Submission to Senate Economics Legislation Committee

Inquiry into the Competition and Consumer Amendment (Misuse of Market Power) Bill 2016

December 2016

INTRODUCTION

1. Optus welcomes the opportunity to comment the Competition and Consumer Amendment (Misuse of Market Power) Bill 2016 to the Senate Economics Legislation Committee.

2. This Bill proposes to make some important amendments to the *Competition and Consumer Act 2010* (the Act) to strengthen the prohibitions on the misuse of market power and better target anti-competitive conduct by corporations with a substantial degree of market power. It also proposes to repeal the telecommunications-specific anti-competitive conduct provisions in Division 2 of Part XIB of the Act, and the competition notices and exemption order regime in Division 3 of Part XIB.

3. Optus' perspective on this issue is informed through its experience competing in several communications markets that are highly concentrated, where an incumbent provider has a substantial degree of market power. The concentrated nature of the telecommunications market has resulted in the industry being subject to specific competition rules under Part XIB of the Act. Whilst the Part XIB provisions differ from the current s46 provisions, they provide useful insights on the key issues underpinning consideration of the reforms. The telecommunications market has also provided useful insights into how misuse of market power can have adverse impacts for competition and consumer interests.

4. An effective and well-functioning misuse of market power law that acts to deter conduct that harms competition and consumer interests is a necessary component of an effective competition regime.

5. Optus supports the reforms set out in the Bill that aim to improve the operation of s46 so that its application is more certain and that it is more effective in discouraging conduct that harms competition. We believe the Bill achieves this by adopting a test that places greater focus on the "effects" of conduct - i.e. whether particular behaviour harms the process of competition. In contrast, the current provisions appear to focus narrowly on the "purpose" of conduct and whether a firm has or has not been able to leverage its market power rather than on the outcomes of that conduct.

6. Optus, therefore, supports the proposed reforms to the misuse of market power provisions set out in s46. However, we believe that the case for repealing Part XIB of the CCA is more finely balanced. The telecommunications market remains highly concentrated and is in a period of transition as related services and markets are starting to converge. New sources of market power are arising that are divorced from traditional ownership of infrastructure. The protections afforded by Part XIB are no less as important as they were in 1997. It is foreseeable that more reliance could be placed upon Part XIB than has been before, as the effectiveness of the Part XIC access regime is reduced due to the structural separation of Telstra.

7. For this reason, Optus believes that Part XIB should only be repealed if the amendments are made to improve the operation of s46. Further, we believe that mandatory factors that a court has to consider in determining whether conduct is anti-competitive should have a narrower application in the telecommunications sector. Specifically, consideration of whether conduct is deemed to be undertaken to enhance efficiency and innovation should not apply in the case of the telecommunications industry, which typically has high fixed costs and increasing economies of scale. These concepts have wide spread application in telecommunications and could be used to shield anti-competitive conduct from enforcement action.

8. Optus has set out below further details on the issues below.

DETAILED CONSIDERATION OF THE ISSUES

Purpose, effect or likely effect test

9. Optus supports the amendments to the existing misuse of market power test 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.

10. Under the proposed amended rule, conduct will be proscribed if it can be determined that it will or will likely lead to a substantial lessening of competition. 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. The proposed change will bring s46 into alignment with other parts of the Competition Law, such as sections 45, 47 and 50. It will also better align s46 with similar competition laws applied in other developed jurisdictions, such as the EU, US, UK and Canada.

11. Contrary to the repeated claims of 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 the Competition Law. Further, telecommunications has operated under a similar effects test in Part XIB of the Act since 1997. There is no evidence that the "effects test" under Part XIB has undermined competitive behaviour or caused an undue level of litigation.

Removal of the 'Take advantage of" test

12. The problem with the "take advantage" limb of s46 – which currently appears to focus on a hypothetical counter factual of whether a competitor without market power could or would have engaged in the alleged conduct – has been well documented in submissions to and the report of 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".

13. Optus believes that removal of the "take advantage of" limb from the current misuse of market power test is a necessary reform to deliver a more effective prohibition or deterrence on the misuse of market power. 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 an effectively 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.

Telecommunications specific issues

Part XIB

14. Part XIB of the Act 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.

15. One of the reasons identified for the sector specific market conduct rules was that communications is a highly complex industry, with a fast pace of change and a high degree of innovation. Further, competition had not yet been fully established is 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.[1] Optus notes that these observations apply in today's market and are likely to do so in the future – especially given the incentives to foreclose competition in the emerging market for NBN services.

16. The communications industry has some unique characteristics that heighten the risks associated with anti-competitive conduct than exists in the broader business environment. The communications industry is the only infrastructure industry that comprises:

    (a) 'utility-like' network economics with economies of scale and scope;

    (b) multi-product firms together with varying levels of vertical and horizontal integration; and

    (c) complicated by a pattern of significant technological change.

17. 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.

18. Similar to the proposed reforms to s46 in the current Bill, Part XIB has provide a more effective deterrence on anti-competitive conduct since it focuses on the outcome or effects of conduct by firms with significant market power. It has also provided for more streamlined enforcement action through the powers granted to the ACCC to investigate anti-competitive conduct and to issue competition notices against potential breaches of the competition rules.

19. Optus believes that the case for repealing Part XIB of the CCA is finely balanced. The telecommunications market remains highly concentrated and is in a period of transition as related services and markets are starting to converge. New sources of market power are arising that are divorced from traditional ownership of infrastructure. The protections afforded by Part XIB are no less as important as they were in 1997.

20. For this reason Optus believes that Part XIB should only be repealed if the amendments are made to improve the effectiveness of the operation of s46. Further, we believe that two exceptions should be made to the application of the revised s46 arrangements for the telecommunications sector. As discussed below these exceptions are likely to improve the overall effectiveness of the revised misuse of market power provisions for the telecommunications industry.

Mandatory factors

21. An issue canvassed in the Harper Review is whether the removal of the "take advantage" limb of the current test may open 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 additional guidance be given to the courts on this matter by including mandatory factors that should be considered in determining whether there has or is likely to be a substantial lessening of competition. The amendments to s46 in the Bill adopt these mandatory factors, which are;

[1] Trade Practices (Telecommunications) Bill 1996, Explanatory Memorandum.

(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.

22. 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. We are concerned that inclusion of the mandatory factors could create a trip-wire to future actions against anti-competitive conduct in the communications sector where there are strong interdependencies between competing firms to provide end-to-end services to end-users.

23. In the communications sector 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.

24. 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.

25. 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.

26. Optus believes that the Bill should be amended to exclude mandatory consideration of the impacts on innovation and efficiency in respect of misuse of market power cases in the communications sectors.