‘yes’
OPTUS

Optus submission:

Review of the competition provisions of the *Trade Practices Act 1974*

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Overview of submission

Optus welcomes the Federal Government's review of the competition provisions of the *Trade Practices Act 1974* (TPA). Optus believes that such a review is both relevant and timely given recent reviews regarding specific provisions and Parts of the Act.

Optus supports a pro-competitive economy in which the Australian Competition and Consumer Commission (the ACCC) has at its disposal an effective legislative instrument designed to enhance the welfare of all Australians through the promotion of competition and fair trading and provision for consumer protection. To realise this purpose the TPA should effectively address anti-competitive behaviour without constraining Australian businesses from effectively competing in an increasingly global market place. Furthermore, there should be consistency between the various aspects of the TPA particularly where Parts IV and XI are concerned.

While the TPA in its current form goes some way to achieving its stated objectives, Optus believes that these could be more effectively realised through a greater reliance on conduct regulation as opposed to market structure based regulation.

This Optus submission makes the following points:

- Optus believes the current telecommunications specific regime in Part XI of the Act should remain. However, there should be consistency between the various aspects of the TPA (including Part IV and XIB).
- Optus supports conduct based regulation in preference to the regulation of market structure.
- The ACCC's current application of s.50 may impede competition and constrain market development. It can inappropriately reduce the ability of Australian industry to attain sufficient scale to compete locally and internationally.
- Optus believes that given the increased globalisation of the Australian economy, it is unlikely that the current form of s.46 will provide an appropriate balance between competing businesses in the future. An effects test should be introduced into s.46.
- Optus believes the third line forcing provision (s.47(6)) does not promote competitive trading, or benefit consumers in terms of services or price. This may be overcome by making third line forcing subject to a competition test (in s.47(10)) as was recommended by the Hilmer Committee in 1993 in its review of National Competition Policy.
- The outcome of the *Daniels* case has created serious anomalies in the operation of legal professional privilege. This ruling should be reversed by legislative intervention.
- Resale price maintenance is not always anti-competitive. In certain circumstances it may enhance economic efficiency. The use of resale price maintenance should be subject to a "significant lessening of competition" test and in cases where it has no adverse consequences for competition it should be permitted.

1. The telecommunications industry

6.1 The purpose of this chapter is to highlight the importance of the telecommunications industry to the Australian economy. It also provides a brief overview regarding the current state of competition within this important industry. Optus' view regarding the appropriateness of sector specific regulation - under Part XI of the TPA - is also discussed.

Why telecommunications is important

1.2 The significance of the telecommunications industry can be illustrated by the following:

- In 1999-00 value added services from telecommunications accounted for around $19 billion which is approximately 3% of Australia's total GDP;
- In 2000-01 investment in new infrastructure totalled more than $9 billion;
- Telecommunications services are an important input into all other industries; and
- Between 1997 and 2000, revenue growth averaged around 13% per year making the telecommunications industry one of the fastest growing sectors in the economy.

1.3 Whilst telecommunications has always been fundamental in providing social and economic benefits to both households and businesses, technological advancements (such as the emergence of broadband technology) will mean that telecommunications will provide the foundations of Australia's future information economy. There is now available a plethora of new services and platforms and there are many others in development. Furthermore, previously separate sectors such as broadcasting and telephony are now converging.

State of telecommunications competition

1.4 In its recent Inquiry Report entitled "Telecommunications Competition Regulation" the Productivity Commission concluded that Australia's telecommunications industry is becoming increasingly competitive, however the extent to which effective competition exists varies in the different market segments. In particular, the Productivity Commission identified the following markets as competitive:

- Mobile services;
- Internet services;
- Data services; and
- Long Distance services (both international and national long distance calls).

1.5 Despite this emerging competition the Productivity Commission also concluded that the markets for basic access and local call services were not effectively competitive. Accordingly, the Productivity Commission concluded that there was a strong case for sector specific regulation. Overall, Optus agrees with the Productivity Commission's market analysis given that Telstra's ownership of the only ubiquitous fixed telecommunications network in Australia and its vertically integrated structure bestows upon Telstra a high degree of market power.

Optus supports the retention of sector specific regulation

1.6 Optus believes the current telecommunications specific regime in Part XI of the Act should remain.

1.7 In particular, Telstra's misuse of its market power is a major concern for Optus. Accordingly, Optus supports the application of an effects test under Part XIB of the TPA when addressing issues of anti-competitive conduct in the telecommunications industry.

2. Does the TPA inappropriately impede the ability of Australian industry to compete locally and internationally?

2.1 This chapter will examine whether the TPA inappropriately impedes the ability of Australian industry to compete locally and internationally. Specifically it will examine the appropriateness of s.50 along with its interaction with s.46.

Conduct based regulation is superior to market structure regulation

2.2 Optus believes there should be consistency between the various aspects of the TPA (including Parts IV and XIB). Industry convergence and the globalisation of the Australian economy means that many of the dynamic forces that apply in the telecommunications sector now apply across the entire economy. Optus supports conduct based regulation as opposed to market structure based regulation. That is, a useable and effective s.46 test is preferred to an overly restrictive s.50 test.

2.3 The ACCC's current application of s.50 can impede the development of competition. It can also inappropriately inhibit Australian industry from attaining sufficient scale to compete locally and internationally. Furthermore, it may not allow markets to evolve, which is the definition of competition – exit, entry, consolidation and divestiture are essential elements of competitive markets.

2.4 As markets evolve, firms will inevitably experience periods of rent accumulation or monopoly profits; this is only a concern if it is sustained. Entry of new firms or competing technologies will dissipate these monopoly rents. Such is the evolution of markets. The regulator should err on the side of caution in imposing a particular market structure at any one time as this may interrupt the market cycle. Instead it is more appropriate for the regulator to address the conduct of market players to ensure the market is allowed to evolve.

2.5 At present, s.50 requires the ACCC to make a "guess" as to what is the appropriate or competitive industry structure. This can lead to significant regulatory error and tempt the regulator to respond to public policy concerns beyond competition issues.

Merger activity can enhance economic welfare

2.6 Merger activity can improve efficiency to the benefit of consumers and the community generally. In particular, mergers between firms are an effective way of developing competitive advantage both domestically and internationally. They are also an

important means of optimising the benefits of complementary strengths and developing economies of scale and scope. Furthermore, the threat of a merger or acquisition also operates as an important discipline upon poorly performing management.

s.50 inappropriately impedes the ability of Australian industry to compete locally and internationally

2.7 The current merger test prevents Australian companies from attaining a critical mass that enables them to compete on an international scale. The ACCC's current application of s.50 is to reject a merger which has the effect, or likely effect, of substantially lessening competition in the relevant market. This test is seldom applied within a truly global context. Therefore it ties the hands of Australian businesses when competing in overseas markets with incumbents that have available to them significantly larger economies of scope and scale. In this regard, being strong at home provides companies with strength abroad.

2.8 The size of a business impacts on its ability to access foreign capital. There is a need to have access to a strong balance sheet in order to overcome the hurdles and risk associated with competing internationally. Capital markets place a significant premium on international ventures if the company is not strong at home. Accordingly, an overly restrictive mergers test may prevent Australian companies obtaining a critical mass that will hamper their ability in obtaining capital necessary to expand into foreign markets and to compete internationally.

2.9 The current s.50 arrangements may also impede the attainment of efficient industry structures. This no doubt adversely impacts on consumer welfare and economic efficiency. Where a market is contestable, with low barriers to entry, the dynamic nature of any given market will mean that in the long run monopoly rents are dissipated by market entry and technological advancement.

2.10 Furthermore, it should be noted that, while companies can appeal the ACCC's decisions regarding possible mergers and acquisitions, commercial realities may place these rights of appeal out of reach.

2.11 Australia's merger provisions are inconsistent with those found in several overseas jurisdictions – see Appendix A.

3. Does the TPA provide an appropriate balance of power between competing businesses, and in particular businesses competing with or dealing with businesses that have larger market concentrations or power?

3.1 This chapter considers whether the TPA provides an appropriate balance of power between competing businesses.

s.46 does not provide an appropriate balance of power between competing businesses.

3.2 Optus believes that given the increased globalisation of the Australian economy it is unlikely that the current form of s.46 will provide an appropriate balance between competing businesses in the future.

3.3 In the Productivity Commission's inquiry into "Telecommunication Competition Regulation", Optus supported the retention of an "effects based" test for assessing anti-competitive behaviour in the telecommunications industry. Optus maintains this view and believes that there should be consistency between Part IV and Part XI of the TPA.

3.4 An effects based test will provide an appropriate balance of power between competing businesses in industries where a particular business has a significant degree of market power. This is because, in many cases, there exists information asymmetry and non-transparency of cost and internal transfer prices. This is particularly the case in industries:

- That require substantial infrastructure such as the telecommunications industry;
- That are characterised by oligopolistic market structures; and
- Where global rationalisation has occurred.

3.5 As a result, it is extremely difficult to prove (to the legal standard) a prescribed anti-competitive purpose by players in such a marketplace. In reality this can often only occur where there is the proverbial 'smoking memo'. Furthermore, despite significant public attention, Optus does not believe that recent legal decisions have significantly altered this position – see Appendix B.

3.6 The question of purpose can often be irrelevant to whether or not particular conduct actually impacts on Australia's economic welfare and the effectiveness of the competitive process. An effects based test overcomes this limitation.

3.7 The legislator has a difficult task in drafting a provision to prevent misuse of market power that allows for aggressive competition but prevents anti-competitive injury to competitors. A purpose test as presently exists in s.46 guides the courts to examine the intent and morals of the firms, rather than the policy objective of increasing competition in markets to ensure the benefits of economic efficiency are maximised.

3.8 It should be noted that an effects test in s.46 would only prohibit conduct by a firm with a *substantial degree of market power* who *takes advantage of that power* to lessen competition or injure competitors. If conduct is not taking advantage of market power, that is, it is conduct that a firm in a competitive market would have engaged in profitably, then it would not be captured by an effects test.

3.9 The case for amending s.46 to include an effects test is supported by international practice – see Appendix C.

4. Does the TPA promote competitive trading which benefits consumers in terms of services and price?

4.1 This chapter will outline Optus' view regarding third-line forcing.

The current third line forcing provision does not promote competition

4.2 Optus generally accepts that Part IV of the Act promotes competitive trading.

4.3 However, as an exception to our general view, Optus believes the third line forcing provision (s.47(6)) does not promote competitive trading, or benefit consumers in terms of services or price.

4.4 Optus believes this provision should be:

(i) Subject to the competition test in s.47(10); and

(ii) Subject to an exemption for bundling activity within a corporate group, so that companies within this group can be consolidated for competition law purposes (as occurs elsewhere in the Act).

4.5 It is possible to restructure transactions between related companies to avoid third line forcing rules. However this usually involve a substantial and wasteful use of a corporation's resources. This may be overcome by making third line forcing subject to a competition test (in s.47(10)) as was recommended by the Hilmer Committee in the 1993 National Competition Policy review.

5. Does the TPA provide adequate protection for the commercial affairs and reputation of individuals and corporations?

5.1 This chapter will examine the current s.155 notice provisions in light of the recent *Daniels* case that has created serious anomalies in the operation of legal professional privilege.

The *Daniels* case undermines the operation of legal professional privilege.

5.2 Optus believes that the current interpretation of the s155 notice provisions does not adequately protect the commercial affairs and reputation of individuals and corporations.

5.3 The outcome of the *Daniels* case has created serious anomalies in the operation of legal professional privilege. Optus believes this ruling should be reversed by legislative intervention.

5.4 Since *Daniels*, the ACCC has continued to seek access to otherwise legally privileged documents as the rule rather than the exception.

5.5 This is contrary to the objectives of the Act and the public policy behind the law of legal professional privilege. In particular, it operates as a disincentive for businesses and

individuals to seek legal advice, and for lawyers to give candid and objective legal advice to their clients.

5.6 Businesses and individuals are more likely to infringe the Act in the absence of candid legal advice, and less likely to seek advice as to how to cease inadvertently infringing it.

5.7 This result is not sensible on policy grounds, and also creates a corporate atmosphere of "lest said, soonest mended", which discourages understanding of, and compliance with, the law.

5.8 Optus believes that this position should be reversed immediately and without waiting for the outcome of the current High Court appeal on *Daniels.*

6. Does the TPA allow business to readily exercise their rights and obligations under the Act, consistent with certainty, transparency and accountability, and use of compliance of authorisation processes applicable to their circumstances?

6.1 Under Part IV, specific types of conduct can be Authorised by the ACCC even if it is deemed to be anti-competitive and therefore prohibited or subject to a "substantially lessening of competition" test.

6.2 While the Authorisation process should be retained, it is important to note that the process is administratively complex and can be time consuming due to the need for public consultation and market enquiries.

6.3 There is therefore a significant difference between having a per se prohibition of conduct and a per se prohibition unless authorised. As above, we would therefore suggest that resale price maintenance be subject to a substantial lessening of competition test rather than introducing an authorisation process.

7. Is the TPA flexible and responsive to the transitional needs of industries undergoing, or communities affected by, structural and/or regulatory change and to the requirements of rural and regional areas?

7.1 This chapter will discuss whether the current prohibition regarding the use of resale price maintenance is appropriate given changing market conditions and structures.

Resale price maintenance should only be prohibited where it results in a significant lessening of competition

7.2 Resale price maintenance is not always anti-competitive. Guaranteeing a minimum retail price may promote economic efficiency by encouraging retailers and distributors to increase the level of service in relation to a product. Scherer and Ross in their paper *"Industrial market structures and economic performance"* highlight a number of instances where resale price maintenance may enhance economic efficiency.

7.3 Optus believes that rather than prohibiting resale price maintenance per se the ACCC should be required to apply a "significant lessening of competition" test and in cases where it has no adverse consequences for competition it should be permitted.

7.4 Using resale price maintenance for tacit price collusion is a thing of the past. Resale price maintenance is now frequently used to enhance service levels, ensure quality of service and maintain the value of brands to customers.

7.5 At a minimum, authorisations should be available, however, as discussed in chapter 6 this process can be cumbersome and time consuming.

Appendix A – International evidence of merger law

International evidence provides a case for a loosening of s.50:

- In New Zealand, mergers that result in or a strengthening of a *dominant position* are prohibited, unless authorised.
- In the EU, the Merger Control Regulation provides that mergers with a Community dimension (assessed by reference to turnover of the merging firms) are assessed by the Commission to determine whether they are compatible with the common market. A merger that creates or strengthens a *dominant position* as a result of which effective competition would be significantly impeded in the common market or in a substantial part of it shall be declared incompatible with the common market.
- In Canada, mergers may be prohibited if they are likely to prevent or substantially lessen competition, but will be allowed if they are likely to bring about efficiency gains which outweigh any lessening of competition.

Appendix B – The impact of recent cases on the effectiveness of s.46

It has been suggested that recent case law relating to section 46 illustrates the increasing effectiveness of section 46 in dealing with competition issues. Optus does not believe this to be the case.

The Melway case

Optus' view is that the Melway decision does not "enhance and extend the law as set down in the Court's Queensland Wire Industries decision" as suggested by the ACCC in its press release.

Rather the court in its majority judgement states the following:

> *"Dawson J's conclusion that BHP's refusal to supply QWI with Y-bar was made possible only by the absence of competitive conditions does not exclude the possibility that, in a given case, it may be proper to conclude that a firm is taking advantage of market power where it does something that is materially facilitated by the power even though it may not have been absolutely impossible without the power. To that extent, one may accept the submission made on behalf of the ACCC, intervening in the present case, that s 46 would be contravened if the market power which a corporation had made it easier for the corporation to act for the proscribed purpose than otherwise would be the case."*

In Melways the High Court has clarified that the Queensland Wire decision does not rule out the possibility that in an appropriate case, it could be found that there was a taking advantage of the power where something was materially facilitated by the power even though it would not have been absolutely impossible without the power. However, the decision does not set a new test in any sense for taking advantage of, and Optus does not believe that it extends or enhances the test.

The Boral case

Optus recognises that the Full Court of the Federal Court in Boral has dismissed the idea that there must be an expectation of recoupment before there can be a finding of predatory pricing and that below cost pricing is not necessary to establish predatory prices. However, the decision does not provide a single principle in respect of predatory pricing. When one examines the judgements it appears that while the judges may be clear on what they believe is not necessary to show predatory pricing (ie an expectation of recoupment) they are less clear on what must be demonstrated in order to show predatory pricing.

Finklestein J said:

> *" In my opinion the existence of predatory pricing should not be determined by reference to some precise formula or definition. Predatory pricing is no more than a price set at a level designed to eliminate a competitor or keep a potential competitor from the market. That is the gist of the definition given by Professor Hay that I mentioned earlier in these reasons. It is all that is necessary for the purposes of section 46. In particular, in my view, it does not matter that the price charged might exceed either the average total cost or average variable cost. In the circumstances of the case it may nevertheless be a predatory price. I do not agree with the view that there is a cost (eg average variable cost) below which there must be a per se*

finding of predatory pricing. I would accept, however that for the purposes of a prosecution under section 46, if a dominant firm persistently prices its goods below average total cost, predatory intent may be inferred and the inference would be much stronger if the price was set below average variable cost. At least in the latter case it would be for the firm to show that there was a legitimate purpose for its conduct."

Optus would argue that while the Federal Court has attempted to formulate a new definition of predatory pricing there remains considerable uncertainty about the application of that definition. Finkelstein J's definition of predatory pricing as being pricing set at a level designed to eliminate a competitor or keep a potential competitor from the market provides little guidance as to how a court might distinguish between predatory pricing and competitive pricing.

Similarly, Optus would argue that the Federal Court's reference to the fact that only a monopolist or a person with monopoly power can recoup profits is inaccurate. If a firm possesses market power it can have a degree of confidence about the level or likelihood of future profit or recoupment without necessarily requiring monopoly power.

Furthermore, the Boral case provides no new jurisprudence relevant to the general application of s.46. It is relatively confined to its facts, with little or no reasoning related to the "take advantage of" hurdle.

Appendix C – International comparison of conduction regulation and misuse of market power provisions

Canada: In Canada, the competition provisions clearly refer to effect or likely effect. Sections 78 and 79 of Canada's Competition Act 1986 prohibit one or more persons from abusing their dominant market position. Also section 79(1) states:

> *"Where, on application by the Director, the Tribunal finds that:*
>
> - *one or more persons substantially or completely control, throughout Canada or any area thereof, a class or species of business,*
> - *that person or those persons have engaged in or are engaging in a practice of anti-competitive acts, and*
> - *the practice has had, is having or is likely to have the effect of preventing or lessening competition substantially in a market,*
> - *the [Competition] Tribunal may make an order prohibiting all or any of those persons from engaging in that practice."*

United States: Section 2 of the Sherman Act renders it unlawful for a person to monopolise, attempt to monopolise, or combine or conspire with any other person or persons to monopolize a line of commerce. An action against a party for monopolisation has two elements: possession of monopoly power, and the wilful acquisition, maintenance or use of that power by anti-competitive or exclusionary means for anti-competitive or exclusionary purposes.[1]

When considering the second limb of this monopolisation offence, the courts focus primarily on the conduct of the defendant rather than on intent. The conduct must be deliberate, and anti-competitive and exclusionary. In doing so the courts are looking at effect rather than purpose. Case law has established a number of forms of conduct that have such an effect, including leveraging, pricing below cost, imposing illegal ties, excessive advertising and other conduct that raises a competitor's costs or risks of entering the market.

United Kingdom: The UK's Competition Act 1998 contains what can be viewed as an effect based test given the language that the provision is framed in. Section 18(1) of the Act provides:

> *"Subject to section 19, any conduct on the part of one or more undertakings which amounts to the abuse of a dominant in a market is prohibited if it may affect trade within the United Kingdom".*

[1] *Aspen Skiing Co v Aspen Highlands Skiing Corp.*, 472 US 585, 595-96 (1985).

European Union: The domestic proscription of abuse of market power in many European countries is drawn from Article 86 of the Treaty of Rome. The Court of Justice of the European Communities (ECJ) defined "abuse" in the context of article 82 (formerly article 86) as:

> *"The concept of abuse is an objective concept relating to the behaviour of an undertaking in a dominant position which is such as to influence the structure of the market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which through recourse to methods different from those which condition [normal commercial operations] has the effect of hindering the maintenance of the degree of competition still existing in the market or growth of that competition".*[2]

In the Continental Can case[3], the European Court of Justice (ECJ) stated that:

> *"the question of causality between the offence of abuse of dominance and the actual exercise or use of that dominance was of no consequence, because the reinforcement of a position of dominance may still be an abuse as prohibited by Article 86 "regardless of the means and procedure by which it is achieved, if it has the effects [of substantially fettering competition]".*[4]

This expansion of the operation of Article 86 means that the abuse of dominance test is broader than the effects based test currently applied under Part XIB because it does not require an equivalent of the "take advantage" threshold test in Australia.

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2 *Hoffman-La Rouce & Co AG v Commission* [1979] 2 ECR 461.

3 Case 6/72 *Europemballage Corporation and Continental Can Company Inc. v EC Commission* [1973] ECR 215; 72/21 EEC *Re Continental Can Company Inc. and Europemballage Inc.* OJ [1972] L7/25.

4 *Continental Can* case, para 27.