

**ACCESS DISPUTES BETWEEN
TELSTRA CORPORATION LIMITED (ACCESS SEEKER)**

AND

**OPTUS MOBILE PTY LIMITED & OPTUS NETWORKS PTY LIMITED (ACCESS
PROVIDERS)**

DOMESTIC MOBILE TERMINATING ACCESS SERVICE (MTAS)

Access Disputes Notified under section 152CM (1) of the *Trade Practices Act 1974* (the Act)
on 13 November 2006

Statement of Reasons for Final Determinations

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BACKGROUND

Details of Access Disputes

1. On 13 November 2006, Telstra Corporation Limited (**Telstra**) submitted two separate notifications with the Australian Competition and Consumer Commission (**ACCC**) under section 152CM (1) of the Act (**Notifications**). The Notifications concern the supply of the Domestic Mobile Terminating Access Service (**MTAS**) by Optus Mobile Pty Limited and Optus Networks Pty Limited (together, **Optus**) to Telstra.
2. On 29 November 2006, the Chairman of the ACCC, Graeme Samuel, constituted the Commission for the purposes of arbitrating the access disputes (**Commission**) notified by Telstra on 13 November 2006 (**Disputes**).
3. Following its constitution for these Disputes, the Commission formed the view that the requirements of section 152CM (1) of the Act are satisfied. That is:
 - Optus is a carrier;
 - Optus supplies the declared MTAS;
 - standard access obligations apply to Optus in relation to the MTAS; and
 - Telstra is unable to agree with Optus about the terms and conditions on which Optus is to comply with those obligations.
4. The Commission issued interim determinations in these Disputes on 18 December 2006. The interim determinations took effect on 1 January 2007 and contained the following price term:
 - the charge payable by Telstra to Optus for the MTAS is to be 12 cents per minute (**cpm**) for the period commencing on 1 January 2007 and expiring on 30 June 2007.
5. On 2 February 2007, the Commission issued parties with directions relating to the final determinations in these Disputes (**Directions of 2 February 2007**). The Directions of 2 February 2007 required parties to make submissions by 2 March 2007 and submissions-in-reply by 16 March 2007.
6. On 28 June 2007 the Commission issued draft determinations and a supporting statement of reasons for these Disputes (**Draft Decision**) and invited submissions on the Draft Decision from the parties by 10 August 2007.
7. On 29 June 2007 Telstra sought an urgent interim determination for these Disputes which the Commission declined on the basis that the *Draft MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008* (**Draft 2007 MTAS Pricing Principles Determination**) was not ‘in force’ and so could not be used to make a decision under section 152CPA(3) of the Act.
8. In response to a request by Optus and with the consent of Telstra, the ACCC granted an extension of time for submissions on the Draft Decision.
9. In accordance with the ACCC’s extended timeframe for submissions both parties provided their submissions on the Draft Decision to the ACCC on 24 August 2007. Telstra provided a copy of its submission to Optus at the same time as the ACCC. Optus made its submission on a confidential basis initially and subsequently provided Telstra with a copy under a confidentiality arrangement.

10. In addition to the present Disputes, the Commission notes that it is concurrently considering disputes notified by Optus against Telstra on 22 December 2006 (**Optus-Telstra Disputes**).
11. In this Statement of Reasons, these Disputes and the Optus-Telstra Disputes are referred to collectively as the ‘**sets of Disputes**’.

MTAS Pricing Principles Determination

12. The MTAS is an access service for the carriage of voice calls from a point of interconnection, or potential point of interconnection, to a B-Party (the end-user to whom a telephone call is made) directly connected to the access provider’s digital mobile network.¹
13. On 30 June 2004, the ACCC declared the MTAS under section 152AL of the Act.² This declaration expires on 30 June 2009. The MTAS declaration covers the termination of voice calls on all types of mobile networks (including third generation – or 3G – mobile networks).
14. On declaration of the MTAS, as required under section 152AQA of the Act, the ACCC made the *MTAS Pricing Principles Determination* which is relevant for the period from 1 July 2004 to 30 June 2007.³ The *MTAS Pricing Principles Determination* indicates that the price of the MTAS should follow an adjustment path such that there is a closer association of the price and underlying cost of the service. In this regard, the ACCC indicated that cost should be estimated in accordance with the ‘total service long-run incremental cost’ (TSLRIC) cost concept, augmented by a mark-up (or ‘+’) for a contribution to the recovery of organisational-level common costs related to the supply of the MTAS (estimated according to the so-called ‘equi-proportionate mark-up’ or ‘EPMU’ rule).⁴
15. Based on the most reliable and robust information the ACCC had available to it at the time of making the *MTAS Pricing Principles Determination*, it was determined that the TSLRIC+ of supplying the MTAS in Australia was likely to fall in the range of 5 cpm to 12 cpm. This estimate was informed by cost information sourced from accounting data supplied by Optus and Telstra under the Regulatory Accounting Framework (RAF) as well as international cost benchmarking information. As a conservative approach, the ACCC selected the *upper bound* of this range (i.e. 12 cpm) as the target price to which the MTAS price should tend in its *MTAS Pricing Principles Determination*.⁵

¹ 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, p. 239.

² A copy of the declaration was published in the Commonwealth of Australia Gazette No. GN 28, 14 July 2004.

³ Determination under section 152AQA, *Trade Practices Act 1974 – Pricing Principles for Domestic Mobile Terminating Access Service* (30 June 2004), www.comlaw.gov.au – Legislative Instrument - F2007B00329 (*MTAS Pricing Principles Determination*).

⁴ The equi-proportionate mark-up (EPMU) rule is a means of recovering fixed and common costs through the addition of a mark-up on top of incremental costs. The costs to be recovered are allocated across a range of services so that each service is allocated the same mark up as a percentage of its incremental cost.

⁵ ACCC, *MTAS Final Report*, section 9 and Annexure.

16. The price related terms and conditions in the *MTAS Pricing Principles Determination* outlined an indicative price path to the upper-bound estimate of the TSLRIC+ of supply of the MTAS of 12 cpm over a 30 month period from 1 July 2004 to 1 January 2007, as detailed in the table below.

Time period	Price related terms and conditions (cpm)
1 July 2004 – 31 December 2004	21
1 January 2005 – 31 December 2005	18
1 January 2006 – 31 December 2006	15
1 January 2007 – 30 June 2007	12

Source: ACCC, *MTAS Final Report*, (June 2004), p. 217.

17. In the *MTAS Final Report*, the Commission stated that:

... before it would reduce the price of the MTAS below the upper end of the range of best estimates available to it of the TSLRIC+ of providing the MTAS, the Commission would develop a more detailed estimate of the TSLRIC+ of providing the MTAS in Australia. This could be via developing a model to specifically model the TSLRIC+ of providing the MTAS in Australia, or via a detailed international benchmarking exercise that sought to make adjustments for all factors that drive the TSLRIC of providing the MTAS in different countries for Australia-specific factors.⁶

18. To this end, WIK Consult was engaged and has developed a bottom-up cost model to inform the ACCC about the efficient cost of supply of the MTAS in an Australian context using a TSLRIC conceptual framework. On 1 February 2007, the ACCC released the Mobile Termination Cost Model for Australia (**WIK Report**) along with its own discussion paper. On 16 February 2007, the ACCC released the WIK Mobile Network and Cost Model (**WIK Model**) to interested parties which signed an access deed. The Commission has considered Telstra's and Optus's submissions arising from the WIK Model consultation process (**WIK Model Consultations**). Further details about the WIK Report and the WIK Model Consultations are available on the ACCC's website: www.accc.gov.au.
19. The ACCC considered the outputs of the WIK Model to inform indicative prices for the supply of the MTAS in an Australian context from 1 July 2007 to 31 December 2008 and the Commission released: the *Draft 2007 MTAS Pricing Principles Determination* and the *Draft MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008 Report (Draft 2007 MTAS Pricing Principles Determination Report)* on 21 June 2007.⁷ The Commission released the final *MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008 Final 2007 (2007 MTAS Pricing Principles Determination)* and the *Final MTAS Pricing Principles Determination 1 July 2007 to*

⁶ *ibid.*, p. 211.

⁷ Refer to: ACCC, *Draft MTAS Pricing Principles Determination for the period 1 July 2007 to 31 December 2008 (Draft 2007 MTAS Pricing Principles Determination)* and *Draft MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008 Report (Draft 2007 MTAS Pricing Principles Determination Report)*.

31 December 2008 Report (*2007 MTAS Pricing Principles Determination Report*) on 28 November 2007. The *Final 2007 MTAS Pricing Principles Determination* provides an indicative price of 9 cpm from 1 July 2007 to 31 December 2008.⁸

MATTERS AND INFORMATION THE COMMISSION HAS CONSIDERED

Legislative requirements

20. Section 152AQA(6) of the Act requires the Commission to have regard to the relevant pricing principles determination which applies to the MTAS.. For these Disputes there are two relevant determinations under section 152AQA:
 - The *MTAS Pricing Principles Determination* relevant for the period to 30 June 2007; and
 - The *2007 MTAS Pricing Principles Determination* relevant for the period from 1 July 2007.
21. Section 152CR(1) of the Act sets out the matters which the Commission is required to have regard to in making a final determination.
22. Section 152CR(2) provides that the Commission may take into account any other matters that it thinks are relevant.
23. Section 152CP(1) of the Act provides that unless the Commission terminates the arbitration, it must make a written determination on access by the access seeker to the declared service.
24. Section 152CP(2) of the Act provides that the determination may deal with any matter relating to access by the access seeker to the declared service, including matters that were not the basis for notification of the dispute.
25. As required by section 152CP(4) of the Act, the Commission issued a draft determination to the parties for each of these Disputes on 28 June 2007.
26. Section 152CP(5) of the Act requires that when the Commission makes a determination it must give the parties to the arbitration its reasons for making the determination.

Parties' submissions

27. In the Directions of 2 February 2007, the Commission directed the parties to provide submissions addressing the relevant issues in dispute, including the:
 - price(s) at which Optus is to provide access to the MTAS to Telstra;
 - time period(s) for which the final determinations should operate; and
 - matters the Commission must take into account in making the final determinations in sections 152CR(1)(a) – (g) of the Act.

⁸ Refer to: ACCC, *Final MTAS 2007 Pricing Principles Determination for the period 1 July 2007 to 31 December 2008 (2007 MTAS Pricing Principles Determination)* and *Final MTAS Pricing Principles Determination 1 July 2007 to 31 December 2008 Report (Final 2007 MTAS Pricing Principles Determination Report)*.

28. The Directions of 2 February 2007 did not limit the matters the parties could address in their submissions.
29. Initial submissions were due on 2 March 2007 and submissions-in-reply were due on 16 March 2007.
30. Telstra provided its initial submission on 2 March 2007.
31. Optus provided its initial submission on 5 March 2007, three days after the deadline set out in the Directions of 2 February 2007.
32. Both Optus and Telstra provided submissions-in-reply on 16 March 2007.
33. The Commission notes that the parties seek to rely on their submissions in both sets of Disputes either in whole or in part.
34. Parties' submissions and submissions-in-reply are not reproduced in this Statement of Reasons but are set out in full as appendices as follows:
 - Appendix 5 – Telstra's Submissions
 - (a) Telstra, *Initial submission in the Optus-Telstra Disputes*, 2 March 2007
 - (b) Telstra, *Initial submission in Telstra-Optus Disputes*, 2 March 2007
 - (c) Telstra, *Submission-in-reply in the Optus-Telstra Disputes*, 16 March 2007
 - (d) Telstra, *Submission-in-reply in Telstra-Optus Disputes*, 16 March 2007
 - (e) Telstra, *Submission on the Draft Decision in the Telstra-Optus Disputes*, 24 August 2007
 - (f) Telstra, *Submission on the Draft Decision in the Optus-Telstra Disputes*, 24 August 2007
 - Appendix 6 – Optus's Submissions
 - (g) Optus, *Initial submission in the Optus-Telstra Disputes*, 5 March 2007
 - (h) Optus, *Initial submission in Telstra-Optus Disputes*, 5 March 2007
 - (i) Optus, *Submission-in-reply in the Optus-Telstra and Telstra-Optus Disputes*, 16 March 2007
 - (j) Optus, *Submission on the Draft Decision in the Telstra-Optus and Optus-Telstra Disputes*, dated 24 August 2007.
35. The Commission has had regard to these submissions in making the final determinations and refers to them as appropriate in this Statement of Reasons.

Extraneous material

36. The Commission has issued instructions and directions to parties about their responsibilities during these Disputes.⁹ These responsibilities include but are not limited to:

⁹ Refer to:
- Commission, letter to Optus, *Notification of Access Dispute – Telstra-Optus Mobile*, dated 24 November 2006;

- providing submissions on the content of the final determinations by the due date and time;
 - providing a copy of any extraneous material relied on by parties in their submissions;
 - ensuring that a copy of all submissions and supporting documents are provided to both the Commission and the other party; and
 - providing separate submissions if several disputes (or sets of disputes) are proceeding in tandem and the parties are both an access seeker and an access provider.
37. The Commission notes that, notwithstanding its instructions and Directions of 2 February 2007:
- Optus did not provide its initial submissions within the deadline set; and
 - both parties have sought to rely on various extraneous material in their submissions but have failed to provide copies of all documents relied on.
38. In the conduct of an arbitration, the ACCC's objective is to make a fully informed and timely decision. The ACCC can only do this if submissions and submissions-in-reply are complete and submitted with the ACCC and provided to the other party in a timely manner.
39. The Commission notes Telstra's submission that the Optus confidential submission, in support of the ordinary access undertaking submitted to the ACCC by Optus on 16 February 2007 (**Optus 2007 Undertaking**), should not be considered because:
- it was not provided in a timely manner to the Commission;
 - Telstra was not provided with a copy of the Optus confidential submission;
 - the Commission refused to grant an extension of time for the submissions under the Directions of 2 February 2007; and
 - Telstra had insufficient time to properly review the Optus confidential submission and comment on it in its submission.¹⁰
40. On 21 March 2007, the Commission sent an email to parties reminding them about their obligations to provide submissions and submissions-in-reply to each other in a complete and timely manner. The Commission also attached a list of extraneous material which parties failed to provide as required.

- Commission, letter to Optus, *Notification of Access Dispute – Telstra-Optus Networks*, dated 24 November 2006;

- Commission, letter to Telstra, *Acknowledging Receipt of Notifications*, dated 24 November 2006;

- Commission, letter to Telstra, *Advising of Notification of Access Disputes by Optus Mobile & Optus Networks*, dated 8 January 2007;

- Commission, letter to Optus, *Acknowledging Receipt of Notifications*, dated 8 January 2007.

- Commission, Directions on Final Determinations - *Optus Entities/Telstra Disputes*, dated 2 February 2007.

¹⁰ Telstra, *Submission-in-reply on the content of the final determination for the Telstra-Optus Disputes*, 16 March 2007, (*Submission-in-reply*), p. 4.

41. The Commission made it clear to parties that where submissions and supporting documents are not provided to the ACCC and the other party within the deadline, the ACCC may not have regard to those documents in the making of a final determination.
42. In the email, the Commission reminded parties that:
 - each arbitration is required to be conducted on a case-by-case basis and it is therefore the parties' responsibility to provide relevant and complete submissions for these Disputes rather than to direct the ACCC to consider extraneous material and submissions made in another dispute or court proceeding.
 - it is not the ACCC's or the other party's responsibility to request or search for missing extraneous material, even when such material is publicly available. To place such an onus on the ACCC would impact on its obligation under section 152DB(1)(b) to, 'act as speedily as a proper consideration of the dispute allows.'
 - at a minimum, if a party wishes to rely on a particular passage in a document, that passage must be clearly identified and provided.
 - where there are many attachments, parties should index attached extraneous material in table format, to ensure the ACCC does not inadvertently overlook material that the party seeks to rely on in supporting its submission.
43. The Commission also stated that the mere provision of a hyperlink to extraneous material is not sufficient to satisfy the requirement of attaching supporting material. Hyperlinks may not always work, can often become redundant over time and the underlying document may change. This is particularly problematic when all that is provided as a reference is a link with no details of the author, title or date of the publication.
44. The Commission informed parties that despite parties' failure to submit all relevant supplementary material, the Commission considered that sufficient time and notice had been given of the requirements for parties' conduct in relation to these matters. In this respect the Commission noted that both parties had also been previously involved in arbitral processes with each other.
45. The Commission notes that both the confidential and public version of Optus's submission in support of the Optus 2007 Undertaking were not provided in a timely manner or in a manner appropriate for a proper consideration by Telstra for the purposes of these Disputes.
46. However, the Commission has had regard to the submissions of both parties on the Optus 2007 Undertaking (**Undertaking Submissions**). In having regard to the Undertaking Submissions, the Commission is not required to accept and adopt Optus's views.
47. In the context of the consultation for the Optus 2007 Undertaking, Telstra has had full access to the Undertaking Submissions (public version) and has provided a detailed response.
48. While not formally within the context of these Disputes, the Commission has not directed or requested the parties to provide further submissions on the Optus 2007 Undertaking, but the Commission is entitled to 'inform itself of any matter relevant to the dispute in any way it thinks appropriate' (section 1525DB (1)(c) of the Act). Accordingly, the Commission has had regard to the Undertaking Submissions in the context of these Disputes.

COMMISSION'S VIEW

The time period/s for which the final determinations should operate

49. The Commission notes that both parties submit that the final determinations for these Disputes should apply to the calendar year 2007.¹¹
50. The Commission considers it appropriate to make final determinations for the period 1 January 2007 to 31 December 2007 in these Disputes.

Proposed prices for these determinations

Consistent pricing outcomes for the calendar year 2007

51. The Commission considers that maintaining consistency in the pricing outcomes and time period across both sets of Disputes is appropriate for the following reasons:
 - the parties have requested consistent pricing outcomes across both sets of Disputes;¹²
 - both sets of Disputes share similar circumstances, especially the relevant time period and issues in dispute, and the Commission is considering both sets of Disputes in tandem;
 - it will provide commercial certainty for the parties in both sets of Disputes; and
 - such consistency has the objective of achieving parity and fairness for the parties across both sets of Disputes.

Pricing for first half of the calendar year 2007

52. Both Telstra and Optus submit that the appropriate price for the supply of the MTAS for the period from 1 January 2007 to 30 June 2007 is 12 cpm because it is consistent with the *MTAS Pricing Principles Determination*.¹³ Both parties agree with the price set out in the Draft Decision for the first half of the calendar year 2007.¹⁴
53. The Commission considers that, consistent with the interim determinations made in these Disputes and the submissions of both parties, 12 cpm is the appropriate price for the supply of the MTAS for the period from 1 January 2007 to 30 June 2007.

Pricing for second half of calendar year 2007

54. For the second half of calendar year 2007, both parties have submitted that the Commission should have regard to extraneous material from other processes, namely, the WIK Model Consultations and the Optus 2007 Undertaking. The Commission notes that it has consulted with interested parties for both the WIK Model Consultations and

¹¹ Telstra, *Initial submission*, p. 1; and Optus's *Initial submission on the content of the Telstra-Optus Dispute*, 5 March 2007, (*Initial Submission*), p. 1. Telstra, *Submission on the Draft Decision for the Telstra-Optus Disputes*, dated 24 August 2007, (*Submission on the Draft Decision*), p. 1; Optus, *Submission on the Draft Decision for the Telstra-Optus and Optus-Telstra Disputes (Submission on the Draft Decision)*, p.70.

¹² Telstra, *Initial submission*, pp. 2-3; Optus, *Initial submission*, pp. 3-4. Telstra, *Submission on the Draft Decision*, pp. 1-2, 8; Optus, *Submission on the Draft Decision*, p.70.

¹³ Telstra, *Initial submission*, p. 1; and Optus, *Initial submission*, p. 1.

¹⁴ Telstra, *Submission on the Draft Decision*, p. 4; Optus, *Submission on the Draft Decision*, p.3.

the Optus 2007 Undertaking. The *Final 2007 MTAS Pricing Principles Determination Report*, and the *Final 2007 MTAS Pricing Principles Determination* were released by the Commission on 28 November 2007. The Commission also released the *Optus 2007 Undertaking in relation to the Domestic Mobile Terminating Access Service, Final Decision, November 2007 (Final Optus 2007 Undertaking Decision)*, on 28 November 2007.

55. Telstra submits that it agrees with the prices proposed in the Draft Decision.¹⁵ In its initial submission Telstra relies on the outputs of the revised WIK Model, a ‘proper consideration of Optus’s own cost modelling’ and the ACCC’s international cost benchmarks which the Commission has identified as being reliable to support its submission that a price of 9 cpm is appropriate after 30 June 2007.¹⁶
56. In its submission on the Draft Decision Telstra submits that the WIK Model is but one piece of information before the Commission in the Dispute that provides support for the adoption of a price of 9 cpm for the second half of calendar year 2007. Telstra submits that other sources of information independently confirm that the efficient costs of supplying the MTAS are likely to be in the order of 6 cpm and that even if the Commission completely disregarded the WIK Model, it has before it other sources of information which independently support the prices proposed in the Draft Decision.¹⁷
57. To this end Telstra relies on the Commission’s previous analysis in relation to the making of the expired *MTAS Pricing Principles Determination*, a critical analysis of the cost model presented by Optus in support of the Optus 2004 Undertaking and the ACCC’s international cost benchmarks.¹⁸
58. In the Draft Decision the Commission stated that Telstra’s reliance on Optus’s own cost modelling needs to be supported and material provided for reliance to be placed on this particular submission.
59. In its submission on the Draft Decision Telstra refers to the Commission’s statement in the Optus 2004 Undertaking decision that, ‘Optus’s own [LRIC + EPMU] cost estimate appears to fit comfortably within the Commission’s previously determined range of 5 – 12 cpm. In fact, CRA’s own model reveals that Optus’s ‘LRIC+EPMU’ estimate of supplying the MTAS lies comfortably in the middle of the Commission’s estimated range.’ Telstra relies on this statement to support its submission that once the empirical errors (as identified by the Commission and the Tribunal on review) and other factors are properly taken into account, the LRIC + EPMU estimate would inevitably trend closer towards 5-6 cpm.¹⁹
60. Telstra also submits that Optus has tried to distance itself from its previous modelling exercise in its submission on the *Draft 2007 MTAS Pricing Principles Determination* where Optus submits that the information is likely to be “out of date”. Telstra submits that Optus claim on the one hand that these sources are outdated and cannot be relied upon, while on the other hand relying on an upper-bound cost estimate derived from

¹⁵ Telstra, *Submission on the Draft Decision for the Optus-Telstra Disputes*, p. 1.

¹⁶ Telstra, *Submission-in-reply*, p. 2; Telstra, *Submission on the Draft*, p. 1.

¹⁷ Telstra, *Submission on the Draft Decision*, p.6.

¹⁸ Telstra, *Submission on the Draft Decision*, p.3.

¹⁹ Telstra, *Submission on the Draft Decision*, pp.3-4.

data sourced from a period prior to June 2004 in the expired *MTAS Pricing Principles Determination*. Telstra also submits that Optus has not put forward any substantive reasons or materials to suggest that the efficient costs of supplying the MTAS have increased since the CRA Model was formulated.²⁰

61. The Commission also notes Optus's submission that Optus relies on the following sources of information to support its submission that 12 cpm will promote competition:
 - (i). The Australian Competition Tribunal's (**Tribunal**) judgement that consideration must be given to Optus's overall revenue in setting domestic GSM terminating access service (**DGTAS**) prices; and
 - (ii). Optus's financial reports, which show the effect of rate reductions resulting from the Commission's pricing principles.²¹
62. The Commission considers Optus's submissions above as relevant to the legitimate business interest criterion for these Disputes at paragraphs [149] to [174] rather than the LTIE criterion as submitted by Optus.
63. Optus also relies on the following sources of information to support its submission that 12 cpm will promote competition.
 - (i). Telstra's financial reports, which Optus submits show that it will likely benefit the most from an immediate reduction in MTAS rates, and, provide evidence that it will strengthen its dominant position in the fixed to mobile market. See the Commission's discussion at paragraphs [111] to [125].
 - (ii). Evidence that competition in the sector has increased since 2004 when the Commission released its pricing principles. See the Commission's discussion at paragraphs [121] to [125].²²
64. Optus considers that the Commission's view that 9 cpm is aligned with the efficient cost of supply of the MTAS is not properly supported by either the WIK model or other corroborating evidence. Accordingly, an MTAS price of 9 cpm cannot properly be the subject of assessment by the Commission on the basis that it is aligned with the efficient cost of the supply of the MTAS in Australia.²³
65. The relevance of the WIK Model consultation, *Optus 2007 Undertaking* and international cost and price benchmarking analyses are considered below.

Relevance of the WIK Model Consultations to these Disputes

66. Telstra submits that a price of 12 cpm is not appropriate for the period from 1 July 2007 because new information resulting from the WIK Model Consultations suggests that the TSLRIC+ of supplying the MTAS is significantly lower than 12 cpm.²⁴ In its submission on the Draft Decision Telstra maintains the view that the efficient cost of

²⁰ Telstra, *Submission on the Draft Decision*, pp. 4-5.

²¹ Optus, *Initial submission*, p. 4.

²² Optus, *Initial submission*, p. 4.

²³ Optus, *Submission on the Draft Decision*, p 61.

²⁴ Telstra, *Initial submission*, pp. 9-10.

supplying the MTAS is significantly below 12 cpm and is likely to be in the order of 6 cpm. However, Telstra agrees with the prices in the Draft Decision.²⁵

67. The 12 cpm ‘target price’ in the *MTAS Pricing Principles Determination* was set having regard to the information the Commission had available to it at the time of making the *MTAS Pricing Principles Determination* but even then it was established as the conservative upper-bound estimate of supply of the MTAS.
68. The Commission notes the WIK Model Consultations have taken place and the consultation process has been finalised regarding the *2007 MTAS Pricing Principles Determination*. The ACCC has already indicated that it engaged WIK Consult to develop a cost model to inform it of a TSLRIC+ estimate of the supply of the MTAS in an Australian context. The purpose of this model is to inform it of costs that may lead to a price below 12 cpm as indicated in the *MTAS Final Report*.²⁶
69. At this point, the WIK Model outcomes confirm that 12 cpm is the conservative upper-bound estimate of the TSLRIC+ of the supply of the MTAS in an Australian context for the period 1 July 2004 to 30 June 2007 and that a price below 12 cpm is relevant for the period from 1 July 2007.
70. Appendix 1 provides an outline of the WIK Model and its key outputs.

Relevance of the Optus 2007 Undertaking to these Disputes

71. In its initial submission Optus submits that the Commission should apply the prices set out in the Optus 2007 Undertaking for the DGTAS at a rate of 12 cpm for the period from 1 July 2007 to 31 December 2007.²⁷
72. Optus submits that given the matters which the Commission must take into account in a final determination are largely the same as those for determining the “reasonableness” of the terms of the Optus 2007 Undertaking, the Commission must make the final determinations using the same analytical process it uses to assess the Optus 2007 Undertaking. To do otherwise would be to disregard the statutory requirement to consider matters under sections 152CR(1) and 152CR(2) in making a final determination.²⁸
73. In its submission-in-reply, Telstra acknowledges that the factors for consideration in making a final determination in an access dispute are similar to the factors for consideration in accepting or rejecting an undertaking. However, Telstra submits that it would be incorrect to conclude that the Commission, “must undertake the same analytical process,” or that failure to do so would be to “disregard” the statutory requirements.²⁹
74. In its submission on the Draft Decision Telstra submits that whilst the factors considered for making a final determination in an access dispute are similar to those

²⁵ Telstra, *Submission on the Draft Decision in the Telstra-Optus Disputes*, p. 1

²⁶ ACCC, *MTAS Final Report*, p. 211.

²⁷ Optus, *Initial submission* p. 1.

²⁸ *ibid.*, p. 2.

²⁹ Telstra, *Submission-in-reply*, pp. 2-3.

considered when accepting or rejecting an undertaking, the analytical process is not the same.³⁰

75. The Commission recognises that the matters to which the Commission must have regard in assessing the reasonableness of the Optus 2007 Undertaking and in making final determinations in these Disputes are similar. However, the Commission notes that the assessment of an undertaking and the arbitration of an access dispute are separate processes with similar, but not identical, statutory criteria.
76. For example, there is no equivalent express requirement for the Commission to demonstrate the ‘reasonableness’ of its final determination in an arbitration so long as regard has been had to the relevant *Pricing Principles Determination* and the statutory matters under section 152CR.
77. When arbitrating an access dispute, the Commission’s role is to actually set a price with an aim of resolving an access dispute between two parties who cannot agree on the terms and conditions of access. In doing this, the Commission is required to consider each access dispute on a case-by-case basis and set the applicable price by reference to the evidence presented during the arbitration. The outcome of making a price in an access dispute is only binding on the parties to the dispute.
78. In contrast, when assessing an access undertaking, the ACCC is required to accept or reject the undertaking based on an express requirement under section 152BV(2)(d) to determine the ‘reasonableness’ of particular terms and conditions. Once accepted, the undertaking will dictate particular terms on which the access provider is to provide the declared service to *any* access seeker and therefore has a broader application as compared to an arbitration determination.
79. For these reasons, the Commission is considering these Disputes on a case-by-case basis, separate from its assessment of the Optus 2007 Undertaking.
80. However, as noted above the Commission has had regard to the Undertaking Submissions as information relevant to these Disputes.

International benchmarking

81. Optus has sought to rely on international benchmarking analyses, but has not provided detailed information about the data sources for the information it is seeking to rely on, including whether the benchmarks are price or cost benchmarks. The Commission is unsure whether the benchmarks are based on regulated prices or benchmarks based on costs derived from models or accounts.
82. In relation to the European cost models submitted by Optus as support for a price of 12 cpm for the second half of calendar year 2007, Telstra reiterates its previous submission that it was unable to comment on or confirm the reliability of the data relied on by Optus as no references were provided for those sources.³¹

³⁰ Telstra, *Submission on the draft decision*, p.8.

³¹ Telstra, *Submission on the Draft Decision in the Telstra-Optus Disputes*, p. 5.

83. Telstra in its response to the Draft Decision submits that it agrees with the Commission's conclusions on Optus's use of international benchmarking of cent per minute costs.³²
84. Telstra submits that, in circumstances where these Disputes are now at a stage where Telstra will be unable to consider and respond to this information even if references are provided by Optus in its submission on the Draft Decision, it would be inappropriate for the Commission to have regard to this information in the making the final determinations in these Disputes.³³
85. The Commission notes that in its response to the Draft Decision, Optus seeks to update and expand its European benchmarking analysis and support its position stating that Optus's 'own international benchmarking data... provides a reasonable basis to conclude that the efficient cost of supply of the MTAS is higher than 9 cpm'.³⁴ The Commission considers that Optus does not demonstrate that a price above 9 cpm is an efficient cost estimate for the supply of the MTAS in providing this updated analysis.
86. The Commission considers the termination prices in three countries set by European national regulators for the applicability as an efficient cost estimate for the supply of the MTAS in an Australian context and outlines reasons why these price benchmarks may not be entirely comparable to an Australian regulatory context. See Appendix 4 of this statement of reasons. The analysis of those countries demonstrates the limitations of the Optus international benchmarking exercise.
87. Telstra submits that other sources (the expired *MTAS Pricing Principles Determination* which listed 12 cents per minute as a conservative estimate, comparable international benchmarks endorsed by the Commission, the CRA cost model and the WIK Mobile and Network Cost Model) demonstrate that 12 cents per minute is likely to significantly overstate Optus's costs of supplying the MTAS.³⁵
88. The Commission notes that Optus's proposed rate of 12 cpm for the full calendar year 2007 reflects what the Commission considers is the conservative upper-bound estimate of the TSLRIC+ of the supply of the MTAS for the period 1 July 2004 to 30 June 2007. These indicative prices were informed by a range of TSLRIC+ estimates between 5 cpm to 12 cpm from international cost benchmarking and regulatory accounting framework (RAF) data analyses.
89. Since 2004, more reliable and robust information about the efficient costs of the supply of the MTAS in an Australian context has also become available to suggest that the efficient cost of supply of the MTAS is not higher than 9 cpm, including:
- the FL-LRIC+ estimate for the supply of the MTAS by Optus in Australia derived from the Charles River Associates (CRA) Model to support Optus's 2004 Undertaking.³⁶ In assessing Optus's earlier undertaking, Analysys Consulting Pty Ltd (Analysys) provided advice to the Commission about the FL-LRIC+ estimates

³² Telstra, *Submission on the Draft Decision in the Telstra-Optus Disputes*, p. 5.

³³ Telstra, *Submission on the Draft Decision in the Telstra-Optus Disputes*, p. 5.

³⁴ Optus, *Submission on the Draft Decision*, p.51.

³⁵ Telstra, *Submission on the Draft Decision*, p. 6.

³⁶ ACCC, *Optus's Undertaking with Respect to the Supply of its Domestic GSM Terminating Access Service (DGTAS): Final Decision Public Version (Optus 2004 Undertaking Final Decision)*, February 2006.

for the supply of the MTAS by Optus in Australia from the CRA Model. At the time, the Commission raised concerns that many assumptions employed to calculate the CRA Model inputs would tend to over estimate the FL-LRIC of the DGTAS.³⁷ The cost estimate for the supply of the MTAS was below 12 cpm in 2004 and confirms that, even without adjustment for higher traffic volumes since that time which are likely to offset rises in costs, the cost estimate for the DGTAS would be below 12 cpm in an Australian context.

- the development of comparable international cost models that can be used as benchmarks to corroborate the TSLRIC+ estimated range of 5 cpm to 12 cpm.
- the development of the WIK Model which indicates, with further refinement, that an efficient cost estimate for the supply of the MTAS in an Australian context is below 12 cpm (refer to Appendix 1).
- Optus's submissions on the WIK Model Version 1.1 are summarised in part in Appendix 1. The Commission is not minded to address these submissions in the context of determining these Disputes. The Commission considers that the issues raised by Optus were more appropriately considered as part of the WIK Model Consultations. The Commission considers that the onus is on Optus to provide information to support its submission that the efficient cost of supply of the MTAS is higher than 9 cpm, which it has not done. The Commission notes that Optus's submission on the WIK Model for the purposes of these Disputes are almost entirely replicated and submitted in response to the consultation process for the *2007 MTAS Pricing Principles Determination*.

90. The Commission considers that there is sufficient information to show that the efficient cost of supply of the MTAS is not higher than 9 cpm for the period 1 July 2007 to 31 December 2007.

Conclusion on pricing for second half of calendar year 2007

91. The Commission considers based on the WIK Model outputs, referable and comparable international cost benchmarking analyses and the FL-LRIC estimate for the supply of the MTAS for Optus from the CRA Model that a price of 9 cpm is appropriate for the period 1 July 2007 to 31 December 2007. With more reliable and robust information at hand, this price is reflective of a more referable estimate of the supply of the MTAS in an Australian context, than the conservative upper-bound estimate of 12 cpm relevant for the period 1 July 2004 to 30 June 2007.

Proposed Pricing for second half of calendar year 2007

92. The Commission proposes a price of 9 cpm for the period 1 July 2007 to 31 December 2007 which it considers against the statutory criteria below.

Statutory Criteria - Section 152CR(1)

93. The Commission has considered the prices proposed by the parties against the relevant statutory criteria prescribed in section 152CR(1). The Commission's assessment in relation to each criterion is set out below.

³⁷ *ibid.*, p. xii.

Section 152CR(1)(a) - long-term interests of end-users (LTIE)

94. Section 152CR(1)(a) requires the Commission to have regard to whether the final determinations will promote the LTIE of carriage services or of services supplied by means of carriage services.
95. Both parties agree that, for these Disputes, 12 cpm for supply of the MTAS for the first half of calendar year 2007 is an appropriate price which is in the LTIE.³⁸
96. With respect to the second half of calendar year 2007:
- Telstra submits that 9 cpm is likely to overstate the efficient costs of supplying the MTAS but it will promote the LTIE more so than 12 cpm as it is more closely aligned with the efficient costs of supply.³⁹
 - Optus submits that a price of 12 cpm is in the LTIE;⁴⁰ and
 - Both parties seek reciprocal pricing.⁴¹
97. In considering whether particular terms and conditions will promote the LTIE, the Commission is required to have regard to whether the terms and conditions are likely to result in:
- promoting competition in markets for carriage services and services supplied by means of carriage services;
 - achieving any-to-any connectivity; and
 - encouraging the economically efficient use of, and economically efficient investment in:
 - the infrastructure by which listed carriage services are supplied; and
 - any other infrastructure by which listed services are, or are likely to become, capable of being supplied.⁴²
98. The impact of the final determinations in these Disputes on each of the three subsidiary LTIE objectives is addressed in turn below.
99. The Commission's views in relation to applying the LTIE criterion are set out in to Appendix 2 of this Statement of Reasons.

LTIE and promoting competition in relevant markets

100. The Tribunal explains that the notion of promoting competition, "...involves the idea of creating the conditions or environment for improving competition." The Tribunal distinguishes this from any requirement to demonstrate, "that there would be an advance in competition in the sense that competition would be increased."⁴³

³⁸ Telstra, *Initial submission*, p. 12; Optus, *Initial submission*, p. 4

³⁹ Telstra, *Submission on the Draft Decision*, p.1

⁴⁰ Optus, *Initial submission*, p. 4.

⁴¹ Telstra, *Submission-in-reply*, p. 3; Optus, *Initial submission*, p. 3.

⁴² *Trade Practices Act 1974*, section 152AB(2).

⁴³ *Sydney International Airport* [2000] ACompT 1 (1 March 2000) at [106]-[107], 40,775.

101. The Tribunal has recently discussed this notion in the context of Part XIC, where it noted the differences in language between Part IIIA (before its amendment) and Part XIC. In particular, the Tribunal noted that when section 152AB(2)(c) directs the Commission (and the Tribunal on review) to have regard to ‘the extent to which’ a term or condition is likely to result in the achievement of the objective of promoting competition:
- ..the Commission (the Tribunal on review) must consider the extent of the competitive impact...and the likelihood of that extent, not only the improvement of the environment for competition.⁴⁴
102. The Tribunal also states that in determining whether terms and conditions are likely to achieve the objective of promoting competition, regard must be had to the extent to which the terms and conditions will remove obstacles to end-users of listed services gaining access to listed services.⁴⁵
103. The parties do not specifically submit in respect of this matter, however, the Commission considers that the proposed pricing in these Disputes, which more closely reflects the TSLRIC+ of supply of the MTAS, is likely to remove obstacles to end-users in gaining access to mobile networks.
104. The Commission is of the view that three markets are relevant in assessing competition under the LTIE criterion for the purposes of the final determinations, namely the:⁴⁶
- (i) individual markets for termination on each MNO’s network;
 - (ii) market within which fixed-to-mobile (FTM) services are offered; and
 - (iii) market for retail mobile services.
105. Each of these relevant markets is discussed in detail below.
106. The Commission notes Optus’s submission that despite the Commission’s finding that fixed and mobile substitution is not strong enough for the two services to be defined in the same market, there is an important form of substitution between fixed and mobile calls that terminate outside the customer’s local calling centre.⁴⁷
107. The Commission also notes Optus’s submission on the existence of a two-sided market.⁴⁸ This issue is directly addressed in Appendix 3.
108. Optus also submits that a price higher than 9 cpm would promote competition in the relevant markets, on the basis that Optus’s own international benchmarking data provides a reasonable basis to conclude that the efficient cost of supply of the MTAS is higher than 9 cpm; and prices in a competitive, efficiently operating market might reasonably include a network externality surcharge.⁴⁹
- (i) *Individual markets for termination on each MNO’s network*

⁴⁴ *Telstra Corporation Ltd (No 3)* [2007] ACompT 3 at [96].

⁴⁵ *Application by Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8 (22 November 2006) at [12]. *Trade Practices Act 1974*, Section 152AB(4).

⁴⁶ For a detailed discussion on the Commission’s approach to market definition, ACCC, *MTAS Final Report*, section 4.2 (particularly pp. 31-32 and 45-55).

⁴⁷ Optus, *Initial submission*, p. 9.

⁴⁸ *ibid.*, pp. 15-17.

⁴⁹ Optus, *Submission on the Draft Decision*, p. 64.

109. The Commission concluded in the *MTAS Final Report* that there is a separate market for the MTAS on each MNO's network⁵⁰ MNOs are not constrained in their pricing decisions for the MTAS and have both the ability and incentive to raise the price of this service above its underlying cost of production. The lack of substitutes for the service means that the MTAS is effectively provided in a monopoly market by each MNO.⁵¹
110. The Commission considers that competition will be unaffected in this market by pricing in these Disputes as each MNO has monopoly power in the individual markets for termination on its network.
- (ii) *Market within which FTM services are provided*
111. In its *MTAS Final Report*, the Commission found that above-cost pricing of the MTAS is particularly disadvantageous to suppliers of fixed-line services.⁵²
112. The Commission notes Optus's submission that a further reduction in the MTAS rates in the second half of calendar year 2007, "is not likely to promote competition in the market(s) for fixed telephony services."⁵³
113. The Commission is of the view that all MNOs, irrespective of their size, have market power when it comes to terminating calls on their network and can increase the cost to providers of FTM calls. One implication of this pricing structure is that an above-cost price for the MTAS increases the costs of an essential input for providers of FTM calls.⁵⁴
114. The Commission consider higher input costs for providers of FTM calls leads to higher FTM call prices for end-users.
115. Further, vertically-integrated fixed and mobile network operators are able to set above-cost prices for rival fixed-line-only operators while vertically-integrated fixed and mobile network operators face the actual costs for calls terminating on their own networks.⁵⁵ The result is that fixed-line-only operators must pay above-cost prices to terminate all FTM calls whereas the vertically-integrated carriers only pay above-cost prices for calls that terminate on other mobile carriers' networks.⁵⁶
116. Above-cost MTAS rates have therefore tended to act as a barrier to providers considering entry into the FTM market and resulted in above-cost retail prices for FTM calls. In the *MTAS Final Report* the Commission stated that, "regulated MTAS charges

⁵⁰ ACCC, *MTAS Final Report*, sections 4.2, 4.3, and 4.4.1.

⁵¹ In the *MTAS Final Report*, the Commission found that the termination services of individual MNOs are not substitutable for each other, irrespective of the size of individual operators or the network technology they employ. Further, the Commission concluded that alternative forms of communication, such as fixed-line network services, SMS messages, email and calls using voice over Internet protocol technology (VoIP), are not sufficiently substitutable means of contacting a mobile subscriber to constrain providers of a MTAS, pp. 29-55.

⁵¹ ACCC, *MTAS Final Report*, p. viii.

⁵² *ibid.*, p. viii.

⁵³ Optus, *Initial submission in the Telstra-Optus Disputes*, p. 10.

⁵⁴ *ibid.*, pp. vi-vii.

⁵⁵ ACCC, *MTAS Final Report*, p. vii.

⁵⁶ *ibid.*, p. vii.

would provide a stimulus for increased competition from existing FTM providers, and possibly from new entrants.”⁵⁷

117. The Commission notes Optus’s submission that the likely benefit of further MTAS rate reductions on promoting competition from resale based competitors, ‘is likely to be limited... as fixed to mobile rates have only modestly reduced when compared to the substantial MTAS rate reductions.’⁵⁸
118. Optus also submits that there is insufficient evidence for the Commission to be satisfied that previous reductions in the MTAS – from 21 to 12 cpm – have improved competition in the FTM market.⁵⁹
119. Optus submits that there is insufficient evidence for the Commission to be satisfied that the reduction in FTM prices is attributable to the reduction in MTAS prices and not other factors, particularly where the reduction does not amount to a straight pass-through of a reduction in costs. Nor is there sufficient evidence for it to be satisfied that a reduction in FTM prices will lead to a promotion of competition in the FTM market either at all or to a non-trivial extent. For example, the Commission has not demonstrated that a reduction in FTM prices would enable fixed-only operators to compete more effectively.⁶⁰
120. The Commission is cognisant that any fall in MTAS rates following the publication of the *MTAS Pricing Principles Determination* in June 2004, was likely, at first, to be slower and more gradual than outlined in the Commission’s indicative price path. It is possible that reductions in the price of the MTAS could lead to even greater absolute reductions in the price of FTM (and other fixed-line services) call minutes than in the price of the MTAS itself.⁶¹ One reason for this modest reduction at first in FTM rates is that the first interim determinations were made in July 2005 and at a rate of 18 cpm, only 3 cpm lower than prices that prevailed at July 2004. Since July 2004, the Commission has finalised 18 MTAS disputes and made interim determinations in 19 disputes which have made prices as low as 12 cpm for the period 1 January 2007 to 30 June 2007 (as evident in the published interim determinations for these Disputes⁶²) which have flowed through as lower prices in the retail FTM and mobile markets.
121. In general, the Commission considers that the ability to raise the price of the MTAS above its underlying cost of production (in the absence of regulation of this service), enables MNOs to make above normal economic profits when providing this service. While some integrated MNOs and mobile-only MNOs can benefit somewhat from a higher MTAS price, the consequence for fixed-only operators is higher input costs than should prevail. That is, higher MTAS prices increase the cost to providers of FTM calls

⁵⁷ *ibid*, p. x.

⁵⁸ Optus, *Initial submission in the Telstra-Optus Disputes*, p. 6.

⁵⁹ Optus, *Submission on the Draft Decision*, pp. 63-64.

⁶⁰ Optus, *Submission on the Draft Decision*, p. 62.

⁶¹ ACCC, *MTAS Final Report*, p. xii.

⁶² <http://www.accc.gov.au/content/index.phtml/itemId/712456/fromItemId/635059>

above the underlying efficient cost of the service and which in turn may result in higher prices for FTM calls.⁶³

122. The Commission considers that linking the price of the MTAS to its underlying efficient cost of production should, by improving the state of competition in the market within which FTM services are provided, help to ensure the level of FTM pass-through increases.⁶⁴

Telstra's indicative FTM pricing

123. To demonstrate these improvements using publicly available data,⁶⁵ the Commission notes that Telstra's revenue from FTM services has fallen in recent years, while FTM call volumes have increased. This is indicative of lower FTM pricing, in the same period in which MTAS prices have fallen from above 21 cpm to 12 cpm. For example, in its results for the full year ended 30 June 2007, Telstra reported FTM revenues of \$1,487 million from total FTM minutes of 4,687 million. This reflects a FTM yield of 31.7 cpm for the full year ended 30 June 2007 compared with a much higher FTM yield that prevailed at 30 June 2004 of 37.8 cpm (based on figures of \$1,597 minutes of 4,226). This represents a fall in FTM yields of 16.1 per cent over that time.⁶⁶

	As at 30 June 2004	As at 30 June 2007	Change between 30 June 2004 and 30 June 2007 (%)
FTM Revenue (\$millions)	1,597	1,487	- 6.9
FTM minutes (millions)	4,226	4,687	10.9
Yield (cpm)	37.8	31.7	-16.1

124. The Commission also considers that, despite Optus's submission about Telstra's structural advantages, both Optus and Telstra as integrated operators are in the best position of all carriers and carriage service providers to effect longer and a more complete pass-through of lower MTAS rates in both the market in which FTM services are provided and the retail mobile services market.

125. The Commission outlined in its *MTAS Final Report* that reducing the price of the MTAS towards its underlying cost of production should, by improving the state of competition in the market within which FTM services are provided, help to ensure the level of FTM pass-through increases over time. The Commission notes that while the reductions in FTM retail rates to date have been positive there is still opportunity for

⁶³ By reducing the ability of incumbent mobile network owners to frustrate new entrants into the market. ACCC, *MTAS Final Report*, Chapters 5 and 6.

⁶⁴ *ibid.*, p. xii.

⁶⁵ There is no publicly available information about FTM prices or yields for Optus, to undertake this analysis.

⁶⁶ Source: *Telstra Corporation Limited and Controlled Entities, Financial Results for the Year Ended 30 June 2007*, p. 13. *Telstra Corporation Limited and Controlled Entities, Financial Results for the Year Ended 30 June 2004*, p. 79.

integrated operators such as Optus to reduce retail FTM prices further particularly for residential end-users in line with reductions in MTAS. It is also important to recognise that the extent of pass-through to lower retail prices 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.⁶⁷ However, information to support these improvements has not been provided by any party.

(iii) *Market for retail mobile services*

126. The Commission notes Optus's submission that competition has increased significantly since 2004, as evidenced by the increased popularity of 'capped' mobile plans.⁶⁸
127. The Commission acknowledges that there has been some improvement in competition in the market for retail mobile services as evidenced by the continued uptake of capped pricing plans, which has tended to contain retail prices, and which has seen price reductions for retail mobile services continue in the last few years.
128. In terms of the type of plans prevalent in the market for retail mobile services, an analysis of both Telstra's and Optus's pre-paid and post-paid mobile data is provided below and shows that the proportion of pre-paid subscribers has increased since 2001-2002.

⁶⁷ ACCC, *MTAS Final Report*, p. 223.

⁶⁸ Optus, *Initial submission*, p. 7.

*Telstra Pre-paid and post-paid data*⁶⁹

Telstra subscribers	2001-2002	2002-2003	2003-2004	2004- 2005	2005- 2006	2006-2007
	Jun-02	Jun-03	Jun-04	Jun-05	Jun-06	Jun-07
Pre-paid (%)	32	35	41	43	42	40
Post-paid (%)	68	65	59	57	58	60

129. From the above table it can be seen that Telstra’s pre-paid subscribers grew from 32 per cent to 40 per cent of total subscribers between 2001-2002 and 2006-2007.

⁶⁹ Sources:

- Telstra, *Telstra Corporation Limited and Controlled Entities, Annual Report 2002*, p. 75;
- Telstra, *Telstra Corporation Limited and Controlled Entities, Annual Report 2004*, p. 81;
- Telstra, *Telstra Corporation Limited and Controlled Entities, Annual Report 2006*, p. 15; and
- Telstra, *Telstra Corporation Limited and Controlled Entities, Results and operations review half-year ended 31 December 2006*, p. 23.

*Optus pre-paid and post-paid data*⁷⁰

Optus subscribers	2001-2002	2002-2003	2003-2004	2004- 2005	2005- 2006	2006-2007
	Jun-02	Jun-03	Jun-04	Jun-05	Jun-06	Jun--07
Pre-paid (%)	33	40	46	53	56	56
Post-paid (%)	67	60	54	47	44	44

130. From the above table it can be seen that Optus’s pre-paid subscribers grew from 33 per cent to 56 per cent of total subscribers between December 2001 and June 2007.
131. The growth in pre-paid customer plans over time is evidence of improving competition through more flexible retail plans as MNOs have vied for market share. Another benefit of the growth in pre-paid mobile subscribers is that it also enables MNOs to be more responsive and pass on lower input costs such as the MTAS more quickly.
132. Optus’s September 2007 quarterly results also illustrate that minutes of use per user per month grew at a faster rate than average revenue per user per month, implying decreasing revenue per minute in the September 2007 quarter compared to previous quarters and the previous year. Minutes of use per subscriber per month for pre-paid services grew by 15.5 per cent from 30 September 2006 to 30 September 2007, while Average Revenue Per User (ARPU) per month grew by 7.3 per cent over the same period; and for post-paid services minutes of use per subscriber per month grew by 3.6

⁷⁰ Sources:

- SingTel, *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 30 June 2007*, p. 41.
- SingTel, *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*, p. 42;
- SingTel, *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 2004*, p. 38;
- SingTel, *Singapore Telecommunications Limited and Subsidiary Companies Management Discussion and Analysis of unaudited financial condition and results of operations for the nine months ended 31 December 2002*, p. 30;
- SingTel, *Singapore Telecommunications Limited and Subsidiary Companies Management Discussion and Analysis of financial condition, results of operations and cash flows for the first quarter ended 30 June 2006*, p. 37;
- SingTel, *Singapore Telecommunications Limited and Subsidiary Companies Management Discussion and Analysis of unaudited financial condition, results of operations and cash flows for the first quarter ended 30 June 2004*, p. 38; and
- SingTel, *Singapore Telecommunications Ltd and Subsidiary Companies Management Discussion and Analysis of unaudited financial condition and results of operations for the first quarter ended 30 June 2002*, p. 25.

per cent, while ARPU fell by 4.9 per cent.⁷¹ This implies that revenue per minute in the quarter ending 30 September 2007 has decreased compared to previous years which is indicative of lower retail mobile rates.

133. The Commission notes Optus's submission that increased competition demonstrates that the structure of the market is such that rents will not be sustained, but competed away through lower retail prices.⁷²
134. Notwithstanding Optus's submission, the Commission considers that, even with an increase in the number of subscribers on capped plans and lower retail prices for mobile services, there remains a concentration of market share at the carrier network level and barriers to effective entry into the market remain high.⁷³ In the *MTAS Final Report*, the Commission indicated that it expected that a closer association of the price and underlying cost would promote competition in the retail mobile services market to the extent that it:
 - serves to overcome the ability established operators might have to frustrate new entrants interconnecting with established networks on reasonable terms and conditions; and
 - leads to a more efficient use of, and investment in, the infrastructure used to provide retail mobile services.⁷⁴
135. The Commission maintains the view that competition is likely to be further enhanced in the market for retail mobile services as MTAS prices become more closely aligned with the TSLRIC+ of supply. Pricing of the MTAS closer to the TSLRIC+ of supply in these Disputes will assist in further reducing existing prices in the retail mobile services market and existing market distortions, such as subsidised handsets; and encouraging operators to compete on their relative efficiencies and merits in the market for retail mobile services.⁷⁵

Conclusion on the promotion of competition in relevant markets

136. The Commission considers that MTAS pricing that reflects the efficient (i.e. TSLRIC+) cost of providing the service will promote competition in the relevant markets and be in the LTIE.
137. To this end, having considered all the matters relevant for promoting competition in relevant markets, the Commission is of the view that MTAS pricing reflecting the conservative upper-bound estimate of TSLRIC+ of providing the service of 12 cpm as outlined in the *MTAS Pricing Principles Determination* for the period 1 January 2007 to 30 June 2007 and the price of 9 cpm for the period 1 July 2007 to 31 December 2007 will promote competition the markets relevant to these Disputes.

⁷¹ SingTel, *Singapore Telecommunications Limited and Subsidiary Companies, Management Discussion and Analysis of Unaudited Financial Condition, Results of Operations and Cash Flows for the Second Quarter and Half Year Ended 30 September 2007*, p. 40.

⁷² Optus, *Initial submission*, p. 9.

⁷³ ACCC, *MTAS Final Report*, p. 125.

⁷⁴ *ibid.*, pp. 125-126 and 207.

⁷⁵ *ibid.*, section 4.4.3.

*The LTIE and achieving any-to-any connectivity*⁷⁶

138. In the *MTAS Final Report*, the Commission concluded that any-to-any connectivity can be promoted through the declaration of the MTAS and this was a key reason for it defining the MTAS in such a way that it applies to termination of both FTM and mobile-to-mobile (MTM) calls on all types of mobile networks. The Commission reached this conclusion due to the ability of established MNOs to frustrate a new entrant's ability to offer a full end-to-end service to its subscribers by hampering supply of the MTAS on reasonable terms and conditions.⁷⁷
139. The Commission considers that the objective of achieving any-to-any connectivity is more likely to be met by implementing an MTAS price that reflects the TSLRIC+ of supplying the service.

*Encouraging the economically efficient use of, and economically efficient investment in, infrastructure*⁷⁸

140. In determining whether terms and conditions are likely to achieve the objective of encouraging the economically efficient use of, and investment in, infrastructure the Commission must have regard to technical feasibility, the legitimate commercial interests of the supplier and the incentives for investment.
141. In the Commission's view, the phrase 'economically efficient use of, and economically efficient investment in ... infrastructure' refers to the concept of economic efficiency, which consists of three components:
- productive efficiency – where individual firms produce the goods and services that they offer at least cost;
 - allocative efficiency – where the prices of resources reflect their underlying costs so that resources are then allocated to their highest valued uses (i.e. those that provided the greatest benefit relative to costs); and
 - dynamic efficiency – the need for industries to make timely changes to technology and products in response to changes in consumer tastes and in productive opportunities⁷⁹.
142. In the *MTAS Final Report*, the Commission indicated that direct efficiency losses would be experienced where the MTAS price was above cost.⁸⁰ In these circumstances there would be:
- lower demand for the MTAS and FTM services, leading to under investment in infrastructure required to supply FTM calls;
 - higher demand for retail mobile services because of subsidised pricing, such as handsets, resulting in excessive investment in infrastructure for retail mobile services; and

⁷⁶ *ibid.*, section 5.2.

⁷⁷ *ibid.*, pp. xiv-xv.

⁷⁸ *ibid.*, section 6.2.

⁷⁹ ACCC, *Access Pricing Principles – Telecommunications, A guide (ACCC, Access Pricing Guidelines) July 1997*, p. 7.

⁸⁰ ACCC, *MTAS Final Report*, p. 182 .

- greater than efficient turn over of mobile handsets by consumers resulting in excessive investment in the infrastructure used to develop new handsets.⁸¹
143. The Commission has considered the following factors in respect of encouraging the efficient use of infrastructure:⁸²
- whether it is technically feasible for the services to be supplied and charged for with regard to technology that is in use, available or likely to become available; and the costs involved in supplying and charging for, the services that are reasonable or likely to become reasonable; and the effects, or likely effects, that supplying and charging for the services would have on the operation or performance of telecommunications networks;
 - 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;
 - incentives for investment in the infrastructure by which services are supplied; and any other infrastructure by which services are or likely to become capable of being supplied; and
 - the risks involved in determining incentives for investment.
144. The Commission notes Optus's submission that it relies on a number of sources of information in order to support 12 cpm as a reasonable estimate of efficient cost, including the ACCC *MTAS Pricing Principles* established in June 2004 and international cost benchmarking of mobile terminating access prices including overseas cost models.⁸³ The Commission's views regarding this submission and a reasonable estimate of efficient costs are set out above in the section discussing the proposed pricing for these disputes at paragraphs [52] to [92].
145. The Commission considers that by lowering MTAS prices, which is a key wholesale input for network providers, that it is more likely in the long run to encourage, rather than discourage, investment for any potential and/or existing infrastructure owners. In general, the Commission considers that pricing tending to the TSLRIC+ of supply of the MTAS provides for an environment that will increase demand stimulated by lower wholesale and retail prices and expand and encourage the economically efficient use of, and economically efficient investment in, infrastructure.

Other issues raised in relation to the LTIE by parties

146. The Commission is not minded to consider Optus's submissions regarding its financial status or its strong reliance on access revenue in comparison to Telstra⁸⁴ as relevant to the LTIE criterion to support a price of 12 cpm. These issues are more appropriately dealt with in the discussion of the legitimate business criterion in paragraphs [149] to [174].
147. In relation to Optus's submission, which again relates more to the criterion of legitimate business interest, that its earnings from its mobile business has been

⁸¹ *ibid.*

⁸² *Trade Practices Act 1974*, sections 152AB(6) and (7A).

⁸³ Optus, *Initial Submission*, p. 10.

⁸⁴ *ibid.*, pp. 5-6.

significantly reduced by reductions in MTAS prices ‘mandated by the ACCC’, the Commission notes that the ACCC does not mandate or set MTAS prices per se. The dispute resolution framework established by Part XIC of the Act reflects a negotiate/arbitrate model. That is, this framework is based on the assumption that an access provider and access seeker first attempt to commercially negotiate the price and non-price terms for access to a declared service. The ACCC will only become involved when commercial agreement cannot be reached between an access seeker and an access provider and only after one party has submitted a dispute notice with the ACCC. In circumstances involving access to a declared service, the ACCC would encourage parties to always try to negotiate prices in a commercial agreement in the first instance. Only when commercial and/or alternative dispute resolution processes for resolving the point of contention about access between parties have been exhausted then is reliance on a price determined by the Commission necessary.

148. The Commission also notes that the relevant *MTAS Pricing Principles Determination* does not mandate MTAS prices and provides indicative prices only. While the Commission is required to have regard to the relevant pricing principles determination when arbitrating a dispute in relation to the MTAS, the Commission will consider whether it has, in the context of a dispute, been provided with robust and reliable information upon which to base a determination.

Section 152CR(1)(b) - Legitimate business interests of the access provider

149. Section 152CR(1)(b) of the Act requires the Commission to have regard to the legitimate business interests of the access provider, and the carrier’s or provider’s investment in facilities used to supply the declared service.
150. As outlined in the Commission’s *Access Dispute Guidelines*, the Commission is of the view that the concept of legitimate business interests should be interpreted in a manner consistent with the phrase ‘legitimate commercial interests’ used elsewhere in Part XIC of the Act. Accordingly, it would cover the access provider’s interest in earning a normal commercial return on its investment. When considering the legitimate business interests of the access provider in question, the Commission may consider what is necessary to maintain those interests.⁸⁵

Optus’s legitimate business interests

151. Telstra submits that a price of 12 cpm for the first half of calendar year 2007 would not violate the legitimate business interests of Optus as this price appears to be significantly above the TSLRIC+ of supplying the MTAS.⁸⁶ In this regard Telstra rely on the *MTAS Pricing Principles* and the *Access Pricing Guidelines*.⁸⁷
152. Telstra submits that a price of 12 cpm for the second half of calendar year 2007 would represent an artificial inflation of MTAS prices resulting in an unjustifiable windfall to Optus.⁸⁸

⁸⁵ ACCC, *Resolution of telecommunications access disputes – a guide (Access Dispute Guidelines)*, March 2004 (Revised), p. 56.

⁸⁶ Telstra *Initial submission*, p. 13

⁸⁷ ACCC, *Access Pricing Principles Guidelines*, p. 18.

⁸⁸ *ibid.*, p. 13.

153. In its submission on the Draft Decision, Telstra submits that MTAS pricing based on the efficient costs of supplying the service best promotes the LTIE and the other statutory criteria under Part XIC of the Act.⁸⁹
154. Telstra submits that if the Commission accepts the WIK Model's output prices and the corroborating evidence indicating that the TSLRIC+ of supplying the MTAS in Australia is in the order of 5-6 cpm then there is no reason not to implement that price immediately.⁹⁰
155. Telstra also submits that although it believes there is no basis to justify pricing the MTAS above the efficient costs of supply for any future period, Telstra accepts that the Commission may err on the side of caution and adopt a conservative approach in making a final determination in the Dispute. Accordingly, Telstra is willing to accept a price of 9 cpm for the period 1 July 2007 to 31 December 2007.⁹¹
156. Telstra submits that the prices set out in the Draft Decision will not jeopardise, and are more than adequate to protect, Optus's legitimate business interests.⁹²
157. Telstra submits that a price of 9 cpm for the second half of calendar year 2007 would provide Optus with a more than generous buffer against regulatory rate shock (if any) by reason of an immediate reduction to a price consistent with the efficient cost of supplying the MTAS.⁹³
158. Optus submits that its financial reports indicate that its earnings from mobile business has been significantly reduced by:
 - the reductions in MTAS prices 'mandated by the ACCC';⁹⁴
 - its 'overall charge' for mobile services being constrained by vigorous competition for mobile service;⁹⁵ and
 - it being far more reliant on access revenues than Telstra.⁹⁶
159. Optus submits that a price of 12 cpm takes into account the significant adjustment in subscription and origination prices needed to implement the price without material negative impact on Optus and its mobile customers.⁹⁷
160. Optus submits that its 'legitimate' business interests require that it is provided with sufficient time to recover the lost termination revenue from other services including origination and subscription. In the two year period to 31 March 2007, Optus notes that the application of regulated prices between Optus and Telstra has resulted in a net loss

⁸⁹ Telstra, *Submission on the Draft Decision*, p. 6.

⁹⁰ Telstra, *Submission on the Draft Decision*, p. 6.

⁹¹ Telstra, *Submission on the Draft Decision*, p. 7.

⁹² Telstra, *Submission on the Draft Decision*, p.10.

⁹³ Telstra, *Submission on the Draft Decision*, p. 7.

⁹⁴ Optus, *Initial submission*, p. 5.

⁹⁵ *ibid.*, p. 5.

⁹⁶ *ibid.*, p. 6.

⁹⁷ *ibid.*, p. 14.

of revenue to Optus of over \$90 million. It would not be appropriate to ‘mandate’ a further price reduction from 1 July 2007.⁹⁸

161. The Commission is not minded to consider the ‘waterbed effect’ as relevant in these disputes and provides its views on this issue in Appendix 3.
162. The Commission reiterates its comments at paragraphs [147] to [148] that it does not mandate MTAS prices and, except in the circumstances of a dispute, does not make prices.
163. The Commission notes Optus’s reliance on, ‘the Tribunal’s judgement that consideration must be given to Optus’s overall revenue in setting DGTAS prices,’ and the impact of the MTAS reductions as evidenced by Optus’s financial reports.⁹⁹
164. The Commission notes Telstra’s submission-in-reply that the Tribunal decision does not establish any *a priori* link between an above cost access price being reasonable and the interaction of the declared service with retail services. Telstra submits that an access price above efficient costs would generally not be reasonable and there is no basis in these Disputes on which to deviate from the general position that access prices should be cost based.¹⁰⁰
165. The Commission notes that in taking into account all of Optus’s mobiles revenue, it has increased consistently over the period in which MTAS prices decreased as illustrated by Optus’s financial information.
166. Further, Optus’s financial information clearly demonstrates that Optus’s mobile division contributes an increasing proportion of Optus’s total EBITDA despite decreases in MTAS revenue and the MTAS price over time. This is indicated in the table below.

⁹⁸ *ibid.*, p. 14.

⁹⁹ *ibid.*, p. 4.

¹⁰⁰ Telstra, *Submission-in-reply*, pp. 10-11.

Summary of Optus's Financial Condition¹⁰¹

OPTUS	2004 full year data to 31 Mar	2005 full year data to 31 Mar	2006 full year data to 31 Mar	2007 full year data to 31 Mar
<i>Group</i>				
Operating Revenue (\$m)	6,609	6,920	7,192	7,475
Operational EBITDA (\$m)	1,892	2,155	2,038	1,988
<i>Mobile Division</i>				
Operating Revenue (\$m)	3,445	3,817	4,036	4,177
Operational EBITDA (\$m)	1,298	1,515	1,528	1,531
Mobile Market Share (%)	35	33	33	33
Mobile Revenue to Total Group Revenue (%)	52	55	56	56
Mobile EBITDA to Total Group EBITDA (%)	69	70	75	77

167. In summary the table shows that:

- Optus's mobile segment EBITDA contributed 77 per cent of the Optus Group's EBITDA for financial year ended 31 March 2007,;
- revenue growth for the mobiles segment increased 3.4 per cent in the financial year ended 31 March 2007 compared to the financial year ended 31 March 2006; and over the longer-term total mobiles revenue growth has increased 21 per cent in the financial years 2004 to 2007, compared with the growth in mobiles EBITDA of 17.5 per cent over the same period. Revenue for the September Quarter 2007, shows a 3.5 per cent increase year-on-year from September Quarter 2006 and EBITDA margin remains high at 33 per cent¹⁰²; and
- the proportion of total operating revenue attributable to mobiles also increased between the financial year to 31 March 2004 and 31 March 2007 from 52 per cent to 56 per cent.

¹⁰¹ SingTel, *Singapore Telecommunications Limited and Subsidiary Companies, Management Discussion and Analysis of Financial Condition, Results of Operations and Cash Flows for the Fourth Quarter and Year Ended 31 March 2005*, pp. 42-43 and SingTel, *Singapore Telecommunications Limited and Subsidiary Companies, Management Discussion and Analysis of Financial Condition, Results of Operations and Cash Flows for the Fourth Quarter and Year Ended 31 March 2007*, pp. 43-44.

¹⁰² SingTel, *Singapore Telecommunications Limited and Subsidiary Companies, Management Discussion and Analysis of Unaudited Financial Condition, Results of Operations and Cash Flows for the Second Quarter and Half Year Ended 30 September 2007*, p. 40.

168. Commission notes Optus's submission about its reliance on access revenues compared with Telstra.¹⁰³ The Commission does not consider this is a relevant factor for consideration under the legitimate business criterion, particularly if those revenues are derived from above cost pricing of an access service such as the MTAS. In addition, the Commission considers that Optus has benefited from lower input costs in the form of lower prices it pays in order to access the MTAS from other MNOs. In reporting its recent annual results (for the year ended 31 March 2007), Optus states that its 'traffic expenses fell by 1.5 per cent due to lower mobile termination rates, partly offset by an increase in mobile traffic'.¹⁰⁴
169. Further, the legitimate business criterion is not concerned with the maintenance of revenues or monopoly profits where these are inflated by prices that return a higher than normal return on investment.
170. This is particularly the case where lower MTAS prices (and service revenue) have had the desired competitive effects and have acted to stimulate mobile volumes in the retail market even with constraints (lower retail prices) serving to increase rather than decrease overall revenue and profit, consistent with the Tribunal's view.¹⁰⁵
171. In respect of Optus's ability to adjust subscription and origination prices, Optus itself makes submissions about the increasing influence of capped plans in the market (refer to paragraph [126] above).
172. The Commission outlines above that Optus's revenue and profit have increased and not decreased, in spite of Optus's growing reliance on pre-paid customers (now 56 per cent of its entire customer base) as evidenced by the table at paragraph [167].
173. Further, the Commission notes that an increased percentage of pre-paid plans provides MNOs greater flexibility and improved responsiveness enabling faster pass-through of these lower input costs to the retail prices.
174. The Commission concludes that a price of 12 cpm for the period 1 January 2007 to 30 June 2007 and 9 cpm for 1 July 2007 to 31 December 2007 is appropriate having regard to Optus's legitimate business interests.

Section 152CR(1)(c) - Interests of all persons who have the right to use the service

175. Telstra submits that the prices it seeks in these Disputes are consistent with its interests (as a person with rights to use the MTAS) by ensuring that prices are not set substantially above cost so that it is able to effectively compete in downstream markets. Telstra submits that it seems odd to suggest that 'no party would legitimately expect' a further reduction in MTAS rates from 1 July 2007.¹⁰⁶
176. Optus submits that the price of 12 cents per minute promotes the interests of access seekers because they are consistent with the expected rates that would have been

¹⁰³ Optus, *Initial submission*, p. 6.

¹⁰⁴ SingTel, *Singapore Telecommunications Limited and Subsidiary Companies, Management Discussion and Analysis of Unaudited Financial Condition, Results of Operations and Cash Flows for the Fourth Quarter and Year Ended 31 March 2007*, p. 51.

¹⁰⁵ *Application by Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8 at [82] and [125].

¹⁰⁶ Telstra, *Submission-in-reply*, p. 17.

arrived at through commercial negotiations, which have been based on 3 cent reductions for each calendar year since 2004.¹⁰⁷ Optus submits that no party would legitimately expect a further rate reduction in the second half of calendar year 2007.¹⁰⁸

177. The Commission refers parties to the *Access Dispute Guidelines* which state that people who have rights to currently use a declared service will generally use that service as an input to supply carriage services, or a service supplied by means of carriage services, to end-users. The Commission believes that these people have an interest in being able to compete for the custom of end-users on the basis of their relative merits. The *Access Dispute Guidelines* further state that the terms and conditions that favour one or more service providers over others and thereby distort the competitive process may prevent this from occurring and consequently harm those interests. The Commission can also consider the interests of access seekers who may wish to use that service.¹⁰⁹
178. The Commission repeats and maintains the view that in the absence of regulation, MNOs are not constrained in their pricing decisions for the MTAS and this market power may raise the input costs for access seekers who purchase the declared service.¹¹⁰
179. The Commission notes that in *Telstra Corporation Limited* [2006] ACompT 4, the Tribunal stated that section 152AH(1)(c) requires it to have regard to the interests of persons who have rights to use the declared service, that is, access seekers. The Tribunal states that such interests would not be served where the prices are set above the access seeker's costs and thereby inhibit its ability to compete in the provision of retail services to end-users.¹¹¹
180. The Commission is of the view that the interests of all persons who have a right to use the MTAS will be promoted by MTAS pricing that better reflects the underlying TSLRIC+ of supplying the service.

Section 152CR(1)(d) - Direct cost of providing access to the declared service

181. Telstra submits that pricing the MTAS on a TSLRIC+ basis would: allow Optus to recover the costs of providing the MTAS; and ensure the access price is not inflated to enable the recovery of any profits Optus may lose in a dependent market as a result of the provision of access. As both 12 cpm for the first half of calendar year 2007 and 9 cpm for the second half of calendar year 2007 exceed the most recent estimates of the TSLRIC+ of supplying the MTAS, these prices would ensure that Optus would more than recover its direct costs of providing the service.¹¹²
182. Optus submits that the price of 12 cpm for the calendar year 2007 is consistent with the direct costs of providing the service.¹¹³
183. The direct costs of providing access to a declared service are those incurred (or caused) by the provision of access. In this context, the phrase 'direct costs' is interpreted to

¹⁰⁷ Optus, *Initial submission*, p. 14.

¹⁰⁸ *ibid.*, p. 14.

¹⁰⁹ *Access Dispute Guidelines*, p. 57.

¹¹⁰ ACCC, *Optus 2004 Undertaking Decision*, p. 162.

¹¹¹ *Telstra Corporation Limited* [2006] ACompT 4 (2 June 2006) at [91].

¹¹² Telstra, *Initial submission*, pp. 13-14; Telstra, *Submission on the Draft Decision*, p.11.

¹¹³ Optus, *Initial submission*, p. 15.

mean that an access price should cover the direct long-run incremental costs incurred in providing access. However, it does not extend to receiving compensation for loss of any 'monopoly profits' that occurs as a result of increased competition.¹¹⁴

184. In its *Access Pricing Principles*, Telecommunications Guide (*Access Pricing Principles*), the Commission stated

Direct costs are those costs necessarily incurred (caused by) the provision of access. As stated in the explanatory memorandum ... 'direct' costs of providing access are intended to preclude arguments that the provider should be reimbursed by the third party seeking access for consequential costs which the provider may incur as a result of increased competition in an upstream or downstream market. (Trade Practices Amendment (Telecommunications) Bill 1996 Explanatory Memorandum p. 44)¹¹⁵

185. The Tribunal's view concurs with the Commission's view when it states that the direct costs

- means the total costs of providing access to the relevant declared service which ordinarily include an appropriate allocation of fixed and common costs (FCCs) because without the existence of the assets in respect of which the FCCs are incurred, the relevant access could not be provided.¹¹⁶

- is intended to exclude the consequential costs which the access provider might incur as a result of increased competition as a result of access in any relevant market.¹¹⁷

186. The Commission notes that in considering whether estimates of efficient costs should be based on the costs incurred by an access provider in providing its service or some other costs, the Tribunal responded as follows:

... we would point out that whenever an access provider seeks approval of an access undertaking from the Commission which involves a consideration of a price term by comparing it with costs, it would be necessary, in order to satisfy the statutory framework, that the access provider establish that its costs are efficient costs. An access provider should also recognise that if the Commission decides against accepting the access undertaking and rejects it and the provider wishes to seek review of the Commission's decision before the Tribunal, it would be necessary to establish before the Tribunal that its costs are efficient.¹¹⁸

187. In this respect the Commission considers that the direct costs of providing the service are not inconsistent with the underlying efficient costs of providing the MTAS

188. In view of these matters, the Commission considers that a price in these Disputes tending toward a TSLRIC+ estimate of supply referable to an Australian context at the conservative upper-bound estimate of the TSLRIC+ of supply of the MTAS of 12 cpm for the period 1 January 2007 to 30 June 2007 and 9 cpm from 1 July 2007 to 31 December 2007 is appropriate to allow Optus to recover the direct costs of supplying the MTAS.

¹¹⁴ ACCC, *Access Dispute Guidelines*, p. 56.

¹¹⁵ ACCC, *Access Pricing Guidelines*, p. 10.

¹¹⁶ *Application by Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8 (22 November 2006) at [137].

¹¹⁷ *ibid.*, at [138].

¹¹⁸ *Telstra Corporation Limited* [2006] ACompT 4 at [46].

Section 152CR(1)(e) - Value of extensions or enhancements

189. Both parties have submitted that they consider this criterion is not a relevant factor in these Disputes.
190. The Commission considers that the price determined in these Disputes will not have an impact on the value to a party of extensions or enhancements of capability whose cost is borne by someone else.

Section 152CR(1)(f) - Operational and technical requirements for safe and reliable operation

191. The Commission notes Optus's submission that a price of 12 cpm for the calendar year 2007 properly takes into account the operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility.¹¹⁹
192. The Commission notes Telstra's submission that this criterion is not relevant to these Disputes. Telstra also submits that the operational and technical requirements for safe and reliable operation of a carriage service, telecommunications network, or a facility, would not be compromised by the prices proposed in the Draft Decision.¹²⁰
193. The Commission considers the price determined in these Disputes will not compromise the operational and technical requirements necessary for the safe and reliable operation of a carriage service, or a telecommunications network or a facility.

Section 152CR(1)(g) - Economically efficient operation of a carriage service, a telecommunications network or a facility

194. Telstra submits that setting the price of a service above the TSLRIC+ of supplying that service will have the tendency to dampen competition in the provision of downstream services provided to end users, leading to the potential to discourage the economically efficient operation of downstream services provided by access seekers using the declared service. Therefore, the economically efficient operation of a carriage service is best encouraged by pricing on a TSLRIC+ basis. Telstra submits the price of 12 cpm for the first half of calendar year 2007 and 9 cpm for the second half of calendar year 2007 are based on the TSLRIC+ of providing the MTAS, and accordingly are likely to promote this criterion.¹²¹
195. Telstra submits that the prices in the Draft Decision and in particular 9 cpm for the second half of calendar year 2007 are likely to promote this criterion as compared to a price of 12 cpm for the entirety of calendar year 2007.¹²²
196. Optus submits that, in line with its submissions made in relation to the LTIE criteria, the price of 12 cpm for the full calendar year 2007 will promote the efficient use of mobile infrastructure and efficient levels of subscription. By promoting technical, allocative and dynamic efficiencies, the price promotes economic efficiency.¹²³

¹¹⁹ Optus, *Initial submission in the Telstra-Optus Disputes*, p. 15.

¹²⁰ Telstra, *Submission on the Draft Decision*, p.11.

¹²¹ Telstra, *Initial submission*, p. 14.

¹²² Telstra, *Submission on the Draft Decision*, p.11.

¹²³ Optus, *Initial submission*, p. 15.

197. In response, Telstra submits that Optus has not shown that a price of 12 cpm would in fact represent the efficient costs of supplying the service. Rather, Optus has argued that it does not know whether 12 cpm is below, at or above cost. Telstra submits that the prices it proposes represent a more accurate assessment of the efficient costs of supply of the MTAS in light of the materials now available.¹²⁴
198. The Commission notes that, like the test described under the ‘efficient use of and investment in infrastructure’ element of the LTIE criterion, this criterion also relates to the effects on productive and allocative efficiency of proposed terms and conditions.
199. For the reasons already outlined in the LTIE discussion, paragraphs [149] to [180], the Commission considers that the economically efficient operation of a carriage service/telecommunications facility will more likely be promoted if the Commission uses the most reliable and robust estimate of the TSLRIC+ of supply of the MTAS.
200. The Commission maintains its view that pricing tending to an estimate of TSLRIC+ of the supply of the MTAS in an Australian context as determined in these Disputes will promote the economically efficient operation of a carriage service/telecommunications facility.

Other Matters

Deferral

201. The Commission notes that in their initial submissions both parties submitted that these Disputes should be deferred: Telstra sought deferral in light of the WIK Model Consultations and Optus sought deferral in light of the Optus 2007 Undertaking. The parties’ submissions on deferral¹²⁵ are considered below.

WIK Model Consultations

202. The Commission notes Telstra’s initial submission that consideration and determination of these Disputes prior to the completion of the WIK consultation is premature.¹²⁶ For the Commission’s discussion of the relevance of the WIK Model to these Disputes see paragraphs [66] to [69].
203. In Telstra’s submission, the Commission should issue final determinations in these Disputes after the WIK Model Consultations is complete and new pricing principles have been made. To do so will enable a proper consideration of all relevant matters affecting the merits of the Disputes. To do otherwise may result in the Commission pre-judging the outcome of the WIK Model Consultations and any new pricing principles that may be adopted.¹²⁷

¹²⁴ Telstra, *Submission-in-reply*, p. 5.

¹²⁵ Optus, *Initial Submission*, pp. 17-18; Optus, *Submission-in-reply on the content of the final determination for both sets of Disputes*, 16 March 2007 (*Submission-in-reply*), p. 1; and Telstra, *Submission-in-Reply*, pp. 20-21.

¹²⁶ Telstra, *Initial Submission*, p. 2; *Submission-in-reply*, p. 20.

¹²⁷ Telstra, *Initial Submission*, p. 2.

204. The Commission notes that since these initial submissions were made, the Commission released the *Final 2007 MTAS Pricing Principles Determination* and the *2007 MTAS Pricing Principles Determination Report*, on 28 November 2007.

Optus 2007 Undertaking

205. In its initial submission, Optus submits that the arbitration of these Disputes should be deferred until the ACCC has considered and reached a decision on the Optus 2007 Undertaking which sets out prices for the MTAS for the second half of calendar year 2007.¹²⁸ For the Commission's discussion of the relevance of the Optus 2007 Undertaking to these Disputes see paragraphs [71] to [80].
206. The Commission notes that it issued a final decision rejecting the Optus 2007 Undertaking on 28 November 2007.¹²⁹

Conclusion on deferral

207. The Commission notes that the *Final 2007 MTAS Pricing Principles Determination* and the *2007 MTAS Pricing Principles Determination Report*; and the *Final Optus 2007 Undertaking Decision* were released by the Commission on 28 November 2007.
208. Finally, the Commission has decided that it is not appropriate to defer the arbitration of the Disputes for the reason that other processes are being conducted in relation to MTAS pricing, particularly given that these processes have now been finalised.

Restrictions on Access Determinations

209. The Commission notes that section 152CQ of the Act restricts the Commission from making a determination in an access dispute, where such a determination would have certain effects.
210. Section 152CQ provides:

The Commission must not make a determination that would have any of the following effects:

- (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 access seeker made a request in relation to the service under section 152AR;
- (b) preventing the carrier or provider from obtaining a sufficient amount of the service to be able to meet the carrier's or provider's reasonably anticipated requirements, measured at the time when the access seeker made a request in relation to the service under section 152AR;
- (c) preventing a person from obtaining, by the exercise of a pre-notification 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;
- (e) resulting in the access seeker becoming the owner (or one of the owners) of any part of a facility without the consent of the owner of the facility;
- (f) requiring a party (other than the access seeker) to bear an unreasonable amount of the costs of:
 - (i) extending or enhancing the capability of a facility; or
 - (ii) maintaining extensions to or enhancements of the capability of a facility;

¹²⁸ Optus, *Initial submission*, p. 17.

¹²⁹ ACCC, *Optus 2007 Undertaking in relation to the Domestic Mobile Terminating Access Service Final Decision*, November 2007.

- (g) requiring the carrier or provider to provide the access seeker with access to a declared service if there are reasonable grounds to believe that:
 - (i) the access seeker would fail, to a material extent, to comply with the terms and conditions on which the carrier or provider provides, or is reasonably likely to provide, that access; or
 - (ii) the access seeker would fail, in connection with that access, to protect the integrity of a telecommunications network or to protect the safety of individuals working on, or using services supplied by means of, a telecommunications network or a facility.

The Commission must not make a determination that is inconsistent with any of the standard access obligations that are, or will be, applicable to the carrier or provider.

If an access undertaking given by the carrier or provider is in operation, the Commission must not make a determination that is inconsistent with the undertaking.

The Commission must not make a determination that is inconsistent with a Ministerial pricing determination.

A determination is of no effect if it is made in contravention of subsection (1), (4), (5) or (6).

- 211. The Commission is of the view that the proposed determination will not have any of the effects specified in section 152CQ(1). The Commission notes that the proposed determination is consistent with the standard access obligations. Further, there is no relevant access undertaking in operation, nor any relevant Ministerial pricing determination.
- 212. Accordingly, the Commission is of the view that the proposed determination will not have any of the proscribed effects specified in section 152CQ.

Interest

- 213. Telstra submits that the final determinations for these Disputes should be backdated and that interest should be calculated daily at the Commission's specified rate for any overpayment.¹³⁰
- 214. Optus submits that if the Commission sets the price of 9 cpm as proposed in the Draft Decision then, given the magnitude of the benefit this will deliver to Telstra, interest should not be applicable. To apply interest would be tantamount to a penalty to Optus and neither appropriate nor consistent with the LTIE.¹³¹
- 215. In the alternative, Optus submits that if the Commission chooses to apply interest then it should not be on the basis proposed in the Draft Decision. Optus notes that the *Access Dispute Guidelines* provide that the rate should reflect the opportunity cost of the overpayment or underpayment, and that the opportunity cost may be assessed by reference to the rate applicable to debt financing.¹³²
- 216. Optus submits that the Reserve Bank's Large Business Variable Indicator Rate, which the Commission proposes in the Draft Decision, is not representative of the actual financing costs which Telstra incurs when undertaking commercial transactions. Rather, it is an average of a large number of actual rates, which are determined by assessing the relevant and specific risks of the individual borrower. Consequently, it is an unreliable measure of the cost of debt to Telstra.¹³³

¹³⁰ Telstra, *Submission on the Draft Decision*, p. 1.

¹³¹ Optus, *Submission on the Draft Decision*, p. 70.

¹³² Optus, *Submission on the Draft Decision*, p.70.

¹³³ Optus, *Submission on the Draft Decision*, p.71.

217. Optus submits that the interest rate in these Disputes should be based on Telstra's credit rating.¹³⁴
218. Optus submits that the Commission should apply interest in accordance with the average yields for 2007 of 6.6 per cent for a company with an 'A' credit rating such as Telstra.¹³⁵
219. Optus submits that the average yield of 6.6 per cent is a better indicator which reflects Telstra's individual risk and the true opportunity cost of the underpayment.¹³⁶
220. Accordingly, Optus submits that if the Commission decides to apply interest it should apply an interest rate of 6.6 per cent to any backdated payment.¹³⁷

Conclusion on interest

221. The Commission notes Optus's submission that interest should not be awarded in the final determinations for these Disputes because it would amount to a penalty; and its submission in the alternative, that if interest is awarded the appropriate rate is 6.6 per cent which reflects Telstra's individual risk and the true opportunity cost of the underpayment.¹³⁸
222. The *Access Disputes Guidelines* provide that the Commission 'will generally' provide for the payment of interest on backdated amounts.¹³⁹ In this respect, while the Commission is required to have regard to its guidelines,¹⁴⁰ the Commission considers interest on a case-by-case basis and does not consider that interest is automatically payable in every circumstance in which backdating of a final determination occurs. The Commission may also have regard to such other matters as it considers relevant.¹⁴¹
223. The *Access Dispute Guidelines* provide guidance as to the rate that should apply such that it reflects the opportunity cost of the overpayment and that in general that daily compounding will be appropriate.
224. That said the Commission believes that in these circumstances consideration of interest should be consistent with its *Access Dispute Guidelines* for any overpaid amounts relevant to the period in dispute.
225. The Commission considers that the applicable interest rate which should apply to backdated amounts in these disputes is the Reserve Bank of Australia (RBA) Large Business Variable Indicator Rate. Such a rate is a reasonable estimate of the opportunity cost of the overpayment. It is noted that the RBA Large Business Variable Indicator Rate is representative of the actual financing costs which large businesses (such as the parties to these disputes) would typically incur when undertaking

¹³⁴ Optus, *Submission on the Draft Decision*, p.71.

¹³⁵ Optus, *Submission on the Draft Decision*, pp.71-72.

¹³⁶ Optus, *Submission on the Draft Decision*, p.71.

¹³⁷ Optus, *Submission on the Draft Decision*, p.71.

¹³⁸ Optus, *Submission on the Draft Decision*, pp. 71-72.

¹³⁹ ACCC, *Access Dispute Guidelines*, p. 63.

¹⁴⁰ Section 152DNA(7)(a).

¹⁴¹ Section 152DNA(7)(b).

commercial transactions. Consequently, the Commission considers that this rate is appropriate in the circumstances of these disputes.

226. As stated in the *Access Disputes Guidelines*, the Commission's view is that the calculation of the interest on any overpayment in these disputes will be calculated on a daily compounding basis.¹⁴²
227. The Commission considers that, except where the parties agree otherwise, the total amount of any overpayment plus interest calculated daily at the applicable monthly rate specified in the Large Business Variable Indicator Rate is to be made within 42 days after the date on which this determination is made.

¹⁴² *ibid.*

CONCLUSION–FINAL DETERMINATIONS

228. In making the determinations in these Disputes, the Commission has taken into account the statutory criteria in section 152CR(1) of the Act and has considered inter alia:
- Parties' submissions;
 - The *MTAS Final Report*;
 - the Commission's *MTAS Pricing Principles Determination* for the period 1 January 2007 to 30 June 2007;
 - the Commission's *Final 2007 MTAS Pricing Principles Determination* for the period 1 July 2007 to 31 December 2007.
 - The WIK Model; and the *Final 2007 MTAS Pricing Principles Determination Report*; and
 - The Optus 2007 Undertaking.
229. The Commission considers that, based on the WIK Model outputs, referable and comparable international cost benchmarking analyses and the FL-LRIC estimate for the supply of the MTAS for Optus from the CRA Model a price of 9 cpm for the period 1 July 2007 to 31 December 2007 is appropriate. With more reliable and robust information at hand, this price is reflective of a more referable estimate of the supply of the MTAS in an Australian context than the conservative upper-bound estimate of 12 cpm relevant for the period 1 July 2004 to 30 June 2007.
230. The Commission considers that, taking into account the statutory criteria and other matters outlined above, the final determinations for these Disputes should include a price for the MTAS of:
- 12 cpm for the period commencing on 1 January 2007 and expiring on 30 June 2007, and
 - 9 cpm for the period commencing on 1 July 2007 and expiring on 31 December 2007
231. Except where the parties agree otherwise, other terms and conditions on which Optus currently supplies the MTAS to Telstra are to continue to apply.
232. Interest should apply on overpaid amounts.

Appendix 1 – WIK Model

BACKGROUND TO THE WIK MODEL DEVELOPMENT

In the *MTAS Final Report*, the Commission stated that before it would reduce the price of the MTAS below 12 cpm, or the upper-end of the range of best estimates available to it of the TSLRIC+ of providing the MTAS, it would develop a more detailed estimate of the TSLRIC+ of providing the MTAS in Australia.

In June 2004, the Commission stated this could be via developing a model to estimate the TSLRIC+ of providing the MTAS in Australia, or via a detailed international benchmarking exercise making adjustments for all factors that drive the TSLRIC+ of providing the MTAS in different countries for Australia-specific factors.¹

WIK-Consult (WIK) has been engaged to develop a bottom-up cost model which will among other information inform the Commission about the estimated efficient cost of supply of the MTAS in an Australian context using a total service long-run incremental cost (TSLRIC) conceptual framework.

Further material relating to the development of the WIK model is available from the Commission's website.

WIK MODEL STRUCTURE

The WIK Mobile Network and Cost Model functionality and description

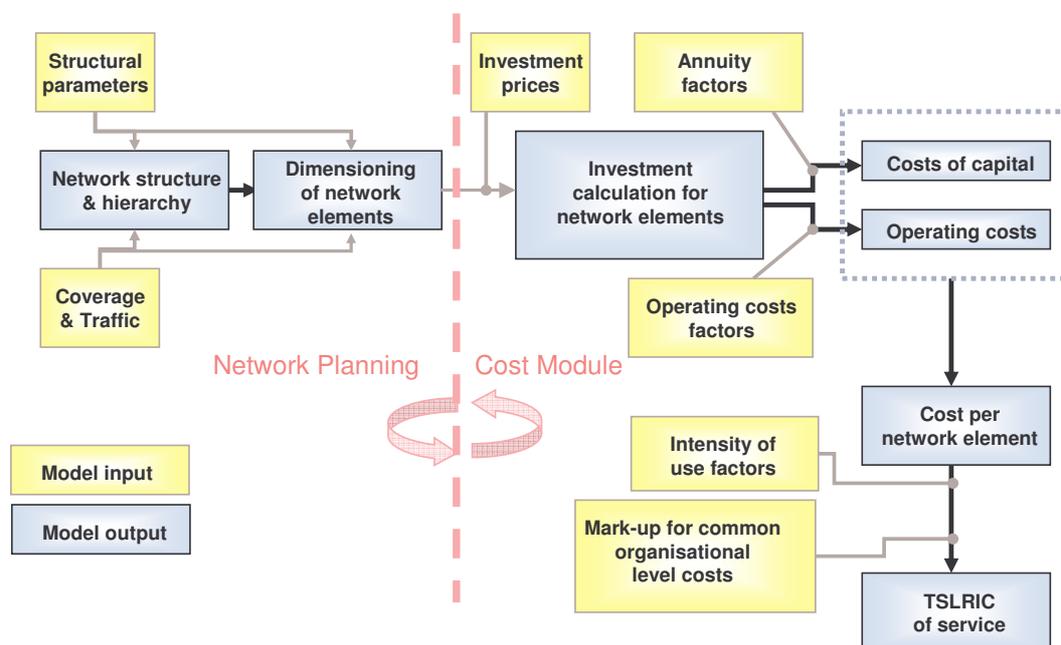
The WIK Model consists of two main modules (as illustrated in the schema below):

- Mobile network design and dimensioning carried out by the Strategic Network Planning Tool; and
- Calculating the costs of the various network elements carried out by the Cost Module.

These modules are discussed below.

¹ ACCC, *MTAS Final Report*, p. 211.

Schematic diagram of the WIK Mobile Network and Cost Model



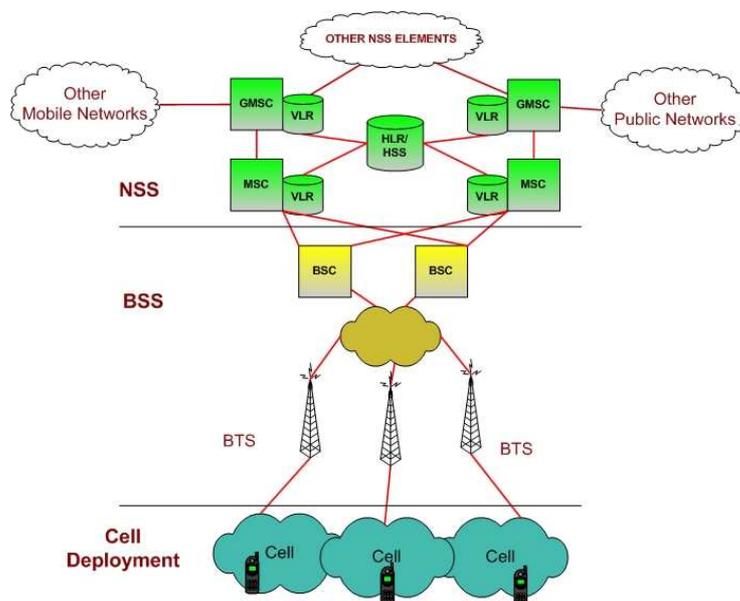
Mobile network design and dimensioning

The network design and dimensioning requires identification of the areas to be covered. This is of particular importance in the Australian context, given its population distribution and topography. The network design and dimensioning part of the model carries out the following tasks:

- Optimal cell radius calculation and cell deployment for each relevant area (based upon coverage and capacity requirements);
- Determination of the network hierarchy; and
- Determination of the capacity requirements of the link structure.

A schematic representation of the resulting architecture of the network is shown in the following picture.

Architecture for a GSM mobile network



- BSS: Base station subsystem
NSS: Network Switching Subsystem
BTS: Base transceiver station
BSC: Base station controller
MSC: Mobile switching centre
GMSC: Mobile switching centre with gate to another network
VLR: Visiting location register
HLR/HSS: Home location register
A line: A transmission link
-

Each of the network elements illustrated above is determined on the basis of optimising algorithms. The values for the following parameters are required:

- (1) Information about topography and population;
- (2) Demand parameters for the different services, geographic coverage requirements, total mobile penetration, market share of modelled operator, average demand per subscriber;
- (3) Technical data, equipment prices, operating and maintenance cost of network elements as a share of value of network elements; and
- (4) Network design configuration data.

Determining the cost of network services (Cost Module)

Once the network structure and all network elements have been determined as described above, the costs of providing services with this network can be determined. Total costs using a TSLRIC framework essentially consist of the annual capital cost of all equipment items that are owned and the cost of operations and maintenance including any amortised cost of leased facilities.

The annual value of capital expenditure items or capex is derived using a tilted annuity formula for the derivation of economic depreciation. Operating expenditure in the WIK Mobile Network and Cost Model is expressed as a percentage mark-up on the value of the network elements.

The total costs comprise the total annual cost of running the network and providing all the services on the network, which, through information about routing factors and number of minutes delivered, can isolate the operating and capital cost of a particular service. Common organisational-level costs are added as an equi-proportionate mark-up on the total network element costs (direct, indirect and operating expenditure).

Determining the cost of MTAS

In the schema below, a simplified view of the network is presented. For a terminating call originating from another network there are essentially two possibilities.

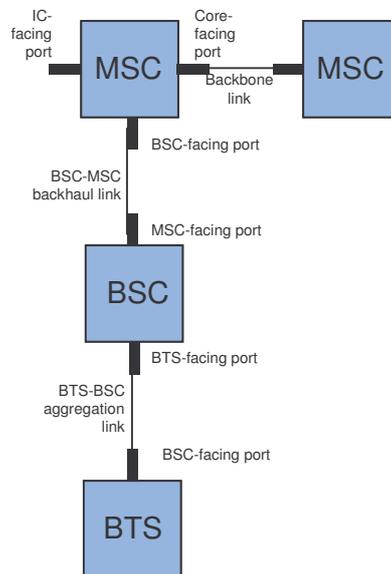
Calls can be delivered at the level of the mobile switching centre (MSC) to which the BTS belongs that serves the user receiving the call. These calls use each of the network elements on the way to this user once: MSC, home location register (HLR), link between MSC and base station receiver (BSC), the BSC itself, the link between BSC and BTS, and the BTS itself.² For each of these network elements the per-minute cost of using it is determined in the Cost Module so that the total cost of delivering the call is arrived at by simply adding up the per-unit costs for each of the six network elements listed.

Alternatively calls can also be delivered at the level of another MSC not serving the BTS of the receiving user. The per-minute cost of this second MSC needs to be added to the cost determined for the first case as well as to the cost of the link between this MSC and the MSC that serves the BTS in question.

For the purposes of a single cost figure for termination, the costs for both of these call types, is derived using a weighted average.

² In some cases BTS hubs may be used between the BTS and the BSC for calls delivered to remote areas.

Simple view of the network



Model functionality

The WIK Model is parameter-driven and various scenarios can be modelled based on these parameters. Key parameters include:

1. Threshold in terms of minimum population per basic geographical area to determine the degree of coverage;
2. Market share achieved by the modelled operator in the area covered by its network;
3. Shares of various services (voice on-net, voice off-net outgoing, voice off-net incoming, SMS, high-speed data, etc.) in the total network load; and/or
4. Prices of equipment and facilities.

The interface of the user with the model software is structured in a way so that parameter values can be modified by:

- Changing the value of a single parameter, by entering the value in a corresponding cell of the mask building the interface; and/or
- Changing the values of a number of parameters, by entering the new data into a data file that the model algorithms refer to when carrying out the calculations.

WIK MODEL VERSION 1.2 SPECIFICATIONS AND OUTPUT

Since the release of version 1.0 of the WIK Model, the Commission has released versions 1.1 and 1.2 in response to the submissions it received. On 28 November 2007 the Commission released the *Final 2007 MTAS Pricing Principles Determination* which is informed by the WIK Model Version 1.2.

The following outlines the assumptions made in calibrating the WIK Model Version 1.2 for use in the consultation process for the *Final 2007 MTAS Pricing Principles Determination* for the period 1 July 2007 to 31 December 2008. It also provides a guide to the TSLRIC+ estimate using these assumptions.

Relevant population coverage assumption

A 96 per cent population coverage assumption is a realistic and relevant coverage assumption for the period after 30 June 2007, as it reflects the current population coverage of two of the three existing GSM networks.

The population coverage assumption of 96 per cent that applies to most 2G networks and that is used in the WIK Model would tend to produce a conservative upper-bound (higher) cost estimate for the MTAS than if the actual population coverage for 3G networks.

Relevant market penetration assumption

The market penetration assumption of 96 per cent reflects current services in operation and is considered relevant for the regulatory period for which the TSLRIC+ estimates derived from the WIK Model (that rely on this assumption) will apply.

Derivation of the WIK Model TSLRIC+ estimate

Version 1.0 of the WIK Model was modified by Version 1.1 to account for:

- Increased minimum SMSCs from 1 to 2
- Adjustments made to recognise transient population in POAs encompassing airport precincts, industrial areas and military bases
- Included unbilled minutes to reduce annual service traffic
- Changed routing usage factors for allocating cent per minute costs of the HLRs to services
- Removal of the Redundant Terrain Parameters
- Increased number of MSC switching machines from 5 to 9
- Increase in service and dimensioning minutes by increasing the average milli-Erlang demand for service traffic from 8.3 to 13.1
- Traffic reduction on core network set to zero, and
- Averaging of dual-band and single-band scenarios to account for spectrum restrictions faced by MNOs WACC changed from 11.68 to 13 per cent.

In addition, Version 1.1 of the WIK Model was modified by Version 1.2 as follows:

- Decrease in service and dimensioning minutes by decreasing the average milli-Erlang demand for service traffic from 13.1 to 12.6
- Change of rounding procedure for the number of BTSs estimated by WIK Model
- Adjustment to service traffic calculation at BTS level

- Inclusion of ability to force single-band deployment on urban, suburban or rural areas (rural areas are single-band in all scenarios)
- Individual uplift factors for all BTS types (uplift factor of 37.7 per cent used on BTS macrocells with 3 sectors and 2 TRXs)
- Allowed deployment of BTS macrocells in urban areas, and BTS picocells in suburbs
- Site sharing factor for microcell sites has been set to zero, and
- Changed SMS Conversion factor from 125 to 40 bytes.

Resulting TSLRIC+ estimate

The relevant reference points for TSLRIC+ estimates for the supply of the MTAS for consideration are summarised in the following table:

TSLRIC+ estimates of MTAS supply

Population coverage: 96 % Penetration rate: 96 %	TSLRIC+ estimate of supply (cpm)
Reference Case 1 (25%)	▪ 6.6
Reference Case 2 (31%)	▪ 6.1

The results in this table indicate that a relevant efficient cost estimate for the supply of the MTAS. In the *Draft 2007 MTAS Pricing Principles Determination Report*, the range for the efficient cent per minute cost of the MTAS was 5.2 to 5.6 cpm for the relevant efficient operator scenarios detailed in the *Draft 2007 MTAS Pricing Principles Determination Report* that used version 1.1 of the WIK Model. These WIK Model estimates were updated to reflect recalibration of the optimised network and inclusion of parameters to reflect an Australian context since receiving submissions in response to the *Draft 2007 MTAS Pricing Principles Determination Report*. These changes are outlined above.

Optus’s submission on the Draft Decision

Use of the WIK Model to inform Draft Decision

Optus submits that even if the regulated price of the MTAS is to be closely aligned with the efficient cost of provision of the MTAS, the Commission should not be informed by the WIK Model as it does not provide an estimate of the efficient cost of the MTAS.³

Optus submits that it considers that the hypothetical MTAS cost that results from its method is not practically achievable by any real world operator, either an existing operator or a new entrant.⁴

Optus submits that the WIK Model is not capable of estimating the forward looking efficient cost of supply of the MTAS (rather, it is likely to underestimate it) since the model designs a

³ Optus, *Submission on the Draft Decision*, p. 4.

⁴ *ibid.*, pp.15, 60.

physical network that is incapable of providing a mobile service of the quality and service delivery standard provided by mobile network operators in Australia.⁵

Optus submits that the WIK Model ignores the costs existing mobile network operators face as the result of past prudent investments and holds them to a standard of operational and cost efficiency they cannot achieve.⁶

Optus submits that the WIK Model uses a number of assumptions that are not feasible for an efficient entrant even if it adopts efficient network structures and operations, and which substantially underestimate the cost to a hypothetical mobile network operator in providing the MTAS service which means that it cannot be relied upon as an estimate of the efficient cost of the supply of the MTAS.⁷

Optus submits that the use of the WIK Model by the Commission as a means of estimating the efficient cost of supply of the MTAS in Australia is inconsistent with the observations of the Tribunal that the task of assessing the forward looking costs of a new entrant must involve some balancing of opposing considerations and must take account of the actual markets in which the relevant services are provided.⁸

Optus submits that by adopting a scorched earth approach the Commission has ignored a relevant consideration being the costs incurred by existing mobile network operators (if they can be shown to be efficient). It submits that this is a relevant consideration because it takes into account the legitimate business interests of the mobile network operator – that the business can receive a reasonable return on invested capital.⁹

WIK Model - scorched-node issues

Optus submits that the Commission has not been informed by either approach (scorched-earth approach with calibration or scorched-node) and that this is inconsistent with the observations of the Tribunal that the task of assessing the forward looking costs of a new entrant must take account of the actual markets in which the relevant services are provided.¹⁰

Optus submits that the Commission's dismissal of the scorched-node approach has no basis; the identified 'issue' is an important practical consideration, but not, however, a fatal flaw in the approach (and if the Commission believes that it this a fatal flaw it has certainly not explained how and why this may be so). The 'issue' has also been addressed by regulators in most other jurisdictions in which MTAS prices are regulated. It submits that it considers that the Commission has not adequately addressed Optus's submissions on the disadvantages of a scorched-earth approach.¹¹

⁵ *ibid.*, p. 4.

⁶ *ibid.*, p. 14.

⁷ *ibid.*, p.19.

⁸ *ibid.*, p. 6.

⁹ *ibid.*, p.19.

¹⁰ *ibid.*, p. 17.

¹¹ *ibid.*, p. 15.

Optus submits that a bottom up scorched-earth model is not practically achievable by an existing mobile network operator which has been operating efficiently for a significant length of time for two main reasons.

- 1) Existing operators built their networks some time ago. Due to the dynamic nature of demand, the design of these legacy networks is no longer likely to be optimal. As it noted in its March submission on the WIK Model, the design of a mobile network is heavily influenced by inter-temporal factors and as such the optimal or efficient configuration of the mobile network will vary depending upon the build date and constraints at the time. Optus therefore submits that it may not be reasonable to impose scorched-earth pricing on existing operators since such efficiencies are not achievable by existing mobile network operators.¹²

Optus submits that a scorched-node design would apply an historic costing approach to certain network elements (consistent with the legitimate business interests of the access provider and the direct cost of providing the service), and a forward looking costing approach would be applied to the remaining elements, encouraging the network owner to make efficient investment decisions and adopt least cost technologies where they are feasible.¹³

- 2) The modern equivalent asset (MEA) prices used in the WIK Model understate the capital investment of a mobile network operator in Australia today, since equipment prices have fallen in recent years. In this circumstance the existing mobile network operators are unlikely to have received appropriate compensation for past network investments because the falling price trends were not used historically to front load the return of capital invested.¹⁴

WIK Model - new entrants and inconsistency

Optus submits that outcome the WIK Model produces is not the MTAS cost of a hypothetical efficient mobile network designed by a bottom up scorched-earth model as it is not practically achievable by a new entrant mobile network operator in Australia for three main reasons.

- 1) The model does not demonstrate that the network could provide the service quality assumed nor does it demonstrate that the network could provide the declared service provided by a mobile network operator competing in the Australian market.
- 2) The model assumes a network design algorithm that can be demonstrated to fail in providing the service quality assumed if it were to be rolled out.
- 3) The model fails to take into account all the practical considerations that a new entrant would face in actually building a network. These are relevant considerations because they represent the forward looking efficient costs a new entrant would incur – being

¹² *ibid.*, p. 15.

¹³ *ibid.*, p. 16.

¹⁴ *ibid.*, p. 16.

the costs that set the benchmark (or contestable) price in a competitive market that the Commission is seeking to mimic.¹⁵

Optus submits that the WIK Model takes the option that is cheaper in both cases: it assumes optimised network design and MEA equipment prices and assumes away practical difficulties in obtaining sites for its mobile network base stations. It submits that this is logically inconsistent and more fundamentally, the cost level it results in is effectively meaningless, since it is not practically achievable by any real world operator (either existing or new entrant).¹⁶

WIK Model - assumptions

Optus submits that an efficient mobile network operator that wished to deliver the standards of service required of a mobile network in Australia would be compelled to deploy a considerably more extensive and more costly network than the WIK Model deploys.¹⁷

WIK Model – 2G/3G considerations

Optus submits that given the rising demand for 3G services, the WIK Model's assumption that a new entrant would supply only 2G services is not realistic, and as a result of this assumption, the WIK Model will underestimate the cost of provision of the MTAS.¹⁸

Optus submits that despite the sharing of spectrum, a 3G network still has significantly increased capital and O&M costs compared to the 2G service, particularly in the early years of operation while the transition from 2G to 3G is still taking place. Further to move from the 2G to 3G sphere, mobile network operators must still alter and upgrade their equipment. It also submits higher 3G subscriber acquisition costs are expected to negatively impact mobile margins in 2007 and beyond.¹⁹

Optus submits that it observes that no mobile network operator has launched a new 2G mobile network in the Australian market since March 2000.²⁰

WIK Model - Market share

Optus submits that having due regard to the directions given by the Australian Competition Tribunal (the Tribunal), as well as the landscape of the Australian mobile market it is not realistic for the WIK Model to use a 25 per cent market share (or a 31 per cent market share) as a standard reference case. It disagrees that the Tribunal has given any indication that the relevant benchmark may be greater than 25 per cent. The Tribunal considered a number of 'potential' outcomes.²¹

¹⁵ *ibid.*, pp. 20-21..

¹⁶ *ibid.*, p. 18..

¹⁷ *ibid.*, p. 22.

¹⁸ *ibid.*, p. 31.

¹⁹ *ibid.*, pp. 32-33.

²⁰ *ibid.*, p. 33.

²¹ *ibid.*, p. 41.

Optus submits that the likely defensive action of the current mobile network operators, an entrant would likely find it extremely difficult to attract market share as high as 25 per cent.²²

Optus submits that a more reasonable estimate of an achievable market share would be based on the market share of the most recent entrants into the Australian mobile market (Vodafone and Hutchison).²³

WIK Model - BTS deployment

Optus submits that a new entrant operator would provide coverage to highways without being subsidised, and that the Commission's assumption that a hypothetical mobile network operator would not provide coverage to highways is unrealistic.²⁴

Optus notes that it submitted that WIK's Model does not appear to take sufficient account of the impact on base station siting decisions of terrain features such as deep valleys and bay-side suburbs, which can often cause quality problems which can best be managed by siting additional base stations (and TRXs).²⁵

Optus notes the Commission's use of the term 'specific operational strategies'. This appears to be code for saying 'if the carrier chooses to supply a higher level of quality MTAS to itself and to access seekers than is assumed in the WIK Model, such a choice is that carrier's operational strategy and it should not be reflected in cost'. Optus submits that if the Commission is defining a particular strategy that a new entrant would follow, then it is the Commission that is adopting 'specific operational strategies' that are inconsistent with market reality and do not appear to be consistent with reasonableness.²⁶

Optus submits that all of these are factors that would be taken into account by an efficient new entrant in designing its network. To assume a new entrant would neglect factors like quality and reliability is an unrealistic assumption. If it did neglect these factors then its ability to attract customers would be compromised. It therefore submits that since the WIK Model estimates the cost of a service provided in fewer areas or at lower quality than the service provided by mobile network operators, it underestimates the efficient cost of supplying the MTAS.²⁷

WIK Model - Aggregation network

Optus submits that it is not technically feasible for a mobile network to use microwave links only in the BTS – BSC aggregation network. The reason for this is that radio links have a limited throughput capacity and accordingly cannot aggregate traffic from all upstream sites.²⁸

WIK Model - Backhaul network

²² *ibid.*, p. 42.

²³ *ibid.*, p. 42.

²⁴ *ibid.*, p. 24.

²⁵ *ibid.*, p.30

²⁶ *ibid.* p. 30.

²⁷ *ibid.* pp. 29-30.

²⁸ *ibid.*, p. 23.

Optus submits that, as a mobile carrier and service provider, it maintains at all times 'Carrier class' annual network availability of 99.95 per cent for backhaul transmission, and this standard of availability is typical of Australian mobile carriers and service providers. To achieve such availability, it is standard practise to employ path protection with equipment interface protection on every backhaul segment in the transmission network, which provides full geographical diversity for backhaul transmission. It appears that the WIK Model does not incorporate such service protection mechanisms for its backhaul network (since discussion of any such mechanisms has not been presented) and consequently Optus considers that its concerns about the resilience of the design of WIK Model's backhaul network remain. Optus submits that as a result, the WIK Model does not appear to be capable of designing a mobile network capable of meeting typical Australian availability standards.²⁹

WIK Model – Traffic and demand issues

Optus submits that it considers that the Commission's view on the usage of an average milli-Erlang demand per consumer is incorrect, and that application of it in the WIK Model to estimate busy-hour traffic is not reasonable for three main reasons:

- 1) It is not necessarily true that the actual milli-Erlang demand per consumer in rural areas is likely to be below the average milli-Erlang demand per consumer (or that in suburban and urban areas the milli-Erlang demand per consumer is expected to be above the average milli-Erlang demand per consumer).
- 2) A-bis transmission has a minimum fixed size (one E1 or 2 Mbps) regardless of carried traffic, and this is not impacted by the milli-Erlang demand per customer at that site. The assumption that as BTS units located in rural areas are further away from BSC locations than suburban or urban areas, using an average milli-Erlang demand per consumer results in an over-estimation of the capacity required for transmission, in general, is incorrect.
- 3) The cost of microwave links has little dependency on the transmission path length, so the assumption that the impact from overestimating milli-Erlang demand in rural areas has a greater impact on cost than the underestimation in suburban and urban areas due to the longer transmission links required in rural areas is not generally correct.³⁰

Optus submits that that the WIK Model does not address variation in busy hours across cell sites through use of the assumption of a morning and afternoon busy hour, since the size of the BTS to BSC transmission pipe (A-bis) is generally fixed at one 2 Mbps link. Diurnal variations in traffic between base stations and across the network provide no A-bis efficiency benefit to the network operator whatsoever. Any "unused" A-bis capacity on a specific site is inaccessible to other traffic.³¹

WIK Model - Asset prices

²⁹ *ibid.*, p. 31.

³⁰ *ibid.*, pp. 26-27.

³¹ *ibid.*, p. 28.

Optus submits that the fact that three out of four mobile network operators are subsidiaries within international telecommunications group and their relative bargaining power will therefore be irrelevant to the equipment prices mobile network operators paid.³²

WIK Model - Risk-free rate

Optus submits that in calculating the risk-free rate, the Commission should average Government bond rates for the at least 10 days leading up to the start of the regulatory periods. The Commission has used this methodology for many years and Optus believes it is suitably robust to address any potential concerns regarding day-to-day market volatility.³³

WIK Model - Site sharing

Optus submits that it disagrees with the statement that Optus is silent on the site sharing assumptions made about microcell sites as it explicitly stated that ‘microcell sites are generally not shared with other carriers...they are typically positioned at busy street intersections...street lightning poles, or shop awning. Neither Optus nor Telstra own or otherwise use these structures.’ It submits that it never implicitly agrees with the WIK’s site sharing assumption of microcell and in fact submitted that the rate of microcell site sharing is zero.³⁴

Optus submits that with respect to the site sharing assumptions for macrocells, it observes the WIK figure is high when comparing the percentage to its own network.³⁵

Optus submits that contrary to the Commission’s apparent belief that shelter costs are negligible compared to overall site costs, shelter costs are in fact a substantial proportion of overall site costs.³⁶

WIK Model - Working capital

Optus submits that it believes that it is unrealistic to say an efficient operator would not face demand for working capital. Such a scenario could only exist in a text book. The demise of Onetel indicates the difficulties faced by new entrants in the mobile market in organising their cash flow. The market is constantly changing and unpredictable outgoings are expected from time to time. Mobile network operators incur substantial up-front costs for infrastructure and labour before receiving payments and unexpected turbulences occur from time to time. An example would be the > \$1 million damage caused by an armoured personnel carrier at our western Sydney mobile base stations in July 2007.³⁷

WIK Model - Carrier licence fees

Optus submits that it continues to hold the view that the entire carrier licence fee should be allocated to network services. According to the Australian Communications and Media Authority (ACMA), there are two types of organisations that can provide telecommunication services to the public – carriers and carriage service providers (CSP). Carriers are required to hold a carrier licence but CSPs are not. Like other carriers in Australia, CSP provides retail

³² *ibid.*, p. 37.

³³ *ibid.*, p. 73.

³⁴ *ibid.*, p.36.

³⁵ *ibid.*, p.36.

³⁶ *ibid.*, p. 36.

³⁷ *ibid.*, p.40.

services to the public but do not own a telecommunication network unit. Accordingly, the licence fee is not related to the entire mobile business of a CSP and Optus therefore submits licence fee should not be treated in the same way as common organisational-level costs.³⁸

WIK Model - Spectrum

Optus submits that the allocation of spectrum costs is incorrect, and that 100 per cent of spectrum costs should be allocated to networks, since possession of spectrum is required for a network operator, but not for a retailer. In any case, even if 100 per cent of spectrum costs were allocated to the network, a proportion would de facto be allocated to retail services, since all mobile services other than termination are sold at retail.³⁹

Optus submits that a more reasonable approach would be for the model to amortise spectrum costs according to a straight line method or with a front loaded tilt to reflect the technology obsolescence risk in 2G (from 3G). This would be necessary to maintain efficient investment in 2G consistent with a competitive market.⁴⁰

Submission on the Draft Decision

Telstra

Telstra submits that it has various reservations concerning the reliability of the WIK Model but that those concerns are set out in full in separate public submissions to the Commission, and it is unnecessary to repeat them.⁴¹

Commission's view

The Commission considers that Optus's detailed submissions on the WIK Model are misplaced and do not provide support for Optus's submission that a price above 9 cpm is appropriate for the second half of calendar year 2007.

Optus's submissions on the WIK Model are more appropriately directed to the Commission's consideration and use of the WIK Model as corroborating support for the MTAS Pricing Principles Determination for the period 1 July 2007 to 31 December 2008. In this respect the Commission notes that an almost identical submission in respect of the WIK Model was provided by Optus to the Commission's consultation process regarding the *Draft 2007 MTAS Pricing Principles Determination* for the period 1 July 2007 to 31 December 2008 and the Commission considers that the issues raised by Optus were more appropriately considered in that process.

³⁸ *ibid.*, p. 38.

³⁹ *ibid.*, p. 39.

⁴⁰ *ibid.*, p.39.

⁴¹ Telstra, *Submission on the Draft Decision in the Telstra-Optus Disputes*, p.2.

Appendix 2 – Commission’s views on the LTIE criterion

1. To consider the likely impact of particular terms and conditions on the LTIE, the Act requires the Commission to have regard to whether the terms and conditions are likely to result in:
 - promoting competition in markets for carriage services and services supplied by means of carriage services;
 - achieving any-to-any connectivity; and
 - encouraging the economically efficient use of, and economically efficient investment in:
 - the infrastructure by which listed carriage services are supplied; and
 - any other infrastructure by which listed services are, or are likely to become, capable of being supplied.⁴²
2. In the Commission’s view, the phrase ‘economically efficient use of, and economically efficient investment in ... infrastructure’ refers to the concept of economic efficiency that consists of three components:
 - Productive efficiency – This is achieved where individual firms produce the goods and services that they offer at least cost;
 - Allocative efficiency – This is achieved where the prices of resources reflect their underlying costs so that resources are then allocated to their highest valued uses (i.e. those that provided the greatest benefit relative to costs); and
 - Dynamic efficiency – This reflects the need for industries to make timely changes to technology and products in response to changes in consumer tastes and in productive opportunities.⁴³
3. In determining the extent to which terms and conditions are likely to result in the objective of promoting competition, regard must be had to the extent to which the terms and conditions will remove obstacles to end-users of gaining access to listed services.⁴⁴
4. In determining the extent to which terms and conditions are likely to result in the achievement of the objective of encouraging the economically efficient use of and investment in infrastructure, regard must be had to technical feasibility, the legitimate commercial interests of the supplier, and the incentives for investment.⁴⁵
5. The Commission has published a guideline explaining what it understands by the phrase ‘long-term interests of end-users’ in the context of its declaration responsibilities.⁴⁶ The Commission has also previously explained what it understands

⁴² *Trade Practices Act 1974*, section 152AB(2).

⁴³ ACCC, *Access Pricing Principles*, p. 7.

⁴⁴ *Trade Practices Act 1974*, subsection 152AB(4).

⁴⁵ *ibid.*, subsection 152AB(6).

⁴⁶ ACCC, *Telecommunications services – Declaration Provisions: A Guide to the Declaration Provisions of Part XIC of the Trade Practices Act*, July 1999.

by the phrase ‘LTIE’ in the context of assessing access undertakings.⁴⁷ The Commission considers that similar interpretations are appropriate to making final determinations in these arbitrations.

6. In the Commission’s view, particular terms and conditions promote the interests of end-users if they are likely to contribute towards the provision of goods and services at lower prices, higher quality or towards the provision of greater diversity of goods and services.
7. The Commission also notes that the Tribunal has offered guidance in its interpretation of the phrase ‘long term interests of end-users’ in the context of access to subscription television services:

*Having regard to the legislation, as well as the guidance provided by the Explanatory Memorandum, it is necessary to take the following matters into account when applying the touchstone – the long-term interests of end-users:

*End-users: ‘end-users’ include actual and potential [users of the service] ...

*Interests: the interests of the end-users lie in obtaining lower prices (than would otherwise be the case), increased quality of service and increased diversity and scope in product offerings. ...[T]his would include access to innovations ... in a quicker timeframe than would otherwise be the case ...

*Long-term: the long-term will be the period over which the full effects of the ... decision will be felt. This means some years, being sufficient time for all players (being existing and potential competitors at the various functional stages of the ... industry) to adjust to the outcome, make investment decisions and implement growth – as well as entry and/or exit – strategies.⁴⁸

8. The Commission also notes that the Tribunal expressed its general agreement with the approach to applying the LTIE test (established by the Commission in its *Access Pricing Principles, Telecommunications – a guide*)⁴⁹ and the Commission’s use of TSLRIC pricing. In the Tribunal’s view, the key principles include:

The price of a service should not exceed the minimum costs that an efficient firm will incur in the long-run in providing the service.

The costs are the forward-looking costs, including a normal return on efficient investment (which takes into account the risk involved).

Forward-looking means prospective costs using best-in-use technology. The access provider should only be compensated for the costs it would incur if it were using this technology, not what it actually incurs, for example in using out-of-date technology which is more costly. Of course, a firm may be using older technology because it was the best available at the time the investment was made and replacing it cannot be justified commercially. In a competitive market, however, that firm would only be able to charge on the basis of using the most up-to-date technology because, if it did not (in this hypothetical competitive market) access seekers would simply take the service from an alternative service provider.

The cost of providing the service should be the cost that would be avoided in the long-run by not having to provide it. Thus, it is the additional or incremental costs necessarily

⁴⁷ ACCC, *MTAS Final Report*, section 2.3.

⁴⁸ *Seven Network Limited (no 4)* [2004] ACompT 11 at [120].

⁴⁹ ACCC, *Access Pricing Principles*.

incurred, assuming other production activities remain unchanged. In this matter, it assumes that Telstra and Foxtel would be providing subscription television services to subscribers.⁵⁰

9. Further, the Tribunal noted that ‘... in the general case where access prices need to be regulated, unless pricing is on a TSLRIC basis, efficient investment is unlikely to be encouraged.’⁵¹ The Commission notes that the Tribunal went on to state that:

This discussion should not be taken to suggest that TSLRIC pricing should be imposed at every opportunity. It will often be the case that regulation, including regulated pricing, is not appropriate in given circumstances. It does mean, however, that, in our view, it would generally not be in the LTIE to depart from TSLRIC pricing where access is regulated. Accordingly, where an access regime requires, or creates an unacceptable risk, of non-TSLRIC pricing, the Tribunal considers that such a regime is unlikely to encourage the efficient use of, and investment in, infrastructure.⁵²

10. These principles are taken into account in the Commission’s consideration of whether the determination will promote the LTIE.

The LTIE and the promotion of competition in relevant markets

11. The Tribunal has also recently discussed the notion of promoting competition in the context of Part XIC, where it noted the differences in language between Part IIIA (before its amendment) and Part XIC. In particular, the Tribunal noted that when s 152AB(2)(c) directs the Commission (and the Tribunal on review) to have regard to ‘the extent to which’ a term or condition is likely to result in the achievement of the objective of promoting competition:

..the Commission (the Tribunal on review) must consider the extent of the competitive impact...and the likelihood of that extent, not only the improvement of the environment for competition.⁵³

12. The Commission considers that three markets are relevant in assessing competition under the LTIE criteria for the purpose of the final determinations:⁵⁴
- the individual markets for termination on each MNO’s network;
 - the market within which FTM services are provided; and
 - the market for retail mobile services.

The Commission believes that MNOs have an ability and incentive to raise the price of the MTAS above the underlying cost of production (in the absence of regulation of this service), which may enable them to make above normal economic profits when providing the service.⁵⁵

⁵⁰ *Seven Network Limited (no 4)* [2004] ACompT 11 at [135].

⁵¹ *ibid.*, at [136].

⁵² *ibid.*, at [137].

⁵³ *Telstra Corporation Ltd (No 3)* [2007] ACompT 3 at [96].

⁵⁴ For a detailed discussion on the Commission’s approach to market definition see: ACCC, *MTAS Final Report*, section 4.2 (particularly pp. 31-32 and 45-55).

⁵⁵ *ibid.*, sections 4.4.1-4.4.4.

13. In the *MTAS Final Report*, the Commission indicated that the following pricing distortions were likely to emerge in the mobile services market:⁵⁶
 - above-cost (inclusive of normal profit) pricing of the MTAS;
 - above-cost pricing of retail FTM services; and
 - subsidised pricing of some retail mobile services.
14. The Commission continues to believe that these pricing distortions prevail in the relevant markets.
15. The Commission believes that competition remains ineffective in the mobile services market and that subsequent above cost MTAS pricing inefficiently raises input costs to service providers. The consequences of MTAS pricing above TSLRIC+ include:
 - MNOs can generate economic rents for the supply of the MTAS which can reduce competition;⁵⁷
 - enables incumbents to maintain entry barriers;⁵⁸
 - it distorts competition in retail markets;⁵⁹ and
 - it can reduce productive, allocative, and dynamic efficiency and investment in, and use of, mobile telecommunications infrastructure.⁶⁰

Commission’s view on encouraging the economically efficient use of, and economically efficient investment in, infrastructure⁶¹

16. In the Commission’s view, the phrase ‘economically efficient use of, and economically efficient investment in ... infrastructure’ refers to the concept of economic efficiency, which consists of three components:
 - productive efficiency – where individual firms produce the goods and services that they offer at least cost;
 - allocative efficiency – where the prices of resources reflect their underlying costs so that resources are then allocated to their highest valued uses (i.e. those that provided the greatest benefit relative to costs); and
 - dynamic efficiency – the need for industries to make timely changes to technology and products in response to changes in consumer tastes and in productive opportunities.
17. In the *MTAS Final Report*, the Commission indicated that the MTAS was likely to be priced above cost for retail mobile and FTM services, generating direct efficiency losses in which these services are provided. Specifically, less than efficient consumption of retail FTM services and greater than efficient consumption of retail mobile subscription services. As already discussed, the Commission outlined the

⁵⁶ *ibid.*, p. xv.

⁵⁷ *ibid.*, sections 4.1 and 4.3.

⁵⁸ *ibid.*, section 4.4.

⁵⁹ *ibid.*, section 4.3.

⁶⁰ *ibid.*, section 6.

⁶¹ *ibid.*, section 6.2.

distortions that are likely to emerge and the likely flow-on effects of higher than efficient pricing of the MTAS for efficient investment decisions by integrated, mobile, and fixed-line only operators, specifically:

- above-cost pricing of the MTAS reduces demand for mobile terminating access (and therefore FTM) services, which is likely to encourage operators to under-invest in the mobile and fixed network capacity needed to provide FTM calls (which is likely to be lower cost and yield a more efficient delivery of calls); and
- subsidised pricing of retail mobile services is likely to encourage excessive investment in the infrastructure used to provide retail mobile services. For instance, subsidised handset prices (such as free handset offers) are likely to have encouraged greater than efficient turn-over of mobile handsets by consumers. Further, it is likely to lead to excessive investment in the infrastructure used to develop new handsets.

18. The Commission considers the following factors are relevant in respect of encouraging the efficient use of infrastructure:⁶²

- whether it is technically feasible for the services to be supplied and charged for with regard to technology that is in use, available or likely to become available; and the costs involved in supplying and charging for, the services that are reasonable or likely to become reasonable; and the effects or likely effects that supplying and charging for the services would have on the operation or performance of telecommunications networks;
- 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;
- incentives for investment in the infrastructure by which services are supplied; and any other infrastructure by which services are or likely to become capable of being supplied; and
- the risks involved in determining incentives for investment.

⁶² *Trade Practices Act 1974*, section 152AB(6) and (7A).

Appendix 3 – Waterbed’ effect and Two-sided market

(a) ‘Waterbed’ effect

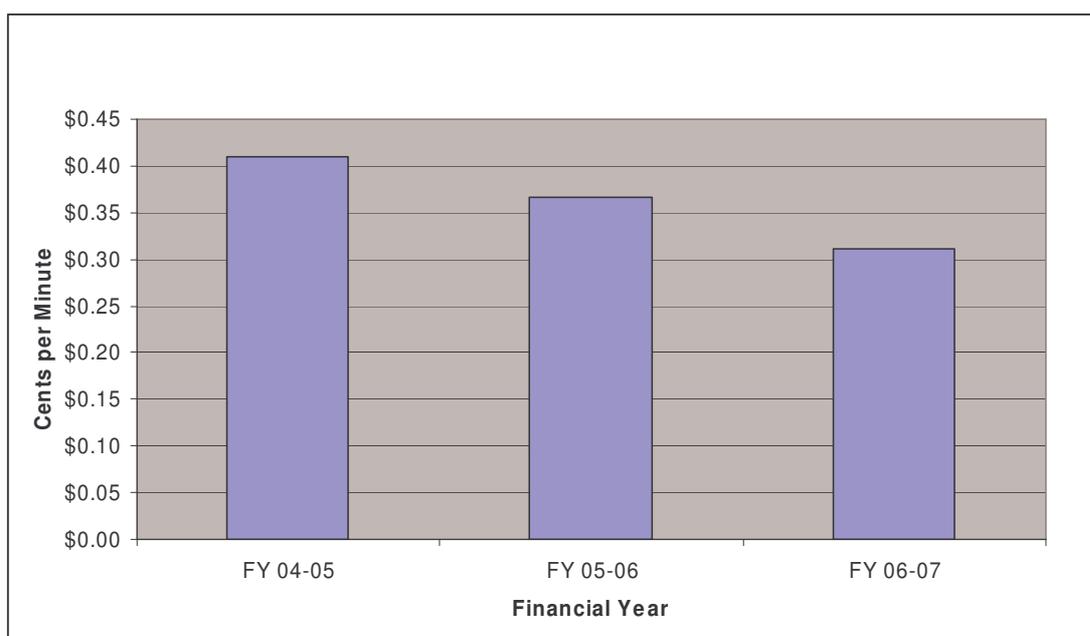
The ‘waterbed’ effect refers to the extent to which regulated reductions in access prices such as the MTAS results in increases in retail prices, which includes the price of outgoing mobile calls and subscription or fixed contract and handset prices. For further discussion on the ‘waterbed’ effect see ACCC, *Optus Undertaking with respect to its Domestic GSM Terminating Access Service (DGTAS) Final Decision*, February 2006, Appendix 5.

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.

i. Average retail price reductions are occurring without pass-through mechanisms:

Figure 1 illustrates that Telstra’s average access fee and call charge revenue per minute does not provide evidence of the ‘waterbed’ effect:

Telstra Average Access and Call Charge Revenue/Minute⁶³



⁶³ Average cent per minute charges calculated using: Telstra Corporation Limited and Controlled Entities, *Financial Results for the Year Ended 30 June 2007*, pp. 23-24. Telstra Corporation Limited and Controlled Entities, *Financial Results for the Year Ended 30 June 2005*, pp. 15-16.

Telstra's average (nominal) call rates have fallen from 41.0 cpm for the full year ended 30 June 2005 to 31.0 cpm⁶⁴ for the full year ended 30 June 2007, coinciding with a fall in the MTAS from 21 cpm to 12 cpm.

Similarly, Optus's 30 June 2007 quarter results indicate that total revenue increased by 8 per cent from 31 March 2006.⁶⁵ There is no information to suggest that this increase in revenue is a result of increasing retail mobile rates bought about by the 'waterbed' effect, but rather this increase in revenue is mainly attributable to an increase in subscribers which grew by 3.8 per cent between June 2006 and June 2007.⁶⁶

Optus's 30 June 2007 quarter results also illustrate that minutes of use per user per month grew at a faster rate than average revenue per user per month, implying decreasing revenue per minute, continuing the trend from the 30 June 2007 quarter compared to previous quarters and the previous year ended 30 June 2007.⁶⁷ This is also indicative of lower, not higher, retail mobile rates.

ii. Real price reductions in mobile services

The ACCC has noted a number of broad trends in post-paid and prepaid plans examined in the Division 12 report examining the financial year ended 30 June 2006.

The average (real) price paid for mobile services has fallen, as reflected by the price indexes for mobile services.⁶⁸

Average real prices for mobile services also decreased a further 6.5 per cent in 2005-06.⁶⁹ The lower real prices for mobile services reflects a fall of 6.7 per cent fall in GSM services, and a 10.2 per cent fall in post-paid services.⁷⁰

Since 2003-04 the decline in the overall prices for reported mobile services has fallen by 18.6 per cent, reflecting a fall of 18.8 per cent in GSM prices. This reflects a large fall in prices for GSM post-paid contracts of around 24 per cent, and a fall of 6.4 per cent for GSM pre-paid contracts.⁷¹

iii. Handset subsidies are increasing not decreasing

Again only Telstra reports financial information on the value of handset subsidies.

⁶⁴ ACCC, *2007 MTAS Pricing Principles Determination Report*, p. 25.

⁶⁵ SingTel, *Management Discussion and Analysis of Financial Condition, Results of Operations and Cash Flows for the First Quarter Ended 30 June 2007*, p. 6.

⁶⁶ *ibid.*, p. 41. It is unclear from the information that the Commission has available to it publicly as to the extent of this increase is attributed if at all to Virgin Mobile subscribers.

⁶⁷ *ibid.*

⁶⁸ ACCC, *Changes In the Prices Paid for Telecommunication Services in Australia 2005-06 – Report to the Minister for Communications, Information Technology and the Arts*, May 2007., p. 99.

⁶⁹ *ibid.*, p. 99.

⁷⁰ *ibid.*, pp. 3-4.

⁷¹ *ibid.*, p. 107..

Handset subsidies for Telstra have not declined since 2004, notwithstanding changes to accounting treatment over time, which Telstra explains as ‘attributable to a rise in the take up of handsets on subsidised plans as well as higher average subsidies offered.’⁷²

iv. Conclusion on the empirical substantiation of the ‘waterbed’ effect

The Commission considers that these trends of lower average retail prices (including lower FTM prices) and the increase in handset subsidies do not allow the acceptance of a ‘waterbed’ effect.

(b) Two-sided market

In the *MTAS Final Report* the Commission stated that it does not consider the MTAS to be part of a retail bundle (or cluster) of mobile services. Rather it considered that MTAS is provided as an individual wholesale service sold to other network operators.⁷³ While the Commission is of the view:

...the MTAS is ‘two-sided’ in nature, in that it provides benefits to both mobile subscribers and those individuals that chose to make calls to them. However, just because the service is two-sided in nature doesn’t mean that it should be defined to be provided in the same bundle (or cluster) as retail mobile services. Further, it should not imply that MNOs are constrained by mobile subscribers when setting the price of the MTAS, or that the provision of retail mobile services provides a constraint on pricing of this service.⁷⁴

In this regard the Commission maintains its view expressed in the *MTAS Final Report* that:

MNOs have control over access to termination of calls to subscribers on their network. As a result of this, the Commission does not believe that MTASs provided on different mobile networks are substitutable for each other – calls to a consumer connected to one mobile carrier’s network cannot be terminated on another carrier’s network. Further, there are no adequate demand- or supply-side substitutes that will constrain mobile network operators in their pricing decisions for the mobile termination service. These factors, combined with a lack of consumer awareness (on the part of both the A- and B-party consumers) and the incentives that arise from the CPP [calling party pays] principle that governs calls to mobile networks, fails to mitigate the control over access mobile operators have with regard to calls terminating on their networks.

The Commission further concluded that alternative forms of communication, such as fixed-line network services, SMS messages, email and calls using voice over Internet protocol (VoIP) technology, are not sufficiently substitutable means of contacting a mobile subscriber to constrain providers of a MTAS from monopoly pricing.⁷⁵

The Commission notes that the Tribunal agrees with the Commission’s interpretation of the Optus MTAS market:

Accordingly, we lean towards the Commission’s view of the appropriate market definitions. It is correct to identify a wholesale market for the supply of Optus’ MTAS. There are no substitutable products and the relevant market transaction is a wholesale transaction provided by one network

⁷² Telstra Corporation Limited and Controlled Entities, Financial Results for the Year Ended 30 June 2007, p. 39.

⁷³ ACCC, *MTAS Final Report*, p. 46.

⁷⁴ *ibid.*

⁷⁵ *ibid.*, pp. 29-56.

operator to another. To the extent to which there is substitutability of products or services it is the bundle of services which is substitutable; one of the services is not substitutable for another of the services. However, 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 705.⁷⁶

The Commission maintains its view expressed in the *MTAS Final Report* that MNOs are not constrained in their pricing decisions for the MTAS, and have both the ability and incentive to raise the price of this service above its underlying cost of production. The Commission's view is based on the lack of alternative substitutes for the service and that the MTAS is effectively a monopoly market for each MNO.

⁷⁶ *Application by Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8 (22 November 2006) at [80].

Appendix 4 – International Cost Benchmarking

The Commission notes that the current *MTAS Pricing Principles Determination* is informed by international cost benchmarking and RAF data analyses, which identified a range of TSLRIC+ estimates for the supply of the MTAS of 5 cpm to 12 cpm. The Commission outlined in the *MTAS Final Report* that before it would reduce the price of the MTAS below 12 cpm with reference to international cost benchmarking any such exercise would need to make adjustments for all factors that influence the TSLRIC+ of providing the MTAS in different countries for Australia-specific factors. For the purposes of this current process, the Commission has not undertaken this detailed benchmarking exercise, so the information provided below in relation to cost and price benchmarking processes is used as corroborating information.⁷⁷

Optus refers to several European mobile termination rates in its benchmarking analysis.⁷⁸ In particular, Optus refers to the cost models that have been developed (or are in development) in the United Kingdom, the Netherlands and Sweden which the Commission considers below.

The Commission considers it is difficult to comprehensively assess the robustness of Optus's international benchmarking analysis without detailed referencing of the sources of these data.

Since the release of the *MTAS Pricing Principles Determination* in June 2004, international benchmarking analyses have further featured in regulatory processes and, in particular, Optus has sought to rely on such analysis to support its position in: (i) the ordinary access undertaking lodged with the ACCC on 23 December 2004 (**2004 Optus Undertaking**) in support of a price of 17 cpm; and (ii) the Optus 2007 Undertaking to support its proposed price of 12 cpm.

The Commission notes that these international benchmarking analyses have not always related to cost benchmarks and have more recently focused on rate or price benchmarks. It was for this reason that the Tribunal concluded in its decision regarding the 2004 Optus Undertaking:

We do not consider that the international benchmarking analysis proffered by Optus is of any assistance to us in determining the issue as to the reasonableness of Optus' price... In order to place any reliance on the international benchmarking analysis it would be necessary to know much more about the regulatory environment within which they were determined...

⁷⁹

These previous analyses have sought to confound price and cost analyses thereby attempting to represent the Commission's cost estimates and range as significantly lower than in other jurisdictions. Further, these analyses have also misrepresented the model framework and approach used in other jurisdictions. The Commission considers without detailed referencing of the benchmarking analyses provided by Optus to support its Undertaking that these concerns remain valid.

⁷⁷ ACCC, *MTAS Final Report*, p. 211.

⁷⁸ Optus, *Optus Submission in Support*, pp. 24-25.

⁷⁹ *Application by Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8 (22 November 2006) at [296-297].

That said, the Commission notes that since the international cost benchmarking analysis was performed, there have been several developments relevant to the benchmarks from European jurisdictions submitted by Optus that it can address at this time.

European Cost Models

United Kingdom Cost Model: On 27 March 2007, Ofcom released its final statement on mobile call termination. In this statement, Ofcom proposes an average price of 5.1 pence per minute (ppm) (12.1 cpm⁸⁰) for four of the mobile carriers and 5.9 ppm (14.0 cpm⁸¹) for one of the mobile carriers operating in the United Kingdom for the period from 1 April 2010.⁸²

There are several features of this model, which may reduce the comparability of its outputs in an Australian regulatory context:

- The prices set included a network externality charge to the value of 0.3 ppm (or 0.72⁸³ cpm), which is not considered relevant in an Australian context.⁸⁴
- Ofcom's approach to spectrum costs is peculiar to the United Kingdom regulatory context reflecting the significant costs incurred for the purchase of spectrum in the United Kingdom and further is inconsistent with a European Union (EU) directive on how spectrum costs should be treated.⁸⁵
- The EU has estimated that the impact of the 3G spectrum costs added on average between 1.2 ppm to 1.9 ppm or the equivalent of 2.9 cpm to 4.5 cpm to the MTAS price.⁸⁶
- The model is a hybrid 'top-down' and 'bottom-up' cost model and has been parameterised with MNOs' accounting data⁸⁷ with limitations including a robust and consistent set of detailed accounting information for all MNOs.⁸⁸

Together the impacts of the NES and spectrum costs would reduce the target price to be implemented in the United Kingdom for 1 April 2010 by 3.6 cpm and 5.2 cpm resulting in target prices less than 9 cpm, when converted to Australian currency.⁸⁹

The Ofcom Model provides a conservative upper-bound estimate of the supply of the MTAS in an Australian context.

The Netherlands Cost Model: The Netherlands national regulatory authority, Onafhankelijke Post en Telecommunicatie Autoriteit (OPTA) has developed a Bottom-Up Forward Looking Long Run Incremental Cost (BULRIC) Model, informing it of 'cost-orientated' MTAS rate from 1 July 2006. The OPTA Model framework, notwithstanding its

⁸⁰ Using an exchange rate of 0.42 GBP to 1 Australian dollar.

⁸¹ Using an exchange rate of 0.42 GBP to 1 Australian dollar.

⁸² Ofcom, *Mobile Call Termination Report Statement*, March 2007, p. 2.

⁸³ ACCC, *Draft 2007 MTAS Pricing Principles Determination 1 July 2007 – 31 December 2008 Report*, p. 48.

⁸⁴ *ibid.*, p. 49

⁸⁵ *ibid.*

⁸⁶ *ibid.*

⁸⁷ *ibid.*

⁸⁸ *ibid.*

⁸⁹ *ibid.*

title, is also a hybrid, ‘top-down’ model as ‘the unit costs used to populate the model have been derived by averaging across operator-provided data’.⁹⁰ The Commission notes that the target rates to be implemented by July 2008 are less than 12 cpm.

The Swedish Cost Model: also adopts a hybrid of ‘bottom-up’ (LRIC + EPMU) and ‘top-down’ (historic costs) approach to parameterising the model.⁹¹ This feature would tend to suggest that the outcomes in this cost model reflects a conservative upper-bound TSLRIC+ estimate for the supply of the MTAS. The Swedish Model also provides for a target price for 2007 below 12 cpm.

The cost parameterisation approaches adopted in the United Kingdom, the Netherlands and Sweden ‘hybrid’ models are not considered to be true ‘bottom-up’ cost models that necessarily reflect efficient cost estimates and will provide at best an upper-bound efficient cost estimate for the supply of the MTAS in an Australian context.

Other Cost Models

The Commission notes that there have been developments of comparable ‘bottom-up’ cost models informing cost benchmarks that can be used as corroborative support for the TSLRIC+ estimate range of 5 cpm to 12 cpm. However, as already noted the Commission has stated in the *MTAS Final Report* that before it would reduce the price of the MTAS below 12 cpm with reference to benchmarking any detailed benchmarking exercise would need to make adjustments for all factors that drive the TSLRIC of providing the MTAS in different countries for Australia-specific factors.⁹²

In these circumstances the Commission is concerned about relying on Optus’s international benchmarking analysis as the sole basis for supporting a sustained price of 12 cpm from 1 July 2007. This is particularly in light of the fact that in 2004, 12 cpm was recognised as a conservative upper-bound estimate of supply of the MTAS for the period 1 July 2004 to 30 June 2007 and comparable cost benchmarks suggest a TSLRIC+ estimate of the supply of the MTAS for lower than this price.

⁹⁰ *ibid.*

⁹¹ *ibid.*, p. 50.

⁹² ACCC, *MTAS Final Report*, p. 211.

Appendix 5 – Telstra’s submissions

[The documents in this appendix have been redacted at the parties’ request]

(a) Telstra, *Initial submission*

Telstra’s submission on the content of the final determination, dated 2 March 2007

(b) Telstra, *Initial submission in Optus-Telstra Disputes*

Telstra’s submission on the content of the final determination for the Telstra-Optus Disputes, dated 2 March 2007

(c) Telstra, *Submission-in-reply*

Telstra’s submission-in-reply on the content of the final determination, dated 16 March 2007

(d) Telstra, *Submission-in-reply in Optus-Telstra Disputes*

Telstra’s submission-in-reply on the content of the final determination for the Telstra-Optus Disputes, dated 16 March 2007

(e) Telstra, *Submission on the Draft Decision in the Telstra-Optus Disputes*, dated 24 August 2007.

Telstra’s submission on the Draft Decision issued 28 June 2007 for the Telstra-Optus Disputes, dated 24 August 2007.

(f) Telstra, *Submission on the Draft Decision in the Optus-Telstra Disputes*, dated 24 August 2007.

Telstra’s submission on the Draft Decision issued 28 June 2007 for the Optus Disputes, dated 24 August 2007.

Appendix 6 - Optus's submissions

[The documents in this appendix have been redacted at the parties' request]

(a) Optus, *Initial submission*

Optus's submission on the content of the final determination, dated 5 March 2007

(b) Optus, *Initial submission in Optus-Telstra Disputes*

Optus's submission on the content of the final determination for the Telstra-Optus Disputes, dated 5 March 2007

(c) Optus, *Submission-in-reply in Telstra-Optus and Optus-Telstra Disputes*

Optus's submission-in-reply on the content of the final determination for the Telstra-Optus and Optus-Telstra Disputes, dated 16 March 2007

(d) Optus, *Submission on the Draft Decision in the Telstra-Optus and Optus-Telstra Disputes, dated 24 August 2007.*

Optus's submission on the Draft Decision issued 28 June 2007 for the Telstra-Optus and Optus-Telstra Disputes, dated 24 August 2007.