

**Anti-competitive conduct in
telecommunications markets —**

An information paper

August 1999



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Important notice

Please note that these guidelines are a summary designed to give you the basic information you need. They do not cover the whole of the Trade Practices Act and are not a substitute for professional advice.

Moreover, because they avoid legal language wherever possible there may be some generalisations about the application of the Act. Some of the provisions referred to have exceptions or important qualifications. In most cases the particular circumstances of the conduct need to be taken into account when determining the application of the Act to that conduct.

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Chapter 1. Introduction

A telecommunications carrier or a carriage service provider must not engage in anti-competitive conduct. This prohibition is known as the competition rule.

This revised information paper discusses issues relating to the operation of the competition rule and the competition notice regime set out in Part XIB of the *Trade Practices Act 1974*. In particular, it sets out the approach the Commission will take when considering whether a carrier or carriage service provider has engaged, or is engaging in, anti-competitive conduct. The paper replaces one issued on 19 May 1997.

Together with the *Telecommunications Act 1997*, the Commission administers, among other things:

- legislation regulating anti-competitive conduct in telecommunications markets (Part XIB of the Act);
- legislation regulating international telecommunications operators¹ engaging in ‘unacceptable conduct’ (the use of market power or of any legal rights or legal status, or engaging in any other conduct, in a manner that is, or is likely to be, contrary to Australia’s national interest — Division 3 of Part 20 of the Telecommunications Act);² and
- a telecommunications access regime (Part XIC of the Act).

This regime applies in addition to Part IV of the Act, which contains the general anti-competitive conduct provisions.

An important part of the regulation of anti-competitive conduct in telecommunications markets is the competition notice regime, which facilitates the Commission’s ability to respond expeditiously to anti-competitive conduct. Under Part XIB, the Commission can issue competition notices (Part A and Part B competition notices) and advisory notices.

Under Part XIB, as well as being able to seek an injunction to stop or prevent anti-competitive conduct by a carrier or carriage service provider, the Commission may issue a Part A competition notice stating that a carrier or carriage service provider has engaged, or is engaging:

- in a specified instance of anti-competitive conduct; or
- in at least one instance of anti-competitive conduct of a kind described in the notice.

1 International telecommunications are operators that provide carriage services from overseas that may originate, terminate or pass through Australia, the supply of goods or services for use in connection with the provision of such carriage services, or the installation, maintenance, operation or provision of access to a telecommunications network or facility where the network or facility is used to provide such a carriage service: s. 367(6) of the Telecommunications Act.

2 Section 367(1) of the Telecommunications Act.

The Commission must have a reason to believe, formed in good faith and on reasonable grounds, that the recipient of the notice has engaged in such conduct prior to issuing a Part A competition notice.

After the Commission has issued a Part A competition notice, and until that notice expires, it may seek and recover pecuniary penalties or ancillary orders and a third party may seek damages or ancillary orders in relation to anti-competitive conduct that falls within the scope of the notice. The Commission and private persons may seek injunctive relief at any stage, irrespective of the issue of a Part A competition notice.

The Commission may issue a Part B competition notice relating to a particular contravention if the Commission has a reason to believe that the carrier or carriage service provider concerned has committed, or is committing, the contravention. In proceedings arising out of Part XIB of the Act, the particulars in a Part B competition notice are *prima facie* evidence of the matters in the notice.

After issuing a Part A competition notice, the Commission may issue an advisory notice that advises the recipient of the Part A notice of the action it should take, or consider taking, in order to ensure that it does not engage, or continue to engage, in the kind of conduct dealt with in the Part A competition notice.

Upon application by a party, the Commission may grant an order exempting certain conduct by a carrier or carriage service provider from the scope of the definition of anti-competitive conduct.

This paper provides carriers and carriage service providers as well as other industry stakeholders (including end-users) with an overview of the relevant legal and economic concepts and issues relating to the operation of the competition rule. Since it covers a variety of issues, not every part of the discussion will be relevant to every form of alleged anti-competitive conduct. Further information papers on the Commission's role in the industry and/or revisions of this paper may be published in the future.

The Commission seeks by this and future papers to inform participants in telecommunications markets about:

- procedures it will follow when investigating possible anti-competitive conduct and the timeframes it will endeavour to meet in undertaking each phase of the investigation; and
- matters it will consider in determining whether, in its view, a carrier or carriage service provider has engaged in anti-competitive conduct.

In forming a view as to whether a carrier or carriage service provider has engaged in anti-competitive conduct, the Commission will be guided by established legal precedents and judicial interpretation of the Act. In addition, it recognises that telecommunications markets are undergoing rapid growth and telecommunications products are undergoing rapid technological change. Each instance of conduct that potentially may be anti-competitive will therefore need to be considered on the particular circumstances.

Further, this paper does not set out exhaustively the ways in which the Commission will determine whether conduct is anti-competitive. In some cases, the individual circumstances of a case will require the Commission to diverge from some of the methods and approaches set out here.

In contrast, the Act requires the Commission to formulate written guidelines to which it must have regard in deciding whether to issue a competition notice. Written guidelines were initially issued by the Commission on 27 June 1997, and revised *Competition Notice Guidelines* are to be issued with this information paper.

This paper is not intended to supplement or expand on the matters set out in the guidelines in any way. However, it does explain the role of the guidelines in the process of issuing competition notices.

It also sets out the general process the Commission will follow when undertaking a telecommunications anti-competitive conduct investigation. The Commission will act quickly to determine whether or not to issue a competition notice after becoming aware of potential anti-competitive conduct, and it has publicly released indicative timeframes on the time within which it will endeavour to complete the various phases of an investigation. An important element of the indicative timeframes is that procedures are established whereby the Commission will inform complainants and interested parties of the progress of investigations. The indicative timeframes for telecommunications anti-competitive conduct investigations are set out in this paper.

Chapter 2. The Trade Practices Act

The Minister for Communications and the Arts (as he was then), in the Second Reading Speech for the *Trade Practices Amendment (Telecommunications) Bill 1996*, stated that the 1997 changes to telecommunications regulation brought the regulation of competition in telecommunications markets more closely into line with general trade practices law. He observed that there is:

scope for incumbent operators generally to engage in anti-competitive conduct because competitors in downstream markets depend on access to the carriage services controlled by them ... Total reliance on Part IV (of the Act) to constrain anti-competitive conduct might, in some cases, prove ineffective given the still developing state of competition in the telecommunications industry.³

Accordingly, Part XIB of the Act contains additional protection for the competitive process in telecommunications markets, building on existing provisions in Part IV. The general approach is consistent with the signing of the Conduct Code Agreement by the Council of Australian Governments (COAG), where it was agreed to expose previously exempted industries and trading bodies to general competition law. It would be inconsistent with this approach for the Commonwealth to isolate a significant part of the Australian economy from the rules that are to be applied to the rest of the economy. The same applies in a general sense to the manner in which the Commission will administer the competition rule in telecommunications markets. Since its introduction, the Act has had a profound effect on business behaviour in many sectors of the economy, with resulting benefits to business and consumer welfare. The Commission (including within this term the Trade Practices Commission) has played a leading role in the changing environment through its program of fostering compliance, disseminating information and enforcing the Act.

In addition to consulting publications specific to telecommunications markets (such as this paper), those seeking guidance on how the Commission will administer the telecommunications regulatory scheme should consider what the Commission has done and said in the past when applying Part XIB and (for the reasons above) the general competition law provisions. Moreover, consideration should also be given to the decisions of relevant courts and tribunals. The ultimate decision-makers in relation to the telecommunications rules is the courts, and in some cases the Commission's actions may also be reviewable by the Australian Competition Tribunal. In deciding how best to enforce the competition rule, the Commission will continue to apply the construction given by the court to general competition law concepts of market definition, market power and substantial lessening of competition.

The Commission notes that there are rights of private action under Part XIB, as well as under the existing general competition law provisions (under Part VI of the Act). While the Commission will promote compliance and bring actions against anti-competitive conduct where appropriate, private persons can, and should in certain circumstances, consider bringing their own actions for injunctive relief, damages or other orders.

³ Second Reading Speech to the Trade Practices Amendment (Telecommunications) Bill 1996, at p. 2.

Chapter 3. The competition notice regime

This chapter outlines the key concepts of the competition notice regime and briefly discusses its relationship to other Parts of the Act. The key concepts of the competition notice regime are:

- the competition rule;
- anti-competitive conduct;
- competition notices; and
- exemption orders.

The competition rule

Part XIB contains the competition rule, which provides that carriers and carriage service providers must not engage in anti-competitive conduct.⁴

Anti-competitive conduct

Anti-competitive conduct is defined under s. 151AJ of the Act. That section sets out the two circumstances under which a carrier or a carriage service provider will engage in anti-competitive conduct for the purposes of Part XIB. Those two circumstances are:

- taking advantage of a substantial degree of power in a telecommunications market by a carrier or carriage service provider with the effect or likely effect of substantially lessening competition in that or any other telecommunications market;⁵ and
- engaging in conduct in contravention of ss 45, 45B, 46, 47 or 48 of the Act by a carrier or carriage service provider where that conduct relates to a telecommunications market.⁶

4 Section 151AK The competition rule

(1) A carrier or carriage service provider must not engage in anti-competitive conduct.

(2) For the purposes of this Part, the rule set out in subsection (1) is to be known as the *competition rule*.

5 Chapter 5 of this paper discusses the goods and services that fall within a ‘telecommunications market’.

6 Section 151AJ(2) A carrier or carriage service provider engages in anti-competitive conduct if the carrier or carriage service provider:

(a) has a substantial degree of power in a telecommunications market; and

(b) either:

(i) takes advantage of that power with the effect, or likely effect, of substantially lessening competition in that or in any other telecommunications market; or

(ii) takes advantage of that power, and engages in other conduct on one or more occasions, with the combined effect, or likely combined effect, of substantially lessening competition in that or any other telecommunications market.

Section 151AJ(3) A carrier or carriage service provider engages in anti-competitive conduct if the carrier or carriage service provider:

(a) engages in conduct in contravention of ss 45, 45B, 46, 47 or 48; and

(b) the conduct relates to a telecommunications market.

Under the first circumstance, a carrier or carriage service provider which has a substantial degree of power in a telecommunications market will be taken to engage in anti-competitive conduct for the purposes of Part XIB if it takes advantage of that power with the effect, or likely effect, of substantially lessening competition in a telecommunications market. Anti-competitive conduct under s. 151AJ(2) is therefore measured using an **effect** test and does not require any examination of the **purpose** of the carrier or carriage service provider engaging in the conduct.⁷

In determining whether a taking advantage of market power has the effect of substantially lessening competition, a court can assess the combined effect, or likely combined effect, of that conduct and other conduct engaged in by the carrier or carriage service provider. The other conduct may or may not itself be conduct that is a taking advantage of market power and may be conduct that is of the same, similar or a different kind.⁸

The second circumstance provides that a contravention relating to a telecommunications market of sections:

- 45 — contracts, arrangements or understandings that restrict dealings or affect competition;
- 45B — covenants affecting competition;
- 46 — misuse of market power;
- 47 — exclusive dealing; or
- 48 — resale price maintenance,

will also be a contravention of the competition rule.

Competition notices

The Government has introduced amendments to the previous competition notice regime, arising partly from concerns by the Commission that it did not facilitate prompt action.

To address these concerns, the... amendments establish a two part competition notice regime. Part A competition notices will allow the ACCC to more quickly identify conduct it considers is in contravention of the competition rule, open the gate for court action against the conduct and thereby warn the notice recipient that it considers the recipient should cease the conduct. Part B competition notices will enable the ACCC to give particulars of conduct or a defined kind of conduct under a Part A notice, enabling the ACCC to provide the detailed, particularised information required for prima facie evidence purposes for use in its own court action or court actions mounted by third parties.⁹

The Commission has a discretion to issue Part A and Part B competition notices. When exercising this discretion it must have regard to any guidelines issued pursuant to s.

7 Contrast s. 46 of the Act (misuse of market power). The 'effect' test is discussed further in Chapter 7 of this paper.

8 Section 151AJ(2)(b).

9 *Telecommunications Legislation Amendment Bill 1998*, supplementary Explanatory Memorandum, at p. 15.

151AP(2).¹⁰ The guidelines identify matters the Commission must take into account when deciding whether to issue a competition notice, although the Commission must also have regard to any other matters it considers relevant.¹¹ The guidelines are therefore not exhaustive.

Reason to believe

Before issuing a Part A competition notice that specifies an instance or describes a kind of anti-competitive conduct, or issuing a Part B competition notice relating to a particular contravention, the Commission must have a ‘reason to believe’ that the carrier or carriage service provider concerned has engaged, or is engaging, in anti-competitive conduct of that instance or kind, or has committed, or is committing, the specified contravention.¹² To satisfy the test, the Commission must have an actual belief and a proper basis in fact for that belief in that there must be reasonable grounds or cause for the belief,¹³ and the power must be exercised bona fide and honestly.¹⁴

The degree of certainty with which the contravention must be established in order to issue a competition notice is less than under the previous regime.

Part A competition notices

Proceedings for the enforcement of the competition rule, other than proceedings for injunctive relief, cannot be instituted unless the alleged conduct is of a kind dealt with in a Part A competition notice that was in force at the time the alleged conduct occurred.

10 Section 151AP guidelines:

- (1) In deciding whether to issue a competition notice, the Commission must have regard to:
 - (a) any guidelines in force under subsection (2); and
 - (b) such other matters as the Commission considers relevant.
- (2) The Commission must, by written instrument, formulate guidelines for the purposes of subsection (1).

11 Section 151AP(1)(b).

12 Sections 151AKA(7), 151AKA(8) and 151AL(3).

13 *Boucaut Bay Co Ltd (in liq) v. Commonwealth* (1927) 40 CLR 98 at p.106 per Isaacs ACJ; *WA Pines Pty Ltd v. Bannerman* (1980) 30 ALR 559 at pp. 572 & 573 per Lockhart J; *TNT Australia Pty Ltd v. Fels* (1992) ATPR 41-190 at p. 40,598 per Gummow J.

14 *Boucaut Bay Co Ltd (in liq) v. Commonwealth* (1927) 40 CLR 98 at p.101 per Starke J; *Melbourne Home of Ford Pty Ltd v. Trade Practices Commission* (1979) 36 FLR 450 at p. 457 per Smithers J and p. 479 per Franki and Northrop JJ; *WA Pines Pty Ltd v. Bannerman* (1980) 30 ALR 559 at p. 571 per Lockhart J; *TNT Australia Pty Ltd v. Fels* (1992) ATPR 41-190.

The Commission may issue a Part A competition notice where it has reason to believe that the carrier or carriage service provider concerned has engaged, or is engaging, in an instance of anti-competitive conduct or at least one instance of anti-competitive conduct of the kind described in the notice.¹⁵

A Part A competition notice provides only a ‘gatekeeper’ role to actions under the competition rule. In contrast with the previous competition notice scheme, a Part A competition notice does not include detailed particulars of the alleged contravention of the competition rule and does not constitute *prima facie* evidence of the matters in the notice. As the standard of proof for issuing, and level of detail required in, a Part A competition notice is less than under the previous regime, Part A competition notices should be issued in a shorter time frame than required previously.

There are two types of Part A competition notices which can be issued by the Commission:

- sub-section 151AKA(1) — a written notice stating that a specified carrier or carriage service provider has engaged, or is engaging, in a specified instance of anti-competitive conduct; and
- sub-section 151AKA(2) — a written notice stating that a specified carrier or carriage service provider has engaged, or is engaging, in at least one instance of anti-competitive conduct of a kind described in the notice.

In issuing a sub-s. 151AKA(2) notice, the Commission is not required to specify any particular instance of anti-competitive conduct.¹⁶ The Commission could simply specify that a specified carrier or carriage service provider has engaged, or is engaging, in a kind of anti-competitive conduct, if it has reason to believe so. The amendments to the competition notice regime will enable the Commission to issue a notice that is of a more general nature and requires less detail than under the previous competition notice scheme. It is not intended that the description of anti-competitive conduct will be finely detailed or that particulars be provided, particularly in sub-s. 151AKA(2) notices.

15 Section 151AKA Part A competition notices

- (1) The Commission may issue a written notice stating that a specified carrier or carriage service provider has engaged, or is engaging, in a specified instance of anti-competitive conduct.
- (2) The Commission may issue a written notice stating that a specified carrier or carriage service provider has engaged, or is engaging, in at least one instance of anti-competitive conduct of a kind described in the notice.
- (3) A notice under subsection (1) or (2) is to be known as a *Part A competition notice*.
- ...
- (7) The Commission may issue a Part A competition notice under subsection (1) that specifies an instance of anti-competitive conduct if the Commission has reason to believe that the carrier or carriage service provider concerned has engaged, or is engaging, in that instance of anti-competitive conduct.
- (8) The Commission may issue a Part A competition notice under subsection (2) that describes a kind of anti-competitive conduct if the Commission has reason to believe that the carrier or carriage service provider concerned has engaged, or is engaging, in at least one instance of anti-competitive conduct of that kind.

¹⁶ Section 151AKA(5).

This facilitates the Commission's ability to respond promptly to anti-competitive conduct by issuing a notice and restricts the potential for a specified carrier or carriage service provider to escape court proceedings by partially modifying its conduct so that its subsequent conduct, whilst still breaching the competition rule, is no longer strictly within the terms of the notice.¹⁷

A Part A competition notice may specify a time in the future when that notice comes into force, and/or a period during which it remains in force.¹⁸ A Part A competition notice has a maximum life of 12 months, although this does not prevent the Commission from issuing a fresh notice relating to the same matter.¹⁹

The Commission can make minor variations to a Part A competition notice.²⁰ It can also revoke a Part A competition notice.²¹ Written notice of a variation or revocation must be given to the carrier or carriage service provider concerned.²²

The effect of issuing a Part A competition notice

Before (and after) a Part A competition notice has been issued, any person (including the Commission) has standing to seek an injunction in relation to a contravention of the competition rule or related conduct.²³ This is in addition to the established powers to challenge anti-competitive conduct which is a contravention of Part IV, under Part VI of the Act.

If a Part A competition notice has been issued, and a carrier or carriage service provider subsequently contravenes the competition rule by engaging in conduct of a kind dealt with in a Part A competition notice in force at the time, the Commission may also seek:

- orders for, and commence proceedings to recover, pecuniary penalties of up to \$10 million and \$1 million per day that the conduct continues;²⁴
- orders to disclose information to the public or publish corrective advertising;²⁵ and
- other compensatory orders, including the setting aside of contracts.²⁶

17 **Section 151AKA(6)** In deciding how to describe a kind of anti-competitive conduct in a Part A competition notice under subsection (2), the Commission may have regard to:

(a) whether the carrier or carriage service provider concerned could, by varying its conduct, continue to engage in anti-competitive conduct and avoid proceedings against it under one or more provisions in Division 7; and

(b) any other matters that the Commission thinks are relevant.

18 Section 151AO.

19 *ibid.*

20 Section 151AOA(1)

21 Section 151AOB.

22 Sections 151AOA(3) and 151AOB(2).

23 Section 151CA. The Commission will generally make a decision early in the investigation whether it should seek an interim injunction.

24 Section 151BX.

25 Section 151CB.

26 Section 151CE.

In addition, once a Part A competition notice has been issued, if the carrier or carriage service provider subsequently contravenes the competition rule by engaging in conduct of a kind dealt with in a Part A competition notice in force at the time, a person who suffers loss or damage may seek:

- orders for damages for loss or damage suffered by that person as a result of the breach of the competition rule;²⁷ and
- other compensatory orders.²⁸

Part B competition notices

Part B competition notices are optional notices which the Commission can issue to facilitate the proof of a contravention of the competition rule. A Part B competition notice states that a specified carrier or carriage service provider has contravened, or is contravening, the competition rule and sets out particulars of the contravention.²⁹

Once issued, a Part B competition notice is *prima facie* evidence of the matters set out in the notice (i.e. the facts comprising the particulars of the contravention) in any proceedings under or arising out of Part XIB. It does not conclusively establish that a carrier or a carriage service provider has engaged in anti-competitive conduct, which is a matter to be determined by the court.³⁰

The Commission may issue a Part B competition notice relating to a particular contravention if it has reason to believe the particular carrier or carriage service provider has committed, or is committing, the contravention.³¹ Whilst the standard of proof for a Part B competition notice is the same as for a Part A competition notice, a Part B notice is more detailed and may therefore take more time to issue.

27 Section 151CC.

28 Section 151CE.

29 Section 151AL Part B competition notices

- (1) The Commission may issue a written notice:
 - (a) stating that a specified carrier or carriage service provider has contravened, or is contravening, the competition rule; and
 - (b) setting out particulars of that contravention.

- (2) A notice under subsection (1) is to be known as a *Part B competition notice*.

...

- (4) To avoid doubt, a Part B competition notice may be issued even if any relevant proceedings under Division 7 have been instituted.

30 Whilst the *prima facie* evidence provision will be of assistance in legal proceedings, its effect may be limited. For example, in circumstances where the Commission is seeking an interim injunction there is still the question of whether a Court will be satisfied as to the balance of convenience in restraining certain conduct. The Federal Court refused such an order in *Tytel Pty Ltd v. Telecom* (1986) ATPR 40-711 at p. 47,783 even though there was *prima facie* evidence to support an allegation of predatory pricing by Telecom.

31 **Section 151AL(3)** The Commission may issue a Part B competition notice relating to a particular contravention if the Commission has reason to believe that the carrier or carriage service provider concerned has committed, or is committing, the contravention.

The Commission can issue more than one Part B competition notice in relation to particular conduct, and can issue a Part B competition notice even after any relevant enforcement proceedings have been instituted under Division 7 of Part XIB.³² Unlike Part A notices, Part B notices are not subject to limited duration. This reflects the need for Part B competition notices to continue to have effect in any relevant court proceedings. The Commission can make variations to a Part B competition notice³³ and can revoke a Part B competition notice. A written notice of a variation or revocation must be given to the carrier or carriage service provider concerned.³⁴

Advisory notices

If a Part A competition notice is in force in relation to a carrier or carriage service provider, the Commission may issue a written advisory notice advising the recipient of the Part A notice of the action it should take, or consider taking, in order to ensure that it does not engage, or continue to engage, in the kind of conduct dealt with in the Part A notice.³⁵

An advisory notice is not legally binding. In issuing such a notice the Commission is only offering advice to the recipient on how it can change its conduct to avoid contravening the Act. However, it is open to a court to have regard to an advisory notice when determining the orders against a carrier or carriage service provider found to have contravened the Act.³⁶

The Commission will issue an advisory notice only where it is appropriate to do so. Examples of circumstances in which the Commission might not issue an advisory notice include where:

- the Commission has sufficient information to issue a competition notice but insufficient to advise actions the carrier or carriage service provider concerned of specified it should undertake to ensure it does not continue to engage in the anti-competitive conduct;

32 **Section 151AL(4)** To avoid doubt, a Part B competition notice may be issued even if any relevant proceedings under Division 7 have been instituted.

33 Section 151AOA(1).

34 Sections 151AOA(3) and 151AOB(2).

35 Section 151AQB Advisory notices

(1) This section applies if a Part A competition notice is in force in relation to a carrier or carriage service provider.

(2) The Commission may give the carrier or carriage service provider a written notice advising the carrier or carriage service provider of the action it should take, or consider taking, in order to ensure that it does not engage, or continue to engage, in the kind of conduct dealt with in the Part A competition notice.

(3) A notice under subsection (2) is an instrument of an advisory character.

(4) A notice under subsection (2) that relates to a Part A competition notice ceases to be in force if the Part A competition notice ceases to be in force.

36 *Telecommunications Legislation Amendment Bill 1998*, Supplementary Explanatory Memorandum, at p. 21.

- there may be multiple, equally valid, actions that ensure the carrier or carriage service provider concerned does not continue to engage in anti-competitive conduct, and therefore it may not be appropriate for the Commission to advise the carrier or carriage service provider to choose one over the others; and
- given the emphasis on industry self-regulation and commercially negotiated outcomes in telecommunications regulation,³⁷ the Commission may consider that, after issuing a Part A competition notice, it would be preferable to give private parties an opportunity to determine a suitable outcome to the dispute.

It may also not be necessary to issue an advisory notice where it is clear what action is required to rectify the anti-competitive conduct, from the contents of the Part A competition notice, Part B competition notice and/or the nature of the contravention.

The Commission may vary or revoke an advisory notice.³⁸ If it does so, it must give the carrier or carriage service provider concerned written notice of the variation or revocation.³⁹ The notice will cease to be in force if the Part A competition notice ceases to be in force.⁴⁰

The recipient of a Part A competition notice will be advised if the Commission does not envisage issuing an advisory notice. If the Commission does decide to issue an advisory notice, it will seek to do so as promptly as possible after issuing the Part A competition notice. This may or may not be at the same time as a Part B competition notice, although it may be possible in certain cases to issue the two simultaneously. The time between the issue of a Part A competition notice and an advisory notice will vary with the need to seek further information from the recipient or interested third parties.

Exemption orders

A carrier or carriage service provider proposing to engage in conduct which may breach the competition rule may apply to the Commission for an exemption order. Subdivision B of Division 3 of Part XIB of the Act sets out the circumstances under which a carrier or carriage service provider may be granted an exemption order. The Commission may grant an exemption order where it is satisfied that:

- the resultant public benefit outweighs any public detriment of lessened competition; or
- the conduct will not breach the competition rule.⁴¹

Conduct which is the subject of an exemption order will not be ‘anti-competitive conduct’ for the purpose of the competition rule.⁴²

³⁷ Section 4 of the Telecommunications Act.

³⁸ Section 151AQB(5).

³⁹ Sections 151AQB(6) and (7).

⁴⁰ Section 151AQB(4).

⁴¹ Section 151BC(1).

⁴² Section 151AS(1).

Relationship of Part XIB to Part XIC

Part XIC sets out an access regime for certain declared services being either carriage services or services which facilitate the supply of carriage services.

The Commission does not consider that there is any ground for dividing actions which potentially undermine the competitive process into ‘conduct’ issues (to be dealt with by Part XIB) and ‘access’ issues (to be dealt with under Part XIC). It is not relevant to the question of whether a carrier or carriage service provider has engaged in anti-competitive conduct that the conduct occurs during or in relation to the supply or acquisition of a service which also is, or is eligible to be, a declared service under Part XIC.⁴³

Under some circumstances, a competition notice may be the most effective response to anti-competitive conduct. In other situations, the operation of the access regime may be more effective. There may also be some circumstances where both a competition notice and action under Part XIC are required — for example, where the competition notice addresses the short-term anti-competitive impact of the impugned conduct, and the access regime is best equipped to determine a long-term solution.

Relationship of Part XIB to Parts IV and VII

Part VII of the Act empowers the Commission to authorise certain conduct which would otherwise be an actual or potential breach of the anti-competitive provisions in Part IV, or to accept notification of exclusive dealing conduct which may otherwise be a contravention of Part IV. A carrier or carriage service provider engaging in anti-competitive conduct which is the subject of an authorisation or notification will not contravene the competition rule.⁴⁴

The operation of Part IV, dealing with general restrictive trade practices, and Part VII, dealing with authorisations and notifications in respect of restrictive trade practices, are not affected by the provisions of Part XIB.⁴⁵ In addition, the Commission is not bound to consider an application for an exemption order where the relevant conduct is also the subject of a pending application for authorisation or notification under Part VII.⁴⁶

43 However, this distinction, and the outcomes which Part XIC may provide, could be relevant to the process of deciding whether to issue a competition notice with respect to that anti-competitive conduct.

44 Section 151AJ(7).

45 Section 151AI.

46 Sections 151AX and 151AY.

Chapter 4. ACCC investigation and decision making procedures

This Chapter discusses:

- the investigative procedures the Commission will follow to determine whether a carrier or carriage service provider has contravened the competition rule;
- the requirement to act promptly pursuant to s. 151AQ, and the Commission's indicative timeframes for anti-competitive conduct investigations;
- the information gathering methods the Commission may use in determining whether a carrier or carriage service provider has contravened the competition rule;
- procedural fairness and natural justice; and
- the role of guidelines issued pursuant to s. 151AP.

Process for responding to anti-competitive conduct

The process the Commission must go through before issuing a competition notice can be characterised in three phases:

- a **preliminary phase**, initiated after the Commission becomes aware (usually by the receipt of a complaint or allegation) of a possible contravention of the competition rule and ending with the Commission deciding whether or not it has a reason to suspect that a contravention has occurred or is occurring, and whether to proceed with the investigation. The complainant (if any) and interested parties will be informed of the Commission's decision;
- an **investigative phase**, commencing after the Commission decides it has a 'reason to suspect' a contravention of the competition rule and comprising:
 - investigation by staff of the alleged anti-competitive conduct;
 - notification of the investigation to the subject of the investigation and other interested parties;
 - where appropriate, receipt of submissions from those parties; and
 - presentation of those matters to the Commission.
- a **decision-making phase**, during which the Commission decides:
 - whether it has reason to believe, in good faith and on reasonable grounds, that the carrier or carriage service provider has engaged, or is engaging in anti-competitive conduct;

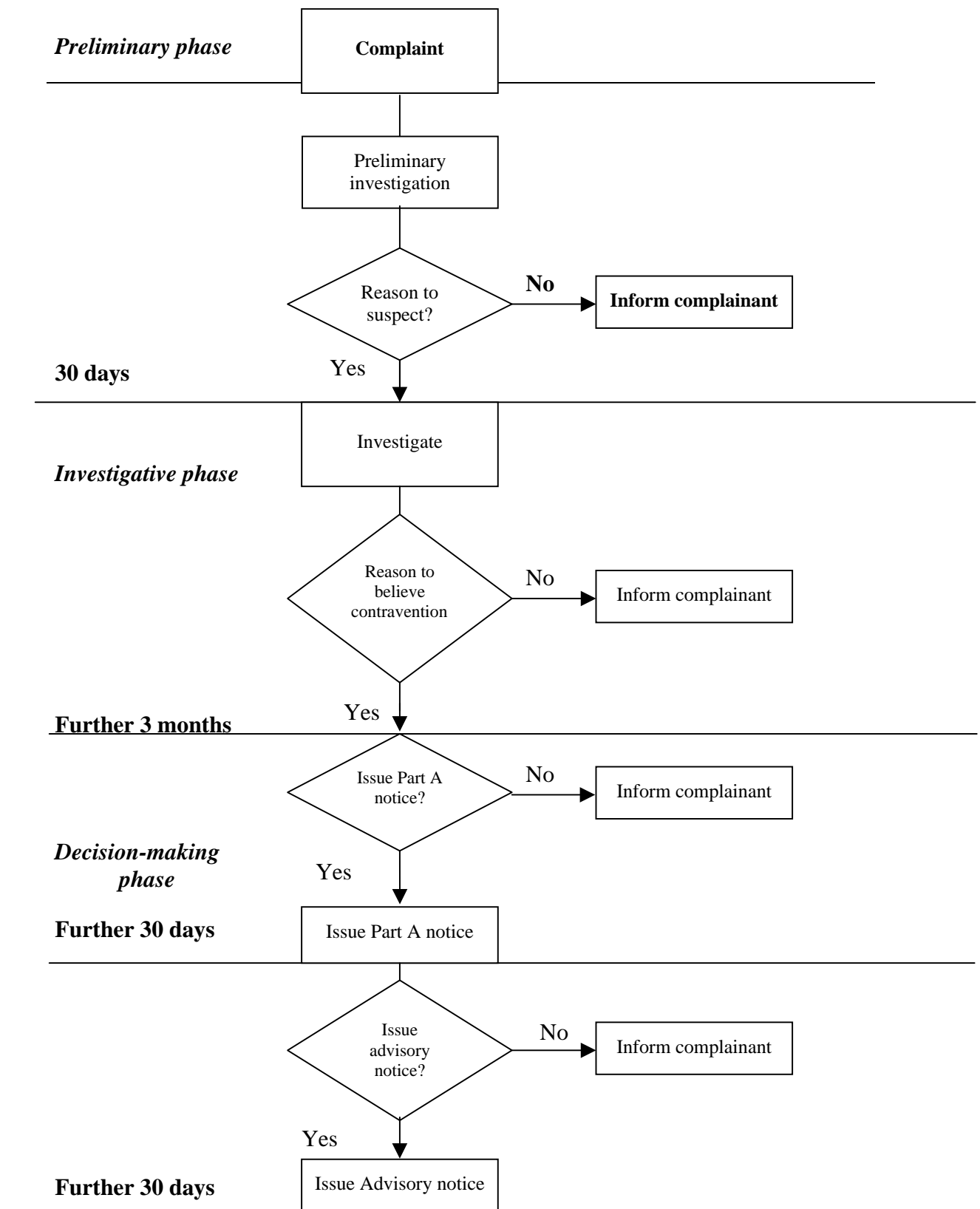
- if the answer to that question is ‘yes’, whether it should use its discretion to issue a Part A competition notice in response to that contravention of the competition rule;
- whether to issue one or more Part B competition notices; and
- if a Part A competition notice has been issued, whether to issue an advisory notice.

As noted in Chapter 3, a Part A competition notice, a Part B competition notice and an advisory notice in relation to the same conduct will not necessarily be issued simultaneously, nor will the Commission necessarily make a decision to issue a Part B or advisory notice at the same time as making a decision to issue a Part A notice.

In deciding whether to issue a competition notice, the Commission must have regard to any guidelines issued pursuant to s. 151AP of the Act, and such other it considers relevant. The Commission issued the first *Competition Notice Guideline* on 27 June 1997. The second *Competition Notice Guideline* has been issued with this information paper.

The Commission has decided to make public indicative timeframes for each phase of an anti-competitive conduct investigation. The indicative timeframes, which operate in relation to the possible issue of a Part A competition notice and advisory notice, are outlined in Diagram 1. While Part B competition notices are not expressly included in the indicative timeframes, the Commission will still seek to issue these as quickly as possible.

Diagram 1: Indicative Timeframes



Initiating investigations

The Commission may begin an investigation under a number of circumstances including:

- following a complaint by any person;
- where indicated by matters arising from an investigation of any person (including a carrier or carriage service provider) as part of the Commission's performance of its duties; or
- where the Commission obtains information by other means and that information suggests a contravention of the competition rule may have occurred, or is occurring.

An example of the second circumstance would be the Commission beginning an investigation in response to information obtained in the process of administering information gathering provisions such as tariff filing directions, record keeping rules, or the access provisions in Part XIC, or in the course of preparing competition reports under Division 12A of Part XIB. An example of the third circumstance would be the Commission beginning an investigation in response to media reports suggesting a carrier or carriage service provider was engaging in anti-competitive conduct.

Reason to suspect

When a person has complained about particular conduct, the Commission's aim is to determine whether it has a reason to suspect that there is a contravention of the Act, and whether it should proceed with the complaint, within 30 days of the initial complaint. The Commission may not proceed with a complaint, even where it has a reason to suspect there is a contravention of the competition rule, if the matter is not of sufficient priority having regard to the costs of proceeding with the investigation. The Commission gives priority to matters where:

- there appears to be blatant disregard for the law;
- the matter particularly affects disadvantaged consumers;
- there appears to be substantial damage to competition;
- there is significant public detriment;
- successful enforcement, by litigation or other means, would have a significant deterrent or educational effect; or
- an important new issue is involved, for example arising from economic or technological change.

The Commission may also decide not to investigate a matter further, despite having a reason to suspect there is a contravention of the competition rule, if it considers that the matter is properly left (at least initially) to private negotiation by the parties involved.

The Commission considers that it would have a reason to suspect and therefore be required to act promptly, where it has a degree of satisfaction, not necessarily amounting to a belief but extending beyond speculation, that a carrier or carriage service provider has contravened, or is contravening, the competition rule.⁴⁷ This will involve the Commission reaching a stage where, after the preliminary phase of its investigation, it has reasonable grounds to make such a decision.

Generally, the complainant and other interested parties will be informed of the Commission's decision as to whether it has a 'reason to suspect' there is a contravention of the Act.

The requirement to act promptly

Where the Commission has reason to suspect that a carrier or carriage service provider has contravened, or is contravening, the competition rule, the Commission is required to act promptly in deciding whether to issue a competition notice.⁴⁸

The Commission's aim is to investigate and reach a decision on whether it has a reason to believe within three months of deciding it has a reason to suspect there is a contravention of the competition rule. However, depending on the particular facts of the case, it may be possible to reach a decision earlier than this. If, on the other hand, a matter is particularly complex or there are other reasons for delay (such as delay in receiving necessary information from industry participants), the three-month timeframe may not be achievable. If the investigation stage is likely to extend beyond three months, the Commission will inform the complainant and interested third parties, and provide regular updates on the progress of the investigation.

Obtaining information

In obtaining information and assessing the probative value of that information, the Commission will draw on the full range of its statutory powers both under Part XIB and under the Act more generally.

Carriers and carriage service providers should be aware that the Commission may obtain information by exercising:

- the general information gathering power (s. 155), permitting the Commission to obtain information where it has reason to believe that a person is capable of furnishing information, producing documents or giving evidence relating to a matter that constitutes or may constitute a contravention of the Act or is relevant to

47 *Commissioner for Corporate Affairs v. Guardian Investments Pty Ltd* [1984] VR 1019 at p. 1025 per Ormiston J.

48 **Section 151AQ Commission to act expeditiously:**

- (1) If the Commission has reason to suspect that a carrier or carriage service provider has contravened, or is contravening, the competition rule, the Commission must act expeditiously in deciding whether to issue a competition notice in relation to that contravention.
- (2) A failure to comply with subsection (1) does not affect the validity of a competition notice.

a designated telecommunications matter.⁴⁹ The section also provides that, where the Commission has a reason to believe that a person has engaged or is engaging in a contravention of the Act, an officer authorised by the Commission may enter premises and inspect and make copies of documents;⁵⁰

- the power to issue tariff filing directions (Division 4 of Part XIB); and
- the power to make record keeping rules (Division 5 of Part XIB).

Information provided pursuant to a tariff filing direction or record keeping rule may, in some circumstances, be made publicly available by the Commission, or by the relevant carrier or carriage service provider according to a written direction by the Commission.⁵¹

Notwithstanding these powers, the Commission considers that complainants who allege anti-competitive conduct have an important role to play in providing information and assistance which may help the Commission to reach a decision. In particular, the Commission is often able to make a decision more quickly where a complainant is able to assist it in its examination of industry-specific practices and provide information which allows the identification of potential market boundaries for the assessment of market power and the effects on competition of the alleged anti-competitive conduct.

However, such information must be provided in a timely manner. To meet the indicative timeframes, the Commission requires the cooperation not only of the complainant but also of interested parties and the carrier or carriage service provider alleged to be contravening the competition rule.

The Commission will often undertake detailed analysis of relevant market information and assessment of statements by actual or potential market participants as to the effect of the conduct under investigation. Therefore, while acknowledging it is obliged to (and will) investigate potentially anti-competitive conduct without assistance if necessary, the Commission will expect complainants to provide all possible assistance to ensure a rapid response.

Procedural fairness

An important requirement of administrative law is that decisions be made in accordance with procedural fairness and provide natural justice to parties whose rights are adversely affected by the decision.

The Commission will make the decision to issue a competition notice after giving proper, genuine and realistic consideration to the merits of the case, and deciding whether it has a reason to believe that that the carrier or carriage service provider

49 A designated telecommunications matter refers to a matter arising in relation to the performance of a function or exercise of a power conferred on the Commission by or under the Telecommunications Act or the *Telstra Corporation Act 1991*, or Part XIB or XIC of the Act.

50 Section 155(2)

51 Sections 151BQ (for tariff information), 151BUA, 151BUB and 151BUC (disclosure rules for record keeping rules).

concerned has contravened the competition rule.⁵² The Commission will make a reasonable and unbiased decision in good faith and based on the facts available.

Amendments have been introduced to diminish the incentive for the notice recipient to bring strategic judicial or administrative law review challenges.⁵³ In proceedings for administrative or judicial review of the issue of a competition notice, the Federal Court (or Judge of that court) cannot suspend the operation of a competition notice pending finalisation of the application. This will ensure that the notice continues to be in effect during the review period. However, the Federal Court (or Judge of that court) can stay proceedings instituted under Part XIB of the Act.

Informing subjects of an investigation

The Commission will determine, case by case, at which point during the overall process it will inform the subject of an investigation that the Commission is investigating an allegation of a contravention of the competition rule, and the possibility that a competition notice may be issued. For example, the subject of an investigation might be first informed:

- upon being approached by the Commission and being offered the opportunity to volunteer information (to give ‘their side of the story’) to assist the investigation; or
- upon receipt of appropriate notification by the Commission outlining the conduct being investigated by the Commission.

Issuing a Part A competition notice

The Commission will endeavour to decide to issue a Part A competition notice within 30 days of having formed a reason to believe there is a contravention of the competition rule. In many cases, it will be able to reach this decision in less than 30 days.

In some circumstances the Commission may, but will not necessarily, use other provisions of the Act to prevent the conduct from occurring before it is able to decide whether or not to issue a competition notice. Importantly, an interim injunction may be sought where procedural fairness constraints might prevent a Part A competition notice being issued in time to prevent significant damage to consumers.

Wherever the Commission encounters conduct:

- which may be the subject of one or more enforcement regimes under the Act;
- for which remedies are available under other Parts of the Act, for example Part XIC; or
- which may be affected by the operation of any other applicable law under which the Commission has a role (such as the Telecommunications Act);

⁵² See for example *Mahon v. Air New Zealand* [1984] AC 808 at p. 821 per Diplock LJ.

⁵³ Section 151AQA.

the Commission will adopt a regulatory response which it believes best utilises its resources in the context of the Act's objective. The assessment as to which remedy is the 'best fit' for a given form of anti-competitive conduct (for example, whether a competition notice should be issued as opposed to other regulatory options under the Act or any other applicable law) will be made by the Commission on a case by case basis.

Chapter 5. Goods and services that fall within the scope of a telecommunications market

This chapter discusses issues arising from the Commission's obligation to consider whether:

- conduct under examination involves a 'carrier' or 'carriage service provider'; and
- conduct under examination is taking place within a 'telecommunications market'.

Does the conduct under examination involve a 'carrier' or 'carriage service provider'?

The competition rule applies only to carriers or carriage service providers.⁵⁴ A 'carrier' means a person who holds a carrier licence issued under the Telecommunications Act.⁵⁵ A carriage service provider is a person who supplies to the public certain communications services (as defined in Division 3 of Part 4 of the Telecommunications Act).

Is the conduct under examination taking place within a telecommunications market?

The conduct of a carrier or carriage service provider can be anti-competitive conduct for the purposes of Part XIB only where that person possesses a substantial degree of power in a 'telecommunications market' and the carrier or carriage service provider takes advantage of the market power with the effect, or likely effect, of substantially lessening competition in that or any other telecommunications market, or engages in conduct in a telecommunications market in contravention of ss 45, 45B, 46, 47 or 48.⁵⁶ Section 151AF defines a 'telecommunications market' to mean a market in which any of the following goods or services are supplied or acquired:

- carriage services;
- goods or services for use in connection with a carriage service; or
- access to facilities.

Section 151AB of the Act defines 'carriage service' and 'facility' as having the same meaning as in the Telecommunications Act. To ascertain the boundaries of the

⁵⁴ Section 151AK.

⁵⁵ Note that companies holding a carrier licence under the (repealed) *Telecommunications Act 1991* are deemed to be granted a carrier licence under the Telecommunications Act by virtue of Division 4 of the *Telecommunications (Transitional Provisions and Consequential Amendments) Act 1997*.

⁵⁶ Sections 151AJ(2) and (3).

Commission's jurisdiction in administering Part XIB it is necessary to examine these goods and services and related concepts.

‘Carriage service’

Under the Telecommunications Act ‘carriage service’ is defined to mean ‘a service for carrying communications by means of guided and/or unguided electromagnetic energy’.⁵⁷ ‘Communication’ is broadly defined in the Telecommunications Act to include communications between people and/or things and includes speech, music, data, text, visual images, signals or any other form or combination of forms.⁵⁸

Therefore, a service is a ‘carriage service’ where the service consists of ‘carrying’ communications by means of electromagnetic energy. ‘Carrying’ communications (as opposed to initiating or modifying that communication) is defined in the Telecommunications Act to include transmission, switching or receipt of that communication.⁵⁹ In the Commission's view, both the natural meaning of the word ‘carry’ and the apparent legislative intent behind the inclusive definition suggest that the content being carried must be reproduced for the recipient in a form substantially unchanged from that provided to the carrier by the originator. (Note that this does not necessitate the signal remaining unchanged during the provision of carriage services.)

Accordingly, services which primarily provide information are not, of themselves, ‘carriage services’ and markets in those services are therefore not necessarily ‘telecommunications markets’. These services are referred to under the Telecommunications Act as ‘content services’.⁶⁰ On the other hand, where content services are ‘for use in connection with a carriage service’, the market for those content services will be a telecommunications market.⁶¹ An example of such a service might be a customer billing information service provided by a carrier.

‘Access to facilities’

As noted above, s. 151AB of the Act provides that the term ‘facility’ has the same meaning as in the Telecommunications Act.⁶² Section 7 of the Telecommunications Act defines ‘facility’ to mean ‘any part of the infrastructure of a telecommunications network ... or ... any line, equipment, apparatus, tower, mast, antenna, tunnel, duct, hole, pit, pole or other structure used, or for use, in or in connection with, a telecommunications network’.

57 Section 7 of the Telecommunications Act.

58 *ibid.*

59 *ibid.*

60 Section 15 of the Telecommunications Act.

61 Section 151AF of the Act.

62 The relevant references in the Telecommunications Act are found in the definition of ‘facility’ in section 7 and the definitions of related terms in Part 5 of Schedule 1 of that Act.

A 'telecommunications network' is defined in that same section to mean 'a system, or series of systems, that carries, or is capable of carrying, communications by means of guided and/or unguided electromagnetic energy.'⁶³

Part 5 of Schedule 1 of the Telecommunications Act provides for a standard carrier licence condition which requires that carriers must provide other carriers with: access to telecommunications towers; the sites of telecommunications transmission towers; and underground facilities that are designed to hold lines. On 22 June 1999, the Commission issued a Facilities Access Code under clause 37 of Part 5 of Schedule 1, which provided detailed administrative and operational procedures to facilitate timely and efficient access to specified telecommunications facilities.

Part 5 of Schedule 1 includes extended definitions of the terms 'eligible underground facility', 'site', 'telecommunications tower' and 'access' for the purposes of the carrier licence condition, which might not be directly applicable to other provisions of the Telecommunications Act. Taken together, however, all the terms in the Telecommunications Act will have relevance to an assessment of anti-competitive conduct under Part XIB by setting the jurisdictional boundaries of the application of the Part XIB provisions.

It follows from these definitions that each physical infrastructure element which is used (or for use) in connection with the provision of carriage services comprises a 'facility'. The Commission considers that:

- 'access' in this context needs to be read broadly, and in its true and natural sense rather than restricted to (for example) a specialised economic term; and
- the purpose of identifying whether a party has supplied or acquired a product being 'access to facilities' is to establish whether the relevant market is a 'telecommunications market'.

The Commission considers that the following examples may be 'facilities' under Part XIB:

- mobile phone towers and base stations;
- each physical component of a customer access network (including both switching and carriage systems such as the existing copper wire or hybrid optic fibre/coaxial cable networks and future networks using wireless or any other technologies);
- physical network elements not primarily contributing to the provision of a particular carriage service (or referable to a particular end-user or users) but which add to overall carriage service functionality, such as common channel systems;
- sites or equipment used to install, create, commission, integrate, repair, maintain, monitor or operate any part of a telecommunications network; or
- satellites used to provide a carriage service within a telecommunications market wholly or partly within Australia. In addition, earth stations, tracking systems and

⁶³ Section 7 of the Telecommunications Act.

other physical infrastructure required for the use of satellites may also and separately be ‘facilities’.

The Commission notes that, under some circumstances, ‘access to facilities’ may include intellectual property or other assets required for the use of, or physical access to, the physical infrastructure comprising a facility. Such intellectual property might include operating manuals or protocols for connection to or handling of a potential facility.

‘Market’

Section 4E of the Act defines a market as meaning ‘a market in Australia and, when used in relation to any goods or services, includes a market for those goods or services and other goods or services that are substitutable for, or otherwise competitive with, the first-mentioned goods or services.’ The Act does not require that the relevant market be defined as wholly within Australia, only that at least some part of it be in Australia.

‘Goods’ and ‘services’

‘Goods’ and ‘services’ are each defined in s. 4 of the Act. Relevantly, ‘goods’ is defined to include electricity — although the court has commented that information encoded in electrical impulses may not, of itself, be ‘goods’.⁶⁴ ‘Services’ is defined to include ‘any rights ... benefits, privileges or facilities that are, or are to be, provided, granted or conferred in trade or commerce’ excluding rights for the supply of goods or the performance of work in an employment contract.

‘Supplied or acquired’

Section 4 of the Act contains specific inclusions to the true and natural meanings of the words ‘supplied’ and ‘acquired’. In addition, s. 4C expands on those terms, stating:

a reference to the supply or acquisition of services includes a reference to the supply or acquisition of services together with property or services, or both.

‘For use in connection with a carriage service’

Whether particular goods or services are ‘for use in connection with a carriage service’ is ultimately a question for the court. However, until the courts provide an alternative view, the Commission’s view is that the expression ‘for use in connection with’ should be construed according to the following principles:

- to the extent that the word ‘for’ implies purpose — one of the purposes or intended uses of the goods or services in connection with a carriage service (there is no requirement that the use in connection with a carriage service be exclusive of any other ‘uses’);

64 *ASX Operations Pty Ltd v. Pont Data Australia Pty Ltd* (1990) 27 FCR 460.

- the word ‘use’ ought to be construed broadly and includes potential or contingent use;⁶⁵ and
- the words ‘in connection with’ imply a link or joining between the use of the goods or services and the use of carriage services.⁶⁶ This connection may be physical (as in the case of certain goods conjoined with a telecommunications network such as customer equipment (e.g. handsets) and including wireless connections), functional (in the case of services such as Internet access provision which are accessed only by underlying use of a carriage service) or commercial (in that the goods or services are marketed in connection with a carriage service).⁶⁷

Although not binding on Australian Courts, the New Zealand decision *A Hatrick & Co v. R* may be a useful illustration of the issue of ‘connection’. In that case, the New Zealand Minister of Railways was empowered to fix a scale of charges to be paid for storage of goods in any facility ‘in connection with’ a railway. The court remarked that the words ‘in connection with’ did not require that the facility be:⁶⁸

merely contiguous to or abutting upon a railway ... in other words, that the expression “in connection with a railway” means connected with, subserving and being ancillary to, the business of a railway ... These words ... must be directed to something different from propinquity or contiguity.

Telecommunications markets and bundling

In many telecommunications markets, combinations of goods and/or services are either offered in groups which are sold as a single package to purchasers (‘tying’) or are offered on terms such that the price of a good or service is affected by the purchase or use of another good or service (‘bundling’).

The Commission notes that:

- where carriage services are supplied or acquired together with other services or with the supply of goods, all the components of the package are part of a telecommunications market whether or not they are all for use in connection with a carriage service;⁶⁹ and

⁶⁵ See the discussion of the word ‘use’ by Lord Denning of the Privy Council in *Newcastle City Council v. Royal Newcastle Hospital* [1959] AC 248 at p. 255.

⁶⁶ In other words, some ‘nexus’ between the goods or services forming the subject of the potential telecommunications market and the use of a carriage service: see *ITP (London) Ltd v. Winstanley* [1947] 1 All ER 177 at p. 178 per Lord Goddard CJ.

⁶⁷ The extent of ‘connection’ was discussed in *Berry v. Federal Commissioner of Taxation* (1953) 89 CLR 653 at p. 659 per Kitto J. In that case a payment would form assessable income if it were ‘for or in connection with’ any goodwill. His Honour concluded that the payment was not ‘for’ goodwill, but was ‘in connection with’ goodwill, since ‘the receipt of the payment has a substantial relation, in a practical business sense’ to the goodwill. ‘Connection’ was to be more broadly construed than purpose.

⁶⁸ *A Hatrick & Co v. R* [1923] AC 213 at pp. 226-227

⁶⁹ By the operation of section 4C.

- where tying or bundling serves to create new products, the competition rule may apply to the markets in those new products as well as to the market in each constituent component. In this case the relevant question is whether the new product is itself a carriage service, a good or service for use in connection with a carriage service or access to facilities.

Overview telecommunications markets

In the Commission's view products which could be supplied or acquired in markets being 'telecommunications markets' may include:

- carriage services (including all forms of voice and data telephony and services such as video carriage, whether on fixed or mobile networks);
- value-added services (intelligent network services) which are for use in connection with a carriage service such as call manipulation (e.g. diversion, call waiting), the use of calling line identification or message services (e.g. voicemail, paging);
- the supply of physical components of telecommunications networks used by carriers or carriage service providers in the provision of carriage services (ranging from handsets through to network components such as switching systems or transmission technologies) and associated services such as development, installation, maintenance and repair of those components;
- information and related services used in connection with carriage services (e.g. 'help desk' consultancy services, directory assistance services, account management services or customer billing information);
- other rights (services) used as inputs for creating, offering or accessing a carriage service (including rights relating to assets such as spectrum or intellectual property rights such as patents);
- any bundled or tied package where one component of that package is a carriage service, a good or service for use in connection with a carriage service, or access to facilities; or
- any goods or services whose 'use' has some nexus with an underlying carriage service (such as where those goods or services are accessible only through the use of a carriage service).

Chapter 6. Markets and the exercise of market power

This chapter discusses the principal elements of anti-competitive conduct, revolving around market definition and market power, considered by the Commission in determining whether a carrier or carriage service provider has contravened the competition rule under s. 151AJ(2) (that a carrier or carriage service provider takes advantage of a substantial degree of market power with the effect, or likely effect, of substantially lessening competition in a telecommunications market).⁷⁰ The key questions addressed are these:

- how are markets defined (within a telecommunications context);
- what does it mean to have ‘a substantial degree of power’ (in a telecommunications market); and
- what does it mean to ‘take advantage of’ that market power?

In considering these questions, it is relevant that s. 151AJ(2) uses similar language to the provisions of Part IV. The Commission considers that, in general, where the same words have been used by Parliament, the Federal Court is likely to use the same meaning as in its past consideration of alleged contraventions of Part IV of the Act. The Commission will revise this view if it considers it necessary to do so (such as where a subsequent and contrary view is expressed by the court).

How are markets defined?

Market definition is fundamental to the assessment of alleged anti-competitive conduct under s. 151AJ(2), as it is to most of the restrictive trade practices provisions in Part IV of the Act. Market definition provides the parameters in which to assess:

- the telecommunications market in which a carrier or carriage service provider does or does not have market power; and
- whether in that market or another market there has been, or will be, the effect of a ‘substantial lessening of competition’.⁷¹

Defining the market and evaluating the degree of power in that market are part of the same process, and it is for the sake of simplicity of analysis that the two are separated.⁷² Moreover, the process of market definition is not an end in itself. It is part of the

70 As noted earlier, a number of Part IV prohibitions fall within the definition of anti-competitive conduct by virtue of section 151AJ(3). The following commentary explains the operation of s. 151AJ(2), and so the elements of those Part IV prohibitions are not set out in detail in this *Information Paper*. Interested persons are directed to existing commentaries on the relevant sections, such as the Commission’s publications on *Misuse of market power* and *Refusal to Deal*.

71 Further information on the Commission’s approach to defining the market can be found in the Commission’s *Merger Guidelines*.

72 *Queensland Wire Industries v. The Broken Hill Proprietary Company Ltd & Anor* (1989) ATPR 40-925 (*QWI*).

process of assessing market power and whether conduct has the effect of substantially lessening competition.

It is important when applying competition law that the relevant market be defined appropriately within the context of demand for, and supply of, goods and services. If the market is not properly specified, then the assessment of the effect of any action on competition may be incorrect. Too broad a market definition may underestimate the market power of the carrier or carriage service provider at issue. At the other extreme, too narrow a definition may result in an assessed likelihood of an anti-competitive outcome greater than that which is really the case.

Substitutability plays a key role in market definition. Where two products are regarded as closely substitutable, they are regarded as being in the same market. Hence, in order to establish the relevant market, the Commission is concerned to establish the actual and potential sources of close substitutes for the good or service in question.

Substitution

Section 4E of the Act provides that the term market ‘includes a market for those goods and services and other goods and services that are substitutable for, or otherwise competitive with, the first-mentioned goods or services’. The process of establishing the market boundaries starts with those goods and services being supplied by the carrier or carriage service provider that relate to the conduct under scrutiny. The boundaries are then extended to include the sources and potential sources of close substitutes.

To identify goods and services that are substitutable for, or otherwise competitive with, the goods or services under consideration, the Commission uses a price elevation test: what would be the response on the demand side and the supply side to a relatively small percentage increase in the price of the carrier or carriage service provider’s particular product or products in question. To test whether the boundaries of the market are correctly defined it is useful to ask whether a hypothetical monopolist of the good or service in question would be likely to raise the price by a small but significant amount above the competitive level in order to maximise the company’s profit. If the answer is in the affirmative, the good or service constitutes a separate market, because the hypothetical monopolist is not deterred from raising its prices by the presence of close substitutes on either the demand or supply side.

Therefore, the process of market definition can be viewed as establishing the smallest area of product, functional and geographic space within which a hypothetical current and future⁷³ profit maximising monopolist would impose a small but significant and non-transitory increase in price (SSNIP) above the competitive level. More generally, the market can be defined as the smallest area over which a hypothetical monopolist (or monopsonist) could exercise a significant degree of market power. This would be possible only if all sources and potential sources⁷⁴ of close substitutes for the products of the carrier or carriage service provider under investigation products have been included in the definition of the market.

73 That is, not subject to the threat of entry.

74 Including production and distribution capacity which could rapidly switch to supplying the relevant product, but not including new entrants.

In practice, it is often difficult to obtain the requisite data for a sufficiently long period to make reliable estimates of such price elasticities, although the Commission will be increasing its level of competition monitoring of the telecommunications industry.⁷⁵ More importantly, elasticities calculated from past price movements may not reflect recent structural or technological changes which are impacting on telecommunications markets, such as the impact of deregulation or the introduction of new products.

Further, historical analysis of pricing and product development decisions in the industry would not necessarily reflect types of responses that one would expect from a profit maximising firm in a competitive market. The Australian telecommunications industry has been shaped to some extent by the decisions of government-owned monopoly enterprises that at times have been concerned with the delivery of goods and services that serve socio-political rather than economic imperatives.

In addition, a problem can arise generally in applying SSNIP using current prices as the basis for market definition (i.e. assessing whether there will be a SSNIP above competitive prices), where an industry is already characterised by market power. Current prices could be distorted, with the result that elasticities are relatively high and applying a SSNIP will indicate that products of dubious substitutability should be included within the market definition; for example, that postal services are substitutes for telephony.

Nevertheless, the Commission considers the SSNIP approach to be the appropriate analytical framework within which to make the necessary judgments in analysing the qualitative data and information on which it will necessarily have to rely. The Commission recognises that careful judgment is needed in each individual case to make allowance for both current and commercially realistic future substitutes. Wherever possible, as part of its analysis of market definition, the Commission will gather direct anecdotal evidence from market participants and/or undertaking consumer surveys.

Demand substitution, supply substitution and market entry

Both demand side and supply side substitution are relevant to the assessment of market boundaries. On the demand side, the Commission will examine which goods or services consumers consider to be close substitutes for the carrier or carriage service provider's product and which geographic sources of supply they consider to be substitutable. If, in the event of a significant price rise or equivalent exercise of market power by the carrier or carriage service provider, consumers would switch to purchasing these alternatives to the extent of defeating such a price rise, these products and sources of supply will be included in the relevant market.

On the supply side, the Commission will consider which suppliers could, without significant investment, switch their production and/or distribution facilities to supply a product substitutable for that supplied by the carrier or carriage service provider, or switch from supplying another geographic area to that supplied by the carrier or carriage service provider. If, in the event of a significant price rise or equivalent exercise of market power by the carrier or carriage service provider, these suppliers

⁷⁵ Such as the introduction of record keeping rules for the telecommunications industry under s. 151BU.

would switch their supply to the extent of defeating the price rise, these suppliers will be included in the relevant market.

While most investigations of breaches of the competition rule will involve the identification of markets where there is actual trade in goods or services, this will not necessarily be the case.⁷⁶ For example, conduct may involve the prevention of trade and competition in an intermediate product by forestalling entry.

Entry to a market generally requires significant investment in areas such as production, distribution or promotion. It differs from supply side substitution, where a carrier or carriage service provider is able simply to switch to producing a different product without needing to undertake such investment.

A carrier or carriage service provider who has, for an extended period, provided a broad range of carriage services and related products to the public may be able to readily switch production and distribution facilities to supply an additional product or significantly vary an existing product with the expectation of gaining market acceptance. On the other hand, a carriage service provider which provides a limited or specialised range of products not associated with the new product may need to make a significant investment in promoting that product for it to gain market acceptance.

Sub-markets

In some cases the Commission will consider the existence of sub-markets. Sub-markets or market segments are identified by special characteristics or by some discontinuity from one segment to another in substitution possibilities. In *Re Tooth*, the Tribunal stated:⁷⁷

within the bounds of the market, substitution possibilities may be more or less intense, and more or less immediate: the field of substitution is not necessarily homogeneous but may contain within it sub-markets wherein competition is especially close or especially immediate. There may be, too, certain key sub-markets such that their competitive relationships have a wider effect upon the functioning of the market as a whole. In these matters we have found that the identification of relevant sub-markets may be rather helpful in clarifying how competition works.

Sub-markets are used as a tool to analyse the functioning of the market as a whole. A carrier's or carriage service provider's conduct will contravene s. 151AJ(2) only where there is a substantial lessening of competition in the market as a whole; notwithstanding that the effect may be primarily or entirely felt in particular sub-market(s).⁷⁸

An example of a sub-market may be a distinct group of consumers of bundled products whose buying decisions are based on specific components of a bundle. For example, a bundled utilities product with security monitoring services might be sold to two distinct purchaser groups, one of which values a 'single bill' utilities service and the other of which values more highly the security monitoring service. In that case, the price

⁷⁶ *QWI* at p. 50,012.

⁷⁷ *Re Tooth & Co. Ltd; in re Tooheys Ltd* (1979) ATPR 40-113 at p. 18,197.

⁷⁸ M. Brunt (1990), 'Market Definition Issues in Australian and New Zealand Trade Practices Litigation', 18 *Australian Business Law Review* 86, at p. 117; *Singapore Airlines Ltd v. Taprobane Tours WA Pty Ltd* (1992) ATPR 41-159.

elasticity of demand of those two groups may be different. Whether the patterns of demand point to the existence of sub-markets, or point to separate markets, is a matter to be assessed against the test of whether a hypothetical monopolist could exercise price discrimination between the two groups of customers.

Linking and chains of substitution

When considering substitution possibilities, it is sometimes necessary to consider a chain creating ‘ripple effects’, (also referred to as the ‘linking principle’).⁷⁹ If A and B are substitutable and B and C are substitutable, should A and C be considered to be part of the same market? The Commission considers that the relevance of ripple effects depends on whether they constrain the price and output decisions of carriers and carriage service providers. This in turn will depend on the degree of substitutability between different products or providers.

The four dimensions of market definition

When considering the boundaries of a market from the supply and demand side, the Commission will have regard to the following four dimensions:

- product;
- geographic;
- functional; and
- time.

Product

Delineation of the relevant product dimension of a market requires identification of the goods or services supplied by a carrier or carriage service provider and the sources, or potential sources, of substitute products. Starting with the product (or products) under examination, the product dimension is gradually expanded to incorporate closely substitutable products in the event of a SSNIP, or equivalent exercise of market power, by the carrier or carriage service provider.

Depending on the conduct under scrutiny and the particular characteristics of substitution forming the relevant market, any one product or number of products may fall within a market boundary. For example, in applying the substitutability test described above, any of the following products could be considered to be a market in itself or elements of the same market:

- personal cordless/wireless or mobile phone services
- public switched telephone network (PSTN) services
- integrated services digital network (ISDN) services
- analogue private line
- analogue data
- narrowband digital data — switched
- narrowband digital data — dedicated

⁷⁹ Brunt (1990), *ibid*, at pp. 104-105; S. G. Corones and N. Norman (1994), *Markets, Competition and Market Power*, ATPR 2-555.

- wideband services — switched
- wideband services — dedicated
- Internet access services
- broadcasting services
- security services.

In some instances the only practical substitute for the goods or services purchased from one carrier or carriage service provider would be a grouping of several goods or services purchased from another (called ‘cluster markets’).⁸⁰ This is likely to occur where the relevant product is in fact an aggregation of several distinct goods or services. For example, in the Commission’s *Declaration of Local Telecommunications Services* report (July 1999), it was noted that, at the time of the report, all local call services were supplied to each end-user by a single service provider, along with line rental. The bundling of line rental by service providers suggests that both local calls and line rental should be considered as a cluster of services.

Product substitutability between different carriage services will increasingly arise through the convergence of various technologies. For example, the use of digital systems leads to an increasing similarity in the performance and characteristics of carriage services provided, despite distinct technologies being used. For example, a packet-switching network such as the Internet may be used to transmit digitised voice signals, thereby mimicking ‘traditional’ (circuit-switched) voice telephony. Similarly, fax transmissions may be sent via either voice or data telephony systems.

As this process of convergence continues, the Commission considers that the increased substitutability of various carriage services will correspondingly weaken the boundaries between markets for those products. A consequence of this process is that a market participant with significant market power in a carriage service market may not possess significant market power when that market becomes contestable by participants using nascent convergent technologies. Nevertheless, the Commission will generally define the relevant markets only through applying the price elevation test, by using commercially available substitute products, and only to the extent that consumers potentially exercise choice between such substitutes.

Geographic

Delineation of the relevant geographic market (or markets) involves the identification of the area or areas over which the carrier or carriage service provider and its rivals currently supply, or could supply, the relevant product and to which consumers can practically turn. Starting with the geographic area (or areas) supplied by the carrier or carriage service provider, each geographic market is gradually expanded to incorporate:

- other geographic sources of supply to which consumers would turn; and
- other carriers or carriage service providers which would supply the relevant product into that area;

⁸⁰ For an analysis of cluster markets, see D. Shiff, H. Ergas and M.G. Landrigan (1998) ‘Telecommunications Issues in Market Definition’ 6 *Competition and Consumer Law Journal* 32.

in the event of a SSNIP, or equivalent exercise of market power, by the carrier or carriage service provider.

Substitutability tests tend to be of limited relevance when delineating the geographical dimensions of telecommunications markets. For example, a local call in one capital city is unlikely to be substitutable for one made in another capital city. Accordingly, in delineating the geographic dimension of telecommunications markets, the Commission looks to factors such as the area over which major suppliers operate to ensure that it describes the relevant arena of competition.

Section 4E defines a market to be a market ‘in Australia’. The Act does not require that the relevant telecommunications market be defined as wholly within Australia, only that at least some part of it be in Australia. While, in most cases, the Commission will define the relevant market to be Australia or a part of Australia, in some circumstances it may be relevant to define the market as broader than Australia, for example country pairs or even a world market.

Functional

Delineation of the relevant functional market requires identification of the vertical stages of production and/or distribution which comprise the relevant arena of competition. This involves consideration of both the efficiencies of vertical integration, commercial reality and substitution possibilities at adjacent vertical stages. After it has made a preliminary assessment of the product and geographic dimension, the Commission will approach this task by assessing:

- at what level or levels in the supply chain the carrier or carriage service provider engaging in particular conduct is involved; and
- whether there is a significant sphere of influence between two or more functional stages of the supply chain such that it is impossible to adequately explain the competitive process at one stage without knowledge of the role/influence of the firms which operate at other stages.

The Commission will consider the extent to which vertically integrated suppliers constrain the price and output decisions of non-integrated suppliers, or are constrained themselves. Where there are overwhelming efficiencies of vertical integration between two (or more) stages, it is inappropriate to define separate functional markets.

For example, if a vertically integrated carrier supplies an essential input such as a local loop to itself and to other downstream suppliers of long distance services, the Commission will ask whether downstream substitution is such as to prevent the imposition of a profit maximising SSNIP. This might occur, for example, if there were close competition between those long distance services using the local loop, and alternative services not requiring access to the carrier’s local loop. In such circumstances, the provision of local loop services would not be distinguished as a market separate from that involving the provision of long distance services. If, on the other hand, there is no such downstream competition and the supplier of a local loop service is not constrained in its pricing or output decisions for the supply of local loop services, to long distance service providers, there will be no need to expand the

functional market. Hence separate markets for the supply of the local loop and for long distance services will be defined.

Time

The time dimension of the market refers to the period over which substitution possibilities should be considered. The telecommunications industry is characterised by products which have a very short time frame for product modification or development (i.e. in offering lower cost versions of existing services or particular pricing strategies) and by substantial infrastructure and establishment costs. The Commission will examine each relevant telecommunications market at the time of the conduct and consider substitution possibilities in the foreseeable future that might effectively constrain the exercise of significant market power. The decision to engage in long and short term analysis of the time aspect of a market must be made with reference to the character of the relevant products.

Planned deregulation may change the relevant product and geographic market boundaries in some industries. Whether or not the Commission defines the relevant market according to current substitution possibilities will depend on the timing and certainty of deregulation, the extent to which current price and output decisions are constrained by future substitution possibilities, and the extent of anti-competitive detriment that is likely to occur prior to deregulation. In *Re: AGL Cooper Basin Natural Gas Supply Arrangements* (concerning the gas industry), the Tribunal referred to ‘a market expanding over time’, in both its geographic and product dimensions.⁸¹

What does it mean to have ‘a substantial degree of power’ in a telecommunications market?

Substantial

Under Part XIB, a carrier or carriage service provider can be in contravention of the competition rule under s. 151AJ(2) only if it has a ‘substantial degree of power’ in a telecommunications market.⁸² Having defined the relevant market using the process described above, the Commission must then consider whether the degree of power that the carrier or carriage service provider exerts in that market is substantial.

There is no ‘line in the sand’ marking when market power is ‘substantial’. Substantial market power has been taken to mean that the degree of power is more than trivial or minimal and that it is real and of substance.⁸³ Importantly the Explanatory Memorandum for the Trade Practices Revision Bill 1986, stated that ‘substantial’ is intended to signify ‘large or weighty’ or ‘considerable, solid or big’.⁸⁴

81 (1997) ATPR 41-593, at p. 44,210.

82 Substantial market power is also an element in section 46 of the Act.

83 *Mark Lyons Pty Ltd v. Bursill Sports Gear Pty Ltd* (1987) 75 ALR 581 at pp. 591-2 per Wilcox J.

84 *Palser v. Grinling* [1948] AC 291 at p. 317 cited at paragraph 41 of the *Trade Practices Revision Bill 1986* Explanatory Memorandum.

Market power in telecommunications markets

In general, a carrier or carriage service provider has market power if it is able to durably charge more and/or give less to consumers than they would obtain in a competitive market.

A carrier or carriage service provider will not normally be able to exercise market power in a telecommunications market if it is subject to strong and effective competition from actual or potential rivals. The discipline of the competitive market means that it will not be possible for the firm to raise its prices unilaterally without a significant loss of business. Moreover, it will need to keep its unit costs no higher than its competitors' and ensure that the quality of its service is at least equal to theirs if it is to survive in the longer term.

There is also a dynamic aspect to the discipline of a competitive market. A service provider in such a market will usually be obliged to introduce new products and services and modify existing products and services to keep pace with the improvements and technological developments taking place elsewhere in that market.

In general, a carrier or carriage service provider will not have substantial market power unless competition in that market is weak or defective in some respect. However, this does not mean that it need be in a monopoly position to have that market power. As the following examples illustrate, a carrier or carriage service provider which does not have a dominant market share may sometimes have substantial market power.

One such case is where a carriage service provider in a downstream market is able to set prices and establish high profit margins with little regard for its competitors because it is owned by an upstream operator which is the sole supplier of an intermediate good essential for the provision of the downstream services. The service provider's market power in the downstream activity depends on the scope that exists for price discrimination in the supply of the essential intermediate good by its upstream affiliate.⁸⁵

A second case is where a carrier or carriage service provider is recognised as a price leader in the market without necessarily having a preponderant market share. Its price leadership role may perhaps reflect a reputation for aggressive competitive pricing in the past or for product innovation. However, the extent of its power depends on the degree to which it can constrain other market participants into accommodating or otherwise accepting its leadership.

A third case is where there are a few carriers or carriage service providers with roughly equal market shares which are involved in tacit collusion or a formal arrangement between themselves which has the effect of maintaining prices above a competitive level.

⁸⁵ Such a circumstance may also be considered by the Commission under Part XIC of the Act. The Commission has published its views on access pricing in its publication *Telecommunications Access Pricing Principles — A Guide*.

Fourth, a carrier or carriage service provider may derive market power not from its large share of a particular telecommunications market but from the ownership of patents which it can choose to exploit itself or license to others.

The examples cited are relevant at this stage only to the question of whether or not a carrier or carriage service provider has a substantial degree of power in a telecommunications market. The further issue, to be considered later in this paper, is whether any such market power is being used to substantially lessen competition.

Where a carrier or carriage service provider has a monopoly, or at least a dominant share of a telecommunications market, it may seem obvious that it must have a substantial degree of power in that market. This will generally be true, although there are exceptions. One possible exception is the case of a 'contestable market' in which a dominant carrier or carriage service provider is subject to a continuing threat of 'hit and run' entry from entrants which believe that they can capture some of the monopoly profits being earned by the incumbent and then withdraw from the market without significant penalty when there are no longer profits to be earned.

If the dominant carrier or carriage service provider takes the threat of such entry seriously, prices in the market would tend to be no higher than they would be if the market were competitive, even if no new carriers or carriage service providers actually enter the market. However, this outcome could occur only if an entrant is always able to enter or exit the market without incurring significant sunk costs. In practice it would be very unusual to find that an entrant to a telecommunications market is able to recover the entire carrier or carriage service provider's marketing expenses, infrastructure outlays and other costs if it leaves the market.

Another situation where a supplier with a dominant share of the market may lack real market power is where all of its sales are to a single customer or to a few highly concentrated buyers able to exert considerable bargaining strength. In such a case the prices that will be established in the market may exceed a competitive level but are likely to be less than would be arrived at if there were a greater number of buyers for the goods or services of the dominant carrier or carriage service provider.

A high market share may not indicate market power if it arises from price distortions. For example, if prices for access to the PSTN are kept by regulation at levels below cost in particular areas, then it is likely that only the former monopolist will supply services in that area.

Finally, the market power, even of a dominant carrier or carriage service provider, will depend not only on its current share of a market but also on the likelihood that a substantial and efficient rival carrier or carriage service provider will enter the market in the near future. The risk of this occurring will depend in turn on the height of barriers to entry to the market. Such barriers may include the extent of excess capacity already evident in the market, the size of the investment needed to establish an efficient operation, economies of scale and the rate at which the market is growing (the lower the anticipated rate of growth the less the likelihood of entry, other things being equal).

The remainder of this section examines certain structural features often found in telecommunications markets which give rise to market power and which may act as impediments to competition. These impediments include factors that restrict entry or

make it difficult for efficient entrants to expand their operations. Forms of anti-competitive behaviour which tend to substantially lessen competition are examined in Chapter 7.

Past monopolies

The current structure of a market, including the extent of seller concentration, often reflects its past history of development and regulation. In the case of telecommunications, the fact that, until relatively recently, a publicly-owned enterprise was the only carrier or carriage service provider permitted to provide a broad range of domestic telecommunication services is a significant influence on current competition and market power in those markets, even in a deregulated environment.

Customers accustomed to dealing with a public monopoly may have to be persuaded that the cost and possible inconvenience of switching their patronage to a new privately-owned carrier or carriage service provider is likely to be worthwhile in the long run. The cost to the new service providers of inducing customers to make this shift may be significant.

In short, there are advantages of incumbency and other barriers to entry which assist incumbents to maintain a substantial degree of market power. One reason that reputation and goodwill can underpin that market position is that, at least in respect of retail services, many customers lack the technical knowledge to compare the quality of the services offered by the established enterprise with that of the new suppliers. Hence the choice of supplier tends to be made on the basis of price and past reputation alone. However, this is less likely to be the case in respect of more technically sophisticated buyers who may account for a substantial share of sales.

A past monopolist or early entrant is likely to have the benefit of marked economies of scale and/or scope. Consequently, it may not be possible for an entrant to match the unit cost of such a player without incurring substantial sunk costs to duplicate some or all of its network. But to do so may not only involve substantial capital outlays but could also result in substantial excess capacity. Thus the feasibility of entry to such a market depends on the entrant being able to gain access to existing networks on reasonable terms and conditions. Such access will usually require oversight by an independent authority, such as the Commission.

Ownership and control of bottleneck facilities

As indicated above, it is unlikely that competition can flourish and promote economic efficiency unless would-be entrants to a telecommunications market can gain access to essential or bottleneck facilities on reasonable terms and conditions — importantly price. The Commission's approach to access pricing can be found in its *Telecommunications Access Pricing Principles — A Guide*, and in its assessment of Telstra's PSTN originating and terminating access undertaking.

The application of these access pricing principles is designed to promote competition while at the same time encouraging investment in economically efficient telecommunications infrastructure. The benefits to end-users of telecommunication services should take the form of sustainable lower prices, improved quality of services and greater choice.

Vertical integration

Depending on the circumstances, vertical integration by a carrier or carriage service provider may create efficiencies and thus potentially result in lower prices to users of its services. However, there are situations in which vertical integration can enhance the market power of the carrier or service provider.

Vertical integration involves a carrier or carriage service provider operating at more than one stage of the production process. It may result in cost savings to the carrier or carriage service provider compared with the alternative of obtaining inputs from independent suppliers or selling its services to arm's length customers. The cost savings can arise from the ability to spread fixed costs across a larger volume of output and the better planning of production and capital expenditures that is possible when there is close coordination between successive stages of production and/or distribution.

Whether or not the potential cost saving from vertical integration is passed on to end-users of the service will mainly depend on the structure of the relevant markets. The following examples will help to illustrate the point.

First, consider the case of a downstream service provider which is facing strong competition in its traditional markets that decides to integrate backward to secure supplies of certain inputs at more favourable prices. If the upstream market is highly concentrated and competition weak, the entry into that market of an additional carrier or carriage service provider through backward integration is likely to stimulate competition and benefit end-users. However, if the integration is effected through the acquisition of one of the existing large carriers or carriage service providers already supplying the upstream market, it is much less certain that there will be favourable effects on competition and prices.

Secondly, consider the case of an established monopoly in an upstream market, protected by significant barriers to entry, that decides to provide services downstream which make use of essential inputs that it alone can supply. This vertical integration may result in lower costs for the carrier or carriage service provider but it also has the potential to increase its market power relative to other service providers in the downstream market. If the transfer prices for the inputs are below the prices at which the same products are sold to arm's length downstream service providers and the price difference is not due to differences in cost, it is possible that the integrated producer is taking advantage of its market power to lessen competition. However, a detailed investigation may be needed to establish whether or not the presumed market power of the integrated producer is constrained by the ability of its competitors in the downstream market to switch to alternative inputs or to set up their own upstream operations to supply the inputs concerned.

What does it mean to 'take advantage of' that market power?

A carrier or carriage service provider engages in anti-competitive conduct under s. 151AJ(2) if the carrier or carriage service provider having a substantial degree of power in a telecommunications market 'takes advantage of' that power with the effect or likely effect of substantially lessening competition in any telecommunications market.

The words ‘take advantage of’ require only that the carrier or carriage service provider exercise its market power in some way, either actively or passively, to produce a discernible effect or likely effect on a telecommunications market. As Deane J said in *QWI*:⁸⁶

Of themselves ... the words ‘take advantage of ... power’ are morally indifferent ... Read in context, the words ‘take advantage of ... power’ are simply inadequate to superimpose upon the economic notions and objectives which sec. 46(1) reflects some indefinite moral or public purpose qualification requiring circumstances where the active or passive use of the relevant market power for one or other of the designated anti-competitive purposes is morally or socially undesirable.

Where there is no nexus between the market power and the influence exerted, there can be no use of market power. The Commission considers that this nexus is best understood as following from the definition of market power. Since to have market power is to possess the means to escape the competitive consequences of the conduct being examined, to ‘use’ that power is to exercise the ability to escape the discipline of a more fully competitive market. In other words, taking advantage of market power is, in most cases, indicated where the carrier or carriage service provider has engaged in conduct which would not be profit maximising in a competitive market (i.e. in the presence of one or more efficient competitors). As French J noted in *Natwest Australia Bank Limited v. Boral Gerrard Strapping Systems Pty Ltd*, the requirement for ‘nexus’ is therefore the requirement that:⁸⁷

there ... [is] a causal connection between the conduct alleged and the market power pleaded such that it can be said that the conduct is a use of that power. In many cases the connection may be demonstrated by showing a reliance by the contravener upon its market power to insulate it from the sanctions that competition would ordinarily visit upon its conduct.

It follows from this that conduct which would be profit maximising in a competitive market will not usually involve the use of market power. For example, achieving efficiencies through economies of scale or through the use of new technologies will generally be profitable regardless of whether a carrier or carriage service provider has market power. Equally, matching a competitor’s price is merely acting as a carrier or carriage service provider would in a competitive market. Eliminating an inefficient rival will normally be no more than would occur in a market where competitive forces were acting normally.

⁸⁶ *QWI* at p. 50,012.

⁸⁷ (1992) 111 ALR 631 at p. 637.

Chapter 7. Substantial lessening of competition and the ‘effect’ test

This Chapter briefly discusses:

- the new ‘effect’ test under s. 151AJ(2); and
- substantial lessening of competition.

It also includes, by way of example, a discussion of certain forms of conduct by a supplier with market power which may lead to a substantial lessening of competition.

The ‘effect’ test

The Explanatory Memorandum that accompanied the 1997 amending legislation stated that Part XIB:

... aims to facilitate vigorous competition in the telecommunications industry. 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.⁸⁸

The Explanatory Memorandum also noted that Part IV of the Act may not be sufficient to constrain anti-competitive conduct in all cases, given that there may be difficulty in obtaining evidence of predatory behaviour by an incumbent with substantial market power. The general misuse of market power provision in Part IV of the Act, s. 46, requires proof of purpose to establish a contravention. Section 151AJ(2), by contrast, requires proof that the conduct had the effect of substantially lessening competition.

Directly proving or inferring purpose under s. 46 may prove more difficult than simply proving that certain conduct had the effect of substantially lessening competition. However, evidence pointing to the effect of undermining competition may be used to infer proscribed purpose.

Substantial lessening of competition

In deciding whether there has been or is likely to be a ‘substantial lessening of competition’, the Commission will be guided by relevant legal principles developed in the context of considering this phrase under Part IV of the Act.

Competition is a process of rivalry between firms, where each market participant, in attempting to set its prices and level of output so as to maximise its profit, must take account of the actions or threatened actions of other market participants. In *Re Queensland Co-operative Milling Association Ltd and Defiance Holdings Ltd*, the

⁸⁸ Trade Practices Amendment (Telecommunications) Bill 1996, Explanatory Memorandum, at p. 6.

Tribunal quoted with approval the report of the U.S. Attorney-General's National Committee to Study the Antitrust Laws:⁸⁹

The basic characteristic of effective competition in the economic sense is that no one seller, and no group of sellers acting in concert, has the power to choose its level of profits by giving less and charging more. Where there is workable competition, rival sellers, whether existing competitors or new or potential entrants into the field, would keep this power in check by offering or threatening to offer effective inducements ...

The Tribunal went on to state:⁹⁰

In our view effective competition requires both that prices should be flexible, reflecting the forces of demand and supply, and that there should be independent rivalry in all dimensions of the price-product-service packages offered to consumers and customers.

Competition is a process rather than a situation. Nevertheless, whether firms compete is very much a matter of the structure of the markets in which they operate. The elements of market structure which we would stress as needing to be scanned in any case are these:

- (1) the number and size distribution of independent sellers, especially the degree of market concentration;
- (2) the height of barriers to entry, that is the ease with which new firms may enter and secure a viable market;
- (3) the extent to which the products of the industry are characterised by extreme product differentiation and sales promotion;
- (4) the character of 'vertical relationships' with customers and with suppliers and the extent of vertical integration; and
- (5) the nature of any formal, stable and fundamental arrangements between firms which restrict their ability to function as independent entities.

Gauging the nature and substance of such effects on the competitive process requires the court to consider the various areas of rivalry between firms both in the absence and following the conduct being considered. In *Dandy Power Equipment Pty Ltd v Mercury Marine Pty Ltd*, Smithers J described the process of analysing substantial lessening of competition in relation to s. 47 of the Act as follows:⁹¹

To apply the concept of substantially lessening competition in a market, it is necessary to assess the nature and extent of the market, the probable nature and extent of competition which would exist therein but for the conduct in question, the way the market operates and the nature and extent of the contemplated lessening. To my mind one must look at the relevant significant portion of the market, ask oneself how and to what extent there would have been competition therein but for the conduct, assess what is left and determine whether what has been lost in relation to what would have been, is seen to be a substantial lessening of competition ...

Although the words 'substantially lessened in a market' refer generally to a market, it is the degree to which competition has been lessened which is critical, not the proportion of that lessening to the whole of the competition which exists in the total market. Thus a lessening in a

89 United States Attorney-General's National Committee to Study the Antitrust Laws (1955), Report, at p.320 (quoted in *Re Queensland Co-operative Milling Association Ltd and Defiance Holdings Ltd* (1976), ATPR 40-012, at p. 17,245-6 (*QCMA*)).

90 *QCMA*, at p. 17, 246.

91 (1982) ATPR 40-315, at pp. 43,887-8.

significant section of the market, if a substantial lessening of otherwise active competition may, according to the circumstances, be a substantial lessening of competition in a market.

It follows from this formulation that, in general, a substantial lessening of competition will occur where, as a result of the conduct, it will be possible for the firm engaging in that conduct to profitably charge more and/or give less than would have been the case absent the conduct. Listed below are examples of anti-competitive which the Commission believes could give rise to the issue of a competition notice and/or court action.

Anti-competitive pricing

In a newly liberalised telecommunications industry, a critical issue is the effective regulation of access by new entrants to an incumbent's network. The access provisions in Part XIC of the Act are an attempt to overcome the imbalance of power between existing players and new entrants. Structural features that give rise to market power would include:

- the control of access to key network elements;
- the degree of vertical integration of the incumbent; and
- assymetrical network and market information.

The Commission will, in administering Part XIC, make every effort to achieve economic and efficient access prices to minimise the opportunity for anti-competitive pricing. However, in an open market where existing players have the advantage of significant monopoly endowments and where bundled service offerings will undoubtedly be made, there will always be the risk that an incumbent could successfully engage in (consumer) pricing conduct which could have the effect of substantially lessening competition. Such practices could include price squeezing or so-called 'predatory' pricing to either defeat new entry or deter subsequent attempts at competition.

'Predatory pricing' describes situations where a carrier or carriage service provider with substantial market power takes advantage of its market power to sacrifice short term profit by setting prices below a particular measure of cost with the purpose or effect of eliminating or substantially lessening competition – for example by forcing a competitor to exit the market and deterring future competitive entry. Such a practice, if proven (under the relevant Part of the Act), would be a breach of s. 46 or s. 151AJ(2) of the Act.

Pricing below cost, even pricing below long-run marginal cost, is not necessarily indicative of predatory pricing. For example, if an entrant builds substantial additional capacity to supply a market, an initial period of intense competition and below-cost pricing may follow as the entrant and the incumbent carriers or carriage service providers strive to utilise their available capacity. The price-cutting will probably cease when the growth in demand for the product or service catches up with the increase in total capacity. In this case, short-term pricing below cost has no predatory intent but is a reflection of intense competition in a product market characterised by economies of scale.

Setting short-term prices below the average cost of unit output is also non-predatory and economically efficient in other circumstances. For example, such low prices may benefit consumers as well as producers if they are established in order to dispose of perishable stocks, or improve the utilisation of capacity at off-peak times.

While it may be difficult to identify predatory pricing simply by examining the recent history of price variations in a market, the Commission believes that there are other avenues to uncover evidence regarding this anti-competitive practice. The Commission considers the following issues relevant in assessing whether a carrier or carriage service provider has engaged in anti-competitive conduct by virtue of predatory pricing.

- Is there a reasonable likelihood that the carrier or carriage service provider will be able to recoup, at some future time, the losses it will incur through the allegedly predatory conduct?
- Will the pricing have an appreciable effect on existing competitors or new entrants to the market?
- Is there some basis for that particular level of pricing which takes account of relevant costing considerations (for example, long run incremental cost)?
- Are the price cuts of some substance and duration?
- Are the price cuts selective in terms of customers?
- Do past patterns of pricing conduct point to similar levels of pricing? For example, is seasonal pricing or pricing related to the utilisation of infrastructure capacity involved?

Predatory pricing is often considered to be a strategy likely to be pursued by a dominant carrier or carriage service provider in a market in order to force out a recent entrant or dissuade a potential competitor from entering. If the strategy is successful, the incumbent will face less competition in the long run and therefore will be able to earn higher long-run profits which will more than compensate for the sacrifice of short-term profits associated with its predatory pricing.

However, such a strategy may not be as successful as it appears at first sight. The would-be predator must be in a position to raise prices and profits to above-normal levels once the threat of entry has been removed. Pricing below cost cannot be sustained indefinitely. The would-be entrant, knowing this, can elect to enter and be fairly confident that prices will be restored to above the predatory level after its entry (assuming that the would-be predator and the entrant have similar costs and financial resources). In other words, the predatory pricing behaviour of the would-be predator may only be a bluff, with the risk that the bluff is called by the prospective entrant.

Nevertheless, the Commission will pay close attention to allegations of predatory conduct, whether it concerns pricing or non-pricing conduct and will seek direct evidence to determine whether or not it is taking place.

Foreclosure (mobility restraints)

Pricing arrangements which inhibit a customer from moving to an alternative supplier or attempt to lock a customer into a long term supply arrangement may have the effect of discouraging entry, or expansion by, a competitor in a telecommunications market, which may have the effect of substantially lessening competition in that market. In general, contracts which are freely entered into will not entail the purchaser accepting less favourable terms than would be available to it from a competitor. As a practical matter, foreclosure is therefore likely to be associated with an element of duress.

Exit penalties which apply where a customer terminates an agreement for supply of a service prior to a specified term may indicate that a carrier or carriage service provider is attempting to lock in customers. The Commission will look closely at exit payments which do not relate to losses which would be sustained (whether as costs incurred or profits lost) in discontinuing the service to the customer.

In assessing the possible anti-competitive effects of exit payments, the Commission will have regard to:

- the length of the agreed term;
- the establishment costs of the service incurred by the supplier;
- the relationship of these costs to establishment charges; and
- the extent to which these costs could be expected to be amortised over the supply period for the service.

The Commission will also take into account any associated commitments of the supplier in providing the service. The share of the relevant market covered by such contracts will also be relevant to an assessment of their possible anti-competitive effects.

The Commission recognises that some pricing and tariffing arrangements amortise capital expenditure over at least the initial contract period and that returns to the carrier or carriage service provider may need to partially compensate non-fungible asset deployment, where there is no possibility of future revenues to cover the replacement cost of the asset. It further recognises that certain stipulated monies on breach of a contract may be considered a penalty by the courts (rather than a liquidated damages clause) and therefore unenforceable.

Refusal to supply goods or services

In the context of possible anti-competitive conduct the term 'refusal to supply' needs to be interpreted in a broad sense, covering:

- an outright refusal to supply inputs to any or all independent downstream service providers;
- a constructive refusal to supply inputs, whereby the price charged for those inputs is so high that the downstream producer is unable to trade profitably (except, for example, where the prices charged for those inputs are cost-based). It might also be

regarded as a constructive refusal to supply if the supply of inputs is made conditional on obtaining unrealistically high sales volumes by the purchaser; and

- a refusal to enter reciprocal charging arrangements.

An example is the Internet Peering matter, where the Commission issued competition notices in relation to Telstra's charge for competing Internet Access Providers (IAPs) to connect to the Big Pond Internet backbone. The notices alleged that Telstra was contravening the competition rule by charging its IAP competitors for Internet backbone services while at the same time not paying for similar services received from those same competitors. The higher costs of rival IAPs threatened their viability and resulted in higher prices to downstream IAPs and, ultimately, end-users.

As a starting point, the Commission is likely to regard outright or constructive refusal to supply products or services which are essential inputs to downstream activity by a carrier or carriage service provider with substantial market power as strong *prima facie* evidence of a substantial lessening of competition. However, in some circumstances, refusal to supply may not contravene the competition rule, such as where the refusal is justified by network safety and integrity.

Particular problems may arise where the refusal or delay relates to a service that requires:

- end to end capability across a network;
- access to all or most originating points to be economically viable for an efficient alternative supplier;
- support for equipment capability to interact with the network (where the access seeker pays for its reasonable share of the incremental costs associated with a new network feature);⁹² or
- the provision of information which may constitute a necessary input to a competitor's operations.

A further problem may be the time taken to supply new access products to a competitor, or supply existing products to a new entrant. Where a competitor requests provisioning for a new service to a particular end-user customer the competitor may, for example, be subjected to unreasonable waiting periods for its customer to receive the service, whereas if the same customer were to request the service directly from the carrier or carriage service provider, the service would be provided in a shorter period. Similarly, excessive delays may be experienced in relation to a carrier or carriage service provider meeting previously arranged appointments at a customer's premises for cabling, network tie-in or other purposes requiring on-site attendance.

These situations have potentially anti-competitive consequences. In assessing this type of complaint the Commission will focus on, among other matters, whether the delays are part of a pattern of conduct by the carrier or carriage service provider against its competitors which is affecting the decisions of the competitors' customers and whether

92 Carriers and carriage service providers may supply a range of support services which are necessary for the day to day operations of competitors. Such support services could include help desk, fault restoration and provisioning.

service levels provided to competitors are substantially equivalent to those directly provided to customers of the carrier or carriage service provider.

Bundling (vertical restraints)

Bundling may sometimes be an economically efficient way of marketing goods and services from the viewpoint of both suppliers and customers. Customers may save on transaction costs by buying a range of related and compatible products from a single supplier. A carrier or carriage service provider may realise economies of scale and scope and a more secure market by bundling certain groups of goods and services for sale.

Nevertheless, bundling may not always be in the interests of consumers and it may have adverse effects on competition. The risk arises when the carrier or carriage service provider supplying the bundle has substantial power over one of the products included in the bundle. In these circumstances the key test is whether competitors which are no less efficient in supplying the potentially contestable components of the bundle can match the prices offered by the carrier or carriage service provider with market power. This requires that the bundle not involve an implicit discount on the contestable service so great as to effectively exclude no less efficient competitors.

Examples of bundling that may have the effect of substantially lessening competition and where the tests set out above may be appropriately applied, may include:

- tying of a service (where the carrier or carriage service provider has substantial power in the market for that service) with another service, or other services, in a market where it lacks market power — for example: the tying of ‘own brand’ equipment to the supply of access to the local loop, or the supply of a competitive service conditional upon the supply of a service in which the carrier or carriage service provider has significant market power; and
- the supply of a bundle of services where the individual service elements are clearly identifiable but any one of these elements cannot be separately purchased by a customer at a price equal to or lower than the price of that element in the bundled offering.

Parallel pricing

Agreements, arrangements or understandings to fix the prices at which goods or services are bought or sold are illegal under the Act.⁹³ If two or more carriers or carriage service providers are observed to vary their prices by the same amount and at the same time this may indicate that they are acting in collusion in breach of the Act.

However, there may be other explanations for parallel pricing. For example, in a strongly competitive market where the cross-elasticity of demand for the services of each supplier is very high, individual service providers cannot afford to allow their prices to differ significantly from those set by their competitors.

⁹³ Section 45A.

Moreover, in a market where there are only a few suppliers of a particular product, the recognition of their mutual interdependence may mean that they will tend to vary their prices at the same time and by the same amount so as not disturb the existing equilibrium and provoke a possible price war. Further, each carrier or carriage service provider may act independently in the same way to a given change in the market situation, such as an increase in the cost of certain inputs.

Where an arrangement or understanding to fix prices is suspected (formal collusion) the Commission will rely on direct evidence of such an arrangement or understanding or by implication supported by relevant facts. The relevant evidence may be collected through the various statutory provisions available to the Commission to obtain information (discussed above). In the past the Commission has received information voluntarily from persons who have been parties to, or had pressure applied to join, certain anti-competitive arrangements of this kind.