TELSTRA CORPORATION LIMITED

Response to the ACCC's Draft MTAS Pricing Principles Determination and indicative prices for the period 1 January 2009 to 31 December 2011

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Overview

In November 2008, the Commission invited industry comment on its draft Pricing Principles Determination and draft Indicative prices for the declared Mobile Terminating Access Service (**"MTAS"**) for the three years, 1 January 2009 to 31 December 2011 (**Draft Determination**). This is Telstra's submission responding to those draft Pricing Principles and Indicative Pricing.

In summary, the Commission's Draft Determination:

- **Is a complete departure** by the Commission from its previous approach to pricing the MTAS taken in its previous pricing principles, as well as the precedents established by several determinations by the Australian Competition Tribunal. The Commission, while stating that MTAS prices "should be cost-based", now proposes that TSLRIC is merely an "appropriate consideration" in determining prices, and that other factors should be considered by the Commission;

- Provides **no certainty** as to how to the Commission will approach MTAS pricing in the future. The factors the Commission now says are relevant are so vague that they would allow the Commission to select almost any price for the MTAS. For example, the Commission says that it will consider TSLRIC prices, RAF information, international benchmarking, fixed to mobile retail prices, etc, without any assessment of whether setting prices by having regard to these factors is in the long term interests of end users and without any guidance as to the weight each factor bears in making any decision. In the Draft Determination, the Commission appears to give so much weight to the cursory study it has found on international benchmark pricing, that it completely overrides the outputs of the WIK model which has been constructed to meet the TSLRIC methodology; and

- Insofar as it considers other factors such as international benchmarks and fixed to mobile retail prices, the Commission's analysis is **deeply flawed,** and does not meet the standard that it and the Tribunal have previously set. These analyses therefore cannot be relied upon in determining the appropriate MTAS price.

In addition, it is unclear why the Commission has chosen to publish revised Pricing Principles and draft Indicative Prices at this time, ahead of the re-declaration inquiry of the MTAS (which must be completed by end of June 2009). To require the industry to undertake two regulatory processes, and to largely pre-empt the outcome of the re-declaration inquiry by issuing prices for a three-year period when the declaration is about to expire, is an unnecessary and inappropriate duplication of regulatory processes.

The Commission's draft indicative price of 9cpm for three years is similarly flawed. In particular, in determining the indicative price, the Commission:

- **totally ignores** the TSLRIC outcome of its own cost model and instead adopts a price which is well above the Commission's own best estimate of the efficient costs of the service;

- **uses the flawed international pricing benchmarks** and a number of other factors **to override TSLRIC outcomes**, when that benchmarking and analysis is unreliable and can give no real guidance as to the appropriate indicative price;

- gives **absolutely no basis** upon which 9cpm can be justified; and

- **does not even attempt** to address how a 9cpm price can be considered a reasonable regulated rate for a further 3 year period.

Instead of adopting such a vague approach to pricing principles (which undermines the numerous statements made to the industry over the years as to how pricing will be determined) the Commission should revert to determining MTAS prices in accordance with its previously established principle of efficient costs – ie TSLRIC+. If it were to do this, it is clear that the indicative price the Commission should adopt from 1 January 2009 **would be 6cpm**. According to the Commission's own previous analysis, this price would actually meet the legislative criteria the Commission is required to address in establishing its pricing principles and determining indicative prices. By contrast, the Commission's draft indicative price of 9 cpm does not.

By proposing indicative pricing for MTAS at 9 cpm for 3 years, the Commission is asking Australia's fixed telephony customers to subsidise the mobile industry by approximately $90m per annum.

In addressing these matters, Telstra's submission:

(a) addresses the Commission's draft pricing principles, including its apparent abandonment of TSLRIC+, thereby demonstrating the Commission's flawed approach in its Draft Determination; and

(b) establishes that the 9cpm price is too high by any principled standard, and that there is no basis upon which the Commission can justify maintaining that price for 3 years. Instead, the Commission should adopt a price of 6cpm for six months, pending the outcome of the re-declaration inquiry.

Section 1 - The Commission's Draft Pricing Principles

The Draft Pricing Principles represent a new approach by the Commission to determining regulated prices for the MTAS. In particular:

- The Commission now sees TSLRIC as only one of a number of factors that it needs to take into account in setting appropriate pricing, and as a floor to the MTAS price. Previously, the Commission and the Australian Competition Tribunal **(the Tribunal)** have clearly stated that MTAS prices should be set according to the efficient costs of providing the service. This departure from precedent is unnecessary, without justification, and is replaced with an approach so vague that it would allow the Commission to choose any methodology that it desires to deliver a pricing outcome;

- There is no evidence that the Commission's new approach to pricing has been examined in accordance with the legislative criteria, or that it satisfies those criteria;

- The Commission now appears to be giving significant weight to "other factors", but none of the "other factors" identified in the Draft Determination are sufficiently robust to warrant consideration. Further the Commission provides no guidance as to how it will weight those other factors in applying its pricing principles with the result that the Commission's approach cannot properly be described as a formulation of principles. For example:

    - International Benchmarking: The Commission uses an international benchmarking study to indicate that Australia's indicative price is below prices set by European regulators. Yet the Tribunal and the Commission have previously rejected international benchmarking studies prepared by network operators, due to the inherent difficulties in ensuring the benchmarking is accurate. It is clear that the cursory study relied upon by the Commission does not meet the standards previously established by the Tribunal (and adopted by the Commission). The Commission's benchmarking analysis is therefore unreliable and flawed, and cannot be used in any analysis in determining appropriate MTAS prices for Australia;

    - RAF Data: The RAF information regarding actual costs of Mobile Network Operatorss **(MNOs)** is not yet available to the Commission. If and when it does become part of the reporting of MNOs within the industry, it is clear that the RAF information will not provide any reliable reflection of the actual costs of providing the MTAS, and therefore will not be any reliable guide on which to determine the efficient costs of providing the service – a qualification which has been established by the Tribunal as being important in determining regulated MTAS prices;

    - Waterbed Effect: Telstra agrees with the Commission that there is no evidence of a waterbed effect in the mobiles markets, and that any argument of the existence of a waterbed effect should continue to be rejected; and

    - Fixed to Mobile Retail Charges: The Commission's focus on Telstra's Retail Fixed To Mobile **(FTM)** pricing, and its apparent call for additional

regulatory mechanisms to achieve greater pass-through of MTAS price reductions, is contrary to the regulatory precedent that has been established in this area. FTM pass-through obligations have been categorically rejected by both the Commission and the Tribunal as being inefficient, unreasonable, and contrary to the LTIE. In any event, the Commission's attempt to analyse FTM retail prices is flawed and cannot be relied upon as it:

(a) Ignores the significant changes in the charging structures for the bundle of retail fixed line services (of which FTM is a prart) that have occurred to retail FTM prices by a range of service providers (not just Telstra) in the retail market in recent years. These changes demonstrate that FTM services, like other call categories, are subject to vigorous competition;

(b) Ignores the fact (which has been again well established in previous decisions of both the Commission and the Tribunal) that changes to FTM services is only one possible way in which benefits of reduced MTAS prices could be demonstrated for fixed network services. By only considering Telstra's retail FTM prices the Commission has ignored its own previous advice and that of the Tribunal's, and has conducted an incomplete and inaccurate study in which to conclude that little competitive benefit has flowed from previous reductions in the MTAS price;

(c) Ignores the significant price changes Telstra has made to its wholesale FTM pricing; and

(d) Incorrectly attempts to categorise the New Zealand requirements of pass-through as a precedent relevant to the Australian regulatory context. In fact, the Commission and the Tribunal have both previously rejected the appropriateness of a FTM pass-through requirement.

Efficient Costs and the TSLRIC+ approach – a Commission Backflip

The Commission's commentary on the TSLRIC+ approach adopted in the Draft Determination departs markedly from the body of precedent it has established over the years in relation to the pricing of the MTAS, including statements by the Tribunal adopting the TSLRIC+ principle. It seems that suddenly the Commission has taken upon itself to re-write its interpretation of the LTIE criteria under Part XIC, and has given itself the liberty to determine prices for declared services based on a range of unproven factors.

That is, rather than now adopting a TSLRIC+ approach for MTAS pricing, the Commission is now saying that efficient operators may be able to price somewhat above their costs[1]; and that consequently, the TSLRIC+ approach as demonstrated by the WIK model should now be taken as a floor on the costs of providing the service.[2]

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1 Draft Determination, page 11.
2 Ibid, page 15.

This is completely contrary to statements made and the pricing principles adopted by the Commission in numerous decisions over the last three to four years in relation to the appropriate price of the MTAS, including those set out below.

In 2004, the Commission determined a glidepath for the MTAS pricing, effectively reducing it from a starting point of 21cpm to a price of 12cpm over 3 years. The aim of the downward glidepath was to reduce MTAS prices towards costs:

> *"Given it has:*
>
> - *not developed a specific model to estimate TSLRIC+ in Australia at this time; and*
> - *concerns the possible harm that might be caused by disrupting the business plans of MNOs if the Commission were to immediately reduce the price of the MTAS to TSLRIC+,*
>
> *the Commission believes a pricing principle that generates a gradual reduction in the price of the MTAS so that it reduces to a level that represents a closer association of price and the best measures the Commission has available to it of the TSLRIC+ of providing the service within Australia would be most appropriate under the Act at this time."* [3]

In February 2006, the Commission rejected the first of two undertakings filed by Optus, as the pricing sought by Optus for the MTAS was higher than the Commission's then estimate of a TSLRIC+ methodology:

> *".. the Commission has concerns with some of the methodological and conceptual decisions made by Optus is [sic] determining its FL=LRIC++ principle. As a result of these concerns, the Commission believes that it would be more appropriate to set a target price for the MTAS on the basis of a TSLRIC+ methodology rather than the FL-LRIC++ methodology proposed by Optus."*[4]

One month later, the Commission rejected an undertaking by Vodafone for a similar reason:

> *".. the Commission considers that there is no certainty that cost estimates based on Vodafone's network will reflect an appropriate forward-looking cost estimate of an 'efficient operator' supplying the MTAS."*[5]

In that decision, the Commission rejected the cost model developed by Vodafone's consultant, PwC, because the Commission considered that it would likely overstate the MTAS costs of an efficient operator in Australia:

> *"The reasons for the Commission reaching this view are that:*
>
> - *the use of a top-down FAC modelling approach based on Vodafone's data is likely to tend toward overstating the 'forward-looking efficient economic costs' of providing the MTAS. This is due to the conceptual and practical differences between a FAC model and a TSLRIC+ model, and also*

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[3] ACCC, MTAS Mobile Services Review Mobile Terminating Access Service, Final Decision, June 2004, at p211

[4] ACCC, Optus's Undertaking with Respect to the Supply of its Domestic GSM Terminating Access Service (DGTAS), Final Decision, February 2006, at p xvii

[5] ACCC, Assessment of Vodafone's Mobile Terminating Access Service (MTAS) Undertaking, Final Decision, March 2006, at p35.

due to the tendency for top-down models to generate, at best, an upper bound on the efficient costs of service provision;

- *the most appropriate benchmark for modelling 'forward-looking efficient MTAS cost is that of an 'efficient operator'."*[6]

Similarly, in issuing its final decision on Optus' 2007 Undertaking, th e Commission said:

> *"The Commission is not satisfied that accepting the Optus 2007 Undertaking will be likely to promote the LTIE. This is because the Optus 2007 Undertaking would establish a price structure for the MTAS in excess of an estimate of the TSLRIC+ relevant for the period 1 July 2007 to 31 December 2007."*[7]

And in November 2007, only 13 months ago:

> *"Throughout three years of consultation, analysis and review of these models the ACCC's position on cost models has been well documented, widely publicised and affirmed by decisions of the Tribunal. For example, in its Vodafone decision the Tribunal indicated that while cost models distinct from TSLRIC+ models are not unreasonable, it is generally not in the LTIE to depart from TSLRIC pricing for regulated access services and that access prices should reflect and not exceed forward-looking efficient costs."*[8]
>
> *"... the Commission considers that it is reasonable to assume that a cost model using 2G technology will provide an upper-bound estimate [of] the efficient cpm cost of the MTAS."*[9]
>
> *"... the Commission's approach to access pricing has been considered by the Tribunal. Key areas affirmed by the Tribunal include the:*
>
> - *Appropriateness of a bottom-up TSLRIC framework for efficient cost-based pricing for the MTAS."* [10]
>
> *"At this point, the Commission notes that lower MTAS prices are inevitable as MTAS prices (cpm) fall and converge to the TSLRIC+ of supply..."*[11]
>
> *"The Commission has previously outlined why it preferred to establish access prices such as the MTAS with reference to the TSRLIC. These reasons are summarised below:*
>
> 1. *it encourages competition in telecommunications markets by promoting efficient entry and exit in dependent markets;*
> 2. *it encourages economically efficient investment in infrastructure and provides the appropriate incentives for future investment in decisions by access seekers to 'build' or 'buy';*
> 3. *in the long run TSLRIC based pricing provides for the efficient use of existing infrastructure, promoting allocative efficiency in the use of infrastructure;*

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6 Ibid, pp43-44.
7 ACCC, The Optus 2007 Undertaking in relation to the Domestic Mobile Terminating Access Service Public Version, Final Decision, November 2007, at p 27.
8 ACCC, MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008, p20
9 Ibit, at p64.
10 Ibid, at p8.
11 Ibid, at p9.

4. *it provides incentives for access providers to minimise the costs of providing access by using the most efficient technology commercially available today and best-in-use technology compatible with the existing network design;*

5. *by allowing efficient access providers to fully recover the costs of producing the service, it promotes the legitimate business interests of the access provider; and*

6. *it protects the interests of persons who have rights to use the declared service."*[12]

"Regardless of the network design, the value of that network should reflect an access price which reflects or is tending toward an efficient cost for the supply of the relevant access services using that network (and in the case of MTAS using a TSLRIC+ estimate). There is also recognition that pricing aligned to efficient costs will more likely encourage efficient investment in infrastructure."[13]

In its Draft Determination the Commission again acknowledges that implementation of a TSLRIC principle is consistent with the legislative criteria set out in sections 152AB and 152AH of the Act[14], however, the Commission then proceeds to provide no basis for now departing from a well-established and implemented TSLRIC approach. The Commission has also not attempted to justify why it considers the alternative approaches canvassed in the Draft Determination are sufficient to satisfy the legislative criteria or why they are so compelling they should override the TSLRIC approach the Commission has said on numerous occasions does meet the legislative criteria.

Instead, the Commission's pricing principles now say that while TSLRIC remains an "appropriate consideration", it can consider other methods in determining indicative pricing for the MTAS. The list of relevant factors that it can consider are not exhaustive, and therefore can be added to over time. The Commission fails to consider whether having regard to any of these other factors will meet the relevant statutory criteria it says it will have regard to in making pricing principles.[15] The Commission also gives no guidance as to the weight each of these other factors should be given.

In the Draft Determination, the Commission takes into account the following considerations:

- the efficient costs (TSLRIC +) of providing the MTAS is between 5.8 and 6.1cpm;
- a cursory look at international benchmarking (which is by no means robust and does not meet the requirements previously established by the Tribunal and endorsed by the Commission) shows that as at 1 July 2008, the average MTAS price of five European countries was 14.6cpm; and
- the Commission's concern that Telstra's retail FTM prices might not be as low as they should be (again, despite this study being inappropriate, incomplete and irrelevant for regulatory purposes),

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12 Ibid, at p15.
13 Ibid, at p48
14 Draft Determination, p12.
15 Draft Determination, at p8

and decides that these factors, when weighed together, mean a regulatory price of 9cpm is appropriate for the period from 1 January 2009 until 31 December 2011.

When considered in this light, it is clear that the Commission's pricing principles move away from a predictable, principled approach implemented over the last four years for the MTAS to one that is vague and gives the industry no certainty as to what price might be determined by the Commission in any given instance. This cannot be in the LTIE. This cannot satisfy the legislative criteria. This cannot mean that a price of 9cpm from 1 January is, by any measure, an appropriate or reasonable regulatory outcome.

For example, the Commission takes the view that "costs incurred in a competitive market may be efficient, even if above the cost estimated using a pure TSLRIC approach".[16] This approach, however, does not accord with the Tribunal's observations that:[17]

> *"... it would generally not be in the long-term interests of end-users to depart from TSLRIC pricing where access is regulated. However, we would repeat the observation of the Tribunal in Telstra Corporation Limited (supra) at par [63]:*
>
> > *"In this area of analysis there is no one correct or appropriate figure in determining reasonable costs or a reasonable charge. Matters and issues of judgment and degree are involved at various levels of the analysis."*
>
> *Nevertheless, we still consider that in general terms the prices in access undertakings should reflect and not exceed forward looking efficient economic costs: Telstra Corporation Limited (supra) at par [46]."*

The effect of the Tribunal's finding was not that actual costs are tantamount to efficient costs. The Commission must still turn its mind to whether the actual costs are demonstrably efficient. In considering factors other than the TSLRIC+ WIK model outputs, the Commission fails to consider whether those other factors arrive at pricing which reflects and does not exceed forward looking efficient costs.

For instance, in its Draft Determination the Commission states that, "In relation to the MTAS the Commission is of the view that the application of the latest technology as well as the most efficient network design will reflect efficient costs"[18], however, the benchmarking analysis conducted by the Commission makes no attempt to enquire whether the benchmarked rates set out in the ERG study are calculated based on the application of the latest technology and efficient network design. In fact the ERG snapshot data uses rates in those countries that reflect regulatory determinations of the various national regulatory authorities in Europe in some cases dating back to 2004. These rates can hardly be relied upon to reflect the latest technology and most efficient design for the purpose of informing pricing decisions from 1 January 2009 and until the end of 2011.

Further, the Commission then states that, "Given a new entrant would not be able to bring the new design and technology to bear immediately in a legacy-sized network the most efficient operator would not be forced to base its prices on the costs of a network optimised for all-new design and technology."[19]

Not only is the Commission being inconsistent with its previous pronouncements and determinations made on the approach that should be taken in setting regulated MTAS rates,

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16 Draft Determination, page 11.
17 Application by Vodafone Network Pty Ltd & Vodafone Australia Limited [2007] ACompT 1 (11 January 2007) at [44].

18 Draft Determination, page 11.
19 Draft Determination, page 11.

but it is clearly also adopting inconsistent positions within its Draft Determination, leaving the industry with no clear guidance as to how prices may be determined, or indeed what the regulated approach may be in the future.

International benchmarking

In its draft Determination, the Commission considers that international benchmarking can be a method of determining MTAS costs.[20] The Commission considers a study undertaken of the average termination rate amongst the "Big Five" European countries by the ERG as at 1 July 2008. The Commission then appears to believe that the resultant rate of 14.6 cpm is one of the main factors to justify maintaining the Australian regulatory price at 9cpm for 3 years from 1 January 2009: indeed, the Commission seems to give so much weight to this outcome, that it overrides the outcome of the Commission's own TSLRLIC+ cost model.

The Commission has previously indicated that international benchmarking would only be used as a relevant factor in determining access prices if the benchmarking "sought to make adjustments for all factors that drive the TSLRIC of providing the MTAS in different countries for Australia-specific factors."[21]

In particular, the Commission has previously indicated that the following factors are relevant to assessing the value of comparative benchmarking data:[22]

- spectrum allocation;
- network purchasing power;
- vertical integration of fixed and mobile network operators;
- geographic terrain;
- population density;
- network usage and scale;
- land and labour costs;
- cost of capital;
- technology employed; and
- exchange rate adjustments.

The Commission has previously rejected a significant volume of benchmarking evidence put forward by various access seekers and access providers for failing to provide the necessary

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20 Draft Determination, p16.

21 ACCC, Mobile Services Review – Mobile Terminating Access Services: Final Decision on Whether or not the Commission Should Extend, Vary or Revoke its Existing Declaration of the Mobile Terminating Access Service, (**MTAS Final Report**), June 2004, p211 cited in ACCC, MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008 Report, November 2007, page 29.

22 The first nine of these factors were identified by the Commission in its MTAS Final Report and exchange rate adjustments were also taken into account in the Commission's assessment of benchmarking data in the context of the Optus MTAS Undertaking of June 2004.

comparative data. Some specific examples of the criticisms the Commission and the Tribunal have made of the use of benchmarking data in the past are set out below.

Optus' use of benchmarking data in support of its June 2004 MTAS undertaking

Optus, in support of its June 2004 undertaking in relation to MTAS, submitted an international benchmarking analysis prepared by CRA based on 3 'comparator' countries: Malaysia, Sweden and the UK. CRA made what it considered to be appropriate adjustments for comparator countries, being the exchange rate, cost of capital and geographic terrain/network coverage.

In rejecting Optus' international benchmarking analysis, the Commission concluded that: [23]

> *"... any analysis that attempts to adjust for factors that drive cost differences between countries should be conducted comprehensively, or not at all. This is because, in the Commission's view, different factors will tend to push particular cost estimates in different directions and by different amounts. Therefore, an approach that only makes 'partial adjustments could lead to misleading results. ...*
>
> *...possession of the information sufficient to make a comprehensive adjustment is tantamount to that necessary to construct a bottom-up model. In the Commission's view, use of the information for the latter purpose would be superior to using it for adjusting cost estimates from other jurisdictions...*
>
> *...reference in the CRA report to the range of 'cost' estimates in international jurisdictions is both misleading and not relevant to the international benchmarking exercise it has actually undertaken to generate its proposed range ... This is because many of the estimates presented by CRA are not strictly 'cost' estimates or they include some form of 'mark-up' over cost to reflect certain factors."*

The Tribunal took a similar approach. In *Re Optus Mobile Pty Ltd & Optus Networks Pty Ltd,*[24], it dismissed the CRA report because the figures used were an inadequate comparator for Australian conditions.[25]

The Tribunal held that in order to place any reliance on international benchmarking it would be necessary to know much more about the following:[26]

- the regulatory environment within which they were determined;
- the state of the relevant markets; and
- the socio-economic environment in which the mobile services were operative.

The Commission adopted this position in its Pricing Principles decision in 2007, where it did not rely on international benchmarking in establishing its indicative price of 9cpm, but said that there was:

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23 ACCC, Optus' Undertaking with Respect to the Supply of its Domestic GSM Terminating Access Service (DGTAS) Final Decision, February 2006, page 124.

24 [2006] ACompT 8.

25 *Re Optus Mobile Pty Ltd & Optus Networks Pty Ltd* [2006] ACompT 8, paras [292]-[296].

26 *Re Optus Mobile Pty Ltd & Optus Networks Pty Ltd* [2006] ACompT 8, para [297].

"a need to make adjustments for all factors that influence the TSLRIC of providing the MTAS in different countries for Australia-specific factors before relying on international cost benchmarks to set indicative prices below 12cpm."[27]

Tribunal Decision on Telstra's 2005 Undertaking

Telstra, in support of its December 2005 undertaking in relation to ULLS pricing, made a submission on international benchmarking for ULLS prices.[28] The submission was filed in response to the Commission's draft decision on the undertaking but was not considered by the Commission in its final decision. However, the submission was considered by the Tribunal on appeal against the Commission's final decision.

Telstra's international benchmarking analysis provided information regarding the regulator of the ULLS (or similar services) in a number of other jurisdictions, outlined the current pricing structure in those jurisdictions, and provided a comparison of ULLS monthly charges across those jurisdictions. It also took into account differences in purchasing power parity and line density.

In proceedings before the Tribunal, the Commission submitted that before taking into account international benchmarks, the Tribunal would have to be satisfied that, notwithstanding differences between Australia and the relevant international jurisdictions, those benchmarks were reasonable comparators. The Commission's submissions identified the following differences in regulatory approaches as relevant:[29]

- the definition of the regulated service;
- the applicable regulatory framework;
- the geographic price structure;
- the cost of capital;
- the prescribed cost standard (if any); and
- population concentration (as opposed to population density).

The Tribunal agreed with the Commission's submissions and found that Telstra did not provide sufficient evidence to support the use of international benchmarking - i.e. in relation to the regulatory framework, the cost of capital and the price structures in other jurisdictions. In addition, the Tribunal was not satisfied that the adjustments proposed by Telstra took into account all of the adjustments which should have been made in order for the benchmarks to be reasonable comparators.[30]

The same criticisms that the Commission and the Tribunal have made of access providers' use of international benchmarking data in the past,[31] can now also be levelled at the Commission's attempt to use international benchmarking data in this case. For example:

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27 ACCC, MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008, at p49.

28 See Telstra's response to the Commission's draft decision on Telstra's ULLS monthly charge undertaking dated 23 December 2005 - ULLS price international benchmarking.

29 Telstra Corporation Ltd (No 3) [2007] ACompT 3, at para 384.

30 Ibid, para 385.

31 See, for example, ACCC, MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008 Report, November 2007, page 57.

- the Commission has failed to provide detailed information about the data sources for the benchmarks, including whether they are price or cost benchmarks, and there is no evidence that the nature of the regulatory framework in which the prices have been generated have been considered. Indeed, it is evident from the commentary provided by the Commission that the EC has recommended national regulatory authorities reduce termination rates to the costs of an efficient operator as soon as possible[32], that the benchmark prices used by the Commission are prices that are well above efficient costs. They are therefore irrelevant in considering the appropriate regulatory price for the MTAS in Australia;

- there is no detailed explanation of how peak and off peak rates have been factored into the ERG's calculation of the average rates;

- in any event, the Commission appears to have used European data in the ERG report that is based on mobile termination rates applicable in those countries as at 1 July 2008. How this is relevant for determining relevant international benchmark prices for the Australian context as at 1 January 2009, and also, for three years hence is not clear, particularly in circumstances where the EC is urging regulatory authorities to reduce those prices quickly towards cost;

- the Commission has converted rates to Australian rates, but there is no accurate point in time reference as again, the European data in the ERG report is based on MTAS prices applicable as at 1 July 2008. Further, ERG has already applied a currency conversion rate (a rate not disclosed in the ERG data snapshot) to adjust the rates for those countries who do not use the Euro currency. No information has been provided about the date at which these exchange rates were applied. The Commission has then further converted the rates into Australian dollars by applying a September 2008 exchange rate. Therefore the Commission has not relied on any data providing an accurate single point in time comparison of the relevant prices;

- The Commission has given no justification for relying on what it refers to as the "big 5" European countries as the most appropriate comparisons for the purposes of the benchmarking of MTAS rates, especially in circumstances where the Commission has previously found that the approach taken to setting termination prices in countries such as the United Kingdom need to be carefully scrutinised before being compared with the Australian regulatory context because it should not be assumed that rates set by other national regulatory authorities serve the same objectives as set out in the relevant Australian legislative criteria;[33] and

- The Commission has previously noted the EU Commission's own concerns about the role that inflated 3G spectrum costs may play in the costs of providing mobile termination in Europe. In the 2007 MTAS Pricing Principles Determination the Commission referred to the fact that on average, the impact of 3G spectrum costs added the equivalent of 2.9 to 4.5 Australian cents per minute to MTAS prices at the time.[34] A proper assessment of European benchmarks for MTAS would need to re-assess and adjust prices to take these inflated European spectrum costs into account prior to making any comparison with Australian rates.

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32 Draft Determination, p16

33 ACCC, MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008 Report, November 2007, pages 12-14, where the Commission highlighted limitations in comparisons with MTAS rates in a number of European countries, including the UK.

34 ACCC, MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008 Report, November 2007, page 56.

The inadequacy of the Commission's approach to international benchmarking is supported by the analysis undertaken by consulting firm Ingenious, which is attached as Schedule 1 to this response.

In addition, the recent and dramatic fall in the Australian dollar (which fell from a price of 97.73 US cents on 17 July 2008 to a low of 61.22 US cents on 28 October 2008, just over 3 months later) demonstrates how volatile any international comparison will be. Not only does this show the high fluctuation that can result from applying an exchange rate at one point in time with another, but it further illustrates that the benchmarking will be even more unreliable if it is used as a reference point for more than 3 years into the future, as the Commission has attempted to do in this instance.

Regulatory Accounting Framework data

The Draft Determination refers to the fact that MTAS is not currently separately reported under the regulatory accounting framework and notes the Commission's current consultation with the industry on its proposal to require separate reporting of the declared MTAS service and separate reporting of 2G and 3G activities.[35] The Commission's expectation is that this RAF data will become increasingly relevant to setting the MTAS pricing over time, as it may be used to derive a TSLRIC+ proxy[36].

The Commission's expectations in this respect are misguided, for the following reasons.

- First, as highlighted in Telstra's response to the discussion paper on the proposed mobile RAF RKR, the proposed RAF RKRs will allow MNOs considerable discretion in the way they can allocate particular costs to particular mobile services. The resultant cost data will therefore be highly variable across the industry, and unreliable and inappropriate as a basis for determining costs for regulatory purposes. A TSLRIC cost model is a far superior tool in this respect;

- Second, the Commission and the Tribunal have previously rejected the use of costs derived from RKRs such as the RAF RKRs in determining the efficient costs of a declared service under Part XIC[37]. In addition, ascertaining what the likely actual costs are of supplying the MTAS is of no assistance, as it does not answer the question of whether those costs are efficiently incurred – a question which must also be answered before they can be considered a relevant factor for determining regulated prices[38]; and

- Third, as Telstra has submitted in the Commission's consultation process on the proposed changes to the RAF, the changes the Commission is seeking to the RAF, if adopted, will not be able to be implemented until at least 2010, with reporting only able to occur after that date.

Telstra is therefore of the view that the RAF RKR data for the MTAS, if required to be implemented by the Commission, will not be of any assistance in determining the regulated price for the MTAS in the future.

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35 Drat Determination, page 17.

36 Ibid, pp16-17.

37 See for example ACCC, Unconditioned Local Loop Service (ULLS) Final Pricing Principles, November 2007, at p10; and the decision of the Tribunal in Telstra Corporation Ltd (No 3) [2007] ACompT3, 17 May 2007.

38 See, for example, Application by Vodafone Network Pty Ltd & Vodafone Australia Limited [2007] ACompT 1, 11 January 2007, at [44].

The Waterbed effect

Telstra supports the approach taken by the Commission in its Draft Determination – namely, that any arguments that a waterbed effect exists in Australia should continue to be rejected and should not form part of the Commission's consideration of appropriate pricing principles for MTAS.

The assertion of a "waterbed effect" cannot be accepted. It has already been dismissed by both the Commission and the Tribunal.[39]

Most recently, the Commission gave full consideration to the issue of the waterbed effect in the context of its 2007 MTAS Pricing Principles Report, where it stated:[40]

> *"There has been no evidence of the so-called 'waterbed' effect existing in Australia. The submission made by Vodafone on the existence of robust empirical evidence of the 'waterbed' effect is discussed in Annexure 8.4, as it does not provide reliable evidence on the existence of a 'waterbed' effect in Australia. Instead of retail mobile prices increasing and handset or subscription subsidies being eliminated due to a fall in the MTAS rates, there has been a decrease in retail prices for mobile outbound calls and an increase in the level of handset subsidies accompanying the fall in the MTAS rates. This suggests that the opposite than the 'waterbed' effect has been occurring."*

The Commission reached the conclusion that there was no empirical substantiation of the waterbed effect.[41]

Optus' financial results in its 2007/2008 Annual Report reinforce this view. They show that Optus has enjoyed continued increases in the number of mobile subscribers, particularly 3G subscribers, and continued growth in mobile revenue, despite a decline in incoming service revenue because of lower termination rates and a decline in operational EBITDA margin due to strategic initiatives that incurred costs.[42]

These considerations strongly refute the existence of any waterbed effect having occurred in Australia or being likely to occur as a result of efficient cost based MTAS pricing.

In addition, as the Commission notes in its Draft Determination, the New Zealand Commerce Commission ultimately concluded that regulated MTAS pricing is more likely to result in lower retail mobile subscription prices than would result if MTAS remained unregulated, and that any increase in retail mobile subscription charges is unlikely.[43] In other words, even where a waterbed effect may be present, the benefits to end users flowing from a regulated reduction in MTAS rates outweighs any detriments from a purported waterbed effect. Telstra considers that these reasons continue to justify the rejection of a waterbed effect in Australia.

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39 ACCC, MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008 Report, November 2007, Page 8 and see Application by Optus Mobile Pty Limited & Optus Networks Pty Limited [2006] ACompT 8 at paras [84]-[85].

40 ACCC, MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008 Report, November 2007, page 23.

41 Ibid, page 24.

42 See Singapore Telecommunications Limited Annual Report 2007/2008, p36.

43 Commerce Commission, Schedule 3 Investigation into Regulation of Mobile Termination, Reconsideration Final Report, 21 April 2006, at para [63].

Fixed to mobile pass through

In the Draft Determination, the Commission analyses Telstra's FTM prices as reported in its Accounting Separation results from 2004 to 2008, and expresses disappointment that in its view, Telstra's retail FTM prices have not reduced as much as it had expected.[44] Aside from presumably using this as a reason to determine MTAS indicative pricing at a level higher than TSLRIC+, the Commission then postulates as to whether additional regulatory requirements should be imposed upon Telstra to require greater FTM pass-through.[45]

The Commission's stance in its Draft Determination again cannot be justified according to the regulatory precedent that has been developed over the past few years.

First, the Commission has previously commented on how MTAS prices that are above cost can actually harm competition for fixed network services:

> *"In the first instance, the Commission notes that the MTAS is a required wholesale input for those providers wishing to supply FTM services. For this reason, the ability and incentive of MNOs to price the MTAS significantly above its underlying cost acts as a serious impediment to the development of effective competition in the market, particularly with respect to those providers of FTM services that only operate a fixed-line network. Moreover, significantly above-cost MTAS rates may also act as a barrier to entry for providers considering entry into the market within which FTM services are supplied. Therefore, contrary to Vodafone's view, the Commission considers that lowering the price of the MTAS towards its underlying cost of production is likely to promote competition in the market within which FTM (and potentially other fixed-line) services are provided, particularly over the longer term, and therefore could have a very important bearing on the structure of the market."*[46]

By seeking to establish indicative prices for the MTAS that are 3cpm above the TSLRIC+ of providing the service, the Commission is, according to its own statement, impeding competition for fixed network services, and effectively requiring end-users of fixed network services to subsidise mobile providers by that amount.

Second, the Commission has previously been very vocal in its objection to any requirement for a pass-through requirement of MTAS price reductions to FTM prices, and has previously rejected attempts by mobile network operators to require specific FTM pricing pass-through. The Commission has even defended the need for flexibility in choice as to how MTAS reductions would be passed on to end users before the Tribunal.

In the appeal of the Commission's decision to reject Vodafone's Undertaking, the Tribunal summarised the Commission's argument against Vodafone's attempt to require MTAS reductions to be directly passed through to reductions in FTM prices as follows:

> *"The Commission submitted that if the undertaking were accepted, the Pass Through Safeguard would deprive access seekers of the flexibility to determine competitively the form in which the reductions in the VMTAS would be passed through to the retail fixed services market. It is submitted that this would retard allocative and dynamic efficiency, would not be in the long-term interests of end-users and was therefore not reasonable."*[47]

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[44] Draft Determination, p18

[45] Ibid, p19.

[46] ACCC, Assessment of Vodafone's mobile terminating access service (MTAS) Undertaking, Final Decision, March 2006, at p100.

[47] Re Vodafone Network Pty Ltd & Vodafone Australia Limited [2007] ACompT 1, 11 January 2007, para [289].

The Commission's argument was accepted by the Tribunal, who similarly was concerned about a requirement for MTAS price reductions to be allocated only to FTM retail pricing:

> *"We are also concerned that the Pass Through Safeguard is inflexible in relation to the opportunity for competition to be promoted as a result of any reduction in the price of the VMTAS. It limits the opportunity of access seekers to determine the form in which any reductions they may receive in the supply of the VMTAS may be passed through to the retail fixed services market.*
>
> *We consider that the pass through provisions in the undertaking deprive access seekers of the flexibility to determine competitively the individual price elements for services within the basket of services that are supplied within the fixed-to-mobile market, and the form in which pass through will take place. This approach retards allocative and dynamic efficiency, inhibits competition, is not in the long-term interests of end-users and, in our view, is not reasonable."*[48]

The Commission's call for FTM pass-through regulation, therefore, is not just contrary to its previous stance on this issue, but it is also contrary to allocative and dynamic efficiency, will inhibit competition, and is also contrary to the LTIE.

In any event, the Commission's attempt to analyse fixed to mobile (FTM) retail prices is flawed, as it:

(a) Ignores the fact that reducing the price of FTM services is only one indicator of how the promotion of competition objective could be satisfied. The Commission has failed to consider any other relevant benchmarks;

(b) Ignores the significant price changes Telstra has made to its wholesale FTM pricing;

(c) Contradicts other analysis undertaken by the Commission in considering Telstra's FTM pricing; and

(d) Ignores that FTM services are provided as part of a bundle of other services, and that FTM has, since 2004, played its part in the bundle of retail PSTN services to reduce the year on year cost of those services when considered across all competitors (not just Telstra) in the retail market in recent years. These changes demonstrate that FTM services, like other call categories, are subject to vigorous competition.

FTM Pricing Is Not The Sole Indicator of Increased Competition, it is only One Indicator

In determining whether reduced MTAS prices have had a positive effect on competition, the Commission cannot seek to answer this question by considering retail FTM prices alone, as it has attempted to do in the Draft Determination. This has previously been acknowledged by the Commission:

> *"The Commission also notes that the extent of pass-through is not the only measure of the extent to which a lower price for the MTAS promotes competition in that market or the LTIE more generally. Improvements in the quality of services provided or reductions in the price of other services provided in the bundle of pre-selected fixed line services can also promote the LTIE."*[49]

And again:

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[48] Ibid, at paras 289-290.

[49] ACCC, The Optus 2007 Undertaking in relation to the Domestic Mobile Terminating Access Service Public Version, Final Decision, November 2007, at p25, adopting the ACCC's comments in the MTAS Final Report at p223.

> *"The Commission notes that this increased competition can manifest itself in many ways, including reduced prices and improvements in the quality of a range of product offerings made available by providers of fixed-line services (eg domestic and international long-distance services).*[50]

Faced with a reduction in MTAS rates, an efficient supplier of mobile and fixed network services (including FTM) may choose to pass a reduction in MTAS costs through to its end users through different means, and via any of those services. There is no reason to assume that the extent to which a reduction in MTAS rates promotes efficient competition should be assessed by reference to the extent to which those reductions are directly reflected in lower FTM rates.

Telstra's Wholesale FTM Prices have been Substantially Reduced

The Commission's analysis of retail FTM prices ignores the substantial changes which have occurred in the pricing of wholesale FTM services – a service which has seen a significant increased level of competition and substantial reductions in pricing as a direct result of MTAS price reductions. Telstra's wholesale FTM price has seen significant reductions since December 2004. Telstra's wholesale customers of its FTM product have therefore had the ability to compete much more vigorously in the retail market as they enjoy the benefits of the reduced pricing, and are able to pass those benefits on to their end users.

The Commission's Other Analysis of Telstra's FTM Retail Pricing

The statements made by the Commission in its Draft Determination are contrary to those made only 12 months ago in its 2007 Pricing Principles, where it concluded that reduced MTAS prices "... have flowed through to both the retail mobile services market and the market in which FTM services are provided."[51]

In addition, FTM prices form part of the basket of costs that make up PSTN bundle of services and have performed well in that basket. The Commission has separately reported that over the 2006-07 reporting year, Telstra's FTM services contributed to an 8.1% reduction in the residential basket[52] and a 7% reduction in the basket for business services[53], despite the high inflationary pressures on retail pricing over that period.

FTM Pricing by other Service Providers as part of their fixed services offering

Telstra further submits that, in any event, considering FTM as an isolated calling market is contrary to the Commission's accepted approach to market definition as evidenced by its recent decision in Telstra's WLR and LCS exemption application:

> *Consumers are increasingly acquiring a bundle of fixed voice services from the one provider. This may be due to customer preferences of receiving a single bill for all the services and the cost savings of acquiring a bundle from the same service provider...For the same reasons, the ACCC is of the view that it is appropriate to include basic access, local calls, national and international long distance calls and fixed to mobile calls within the bundle.*[54]

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50 ACCC, Assessment of Vodafone's MTAS Undertaking, Final decision, March 2006, at p101.
51 ACCC, MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008, at p26.
52 ACCC, Telecommunications Reports 2006-2007, at page 83.
53 ACCC, Telecommunications Reports 2006-2007, at page 87.
54 ACCC, *Telstra's Local Carriage Service and Wholesale Line Rental Exemption Applications, Final Decision and Class Exemption*, August 2008, at p42.

Schedule 2 to this response contains a table comparing current retail FTM pricing offered as part of a bundle to end users by various operators.

The data shows that among bundles that have been in the market for a while:

- most of these bundles include a capped FTM pricing option applying at least during off-peak calling times. The effect of the cap on FTM calls is that the cap applies as the maximum price payable by the consumer until the call duration reaches 20 minutes. After that time, the standard per minute charge applies; and

- some bundled offers, such as the Optus Fusion packages, include unlimited FTM calls for a flat charge.

Telstra considers that the FTM data relied upon by the Commission, which is the Telstra network average, does not adequately reflect these bundled offers in the retail market, and how the structure of the pricing may alter within individual offers. In particular, the fact that these offers are in place means that the benefits to consumers of lower FTM prices are being passed through to consumers.

Ultimately, any perceived lack of a direct correlation between the decline in MTAS rates and the reported FTM rates should not warrant concern by the Commission, let alone any notion of the need for further retail price controls. Telstra's track record of compliance with retail price controls is exemplary. There is no reason to introduce further retail price controls in the form of sub-price caps. The LTIE would be better served by a further reduction in MTAS pricing in line with the Commission's TSLRIC cost model, rather than by the imposition of further retail price controls affecting retail fixed services charges.

New Zealand Pass-Through Requirements

The Commission's Draft Determination also refers to the fact that in New Zealand a reduction in mobile termination rates is required to be passed through to fixed retail customers. However, as the Commission is aware, this is the result of the operation of voluntary deeds entered into by the two MNOs in New Zealand. The context of such voluntary commitments is also important to note: the commitments by those operators were part of a deal struck between those operators and the Government of New Zealand as a trade off to avoid mobile termination becoming the equivalent of a declared service. Further, it is worth noting that higher mobile termination rates are applied in New Zealand, than in Australia.

In Telstra's submission, there are greater competitive constraints on fixed and mobile MNOs in Australia than in New Zealand by virtue of there being a greater number of MNOs present in the Australian mobile service s market.

In such circumstances the LTIE is better served through direct regulation to lower MTAS rates, the benefits of which can be passed on to consumers through a variety of competitive initiatives, than through retail price controls being imposed on mobile services. The desirability of fixed network operators having the ability to choose how best to pass through reductions in MTAS rates to their end-users has been previously considered by both the Commission and the Tribunal, with both concluding that access seekers should have the freedom to select how best to pass on the reduction, as detailed more particularly above. There is simply no justification for the Commission departing from this precedent.

Why is the Commission Determining Pricing Principles and Indicative Prices Now?

In its draft Pricing Principles paper, the Commission seeks to determine new pricing principles and draft indicative prices for a period of three years, when the declaration of the MTAS is due to expire in only six months time. The reasoning given by the Commission for this is weak:

namely, that the declaration could be extended in any event, and that if there are arbitrations, they may need to determine a price beyond 30 June 2009.

There is simply no justification for the Commission seeking to impose the proposed MTAS Pricing Principles and indicative MTAS pricing until December 2011. In particular:

a) The legislation contemplates, quite correctly, that Pricing Principles should be determined at the time the re-declaration occurs, or shortly thereafter [55] This enables the determination of the question as to whether to re-declare the service to be considered together with the question of how the declared service should be priced. By considering Pricing Principles now for a period of three years, the Commission is almost pre-judging the outcome of the declaration inquiry;

b) if there is for some reason a regulatory need to publish indicative prices for the period beyond 31 December 2008, then the Commission could publish its view of the new indicative price for a further 6 months, and then allow the re-declaration process to proceed, coupled then with a revised version of the pricing principles and further indicative prices. Indeed, this is the standard practice the Commission has comfortably adopted for numerous declared services, including the MTAS. There is no obvious reason for departing from it in this case; and

c) while the Commission claims that it is seeking to provide long-term certainty about its views on appropriate pricing to the industry as it can,[56] the Commission is providing **no certainty** to the industry. For example:

   I. as mentioned above, the draft Pricing Principles demonstrate a significant departure from the Commission's previous well-stated approach to pricing the MTAS – a departure which will apparently see MTAS prices stagnate for a period of 3 years, rather than decline towards the TSLRIC of the service. This change in approach contradicts all industry expectation on where the pricing for the MTAS was likely to head;

   II. the numerous factors that the Commission now appears to be wishing to take into account in determining the price are vague, uncertain, and give the industry no insight as to how the Commission will apply those factors in the future to any given case, and therefore, how regulated prices will be determined in the future. This does not and will not promote efficient investment in the industry; and

   III. in any event, the Commission's draft Pricing Principles can give no certainty beyond 30 June 2009, until the re-declaration process is complete, and the Commission again addresses the question of the appropriate Pricing Principles for the service.

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55 section 152AQA(3) of the Trade Practices Act.
56 Draft Determination, page 6.

As demonstrated above, the Commission's draft Pricing Principles, as pronounced in its Draft Determination, are flawed, and amount to a significant turnaround from previous statements as to how regulated MTAS prices should be determined. The concerns Telstra has with this approach become even more acute when the Commission's draft indicative price of 9cpm is analysed.

Section 2 - The Commission's Draft Indicative Price

The Commission has issued a draft indicative price of 9cpm, which it proposes should apply from 1 January 2009 until 31 December 2011. However, as explained further below:

- There is no justification for setting the price of 9cpm for 1 January 2009; and
- There is even less justification (and indeed, the Commission provides none) for maintaining that price as a regulated price for 3 years, until 31 December 2011.

The 9cpm indicative price is above cost, and is an unreasonably high starting point

The Commission's draft pricing principles adopt a cost-based pricing approach, and indicate that in determining this cost-based approach, TSLRIC costs, plus other factors, should be taken into account. **Yet it is clear that 9cpm is not cost-based.** Indeed, the Commission provides no basis upon which it has determined 9cpm as a starting point for the indicative prices, and in fact the evidence clearly demonstrates that the 9cpm price has no correlation whatsoever to efficient cost -- it is well above the efficient cost of providing the MTAS.

In 2007 in its Pricing Principles Determination, the Commission lowered its indicative price from 12cpm which applied previously, to 9cpm. That rate applied from 1 July 2007 to 31 December 2008. In this context, the Commission justified its 9cpm price on the basis that it reflected "an upper-bound estimate of the total service long-run incremental cost plus a mark-up (TSLRIC+) for the supply of MTAS for the period after 30 June 2007".[57] The choice of the 9cpm price was also consistent with the Commission's previous lock-step decline of MTAS prices in 3cpm increments towards a TSLRIC benchmark price, as it had determined in its 2004 Pricing Principles.[58]

However, in 2007, the Commission also:

- demonstrated that the actual estimate of the rate which should apply for **efficient operators was 6.1 to 6.6cpm**, and only for smaller operators was 7.8cpm.[59] This was based on the Commission's own WIK Cost Model, which used 2G technology as a benchmark for efficient costs of 2G and 3G mobile networks in Australia;
- concluded that:

  *"...there is **ample information** to support that an efficient cost estimate lies below 9cpm".*[60] [emphasis added]

- noted that:

  "the Commission considers that it is reasonable to assume that a cost model using 2G technology will provide an upper-bound estimate [of] the efficient cpm cost of the MTAS"[61]

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57 ACCC, MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008 Report, November 2007, page 1.

58 ACCC, Mobile Services Review, 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, at pxix.

59 ACCC, MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008 Report, November 2007, Page 1 and table A.3-1 in Annexure A.3.1.2 of the Report.

60 Ibid, Page 47.

61 Ibid, p64.

- And then concluded that:

  ... in an Australian context, in the long-run, most MNOs will either deploy or be using 3G networks which cover at least 96 per cent of the population ... This enables MNOs to deploy a mobile network at a lower cost for rural and regional areas, as less Node Bs are required in these areas to cover larger distances."[62]

These statements clearly demonstrate the Commission's view that the efficient costs of mobile operators in Australia are below 9cpm, and that as the migration of customers from 2G to 3G spectrum continues, those costs should reduce even further. In addition, the updated outputs from the WIK model show clearly that the Commission's starting price of **9cpm greatly exceeds the current efficient cost estimates,** which have reduced in the last 18 months to a range **of 5.8 to 6.1cpm.**

The WIK Cost Model

The development of the WIK pricing model has been a long term initiative by the Commission to develop a cost model which was a bottom up cost model to estimate the efficient cost of supplying MTAS in the Australian context using a TSLRIC conceptual framework.[63] As the only cost model currently available to the industry, it provides the only guidance on what the efficient costs of a MNO are likely to be in Australia. The WIK model currently produces cost estimates in the range of 5.8 to 6.1cpm.

As referred to above, the Commission has previously highlighted that using the WIK model to set pricing for MTAS is appropriate because it is generally not in the LTIE to depart from TSLRIC pricing, and because access prices should reflect and not exceed forward-looking efficient costs.[64] Accordingly, the Commission's prices should continue to be informed by the results produced by the WIK model, as it remains the best means of determining the efficient costs of the MTAS available to the Commission and industry at this time.

Limitations on access to the WIK model

While Telstra has reviewed the WIK model made available by the Commission, part of the difficulty experienced in using the WIK model arise from the fact that:

- The Commission has not made a complete version of the model available to the industry - the version of WIK provided does not allow parties to scrutinise the calculations that are used to arrive at the outputs generated. Users of WIK can enter data and generate results but have a limited ability to test how the results are generated because the back end calculations are not transparent to a user of the WIK model; and

- The Commission has also not published a detailed description of how it has used the model to arrive at the outputs published. This in turn makes it very difficult for any one with access to the WIK model to replicate the Commission's use of the WIK model. It is also not possible to comment on any errors or for that matter any benefits in the Commission's approach, other than to seek to question the outputs.

The results of the sensitivity analysis which Telstra has been able to perform as a result of the limited time and access granted to the WIK model are attached in Schedule 3.

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62 Ibid, p65.

63 ACCC, MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008 Report, November 2007, Page 4

64 See ACCC, MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008 Report, November 2007, in which the Commission cites the Australian Competition Tribunal's Decision in *Application by Vodafone Network Pty Ltd & Vodafone Australia Limited* [2007] ACompT 1, 11 January 2007, at [44].

The problems regarding access to the WIK model noted above are not problems with using a TSLRIC model, or a TSLRIC approach more generally. Instead it is the Commission's particular use of the model that makes it less than ideal. However, rather than turn to less accurate and less informative means of seeking to justify an alternative approach to setting MTAS pricing, Telstra would urge the Commission to take steps to rectify the problems with access to the WIK model to make the model a more transparent tool for the industry.

There is no basis for determining an indicative price of 9cpm

Even though it has developed a cost model, and consulted with industry over a considerable period of time in the development of that model, the Commission is not proposing to adopt the outputs of the WIK model in determining MTAS pricing. This is because, as mentioned above, the Commission now proposes that TSLRIC+ pricing is only one factor which it should take into account in determining regulated MTAS prices.

In particular, the Commission now considers that the WIK model "provides a floor price on the cost of supplying the MTAS on a 2G network"[65]. However, the Commission also accepts that 3G networks can be more efficiently provided than 2G networks, and that MNOs are likely to continue to operate 2G and 3G networks simultaneously for some time. Setting aside for a moment the fact that Hutchison operates only a 3G network, even if it is accepted that WIK provides a lower range estimate of the cost of supplying MTAS on a 2G network, it is legitimate to expect that the Commission would not depart too far from this lower range estimation in circumstances where most MTAS providers are operating with enhanced efficiencies of a 3G network combined with their operation of a 2G network.

The WIK model is the best tool the Commission currently has available to it to approximate the TSLRIC of providing the MTAS service. However, rather than relying on this model, the Commission has sought to override its outcomes by choosing an indicative price of 9cpm, without any proper basis for determination (see the criticisms levelled above regarding the Commission's attempted international benchmarking study and its FTM pricing analysis), and without considering or indeed applying the LTIE and related legislative criteria.

This does not reflect "a more pragmatic application of the TSLRIC approach", as claimed by the Commission[66]. It instead is an unsubstantiated move away from the TSLRIC principle, without regard to the legislative criteria, and with no justification for the indicative price selected, in a manner which would keep MTAS rates artificially high for the next 3 years.

It is extraordinary for the Commission to maintain the same price for the MTAS as it determined was appropriate in June 2007, in circumstances where the efficient costs of the MTAS in Australia has been known and accepted by the Commission for some time to be below 9cpm, and according to the Commission's own cost model, to be further below that benchmark price than was previously determined. It is even more extraordinary that at the same time, the Commission would then seek to establish pricing principles which state that prices for the MTAS should be cost-based.

There is no basis for maintaining 9cpm for a 3 year period.

While the Commission's choice of a 9cpm price has no basis, the current Draft Determination provides even less justification for seeking to maintain that price for a period of 3 years.

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[65] Draft Determination, page 15.
[66] Draft Determination, p13.

Implicit in this approach is the assumption not only that costs greatly exceed those determined by the Commission's own cost model, but more importantly, that those costs will not trend downwards at all over the next 3 years.

As mentioned above, the Commission acknowledged in 2007 that MTAS rates would continue to decline as the rates converged to the TSLRIC of supply.[67] A number of factors suggest that unit costs of supplying the MTAS should continue to reduce over the coming 3 years. Such factors include:

- Expected reductions in the cost of technology;
- Increasing mobile call volumes;
- Increasing migration to lower-cost 3G platforms; and
- Efficiencies gained from providing a wider range of services over the mobile platform eg data services.

These factors were considered by the Commission in the context of its consideration of the Vodafone MTAS Undertaking in 2006, where the Commission stated: [68]

> *... in the Commission's view, the likelihood of declining GSM network asset costs coupled with increasing traffic volumes (among other factors) suggests that the per-unit costs of providing the MTAS on a GSM network are likely to be lower, perhaps significantly, in 2007 and beyond (even once inflation is factored in), as compared to 2002-03.*

The Draft Determination fails to consider the impact of any of these factors since 2007. It also fails to address how these factors are likely to impact MTAS pricing for the next three years.

As the Draft Determination fails to consider these fundamental factors, the Commission cannot be satisfied that 9cpm meets the legislative criteria as a regulated price for 1 January 2009. It can be even less satisfied that 9cpm will meet the legislative criteria for a period of 3 years, to 31 December 2011. Indeed, the information available to the Commission and previous statements made by it suggest that a more appropriate indicative price for the industry would be 6cpm.

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[67] ACCC, MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008 Report, November 2007. Page 9.

[68] ACCC, Assessment of Vodafone's mobile terminating access services (MTAS) Undertaking, Final Decision, March 2006, page 39.

Conclusion

Since its Mobile Services Review conducted in 2003, the Commission has been seeking to implement a regulated price for the MTAS that would reflect the costs incurred by an efficient MTAS provider. To assist it in achieving this, the Commission engaged WIK to develop a TSLRIC cost model – the basis upon which MTAS prices would ultimately be determined. Yet in its Draft Determination the Commission rejects the results produced by that model in favour of a combination of other approaches that, if applied, are unpredictable and variable and provide no real guidance or certainty to the industry around how MTAS prices will be determined in the future. They instead appear to give the Commission complete discretion as to the regulatory price it may apply. Indeed, the methodologies the Commission adopts (such as international benchmarking and FTM retail price analyses) are clumsy, irrelevant, and cannot be used as any reliable guide on the MTAS price.

Similarly, the Commission cannot justify its 9cpm indicative price as meeting the relevant legislative criteria. The Commission has long since acknowledged that the efficient costs of the MTAS are below 9cpm, and there is simply no justification or evidence to support its selection as an appropriate price for the industry for 1 January 2009, let alone a further three years hence.

The Commission's abandonment of its long-held approach to pricing the MTAS, and its subsequent indicative price determination, is completely unacceptable for an industry which is seeking certainty and consistency in regulatory decisions in order to make considerable investment decisions.

Telstra urges the Commission to undertake a complete re-think of its approach, and to consistently apply the TSLRIC pricing principle for the MTAS, which according to the cost model developed by the Commission's own consultant, will necessarily result in an indicative price of 6cpm for 1 January 2009.