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Stephen Farago
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Dear Mr Farago

Transmission Capacity Service

I refer to the Australian Competition and Consumer Commission's (ACCC) discussion paper reviewing the declaration for the domestic transmission capacity service. Vodafone welcomes the opportunity to comment on the paper.

This letter firstly includes a discussion on general principles that Vodafone believes should be adhered to when considering whether to renew or revoke a declaration. We then turn to dealing with the inter-capital transmission service.

General Principles

Vodafone believes that declaration should only be considered in the context of a durable market failure. By this we mean:

- That the failure has been identified and observed in the relevant market; and
- If a market failure is shown to exist, that the market is given time to 'correct' the failure in the first instance before regulation is implemented.

Rarely, if at all, do markets exhibit the properties of perfectly competitive markets. Perfectly competitive markets require a large number of buyers and sellers, a homogenous product or service, no barriers to entry and perfect information. Prices in a perfectly competitive market equate to marginal cost. Where firms must make significant investments in infrastructure to deliver products and services, marginal cost pricing is insufficient for the firm to recover all of its costs and earn a return on investment. It is widely accepted that in these cases, economic efficiency will be best promoted by adopting Ramsey pricing principles. Firms will seek to recover their fixed and common costs across an array of products and services.

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In practice, perfectly competitive markets do not exist – most markets will breach one or more of the principles of perfect competition. Vodafone therefore believes it is important to determine whether a market is subject to effective competition. Competitive markets work in rough and ready ways. They may typically have numerous buyers and sellers and prices - in an overall sense - will reflect costs in the medium to longer run including a risk adjusted return.

Firms operating in this environment typically offer differentiated products and services at different prices (or at least different pricing structures) and to different customer segments. Further, for products and services that require significant investment in infrastructure and may therefore exhibit economies of scale and scope, it is most likely for it to be optimal for the product or service to be provided by a small number of players. These are important considerations for determining whether effective competition exists and therefore whether a market failure exists.

Vodafone also believes that it is important that before regulation is implemented – the benefits and costs of regulation and the risk of regulatory error must be weighed up against the likely outcomes the market would deliver without regulation. One must assess whether introducing regulation will actually lead to a better result in terms of economic efficiency than if the market was left to its own devices. Vodafone therefore urges regulators to take a precautionary or a 'wait and see' approach to regulation.

Vodafone believes that the ACCC can effectively deal with any abuse of market power under Part XIB of the TPA and through competition notices. We therefore believe regulatory forbearance should be the default position until such time that it can be demonstrated that a durable market failure exists, and also that regulatory intervention will actually deliver a superior outcome to that delivered by the market.

To this end, Vodafone supports the views expressed by the Productivity Commission in its inquiry into Telecommunications Competition Regulation (September 2001) that monitoring of prices may be more appropriate than declaration in certain circumstances. The Productivity Commission recommended (9.6) that on the completion of a declaration or revocation inquiry, the ACCC may use formal price monitoring for a fixed period as an alternative to declaration.

Inter-capital Transmission

Vodafone is a purchaser of inter-capital transmission – it is a key input to our business that is required to enable the delivery of mobile voice and data services to our customers. Vodafone notes that inter-capital transmission is currently not a declared service – in 1998 the Melbourne-Canberra-Sydney routes were 'undeclared' and in 2001 all remaining inter-capital transmission routes were 'undeclared' by the Commission.

Although there have been some changes to the structure of the market in the period since the above declaration was revoked, it is Vodafone's view that there have been no fundamental changes that would warrant the re-declaration of the inter-capital transmission service. There are strong competitive pressures in the market for inter-capital transmission. This can be demonstrated by:

- The number of new entrants into the market; and

- The significant reductions in prices for inter-capital transmission.

Telstra and Optus remain the only suppliers with transmission networks on all inter-capital routes. However, there have been many new entrants into the market over the last few years including Maracom, PowerTel, Nextgen, and IP1. Furthermore Vodafone is also aware of agreements that allow for the resale of inter-capital transmission, for example AAPT has a resale agreement with Optus.

Vodafone believes that this quite high degree of market entry may reflect a number of things including:

- Prices paid for inter-capital transmission may have been, prior to the entry of the new players, inefficiently high;

- New entrants may have forecast very high growth in demand for inter-capital transmission; and

- Barriers to entry for the market of inter-capital transmission are relatively low.

As a result of the entry of a number of players into the market, there have been significant reductions in the prices paid for inter-capital transmission. Vodafone estimates that the prices it pays for inter-capital transmission have reduced in the order of 75% over the last two years – this has corresponded with the period in which the inter-capital transmission service has been 'undeclared'.

With regard to market structure, Vodafone notes that both Nextgen and IP1 have been placed into receivership. We also note that Telstra recently announced the acquisition of IP1 from the receivers, Korda Mentha. Prior to the Telstra acquisition, Vodafone made a submission to the ACCC with regard the sale of Nextgen and IP1 – focusing on the potential for lessening of competition for inter-capital transmission should one or both be acquired by existing network owners/operators.

Undoubtedly, the entry of both IP1 and Nextgen into the market did contribute to the significant price reductions referred to above. However, it is extremely difficult and complex to analyse the medium to long term competition impacts of the acquisition by Telstra of IP1 or any other changes to the market structure/ownership. Although changes to market structure and ownership have the potential to effect competition, Vodafone does not believe at this point in time there any evidence to suggest that these changes to the market structure will actually reduce competition for inter-capital transmission and lead to increased prices. Vodafone therefore recommends that the ACCC not re-declare the inter-capital transmission service. We also recommend that the ACCC continues to adopt its current monitoring approach of both market structures and market outcomes for both undeclared and declared services. Only if this monitoring demonstrates that there is a durable market failure should the ACCC consider re-declaration of the inter-capital transmission service.

Should you require any further information on this matter, please do not hesitate to contact me on (02) 9425 9499.

Yours sincerely

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