TELSTRA CORPORATION LIMITED

Submission to Treasury in response to misuse of market power discussion paper

12 February 2016

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EXECUTIVE SUMMARY

Telstra supports Option A of the 'Options to strengthen the misuse of market power law', Discussion Paper, December 2015 – *Make no amendment to the current provision*. Telstra's comments below are based on its unique experience being subject to both a 'purpose' and 'effects' test in s.46 and Part XIB of the *Competition and Consumer Act 2010* (**CCA**).

Telstra believes any changes to the legislative framework should adhere to principles of best practice regulation. It is Telstra's view that the proposed amendments do not adhere to these principles as there does not appear to be a clear articulation of the problem with s.46 or evidence that the law is failing to capture anti-competitive conduct. All options discussed in the Discussion Paper, with the exception of Option A, remove the 'take advantage' test and risk over-capturing pro-competitive conduct, increasing regulatory uncertainty contrary to the original intent of the Harper Review. Without a clear articulation of the problem with s.46 and detailed cost-benefit analysis, any change to s.46 is likely to do more harm than good.

Telstra's experience with the 'effects' test under Part XIB of the CCA indicates the proposed changes could harm competition to the detriment of consumers. While the 'effects' test can cause much uncertainty and reduce a firms' ability to be agile and respond to market changes, the 'take advantage' test in the current law has provided a relatively more certain way of determining which conduct requires minimal or no further assessment as to whether it is helpful or harmful to competition.[1] This allows a firm to minimise or avoid embarking on a costly and complex assessment of the likely 'effect' on competition of its conduct in circumstances where they are comfortable they are engaging in conduct they could have engaged in absent any alleged market power. Without the 'take advantage' test, s.46 will over capture benign and competitive conduct, requiring firms to make complex competition assessments on a daily basis, increasing regulatory uncertainty.

Under the proposed 'effects' test, the lawfulness of conduct, where it may be considered a use of market power, would be assessed according to the effect, or likely effect, on competition in a relevant market even where that conduct does not have an anti-competitive purpose and the effects are not foreseeable. Assessing conduct according to the 'effects' test would be time consuming and costly, and would need to be carried out on everyday business decisions because s.46 captures unilateral (as opposed to, joint) conduct. Given the likelihood of impacts in the market is dependent upon a number of choices and decisions outside of any one firm's control, any such compliance assessment is necessarily uncertain. This would result in slowing down firms' decision making processes, reducing flexibility, and firms being slower to respond to competitive changes in the market.

High levels of regulatory uncertainty will cause firms to adopt low risk strategies, reducing pro-competitive conduct in markets. This will inevitably have a detrimental impact on consumers and the economy more broadly because a reduction in competitive conduct and innovation will prevent the benefits of competition and technological advances flowing to consumers, with flow-on effects on investment, employment and national productivity. This is inconsistent with the aims of best practice regulation and the country's longer term economic goals, and should be avoided.

[1] Note: this does not necessarily involve assessing whether small firms could undertake the same conduct as a firm with market power, instead, it typically involves assessing whether the conduct is rational without the source of market power.

01 Introduction

Telstra welcomes the Government's consultation on 'Options to strengthen the misuse of market power law'. We are grateful for the opportunity to provide our views on this issue which is of great importance to ensure Australia's international competitiveness and to further the country's innovation and investment agenda.

Competition in markets is key to improving the economic welfare of Australians. In the telecommunications market, competition has spurred Telstra to invest billions of dollars in its network and encourages continued innovation to provide customers with high quality services that meet their needs. Telstra supports regulation that is pro-competitive and promotes investment, increases productivity and boosts Australia's international competitiveness.

02 Changes to the legislative framework should adhere to principles of best practice regulation

As a general statement, any changes to the legislative framework should adhere to principles of best practice regulation. This would dictate that any problems with the law are clearly defined including evidence of how and why it is failing. Once the problem has been clearly defined, the most appropriate solution should represent the least costly and most efficient means of achieving a beneficial outcome, and minimise any unintended consequences. To ensure this is achieved, changes to the legislative framework should be informed by detailed cost-benefit analysis.

In Telstra's view, there does not appear to be a clear articulation of the problem with s.46. In our experience, the law is fit for purpose, certain and well understood and there is no evidence that the section is failing to capture anti-competitive conduct that is not adequately caught by other sections of the CCA. For example, the ACCC has brought twice as many cases as the U.S. Department of Justice has brought monopolisation cases over the past 25 years. Of these the ACCC has won almost two thirds of s.46 cases it has run and where it has failed it has often prevailed on other sections of the CCA. As the Harper Report pointed out, of the 11 prior reviews of s.46 only one recommended an 'effects' test. None of these reviews recommended removing the 'take advantage' element.

Without a clear articulation of the problem, and consistent with best practice regulation, Telstra supports Option A in the discussion paper – make no amendment to the current provision. Telstra has not provided detailed commentary on the other options set out in the discussion paper, which Telstra does not support, as all of these options remove the 'take advantage' element which Telstra considers essential to minimise regulatory uncertainty. We do, however, set out a brief summary of our view on the elements of s.46 in **Annexure A**. The remainder of this submission focuses on Telstra's unique experience being subject to both a 'purpose' and 'effects' test, and our view on the likely detrimental impacts of any change to the law based on this experience.

03 Telstra's experience with the 'effects' test indicates the proposed changes will harm competition to the detriment of consumers

Telstra is in a unique position to comment on the proposed changes to the law as Telstra is subject to both a 'purpose' and 'effects' test in s.46 and Part XIB of the *Competition and Consumer Act 2010* (**CCA**).

From Telstra's experience living with both tests its view is that the proposed amendments would blur the line between conduct which harms competition and that which benefits it. This would have the

unintended consequence of increasing uncertainty for businesses, harming competition and reducing innovation and investment in Australian markets.

3.1. While the 'effects' test is uncertain, the 'take advantage' test has provided a more certain means in many cases as to whether Telstra's conduct is lawful

While operating under an 'effects' test can cause much uncertainty and reduce a firm's ability to be agile and respond to market changes, in practice Telstra has been able to include in its assessment of its conduct the 'take advantage' test which provides a relatively more certain means of assessing whether conduct is lawful. Generally, the 'take advantage' test ensures a firm with alleged market power is not prevented from competing in the same way as a firm without market power might, in the same market context.

A common example is the *Melway* case[2] in which a street directory publisher was found not to have taken advantage of its market power because its exclusive distribution arrangement was preventing intra-brand competition which can actually help rather than harm competition. Importantly, the High Court found Melway could have maintained an exclusive distribution arrangement absent any market power, and in fact did so before it could be said to have such power.

The 'take advantage' test allows Telstra to make a reasonably certain assessment of whether it is able to engage in the conduct because of any alleged market power or whether it is simply engaging in competition on the merits. This allows Telstra to gain greater certainty about the risks associated with its conduct than relying solely on a complex assessment of the likely "effect" on competition of its conduct. For example, Telstra generally believes it is able to match competitors' prices or offer short term promotions such as a 6 month free Apple Music subscription because its competitors can do the same. That is, Telstra is not able to offer this to its customers only as a result of some alleged market power.

As the High Court said in Queensland Wire:

> *"Competition by its very nature is deliberate and ruthless. Competitors jockey for sales, the more effective competitors injuring the less effective by taking sales away. Competitors almost always try to "injure" each other in this way. This competition has never been a tort ... and these injuries are the inevitable consequence of the competition s.46 is designed to foster."*[3]

If Telstra were to engage in pro-competitive conduct that harmed a less effective competitor causing it to exit the market, Telstra would need to have confidence that it is not breaching the law by 'taking advantage' of any alleged market power but rather competing on the merits. Without this test regulatory uncertainty would increase significantly for Telstra, slowing its decision making to the detriment of the competitive process and therefore the welfare of consumers.

Because of this uncertainty, in Telstra's experience the 'take advantage' test is key to ensuring the law strikes the right balance between rendering anti-competitive conduct illegal without inadvertently capturing pro-competitive conduct. Any changes to the law risks disrupting this balance and disproportionately capturing pro-competitive conduct significantly increasing regulatory uncertainty and discouraging firms from engaging in pro-competitive conduct.

3.2. The 'effects' test has created uncertainty for Telstra and impacts its ability to be agile in the market

The 'effects' test is complex and difficult to analyse with any assessment of likely impact necessarily uncertain and therefore unhelpful to assess the legality of Telstra's conduct. In Part XIB of the CCA, the legality of Telstra's conduct is assessed according to the effect, or likely effect, on the market even

[2] *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* (2001) 205 CLR 1.
[3] *Queensland Wire Industries v BHP* (1989) 167 CLR 177 per Mason CJ and Wilson J at [24].

where that conduct did not have an anti-competitive purpose and the effects are not foreseeable. In practical terms this means that every decision Telstra makes – unless we are confident that it does not involve a use of any alleged market power – has to be assessed to determine whether the conduct could substantially lessen competition in a relevant market. Determining whether its conduct could substantially lessen competition involves a complex analysis including of:

- the market;
- competitor positions within the market;
- the likely success of Telstra's conduct;
- likely competitive responses to Telstra's conduct; and
- how each likely scenario may impact competition in the market.

Which scenarios are likely or unlikely is dependent upon a number of choices and decisions outside of Telstra's control. An assessment of the likelihood of each of these elements and their effect on competition in a market is difficult and complex. Any assessment, therefore, carries a higher degree of uncertainty.

Telstra does not agree with the suggestion that the 'effect of substantially lessening competition' is a well-known test that is commonly used in the CCA and would therefore not be difficult or costly for companies to test if inserted into s.46. Our experience has shown that while this test is currently used in other sections of the CCA, with the exception of Part XIB, it is only used in sections which assess the legality of 'contracts, arrangements or understandings' made between competitors or likely competitors, or suppliers or customers. Entering into these contracts, arrangements or understandings provides a trigger for Telstra and other firms to make such assessments of the legality of their conduct.

On the other hand, the 'effects' test in Part XIB relates to Telstra's unilateral conduct. This means the trigger for Telstra to make an assessment of whether its conduct has an effect on competition is any decision made by Telstra that could impact the market, unless it clearly does not involve a use of any alleged market power. In practical terms this means that every business decision made by Telstra such as decisions on prices, discounts, optional bundles, distributor rebates, distribution channels, sales incentives, investment in capacity, new product features, innovations etc. are potentially caught by this law and so may need to be assessed.

3.3. Inserting the 'effects' test and removing the 'take advantage' test will introduce complexity and uncertainty into the law impacting competition to the detriment of consumers.

Regulatory uncertainty causes firms to operate with substantially higher legal risk which will cause firms to adopt low risk strategies reducing pro-competitive conduct in markets. Best practice regulation aims to provide regulatory certainty and predictability to allow firms to make decisions with relative certainty that their conduct complies with the law. Without this regulatory certainty firms may opt to adopt low-risk strategies to reduce the possibility of defending costly regulatory actions and the need to manage any resulting reputational damage. This would have a detrimental impact on competition across the economy as companies competing less vigorously will innovate less and negatively impact advances in technology. This is because the proposed inclusion of the 'effects' test and removal of the 'take advantage' test would expand the scope of the law so wide as to capture the release of new innovative products or a company entering new markets.

A reduction in competition, innovation and technological advances will stifle investment, employment and productivity which ultimately will have a detrimental impact on consumers. Harper's objective was to identify reforms that will reinvigorate competition, help raise Australia's productivity levels and living standards, and meet the economic challenges and opportunities in the decades ahead. Telstra does not believe the proposed amendments to s.46 will achieve this objective. Without a clear articulation of the

problem with s.46 or a detailed cost benefit analysis of the options, Telstra believes any change to the law risks doing more harm than good.

Attachment A: Summary of Telstra's views on the elements of s.46

Element	Telstra's view
Take advantage	The 'take advantage' element is essential to retain as it provides the causal connection between the conduct and a firm's market power. Without it s.46 renders illegal any conduct by a firm – large or small – with market power, which harms competition. This occurs on a daily basis by firms investing, innovating and competing to win business and should not be illegal unless a firm is misusing its market power with an anti-competitive purpose. Further, removal of this element would put Australia out-of-step with international jurisdictions in which a causal connection is considered an essential element.
Purpose or effect (or likely effect)	A purpose only test should be retained. Prohibiting conduct on the basis of effect alone would punish inadvertent and unforeseen consequences, and put legitimate competitive conduct at risk. If 'effect' is inserted, in order to be in line with overseas jurisdictions the 'effects' test should be an additional test to purpose (i.e. purpose and effect), not an alternative test (i.e. purpose or effect).
Substantially lessening competition	The 'substantially lessening competition' test is broad and difficult, time-consuming and expensive to apply to unilateral behaviour and will not provide a clear guide to business about the likely effects of its actions. In comparison, prohibited exclusionary conduct in the current section provides a clear guide to business about prohibited exclusionary behaviour. We recommend the current forms of exclusionary conduct be retained as the law interpreting these provisions is well-established and rewording the forms of exclusionary conduct will only increase uncertainty.
Mandatory factors	The mandatory factors the court must take into account may be useful but are insufficient to prevent over capture of pro-competitive conduct in the face of other proposed changes, particularly the removal of the 'take advantage' test.
Authorisations	While we do not object to the use of authorisations, we query whether authorisation for such conduct is practical given the need for businesses to be agile in order to respond to competition and changes in the market. This will not reduce uncertainty and will not alleviate the lessening of competition that the proposed amendments will effect.