

Submission to the ACCC



Vodafone Australia Limited ACN 056 161 043

**Discussion paper reviewing the declaration for the
domestic transmission capacity service (DTCS)**

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1. Executive summary

- 1.1 Vodafone welcomes the opportunity to comment on the Australian Competition and Consumer Commission's (the Commission) review of the declared Domestic Transmission Capacity Service (DTCS) for the purpose of determining whether the declaration should be extended, revoked, varied or allowed to expire.
- 1.2 It is important to understand that this issue is not only about fixed line communications: it is about the maintenance of a competitive mobile market, and also the ongoing sustainability of competition in the telecommunications sector more generally.
- 1.3 Vodafone submits that the DTCS declaration should be extended for five years because:
- Access to the Declared DTCS is a critical input in the supply of a broad range of telecommunications services, including mobile voice and mobile broadband services delivered by mobile operators. Due to increasing demand and supply of capacity intense mobile broadband services, access to transmission at reasonable costs is an increasingly crucial consideration for mobile-only operators – such as Vodafone – for the ongoing delivery of innovative mobile services;
 - There is a clear and growing trend globally that mobile communications are converging with fixed line communications. Therefore transmission is becoming an increasingly vital input to the supply of mobile communications services – both mobile voice and mobile broadband data; and
 - The markets in which the Declared DTCS are supplied continue to exhibit natural monopoly characteristics. We do not believe that this is likely to change in the foreseeable future given the high barriers to entry and excess capacity available on the existing networks used to supply the service.
- 1.4 Vodafone believes that the Commission should extend the existing declaration for a period of five years rather than revoking and remaking the declaration. This will allow the current exemptions from compliance with the standard access obligations on certain routes which have been subject to approval under the *Trade Practices Act 1974 (Cth)* (TPA) to continue.¹ We also support the continued exemption process under the TPA.²

¹ *Telstra's domestic transmission capacity service exemption applications - Final Decision*, November 2008.

² section 152AT of the TPA, whereby the supplier of the Declared DTCS to apply for an exemption from the standard access obligations on the affected routes

2. The changing competitive dynamics of transmission

- 2.1 Telstra remains the dominant supplier of a broad range of telecommunications services and is the monopoly supplier of the DTCS across large parts of Australia, specifically transmission on certain regional routes and tail-end transmission.
- 2.2 Access to the Declared DTCS is critical for the supply of a range of telecommunications services, including the supply of mobile voice and mobile broadband services. While Vodafone has been able to obtain access to the Declared DTCS it is only because those services have been declared. Therefore with the introduction and increasing demand for mobile broadband services the same access problem will arise and if anything will be exacerbated because the significant capacity requirements of mobile broadband services make access to transmission critical.
- 2.3 Vodafone has an extensive microwave transmission network. To date microwave technology has provided a useful solution in some circumstances for Vodafone, particularly in short distance, low capacity situations where line of sight and environmental approvals are available. With the growth of high speed mobile data services it is expected that the limited capacity of microwave transmission will further diminish this option.
- 2.4 Lastly, the National Broadband Network (NBN) is currently being decided by Government. The construction of the NBN will involve a substantial deployment of fibre optic cable into local communities in metropolitan and regional areas enabling the installation of broadband equipment close to homes. Vodafone does not expect the NBN to impact in the near term. However, regardless of which party is successful in the tender process, the NBN will be a monopoly network.
- 2.5 In light of these issues, Vodafone submits that the DTCS declaration should be extended.

3. Increasing demand for transmission

- 3.1 Demand for access to transmission across Australia is increasing and will continue to increase significantly. In the mobile market this is being driven by the increase in consumer demand for a range of communications services including high-speed mobile internet and email access, video calling, full track music downloads and mobile television. Demand for this range of services is increasing as a result of:
- Improvements in mobile technology;
 - Increasing convergence of fixed and mobile telecommunications; and
 - Extending the coverage of mobile capability.

Improvements in mobile technology

- 3.2 Mobile broadband is becoming more attractive as speeds and functionality increase making mobile services suitable for offering a range of communications services (as outlined above). Demand for backhaul transmission will increase commensurate with these functionality improvements.
- 3.3 Additionally, the roll-out of 3G HSPA will significantly enhance the services that can be provided over the Vodafone network, providing data speeds up to 7.2Mbps; and the introduction of Long Term Evolution (LTE) – a form of 4G technology – will further improve the quality of the broadband services offered to consumers. LTE will further increase the demand for transmission and therefore the operational costs to mobile operators – particularly mobile only operators such as Vodafone.

Increased fixed and mobile convergence

- 3.4 There is a clear and growing global trend towards mobile communications replacing fixed line communications³, particularly for voice. While mobile and fixed communications use the same terrestrial infrastructure, they are also already bundled together and customers will increasingly substitute between voice and broadband on mobile and fixed networks.
- 3.5 Vodafone is a provider of 3G mobile broadband services, which are a substitute service for some consumers as well as being a complementary service for others. Some consumers value mobility over data speeds and have fully substituted their fixed line services for mobile voice and mobile broadband services. Other consumers value the higher speed and data capacity of fixed line networks, but want to supplement that service with mobile access services for use over a broader geographic area.
- 3.6 The manner in which consumers use fixed and mobile services is complex and changing:
- Digitisation has made it possible to deliver the same communications services (voice, video and data) over both fixed and mobile networks; and
 - The recent improvements in mobile service bandwidth and functionality have resulted in mobile services becoming more comparable with the capabilities of fixed-line services, making mobile services such as wireless broadband increasingly attractive and substitutable for customers who value fast and flexible access to broadband interactive services across a wide geographic area.

³ OECD Committee for Information, Computer and Communications Policy paper on *Fixed-Mobile Convergence: Market Developments and Policy*, 23 March 2007 (<http://www.oecd.org/dataoecd/20/26/38309911.pdf>).

Extending the coverage of mobile capability

- 3.7 To date Vodafone has introduced mobile broadband services in metropolitan areas around Australia. As the improvements in mobile technology are extended into regional areas demand for backhaul transmission will likewise increase significantly.
- 3.8 Increased demand for mobile services because of improvements in mobile technology, convergence of fixed and mobile telecommunications and extended coverage of mobile capability is evidenced by the revenue growth rate in the mobile market. This remains strong and well above the subscriber growth rate largely due to the increased revenue streams that the mobile operators are getting from mobile broadband.⁴ For example, Telstra's mobile revenue for the 12 months to June 2008 was fuelled by very strong mobile data growth from wireless mobile broadband of 44% to \$1.5 billion.⁵ This rapid growth in wireless mobile broadband subscribers is expected to continue in 2009 and 2010. While wireless broadband technology had less than 1% of the broadband market share in 2005, this figure is forecast to grow to 20% by 2015⁶, indicating that demand for wireless broadband, including mobile broadband services, is likely to significantly increase in the short to medium future.
- 3.9 As a result of mobile voice and mobile data growth, Vodafone's transmission capacity demand is forecast to increase by [c-i-c] over the next 3 years. Therefore mobile broadband demands will materially increase the significance of transmission operating expenditure (opex) for mobile operators – particularly for mobile only operators including Vodafone. Integrated operators, such as Telstra and Optus, do not have such issues due to their existing extensive fibre networks.
- 3.10 Further, we believe that Telstra has every incentive to seek to leverage its market power in transmission into downstream markets, particularly where it already enjoys market leadership and advantage through its 850 3G network in regional and rural areas.

4. Declared routes retain natural monopoly characteristics

- 4.1 Although demand for Declared DTCS is increasing, Vodafone holds that this will not provide an incentive for new entry because the markets in which the Declared DTCS are supplied display natural monopoly characteristics.⁷

⁴ Paul Budde Communications Pty Ltd, *Australia - Revenue statistics, Analysis & Forecasting (by service) - 2000- 2010*.

⁵ Paul Budde Communications Pty Ltd, *Australia - Revenue statistics, Analysis & Forecasting (by service) - 2000- 2010*.

⁶ Paul Budde Communications Pty Ltd, *Australia - Revenue statistics, Analysis & Forecasting (by service) - 2000- 2010*.

⁷ The Commission's Final Report on *Review of the declaration for the domestic transmission capacity service*, April 2004 at paras 5.1.3, 5.1.4 and 5.2.

- 4.2 The customers served on the declared routes are small in number, the individual routes span considerable geographic areas, the cost of infrastructure required to service these routes is significant and in most cases an incumbent supplier has economies of scale and is vertically integrated with a significant share of downstream markets including markets involving the supply of mobile voice and/or broadband services. As a result, barriers to entry are high and it is unlikely that there will be any new entry in the supply of the Declared DTCS in the foreseeable future.
- 4.3 Some may argue that other technologies (for example, microwave, HFC, LMDS, MMDS and ULLS) may provide some competitive constraint on inter-exchange local transmission and tail-end transmission. As outlined above at 2.3, Vodafone submits that these technologies increasingly cannot compete with optical fibre in terms of capacity and will provide even less effective commercial constraint – it is a fact that increased capacity intensive services such as mobile broadband will require an optical fibre solution.
- 4.4 Therefore Vodafone supports the extension of the DTCS declaration for five years. Further, Vodafone submits that basis on which the Commission establishes that ‘sufficient competition’ exists should be continually assessed throughout the regulated period against the changing competitive dynamics (outlined at Section 2) of the market.

5. Impact of the existing declaration

Vodafone’s use of the Declared DTCS

- 5.1 Vodafone currently provides mobile voice and mobile broadband services and competes in the provision of telecommunications services with other voice and broadband suppliers. Access to the Declared DTCS service is a critical input for Vodafone to continue to compete and offer innovative services and propositions in a competitive mobile marketplace. As we have outlined, access to Declared DTCS services will become increasingly critical as demand for mobile broadband increases.

Impact of existing declaration on Vodafone

- 5.2 The existing declaration has provided a means by which Vodafone can obtain access to the Declared DTCS and provide competitive and compelling mobile voice and mobile broadband services. Vodafone notes that over [c-i-c] of our non-microwave transmission outside metro areas is currently purchased from Telstra. It has also allowed Vodafone to continue to innovate and supply these services in response to evolving technological developments and the growing market demand for such services. Vodafone supports the extension of the DTCS declaration for five years.

6. Impact of removing the declaration

- 6.1 To date Vodafone has been able to negotiate for the supply of transmission capacity services on a commercial basis without reverting to arbitration. This has been due to a number of factors, including:
- pricing for both Declared and Exempt services has been negotiated as a bundled arrangement, with additional discounts for commitments across both types of services; and
 - transmission capacity to date has formed a relatively modest component of our total operating expenses.
- 6.2 As our transmission capacity demand increases (as outlined at 3.9) and the associated costs become a significantly more material component of our total expenses, it is imperative that there remains recourse through the regulatory process to ensure access costs are reasonable and proximate a competitive market.
- 6.3 Therefore, if the DTCS declaration is revoked, or allowed to expire, a vertically integrated supplier of Declared DTCS may take advantage of its monopoly over the supply of access to the declared service on one or more routes by refusing access or charging unreasonable prices to customers who compete with it in downstream markets. The impact of this significant market power can most clearly be seen from the fact that prices on contestable routes have declined significantly in comparison to those on regulated routes.
- 6.4 Without declaration, Vodafone would offer customers significantly reduced coverage as it will not be able to access the critical input, the Declared DTCS, on reasonable terms. This will increase market concentration in the supply of a range of telecommunications services, including mobile voice and mobile broadband services. This will not promote the long-term interests of end users (LTIE) as it would harm competition and could lead to higher prices, diminished consumer choice and lower quality mobile services.

7. Extending the declaration is in the long-term interests of end-users (LTIE)

- 7.1 Extending the declaration pursuant to section 152ALA(4) of the TPA for a period of five years is in the LTIE by promoting:
- competition in downstream markets, including markets involving the supply of mobile voice and/or broadband services by providing customers with an increased choice of mobile telephony services and at lower prices; and
 - the efficient use of DTCS by regulating to remove the ability of a vertically integrated owner of the Declared DTCS to misuse its substantial market power by refusing access or charging prices significantly in excess of efficient prices.

- 7.2 Extending the declaration and allowing the Commission to exempt certain routes from the declaration provides a framework that ensures that declaration only applies to those services which are affected by a durable market failure.

8. Conclusion

- 8.1 The current and forecast growth in mobile broadband for mobile only operators (including Vodafone) will significantly increase the capacity and quality requirements of transmission to business and operational costs will also increase significantly as a result.
- 8.2 The markets in which the Declared DTCS are supplied continue to exhibit natural monopoly characteristics. We do not believe that this is likely to change in the foreseeable future given the high barriers to entry and excess capacity available on the existing networks used to supply the service.
- 8.3 Therefore Vodafone supports the extension of the DTCS declaration for five years to ensure the continued sustainability and robust competition of the mobile market, and the continued investment and innovation in mobile voice and mobile broadband services.