ACCC Draft Ruling on terminating access

Allphones Submission

EXECUTIVE SUMMARY

- This submission is prepared by Allphones Retail (Allphones), one of the largest specialist communications retailers in Australia. Our submission will focus on the empirical market outcomes of the proposed ruling, as opposed to the policy framework. We have neither the expertise or time to add any significant value to the policy argument.

- We believe that the draft ruling contains a number of factual flaws which may impact at retail and have knock on effects for consumers. We identified these as a source of further investigation and research for the ACCC. We believe that once reviewed some of the basis for the interim determination may also change.

- The terminating access fees as they stand do lead to lower charges for end-users and therefore satisfy one of the key aims of the policy framework. At retail, competition has never been higher and consumers never better off. A reduction in terminating access for the primary sources of this competition, namely Optus and Vodafone, will reduce competition and hurt consumers.

- Mobile competition manifests itself in distribution. Over the last three years, retail margins have been declining, while rents increase. A reduction in terminating access charges will lower margins further and impact on the competitiveness of companies like us, who are the coal face of the competition. By hurting the competitiveness of Optus and Vodafone, you are ultimately going to reduce competition and hurt consumers.

- Consumers are better off now than at any other time in the 15 years Allphones has been selling communications. This, in our submission, is due in large part to the improved market share of Optus and Vodafone against Telstra and the introduction of 3 as a fourth force in communications.

- Overall, lower margins will benefit Telstra, particularly in the fixed to mobile category. We reject the notion that lower terminating access will enhance competition in the markets because other than Optus, Vodafone and 3, none of the other interested parties will be able to provide any meaningful competition to Telstra. We submit that fixed to mobile calls are irrelevant to retail mobile competition.

INTRODUCTION

Allphones is the second largest specialist retail communications retailer in Australia with 78 stores. It is our intention to expand to 120 stores this year. We operate in every mainland State. Our proposition is based on choice and convenience; we sell all networks for pre-paid, and all networks other than Telstra for contracts. We respectfully submit that we have an excellent understanding of retail communications as it relates to end-users. Moreover, we note that no other retailer put in a submission for the interim decision.

We are unable to provide detailed empirical, statistical or econometric data to support our submissions contained herein. We would, however, ask the ACCC to cross-reference our assertions to corroborate their validity. We do not have the resources for detailed economic analysis. We instead rely on our market experience and my personal history as a regulatory lawyer in telecommunications for eight years.

We feel that the major voice in this argument, being retailers, has all but been ignored.

POLICY CONSIDERATIONS

We note that among other things, the long-term interest of end-users (LTIE) is the driving force behind this determination. We support this aim. We also agree with the ACCC submission at page 11 which says:
"The greater the level of competition for retail mobile services, the greater will be the incentive to transfer economic profits earned for mobile termination services to retail mobile subscribers".

We submit that the regulatory framework which has been established does currently promote competition. The current terminating access arrangements have enabled increased competition from Vodafone and Optus. Over the last five years, their combined market shares (including their wholesale customers) have doubled.

We take a lot of comfort with the Commission's comments (at page 47) which says that the ACCC will be particularly mindful of the impact of the declaration on the supply of services at the retail level. We submit that the draft determination does not reflect this clearly stated, and in our view, correct consideration.

We also believe that the ACCC's comment (at page 97) that without significant growth in the future, additional market participants may not have sufficient incentives to enter the mobile services market. We believe, with respect, that this should be broadened. Without the competitiveness of the *existing market participants* the future growth of the market will be slowed. The second and third tier carriers will never be able to get the scale in distribution or retail margins to be able to effectively compete. We also believe that a significant decline in the overall competitiveness of either Optus, Vodafone or Hutchison will reduce the price tension on Telstra. This would be disastrous for both retailers and end-users.

Overall, we support the Commission's policy aims. We do not, however, believe that these aims can be reconciled with what is in our view a flawed view of how competition manifests itself at retail. Competition is a process, not an outcome. We believe that the process of competition today with mobile has already yielded significant results (discussed later). We submit that the policy goals, which we wholeheartedly endorse, would be compromised based on the reasoning behind the lowering of rates.

QUESTIONING SOME ACCC CONCLUSIONS

The basis for the following commentary is to ask the Commission to review the basis for some of its statements, which we believe may have impacted on its interim decision. Again, we provide this information as a market participant, not as an economic expert.

On page 11, the ACCC noted that consumers are sometimes offered free handsets. This is manifestly incorrect and a dangerous conclusion in the context of the draft ruling.

Firstly, 80% of handsets currently sold in the Australian market today are for pre-paid services. With some minor exceptions, particularly during busy retail periods like Christmas, these handsets are offered above cost price. Not only are they not free, but they are not subsidised. The ($0) handset offered with mobile service carriage contracts are subsidised only to the extent that customers agree to a minimum level of usage over the contractual period. In effect, the handset is mortgaged against the usage, not unlike a home loan. There is nothing free about these handsets. Where a carrier has suggested otherwise, the commission has on at least 12 occasions taken them to court.

We do submit, however, that focusing on the role of the handset and in particular the ability of the carriers to cross subsidise handsets with usage is important. According to recently released industry figures, last year Australia added 1.8 million new users, in a market where 6 million handsets were sold. We have been in mobile communications since its inception in Australia and have always known that the handset is the major portal to the customers. In all mature markets (UK, Italy, Hong Kong) handset purchases greatly outweigh net subscription increases every year. Handsets are the greatest driver of competition in Australia. It is our submission, therefore, that everything should be done to preserve the ability of all carriers to use the handset to stimulate competition.

Some recent examples of the impact of handset pricing include the following;

- In 2002, Telstra decided to stop handset subsidy and immediately lost market share. They came back in 2003 more aggressive with their handsets than ever before. This stimulated massive market activity.

- Hutchinson launched its new (3) product recently on the back of new technology. Its subscription numbers were not significant until such time as it launched a series of new consumer-friendly handsets. Since that time its published subscription numbers have increased five fold.

- Any carrier will tell you on request that their subscription numbers on certain plans are a function of the handset, the tariff and then the network in that order.

On page 12, the ACCC said that the raising of fixed to mobile calls eases competitive pressure in the market in which fixed to mobile calls are provided. We were unclear that these were in the same markets. We submit that there are two separate markets being the fixed market and the mobile market. A quick look at the fixed line market will show the ACCC that over the last two years Telstra has increased its access charges by 40%, without discounting its call rates. It has appeared not to have had a significant impact on its market share. Telstra announced last week a 6% increase in access from July. If Telstra raised access charges in the mobile market, it would immediately lose market share. We therefore submit that combining the two markets is fraught with risk.

We were particularly disappointed with the statement (at page 14) that existing mobile operators are making excess profits. To my knowledge, Optus declared its maiden profit last year, as did Vodafone. Virgin (a key Optus wholesale customer) has never announced a profits and Hutchison lost an excess of $500 million dollars. The combined profitability of all these operators is somewhere around $100 million dollars. In the same period, Telstra made $4 billion. The reason this is important to us is that our margins and long-term liability are a function of the success of all the carriers.

The Commission said at page 14:

"In addition to this, the ACCC notes the reductions in the prices paid for retail mobile services appear to have slowed in recent years, were some indication that prices may have even increased, on average, during the 2002/2003 financial year."

With respect, we can find no empirical or anecdotal evidence to support this. Our summary of the price changes for the last twelve months are that consumers have never been better off. We use the following evidence.

- In the case of Optus, the introduction of the Optimiser plan and Roll Over has enabled consumers to better utilise their existing tariffs. On average, the customers save about 10% a month by using this. Moreover, customers that reach their minimum spend early in their contract are now able to leave early, further promoting contestability among carriers. Thirdly, Optus has recently introduced new tariffs with call caps in response to the competitive pressures imposed by "3".

- As recently as yesterday, Vodafone has further reduced its call rates, meaning overall call charges on the Vodafone network have reduced by 50% in the last two years. In some cases, where consumers spend in excess of $70 per month, these call charges have dropped by 65-70%.

- Virgin Mobile has consistently been the price leader in the mobile market. Late last year, Virgin introduced 5cent SMS between Virgin users and 15cents across all networks. Since then, Vodafone and "3" have reduced their SMS rates. Virgin have also reduced their call rates over the last twelve months by 25%.

- "3" have introduced call caps for the first time into the Australian market. Voice calls are capped at $99 per month - an extraordinary outcome for consumers. Moreover, calls between "3" users are free. This has not been seen since One Tel.

- Telstra have only last week re-launched their pre-paid offering called "Telstra pre-paid plus". One of the cornerstone features of this new offer is cheaper calls for Telstra pre-paid customers.

The overall impact of the above suggests to us that consumers are far better off. In our experience, our corporate phone bill has been reduced by 50% through a tendering process. We respectfully submit that there is no basis to say call charges have on average increased. We've seen no evidence of it.

We are concerned that the ACCC is relying on the UK experience. We submit that competition in mobile is a function of distribution. It is impossible to compare distribution in the UK to Australia. For example, the Car Phone Warehouse is the largest retail of communication in the UK, operating just under 2000 stores. In Australia, the largest specialist communications retailer is Fone Zone, which has 100. Moreover, the UK has a population base of 60 million in an area the size of Victoria whereas Australia has a population base (with coverage) of 17 million in an area the size of Europe. No meaningful comparison can be reached at retail on this basis. The interconnect regime is also totally different.

We are also concerned that the Commission said that there was no evidence that consumers are unaware of the charges of terminating calls on another network. We believe they are, but perhaps not in the sense that the Commission realises. Our evidence and sales data confirms that consumers are increasingly looking at on-net calls because they are cheaper across *every network*. Lower rates, call caps and cheaper data services are available on all on-net offerings. We agree that there is very little, if any, knowledge of fixed to mobile rates, but submit that this is not the market that should be viewed from a functional or product perspective.

COMPETITION IS DISTRIBUTION

The one area that was not addressed at all in the ACCC draft ruling was what drives competition. The ACCC concluded that it was the market for terminating access which drove behavior at retail level. We agree. We believe, however, that the framework established now enables more meaningful and aggressive competition than would occur under the scenario in the draft determination. With the greatest respect to the smaller competitors, other than Optus, Vodafone and "3" they lack the scale, efficiencies and distribution to provide any meaningful competition to Telstra. We believe the ACCC should focus on the impact of distribution of offering an incontrovertible benefit of hundreds of millions of dollars to the incumbent with 50% market share, and the only one able to offer an integrated bundling of fixed, mobile and broadband/pay TV services on one bill.

We believe that market share is a function of distribution. We rely on the following information about who sells which product. Ultimately, you cannot sell product if you don't have the retail points of presence.

It should be noted that unlike all other competitors, Telstra has maintained a position where all of its mobile dealers and retailers must be exclusive if they wish to sell Telstra Contract Services. Indeed, as late as September 2003, Harvey Norman, which was previously a multi network operator switched to Telstra and was required to offer exclusivity in order to do so.

The following are the major retailers offering contracts and the number of points of presence they have for each network.

1. Telstra

   Retrovision (550)
   Myer (60)
   Fone Zone (100)
   Crazy Johns (65)
   Harvey Norman (160)
   Leading Edge (400)

Tandy Dick Smith (450)

Betta Electrical (500)

T Shops (160)

All of these have to offer Telstra Contract Services exclusively and most choose to offer only Telstra pre-paid.

2. Optus

Optus World (150)

Alphones (78)

Strathfield (88)

Telechoice (72)

Network Communications (38)

C21 (32)

With the exception of Optus World, C21 and Network Communications, all of these channels offer Optus Services non-exclusively. In Allphones case, we could not function without Optus. We rely on them for our survival.

3. Vodafone

Vodafone Stores (90)

Allphones (78)

Strathfield (88)

Premium Dealers (100)

Allphones would not be able to survive without a strong Vodafone.

4. “3”

“3” Store (60)

Strathfield (88)

Allphones (78)

Please note, these are the specialist communications outlets. Australia Post, the largest retailer offering only pre-paid has 4000 sites. It sells all networks.

The above distribution reflects overall market share. Telstra is able to command exclusivity because of its market position. In our view, the only way that meaningful competition will continue is if the challenger Telcos have the incentive to continue to support the growth of their distribution.

We believe we are a good case in point. Allphones have doubled in size for the last 3 years. We intend to open another 43 stores this year, in four states. We are doing so because we have the business case to operate on an efficient retail basis and make money where others cannot. Importantly, this year we are looking at regional markets for the first time because of the network investment from both Optus and Vodafone (which also helps their wholesale customers). We would not be able to enter any regional area without sufficient coverage of all three major networks. We will review that decision if terminating access charges come down. This is because we know that ultimately the reduction in margins will filter through to retail (it always does!).

Lower terminating access charges means reduced retail competition. Our business case will therefore be compromised.

Any meaningful review undertaken by the ACCC will show that the level of non-Telstra distribution in all but the major capital cities is minimal. Networks are certainly rolling out increased coverage to enable us to compete, but if the business case is not there then this network investment is, from our perspective, irrelevant. The margins for mobile phone retailers have steadily been declining for three years. In the last 12 months, our margins have decreased materially across all networks, despite our growing size and relative importance to a number of them.

We submit that a reduction in terminating access charges will result in lower margins for retailers, which in turn will reduce our ability to compete with Telstra distribution at retail for those customers. As it stands today, it is a difficult enough decision to enter these markets such is Telstra's brand equity in regional areas and the unique social position in those communities. Ask any local member of Federal parliament.

UNDERSTANDING THE MARKET AT THE COAL FACE

Here is our overall summary of the market as it stands today.

Firstly, the consumers have never had more choice. The regulatory framework established by the ACA and the ACCC has enabled levels of competition unseen in any other network-based industry. We believe it is a credit to the regulatory model that Hutchison is prepared to invest $3 billion over five years to gain market share, such as its belief in the ability to make money over that period. For reasons already mentioned, we believe consumers are getting a better deal than ever before. It should also be noted that the handset, which is the device for competition, has never been subsidised more heavily.

Our understanding is that porting data between networks is a publicly available statistic. In our experience, based on feedback from carriers, the level of porting at the moment is greater than any time since the introduction of mobile number portability. This should be considered a healthy sign in a competitive market. Any change in the terminating access rates would in our view decrease porting as the competitiveness of Optus, Vodafone and Hutchison would be declined.

At a recent analyst briefing, the CEO of Telstra was asked what kept him awake at night. His response was one word: “mobiles”. Even Telstra is acutely aware of the heightened competitive state of this market. We obviously do not know how carriers cross subsidise the terminating access rate with the end-user offering, but we do know categorically that consumers are getting a great deal, competition has never been higher and that we are confident that our distribution expansion can continue profitably, to further facilitate long term competition where it matters most: in the major shopping centers of Australia.

CONCLUDING COMMENTS

In summary, we maintain the following:

- The current terminating access arrangements promote the underlying policies.
- The ACCC relied on some flawed facts in reaching its determination. We ask that they be reviewed.
- It is disappointing that no retailer submitted in the initial round. We hope that our submission will be considered as part of the overall framework, because retail is where the competition happens
- We believe that only Optus, Vodafone and "3" can offer Telstra meaningful competition. None of the second tier players will offer any meaningful competition at retail, because they lack the distribution to do so.
- We believe the policy framework is being achieved under the current environment. Any material change in the terminating access regime may have capricious outcomes as ultimately the only major beneficiary will be the incumbent with 50% market share.
- Competition is distribution.
- The market has never been more competitive and should be left as it is. Retail price benchmarking should be used and stay at the current levels.