



TELSTRA CORPORATION LIMITED

Submission in response to the ACCC's  
Draft Decision on Optus' 2007 Undertaking in  
relation to the Domestic Mobile Terminating  
Access Service

August 2007

# 1 Introduction

On 21 June 2007, the Australian Competition and Consumer Commission (the “Commission”) released a draft decision to reject the ordinary access undertaking (“Optus Undertaking”) lodged by Optus Mobile Pty Limited and Optus Networks Pty Limited (collectively “Optus”) in respect of Optus’ domestic GSM terminating access service (“DGTAS”) for the period 1 July 2007 to 31 December 2007 inclusive (“Draft Decision”). The DGTAS is described by Optus as a subset of the declared Domestic Mobile Terminating Access Service (“MTAS”). The Optus Undertaking proposes a price of 12 cpm for the supply of the DGTAS in the period 1 July 2007 to 31 December 2007 (inclusive) (“relevant period”).

On 5 April 2007, Telstra provided a submission (“First Telstra Submission”) in response to the Commission’s discussion paper on the Optus Undertaking (“Discussion Paper”). Telstra maintains the views set out in the First Telstra Submission and provides this submission in response to the Draft Decision and to address certain matters raised in a further submission provided by Optus on 14 May 2007 (“Additional Optus Submission”).

## 2 Summary of Submissions

Telstra agrees with the Commission’s overall conclusion that the Optus Undertaking should be rejected on the grounds that the terms and conditions of the Optus Undertaking are not reasonable.

In particular, Telstra maintains that the Commission cannot be satisfied that the price of 12 cpm as specified in the Optus Undertaking reflects the efficient cost of supplying the MTAS (and/or the DGTAS) for the relevant period.

Therefore, as explained in the First Telstra Submission, the Optus Undertaking is not consistent with the “reasonableness” criteria set out in section 152AH of the *Trade Practices Act 1974 (Cth)* (the “Act”), including specifically:

- the long-term interests of end-users (“LTIE”);
- the interests of persons who have a right to use the service;
- the direct costs of providing the service; and
- the economically efficient operation of a carriage service, a telecommunications network or a facility.

In respect of the three limbs of the LTIE test, Telstra broadly agrees with the Commission's conclusion that the Optus Undertaking:

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

### 3 Reasonableness of the Optus Undertaking

#### 3.1 Price terms and conditions

Telstra agrees with the conclusion in the Draft Decision that the price terms and conditions of the Optus Undertaking are not reasonable.

To satisfy the Commission that a price of 12 cpm for the supply of the DGTAS is a reasonable price for the period in which the Optus Undertaking is intended to operate, Optus must demonstrate that 12 cpm reflects its efficient costs of supplying that service. Optus has failed to do so.

In adopting a price of 12 cpm for the Optus Undertaking, Optus has not undertaken any cost modelling or even relied upon a broad pricing framework. Rather, Optus has sought to justify its price solely on the basis that it is consistent with:

- the MTAS Pricing Principles which were determined back in 2004 and expired on 30 June 2007, before the proposed commencement date of the Optus Undertaking ("**Expired Pricing Principles**"); and
- MTAS rates in a number of European jurisdictions.

In respect of the international benchmarks which Optus proffered in support of 12 cpm, Telstra agrees with the Commission that *"it is difficult to comprehensively assess the robustness of Optus' international benchmarking analysis without detailed referencing of the sources of these data."*<sup>1</sup>

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<sup>1</sup> Draft Decision, p. 52.

On the other hand, there are various other sources which demonstrate that Telstra's assertion that 12 cpm is likely to significantly overstate Optus' costs of supplying the MTAS (and/or DGTAS). These include:

- the Expired Pricing Principles, which listed 12 cpm as a conservative "upper-bound" estimate of supplying the MTAS and suggested that MTAS prices could be as low as 5 cpm even as far back as 2004;
- comparable international benchmarks endorsed by the Commission which demonstrate that 12 cpm cannot be regarded as reflective of the efficient costs of supplying the MTAS (and/or the DGTAS) in Australia;
- the cost model prepared by CRA which Optus used to support its rejected MTAS undertaking lodged in December 2004, which according to the Commission, revealed a price for supply of the MTAS significantly below 12 cpm; and
- the outputs of the WIK Mobile and Network Cost Model ("**WIK Model**") which indicate that the efficient costs of supply of the MTAS are likely to be below 12 cpm.

Telstra again notes Optus' own admission that it is "uncertain as to whether 12 cent [sic] per minute is above, at or below cost".<sup>2</sup> If Optus can't be sure whether 12 cpm is above cost, it is difficult to see how the Commission can be satisfied that that price reflects the efficient costs of supplying the MTAS (and/or the DGTAS).

On that basis, Telstra agrees with the Commission that it cannot be satisfied that the price terms and conditions of the Optus Undertaking are reasonable.

### 3.2 Non-price terms and conditions

Telstra agrees with the Commission's conclusion that the non-price terms and conditions of the Optus Undertaking are consistent with the statutory criteria.

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<sup>2</sup> Optus, *Optus Submission to the Australian Competition and Consumer Commission on Domestic GSM Terminating Access Undertaking*, (March 2007) at para 7.3.

### 3.3 Consistency with applicable SAOs

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

### 3.4 Consistency with Ministerial Pricing Determination

Given that no Ministerial Pricing Determination has been made in relation to the MTAS, Telstra agrees with the Commission that this is not a relevant consideration in the present context.

## 4 Relevant test in assessing an undertaking

While Telstra accepts the Commission's overall conclusion to reject the Optus Undertaking, it should be noted that in assessing an undertaking, the statutory criteria require the Commission to form a view, based on the materials before it, as to whether it is satisfied that the undertaking is *reasonable*. The test does not involve an assessment of whether it would be *appropriate* to lower current MTAS rates or adopt an alternative price that is preferable to the Commission. Nor does it involve any consideration as to whether other terms (including as to price) would be more reasonable.

However, the Commission's reasoning in the Draft Decision appears at times to have confused the relevant test. For instance, at page 9 of the Draft Decision, the Commission states:

*"...the information above provides a reasonable basis to conclude **that a price below 12 cpm is appropriate** for the supply of the MTAS for the period 1 July 2007 to 31 December 2007."* (Emphasis added)

Similarly, at page 18 of the Draft Decision:

*"...the Commission considers that an MTAS price more closely aligned to the TSLRIC+ estimate of the supply of the MTAS and **below 12 cpm would be more likely to promote competition** in the market within which FTM services are provided."* (Emphasis added)

Further, at page 25:

*"The Commission considers that over three years notice has been provided to Optus and other access seekers that 12 cpm reflects the conservative upper-bound*

*estimate of the supply of the MTAS and that a rate below this may prevail if more robust and reliable information referable to an Australian context was forthcoming.” (Emphasis added)*

The critical issue in the present context is not whether it is appropriate for the Commission to lower MTAS rates below 12 cpm - clearly, the Commission has no price setting power in relation to the assessment of an undertaking. Rather, it is whether, after an assessment of the materials available before it, the Commission can be satisfied that the terms and conditions of the Optus Undertaking are reasonable. Put another way, the Commission’s approach should be focused on the persuasiveness of the materials provided by Optus in justifying 12 cpm as a reasonable price for supply of the MTAS (and/or the DGTAS), rather than on the materials suggesting that a price below 12 cpm for supply of the MTAS (and/or the DGTAS) would be more appropriate.

As submitted in the First Telstra Submission and repeated above, Optus has simply not provided any robust or verifiable evidence for the Commission to be satisfied that a price of 12 cpm for supply of the MTAS (and/or DGTAS) from 1 July 2007 to 31 December 2007 is reasonable.

## 5 WIK Model

The Commission engaged wik-Consult GmbH (“WIK”) to prepare the WIK Model for the purposes of informing new MTAS Pricing Principles for the period 1 July 2007 to 30 June 2008 (“New Pricing Principles”). The consultation process for the New Pricing Principles is still ongoing, although the Commission has released a draft of the New Pricing Principles for comment by interested parties (“Draft Pricing Principles”).<sup>3</sup> Since the period covered by New Pricing Principles overlaps with the operative period of the Optus Undertaking, the outcomes of the New Pricing Principles will necessarily become relevant to the present inquiry. In this regard, Telstra makes the following submissions.

Both Telstra and the Commission have referred to the outputs of the WIK Model as corroborative evidence indicating that the price terms and conditions of the Optus Undertaking are not reasonable. The original version of the WIK Model which Telstra referred to in the First Telstra Submission generated an estimate for the efficient cost based price for the MTAS in the order of 5-6 cpm. Since then, the Commission has released a revised version of the WIK Model (following the first round of submissions from interested parties). Despite the adjustments to the revised WIK Model, the output prices have remained in the order of 5-6 cpm.

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<sup>3</sup> ACCC, *Draft Pricing Principles Determination 1 July 2007 to 31 December 2008*, (June 2007).

In the Additional Optus Submission, Optus criticised the WIK Model as it believed that *“there is sufficient information to determine that the WIK model cannot be relied upon to produce a reasonable estimate of the costs of mobile termination without substantial modification to its methodology and parameters.”*<sup>4</sup>

Irrespective of the merits of the WIK Model, the relevant question is whether there is anything to support Optus’ claim that 12 cpm represents the efficient costs of supplying the MTAS (and/or DGTAS). Even if the Commission were to ignore the outputs of the WIK Model in assessing the Optus Undertaking, there are several other sources (as set out above and in the First Telstra Submission) which demonstrate that 12 cpm significantly overstates the efficient costs of supplying the MTAS. Optus has failed to provide any credible or corroborated material at all to indicate that 12 cpm reflects the efficient costs of supply. Optus has also not supplied any other evidence to contradict Telstra’s and the Commission’s findings.

Accordingly, while the outputs of the WIK Model may tend to support the conclusion that the Optus Undertaking is not reasonable, Telstra submits that, even without regard to the WIK Model outputs, the Optus Undertaking is still unreasonable based on the other materials available before the Commission.

In the Additional Optus Submission, Optus also attacks Telstra’s apparent *“stratagem of on one hand criticising the WIK model’s methodology and parameters, while on the other hand relying on its results to criticise Optus’ undertaking.”*<sup>5</sup>

Telstra maintains its concerns in relation to the development and implementation of the WIK Model. Telstra does not intend to repeat here what it has said (and will say) in its submissions on the WIK Model in the associated consultation process. Telstra also acknowledges that the WIK Model may still undergo further modifications and transformations before it is finalised.

Notwithstanding these matters, Telstra continues to believe that the outputs of the WIK Model as they now stand appear to be consistent with the view that 12 cpm overstates the efficient costs of supplying the MTAS. In saying this, it needs to be understood that Telstra is not endorsing the WIK Model itself. Telstra expects that even if the ACCC were to modify the WIK Model to address all of Telstra’s concerns with it, the modified model would still produce a cost estimate below 12cpm. This is consistent with, and corroborated by, numerous other sources (including a critical assessment of Optus’ own cost model offered

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<sup>4</sup> Additional Optus Submission, p. 2.

<sup>5</sup> Additional Optus Submission, p. 2.

in support of its previous undertaking). On the balance of all the information available to Telstra, the efficient costs of supplying the MTAS are likely to be significantly below 12 cpm.

## 6 Other issues

### 6.1 Market definition

Telstra's consideration of market definition issues is set out fully in the First Telstra Submission.<sup>6</sup> Telstra maintains the view that market definition is not relevant to the present inquiry and in any event, the majority of Optus' arguments in relation to the "two-sided nature" of the mobile services market and the "waterbed effect" have already been rejected by the Australian Competition Tribunal and do not provide any support for the reasonableness of the Optus Undertaking. On that basis, Telstra makes no further comment on these matters.

### 6.2 Competition in the fixed line market

Telstra acknowledges the comments made by Optus in the Additional Optus Submission in relation to the level of competition in the fixed line market. Telstra has already provided detailed submissions on this issue in the First Telstra Submission which Telstra continues to rely on. Telstra does not intend to provide any further detailed submissions on the level of competition in the fixed line market in this submission but notes four observations.

First, the only additional information referred to by Optus in support of its most recent contentions is dated market share information. Leaving aside the continued relevance of that information, it is well established that market share alone is a poor indicator of the state of competition.<sup>7</sup> In that light, these contentions lack substance.

Secondly, in the Commission's analysis of the benefits that might be available in the relevant downstream market, the Draft Decision appears to overlook the fact that competitive improvements could be realised across a basket of fixed line services. Submissions in relation to this issue were provided in the First Telstra Submission and this position has been accepted by the Commission in its previous decisions.

Thirdly, Telstra notes that the submissions it has provided in support of its application for exemption from the standard access obligations in respect of the Local Carriage Service

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<sup>6</sup> See First Telstra Submission, pp. 8-14.

<sup>7</sup> *Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd* (1989) 83 ALR 577; *Dowling v Dalgety Australia Ltd* (1992) 106 ALR 75.



and Wholesale Line Rental are also relevant to an assessment of this issue.<sup>8</sup> Telstra relies on those submissions for the purposes of the present inquiry.

Fourthly, the Commission's analysis in section 2.7 of its Draft Pricing Principles - while not necessarily endorsed by Telstra in its entirety - is generally consistent with many of Telstra's submissions in relation to matters concerning pass-through and related issues.

### 6.3 Optus' legitimate business interests

Telstra generally agrees with the Commission's assessment of Optus' legitimate business interests and notes that it is generally consistent with the position maintained in the First Telstra Submission and submissions provided by Telstra over a period of time in a number of contexts. In particular, Telstra agrees that the rejection of the Optus Undertaking will not adversely affect Optus' legitimate business interests and that a price of 12 cpm is more than is needed to maintain those interests. Further, that *"there is no evidence of the predicted disruptions to business plans or possible harm as a result of the fall in MTAS prices, but rather the contrary has prevailed..."*<sup>9</sup>

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

### 6.4 Use of the "future with or without test"

In Appendix 1 of the Discussion Paper, the Commission asked parties to *"address the appropriateness of the 'future with or without test' against the relevant statutory criteria"*. In the First Telstra Submission, Telstra made a number of submissions on this issue in accordance with the Commission's request.<sup>10</sup> However, the Draft Decision does not discuss this matter.

For some time now Telstra has maintained that the "future with or without test" has little or no application in the assessment of an ordinary access undertaking. Further, that it may in fact be a misleading tool of analysis if it leads to a comparison of whether some hypothetical terms and conditions are more reasonable than those set out in the undertaking.

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<sup>8</sup> See Telstra, *Submission to the Australian Competition and Consumer Commission - Telstra's Local Carriage Service and Wholesale Line Rental Service Exemption Applications (Public Version)*, (July 2007).

<sup>9</sup> Draft Decision, p. 25.

<sup>10</sup> See First Telstra Submission, pp. 4-5.

Obviously the way in which the Commission intends to assess undertakings is a matter of some importance. Given the Commission's previous inconsistent statements about the use of the future with or without test (both in its public decisions and before the Tribunal), and the fact that submissions were specifically called for on the issue, Telstra maintains that the Commission should clearly state its position in relation to the use of this test in its Final Decision.

Telstra Corporation Limited

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