

**OPTUS**

Submission to Department  
of Communications & the  
Arts

**Review of the Part XIB  
telecommunications anti-  
competitive conduct  
provisions**

September 2016

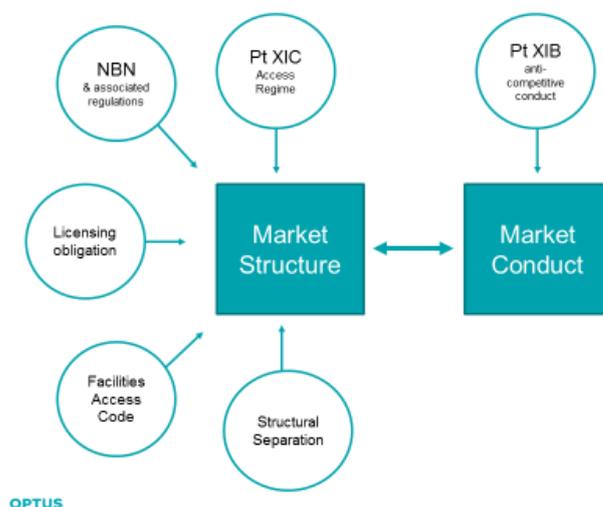
## INTRODUCTION

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1. Optus welcomes the opportunity to provide comments on the Department's discussion paper on the "Review of the Part XIB telecommunications anti-competitive conduct provisions".
2. Optus believes there is merit in retaining separate Part XIB anti-competitive conduct provisions for the communications industry. The communications market has a number of unique characteristics that provides a higher risk of anti-competitive conduct than is likely to be present in other industries. Notwithstanding the development of competition, sections of the communications market remain highly concentrated and there are number of bottlenecks that can provide a source of market power. Further, there are strong inter-dependencies between firms within the communications market to enable end-to-end services to end-users. This means that the actions of one firm can have broad implications for other firms and the competitive process.
3. In addition, it would be premature to remove Part XIB during the roll-out of the NBN. The NBN is likely to have a material impact on the structure of the market; but the specific effects are uncertain. Retaining Part XIB will provide continued competition safeguards as the market adjusts to these structural changes and their final impact can be assessed with greater surety.
4. Whilst Optus supports the retention of Part XIB, we believe it will be appropriate to update it to reflect a number of the amendments being made to s46. The one exception to this principle is the mandatory factors that are to be included in s46. These relate to specific factors that must be considered in the s46 test when assessing whether there has been a significant lessening of competition. The factors include whether the conduct alleged to be anti-competitive promotes efficiency and/or innovation.
5. Optus does not believe it is appropriate or necessary to apply these factors to the communications sector. Firstly, that the concept of significant lessening of competition is well founded and understood and has been a long standing feature of the communications sector. Secondly, in the case of communications actions to enhance efficiency or innovation by one firm can have a material impact on other firms who may rely directly or even indirectly on access to the first firm's network or customers.

## PART XIB SHOULD BE RETAINED

6. The competition regime for the communications industry comprises both general competition law provisions and specific provisions that reflect the special nature of communications markets. This regime regulates both:
  - (a) Market conduct (Part XIB); and
  - (b) Market structure (Part XIC).
7. The sector specific competition regime recognises that the communications industry has unique features that limit the effectiveness of general economic competition provisions (such as Part IV and Part IIIA).
8. The communications industry is the only infrastructure industry that comprises ‘utility-like’ network economics with economies of scale and scope, multi-product firms together with varying levels of vertical and horizontal integration, complicated by a pattern of significant technological change. There are also potentially significant externality effects (i.e. the need for any-to-any connectivity). This is further complicated by the presence of competing networks, natural monopoly networks, competing service providers, all combined with a fast rate of change and innovation.
9. The structural competition aspects of the communications markets are regulated through Part XIC primarily. In addition, there are other communications-specific regulations that address structural issues including; facilities access codes, NBN-related legislation, structural separation rules, licensing and spectrum regulations. These are shown in the figure below.



10. But there is only one communications specific regime aimed at addressing market conduct – Part XIB. Outside of Part XIB, any issue relating to market conduct would need to go through the general sector terms outlined in Part IV.
11. In order to assess whether Part XIB is still required, it is first necessary to reflect on the original reasons why a communications specific market conduct regime was introduced.

## The purpose of Part XIB

12. Part XIB was introduced in 1997 to provide a specialised regime to regulate anti-competition conduct in the communications industry. It was intended that Part XIB would work in line with the general market conduct rules under Part IV. The Explanatory Memorandum stated that communications providers would remain fully subject to Part IV of the Act.
13. One of the reasons identified for the sector specific market conduct rule was that communications is a highly complex industry, with fast pace of change and innovation. Further, competition had not yet been fully established in some communication markets. The prospect of firms with market power in one market cross-subsidising from non-competitive markets to markets in which competition exists or is emerging was considered a threat to the establishment of a competitive environment.<sup>1</sup> Optus notes that these observations apply in today's market and are likely to do so in the future.
14. Part XIB was established to focus on the market conduct of firms with a substantial degree of market power in any communication market:

*It is also concerned to prevent members of the industry with a substantial degree of power in a telecommunications market from engaging in anti-competitive conduct. Carriers and carriage service providers with substantial market power should not be able to take advantage of that market power to stifle competition.*<sup>2</sup>
15. It was highlighted that there were difficulties on relying on Part IV in the communications industry, given the level of vertical and horizontal integration, and the fixed cost nature of the business. Reliance on Part IV could be problematic due to evidentiary requirements and the integrated nature of the industry. For example, it was noted that it may be difficult to prove predatory pricing due to the reliance on acquiring evidence of internal cost allocations from integrated firms.
16. The above observations were made in the context of the liberalisation of the communications markets in 1997; but the observations apply equally now. They are also particularly pertinent during the transition from legacy networks to the NBN, where issues of market power and market conduct are likely to arise. Optus believes it is vital that competition be protected and promoted in this transitional period and beyond.

## Market structure and conduct rules work together

17. Part XIB seeks to prevent anti-competitive conduct in the market. It regulates the behaviour of firms with substantial degree of market power. This can be distinguished from the purpose of Part XIC, which has a broad aim of enabling greater competition in communications markets by opening up access to wholesale services provided on communications networks that are unlikely to be duplicated but which are necessary in order to provide services in downstream retail markets.
18. There is no requirement under Part XIC for a provider to have substantial degree of market power in any downstream market; it is the ownership of bottleneck infrastructure that gives rise to regulatory intervention. As can be seen in the above figure, much regulatory attention has been afforded to issues around market structure. Regulations dealing with structural separation have been introduced together with the introduction of

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<sup>1</sup> Trade Practices (Telecommunications) Bill 1996, Explanatory Memorandum.

<sup>2</sup> Ibid., p.6

the NBN and associated legislation. These rules are addressing specific market failures arising from the vertical integration of firms.

19. While it is expected that these reforms are likely to address some of the legacy competition concerns in certain markets, these rules will not address market behaviour issues that are not linked to vertical integration. The transition to the NBN and downstream markets that rely on the NBN, are susceptible to market behaviour issues not related to ownership of bottleneck infrastructure. Optus believes it is important that the competition regulator has access to communications-specific market behaviour rules to enable it to address future competition problems.

### **Part XIB should be improved not removed**

20. Optus submits that there is a continuing need for communications specific market conduct rules and scope for some functional improvement.
21. It is particularly important that the communications specific enforcement regime is retained in the period of transition to the NBN. It is likely that the NBN, once it is complete, will alter the structure of related downstream markets. However, it is unclear how these changes will affect competition and the opportunities/incentives for firms with sufficient market power to impede competition.
22. The implementation of structural separation through the roll-out of the NBN may reduce the opportunities for vertically integrated firms to use ownership of infrastructure to exercise market power. However, it is possible that new sources of market power will arise. As communications markets increasingly become cloud based and the importance of over-the-top applications grows, it is foreseeable that market power issues could arise independent of the ownership of bottleneck infrastructure.
23. Further, it will take time for the structural reforms to be implemented. The importance of retaining Part XIB in this long transition period was again acknowledged by the ACCC in a 2009 paper to the Department of Communications:

*In the transitional environment, Telstra is likely to retain a dominant position in many telecommunications markets by virtue of its vertical integration. Accordingly, a range of regulatory enforcement and compliance powers are required to address the incentives to engage in anti-competitive conduct in downstream markets via both price and non-price means<sup>3</sup>*

24. Optus believes that rationale for retaining the Part XIB powers is somewhat stronger than it was in 2009 given recent changes to the NBN roll-out that will see Telstra undertake extensive deployment and ongoing maintenance activities for NBN Co. Competition concerns related to the network service delivery contracts Telstra has with NBN Co has also been recently raised by the ACCC.<sup>4</sup> Should evidence arise Telstra is using its substantial degree of market power in retail broadband market to engage in anti-competitive behaviour, it is important the ACCC has the tools to address it.

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<sup>3</sup> ACCC, *Submission to the Department of Broadband, Communications and the Digital Economy, "National Broadband Network: Regulatory reform for the 21<sup>st</sup> Century"*, June 2009, p.69

<sup>4</sup> <http://www.accc.gov.au/regulated-infrastructure/communications/industry-reform/accc-assessment-of-nbn-telstra-service-delivery-agreements>

## AMENDMENTS TO PART XIB

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25. As indicated above, Optus believes there is a strong case to retain the communications competition rule under Part XIB of the CCA. However, we also believe it is important to update the rule to reflect some, but not all of the amendments being made to s46 of the CCA.

### **Maintain the “effect or likely effect test”**

26. Optus notes that it is proposed to amend the current provisions of s46 to include an “effect or likely effect” test as opposed to the current “purpose” test. This is an important change that will amend the existing misuse of market power test under s46 to extend the focus of the test beyond questions of whether conduct was undertaken with the express purpose of undermining competition to examine whether the conduct will or is likely to harm competition.
27. This amendment to s46 will bring it into line with the current formulation of Part XIB. Optus supports this change to s46 and believes it should be retained in Part XIB. It is appropriate that a law designed to discourage the misuse of market power actually focuses on the outcomes of such conduct rather than just the “purpose” of such conduct. Contrary to claims by some opponents of reform, the concept of “significant lessening of competition” is well understood by businesses, regulators and the courts. Such analysis is undertaken to apply other parts of competition law. Further, communications has operated under the effects test in Part XIB of the CCA since 1997. There is no evidence that the “effects test” under Part XIB has “chilled” competitive behaviour or caused an undue level of litigation.

### **“Take advantage of”**

28. In line with the introduction of an effects test, it is proposed that s46 is also amended to remove the “take advantage” limb of the competition rule. Optus supports updating Part XIB to reflect this change.
29. The problem with the “take advantage of” limb of the competition rule – which currently appears to focus on a hypothetical counterfactual of whether a competitor without market power could or would have engaged in the alleged conduct – has been well documented in the Harper Inquiry. In a speech to the Competition Law Conference in Sydney in May 2015, the Chairman of the ACCC summarised the problem with the current approach:

*Unilateral conduct by a firm with a substantial degree of market power is much more likely to distort the competitive process than the same conduct by a firm without market power.*

30. Optus considers that the case to remove the “take advantage of” limb from the current misuse of market power test is well made. Firms with a substantial degree of market power can, by definition, operate independent of the market. These firms are not subject to the same disciplines as firms that operate in a competitive market. Actions that take advantage of this market power will typically not see a response from other market participants to countervail their actions. Consumers often lose as a result of such conduct through higher prices or reduced supply in the longer term. As such, it is appropriate that firms in the ‘special’ position of having substantial market power are subject to rules to which firms without market power are not subject.

## Mandatory factors or guidance

31. Whilst Optus believes that the Part XIB competition rule should be brought into alignment with above changes being made to s46, we do not believe that the additional mandatory factors to be included in s46 should be adopted in Part XIB.
32. A concern canvassed in the Harper Review is that by removing the “take advantage” limb of the current s46 competition rule may create a risk that behaviour which ought to be considered normal commercial competitive behaviour will be inappropriately proscribed. To address this risk the Harper Review recommended that an amended s46 should require the court to consider certain specified factors in determining whether there has or is likely to be a substantial lessening of competition. The proposed mandatory factors are;
  - (a) the extent to which the conduct has the purpose, effect or likely effect of increasing competition in the market, including by enhancing efficiency, innovation, product quality or price competitiveness; and
  - (b) the extent to which the conduct has the purpose, effect or likely effect of lessening competition in the market, including by preventing, restricting or deterring the potential for competitive conduct in the market or new entry into the market.
33. The Government has adopted the recommendations of the Harper review in its Exposure Draft of the Competition and Consumer Amendment (Competition Policy Review) Bill 2016.
34. As indicated above, we believe that the concept of significant lessening of competition is well founded and understood, especially in communications and has been a long-standing feature of other parts of the Competition Law. It is not clear, therefore, that these factors are necessary.
35. Further, there is a risk that inclusion of the mandatory factors could create a trip-wire to future actions against anti-competitive conduct. These risks are especially acute in the communications sector where there are strong interdependencies between competing firms to provide end-to-end services to end-users.
36. Optus believes that the inclusion of the mandatory factors would undermine the effectiveness of Part XIB in the communications markets. Removal of these factors would ensure that the intent of the market behaviour rules could be achieved in the communications markets
37. In the case of communications actions to enhance efficiency or innovation by one firm can have a material impact on other firms who may rely directly or even indirectly on access to the first firm’s network or customers.
38. As an example, in 2001 Telstra launched an ADSL broadband service into the market but refused to offer a wholesale version of the service that would allow its wholesale customers to compete with Telstra’s retail service. In this instance the ACCC determined that Telstra’s action was likely to lead to a significant lessening of competition and had breached the competition rule under Part XIB of the Competition Act. Telstra was required to open up wholesale access to the service and competition not only drove rapid take-up of broadband, it also enabled Telstra’s competitors to lead the next phase of innovation with the upgrade to ADSL2+. However, under the proposed s46 construct it would have been open to Telstra to mount a defence on the basis that the ADSL service promoted innovation and that it ought to be entitled to exclude competitors from accessing the new service.

39. It is also unclear how the concept of enhancing efficiency would be assessed in communications markets. One reason for the persistence of market power in communications markets is the efficiency advantages of increased scale and scope in the presence of significant fixed costs – either network based or otherwise. Traditionally, communications networks that have greater scale (i.e. traffic) face significantly lower unit costs and, therefore, have significant market advantages. This is also typically combined with first mover advantages (i.e. advantages of incumbency). Often it is this scale advantage that is the source of market power. It is not clear how the mandatory factors would operate in circumstances where a communications company with substantial market power that engages in anti-competitive conduct but as a result gains significant traffic and, therefore, enhances its network efficiencies.
40. It is also uncertain how the mandatory factors will be balanced between each other to reach a judgement. It is not clear, therefore, that adoption of the mandatory factors will assist in discouraging the misuse of market power because of this lingering uncertainty as to how the provisions will be applied.
41. Optus believes that the misuse of market power test should focus on the outcomes of conduct – that is; will particular conduct lead to a substantial lessening of competition or not? If it does, then such conduct should be proscribed. As indicated above, firms with substantial market power ought to be subject to a higher threshold of conduct than firms without market power because their actions can have a significant impact on the market and consumers.
42. If a firm believes that particular conduct has pro-competitive benefits then it is open to it to seek an exemption order under Part XIB or an authorisation. Each of these processes applies a clear and well defined balancing of pro and anti-competitive effects based on a net public benefit analysis. Ultimately, it is the public interest that determines whether conduct that lessens competition ought to be allowed.

### **Procedural amendments**

43. Optus does not believe that any further changes are required to Part XIB as it is currently constructed. This means that the current competition notice and exemption order powers would remain unchanged. Optus sees no valid reason to amend these long-standing features of Part XIB.