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REVIEW OF TELECOMMUNICATIONS-SPECIFIC COMPETITION REGULATION

ATUG SUBMISSION TO PRODUCTIVITY COMMISSION ON IMPROVEMENTS TO PART XIB OF THE *TRADE PRACTICES ACT* 1974

1. Introduction

The Australian Telecommunications Users' Group ("**ATUG**") provide this submission in response to the Productivity Commission's *Draft Report on Telecommunications–Specific Competition Regulation* ("**Draft Report**"). These comments are intended to provide further material for use by the Commission in its preparation of the final report later this year. In this submission, we seek to provide more detailed suggestions on Part XIB, and how it may be improved, than we gave in our submission dated 10 May 2001.

The Commission found, in its Draft Report, that there were a number of reasons for the repeal of the Part XIB competition safeguards of the *Trade Practices Act* 1974 ("**TPA**"). The most weighty appear to have been the risk of regulatory error and overreach, the complexity and cost of administration, the slowness in enforcement procedures and the absence of a worthwhile deterrent effect posed by the competition safeguards.[1]

2. Effects Test vs Purpose Test

The Commission was of the view that the objectives which the Part XIB safeguards seek to achieve could be adequately pursued through the provisions of Part IV. The so-called "effects test" in sub-section 151AJ(2), which embodies the Competition Rule, could, in the Commission's view, be replaced by the current version of section 46. The Commission comments[2] that "the differences between section 46 and Part XIB in regard to purpose and effect may not be large, in practice." Sub-section 46(7) allows a proscribed purpose to be inferred from "the conduct of the corporation" or "from other relevant circumstances".

We would differ in our assessment of the usefulness of section 46 in allowing inferences of a proscribed purpose to be drawn from a firm's conduct or other circumstances. The prohibition on conduct that takes place with a prohibited *purpose* is substantially different from a prohibition on conduct that has an anti-competitive effect. While various judicial decisions have found that the language of section 46 does not connote moral blameworthiness on the part of the respondent, the emphasis of section 46 is on the subjective purpose of the firm which takes advantage of its market power. Contrary to what some submissions have suggested, proof of purpose is rarely an easy or straightforward process. Indeed, most cases in which there has been a finding of a contravention of section 46 have involved either an admission of a proscribed purpose, or tangible evidence of one.

The large majority of section 46 cases which have been litigated have not successfully demonstrated a breach of that section. Although it is generally not too difficult to show whether a firm has substantial market power, it has been very difficult in most circumstances to show that the defendant took advantage of that power for a proscribed purpose. The landmark case on section 46, *Queensland Wire Industries* v *BHP*[3], was one in which a proscribed purpose was inferred but,

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[1] The Commission did list other specific factors in favour the repeal of the competition safeguards in Part XIB (eg. those listed at p. 5.40), but we have identified what appear to be the main reasons cited in favour of repeal.

[2] Draft Report, page 5.23

[3] (1989) 167 CLR 177

even then, the High Court held that the test to be used was whether there was any plausible explanation of a legitimate purpose that was behind the conduct in question. Such an approach clearly creates a high threshold of proof, and one that would rarely be discharged in a practical context.

Another difficulty with section 46 (in contrast with part XIB) is that its emphasis is not market-wide, but rather on individual firms which may be deliberately targeted by a firm with market power. It is a truism that section 46 seeks to protect and promote competition, not competitors. As a practical matter, however, the means by which section 46 attempts to protect and promote the competitive process is by safeguarding the interests of firms which lack market power, as opposed to those which both have market power and deliberately misuse it against those firms which lack such power.

The Competition Rule in Part XIB and the method by which it is enforced (the Competition Notice) are novel in Australian competition law. The Competition Rule's emphasis on a misuse of market power with the *effect* of substantially lessening competition in a market could truly be said (unlike section 46) to be directly oriented towards the protection of the competitive process, rather than competitors as such. The Competition Rule is concerned with market-wide decreases in competition, with the consequent effects of increased prices and/or reduced or poorer services for end-users. An effects test recognises that certain business decisions which are made without an anti-competitive intention can still have an anti-competitive effect.

3. Distinctive Features of Telecommunications Industry

The effects test is especially justified in an industry, like telecommunications, which has two distinctive characteristics. The first distinctive characteristic is the existence of network effects. Network effects can arise because of the inherent two-way operation of telecommunications networks. In addition, instead of the service in question flowing only from one defined point to another, as in the case of gas or water, telecommunications networks necessitate the ability of calls to be made from any one point to any other point in the network. If a network operator refuses to allow another network operator to terminate calls on the first network, then that effectively excludes the second network operator from being able to provide an appropriate service to its customers, with a consequent loss of custom.

Where a dominant network operator engages in such exclusionary conduct, the network effects will be all the more serious for the second network operator, as a much larger and more widespread network will naturally be more attractive to customers than an a smaller, more restricted network. Moreover, commercial imperatives will not necessarily always be sufficient to ensure that a large or dominant network will be willing to allow another network to interconnect with it. The potential for unusually serious detriment to flow from network effects in the telecommunications industry means that special regulatory attention needs to be paid to telecommunications, in possible contrast with some other networked industries.

The second distinguishing characteristic of telecommunications is the existence of a large single participant that is both vertically integrated and able to control important inputs of its competitors (most particularly, access to the Customer Access Network). The structure of the telecommunications industry thus means that the unilateral conduct of the dominant firm could have a significant effect on overall competition in the market.

It is true, as some other submissions point out, that telecommunications is not unique in exhibiting network effects: railways, water, gas and other utilities can also exhibit them. It is rather the potential for network effects to have such a detrimental effect on competition in the telecommunications market, coupled with a high degree of market power possessed by one firm,

that justifies the existence of an effects test. Rather than remove industry-specific regulation for telecommunications, it may prove appropriate for there to be specific regimes that regulate other network industries, such as gas and electricity.[4]

Accordingly, we argue that the rationale for the Competition Rule is strong and will remain so at least until competition matures in the telecommunications industry. While we argue that there will remain a need for a Competition Rule for the foreseeable future, we acknowledge the Commission's concerns as to the complexity, cost and tardiness of the means by which the Competition Rule is enforced. We believe that these aspects need to be addressed.

4. Need to Address Inefficiencies of Part XIB

While submissions have often been sharply divided as to the need for a Competition Rule, nearly all were in accord as to the procedural delays and complexities currently involved in its enforcement. It is true that Competition Notices have been issued in relation to just two (albeit major) matters. Other investigations have either resulted in a finding that no breach had occurred, that the evidence was insufficient, or that commercial negotiation was a preferable alternative to the exercise of the enforcement procedures in Part XIB.

Notwithstanding the complexities involved in Part XIB, we would argue that the deterrent effect of Part XIB *against anti-competitive conduct* has been significant, and we would not dismiss it as quickly as the Commission appears to have done. At the same time, we would argue that there has been no deterrent effect *on investment* since Part XIB was introduced. We agree with other submissions that the level of Telstra's investment over the past four years has been considerable and shows no evidence that Telstra has been discouraged from investing by the Part XIB competitive safeguards. We also note that other carriers and industry participants have pursued aggressive investment strategies of their own. This suggests that, if anything, the deterrent against anti-competitive conduct has been positive in *promoting* overall levels of investment in industry. It is acknowledged that a concept as nebulous as deterrence against unlawful conduct cannot be readily quantified, but the effect of providing for significant penalties for statutory breaches is undeniable. We note further that the Commission generally acknowledges the need for at least some major aspects of industry-specific regulation to continue and for competition to continue to be fostered.

In light of such a conclusion, we would argue that, at the very least, the Competition Rule and Competition Notice provisions should continue for the foreseeable future (possibly at least two to three years) pending a further review. ATUG believes that there is little or no evidence to suggest that this is likely to cause significant detriment to investment. However, we believe that their premature repeal could pose serious risks to industry development at a time when it is widely acknowledged that competition needs to develop further.

5. Need for Objects Clause

We would recommend a legislative amendment to the effect that the paramount objective of the Part XIB competitive safeguards (ie. Divisions 2 and 3) is the prevention of anti-competitive conduct and the prompt cessation of such conduct if and when it does occur. We note that the Commission has criticised the absence of an objects clause in Part IIIA of the TPA and the nature

[4] We note that, in fact, there is already industry-specific regulation for gas and electricity in the form of the National Third Party Access Code for Natural Gas Pipelines and the National Electricity Code respectively. However, these regimes are confined to ensuring third party access, rather than the promotion and protection of competition as such.

of the objects clause in Part XIC. It would be consistent with these criticisms for a clear objects clause to be inserted into the competitive safeguards of Part XIB.

Such a clause could read:

Section 151AIA [ie. a new section]

"(1) The object of Divisions 2 and 3 [ie. the competitive safeguards provisions] is the protection and promotion of competition in telecommunications markets through speedy, fair and effective use of the safeguards set out these Divisions.

(2) The focus of Divisions 2 and 3 is, wherever possible, the prevention of anti-competitive conduct commencing or continuing.

(3) Subsection (2) does not prevent the ACCC issuing a Competition Notice, or the ACCC or a private party instituting proceedings, for a contravention of Division 2 or 3."

6. Shift Emphasis of Part XIB from Penalties to Prevention

The Commission noted the pecuniary penalties that are available for a proved breach of the Competition Rule. It should be noted that these penalties are *maxima*.[5] The Federal Court has broad discretion when imposing penalties and, in practice, actual penalties are usually considerably less than those provided for by statute. The Federal Court will take into account a range of factors when assessing a pecuniary penalty, including the nature and extent of the contravention, the amount of loss or damage caused, the deliberateness of the contravention, and a number of other factors.[6] Indeed, the pecuniary penalties imposed for anti-competitive conduct can sometimes be small compared with the maximum available.

At the same time, we can understand the Commission's concerns that the threat of a large pecuniary penalty under Part XIB could make a respondent unwilling to challenge possible regulatory overreach in the Courts. While the risk of regulatory overreach may exist, we would argue that it is not as great as the Commission seems to conclude. Furthermore, a graded scale of pecuniary penalties is preferable to the draconian pre-1997 option of withdrawal of licence. We would argue that, rather than scrapping the pecuniary penalties as such, there should be more emphasis on the correction and prevention of anti-competitive conduct in the first place.

There already exists the power of the ACCC or private parties to seek injunctions under Part XIB, without a Competition Notice being in effect. (The granting of an injunction is the only redress under the competition safeguards in Part XIB that can be obtained without a Competition Notice being in effect.) However, an injunction is a discretionary remedy and still needs to fulfil a fairly high threshold of proof, and there is the inhibiting prospect for a complainant of an undertaking as to damages.

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[5] Subsection 76(1) of the TPA states that pecuniary penalty for a breach of Part IV "is not to exceed" $10,000,000.

[6] The best authority for factors to be addressed is *Trade Practices Commission v CSR Ltd* (1991) ATPR 41-076 at 52,152.

7. More Constructive Use of Advisory Notices

Section 151AQB allows the ACCC to issue an Advisory Notice when a Part A Competition Notice is in force. It is not binding, but is merely of an advisory character. It can stipulate the kinds of actions that the recipient should take to avoid breaching the Competition Rule.

Section 151AQB should be amended to allow an Advisory Notice to be issued at any time, whether or not a Competition Notice is in force. The Advisory Notice would act as a cautionary notice and remain non-binding on the recipient, but there should be a new requirement that the recipient would not be liable for any pecuniary penalties or damages under Part XIB, in relation to the matters identified in the Advisory Notice, for a short "grace period" (say 28 days) from the date of issue of the Advisory Notice. The existence of an Advisory Notice would not, however, prevent the ACCC or a private party from seeking an injunction under Part XIB. (An injunction would not involve any damages or pecuniary penalty being awarded against the respondent.) The Advisory Notice would not affect a Competition Notice that was already in force.

After the grace period ended, however, the ACCC and private parties would be able to commence litigation or issue a Competition Notice (in the ACCC's case) but would only be able to seek damages for the period commencing immediately after the end of the grace period. The existence of an Advisory Notice would not prevent the ACCC or another party commencing legal action under another Part of the TPA or another law.

The benefit of the proposed approach would be that the emphasis would initially be on rectification or avoidance of breaches, rather than on expensive litigation and the risk of hefty penalties. This would go some way to addressing the Commission's concerns about cost and regulatory error.

In addition, a change to the use of Advisory Notices would not make Part XIB more complex than it is already. Rather, it would involve a more effective, less punitive use of current mechanisms in Part XIB.

Experience of the Competition Notice regime suggests that an emphasis on *preventing* anti-competitive behaviour would be both possible and desirable. In the Internet peering matter, Telstra promptly signed peering agreements with other Internet Access Providers when the Competition Notice was issued. The Notice was subsequently withdrawn and no litigation was commenced. While it is clear that the risk of penalties influenced Telstra's behaviour, the issue of the Competition Notice enabled Telstra to identify and correct the conduct that was allegedly in breach of Part XIB. The benefit of the proposed "preventive" or cautionary approach, through the issue an Advisory Notice, would be that the alleged contravener would not only be given warning of the alleged breach, but also an opportunity to correct the conduct before any risk of penalties arose. The emphasis of Part XIB would shift from enforcement itself to the *prevention* of anti-competitive conduct.

8. Allow Private Parties to Sue Under Part XIB – but Keep ACCC Role

Another method for reducing the risk of regulatory error would be to allow private parties to sue under Part XIB for *any* breach of the competitive safeguards without a Competition Notice being in force. This would reduce the burden of investigation and enforcement which the ACCC currently exclusively bears. Furthermore, it would address Telstra's and other parties' concerns about the absence of risk for those who initiate complaints under Part XIB. If private parties' complaints were not accepted by the ACCC, or the private party did not want ACCC involvement, it could fund and pursue its own case. This would eliminate the risk of regulatory error in such cases and place a greater onus on private parties to accept the risks involved in litigation. This procedure would not exclude the ACCC – the ACCC would maintain its current role – rather it

would be supplementary to it. Naturally, a private party should only be entitled to damages, and no pecuniary penalty should be imposed. (The imposition of pecuniary penalties should only be possible when the ACCC brings the action.) The Competition Notice mechanism should be retained, for sole use by the ACCC, to deal with cases where a pecuniary penalty is appropriate.

9. Amendments to Part XIC to Reduce Reliance on Part XIB

A large number of submitters, including ATUG, have suggested improvements to Part XIC arbitrative processes. We are pleased that the Commission appears to be inclined to accept them. A revised Part XIC can provide a avenue by which disputes involving alleged anti-competitive conduct and declared services are less likely to be handled under Part XIB. (Obviously, Part XIC does not apply to undeclared services.) We believe that there is a particular need to allow multi-lateral arbitrations to ensure that problems that are common to more than one carrier can be heard in a single forum and be adjudicated in a consistent way.

As suggested by the Productivity Commission, there should be a clarification in Part XIC that evidence and information obtained in one context (eg. an undertaking assessment) can be used in another Part XIC context (eg. an arbitration).

There is also a need for it to be possible to make final determinations effective from the date of first *supply*, rather than the date of notification (as is currently the case). This would require an amendment to subsection 152DNA(2). The earliest specified date that could be referred to in a final determination would need to be the date of "first supply" of the declared service or services that is, or are, subject to the notification. This would ensure that there would be less pressure on complainants to notify early. Naturally, these changes would only apply to *declared*, rather than undeclared services. However, these changes would assist in directing more disputes to the less confrontational and non-punitive mechanisms of Part XIC.

10. Exemption Orders

The availability of exemption orders (under section 151AS) appears to have been overlooked by industry. No applications for exemption orders have been made. This is a little surprising given the significant benefits that an exemption order could have for a firm that wishes to ensure that proposed conduct does not breach the Competition Rule. Nonetheless, the fact that exemption orders are available should modify any assessment by the Commission that Part XIB is too burdensome on a particular competitor, as it contains a clear procedure for avoiding the application of the Part XIB competitive safeguards where that is in the public interest. The exemption order application process is similar to the one set out in Part VII of the TPA for authorisation and should not pose any novel obstacles to industry participants.

The exemption order process is currently not discussed in great detail in ACCC publications (eg. its guide on *Anti-competitive Conduct in Telecommunications Markets* (August 1999). It would be positive if the ACCC were to more widely publicise the availability of exemption orders, as there is currently a low level of awareness of them. There should be a requirement introduced into section 151AS that the ACCC be required to issue a binding guideline on what factors and circumstances it will consider when assessing applications for exemption orders and what procedure will be followed. (A similar requirement in regard to Competition Notices already exists under section 151AP.)

11. Conclusion

We recommend that Part XIB competition safeguards be retained. They are an important "safety net" that allow serious anti-competitive conduct in the telecommunications market to be addressed in way not permitted by Part IV.

At the same time, there is a need for amendment to Part XIB to ensure that it works more effectively and efficiently. There should be an emphasis on prevention and correction of anti-competitive conduct rather than merely on the imposition of large penalties as such. This could be achieved through the wider use of Advisory Notices as a prelude to any use of Competition Notices, with the result that penalties could not be imposed during the grace period (however long it may be) in which the carrier attempted to correct the anti-competitive conduct.

The ACCC's role should be maintained, but private parties should be able to take legal action under Part XIB in their own capacity. This would ensure that private litigants would assume their own risks, and the risk of regulatory error would be reduced, assuming that the ACCC did not become involved. In clearer cases of anti-competitive conduct, the ACCC would presumably accept the burdens of litigation and accept responsibility for initiating the complaint. (The right of private and public parties to litigate under Part IV demonstrates that a "dual avenue" approach of this kind would be workable.)

Finally, there already exists provision in Part XIB for exemption orders. These would allow carriers to seek "clearance" of their activities that risked being anti-competitive, provided that net public benefit was demonstrated. The ACCC should be required to issue binding guidelines on the granting of exemption orders.

We hope that these comments are useful for the Commission's deliberations. Please contact us if you would like to us to provide further commentary.

Australian Telecommunication Users' Group

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