying their ‘leg’ of the call they are effectively ‘sharing’ the costs of it.
- 5.42 The ACCC states that recent academic literature has recognised that the benefits of interconnected voice calls are not entirely accrued to the calling party. This implies that in a CPP retail scheme ‘calling parties’ may be cross subsidising ‘called parties’ since some of the benefits are being accrued to the called parties without the later paying to receive those benefits. The ACCC has therefore concluded that:

*BAK recognises that theoretically both the caller and the recipient derive utility from a call in most cases, and imposes some of the cost of a call on each of the calling and receiving networks, thereby improving allocative efficiency.<sup>88</sup>*

- 5.43 However, CEG examined the ACCC’s claims and stated that:

*We find that a number of recent academic papers do not support BAK and even some of the papers referred to in the Discussion Paper as supporting BAK do not do so. The papers that do support BAK are generally based on empirical evidence that is flawed or on an assumption about significant uninternalised call externalities that lacks empirical support.<sup>89</sup>*

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<sup>88</sup> ACCC, Domestic Mobile Terminating Access Service (MTAS): Public Inquiry to make an Access Determination, Discussion Paper, June 2011, p.19

<sup>89</sup> CEG, Domestic mobile terminating access service (MTAS): A report for Optus, July 2011

5.44 Although it may be the case that some academic literature recognises that the benefits are shared, practical experience has shown that consumers remain unwilling to pay to receive calls. This has led Ofcom to conclude that:

*...based on consumer research, we think that under all plausible scenarios, UK mobile communications providers would not seek to charge customers to receive calls ('receiving party pays' or RPP). Consumers would find such a move highly unpopular and competitive pressures on providers to resist RPP (and offer consumers non-RPP options) would be very strong.<sup>90</sup>*

5.45 It would not therefore be possible for operators to successfully introduce charges for receiving calls, as discussed in section 4. Accordingly, as discussed operators would respond by recovering network costs in other ways, such as introducing higher fixed charges or lower handset subsidies or reducing the availability of certain prepaid plans. As a result, the introduction of a BAK MTAS rate would reduce overall consumer welfare. Indeed, for this reason, the global mobile operators association (GSMA) expressed concern to the European Regulators Group (ERG) in response to a proposal to impose BAK:

*All operators believe that a proposed major change to the interconnection regime should first be subject to a rigorous, evidence-based impact assessment. A substantial reduction in mobile termination revenues can be expected to significantly affect the mobile industry and consumer outcomes in Europe.<sup>91</sup>*

*There are no frictional cost savings to be made*

5.46 To support the ACCC's assertion regarding BAK, it has postulated that:

*MNOs will improve productive efficiency through a significant reduction in frictional costs associated with collecting and reconciling the large volume of CDRs [call detail records] under the current interconnection charging regime. In the longer run, BAK systems will substantially reduce the regulatory burden on MNOs by eliminating the need for mobile industry record-keeping rules (RKR).<sup>92</sup>*

5.47 However, in making this statement the ACCC assumes both A) that the frictional costs it refers to are significant and B) that the frictional costs it refers to would no longer be required under a BAK regime. These assumptions are not correct. **CiC**

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<sup>90</sup> Ofcom, Wholesale mobile voice call termination: market review, Volume 3 – supporting annexes, 1 April 2010, p.183

<sup>91</sup> GSMA, ERG Draft Common Position on NGN Charging Mechanisms – Long term termination issues, GSMA Europe Response, 10 December 2009, p.6

<sup>92</sup> ACCC, Domestic Mobile Terminating Access Service (MTAS): Public Inquiry to make an Access Determination, Discussion Paper, June 2011, p.19

5.48 Moreover, since BAK would only apply to MTM, billing activities would remain in place for FTM calls, so savings from the introduction of BAK in this area would be negligible. CiC Furthermore, call detail records are also utilised by law enforcement for investigation purposes (eg, what calls did a specific customer make, what data did they download).

5.49 The New Zealand Commerce Commission recognised that the benefits of reduced frictional costs of BAK are limited and depend on a number of assumptions. Specifically, it stated that:

*The level of avoided costs associated with a pure BAK regime would depend on:*

- *Whether BAK applies only to one form of traffic (such as MTM) or to all forms of traffic. If BAK does not apply to FTM calls, MNOs would still incur implementation costs for FTM termination, such as billing and number identification systems. These costs may be avoided only where BAK is applied in respect of all mobile termination services;*
- *Whether the costs of billing and number identification system have already been incurred. Joan Obradors of Analysys Mason, as the MTAS STD [standard terms determination] Conference, stated that:*

*...one of the advantages without doubt for bill-and-keep is that you have – you save costs in terms of the billing systems, but I think that this is a theoretical advantage because the point is that, as of today all the networks do have billing systems in place...*

- *Whether these costs relate to ongoing operation costs associated with billing (where the billing systems are already in place), for example, costs associated with systems maintenance and employment of staff to manage the billing process. These operation costs would be avoided under a pure BAK regime; and*
- *Whether billing systems are required for other ongoing operation reasons, such as the monitoring of traffic levels. These costs would be incurred irrespective of which pricing principle is in place.<sup>93</sup>*

5.50 Given the facts stated above, it is clear that the limitations listed by the New Zealand Commerce Commission will apply in Australia. That is, billing systems are already in place and will be required for FTM traffic as well as planning.

5.51 The other benefit noted by the Commerce Commission is the avoided costs of no longer having to set cost-based regulated termination rates.<sup>94</sup> However, as the ACCC has proposed a BAK regime potentially for only MTM, a cost-based rate would still need to be determined for FTM calls, and so the benefits of a BAK regime for MTM only are negligible.

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<sup>93</sup> Commerce Commission, Standard Terms Determination for the designated services of the mobile terminating access service (MTAS) fixed-to-mobile voice (FTM), mobile-to-mobile voice (MTM) and short message services (SMS)), Decision 724, 5 May 2011, pp. 39-40

<sup>94</sup> Commerce Commission, Standard Terms Determination for the designated services of the mobile terminating access service (MTAS) fixed-to-mobile voice (FTM), mobile-to-mobile voice (MTM) and short message services (SMS)), Decision 724, 5 May 2011, p. 39

### Unintended consequences for network efficiency and quality of services

- 5.52 The New Zealand Commerce Commission recognised two possible detriments from the introduction of BAK – which would apply even if traffic appeared to be balanced.<sup>95</sup>
- (a) Incentives to offer more favourable terms for outgoing calls (off-net) than on-net calls; and
  - (b) Reduced incentives to provide high quality of service for incoming calls.
- 5.53 The incentive to offer more favourable terms (prices) arises because off-net calls become cheaper to provide due to the absence of a termination price, as well as utilising less of the network's own resources. This incentive could also manifest itself in an activity known as 'hot potato' routing. Hot potato routing is when calls are handed off at the closest possible point to reduce the use of a network's own infrastructure and pass-on traffic, like a hot potato, as quick as possible to the other network such that fewer costs are incurred.
- 5.54 Furthermore, since network operators do not receive any revenue for terminating another network's calls, it may reduce the network's incentive to allocate capacity to incoming calls.<sup>96</sup> This may lead to a decline in quality of service, imposing costs on outgoing operators as customers would complain due to experiencing difficulties with call drop out, delay, quality, etc. Requiring a termination charge provides an incentive to treat incoming traffic as if it is the network's 'own traffic'. Vodafone has previously highlighted these concerns in more detail in submissions to the European Commission.

### **Regulation of FTM retail prices is not appropriate**

- 5.55 The ACCC has observed that historic reductions in the MTAS rate have not been fully passed through into retail FTM prices. It has thus concluded that:
- the lack of FTM pass-through demonstrates inherent structural issues in the fixed line services market where integrated operators remain dominant with their full suite of services.*<sup>97</sup>
- 5.56 Accordingly, the ACCC has stated that it is considering applying a pass-through safeguard to fixed-line service operators to ensure that any reduction in the MTAS is realised in retail FTM prices.
- 5.57 Optus submits that a pass-through safeguard, or any additional form of retail regulation, is an inappropriate response to address insufficient FTM pass-through. In any event, as Optus has argued at section 4, the proposed measure is highly unlikely to be effective since Telstra would

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<sup>95</sup> Commerce Commission, Standard Terms Determination for the designated services of the mobile terminating access service (MTAS) fixed-to-mobile voice (FTM), mobile-to-mobile voice (MTM) and short message services (SMS)), Decision 724, 5 May 2011, p. 43

<sup>96</sup> Commerce Commission, Standard Terms Determination for the designated services of the mobile terminating access service (MTAS) fixed-to-mobile voice (FTM), mobile-to-mobile voice (MTM) and short message services (SMS)), Decision 724, 5 May 2011, p. 44

<sup>97</sup> ACCC, Domestic Mobile Terminating Access Service (MTAS): Public inquiry to make an Access Determination, Discussion Paper, June 2011, p.8

have the means and incentive to circumvent the requirement. By way of a superior and alternative approach, Optus submits that:

- (a) Regulation should be targeted at wholesale markets to address any competition concerns; and
- (b) Retail price regulation has the potential to distort markets, impose additional burdens on participants and limit innovative pricing approaches.

5.58 Furthermore, as Optus will discuss later in this section, a pass-through safeguard will not fix the problem as Telstra will find other ways to raise prices within its overall price cap. Therefore, in addition to not benefiting consumers, a pass-through safeguard will simply add additional costs and be distortionary.

#### Regulation should concentrate on wholesale markets

5.59 Optus considers that the promotion of long-term competitive market structures is far preferable to retail-level regulation. At best, retail-level regulation is a second-best policy measure to address a market failure and, in terms of regulatory 'tools', retail price caps represent a relatively inflexible and stringent form of regulation. Optus has previously submitted these views to the ACCC.<sup>98</sup>

5.60 There have been a number of developments in competition in retail telecommunications markets. Specifically, Optus has previously submitted that there has been:<sup>99</sup>

- (a) An increase in the number of retail and wholesale service providers;
- (b) FTM substitution in the consumer voice telephony market;
- (c) Growth in wireless technologies;
- (d) Significant reduction in service prices; and
- (e) Facilities competition in metropolitan areas.

5.61 These changes have been facilitated by addressing impediments in the wholesale market, not by applying stricter retail regulations (as retail prices have been changing at a rate below the retail price cap).<sup>100</sup>

5.62 However, there are still a number of impediments in the wholesale access regime. Measures to address these issues are currently in the process of implementation, including:

- (a) Elimination of the lengthy and costly negotiate/arbitrate regulatory model, which has been replaced by ex ante price regulation by the ACCC;
- (b) Increased price certainty through adoption of a building block model framework, which locks in the initial regulated asset base;

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<sup>98</sup> Optus, Optus submission to ACCC on Review of Telstra Price Control Arrangements, February 2010, p.18

<sup>99</sup> Optus, Optus submission to ACCC on Review of Telstra Price Control Arrangements, February 2010, p.7

<sup>100</sup> Optus, Optus submission to ACCC on Review of Telstra Price Control Arrangements, February 2010, pp.10-11

- (c) Structural separation of Telstra; and
- (d) The establishment of the NBN as a structurally separate, open access, wholesale-only fixed line infrastructure access provider.

5.63 These reforms are intended to address the considerable underlying impediments to competition which remain in the fixed telecommunications market. It can be expected that these reforms will improve competitive conditions in the near to medium term (depending on the quality of the implementation), and so improve the ability for competitive service providers to offer services in effective competition to Telstra.

5.64 Importantly, the very purpose of the introduction of the NBN is to remedy significant structural problems in the wholesale market. In the Government's own words, the NBN will:

*...deliver open and equivalent access to retail providers, thereby providing a platform for retail-level competition to flourish.*

*...this approach responds to longstanding concerns about barriers to competition in the Australian telecommunications market flowing from Telstra's control of the access network and its vertical integration.<sup>101</sup>*

5.65 This very substantial reform – not additional retail regulation in the form of a pass-through safeguard – is the best way to address the 'inherent structural problems' in the retail market.

5.66 It is therefore appropriate that at present the ACCC should focus on the correct implementation of structural reforms in the fixed line market, and on monitoring developments in the retail market as a result of these significant changes, prior to implementing costly (and unnecessary) additional regulation in the form of a pass-through safeguard.

5.67 Optus considers that it would be imprudent to apply additional regulation in the form of a pass-through safeguard in the interim period whilst industry is transitioning to new regulatory regimes. In fact, applying further retail regulation has the potential to limit or depress the expected outcomes from these considerable reforms.

#### *Additional retail regulation is distortionary*

5.68 Telstra is currently subject to retail price controls. That is, a number of services make up 'baskets' for which the average prices cannot exceed determined levels. These retail price controls are currently in place until 30 June 2012. These regulations are in addition to the price regulation of wholesale inputs, which are required for it (and other industry participants) to provide retail services.

5.69 Therefore, any pass-through mechanism will in effect add a *third layer* of price regulation to telecommunications services.

5.70 Retail price regulation often has the effect of 'locking-in' existing pricing structures and allowing prices to change with determined costs. Although a basket approach allows for flexibility in pricing structures, a targeted control on a specific service such as FTM calls effectively forces all participants to structure and price calls in the manner determined by the regulator.

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<sup>101</sup> Australian Government, National Broadband Network Companies Bill 2011, Explanatory Memorandum

- 5.71 This can have the potential to prevent innovative pricing structures from developing, or for input cost savings to be allocated to the services most consumed or valued by end-users. In the UK, where the fixed market is considerably more advanced than in Australia, the regulator has observed that:

*There is some evidence that competition in the fixed market is increasingly focusing on calls to mobiles, with BT and Virgin both offering packages or add-ons which significantly reduce the price of fixed-to-mobile calls.<sup>102</sup>*

- 5.72 It is thus not necessary for the ACCC to intervene in the retail market since the structural reform which is currently underway is likely to lead to such results in Australia anyway.
- 5.73 Furthermore, additional retail regulation, as proposed by the ACCC, is inconsistent with efficient pricing principles. For services which share common costs, it is considered efficient for the provider to price services which are least sensitive to price changes with higher margins to recover common costs than those services which are more sensitive to price changes.
- 5.74 This means that should Telstra (or others) be required to reduce margins on FTM call prices, where demand is presumed to be less sensitive to price changes, the corresponding increases on other services may reduce consumer welfare. This net reduction may occur because without an increase in demand for FTM services in response to the price reduction, the corresponding price increase in another service will lead to lower consumption. Depending on the size of the response, the same consumer could be consuming fewer services for the same total price.
- 5.75 For this reason, the ACCC has consistently favoured broad price caps in order to promote efficient pricing. Recently, in its 2010 review of Telstra's retail price control arrangements, it stated that:

*The ACCC has a general preference for broadly based baskets (covered by weighted average price caps), rather than price caps on individual services. The key reason for this preference for broad based baskets is that it allows Telstra to be flexible in setting prices for services that share common infrastructure and costs.*

...

*The ACCC recognises that there are arguments for and against the imposition of a subcap on FTM calls. However, on balance the ACCC does not recommend that this step be taken, and instead these services should remain subject only to a broadly based cap.<sup>103</sup>*

- 5.76 It is also the case that such a specific pass-through provision has been rejected by the Australian Competition Tribunal.
- 5.77 In Vodafone's 2004 MTAS undertaking it proposed to include a pass-through safeguard provision. The ACCC rejected this pass-through safeguard provision as it considered that the pass through provision was not necessary as pass-through might occur in a number of other ways.<sup>104</sup> The ACCC further considered that the pass through would be more appropriately

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<sup>102</sup> Ofcom, Wholesale mobile voice termination: Market review, Volume 3 - Supporting Annexes, 1 April 2010, p.192

<sup>103</sup> ACCC, Review of Telstra's Price Control Arrangements – an ACCC report, March 2010, pp.27-28

<sup>104</sup> ACCC, Final Decision on Vodafone MTAS Undertaking March 2006, p.77

achieved by instituting price controls at the downstream level applied to a broad-based basket of services such as all the services supplied in the retail fixed line services market.<sup>105</sup>

5.78 This provision was also challenged on other grounds, including:

- (a) the provisions were invalid as they were not provisions “in relation to” the standard access obligations applicable to a declared service;
- (b) price regulation in respect of retail telco services was the function of the responsible Minister; and
- (c) implementation problems such as:
  - (i) the assumption used for the proposed FTM retail rates;
  - (ii) the pass through disputes provision; and
  - (iii) the transit traffic arrangement provision.

5.79 While the Tribunal did not consider the pass through provisions were inconsistent with Vodafone’s standard access obligations or the Ministerial Determination<sup>106</sup>, the Tribunal was concerned that the pass through provisions were unreasonable on the following basis:

*...We are also concerned that the Pass Through Safeguard is inflexible in relation to the opportunity for competition to be promoted as a result of any reduction in the price of the VMTAS. It limits the opportunity of access seekers to determine the form in which any reductions they may receive in the supply of the VMTAS may be passed through to the retail fixed services market.*

*We consider that the pass through provisions in the undertaking deprive access seekers of the flexibility to determine competitively the individual price elements for services within the basket of services that are supplied within the fixed-to-mobile market, and the form in which pass through will take place. This approach retards allocative and dynamic efficiency, inhibits competition, is not in the long-term interests of end-users and, in our view, is not reasonable.*

5.80 The Tribunal further considered that it did not have sufficient evidence before it to satisfy the assumption of the cost of fixed origination and termination used by Vodafone. It also raised a concern about the operation of the transit traffic provisions.<sup>107</sup>

5.81 It is unclear why the ACCC would depart from this view, given that competition in the fixed line services market is likely to improve with a number of substantial structural reforms occurring in the wholesale market. As a result of these reforms, the benefits which the ACCC is seeking to achieve will be delivered in a far more efficient manner than a pass-through safeguard could achieve.

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<sup>105</sup> Tribunal, ACCC Final decision on Vodafone MTAS undertaking March 2006, p.82

<sup>106</sup> Telstra Carrier Charges – Price Control Arrangements, Notification and Disallowance Determination No. 1 of 2005, Clause 11

<sup>107</sup> Australian Competition Tribunal judgement (Vodafone MTAS appeal), Para 288



### ACCC's ability to impose a pass-through safeguard

5.82 There are serious questions as to whether the ACCC can impose a pass through safe guard under Part XIC of the Act. A pass through obligation is, by definition, concerned with the retail price charged by a service provider to an end user for a carriage service. The ACCC has no power to regulate such prices under Part XIC. Section 152AR of the Act imposes an access obligation on an access provider only in order that the access seeker can provide carriage services or content services (also see the definition of 'access' in section 152AF(1)). An access determination sets out terms and conditions upon which an access provider must comply with the standard access obligations in the event that the access provider and an access seeker cannot agree (see section 152AY). However, the ACCC cannot, in an access determination, regulate matters that are not the subject of the standard access obligations under section 152AR or, more broadly, access under Part XIC.

### Degree of pass-through that has already occurred

5.83 As noted above, Optus considers that a specific pass-through provision is inappropriate.

5.84 Nevertheless, in the event that the ACCC did decide to implement a specific pass-through provision, Optus submits that any additional mechanism such as that contemplated by the ACCC should take into account the degree of pass-through that has already occurred to date, and the extent to which the degree of pass through has differed between different operators. As noted above, since 2004 Telstra has failed to pass through more than 45% of the reduction in MTAS rate to its retail customers; whereas Optus has passed through a significantly greater proportion, **CiC**, to its customers. Any measure which failed to recognise the substantial pass through already achieved by Optus and the substantial windfall pocketed by Telstra to date would be manifestly inequitable and inconsistent with the legislative criteria set out in the Trade Practices Act.

5.85 For example, any proposal which required all future rate reductions to be passed through in full, but left existing FTM rates unchanged, would in effect crystallise current FTM rates. This would reward Telstra for its failure to pass through in the past – and punish Optus for passing on benefits to consumers in the past. Such a proposal would not promote competition (since it would be discriminating against carriers that have already passed on rate cuts) and would not be consistent with the legitimate business interests of MNOs. A more equitable approach would be one which sought to influence not only the proportion of pass-through which occurs in future, but also addressed the different proportions that operators have passed through in the past.

## Section 6. MTAS Pricing Methodologies

6.1 The main points made in this section are as follows:

- (a) modelling a hypothetical operator's network using the "pure LRIC" (or TSLRIC) methodology is not an appropriate way to calculate the cost of supplying the MTAS, and would result in inefficiency and prevent operators from recovering their full cost of service delivery;
- (b) hypothetical cost modelling generally is not appropriate;
- (c) benchmarking MTAS prices from other jurisdictions would require substantial adjustment for Australian-specific factors such as larger coverage areas and lower population density before they are capable of being used to calculate an appropriate MTAS price for Australia; and
- (d) an obligation on mobile operators to provide their own internal costs would be data-intensive, onerous and ultimately unhelpful given the rapid pace of technological change.

### Pure LRIC and TSLRIC costing approaches are inappropriate

6.2 Optus submits that the costing approaches which European regulators have relied on (TSLRIC and/or pure LRIC) are inappropriate.

6.3 The ACCC is required to have regard to the access provider's "legitimate business interests" under the Competition and Consumer Act. The Australian Competition Tribunal has previously interpreted "legitimate business interests of access provider" as follows:

*... We consider that a carrier's "legitimate business interests" is a reference to what is regarded as **allowable and appropriate in commercial or business terms**. In the context of s 152AH(1)(b), the expression connotes something which is allowable and appropriate when negotiating access to the carrier's infrastructure. When looked at through the prism of a charge term and condition of access and its relationship to a carrier's cost structure, **it is 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>108</sup> [emphasis added]*

6.4 In other words, the regulated MTAS rate should allow the access provider to recover all of its costs and earn a normal commercial return on its investment.

6.5 Adopting a pure LRIC approach for MTAS however will not allow access provider to recover all of its costs. As the ACCC stated in its discussion paper, pure LRIC does not include the common costs of a network providing a full range of services. It only allows access providers to recover the costs of additional infrastructure investments if those investments are considered "necessary" to providing the MTAS.<sup>109</sup>

<sup>108</sup> Telstra Corporation Limited [2006] ACompT 4 at [89] (referred to with approval in Re Telstra Corporation Ltd (No 3) [2007] ACompT 3 at [180]).

<sup>109</sup> ACCC, MTAS public inquiry to make an Access Determination, discussion paper, June 2011, p.16

- 6.6 CEG has recognised that a pure LRIC approach does not allow access provider to recover its common costs:

*Pure LRIC as a general pricing principle is not consistent with a competitive price benchmark because if pure LRIC was applied to all services, it would leave operators unable to recover their common costs.*<sup>110</sup>

- 6.7 Optus submits that the EC regulators' view of the costs that are "necessary" to providing the MTAS is an inappropriately narrow and artificial view of mobile network cost. Under pure LRIC, access providers will not be allowed to recover common network costs which in fact required to provide the MTAS, taking a realistic view of network cost. As discussed in section 3 of this submission, the vast bulk of mobile network investment costs are driven by the need to provide voice coverage. The pure LRIC method would prevent mobile operators from recovering these common network costs which are critical to provision of the MTAS. Consequently, Optus submits the pure LRIC method is inconsistent with its "legitimate business interests" and must be rejected.

- 6.8 Further, Optus submits that it would be inefficient and impractical to adopt a pure LRIC and/or TSLRIC in setting MTAS. As mentioned elsewhere a pure LRIC approach does not allow access provider to recover the common costs of a network. Allocative efficiency will not be promoted if access charge fails to allow access provider to recover both the common costs and incremental costs of providing the service. This is recognised by CEG:

*We find that established economic theory shows that allocative efficiency is best promoted by setting charges to cover incremental costs as well as an efficient contribution to common costs. By spreading the recovery of common costs across all services, the efficiency or dead weight loss of recovering those costs can be minimised. Pure LRIC...would result in MTAS charges being reduced well below the efficient level at a potentially large cost to overall consumer welfare.*<sup>111</sup>

- 6.9 CEG also considers a pure LRIC approach could harm investment, particularly if the estimated level of pure LRIC was substantially below current MTAS charge levels. This is because dynamic efficiency will be harm if investment and/or competition are harmed. The impact of termination regulation on investment returns depends on the strength of the waterbed effect, which CEG found is likely to be strong.<sup>112</sup>

- 6.10 Optus further submits that there are a number of practical disadvantages with adopting LRIC and/or TSLRIC cost modelling. Some disadvantages have been recognised by the ACCC.<sup>113</sup> CEG also identifies other problems with measuring pure LRIC, including the following:

*For pure LRIC...only those costs that are labelled as traffic-sensitive are taken into account. Hence the resulting pure LRIC cost estimate is highly sensitive to the correct identification of whether or not each cost category is traffic-related. This requires detailed technical information as well as economic analysis such as in relation to the correct treatment of opportunity costs of coverage and spectrum.*

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<sup>110</sup> CEG, Domestic mobile terminating access, a report for Optus, July 2011, p.25

<sup>111</sup> CEG, Domestic mobile terminating access service, a report for Optus, July 2011, p.2

<sup>112</sup> Ibid p.15

<sup>113</sup> ACCC, Discussion paper p.15, p.17

...

*The appropriate identification of traffic related costs has been a key issue. In addition, there are disputes over to what extent the network would be designed differently if it did not carry termination services. There are also other issues as to whether last increment of traffic would be higher costs than traffic in general such as may result from local congestion. In Belgium, the Netherlands and the UK, there are currently substantive appeals of whether pure LRIC is appropriate in principle and whether the regulator has accurately measured it.<sup>114</sup>*

### **Hypothetical cost modelling is not appropriate**

- 6.11 The Australian Competition Tribunal has previously recognised that hypothetical cost modelling (an approach which includes TSLRIC+, TSLRIC and/or pure LRIC) is the wrong approach. The Tribunal considered that hypothetical TSLRIC cost modelling only provides an estimate of what it would cost a hypothetical firm, which could be impossible to achieve in the real world:

*... TSLRIC+ modelled by the TEA Model, at best, is an estimate of what it would cost a hypothetical firm to replace Telstra's current network in today's conditions in a very short period of time using a single vintage of the best technology currently in use. That would be impossible to achieve in the real world.*

...

*But the Tribunal's difficulty with the submissions presented to it on TSLRIC+ goes deeper than the specifics of the TEA Model. It is troubled by the notion that prices should be set on the basis of hypothetical competition for a market that has natural monopoly characteristics, just as it would be puzzled by a proposal to price access to an electricity distribution network in a way intended to cause users to choose whether or not to overbuild the whole network, replacing it completely...<sup>115</sup>*

- 6.12 The ACCC has experience of the limitations of hypothetical cost modelling in the mobile industry. The cost model which the ACCC has used to inform itself with regard to the MTAS (the WIK model) assumes efficiencies that are not obtainable by real world operators in a network roll out under competitive conditions, as the ACCC has correctly recognised.<sup>116</sup> In response to these limitations, the ACCC adopted the position that cost estimates produced by models based upon a hypothetical operator cannot be considered conclusive in determining an appropriate indicative price.

### **Benchmarks would require substantial adjustment for Australian-specific factors**

- 6.13 Optus submits that if the ACCC is to rely on benchmarking evidence, substantial adjustments would be required in order to take account of Australian-specific factors before such evidence was capable of being used to calculate an appropriate MTAS price for Australia.

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<sup>114</sup> CEG, *Domestic mobile terminating access service, a report for Optus, July 2011, pp.25-26*

<sup>115</sup> Application by Telstra Corporation Limited [2010] ACompT1 para 113 and 239

<sup>116</sup> ACCC, Nov 2008, Draft MTAS Pricing Principles Determination and indicative prices for the period 1 January 2009 to 31 December 2011, p.13

6.14 In particular, the ACCC should at a minimum heed its own stated views on the appropriate adjustments required, as set out in its last MTAS pricing principles and indicative prices determination, which stated:

*... these adjustments include spectrum allocations, network purchasing power, vertical/horizontal integration, network usage and scale, population density, land and labour costs, the use of different technology, retail prices, scope of services offered and the quality of services offered.*<sup>117</sup>

6.15 For example, consider the recent MTAS decisions released by both the UK and New Zealand regulators during the first half of 2011, which have led to a marked decline in the regulated MTAS rate in both jurisdictions. Notably there are several key differences between these jurisdictions and Australia, such as population density, which suggests a significant difference in the required scale of coverage. For example, according to the OECD,<sup>118</sup> Australia has a significantly lower population density (2.74 persons per km<sup>2</sup>) compared to both the UK (248.88 persons per km<sup>2</sup>) and New Zealand (15.74 persons per km<sup>2</sup>).

6.16 This was also recognised in the New Zealand Commerce Commission's decision following a country-specific difference analysis between Australia and New Zealand. In particular, the Commerce Commission considered that because New Zealand has a higher degree of population density than Australia but a similar rate of urbanisation, this implies that:

*Australian networks will be less efficient than networks in New Zealand because there will be proportionally more coverage-driven network elements, increasing average costs for a given level of coverage. Having a greater proportion of coverage-driven network elements in Australia will also result in average link distances being higher in Australia, resulting in higher costs in Australia.*<sup>119</sup>

6.17 Ofcom also notes "[t]here are many factors that affect competition among MCPs, including the availability of spectrum, incumbency advantages, and advertising sunk costs that create brand value."<sup>120</sup>

6.18 In addition, there is no single pricing methodology used across all jurisdictions to warrant an unadjusted benchmark MTAS price. It follows that a number of factors may unduly impact on MTAS costs, making any direct comparison or benchmark of MTAS rates problematic.

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<sup>117</sup> ACCC, Domestic mobile terminating access service pricing principles determination and indicative prices for the period 1 January 2009 to 31 December 2011, March 2009, p.19

<sup>118</sup> These figures compare against the OECD total population density (per km<sup>2</sup>) of 33.88, using 2007 country data. OECD, OECD in Figures 2009, Demography

<sup>119</sup> Commerce Commission, Standard terms determination for the designated services of the mobile termination access services (MTAS) fixed-to-mobile voice (FTM), mobile-to-mobile voice (MTM) and short messaging services (SMS)), Decision 724, May 2011, page 79 [Citing Commerce Commission, Final Report on whether the mobile termination access services (incorporating mobile-to-mobile voice termination, fixed-to-mobile voice termination and short-message service termination) should become designated or specified services, 22 February 2010, page 113, paragraphs 451–452]

<sup>120</sup> Ofcom, Wholesale mobile voice call termination, Statement, March 2011, p.184

### Australian Competition Tribunal's and ACCC's views on international benchmarking

- 6.19 It was recognised by the Australian Competition Tribunal that international benchmarking evidence would only be relied upon if various matters were taken into account, including the regulatory environment, the state of the relevant markets and the socio-economic environment:

*In any event, the nature of the international benchmarking exercise was such that it teaches very little, or nothing at all, as to whether Optus' price terms are reasonable having regard to the matters set out in s 152AH and the objectives in s 152AB. In order to place any reliance upon the international benchmarking analysis it would be necessary to know much more about the regulatory environment within which they were determined, **the state of the relevant markets and the socio-economic environment in which the mobile services were operative.**<sup>121</sup> [emphasis added]*

- 6.20 Similarly, the ACCC has stated that international benchmarking evidence would be useful but only if adjustments are made for Australian-specific factors including spectrum allocations, network purchasing power, vertical/horizontal integration, network usage and scale, population density, land and labour costs, the use of different technology, retail prices, scope of services offered and the quality of services offered.<sup>122</sup> Specifically the ACCC said:

*The ACCC will place progressively more weight on benchmarking analyses that contain progressively more comprehensive adjustments to address Australian-specific factors. However, substantive reliance cannot be placed upon international benchmarks in any arbitration proceedings or assessment of undertakings without making substantive adjustments to account for the differences between Australia and the benchmark countries as envisaged by the Tribunal in the Optus decision.*<sup>123</sup>

### The WIK model

- 6.21 Optus submits that the ACCC should not rely on the WIK model to set prices for MTAS. This is because the WIK model does not provide an estimate of the efficient cost of MTAS in Australia.
- 6.22 The WIK model purports to estimate the costs of a hypothetical mobile network operator in Australia using a scorched earth approach. However, 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. As mentioned elsewhere, the Tribunal has previously recognised that hypothetical TSLRIC+ cost modelling only provides an estimate of what it would cost a hypothetical firm, which could be impossible to achieve in the real world.
- 6.23 The WIK 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. The WIK model ignores the costs existing MNOs face as a result of past prudent investments and hold them to a standard of operational and cost efficiency they cannot achieve.

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<sup>121</sup> Application by Optus Mobile Pty Limited & Optus Networks Pty Limited [2006] ACompT 8(22 November 2006) para 297

<sup>122</sup> ACCC, Domestic mobile terminating access service pricing principles determination and indicative prices for the period 1 January 2009 to 31 December 2011, March 2009, p.20

<sup>123</sup> ACCC, Domestic mobile terminating access service pricing principles determination and indicative prices for the period 1 January 2009 to 31 December 2011, March 2009, p.20

- 6.24 The WIK model also 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 underestimates the cost to a hypothetical MNO in providing MTAS.
- 6.25 MNOs have a legitimate business interest in receiving a reasonable return on investment. This is one of the legislative criteria outlined under s152AB of the Competition and Consumer Act. To rely on the WIK model's model estimates of efficient cost would therefore adversely impact Australian MNOs' legitimate business interests.
- 6.26 The ACCC has recognised that MNOs face certain constraints.<sup>124</sup> It has further noted the difference between the costs faced by a hypothetical operator and by an actual MNO:

*The concept of an efficient operator has two implications in the context of the WIK model. The first is that the network of a hypothetical operator will not necessarily duplicate precisely that of an actual mobile network and will reflect the best-in-use technology currently deployed.*

*The second is that the hypothetical operator will incur the efficient costs of providing a service rather than the actual costs necessarily incurred by MNOs. The cost difference derives from both the nature of the networks actually deployed compared to an optimised network and differences in cost between actual cost and efficient cost that may be present; which may be influenced, for example, by the business strategies employed by the individual MNOs, differences in pricing within multinational groups and cross subsidisation of certain services vis-à-vis other services provided by MNOs.<sup>125</sup>*

- 6.27 Moreover, there is a serious risk that the ACCC will fail to have proper regard to the matters stipulated in section 152BCA(1) of the Act if it seeks to determine MTAS access prices by reference to benchmark prices. Section 152BCA(1)(d) of the Act requires the ACCC, in making an access determination, to take into account the direct costs of providing access to the declared service. These are the direct costs of access providers, not a notional benchmark determined by the ACCC.<sup>126</sup> Benchmarking may have a role to play in determining whether an access provider's costs are efficient, but a pricing methodology which has, as its basis, benchmark prices charged in other jurisdictions will fail to take into account the direct costs incurred by access providers as required by the Act.

### Internal costs

- 6.28 Optus submits that MNOs should not be required to provide their own internal costs.
- 6.29 Reporting on MTAS costs is likely to be an onerous and data-intensive obligation. Optus' concerns about reporting on MTAS costs were previously raised to the ACCC in the proposed changes to the RAF RKR consultation.<sup>127</sup> **CiC**

<sup>124</sup> ACCC, MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008 Report, November 2007, p.1

<sup>125</sup> ACCC, MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008 Report, November 2007, p.15

<sup>126</sup> Telstra Corporation v ACCC [2008] FCA 1758.

<sup>127</sup> Optus, Submission to the ACCC on proposed changes to the Regulatory Accounting Framework Record-Keeping Rules, May 2010; Optus, Submission to the ACCC on proposed changes to the Regulatory Accounting Framework Record-Keeping Rules, November 2008

6.30 **ciC**

6.31 **ciC**



## Section 7. A Stable MTAS Rate will Promote Investment and Competition

### Recent mobile network investment has been substantial

7.1 The MTAS rate has remained at 9 cpm from July 2007 to July 2011. During this period, there has been strong growth in mobile network investment, in particular the extensive deployment of 3G infrastructure. This has been noted by the ACCC:

*“During 2007-08, the trend of Australia’s four 3G mobile telephony network operators investing heavily in mobile wireless data technology continued...”<sup>128</sup>*

*“During 2008-09, mobile service providers continued to invest in their 3G networks and backhaul transmission, increasing coverage areas and network speeds.”<sup>129</sup>*

7.2 Optus has made significant investments in its mobile network. Optus made capital investments of **CiC** in its mobile network between April 2007 and March 2011. It has continued to increase its mobile investment from \$495 million in 2009 to \$536 million in 2010 and \$575 million in 2011.<sup>130</sup> Its network coverage has expanded from 60% of population in December 2007 to > 97% in March 2010.<sup>131</sup> In September 2010, Optus announced that its Open Network will be extended to 98% of population.<sup>132</sup> As of 2011, Optus has expanded its network coverage to over 700,000 square km.<sup>133</sup> In FY 2011, over 660 mobile sites were built and 1,000 in-building solutions were delivered.<sup>134</sup>

7.3 Other MNOs have also made significant investments during the period 2007-2011:

- (a) October 2007 –Telstra announced that its 3G network coverage reaches more than 98.9% of Australia’s population;<sup>135</sup>
- (b) December 2007 –Vodafone announced plans to extend its 3G network coverage from 63 to 95% of the population;<sup>136</sup>
- (c) January 2009 –Telstra announced completion of its 3G network upgrade, which it claims increases its theoretical peak network speed from 14.4 Mbps to 21 Mbps<sup>137</sup>;
- (d) 2010 –Telstra completed deploying more than 270 new or improved mobile sites.<sup>138</sup>

<sup>128</sup> ACCC, Telecommunications Report 2007-08, June 2009, p.21

<sup>129</sup> ACCC, Telecommunications Report 2008-09, November 2010, p.18

<sup>130</sup> Optus, Investor Day 2011: Mobile Business Overview, 11 July 2011

<sup>131</sup> Optus, Investor Day 2010: Mobile business Overview, 5 July 2010

<sup>132</sup> Optus, Media Release, 10 September 2010

<http://www.optus.com.au/aboutoptus/About+Optus/Media+Centre/Media+Releases/2010>

<sup>133</sup> Optus, Investor Day 2011: Mobile Business Overview, 11 July 2011

<sup>134</sup> Optus, Investor Day 2011: Mobile Business Overview, 11 July 2011

<sup>135</sup> ACCC, Telecommunications Report 2007-08, June 2009, p.16

<sup>136</sup> ACCC, Telecommunications Report 2007-08, June 2009, p.16

<sup>137</sup> ACCC, Telecommunications Report 2008-09, November 2010, p.17

## Future mobile network investment will be substantial

7.4 Optus submits that a stable MTAS rate of 9 cpm would facilitate much-needed investment in critical mobile network infrastructure including the introduction of LTE technology. The ACCC has very recently expressed the view that price stability is important in promoting investment, in its FAD on fixed line services:

*...the ACCC was guided by its view that pricing stability is desirable to the extent that it supports past investments and promotes industry confidence in making future investment decisions.*<sup>139</sup>

7.5 Future mobile network investment will be substantial and Optus considers that a stable MTAS rate of 9 cpm would enhance revenue certainty and thereby support its ability to make further investment in the near future, including the deployment of LTE. Ofcom previously has recognised that large amounts of upfront capital investment will be required for the deployment of LTE.<sup>140</sup>

7.6 All MNOs in Australia have made investment commitments in the coming years:

(a) Optus has committed to do the following in 2012 and beyond:

- (i) Continue regional expansion;
- (ii) Invest in metro network depth;
- (iii) Complete upgrade to HSDPA+; and
- (iv) Finalise trial of LTE and deploy.<sup>141</sup>

(b) Telstra announced in February 2011 that it would upgrade its existing Next G network with LTE technology in CBD of all capital cities and selected regional centres by the end of 2011.<sup>142</sup>

(c) VHA announced in February 2011 that it would replace its 2G radio equipment at all of its 8,000 mobile base stations with new 3G equipment to improve mobile coverage and download speeds. Over 2500 sites would be upgraded or added to the Vodafone 3G network.<sup>143</sup>

(d) VHA announced in April 2011 that it would launch LTE service later in the year.<sup>144</sup>

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<sup>138</sup> Telstra, Corporate Citizenship Report 2010, p.5

<sup>139</sup> ACCC, Final Report, Inquiry to make final access determinations for the declared fixed line services, July 2011, p.38

<sup>140</sup> Analysys Mason, Draft standard terms determination analysis, Report for NZ Commerce Commission, 4 February 2011, p.37

<sup>141</sup> Optus, Investor Day 2011: Mobile Business Overview, 11 July 2011

<sup>142</sup> Telstra media release, 10 February 2011, [www.telstra.com.au](http://www.telstra.com.au)

<sup>143</sup> Mitchell Bingemann, VHA taps Huawei to upgrade mobile network, The Australian, 22 February 2011 <http://www.itnews.com.au/News/254514,vha-to-launch-lte-mobile-services-this-year.aspx>

<sup>144</sup> Ry Crozier, VHA to launch LTE mobile services this year, IT news, <http://www.itnews.com.au/News/254514,vha-to-launch-lte-mobile-services-this-year.aspx>

7.7 Optus is currently planning to make capital investments in its mobile network in the order of **CiC** over the 5 year period FY2010 – FY2014 (April 2009 – March 2014). On average across all mobile products, MTAS revenue represents **CiC**. If this revenue is lost, the reduction would inevitably cause Optus and other carriers to re-think the case for current planned mobile network investment.

### **The mobile market is competitive**

7.8 The mobile market has been highly competitive in the period 2007 – 2011, during which the MTAS rate remained at 9cpm. This is evident through the vast array of choice available to consumers, significant declines in mobile prices; and the large number of mobile service suppliers in the market. Further details on the competitiveness of the market are set out at Appendix A.

7.9 The ACCC has recently acknowledged the competitiveness of the mobile market, in its consideration of the merger of Vodafone and Hutchison,<sup>145</sup> and subsequent observations.<sup>146</sup>

### **MTAS rate stability will promote competition**

7.10 As mentioned above, the ACCC has recently expressed the view that price stability will promote investment. It follows that maintaining a stable MTAS rate will also promote competition. This is recognised by the ACCC in its FAD on fixed services:

*...an important consideration for the ACCC has been promoting price stability to the extent that it supports past investments **and promotes competitive outcomes.***<sup>147</sup>  
[emphasis added]

7.11 Optus has played a central role in driving competition with innovative price and product offerings. The innovative plans pass through value to end users and increase consumer welfare. **CiC** Examples of Optus' innovative mobile product offerings during 2007 – 2011 are outlined in Appendix A.

7.12 Optus refers the ACCC to Section 2 which discusses increasing network costs which are not matched by revenues. A stable MTAS rate of 9cpm is therefore crucial in providing Optus with certainty of revenue and allowing Optus to continue to offer new innovative plans and bundling arrangements which pass through value to end users.

7.13 Optus submits that an MTAS rate of 9 cpm is not inhibiting the growth of VoIP and complementary services. This is evident given the large number of such operators currently active. For example, the ACMA has noted that as at June 2010, there were 204 VoIP providers and 2.9 million VoIP users in Australia.<sup>148</sup> This is compared to the 160 VoIP providers which the ACMA had reported as at June 2006.<sup>149</sup> In addition, the ACCC also notes that while:

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<sup>145</sup> ACCC, Public Competition Assessment Vodafone Group plc and Hutchison 3G Australia Pty Limited –proposed merger of Australian mobile operations, 24 June 2009, p.7

<sup>146</sup> ACCC, Telecommunications Report 2008-09, November 2010, p.4

<sup>147</sup> ACCC, Final Report, Inquiry to make final access determinations for the declared fixed line services, July 2011, p.38

<sup>148</sup> ACMA, ACMA Communications Report 2009-10, November 2010, p.23

<sup>149</sup> ACMA, ACMA Communications Report 2006-07, February 2008, p.45

*It is difficult to quantify the number of VoIP users; however data from Nielsen Online, show that at April 2008 there were one million unique visitors to VoIP sites that month.*

***VoIP providers are also reporting increased take-up of services:***

- *Engin reported 68,000 active subscribers (88,000 subscribers in total) at the end of June 2008, an increase of nine per cent from June 2007.*
- *MyNetPhone reported over 60,000 subscribers at the end of June 2008; an increase of 71 per cent from June 2007.<sup>150</sup> [emphasis added]*

7.14 Regardless, the growth of VoIP and complementary services has not been impeded by the level of the MTAS rate – which has remained at the 9cpm level since 1 July 2007.

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<sup>150</sup> ACCC, Communications infrastructure and services availability in Australia 2008, 2008, p.30

## Section 8. Phase-in Period

- 8.1 Optus submits that should the ACCC decide to make a significant change to the MTAS price, a lengthy phase-in period would be necessary to promote the legitimate interests of both access providers and end users. In these circumstances, a glide path would be in the LTIE.
- 8.2 The NZ Commerce Commission (NZCC) has adopted a phase-in period in its recent MTAS decision. The NZCC considered that *“it is in the best long term interests of end users that a transition period be allowed where investment and other decisions have been made on the basis of an existing regulatory regime.”*<sup>151</sup> It further noted that:
- Glide-paths are commonly used by regulators to balance the short term welfare gains of immediate price reductions with the long term interests of protection of efficient investment incentives. Glide paths allow time for operators and customers to adjust to new price levels and structures, and allow operators sufficient time to unwind business decisions made in reliance on a previous regulatory approach. It is unusual for regulators to impose new pricing without a glide-path.*<sup>152</sup>
- 8.3 This is further supported by Analysys Mason<sup>153</sup> and NERA<sup>154</sup>. Both Analysys Mason and NERA consider that the NZCC should adopt the standard overseas regulatory practice and implement a glide path.
- 8.4 Analysys Mason shows that regulators abroad including Australia, Hungary, Netherlands, Norway, UK, Israel, Slovenia, Ireland, Sweden, Kenya, Belgium, Macedonia, Luxembourg, Romania and Portugal all implemented a glide path for MTAS. Reasons for implementing a glide path include promoting commercial certainty and allowing operators to make adjustments to their business plans.<sup>155</sup>
- 8.5 The UK regulator adopted a glide path of 5 years since it considered that this would provide a more stable investment environment for both suppliers and operators, in light of the expected deployment of LTE which requires large amounts of upfront capital investment.<sup>156</sup>
- 8.6 As mentioned elsewhere, all MNOs in Australia are in the process of making substantial capital investments in their mobile networks, and have made commitments to deploy LTE in the future. It therefore follows that, should the ACCC decide to make a significant change to the MTAS

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<sup>151</sup> NZ Commerce Commission, Final report on whether the mobile termination access services (incorporating mobile-to-mobile voice termination, fixed-to-mobile voice termination and short-message-service termination should become designated or specified services, 22 February 2010, p.16

<sup>152</sup> NZ Commerce Commission, Final report on whether the mobile termination access services (incorporating mobile-to-mobile voice termination, fixed-to-mobile voice termination and short-message-service termination should become designated or specified services, 22 February 2010, pp. 15-16

<sup>153</sup> Analysys Mason, Draft standard terms termination analysis report for NZ Commerce Commission, 4 February 2011

<sup>154</sup> NERA, Review of Draft STD for MTAS Telecom New Zealand, 7 February 2011

<sup>155</sup> Analysys Mason, Draft standard terms determination analysis report for NZ Commerce Commission, 4 February 2011, pp.34-39

<sup>156</sup> Analysys Mason, Draft standard terms determination analysis report for NZ Commerce Commission, 4 February 2011, pp. 34-39

price, a lengthy phase-in period would be necessary in order to promote commercial certainty and support future investments, which would be in the long term interests of end users.

## Section 9. Additional Mobile Termination Services Should Not be Regulated

- 9.1 Currently, the mobile terminating access service (MTAS) is defined such that it relates to the domestic termination of voice calls on a mobile network. This means that the termination of non-voice services do not fall within the MTAS description and so are not subject to regulation. The ACCC listed short message service (SMS), voicemail, call diversion or data services as currently not included in the MTAS. Therefore, wholesale termination rates for these other services in Australia are currently negotiated on a commercial basis.
- 9.2 The ACCC has asked stakeholders:
- (a) Is the current MTAS service description appropriate and relevant to the continued promotion of the long-term interests of end-users?
  - (b) Would there be significant consumer benefits gained from including other mobile termination services in the MTAS service description?
- 9.3 Optus submits that the current description of MTAS remains appropriate and the costs of expanding regulation would outweigh any benefits. Below Optus will provide arguments in support of this view.

### Current MTAS service description remains appropriate

- 9.4 The ACCC has previously considered expanding the MTAS description to include SMS, MMS and other data services in its review of the MTAS declaration in 2009. It concluded that:
- ...it is not necessary, at this stage, to include SMS, MMS and other data services in the MTAS service description as they are still **exhibiting significant growth**, are subject to **ongoing commercial agreements** and there has been **no demonstrable market failure**.<sup>157</sup> [emphasis added]*
- 9.5 Optus submits that the ACCC's conclusions at that time remain appropriate. As discussed in Section 2 data services remain in a period of significant growth and consumers have benefited from ongoing price reductions in 3G mobile services. The ACCC measured an average 4.2 per cent decline in 2008-09 from the previous year.<sup>158</sup> The overall mobile services index fell by an average 7.8 per cent in 2008-09 from the previous year.<sup>159</sup>
- 9.6 A number of commercial agreements are in effect for the termination of non-voice mobile services and to date, there have not been any access disputes lodged for any of these services. It therefore remains the case that there are no demonstrable market failures.
- 9.7 Optus notes that there is limited precedent for the regulation of non-voice mobile termination in other jurisdictions, and where it has been introduced market conditions were significantly different to those currently prevailing in Australia.

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<sup>157</sup> ACCC, Mobile Terminating Access Service: An ACCC final report on reviewing the declaration of the mobile terminating access service, May 2009, p.11

<sup>158</sup> ACCC, Changes in the prices paid for telecommunications services in Australia, 2008 – 09, 1 June 2010, p.129

<sup>159</sup> ACCC, Changes in the prices paid for telecommunications services in Australia, 2008 – 09, 1 June 2010, p.125

- 9.8 For example, in 2007 New Zealand the Commerce Commission observed significant differences in on-net and off-net pricing, as well as some evidence that retail prices were significantly above cost, for both voice and SMS. This prompted a review of the then, unregulated termination service.<sup>160</sup> Furthermore, a new entrant in the mobile market had voiced significant concerns over termination pricing presenting major barriers to entry in the New Zealand mobile market.<sup>161</sup>
- 9.9 In France, specific industry concern over the charging for SMS termination promoted the regulator, ARCEP, to launch a review in July 2004.<sup>162</sup> In October 2005 ARCEP determined to regulate the wholesale price of SMS termination.<sup>163</sup> France was the first country in Europe to consider and subsequently regulate SMS termination.
- 9.10 Following France's lead, in 2006 the UK telecommunications regulator, Ofcom, published its intention to review the market in which SMS termination is provided.<sup>164</sup> However, no further information has been provided regarding the commencement of the review. It therefore remains the case that there is limited precedent in Europe, and elsewhere, to regulate non-voice mobile termination services. This was recognised by the New Zealand Commerce Commission, as it utilised a benchmarking approach for both (voice and SMS) services, however notes the limited availability of benchmarks for the SMS rate:

*There are few countries in which SMS termination has been regulated, and for which forward-looking cost estimates are available. As a result, the Commission's benchmark set includes only three jurisdictions that have modelled the forward-looking costs of providing MTAS for SMS: Denmark, Malaysia, and Israel.*<sup>165</sup>

- 9.11 In the ACCC's 2009 MTAS declaration review, the majority of parties did not support an expansion of the service description.<sup>166</sup> Furthermore, the ACCC had observed significant declines in revenue per SMS and MMS message sent.<sup>167</sup> There is therefore no *a priori* reason to impose additional costs on industry without any foreseen benefits to end-users.

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<sup>160</sup> Commerce Commission, Telecommunications Act 2001: Schedule 3 investigation into regulation of mobile termination access service, Issues Paper, 8 August 2008, p.3

<sup>161</sup> Commerce Commission, Telecommunications Act 2001: Schedule 3 investigation into regulation of mobile termination access service, Issues Paper, 8 August 2008, p.5

<sup>162</sup> ARCEP, "Relevant Market Analysis: ART launches an analysis of wholesale SMS termination services on mobile networks", Press Release, 29 July 2004

<sup>163</sup> ARCEP, "Relevant Market Analysis: ARCEP proposes regulating the wholesale price of SMS termination in order to revitalise the play of competition for SMS on the retail market and allow the diffusion of SMS beyond the mobile world", Press Release, 24 October 2005

<sup>164</sup> Ofcom website, Wholesale SMS termination market review, published 13 September 2006, <http://stakeholders.ofcom.org.uk/telecoms/policy/mobile-policy/sms-termination-market-review/>

<sup>165</sup> Commerce Commission, Standard Terms Determination for the designated services of the mobile termination access services (MTAS), fixed-to-mobile voice (FTM), mobile-to-mobile voice (MTM) and short messaging service (SMS)), Decision 724, 5 May 2011, p.97

<sup>166</sup> ACCC, Mobile Terminating Access Service: An ACCC final report on reviewing the declaration of the mobile terminating access service, May 2009, pp.6-9

<sup>167</sup> ACCC, Mobile Terminating Access Service: An ACCC final report on reviewing the declaration of the mobile terminating access service, May 2009, p.10



*Costs of additional regulation would outweigh any benefits to end-users*

- 9.12 Any expansion in the scope of regulation would impose material costs on both the regulator and regulated parties to participate in consultations to implement and subsequently revise any regulatory regime. These costs could include consultancy and expert fees, as well as the diversion of managerial and staff attention from other matters.
- 9.13 It is also the case that the regulation of the wholesale service is unlikely to deliver any benefits to end-users. This is because these services are provided on an MTM basis. Given that the mobile market is highly competitive (as discussed in section 7), the issue of MNOs and integrated operators discriminating against fixed-line only operators and impairing their ability to compete effectively does not arise.
- 9.14 This means that the current prices offered to end-users of these services are likely to reflect the cost of providing it on a bundled basis. Accordingly, it is unlikely that any regulated change in wholesale prices will materially affect retail prices to end-users after considering the significant costs of participating and complying with any new regulation.

## Section 10. Non-price Terms

### The inclusion of non-price terms and conditions in the FAD

- 10.1 The ACCC has sought views on the appropriateness of the proposed non-price terms and conditions (NPTCs). The NPTCs that are likely to be considered for inclusion in the MTAS FAD include:
- (a) billing and notification;
  - (b) creditworthiness and security;
  - (c) general dispute resolution procedures;
  - (d) confidentiality provisions;
  - (e) communication with end users;
  - (f) network modernisation and upgrade provisions;
  - (g) suspension and termination; and
  - (h) facilities access.<sup>168</sup>
- 10.2 Optus in general supports the inclusion of NPTCs relating to access to MTAS in the FAD. While parties may already have Access Agreements in place, it will still be useful to include the above NPTCs in the FAD. This will provide greater certainty to the industry and will provide parties with better guidance on what constitutes fair and reasonable conditions of access, especially in the case when an Access Agreement expires or when parties wish to have the Access Agreement varied.
- 10.3 Optus further proposes that the ACCC include in the FAD a NPTC on network conditioning for mobile numbers. The network conditioning process involves a MNO, eg Optus, sending a request to another MNO, eg Telstra, requesting Telstra to:
- (a) accept incoming calls from the Optus network to Telstra's end users with a new mobile number range eg 0400 xxx xxx ; and
  - (b) ensure Telstra's network is conditioned to send calls directed to a new mobile number range eg 0400 xxx xxx to the Optus network.
- 10.4 **CiC**
- 10.5 **CiC**

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<sup>168</sup> ACCC, MTAS Public inquiry to make an Access Determination, Discussion Paper, June 2011, p.22

- 10.6     **CiC**
- 10.7     **CiC**
- 10.8     **CiC** Optus submits that a maximum time allowed for network conditioning should be specified.
- 10.9     The ACCC has further sought parties' views as to whether it should include terms and conditions relating to liability and risk allocation in the FAD. Optus submits that the ACCC should not include the liability and risk allocation terms in the FAD as this would increase regulatory uncertainty and disrupt current industry processes.
- 10.10    As Optus has previously submitted, the liability provisions outlined in the 2008 Model terms and conditions determination are unnecessarily complicated and appear to be a legacy of access agreements from the early 1990s. They do not reflect modern standards of drafting, which are more concise and straightforward.

#### **Optus' comments in response to the drafting of the non-price terms and conditions**

- 10.11    While Optus in general supports the drafting of the proposed non-price terms and conditions, it considers that more work is required on some of these provisions to better reflect the ACCC's in principle position. This in particular applies to the facilities access provision and the network modernisation provision. Optus' comments in response to each of the NPTCs will be discussed below.

#### ***The Facilities Access provisions and the Network Modernisation and Upgrade provisions***

- 10.12    Optus supports the ACCC's proposal to include the facilities access provisions and the network modernisation and upgrade provisions in the FAD. However the current drafting of these two provisions appears to relate more to fixed line services rather than mobile services. Optus therefore proposes the ACCC amend this provision.
- 10.13    Optus currently has an arrangement with Telstra to access Telstra's telecommunications transmission towers and sites. Under the Telco Act Schedule 1 Part 5 it states:

*A carrier (the first carrier) must, if requested to do so by another carrier (the second carrier), give the second carrier access to a telecommunications transmission tower owned or operated by the first carrier.*

10.14 Telstra's sites could either be its own site or a leased site. This includes Telstra's exchange buildings. **CiC**

10.15 **CiC**

10.16 **CiC**

10.17 **CiC**

10.18 **CiC**

10.19 **CiC**

10.20 **CiC**

### **Billing and Notification**

- 10.21 Optus supports the inclusion of billing and notification provisions in the draft FAD. It outlines the billing and notification framework, including the manner in which access provider is paid for services it supplies, and sets out procedures dealing with billing disputes.<sup>169</sup>
- 10.22 The ACCC should however amend some of these clauses so that it reflects the ACCC's in principal position in ensuring access provider will provide accurate bills to access seekers so that end-users are billed accurately and in a timely manner.<sup>170</sup> Optus' specific comments in response to the billing provisions are outlined below:

(a) Backbilling: Clause 8.5 (b)

Optus submits that access provider should only be allowed to backbill within a period of 95 days instead of six months outlined in the draft FAD. This brings the provision in line with what is currently adopted in the Telecommunications Consumer Protections (TCP) Code.<sup>171</sup> The TCP Code says:

*A Supplier must ...not delay the Billing Charges to another Supplier in the Billing chain by more than 95 days from the date the Charge was incurred by the Customer.*<sup>172</sup>

(b) Backbilling in relation to "New service": clause 8.5(b)(ii)

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<sup>169</sup> ACCC, Public inquiry to make final access determinations for the declared fixed line services, Discussion paper, April 2011, p.190

<sup>170</sup> ACCC, Final Determination –Model Non-price Terms and Conditions, November 2008, p.14

<sup>171</sup> Communications Alliance, Industry Code Telecommunications Consumer Protections Code C628:2007

<sup>172</sup> Communications Alliance, Industry Code Telecommunications Consumer Protections Code C628:2007, clause 6.5.4(c)

Optus submits that the ACCC should define the term “New Service”. It is not clear what new service refers to, eg whether it is a new account or individual service. If it is an individual service, then the six month clause is largely redundant. Missed billing is usually only with new individual services.

Further, the backbilling period for “New service” should be restricted to 190 days instead of 8 months. Again, this brings the provision in line with the TCP Code. The TCP Code says:

*A Supplier must...not Bill for Charges older than 190 days from the date the Charge was incurred by the Customer.*<sup>173</sup>

- (c) Timeframe to provide material relied upon: clause 8.17

There is no period within which the other party has to provide the relevant materials upon which it is to rely. Optus suggests that this information should be provided within 25 days of the Billing Dispute Notice. The proposed redraft is as follows:

*Clause 8.17: “Each party shall, as early as practicable after a Billing Dispute Notice, but in all cases within 25 Business Days of receipt of the Billing Dispute Notice (or longer period if agreed by the parties), provide...”*

### **Creditworthiness and security**

- 10.23 Optus accepts the ACCC’s proposal to include creditworthiness and security terms in the draft FAD. Optus however proposes the ACCC to make a minor amendment to clause 9.1 in ensuring security should only be requested when it is reasonably necessary to protect the legitimate business interests of the Access Provider. The proposed amendment is outlined below:

*Unless otherwise agreed by the Access Provider, subject to clause 9.3, the Access seeker must (at the Access Seeker’s sole cost and expense) provide to the Access Provider and maintain, on terms and conditions reasonably required by the Access Provider and subject to clause 9.2, the Security (as shall be determined having regard to clause 9.3 and as may be varied pursuant to clause 9.4) in respect of amounts owing by the Access Seeker to the Access Provider under this FAD.*

### **General dispute resolution procedures**

- 10.24 Optus supports the ACCC’s proposal to include general dispute resolution procedures in the draft FAD. Optus agrees with the ACCC that general dispute resolution procedures facilitate the resolution of disputes in an expeditious manner without the need to resort to legal proceedings or commercial arbitration.<sup>174</sup>
- 10.25 Optus further agrees with the ACCC’s proposed drafting.

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<sup>173</sup> Communications Alliance, Industry Code Telecommunications Consumer Protections Code C628:2007, clause 6.5.4(d)

<sup>174</sup> ACCC, Public inquiry to make final access determinations for the declared fixed line services, Discussion paper, April 2011, p.191

### ***Confidentiality provisions***

- 10.26 Optus supports the ACCC's proposal to include confidentiality provisions in the FAD. The provisions ensure confidential information will only be used or disclosed where there is a legitimate purpose.
- 10.27 Optus further supports the ACCC to include the standard confidentiality undertaking form in the FAD.
- 10.28 The drafting of the confidentiality provisions are appropriate. Optus however questions the inclusion of clause 11.11 since it does not appear to be a standard contract term –it provides access seekers the right to invoke an audit process if it has prima facie evidence to suggest that an access provider has used the confidential information for non-legitimate reason.

### ***Communication with end-users***

- 10.29 Optus supports the ACCC's proposal to include terms and conditions for communications with end users. This is particularly so when access seekers often have to rely on the Access Provider's technicians to perform services which means that access seekers are placed in a vulnerable position should the access provider try to 'win back' customers.
- 10.30 However Optus questions the practicality of clause 12.4, as it would be onerous to make and maintain each record of communication the party has with the other party's end user.

### ***Suspension and termination***

- 10.31 Optus generally accepts the ACCC's position to include suspension and termination provisions in the FAD. Optus however is concerned that:
- (a) the proposed termination provisions do not address circumstances in which an access seeker would be entitled to terminate part, or all of, the services or agreement as a result of contractual breaches of the access provider;
  - (b) the proposed termination provisions give the access provider the right to terminate the service in the event that there is a billing dispute on hand;
  - (c) in some circumstance, remedial actions requested by access provider might take longer than 20 business days.
- 10.32 To address these problems, Optus proposes the ACCC to amend clause 14.2 so that:
- (a) it is mutual (and make all other consequential amendments), or insert new clauses that deal with suspension and termination by access seeker;
  - (b) it ensures the service does not terminate in the event that there is a billing dispute on hand;
  - (c) it allows the 20 business days to be extended in circumstance where reasonably required as a result of the remedial action requested by the access provider. This prevents the situation where the access provider requests remedial action that cannot be undertaken within 20 business days and therefore is able to engineer a right to terminate part or all of the services. The proposed amendment to the wording of clause 14.2(3) is as follows:

...within 20 Business Days (or other period as is reasonable as a result of the remedial action requested in the Suspension Notice)...

**Changes to operating manuals**

- 10.33 The ACCC has proposed not to include the provision on changes to operating manual in the FAD.
- 10.34 Optus accepts the ACCC's proposal as this provision is related more to other fixed line services than to MTAS.

**Ordering and provisioning**

- 10.35 The ACCC has proposed not to include the provision on ordering and provisioning in the FAD.
- 10.36 Optus accepts the ACCC's proposal as this provision is related more to other fixed line services than to MTAS.



## Appendices

### Appendix A: Competitive Mobile Market

- 10.37 The mobile market has been highly competitive in the period 2007 – 2011, during which the MTAS rate remained at 9cpm. This is evident through the vast array of choice available to consumers, significant declines in mobile prices; and the large number of mobile service suppliers in the market.
- 10.38 The past few years have seen the introduction of high quality new offers from all players in the marketplace. Increasingly, plans are becoming more competitive with operators offering more value – through increased caps, data allowances, and improved coverage – in an effort to differentiate themselves from competitors. For example, recent months have seen the introduction of competitive “all-you-can-eat” offerings by operators including:
- (a) In October 2010, Optus introduced an innovative range of pre-paid plans offering customers access to unprecedented value from as little as \$1 a day,<sup>175</sup> complementing its range of Timeless offerings for post-paid customers; and
  - (b) In November 2010, VHA introduced its range of Infinite plans offering customers unlimited calls and texts to all Australian mobiles and landlines.<sup>176</sup>
- 10.39 A brief description of these sample “all-you-can-eat” plans is illustrated in the table below.

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<sup>175</sup>Optus, “Optus unlocks unprecedented value on Pre-Paid with Optus Dollar Days,” Media Release, 15 October 2010

<sup>176</sup>VHA, “Vodafone answers customer call for ‘infinite’ freedom to talk, text and tweet,” Media Release, 16 November 2010

Provider	Inclusions
Optus: Dollar Days Offer	For \$1 get: unlimited national calls, SMS, MMS to Optus GSM mobiles; unlimited national calls to fixed lines; and free voicemail retrievals. Add another dollar (\$2) and get: unlimited national calls, SMS and MMS to Australian GSM mobiles. Add another dollar (\$3) and get: unlimited mobile internet browsing within Australia. <sup>177</sup>
Optus: Timeless Plans	All Timeless plans: unlimited national calls, SMS, MMS to Optus GSM mobiles (excl. Pivotel); unlimited access within Australia to select social websites. Choice of \$99, \$115 and \$129 Timeless plan dependent on included data usage and included value on international calls, voicemail retrieval and calls to 13/1300 numbers. <sup>178</sup>
VHA: Infinite Plans	All Infinite plans: unlimited standard national voice and video calls within Australia, unlimited text to any personal mobiles in Australia and to overseas from within Australia, calls to Customer Care and unlimited access within Australia to selected social websites. Choice of \$45, \$65, \$85 and \$100 Infinite plan dependent on included data usage and included value on voicemail, 13/1800 numbers, re-routed calls and calls to national and international directories. <sup>179</sup>

10.40 Retail prices of mobile also have fallen over the period 2007 – 2011. In 2007-08, the ACCC measured a 5.4% overall reduction in mobile services prices over the previous year.<sup>180</sup> In 2008-09, the reduction was even greater at 7.8%.<sup>181</sup>

10.41 In addition, a year on year price reduction of 18.5% was observed for wireless internet service in 2008-09.<sup>182</sup> This substantial and rapid decline in prices is a strong indication of the high level of competition in the mobile market. In a competitive market, all service providers are obliged to offer lower prices or superior quality services, relative to their competitors, in order to win customers.

10.42 Besides the three MNOs Optus, Telstra and VHA, there are dozens of resellers and MVNOs operating in the Australian mobile market. These participants offer hundreds of pricing plan choices on dozens of devices for mobile voice, data and broadband services. Some of the MVNOs and mobile resellers include Woolworths, Amaysim, Go Talk, Soul, TPG, AAPT, Transact, Macquarie Telecom, TPG, DoDo, Lyca mobile and Primus.

<sup>177</sup> Optus, "Optus unlocks unprecedented value on Pre-Paid with Optus Dollar Days," Media Release, 15 October 2010

<sup>178</sup> See:

[http://personal.optus.com.au/web/ocaportal.portal?\\_nfpb=true&\\_pageLabel=Template\\_woRHS&FP=/personal/mobile/plansandratesmobile&site=personal](http://personal.optus.com.au/web/ocaportal.portal?_nfpb=true&_pageLabel=Template_woRHS&FP=/personal/mobile/plansandratesmobile&site=personal), accessed 8 March 2011.

<sup>179</sup> See: <http://shop.vodafone.com.au/all-plans?id=900013&cid=sem:g:infin:ingen:d>, accessed 8 March 2011.

<sup>180</sup> ACCC, Telecommunications Report 2007-08, June 2009, p.135

<sup>181</sup> ACCC, Telecommunications Report 2008-09, November 2010, p.28

<sup>182</sup> ACCC, Telecommunications Report 2008-09, November 2010, p.45

10.43 The wide variety and high quality of product and price offerings is reflected in the ACMA’s estimate that in 2008-09 competition in the telecommunications sector delivered a consumer surplus of approximately \$957 million. The ACMA’s estimate reflects the fact that telecommunications services have seen significant price declines and associated increases in usage. Mobile has played a disproportionate role in improving competition in the sector; as the ACMA notes, the estimate “emphasises the continuing growth of the mobile telephone and internet sectors of the telecommunications market.”

10.44 The ACCC also acknowledges the mobile market is competitive. It considers that the competitive state of the market has not been compromised by recent consolidation. In fact, the reverse is the case. The ACCC stated, in its 2009 assessment of the proposed merger between Vodafone and Hutchison 3G (now VHA), that:

*Given the high level of penetration of mobile telephony services, in order to gain market share, MNOs, MVNOs and resellers must compete to attract subscribers from competitors. This has led to strong retail price-based competition.<sup>183</sup>*

10.45 The ACCC considered that the proposed merger was unlikely to result in a substantial lessening of competition in the relevant markets. In fact, the ACCC stated that consolidation was likely to have a pro-competitive effect given the greater capacity of the new merged entity to make the substantial investments required to effectively compete with Optus and Telstra.

10.46 Looking back on the results of the merger, the ACCC found that in fact competition had improved – not deteriorated – after the merger, stating in its 2008-09 telecommunications report that:

*Mobile services remained more competitive during 2008-09, notwithstanding that the mobile services market ended the year more concentrated following the merger of Vodafone and Hutchison, the third- and fourth-largest network operators.<sup>184</sup>*

10.47 Examples of Optus’ innovative mobile product offerings during 2007 – 2011 are outlined in the boxes below.

**Sample of Optus’ innovative mobile product offerings**

**21 October 2010** – Optus was the first Australian carrier to market with the BlackBerry®Torch™ 9800.<sup>185</sup>

<sup>183</sup> ACCC, Public Competition Assessment Vodafone Group plc and Hutchison 3G Australia Pty Limited –proposed merger of Australian mobile operations, 24 June 2009, p.7

<sup>184</sup> ACCC, Telecommunications Report 2008-09, November 2010, p.4

<sup>185</sup> Optus, “Optus unleashes the power of the Blackberry® Torch™ 9800”, Media Release, 21 October 2011.

**6 October 2010** – announced that as a partner of the Australian Open 2011 customers can download an application with updates and for the first time, live streaming directly to their mobiles.<sup>186</sup>

**1 June 2010** - announced will be one of the first mobile operators in the world and the first in Australia to deliver the navigation savvy Garmin-Asus A10 smartphone to its customers from 7 June 2010.<sup>187</sup>

**24 May 2010** - launched Australia's first mobile operator application developer portal, Optus Partner Connect. Designed to give developers the opportunity to showcase and sell their applications direct to the Optus mobile customer base.<sup>188</sup>

**30 March 2010** - announced it will be the first Australian mobile operator to offer Motorola's unique mobile experience MOTOBLUR with the launch of two new handsets.<sup>189</sup>

**18 February 2010** - launched industry first built for business App Store.<sup>190</sup>

**3 May 2007** - partners with Fairfax Digital to provide business and finance content on the mobile in an Australian first, effective May 8.<sup>191</sup>

#### Sample of Optus' innovative mobile price and plan offerings

**15 October 2010** – Optus launches Dollar Days, an innovative range of prepaid offers ranging from \$1, \$2 or \$3 per day.<sup>192</sup>

**22 June 2010** – Optus updates its Turbo Text \$30 recharge offers (introduced on 10 February 2010) to include unlimited SMS to and up to 100 mobile minutes to 10 nominated numbers on any Australian mobile network plus 50MB of data, while the \$40, \$50, \$70 and \$100 recharges offer up to 3000 SMS and up to 100 mobile minutes to any Australian mobile plus 100MB of data.<sup>193</sup>

**10 March 2010** – Optus launches two new Prepaid Turbo Max plans. The \$70 plan offers 3000 minutes worth of voice calls per recharge, while the \$100 plan also offers an additional 3000 SMS and up to 2GB of data.<sup>194</sup>

**21 September 2009** – Optus launches Optus Family Value Packs, allowing customers to tailor a bundled package of Optus products, and free unlimited standard voice calls within Australia to each other when combined under the same account.<sup>195</sup>

<sup>186</sup> Optus, "Optus serves up a seventh year with Tennis Australia as official Telecommunications Partner for the 2011 Australian Open", Media Release, 6 October 2011.

<sup>187</sup> Optus, "At the next Australian first, turn right", Media Release, 1 June 2010.

<sup>188</sup> Optus, "Optus launches Australia's first mobile operator application developer portal", Media Release, 24 May 2011.

<sup>189</sup> Optus, "Australians can now live their social life without limits with Optus and MOTOBLUR", Media Release, 30 March 2010.

<sup>190</sup> Optus, "Optus launches industry first built for business App Store", Media Release, 18 February 2010.

<sup>191</sup> Optus, "Optus partners with Fairfax Digital to provide business and finance content on the mobile", Media Release, 3 May 2007.

<sup>192</sup> Optus, "Optus unlocks unprecedented value on Pre-Paid with Optus Dollar Days", Media Release, 15 October 2010.

<sup>193</sup> Optus, "Optus beefs up Pre-Paid Mobile Value with Turbo Text", Media Release, 22 June 2010.

<sup>194</sup> Optus, "Optus takes it to the 'Max' with new Pre-Paid mobile plan", Media Release, 10 March 2010.

<sup>195</sup> Optus, "Optus launches Family Value Packs", Media Release, 21 September 2009.

**5 May 2009** – Optus launches the ‘yes’ \$59 Mobile Cap plan, offering up to \$680 worth of total included value per month plus unlimited standard national SMS and MMS.<sup>196</sup>

**24 April 2009** – Optus updates its Total Business Cap (introduced on 26 August 2008) by extending the offer to include fixed voice, internet, wireless broadband and mobile services on a single bill.<sup>197</sup>

**30 October 2008** – Optus launches IOU Credit, a prepaid mobile feature that enables Optus Prepaid Mobile customers who run out of credit, when they need to make an urgent phone call or text, the chance to borrow up to \$3 by simply texting IOU to 468.<sup>198</sup>

**18 August 2008** – Optus launches Prepaid Wireless Broadband, an industry first product offering consumers the ability to access wireless broadband with the certainty and flexibility of prepaid.<sup>199</sup>

**11 August 2008** – Optus launches the Optus \$79 Wireless ‘yes’ Fusion plan, offering unlimited standard local and national calls, calls to Optus GSM mobiles, and 2GB broadband data.<sup>200</sup>

**21 July 2008** – Optus launches the \$99 and \$129 ‘yes’ Timeless plans, offering customers unlimited calls on local, national and GSM networks in Australia.<sup>201</sup>

**13 May 2008** – Optus launches new and improved Mobile Internet Packs representing greater value for customers with lower prices, more data and bonus calls for text value benefits.<sup>202</sup>

**12 July 2007** – Optus introduces Optus Fusion, Australia’s first combined phone and broadband cap with unlimited local and national calls; calls to Optus mobiles; fast broadband with no excess download charges; and included line rental. The plans start from \$69, \$89 and \$99 per month.<sup>203</sup>

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<sup>196</sup> Optus, “Monster caps set to shake up mobile market”, Media Release, 5 May 2009.

<sup>197</sup> Optus, “Optus offers small business value”, Media Release, 24 April 2009.

<sup>198</sup> Optus, “Optus launches Australian Pre-Paid Mobile First – IOU Credit”, Media Release, 30 October 2008.

<sup>199</sup> Optus, “Optus unveils Pre-Paid Wireless Broadband”, Media Release, 18 August 2008.

<sup>200</sup> Optus, “Optus extends reach of ‘yes’ Fusion”, Media Release, 11 August 2008.

<sup>201</sup> Optus, “Optus ‘stops time’ with unlimited calls and sms mobile plan”, Media Release, 21 July 2008.

<sup>202</sup> Optus, “Optus asks – how do you want your Mobile Internet”, Media Release, 13 May 2008.

<sup>203</sup> Optus, “Optus launches Australia’s first phone and broadband cap”, Media Release, 12 July 2007.

## Appendix B: FTM Pass-through

10.48 Table B1 below compares Telstra's averaged FTM price with the regulated rates of MTAS for the relevant period.

**Table B1 Telstra's Averaged retail FTM price**

	2004	2005	2006	2007	2008	2009	2010
Telstra's Averaged retail FTM price <sup>204</sup>	\$0.378	\$0.39	\$0.37	\$0.361	\$0.366	\$0.378	\$0.37
ACCC Regulated MTAS (Averaged)	\$0.21	\$0.195	\$0.165	\$0.135	\$0.09	\$0.09	\$0.09

10.49 The table above shows that since 2004 Telstra's average FTM price has been relatively stable, despite the significant reduction in the MTAS price. Optus estimates that Telstra has received a windfall of \$1 billion as a result of not passing through the reduction in MTAS.

10.50 Telstra also has not passed-through its savings from MTAS rate reductions onto its other retail fixed services including local, national and international calls. As shown in table B2, the proportion of the MTAS reduction is higher than the proportion of Telstra's price reduction in local calls, trunk calls (FTM + national calls), and international calls throughout the period 2004 to 2009. Indeed, in 2008/09, there was a price increase in local calls, trunk calls and line rental. This was noted by the ACCC:

*"Price changes for basic access services increased significantly in real terms from 2000-01 to 2004-05 before dipping in subsequent years. Most recent data, for 2008-09, suggests that the average real price for basic access has levelled off or tended to increase slightly.*

*That said, prices for retail FTM services (as well as the price for the overall basket of PSTN services) continue to be well above cost. In respect of FTM services, it appears that input costs (in particular mobile termination input costs, and the price of wholesale mobile termination services acquired for off-net calls) have decreased more than the retail prices."<sup>205</sup>*

<sup>204</sup> ACCC imputation testing reports, [various]

<sup>205</sup> ACCC, Review of Telstra price control arrangements, 2010, p.20

**Table B2**

Telstra FTM Pass Through					
	1 July 2008 to 30 June 2009	1 July 2007 to 30 June 2008	1 January 2006 to 30 June 2007	1 July 2005 - 30 December 2006	1 July 04 - 30 June 2005
Basket 1	Price Movement (%)	Price Movement (%)	Price Movement (%)	Price Movement (%)	Price Movement (%)
Local calls	2.60%	-0.20%	-6.50%	-6.30%	-5.20%
Trunk calls (FTM + National calls)	1.60%	-1.10%	-6.20%	-3.70%	-2.70%
International calls	-1.40%	-3.10%	-8.30%	-4.30%	-0.90%
Line Rentals	1.30%	-0.90%	-1.50%	0.30%	
MTAS regulated rate	9cpm	9cpm	15cpm & 12cpm	18cpm & 15cpm	21cpm & 18cpm
MTAS reduction %	0%	25%	20%	17%	14%

10.51 On the other hand, it was reported in the ACCC price changes report that the industry’s average prices of national long-distance and FTM calls continued to decrease significantly. As shown in Table 4.1, in the years 2005-06, 2006-07, 2007-08, 2008-09, the price changes were -10.5, -7.6 - 6.4 and -6.8 for FTM respectively. Similarly for national long-distance, the price changes were -6.9, -10.9, -10.9 and -6.7 respectively.

**Table 4.1 Year-on-year percentage changes in the PSTN services index by service type, 2000-01 to 2008-09**

	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
Basic access	15.2	13.2	12.4	6.9	5.1	-2.4	-1.4	-1.6	1.1
Local calls	-17.9	-11.7	-3.8	-3.3	-7.9	-9.5	-6.7	-10.1	-2.5
National long-distance	-6.3	-8.7	-4.7	-1.9	-3.0	-6.9	-10.9	-10.9	-6.7
International	-17.2	-15.3	-5.8	-6.1	-4.1	-8.8	-4.8	-7.7	-3.9
Fixed-to-mobile	-6.2	-3.2	-2.4	-2.2	-3.9	-10.5	-7.6	-6.4	-6.8
PSTN services index	-5.8	-2.6	1.0	0.3	-1.3	-6.6	-5.4	-5.5	-2.6

Source: Data from Telstra, AAPT, Primus and Optus (except 2001-02 data, which was excluded from the index).  
 Note: Figures for 2006-07 have been revised based on updated data from reporting carriers.

10.52 This compares to Telstra’s price changes of -3.7, -6.2, -1.1 and 1.6% for trunk calls in the same period. The difference between Telstra’s price changes for trunk calls and the industry’s figure is particularly large in the year 2008-09 since it was reported that Telstra has raised its prices for national long distance and FTM calls while the industry figure shows that there has been a significant decline in the price of national-long distance and FTM calls.

10.53 Telstra currently holds the majority market share in the fixed line market. In 2010, Telstra had 72% market shares compared to 12% from Optus and 3% from AAPT. The fact that the industry figure still manages to show a decline while Telstra has raised its price must mean that other

fixed operators have been passing through its savings from MTAS onto its national long distance and FTM calls.

10.54 This is further reflected in Optus' averaged retail FTM price. **CiC**



## Appendix C: Optus' Experience with Network Arbitrage

10.55 CiC



## **Attachments**

**Attachment 1: Covec Report: Mobile Termination Welfare Analysis, March 2011**

**Attachment 2: CEG Report: Domestic mobile terminating access service (MTAS), July 2011**