

**Optus Submission to**  
**Australian Competition and Consumer Commission**  
**on**  
**Domestic GSM Terminating Access Service Ordinary Access**  
**Undertaking**

**March 2007**

*'yes'*  
**OPTUS**



**PUBLIC VERSION**

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## 1. Introduction

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- 1.1 The Domestic GSM Terminating Access Service was deemed to be a declared service in 1997. The service description for that declared service was varied in 2002 to include CDMA as well as GSM terminating access. Following the expiry of that declaration on 30 June 2004, the ACCC declared the service entitled, “Domestic Digital Mobile Terminating Access Service” with effect from 1 July 2004.
- 1.2 The current service description for the Domestic Digital Mobile Terminating Access Service is not expressed to apply to a specific mobile technology (GSM, CDMA or otherwise). It is instead described as an access service for:
- “the carriage of voice calls from a point of interconnection, or potential point of interconnection, to a B-Party directly connected to the access provider’s digital mobile network.”*
- This current declaration will expire on 30 June 2009.
- 1.3 As Optus is a provider of the Domestic Digital Mobile Terminating Access Service, it is an access provider of an active declared service. Accordingly, Optus is required to supply the Domestic Digital Mobile Terminating Access Service to any service provider on request. Optus must also supply the active declared service in accordance with the standard access obligations (SAOs).
- 1.4 There are three options available for Optus to comply with the SAOs in relation to the Domestic Digital Mobile Terminating Access Service: on terms and conditions agreed between Optus and the access seeker; on such terms and conditions as determined by the ACCC in an arbitration; or in accordance with an access undertaking given by Optus.
- 1.5 These three options are not mutually exclusive. Part XIC of the *Trade Practices Act 1974 (the Act)* enables an access seeker to comply with the SAOs using a combination of the options. For example, the terms and conditions of compliance can be partly set out in an access undertaking, partly agreed and partly determined by arbitration. This means that an access undertaking does not need to specify all aspects of the terms and conditions of access to a declared service. Any ‘residual’ SAOs not covered by an undertaking would remain subject to agreement between the access provider and access seeker or, failing agreement, subject to determination by the ACCC.
- 1.6 Optus has lodged an ordinary access undertaking with the ACCC pursuant to section 152BS of the Act (the **undertaking**). The undertaking specifies the price and non-price terms and conditions on which Optus will provide access to the Optus Domestic GSM Terminating Access Service (**Optus DGTA Service**). The undertaking applies to the period 1 July 2007 to 31 December 2007.
- 1.7 This submission is provided in support of the undertaking. The Act specifies the process and criteria to be applied by the ACCC in its assessment of the

undertaking. Optus submits that the undertaking satisfies those criteria and should therefore be accepted by the ACCC.

## 2. Executive Summary

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2.1 Optus has lodged an ordinary access undertaking for the Optus Domestic GSM Termination Access Service (**Optus DGTA Service**).

2.2 Optus contends that the prices and non-price terms and conditions of its undertaking are consistent with the standard access obligations (**SAOs**). Optus also contends that all the terms and conditions of the undertaking are *reasonable*, as defined in the statutory criteria.

2.3 This submission is structured as follows:

- **Section 3** provides an overview of the Optus undertaking;
- **Section 4** sets out the legislative background and criteria by which the ACCC is required to assess the undertaking;
- **Section 5** details the undertaking's compliance with the SAOs;
- **Section 6** discusses how the long-term interests of end-users (**LTIE**) criteria are to be applied the undertaking price and non-price terms and conditions;
- **Section 7** discusses how competition is promoted by the undertaking prices;
- **Section 8**; outlines how the undertaking will encourage efficient use of an investment in infrastructure;
- **Section 9**; discusses how the undertaking will meet the other reasonableness criteria in the ACT, including the legitimate business of Optus;
- **Section 10**; set out the reasonableness of the non-price terms and conditions;
- **Section 11** provides conclusions on the reasonableness on the undertaking non-price terms and conditions; and
- **Section 12** provides a statement regarding the confidentiality of information in this supporting submission.

- 2.4 In support of the above contentions in relation to the reasonableness of the above terms and conditions, Optus relies on the following Appendices:

**Appendix I** ACCC pricing principles for MTAS

**Appendix II** Benchmarking of MTAS prices.

**Appendix III** SingTel MD&A for 2005 and 2006

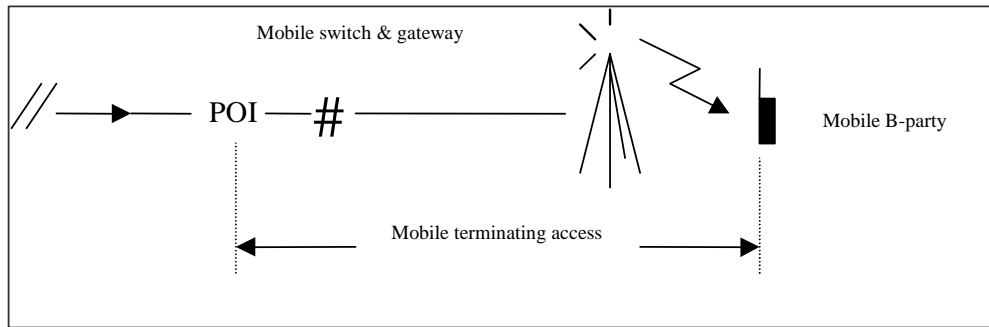
- 2.5 Optus also relies upon the full contents of all documents referred to in the footnotes of this submission that contain hypertext links. These include the models and modelling documentation for the international bottom up costing models referenced and linked. Optus provides these documents to the Commission in this form.

### **3. Overview of the undertaking**

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#### **Service and infrastructure**

- 3.1 Optus Mobile is a carrier that owns and operates a GSM network with coverage of approximately 96% of the Australian population. Optus has installed over 3,500 base stations.
- 3.2 The Optus DGTA Service is an access service for the carriage of voice calls from a point of interconnection (**POI**) to a B-party directly connected to the Optus GSM network.
- 3.3 The access seeker will hand over the carriage of call from its network to the Optus GSM network at the POI nearest to the location of the calling number at the time of the call.
- 3.4 The Optus DGTA Service may be used by access seekers with (access to) fixed networks, in order to provide fixed-to-mobile call retail services for the termination of calls to mobile service numbers located on the Optus GSM network.
- 3.5 The Optus DGTA Service may also be used by access seekers with (access to) mobile networks, in order to provide mobile-to-mobile call retail service for the termination of calls to mobile service numbers located on the Optus GSM network.
- 3.6 The Optus GSM network will be used to supply the Optus DGTA Service. The infrastructure used in supply the Optus DGTA Service is illustrated in the following diagram:



3.7 The Optus DGTA Service comprises two essential elements:

- (a) the carriage of the call from the POI to the Optus network; and
- (b) the termination of the call on the Optus network.

3.8 The Optus GSM network is used to provide a range of services in addition to the Optus DGTA Service. They include origination services and subscription services. Other services may also be provided in the future.

### Price terms and conditions

3.9 The prices for the Optus DGTA Service are set out in [Schedule 2] to the undertaking.

3.10 Optus offers a price of 12 cents per minute.

3.11 Optus submits that the availability of this for the Optus DGTA Service satisfy the legislative criteria set out in Part XIC and should therefore be accepted by the ACCC because they are:

- prices consistent with the ACCC pricing principles;
- prices that are consistent with the efficient cost of providing mobile termination services; and
- prices that recognise the legitimate interests of both the access provider and access seeker.

### Term of undertaking

3.12 Clause 2.1 of the undertaking states that it will take effect from the later of 1 July 2007 or the time it is accepted by the ACCC and will continue until the earlier of:

- 31 December 2007; or
- its termination, withdrawal or replacement (in accordance with the Act).

3.13 The expiry date of the undertaking is therefore consistent with the statutory criteria for the term of an undertaking. Section 152BV(2)(e) requires the

expiry of an undertaking to occur within three years after the date on which the undertaking comes into operation.

### **Non-price terms and conditions**

- 3.14 The non-price terms and conditions for the Optus DGTA Service are set out in Clauses 2 and 3 of the undertaking and Schedules 1 and 3 of the undertaking. These terms and conditions are comprehensive and unambiguous in their scope and operation.
- 3.15 Schedule 1 of the undertaking contains a description of the Optus DGTA Service. This service description is consistent with the declared service description for the Domestic Mobile Terminating Access Service and, whilst technologically neutral in respect of the method of carriage, is limited to the carriage of voice calls from a POI to a B-party directly connected to the Optus GSM network.
- 3.16 Optus submits that the terms and conditions for the Optus DGTA Service satisfy the legislative criteria set out in Part XIC and should therefore be accepted by the ACCC. Clause 3 and Schedule 3 of the undertaking clearly state that the undertaking is based on the principle that Optus will comply with the SAO's.
- 3.17 The non-price terms of the undertaking are therefore compliant with the SAOs and reasonableness criteria in Part XIC. The application of the legislative criteria to the non-price terms and conditions in the undertaking is elaborated in section 5 of this submission.

### **Other terms and conditions not specified**

- 3.18 The undertaking sets out the terms and conditions on which Optus will provide access seekers with the Optus DGTA Service. The scope of the Optus DGTA Service covered by the undertaking does not purport to cover the exact scope of the declared service description. As described above, the Optus DGTA Service is limited to the termination of voice calls on the Optus GSM network.
- 3.19 The undertaking does not purport to exclude Optus' obligations to provide those elements of the declared Domestic Digital Mobile Terminating Access Service that are not specified in the undertaking. To the extent that the undertaking does not cover the terms on which Optus will fulfil a particular SAO in relation to the declared service, the undertaking commits Optus to comply on terms that are either:
- agreed with the access seeker; or
  - determined under an arbitration conducted under Part XIC of the Act.
- 3.20 To this end, clause 3.2(a) of the undertaking clarifies that:
- the undertaking does not specify all the terms and conditions on which Optus will comply with the applicable SAOs in relation to the declared service;



- additional terms and conditions will be negotiated and agreed between Optus and an access seeker in relation to the terms and conditions not specified in the undertaking; and
  - failing agreement, those unspecified terms and conditions will be determined in accordance with Part XIC, including the arbitration process.
- 3.21 The undertaking is therefore unambiguous regarding the status of terms and conditions not included in the scope of the undertaking service. This point is elaborated in the context of compliance with the SAOs in section 5 of this submission.

#### **4. Legislative background**

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##### **Threshold test for accepting the undertaking**

- 4.1 Section 152BV of the Act sets out the criteria for acceptance of ordinary access undertakings by the ACCC in cases where the undertaking does not adopt the model terms and conditions set out in the telecommunications access code. The criteria for acceptance are set out in section 152BV(2) of the Act as follows:

*The Commission must not accept the undertaking unless:*

- (a) *the Commission has:*
    - (i) *published the undertaking and invited people to make submissions to the Commission on the undertaking; and*
    - (ii) *considered any submissions that were received within the time limit specified by the Commission when it published the undertaking; and*
  - (b) *the Commission is satisfied that the undertaking is consistent with the standard access obligations that are applicable to the carrier or provider; and*
  - (c) *if the undertaking deals with price or a method of ascertaining price — the Commission is satisfied that the undertaking is consistent with any Ministerial pricing determination; and*
  - (d) *the Commission is satisfied that the terms and conditions specified in the undertaking are reasonable; and*
  - (e) *the expiry time of the undertaking occurs within 3 years after the date on which the undertaking comes into operation.*
- 4.2 The elements of items (a) to (e) above in this threshold test are elaborated below.

##### **Compliance with the standard access obligations**

- 4.3 Section 152BV(2)(b) requires the ACCC to be satisfied that an undertaking is consistent with the SAOs, as listed in section 152AR of the Act.

- 4.4 A carrier or carriage service provider must comply with the SAOs in relation to an active declared service, if it supplies that service either to itself or to other persons. Section 152AR sets out four categories of SAOs relating to:
- the supply of an active declared service;
  - interconnection of the access provider's facilities with the facilities of a service provider;
  - the provision, timing and content of billing information; and
  - active declared services supplied by means of conditional access customer equipment to supply additional services.

- 4.5 In relation to the supply of an active declared service, section 152AR(3) of the Act states that:

*An access provider must, if requested to do so by a service provider:*

- (a) *supply an active declared service to the service provider in order that the service provider can provide carriage services and/or content services; and*
- (b) *take all reasonable steps to ensure that the technical and operational quality of the active declared service supplied to the service provider is equivalent to that which the access provider provides to itself; and*
- (c) *take all reasonable steps to ensure that the service provider receives, in relation to the active declared service supplied to the service provider, fault detection, handling and rectification of a technical and operational quality and timing that is equivalent to that which the access provider provides to itself.*

- 4.6 Section 152AR(4) further states that these obligations in relation to the supply of an active declared service will not be imposed to the extent to which the imposition of the obligation would have any of the following effect:

- (a) *preventing a service provider who already has access to the declared service from obtaining a sufficient amount of the service to be able to meet the service provider's reasonably anticipated requirements, measured at the time when the request was made;*
- (b) *preventing the access provider from obtaining a sufficient amount of the service to be able to meet the access provider's reasonably anticipated requirements, measured at the time when the request was made;*
- (c) *preventing a person from obtaining, by the exercise of a pre-request right, a sufficient level of access to the declared service to be able to meet the person's actual requirements;*
- (d) *depriving any person of a protected contractual right.*

- 4.7 A contractual right referred to in section 152AR(4)(d) may include an exclusivity or bundling provision and need not continue under the same

contract, or be identical to that which was in existence at 13 September 1996, to be afforded protection. It is the substance of the right, and not simply its form, which is protected.<sup>1</sup>

### **Reasonableness criteria**

- 4.8 In order to accept an undertaking, section 152BV(2)(d) of the Act requires the ACCC to be satisfied that its terms and conditions are reasonable.
- 4.9 The reasonableness of the undertakings will be assessed having regard to the non-exhaustive list of matters outlined in section 152AH of the Act. These are:
- whether the undertakings will promote the LTIE of carriage services or of services supplied by means of carriage services;
  - the legitimate business interest of the carrier or provider, and the carrier's or provider's investment in facilities used to supply the declared service;
  - the interests of all persons who have rights to use the declared service;
  - the direct costs of providing access to the declared service;
  - the value to a party of extensions, or enhancement of capability, whose cost is borne by someone else;
  - the operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility; and
  - the economically efficient operation of a carriage service, a telecommunications network or a facility.
- 4.10 The application of the LTIE reasonableness criteria in Part XIC to the undertaking is set out in sections [6 to 8] of this submission. The other reasonableness criteria are applied to the undertaking in section [9] of this submission.

### **Other threshold requirements**

- 4.11 Section 152BV(2)(a) of the Act sets out procedural steps that must be taken by the ACCC in order to accept an ordinary access undertaking if containing terms other than the model terms and conditions set out in the telecommunications access code. The ACCC must publish the undertaking, invite comments and consider submissions on the undertaking.
- 4.12 As there is no Ministerial pricing determination applicable to the Domestic Digital Mobile Terminating Access Service, the criteria in section 152BV(2)(c) of the Act are not relevant to the assessment of the undertaking.

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<sup>1</sup> *Seven Cable Television Pty Ltd v Telstra Corp Ltd* [2000] FCA 350.

- 4.13 In relation to the requirement regarding expiry time in section 152BV(2)(e) of the Act, this criteria is satisfied because the undertaking will expire within three years after the date on which the undertaking comes into operation.

## **5. Consistency with the standard access obligations**

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- 5.1 The undertaking has to be consistent with the SAO's but it is not necessary for an undertaking to specify the terms and conditions for compliance with every element of the SAOs.
- 5.2 As stated by the ACCC in its final report on the assessment of Telstra's proposed line sharing service undertaking:

*"...if the terms and conditions are not inconsistent with the obligations, the Commission is likely to regard them as being consistent with the obligations..."; and*

*In considering consistency with the SAOs, the Commission considers there is no requirement that the undertaking set out a complete set of terms and conditions in respect of the declared service."*<sup>2</sup>

- 5.3 Accordingly, it is important to be able to confirm that the undertaking is not inconsistent with the SAO's and the mere fact that the undertaking does not include all the terms and conditions applicable to the declared service does not render the undertaking incompatible with the requirement in section 152BV(2)(b).
- 5.4 As noted in section 3 above, the undertaking states that Optus will comply with, and therefore be consistent with, the SAO's and the undertaking does not purport to exclude from arbitration or commercial agreement those price and non-price terms that are not included in the scope of the Optus DGTA Service. Optus acknowledges that the legislative scheme in Part XIC of the Act enables access seekers to seek ACCC determinations on such terms in the event that agreement is not reached on those terms and conditions.
- 5.5 The undertaking explicitly states that Optus will comply with the SAO's and will accept terms and conditions that are not set out in the undertaking when supplying the Optus DGTA Service. Therefore the undertaking is consistent with the SAOs.

## **6. Long-term interests of end-users test to be applied to the undertaking**

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### **Interpretation of the LTIE test**

- 6.1 The term "long-term interests of end-users" (**LTIE**) is defined in section 152AB of the Act in terms of:
- the primary objectives (sub-section 152AB(2) of the Act); and

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<sup>2</sup> ACCC, *A final report on the assessment of Telstra's undertaking for the Line Sharing Service*, August 2004 at page 21.

- the secondary objectives, through which the primary objectives may be interpreted (sub-sections 152AB(4) and (6) of the Act).
- 6.2 The three primary objectives set out in section 152AB(2) of the Act which must be considered in assessing LTIE are:
- (a) the promotion of competition in the relevant markets;
  - (b) achieving any-to-any connectivity in relation to services that involve communication between end-users; and
  - (c) encouraging the economically efficient use of and investment in infrastructure.
- 6.3 The LTIE assessment firstly requires identification of the relevant markets in relation to the undertaking. This is in order to determine whether the above three criteria are satisfied for each of those markets.

### **Relevance of market definition**

- 6.4 Market definition is a key factor in competition analysis because it provides the service, geographic, product and timing dimensions within which the existing degree of competition can be measured. Market definition therefore forms the basis for determining whether the LTIE will be served by assessing, in each of those relevant markets, the LTIE criteria.
- 6.5 Section 4E of the Act defines a market as:
- “... a market in Australia, and, when used in relation to any goods or services, includes a market for those goods or services that are substitutable for, or otherwise competitive with, the first-mentioned goods or services.”*
- 6.6 In Australia the market has been defined using a SSNIP test, which the ACCC’s *Merger Guidelines* of June 1999 elaborate as follows:
- “The process of market definition can be viewed as establishing the smallest area of product, functional and geographic space within which a hypothetical current and future monopolist would impose a small but significant and non-transitory increase in price (SSNIP) above the level that would prevail absent the merger. More generally, the market can be defined as the smallest area over which a hypothetical monopolist (or monopsonist) could exercise a significant degree of market power. This would only be possible if all sources and potential sources of close substitutes for the merged firm’s products have been included in the definition of the market.”*
- 6.7 It is important to note that the precise identification of markets is not the exhaustive step in the LTIE analysis. Rather, market identification is a tool for drawing the boundaries within which the elements of the LTIE criteria can be assessed. The non-exhaustive role of market definition in competition analysis has been highlighted by Federal Court, itself quoting the ACCC’s own position on the issue:

*“ACCC referred to market definition principles, as stated in the Trade Practices Act and elaborated by the High Court in Queensland Wire Industries Pty Ltd v The Broken Hill Proprietary Company Limited (1989) 167 CLR 177. However, ACCC noted the limited relevance of market definition:*

*‘In identifying relevant markets, Part XIC of the Act does not require the Commission to take a definitive stance on market definition. Furthermore, over time, declaration itself might affect the dimensions of these markets, particularly in relation to the functional dimension. Accordingly, market analysis under Part XIC should be seen in the context of shedding light on how declaration would promote competition rather than in the context of developing ‘all purpose’ market definitions.’ ”<sup>3</sup> (emphasis added)*

- 6.8 Accordingly, Optus’ submission in support of its undertaking price and non-price terms is structured in terms of:
- (a) the identification of the relevant markets; and
  - (b) in relation to each of those markets:
    - i) how the undertaking promotes competition;
    - ii) how the objective of any-to-any connectivity is achieved; and
    - iii) how the undertaking encourages economically efficient use of and investment in infrastructure.
- 6.9 As the ACCC and the courts have noted, the ultimate purpose of market analysis under Part XIC is the promotion of competition. Therefore, the price and non-price terms and conditions of access must be measured in terms of whether they promote competition. For these reasons, this submission separately analyses how the undertaking is consistent with the promotion of competition.
- 6.10 Optus submits that there are two markets that will be affected by the undertaking. These two markets are relevant for assessing the legislative criteria for reasonableness. They are:
- the mobile services market; and
  - the fixed-to-mobile services market.
- 6.11 Optus submits that a separate market for the Optus DGTA Service does not exist and should therefore not be considered as part of this LTIE analysis. The following parts of this submission define the scope of the mobile services market and the fixed-to-mobile services market and apply the LTIE criteria to the terms of the undertaking.

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<sup>3</sup> *Foxtel Management Pty Ltd v Australian Competition & Consumer Commission* [2000] FCA 589 at 153.

## Mobile services market

- 6.12 Optus contends that it sells the DGTA Service into a market for mobile services. This market has different ‘functional’ levels in the sense that origination services are purchase directly by retail customers, but termination services are purchase indirectly by fixed to mobile operators who provide services to their retail customers.
- 6.13 Optus does not contend that the mobile services market into which the DGTA Service is supplied is a *retail* market.
- 6.14 The relevant products and services in this market include:
- origination services;
  - termination services (including the Optus DGTA Service itself); and
  - subscription services.
- 6.15 Optus sells these services as a cluster given the strong economies of scope between the services. This market definition overtly takes into account the two sides of the market including the origination/subscriptions services sold to retail mobile users and termination services to those mobile users sold at wholesale. Such a market definition is consistent with current judicial interpretation. In what could otherwise be described as a market for selling newspapers, the court has found that the relevant market included several elements other than provision of a product (the newspaper). Instead, the relevant market was defined as provision of services by the publication of regional newspapers containing news and advertising, and offering the opportunity for advertising.<sup>4</sup>
- 6.16 Whilst the Australian Competition Tribunal has identified a separate market for Optus’ mobile termination service, it also noted the artificial nature of separating consideration of the market:

*“it would be somewhat artificial to use this wholesale market for the purpose of identifying and analysing Optus’ conduct and that of its competitors, and the effect of Optus’ pricing of its DGTAS on its customers and its competitors, both mobile network and fixed line operators, independently of the national market for retail mobile services. Nor, indeed, did the Commission suggest such an approach. Such conduct and effect is only meaningfully analysed and understood in the context of the wider markets identified by Optus and the Commission: see Power New Zealand Ltd v Mercury Energy Limited and Commerce Commission [1996] 1 NZLR 686 at 705.*

*The important thing is to note and seek to understand the interactions between the relevant markets, however they are defined.*

*When competing with each other, mobile service providers take into account all their sources of revenue.”<sup>5</sup>*

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<sup>4</sup> *Rural Press Ltd v Australian Competition & Consumer Commission* [2002] FCAFC 213.

<sup>5</sup> Application by Optus Mobile Pty Limited & Optus Networks Pty Limited [2006] ACompT 8

- 6.17 A SSNIP analysis demonstrates that the services (termination, origination and subscription) are all part of the same market. If an individual operator raised the price of termination services (SSNIP) to its subscribers, this increases the profitability of attracting additional subscribers and as a direct result increases competition for those subscribers. Hence, the price of subscription and origination services would adjust to attract subscribers and the higher termination revenue would be competed away. The SSNIP would be unsuccessful indicating a wider market definition, incorporating all the services is appropriate.
- 6.18 Optus submits that the undertaking needs to be assessed according to the LTIE criteria, having regard to the two-sided character of the mobile services market.

### **Fixed to mobile market**

- 6.19 In defining a fixed-to-mobile service market it is necessary to consider the demand side substitutability of potential substitutes. These would include fixed-to-fixed services and mobile-to-mobile services. Clearly, for the proportion of time a mobile user is away from their fixed line(s), fixed-to-fixed services are functionally not a substitute for fixed-to-mobile services and could not be considered in the same market.
- 6.20 Mobile-to-mobile services are increasingly becoming a substitute for fixed-to-mobile services. At the margin these services may provide a competitive constraint on the pricing of fixed to mobile services.
- 6.21 Whilst fixed to mobile services are preselected by customers in a bundle of long distance and international services, Optus contends that fixed to mobile services are supplied in a separate market to long distance and international. Even though there are complementarities in the demand for the bundle of services, it may be that operators can compete on single services, such as by offering calling cards and over-ride codes.
- 6.22 Notwithstanding this, the affect of this undertaking on the fixed to mobile services market may be impacted by the pricing of any of those bundled services. For example, changes in the price of the Optus DGTA Service may be passed on in the bundle of preselect services via a change in the price of long distance services rather than fixed to mobile services.

### **Criteria for the promotion of competition**

- 6.23 Competition is the process of rivalry between firms, where each market participant is constrained in its price and output decisions by the activity of other market participants.
- 6.24 However, the test for “promotion of competition” in the context of the Act does not require the achievement of any particular outcome with respect to the level of competition in a market. As the National Competition Council noted in considering the application for access declaration of Carpentaria Transport:

*“The application of the test does not require the Council to prove that a sequence of future events will actually take place but rather to make a*



*considered judgment as to the likely effects of access in respect of the promotion of competition in the market for the service.”<sup>6</sup>*

- 6.25 In the Sydney Airports case, the Australian Competition Tribunal (ACT) specifically rejected an argument that competition needs to be quantified. It was argued that the notion of “promoting” competition was stronger than “encouraging” competition; and that the test required a measurable advancement of competition. The ACT disagreed with this analysis:

*“The Tribunal does not consider that the notion of ‘promoting’ competition...requires it to be satisfied that there would be an advance in competition in the sense that competition would be increased.”<sup>7</sup>*

- 6.26 It was also argued that the ACT needed to have a “degree of confidence” which was greater than a “mere likelihood” that competition would be promoted. The ACT again rejected the notion that any increase in competition needs to be capable of measurement before regulation is justified under the test for declaration under Part IIIA of the Act:

*“Rather, the Tribunal considers that the notion of ‘promoting’ competition...involves the idea of creating the conditions or environment for improving competition from what it would be otherwise. That is to say, the opportunities and environment for competition given declaration, will be better than they would be without declaration.”<sup>8</sup>*

- 6.27 The ACCC has also rejected the notion that regulation must always result in an increase in competition. The test under Part XIC of the Act is that an increase in competition is a relevant, but not determinative, factor:

*“The question of whether competition will actually improve or increase will be highly relevant but is not determinative of this issue [of declaration]. The key issue when considering the proposed variation is whether it will assist in establishing conditions by which such improvement will be more likely to occur. This interpretation of promoting competition was endorsed by the Australian Competition Tribunal, which stated that the concept of promoting competition involves a consideration that if the conditions or environment for improving competition are enhanced, then there is a likelihood of increased competition that is not trivial.”<sup>9</sup>*

- 6.28 In the context of Part XIC, the ACCC has adopted the position that the promotion of competition does not involve the achievement of a particular level of competition:

*“...the Commission considers that competition is promoted when market structures are altered such that the exercise of market power becomes more difficult; for example because barriers to entry have been lowered*

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<sup>6</sup> National Competition Council, *Reasons for its decision on the declaration of rail freight services on the line between Brisbane and Cairns*, provided by Queensland Rail, May 1997 at page 20.

<sup>7</sup> *Sydney International Airport* [2000] ACompT 1 (1 March 2003) at page 106.

<sup>8</sup> *Sydney International Airport* [2000] ACompT 1 (1 March 2003) at page 106.

<sup>9</sup> ACCC, *Proposed variation to make the GSM service declarations technology-neutral*, September 2001 at page 18, considering *Re Review of Declaration of Freight Handling Services at Sydney Airport* (2000), ATPR 40-775 at page 107.

*(permitting more efficient competitors to enter a market and thereby constrain the pricing behaviour of the incumbents) or because the ability of firms to raise rivals costs is restricted.”<sup>10</sup>*

- 6.29 This position is consistent with section 152AB(4) of the Act: in determining the extent to which a particular thing is likely to result in the promotion of competition, regard must be had to the extent to which the thing will remove obstacles to end-users of listed services gaining access to listed services.
- 6.30 As a result, the notion of promoting competition can be summarised as creating the conditions or environment for improving competition from what it would otherwise be. In order to achieve this, the undertaking would have to put in place better conditions for competition to occur than the current case.

#### **Any-to-any connectivity applied to prices**

- 6.31 The objective of achieving any-to-any connectivity in section 152AB(2)(d) is achieved if each end-user of a service that involves communication between end-users is able to communicate, by means of that service or a similar service, with every other end-user even where they are connected to different telecommunications networks.
- 6.32 Optus believes that the offering of access to the Optus DGTA Service in this undertaking will allow any-to-any connectivity. In addition, as the prices offered are consistent with existing rates and consistent with efficient costs, then they will encourage any-to-any connectivity.

#### **Efficient use of and investment in infrastructure**

- 6.33 An assessment of whether the undertaking encourages the efficient use of infrastructure is closely linked to the promotion of competition. This is because factors affecting competition, such as the terms and conditions of access to infrastructure, will determine the extent to which the infrastructure is utilised efficiently.
- 6.34 In relation to encouraging investment in infrastructure, it is important that consideration not only be given to the extent to which the undertaking will encourage investment in new infrastructure but also the extent to which continued investment in existing infrastructure will be encouraged.
- 6.35 Section 152AB(6) of the Act provides that in determining the extent to which a particular thing is likely to encourage the efficient use of infrastructure, regard must be had to the following matters:

*“(a) whether it is technically feasible for the services to be supplied and charged for, having regard to:*

*(i) the technology that is in use or available; and*

*(ii) whether the costs that would be involved in supplying, and charging for, the services are reasonable; and*

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<sup>10</sup> ACCC, *Mobile Services Review – Mobile Terminating Access Service*, June 2004 at page 11.

*(iii) the effects, or likely effects, that supplying, and charging for, the services would have on the operation or performance of telecommunications networks;*

*(b) the legitimate commercial interests of the supplier or suppliers of the services, including the ability of the supplier or suppliers to exploit economies of scale and scope;*

*(c) the incentives for investment in the infrastructure by which the services are supplied.”*

6.36 Economists identify three types of efficiency: technical, allocative and dynamic. Technical efficiency requires that access service be priced based on production at least cost. Access prices below efficient costs will harm technical efficiency by discouraging efficient facilities-based entry.

6.37 Allocative efficiency generally requires that consumption decisions be based on prices that reflect marginal cost. However, in the presence of fixed and common costs, prices based on marginal costs will likely deter future investment. This will harm dynamic efficiency.

6.38 Access prices set below the efficient cost can undermine the incentive to invest in new low cost technology and quality improvements. Access prices should therefore be set to recover efficiently incurred costs, including a contribution to fixed and common costs. If these fixed and common costs can be recovered in the most efficient manner possible, the reduction in allocative efficiency can be minimised.

## **7. Competition is promoted by the undertaking price**

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7.1 Optus’ relies on a number of sources of information in order to support 12 cents per minute as a price that will promote competition:

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

7.2 The Australian Competition Tribunal determined that:

*When competing with each other, mobile service providers take into account all their sources of revenue. It is a feature of the Australian market that providers offer retail customers a bundle of services in which usage charges subsidise charges for handsets and for access to the network (where access means connection and thus the ability to make and receive calls, while usage is the actual making and receipt of*

*calls). Thus some components of the mobile service provided to the customer may be supplied below cost and some components above cost. If Optus' DGTAS is supplied at a price which exceeds the efficient costs of supply of that service, it does not necessarily follow that such price is unreasonable. The interactions between the provision of the DGTAS and of the retail services need to be examined. Such a price may not be unreasonable where the overall charge for all the relevant services does not exceed the efficient costs of supply of those services. [paragraph 82]<sup>11</sup>*

- 7.3 Neither the Commission nor Optus has finalised a view as to the TSLRIC of providing mobile termination services using bottom up modelling. It is uncertain as to whether 12 cent per minute is above, at or below cost. Though indications exist that 12 cents per minute is below cost (see below) In this circumstance, the Commission should set a price for the DGTAS at 12 cent per minute and rely on the competitive effects in the mobile market to compete away any 'potential' above cost component to this charge, rather than risk setting a price below cost.
- 7.4 The 'overall charge' for mobile service for Optus is constrained by vigorous competition in the retail market for mobile services. This competition in conjunction with a near halving of the mobile termination rate by the Commission (from 21 cents per minute to 12 cents per minute) since 2004 has significantly reduced Optus' earnings from its mobile business. As noted by Optus in its latest financial reports:

*Excluding the impact of acquisitions, Optus' operating revenue grew 1.1%, as Optus showed its resilience in an intensely competitive environment. This growth was achieved notwithstanding the increased penetration of capped mobile pricing plans; a continuing decline in fixed telephony usage across the market; and the ACCC mandating ongoing reductions in mobile termination rates, from 18 cents to 15 cents per minute effective 1 January 2006. The mobile termination rates were further reduced to 12 cents from 1 January 2007.*

*As previously indicated, the negative impact on Optus' revenue growth increased in the second and the third quarters of this financial year, because the effective rate reduction faced by Optus was greater than the reduction mandated by ACCC. The reason was that in the corresponding quarters of the previous year, Optus had commercially negotiated rates which were higher than those set by the ACCC. [page 39]<sup>12</sup>*

- 7.5 This latest report (attached in Appendix [III]) shows that incoming service revenue to Optus' mobile division fell by 7.9% from the December 2005 quarter to the December 2006 quarter, or \$20 million for the quarter. This is despite Optus' subscriber base increasing by 6 percent. Reductions in MTAS rates therefore have a significant financial effect on Optus. Importantly for the competitive effects in the mobile and fixed to mobile markets, the effect on Optus is significantly greater than the effect on Telstra.

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<sup>11</sup> Application by Optus Mobile Pty Limited & Optus Networks Pty Limited [2006] ACompT 8

<sup>12</sup> Singapore Telecommunications Limited And Subsidiary Companies, Management Discussion and Analysis of Unaudited Financial Condition, Results of Operations and Cash Flows for the Third Quarter and Nine Months Ended 31 December 2006.

- 7.6 In determining whether a particular thing is likely to result in the achievement of the objective of promoting competition in markets for listed services, regard must be had by the Commission to the extent to which the thing will remove obstacles to end-users of listed services gaining access to listed services: s 152AB(4). Listed services include mobile telephony services and fixed telephony services.
- 7.7 A further reduction in the mobile termination rate during the period of the undertaking is not likely to promote competition in the market(s) for fixed telephony services.
- 7.8 Competition in the fixed line market is limited by Telstra's control of the local loop. Competitors have made modest inroads into Telstra's market share over time and have not significantly eroded Telstra's share and capacity to earn monopoly rents. Competitors have taken the form of
- Fixed line resellers (such as AAPT);
  - An integrated fixed and mobile carrier (Optus);
  - Mobile network operators (Vodafone and Hutchison); and
  - Broadband providers (such as Primus and iiNet).
- 7.9 We consider the impact of each of these forms of competitors in turn, at least in terms of the effect of mobile termination rates has on their ability to be an effective competitor to Telstra in fixed telephony services.
- 7.10 The economics of fixed telephony resale has made competitors with resale as their primary means of competing in the market ineffective. Telstra's behaviour in this market, particularly in relation to its raising of access prices was the subject of a Competition Notice issued by the Commission in April 2006.<sup>13</sup> Whilst resale competitors in the fixed line services may have benefited from lower MTAS prices (in terms of a lower cost base), Telstra has maintained a structural advantage in this market, such that it can take advantage of its market power. It is notable that Telstra has pursued and received MTAS rate reductions that are equivalent to those of its smaller resale competitors. In its Results and Operations Review for the Half-year ended 31 December 2007 Telstra notes that "Our network payments declined by \$118 million to \$887 million largely due to ...• a reduction in the mobile terminating access rate to 15 cents per minute, which was backdated to January 2006 based on an ACCC determination. Hence, \$61 million of the reduction in our domestic network outpayments relates to the second half of fiscal 2006..."<sup>14</sup>
- 7.11 The likely benefit then of further MTAS rate reductions on promoting competition from resale based competitors is likely to be limited. This is

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<sup>13</sup> See

<http://www.accc.gov.au/content/item.phtml?itemId=756874&nodeId=601f1a176cb082ac8ee6ec3582a2874f&fn=Part%20A%E2%80%9494Competition%20notice%2012%20April%202006.pdf>

<sup>14</sup> Telstra Corporation Limited and controlled entities Results and operations review Half-year ended 31 December 2006, page 39

particularly true as fixed to mobile rates have only modestly reduced when compared to the substantial MTAS rate reductions.

- 7.12 The prices paid for telecommunications services report of the ACCC demonstrates that reductions in the revenue yield from fixed to mobile services. For example, fixed to mobile prices fell by 202 percent in 2003-04 and 3.8 percent in 2004-05.<sup>15</sup> This compares with a reduction in MTAS rates of 14 percent in 2005, 16% in 2006 and 20% in 2007.<sup>16</sup>
- 7.13 In issuing determinations, the Commission has reduced MTAS rates from 21 cents per minute in 2004 to 12 cents per minute in 2007<sup>17</sup>. Over the same period PSTN originating and terminating access charges have fallen from 1.25 cents per minute to 1 cent per minute<sup>18</sup>. However, Telstra has largely been cushioned from the impact this reduction since wholesale line rental charges have risen from \$21.36 per month to \$27.60 per month (exclusive of GST) over the same period.<sup>19</sup>
- 7.14 The greater relative falls in MTAS rates when compared to reductions in PSTN OTA rates does not assist Optus as an integrated fixed and mobile network operator. As Telstra is by far the largest fixed network operator, the reductions in MTAS rates benefit it the most. MTAS revenues are a much larger source of Optus' revenue than are Telstra's access revenue streams.
- 7.15 An analysis of figures from Optus' and Telstra's financial reports in recent years shows that Optus is far more reliant than Telstra on access revenues. In the 2006 financial year incoming service revenue, which is predominantly MTAS, accounted for more than 20 percent of Optus total revenues from its mobile division. This compares with around 13 percent for Telstra in both its PSTN and mobile divisions.

**Table: Optus, Telstra – importance of access revenues**

	FY 2006	FY 2005
Optus <sup>20</sup>		

<sup>15</sup> ACCC, *Changes in prices paid for telecommunications services in Australia, 2004–05*, Report to the Minister for Communications, Information Technology and the Arts April 2006

<sup>16</sup> ACCC *Mobile Terminating Access Service Final Decision on whether or not the Commission should extend, vary or revoke its existing declaration of the mobile terminating access service*, June 2004 or [http://www.accc.gov.au/content/item.phtml?itemId=780600&nodeId=7c258859e04d8fbbcbf4cc34e5ec329e&fn=Telstra/Optus%20interim%20determinations%20-%20mobile%20terminating%20access%20service%20\(MTAS\)%20-%20December%202006.pdf](http://www.accc.gov.au/content/item.phtml?itemId=780600&nodeId=7c258859e04d8fbbcbf4cc34e5ec329e&fn=Telstra/Optus%20interim%20determinations%20-%20mobile%20terminating%20access%20service%20(MTAS)%20-%20December%202006.pdf)

<sup>17</sup> [http://www.accc.gov.au/content/item.phtml?itemId=780600&nodeId=7c258859e04d8fbbcbf4cc34e5ec329e&fn=Telstra/Optus%20interim%20determinations%20-%20mobile%20terminating%20access%20service%20\(MTAS\)%20-%20December%202006.pdf](http://www.accc.gov.au/content/item.phtml?itemId=780600&nodeId=7c258859e04d8fbbcbf4cc34e5ec329e&fn=Telstra/Optus%20interim%20determinations%20-%20mobile%20terminating%20access%20service%20(MTAS)%20-%20December%202006.pdf)

<sup>18</sup> <http://www.accc.gov.au/content/item.phtml?itemId=754407&nodeId=b18a5ce3697f6645c5326426da29882b&fn=Final%20determination%E2%80%94October%202003.pdf>

<sup>19</sup> [http://www.accc.gov.au/content/item.phtml?itemId=756967&nodeId=6b8720f4a707d92287343961b84025bd&fn=Final%20decision%E2%80%94local%20services%20review%20\(Jul%202006\).pdf](http://www.accc.gov.au/content/item.phtml?itemId=756967&nodeId=6b8720f4a707d92287343961b84025bd&fn=Final%20decision%E2%80%94local%20services%20review%20(Jul%202006).pdf)

<sup>20</sup> Singapore Telecommunications Limited And Subsidiary Companies Management Discussion and Analysis of Unaudited Financial Condition, Results of Operations and Cash Flows 31 March 2006

Mobile communications revenue	3965	3817
Incoming service revenue	815	742
	20.6%	19.4%
Telstra <sup>21</sup>		
Total PSTN revenue	7478	8018
Fixed interconnection and domestic wholesale revenue	1012	946
	13.5%	11.8%
Telstra		
Total mobile goods and services revenue	4972	4688
Mobile services revenue - wholesale and interconnection	659	571
	13.3%	12.2%

7.16 It is clear that in responding to an integrated player such as Optus, Telstra as the dominant carrier in the fixed to mobile market has not passed on the full benefits of the MTAS price reduction enforced by the ACCC since 2004.

7.17 Competition in the mobile sector has increased substantially since 2004. Evidence of this can be seen in the increase popularity of ‘capped’ mobile plans. As noted by the Commission in April 2006, the “fall in [mobile] prices was mainly due to the introduction of capped or ‘bucket’2 plans by carriers which resulted in large decreases in prices paid by consumers for post-paid services. Specifically, prices for GSM post-paid services fell by 15.3 per cent and prices for post-paid CDMA services fell by 14.2 per cent.”<sup>22</sup> As noted by the Australian Competition Tribunal:

*... we note that the mobile services operators do appear to compete vigorously through the provision of differentiated packages (para 87)*<sup>23</sup>

7.18 Optus capped plans were introduced in the 31 Dec 2004 quarter. The take up rate has increased dramatically over the years, starting from 2% of the total Optus postpaid mobile base in the 31 Dec 2004 quarter to 25% in the 31 Dec 2006 quarter<sup>24</sup>.

7.19 In the calendar year 2005, the average percentage of Optus postpaid mobile base on capped plans is 9%, comparing to 22% in the calendar year 2006, representing a 13% increase in the percentage of Optus postpaid customers on capped plans.<sup>25</sup> (refer to table)

**Table: Percentage of Optus postpaid mobile base on capped plans**<sup>26</sup>

Quarter/Year	2004	2005	2006
31-Mar		5%	19%
30-Jun		7%	21%
30-Sep		10%	24%
31-Dec	2%	14%	25%
Average		9%	22%

<sup>21</sup> Telstra Corporation Limited and controlled entities Full Year Results and Operations Review – June 2006

<sup>22</sup> ACCC, *Changes in prices paid for telecommunications services in Australia, 2004–05*, Report to the Minister for Communications, Information Technology and the Arts April 2006

<sup>23</sup> [Optus Tribunal decision]

<sup>24</sup> Management Discussion and Analysis for SingTel, various.

<sup>25</sup> Management Discussion and Analysis for SingTel, various.

<sup>26</sup> Management Discussion and Analysis for SingTel, various.

- 7.20 Telstra also experiences a similar pattern where Telstra has “moved from 4.8% of ...mobile customers on capped plans in December 2005 to 10.3% in December 2006”<sup>27</sup> (Telstra half year results).
- 7.21 Hutchison launched its first “\$99 Talk Cap” plan in the calendar year 2003, targeting higher spending customers<sup>28</sup> and similarly, Orange re-launched its capped plans with new pricing structure, catering to both high spend customers who use their mobile device as a key communication tool and those who combine their mobile and home fixed line usage into the one communication tool.
- 7.22 In the 2005 full year report, it shows that Hutchison are already “delivering \$19 of non-voice ARPU from 3 customers, have over 75% of customers on capped plans and derive over 80% of ...revenue on 3G networks.”<sup>29</sup>
- 7.23 The number of mobile customers on Hutchison has also grew significantly from 412,000 in 2003 to 1,131,000 customers in the 12 months to June 2006 and there has also been an improvement in the EBITDA losses by \$230 million in 2005<sup>30</sup>.

#### **Hutchison subscriber numbers**

	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>June ended 2006</b>
<b>Number of mobile customers</b>	412,000	879,000	1,035,000	1,131,000

- 7.24 In terms of Vodafone Australia, the annual report for the year ended 31 March 2006 has also shown a significant increase in “its customer base by 16% and the local currency service revenue by 11.8% due to the popularity of the capped plans<sup>31</sup>”. The number of venture customers as at 31 March 2006 is 3,177,000<sup>32</sup> (p15) when compared to 2,731,000 as at 31 March 2005<sup>33</sup>.
- 7.25 Increased competition demonstrates that the structure of the mobile service market is such that rents will not be sustained, but competed away through lower retail prices. In the presence of regulated (symmetric) termination

<sup>27</sup> Telstra: “Financial results for the half year ended 31 Dec 2006” p32,

[http://www.telstra.com.au/abouttelstra/investor/docs/tls519\\_halfyearfinancials.pdf](http://www.telstra.com.au/abouttelstra/investor/docs/tls519_halfyearfinancials.pdf)

<sup>28</sup> Hutchison half year report 2003 p9,

<http://www.hutchison.com.au/hutchison2004staging/object/attachment/docs/Final%20report%20to%20shareholders%20Sept%202003%2Epdf>

<sup>29</sup> Hutchison Full Year Results 2005, 7 March 2005, Chief Executive Address,

[http://www.hutchison.com.au/hutchisonstaging/object/attachment/docs/Annual\\_Results\\_Presentation\\_7\\_Mar\\_06.pdf](http://www.hutchison.com.au/hutchisonstaging/object/attachment/docs/Annual_Results_Presentation_7_Mar_06.pdf)

<sup>30</sup> Hutchison Annual report 2003, Hutchison Annual report 2006, Hutchison Annual report 2005

<http://www.hutchison.com.au/index.cfm?pareauuid=FD47F589-B002-11D6-813800A0CC617B10&psubareauuid=FD47F59C-B002-11D6-813800A0CC617B10>

<sup>31</sup> Vodafone Group Plc Annual Report for the year ended 31 March 2006 p37,

[http://www.vodafone.com/assets/files/en/vodafone%20ar\\_06\\_v2.pdf](http://www.vodafone.com/assets/files/en/vodafone%20ar_06_v2.pdf)

<sup>32</sup> Vodafone Group Plc Annual Report for the year ended 31 March 2006 p15,

[http://www.vodafone.com/assets/files/en/vodafone%20ar\\_06\\_v2.pdf](http://www.vodafone.com/assets/files/en/vodafone%20ar_06_v2.pdf)

<sup>33</sup> Vodafone Group Plc Annual Report for the year ended 31 March 2005 p13,

[http://www.vodafone.com/assets/files/en/VOD\\_annual\\_report\\_2005\\_3.pdf](http://www.vodafone.com/assets/files/en/VOD_annual_report_2005_3.pdf)



charges mobile network operators compete on equal terms. Further regulated price reductions (below 12 cents per minute) during the period from 1 July 2007 to 31 December 2007 are unlikely to promote competition beyond what has occurred since 2004.

7.26 Competition from the mobile sector is likely to be the most substantive influence on competition in fixed line telephony calling markets, including those in which fixed to mobile services are supplied. Regulators around the world, including the ACCC, have considered evidence of fixed to mobile substitution and have generally found that it is not strong enough for the two services to be defined as 'in the same market'. However, these considerations have generally taken place in the context of considering whether mobile *subscriptions* place a significant constraint on the cost of fixed line subscriptions. However, the most important form of fixed-mobile substitution is between fixed and mobile *calls* that terminate outside the customer's local calling area (that is, calls that terminated in another Australian city/town, in another country or on a mobile network). Importantly, this is also the area where there is the strongest evidence of substitutability between fixed and mobile calling.

7.27 For example, Glenn Woroch and Michael Ward<sup>34</sup> have found that:

*“Consumers indicate that mobile usage has replaced wireline calling to a large degree. This is especially true **for long distance calling**. Unlike many developing countries, US consumers tend **not to disconnect their wireline service when they subscribe to mobile service**. However, we find that they have migrated **minutes** from their wireline service to their mobile service due to growing price differences.” [Emphasis added]*

7.28 Thus, while it may be the case that competition from mobile subscription may not prevent Telstra (or other fixed line incumbents internationally) from exercising monopoly power over its fixed line network, it may still be the case that competition from mobiles would prevent Telstra from raising its fixed line calling margins. However, this is predicated on the mobile sector not being affected unduly by regulation. Lower mobile termination rates limit Optus' ability to compete in telephony calling markets.

7.29 Competition from broadband providers in calling markets is immature and the mobile termination rate is unlikely to influence the competitive landscape in any material way.

7.30 In all of these cases Optus contends that a further reduction in the mobile termination rate during the period of the undertaking is not likely to promote competition in the market(s) for fixed telephony services.

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<sup>34</sup> *Usage Substitution between Mobile Telephone and Fixed line in the U.S.*, May 2004, available at <http://elsa.berkeley.edu/~woroch/usage%20substitution.pdf>

## **8. The undertaking prices encourage efficient use of and investment in infrastructure**

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- 8.1 Optus considers that the 12 cents per minute rate offered in the undertaking is a reasonable estimate of efficient cost. It reflects the best information available to the Commission at this time. It also provides commercial certainty for access seekers for the six months from July 2006 to December 2007. During this period it is likely that substantive work will be undertaken on cost modelling and the estimation of efficient mobile network costs.
- 8.2 There is considerable uncertainty as to efficient costs. The Australian Competition Tribunal has determined that prices above cost for the Optus DGTA Service may promote competition, which may allow some leeway for the Commission in making a decision where costs are uncertain.
- 8.3 Optus relies on a number of sources of information in order to support 12 cents per minute as a reasonable estimate of efficient cost. These include:
- The ACCC pricing principles established in June 2004.
  - International benchmarking of mobile terminating access prices including overseas cost models.
- 8.4 These sources are considered in turn.

### **ACCC pricing principles**

- 8.5 In June 2004 the Commission released a Final Decision in its mobile service review relating to the Mobile Terminating Access Service (MTAS). It decided to declare the service and to set a pricing principle.
- 8.6 At the time of releasing its June 2004 pricing principles the Commission had not modelled the TSLRIC of providing MTAS in Australia. Instead, it sought to estimate costs using reasonable estimates available to the Commission at the time. Based on sources including cost models developed in overseas jurisdictions, RAF data and advice from an external consultant the Commission considered that the TSLRIC of providing MTAS in Australia was likely to lie within the range of 5 to 12 cents per minute.
- 8.7 Based on this the Commission determined a pricing principle as follows.

*Principles relating to the price of access to the Domestic Mobile Terminating Access Service*

*The price of the Domestic Mobile Terminating Access Service should follow an adjustment path such that there is a closer association of the price and underlying cost (i.e. TSLRIC+) of the service.*

*This adjustment path should have the following characteristics:*

- *The starting price should be set at the lowest price at which the service is being supplied;*

- *The end price should be set at the upper end of the range of reasonable estimates of the TSLRIC+ of supplying the service that are currently available;*
  - *The adjustment path should commence on 1 July 2004 and conclude on 1 January 2007;*
  - *Decrements should initially be made on a six monthly basis then, as prices become more proximate to TSLRIC+, be made on an annual basis; and,*
  - *Each decrement between the start price and end price should be of equal amount. (page 244)<sup>35</sup>*
- 8.8 Given the Commission had at the time not undertaken cost modelling of its own it took a view that it would set a target price at the upper end of its range of reasonable cost estimates.
- 8.9 Optus is aware that the Commission has commenced a consultation process surround a bottom up cost model built by a consultant, WIK. A draft version of this model is being made available to interested parties for a one month period between 16 February 2007 and 16 March 2007. This modelling is in a draft stage of development and is unlikely to be finalised before June 2007 in a form capable of setting MTAS prices. It is also unclear the extent to which the Commission will rely on this modelling to set future prices.
- 8.10 As such, Optus considers that it is appropriate for the Commission to continue to rely on the framework behind its current pricing principles in setting access prices for the period 1 July 2007 to 31 December 2007. That is, to set price based on the upper end of the range of reasonable estimate of the TSLRIC of supplying the services that are currently available. Consistent with the application of those pricing principles, the ACCC's proposed price of 12 cents should apply for a 12 month period through to 31 December 2007.

### **Benchmarking**

- 8.11 European mobile termination rates for 2007 range from 5.89 euro cents per minute (cpm) (9.87 Aust. cpm) in Sweden to 11.72 euro cpm (19.63 Aust. cpm) in Spain.<sup>36</sup>
- 8.12 Mobile termination rates in the EU15 are declining at 15% per year on average. Between 2006 and 2008 European regulators reduced mobile termination rates in all jurisdictions for which new rates have been announced.
- 8.13 The following figure provides average published mobile termination rates for 2006, 2007 and 2008 for all mobile operators in each of the EU15 jurisdictions (with operator rates weighted by number of subscribers). Note that not all countries have published rates for 2007 and 2008.

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<sup>35</sup> ACCC *Mobile Terminating Access Service Final Decision on whether or not the Commission should extend, vary or revoke its existing declaration of the mobile terminating access service*, June 2004

<sup>36</sup> Appendix [II]

- 8.14 The current mobile termination rate in Australia (12 Aust. cpm) is below average EU15 rates. The weighted average rates for all regulated operators in the EU15 are as follows:
- 2006: 11.08 euro cpm (18.56 Aust. cpm)
  - 2007: 9.37 euro cpm (15.70 Aust. cpm)
  - 2008: 7.93 euro cpm (13.28 Aust. cpm)
- 8.15 European regulators are increasingly using ‘bottom-up’ cost models to determine mobile termination rates. Regulators in the Netherlands and Sweden are now using ‘bottom-up’ models (discussed below). In Sweden the 2007 mobile is 9.87 Aust cpm. In the Netherlands, the 2008 MTR (for large operators) is 10.75 Aust cpm.
- 8.16 In January the Commission released a new draft bottom-up cost model for Australia. The model calculates a termination cost of 5.9 Aust cpm for its central scenario. This model is in draft and subject to limited industry consultation.

#### **Finalised bottom up cost models**

- 8.17 The Commission’s previous views as to the TSLRIC of providing MTAS in Australia was that it was likely to lie within the range of 5 to 12 cents per minute. The upper bound of this range appears to be informed by the report of Ofcom, *Wholesale Mobile Voice Termination*, Statement, 1 June 2004. In its Final Decision on MTAS as part of the mobile services review “the Commission suggests that the unadjusted UK results (suggesting TSLRIC+ cost estimates of around 12 cpm [cents per minute]) be viewed as one of a substantial and growing number of indicators of the cost of mobile termination available from other jurisdictions.” (page 233)
- 8.18 Since this time a number of other European regulators have determined mobile termination rates based on bottom up cost models. These include regulators in the Netherlands and Sweden.
- 8.19 In Sweden the mobile termination rate was set at around 9.87 Australian cents per minute for 2007.<sup>37</sup> In the Netherlands the mobile termination (for large operators) was set at around 10.75 Australian cents per minute for 2008. Regulators in Greece have also completed cost modelling but the result is not transparent to Optus.
- 8.20 Based on these model results, Optus contends that the 12 cent per minute is reasonable.

#### **Draft bottom up cost models**

- 8.21 The Commission’s previous views as to the TSLRIC of providing MTAS in Australia was that it was likely to lie within the range of 5 to 12 cents per minute. The upper bound of this range appears to be informed by the report of

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<sup>37</sup> <http://www.pts.se/Sidor/sida.asp?SectionId=1848>

Ofcom, *Wholesale Mobile Voice Termination*, Statement, 1 June 2004. In its Final Decision on MTAS as part of the mobile services review “the Commission suggests that the unadjusted UK results (suggesting TSLRIC+ cost estimates of around 12 cpm [cents per minute]) be viewed as one of a substantial and growing number of indicators of the cost of mobile termination available from other jurisdictions.” (page 233)

- 8.22 Ofcom will impose new controls on wholesale mobile voice call termination charges when the current regulation expires in March 2007. The wholesale mobile call termination rate is the fee that mobile network operators (MNOs) charge to connect calls that are made from another fixed or mobile network.
- 8.23 Ofcom previously imposed a limit on average termination charges of 14.3 to 16.02 cents per minute, depending on the extent to which operators can use 900MHz or 1800MHz spectrum bands for their networks. These figures included a network externality surcharge. This surcharge was excluded from the Commission’s previous analysis. Up to this point, restrictions on charges only applied to calls connected using operators’ 2G networks.
- 8.24 In its previous report Ofcom used a long run incremental cost (LRIC) model to estimate the cost to a 2G mobile network operator of providing mobile terminating access services.
- 8.25 Ofcom recently built a new bottom up model of a mobile network operator providing voice and data services over a 2G and/or 3G mobile network. This report is cited as Ofcom, *Mobile Call Termination – Proposals for consultation*, 13 September 2006
- 8.26 Ofcom proposed that the average termination charges of Vodafone, O2, T-Mobile and Orange should be reduced to approximately 13.5 cpm across 2G and 3G networks by 2010/11 (page 114) and that the average termination charge of ‘3’ should be reduced to approximately 15.2cpm by 2010/11 (page 114). Ofcom has proposed that the order will expire on 31 March 2011.
- 8.27 Included in the proposed prices was a network externality surcharge of 0.3 pence per min (0.76 cents per min) (page 108). Prices converted from Pence to Australian cents using a conversion rate of 1 pound = \$AU2.54.
- 8.28 We understand that regulators in Norway are currently developing draft models. Bottom up models are at early stages in Austria, Germany, Belgium.
- 8.29 Based on these draft model results, Optus contends that the 12 cent per minute is reasonable.

## **9. Other reasonableness criteria**

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### **Legitimate business interests of access providers**

- 9.1 As set out above, the reasonableness criteria in s 152AH of the Act also requires the ACCC to take into account:

- the legitimate business interest of the carrier or provider, and the carrier's or provider's investment in facilities used to supply the declared service;
- the interests of all persons who have rights to use the declared service;
- the direct costs of providing access to the declared service;
- the operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility; and
- the economically efficient operation of a carriage service, a telecommunications network or a facility.

9.2 The legitimate business interests of service providers has been included in the reasonableness criteria in s 152AH of the Act in recognition of the fact that investment in existing and new infrastructure will not be sustainable unless the ability of carriers and carriage service providers to recover the cost of providing services and to earn a commercial return on the investment in infrastructure is protected.

9.3 In considering access pricing in the context of Part IIIA, the Hilmer Committee recognised the need for protection of the legitimate interests of the facility's owner. The Hilmer Report stated that:

*"Access to a facility should only be declared if the legitimate interests of the owner of the facility are protected through a requirement for a "fair and reasonable" fee for providing access, and other appropriate terms and conditions."*<sup>38</sup>

9.4 The use of the word 'legitimate' in the context of the conflicting expectations of the service provider and access seeker raises questions as to the categorisation of business interests as legitimate. The ACCC has stated that in this respect its focus will be the commercial considerations of the service provider, noting:

*"The Commission will take into account the provider's obligations to shareholders and other stakeholders including the need to earn commercial returns on the facility. It will also aim to ensure that any undertaking provides appropriate incentives for the provider to maintain, improve and invest in the efficient provision of the service."*<sup>39</sup>

9.5 In its final decision with respect to Telstra's undertaking for domestic PSTN originating and terminating access, the ACCC stated that:

*"Telstra's legitimate business interests include its ability to at least recover the costs incurred by an efficient operator in providing PSTN originating and terminating access, including a normal commercial*

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<sup>38</sup> *National Competition Policy*, Report by the Independent Committee of Inquiry, August 1993 at page 253.

<sup>39</sup> ACCC, *Access Undertakings: a Draft Guide to Access Undertakings under Part IIIA of the Trade Practices Act*, at pages 4-6.

*return on prudent investment commensurate with the risk. [ ... ] However, Telstra's legitimate business interests do not extend to achieving a higher than normal commercial return resulting from the lack of competition in the provision of originating and terminating access.”<sup>40</sup>*

- 9.6 However, in interpreting the term ‘legitimate business interests’ in the context of the access regime set out in the National Gas Code, the Supreme Court of Western Australia has taken a different view of the legitimacy of service providers achieving a higher than normal commercial return:

*“There was a submission from Alinta that in the context of this Code the recovery of monopoly prices or tariffs, above the level of economically efficient prices, should not be seen as "legitimate". I find no support in the Act or the Code for such a view. While some expressions of economic theory and passages in the Hilmer Report would suggest that it is against the interests of society as a whole, at least in some situations, for a monopolist to be able to recover monopoly prices or exercise monopoly power in the market, that does not make the enjoyment by a monopolist of a monopoly an illegitimate business interest.”<sup>41</sup>*

- 9.7 This position has been reflected in more recent statements by the ACCC in relation to legitimate business interests of access providers as follows:

*“However, it is unlikely that the legitimate business interests extend to achieving a higher than normal commercial return through the use of market power. For example, an access price should not, in most cases, be artificially inflated because of a lack of competition in the supply of infrastructure services.”<sup>42</sup> (emphasis added).*

- 9.8 In setting the undertaking price, Optus has had regard to the significant adjustment in subscription and origination prices needed to implement a price lower than that offered in the undertaking.
- 9.9 As outlined above, the impact on Optus from reduced MTAS rates is significant. Mobile termination rate reductions have had a significant effect on Optus’ net revenues and hence ability to adjust prices.
- 9.10 Optus’ legitimate business interests require that it is able to set a price that will allow it time to recover the lost termination revenue from other services including origination and subscription. Optus submits that application of a price of 12 cents per minute for an additional 6 months, as contemplated by the undertaking, is consistent with those legitimate business interests.

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<sup>40</sup> ACCC, *Assessment of Telstra's Undertaking for Domestic PSTN Originating and Terminating Access - Final Decision*, June 1999 at page 33.

<sup>41</sup> *Re: Dr Ken Michael AM; ex parte EPIC Energy (WA) Nominees Pty Ltd & Anor* [2002] WASCA 231 (23 August 2002) at para 130.

<sup>42</sup> ACCC, *Telstra's Undertaking for the Line Sharing Service*; Discussion Paper, December 2003 at page 11.

### **Interests of access seekers**

9.11 Section 152AH(1)(c) of the Act requires the interests of persons that have a right to use the declared service to be taken into account.

9.12 In interpreting this requirement, the ACCC has focused on other users' interests in a competitive environment stating that:

*“persons who have rights to use the declared service have an interest in competing for the custom of end-users on the basis of their technical and commercial merits. Their ability to compete in the supply of a service in a dependant market should be based on the cost or quality of their service relative to their competitors.”*<sup>43</sup>

9.13 Optus' undertaking prices promote the interests of access seekers because they are consistent with the rates that we expect would have been arrived at through commercial negotiations which are capped by the existing pricing principles that had 3 cent decrements in price on a calendar year basis..

### **Direct costs**

9.14 Consideration of the direct costs of providing access to the declared service has been included the reasonableness criteria in order to ensure that:

- access providers are compensated for the cost of providing access; and
- access prices are not inflated by the access provider to recover any increase in costs arising from an increase in competition that access has facilitated.

9.15 Optus' undertaking prices are consistent with the direct costs of providing the undertaking service, though these remain uncertain.

### **Operational and technical requirements**

9.16 Section 152AH(1)(e) of the Act requires the operational and technical requirements necessary for the safe and reliable operation of a network to be taken into account in assessing the reasonableness of an undertaking.

9.17 The objective of this requirement is to ensure that access prices that are the subject of an undertaking do not lead to arrangements between access providers and access seekers that will lead to or encourage the unsafe or unreliable operation of a carriage service, telecommunications network or facility.

9.18 Optus contends that the undertaking offers an operationally and technically feasible service.

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<sup>43</sup> ACCC, *Telstra's Undertaking for the Line Sharing Service: Discussion Paper*, December 2003 at page 11.



## **Economic efficiency**

9.19 This criterion concerns a general application of the efficiency criteria applicable under the LTIE test including the elements of dynamic, productive and allocative efficiency.

9.20 As the ACCC has stated:

*“An access price should encourage access providers to select the least-cost method of providing the service and provide those services most highly valued by access seekers.”<sup>44</sup>*

9.21 As discussed, Optus has relied on a number of data sources to devise its undertaking prices. Optus has not undertaken a bottom up cost modelling exercise, as it believes that given its operation in a competitive mobile services market (with four infrastructure competitors) and the age of the assets, its approach is reasonable.

## **10. Non-price terms and conditions are reasonable**

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10.1 The non-price terms and conditions in the undertaking are reasonable, satisfy the statutory criteria and should therefore be accepted by the ACCC because:

- they are consistent with the regulatory requirements for the acceptance of an undertaking;
- they are commercially reasonable and are accepted good industry practice; and
- Optus agree to comply with the SAOs.

## **11. Confidentiality**

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11.1 As stated in section 2.4 of this submission, Optus is providing the ACCC with this submission and a number of reports in support of its undertaking for the Optus DGTA Service. These reports, opinions and studies are relied on by Optus to support the reasonableness of the price and non-price undertaking terms and conditions.

11.2 The ACCC will appreciate that this submission and the content of these appendices contain information which is confidential in nature and would compromise Optus' commercial position and cause damage to Optus' business if made publicly available in the current form provided to the ACCC.

11.3 Optus intends to prepare public versions of this submission and the Appendices. These will be provided to the ACCC in the near future for dissemination as the ACCC so determines. Accordingly, Optus requests that the ACCC keep this submission and these Appendices confidential until these public versions are prepared.

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<sup>44</sup> ACCC, *Telstra's Undertaking for the Line Sharing Service: Discussion Paper*, December 2003 at page 11.

- 11.4 In all other respects, Optus proposes to institute procedures by which all confidential information supplied by Optus may only be disclosed by the ACCC to persons approved of in writing by Optus, where those persons have signed confidentiality agreements that are acceptable to Optus.