



**BUNDLING
IN
TELECOMMUNICATIONS MARKETS**

—response to submissions on the ACCC draft information paper

August 2003

Introduction

The Australian Competition and Consumer Commission (the Commission) released its draft information paper entitled *Bundling in telecommunications markets* for industry comment in January 2003. The draft information paper outlined factors that the Commission considers relevant to its considerations of bundling conduct in telecommunications markets. It outlines the Commission's approach when considering bundling, including the structure of the internal analysis it would likely undertake, and the types of information which are relevant. It provides guidance for the telecommunications industry, their advisers and the public generally.

In response to the draft information paper, public submissions were received from:

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| ■ AAPT (including a submission from CoRE Research) | ■ Hutchison |
| ■ AOL/7 | ■ Macquarie Corporate Telecommunications |
| ■ ATUG | ■ Optus |
| ■ Brisbane City Council | ■ PowerTel |
| ■ Charles River Associates | ■ Primus Telecom |
| ■ Comindico | ■ Telstra (including a submission from NECG) |

Public versions of the submissions are available from the Commission's website at <www.accc.gov.au>. The submissions:

- generally supported the Commission's approach to assessing bundling in telecommunication markets, although many submissions noted the difficulties in assessing the competitive implications of bundling in complex telecommunications markets;
- while generally supporting the Commission's proposed approach to imputation tests, expressed concern that the Commission would rely too heavily on the tests, which it was submitted can be inconclusive and subject to regulatory gaming; and
- generally welcomed the Commission's proposed further use of its information gathering powers to identify anti-competitive behaviour, although concerns were raised about the Commission's ability to expeditiously enforce the *Trade Practices Act 1974* (the Act) if such behaviour were identified.

Telstra's submission was less supportive of elements of the Commission's draft information paper.

Some submissions made specific proposals for legislative amendments to restrict bundling conduct or for the examination of bundling conduct to occur on a more *ex ante* basis. Legislative amendments were also suggested in light of the High Court's *Boral* decision.¹ Also, some submissions recommended that the Commission further investigate Telstra's current bundling practices.

The Commission has considered the issues raised by submissions made in response to the draft information paper and has now released its finalised information paper on *Bundling in telecommunications markets* (the information paper). The Commission's purpose in developing these guidelines is to provide general guidance on its approach to the current legislative provisions.

This addendum to the information paper, discussing the significant issues raised by the submissions and the Commission's response to them, has been released in the interests of promoting an informed, transparent and robust consultative process.

1 General comments

1.1 Market definition

ATUG queried the Commission's current approach to market definition, suggesting that the Commission should consider analysis of competition concerns on the basis of the effect on customer groups, not by products. Charles River Associates also commented that it believed imputation testing over customer groups rather than products may be appropriate when the level of competition for these customers differs.

The Commission currently determines market definitions in accordance with section 4E of the Act, that is, the market in relation to any good or service, and will continue to so. Where market inquiries support doing so, the Commission may define a market on the basis of customer groups.

In analysing particular conduct, the Commission may assess its effect on a submarket or segment of a broader market. The results of that analysis, however, must be considered in context with the defined broader market.

1.2 Ex ante consideration of bundling

Many submissions called for the Commission to consider the bundles that Telstra proposed to offer prior to them being marketed.

One particular form of *ex ante* clearance that was raised by submissions including AAPT, Brisbane City Council and Comindico, was that the Commission require evidence that any discount on a bundled service offering is justified by cost savings derived from providing the service as a bundle.

¹ *Boral Besser Masonry Limited (now Boral Masonry Limited) v Australian Competition and Consumer Commission* [2003] HCA 5, 7 February 2003.

This evidence might assist to understand the reasons for a service provider bundling, and may provide useful information in some investigations. For example, such evidence could be considered when the pricing of bundling conduct falls in the ‘grey area’, discussed in section 4.2.3 of the information paper. However, it is unlikely such evidence can be more informative of anti-competitive effect. This is particularly so given the pro-efficiency reasons for bundling also potentially include price-discrimination. In any event, the Commission does not have the ability to require *ex ante* consideration of bundling conduct under the current legislative framework.

2 Issues associated with pricing — imputation tests

2.1 Use of imputation tests

Telstra and NERAG consider that an imputation test, properly executed, will provide incentives for efficient investment. Also, Telstra and NERAG argue that an imputation test based on an average cost measure may create an artificially high retail-price floor, thus dissuading efficient investment. Telstra also commented that a failed imputation test is a pre-requisite for identifying anti-competitive behaviour.

Having reviewed the submissions, the Commission continues to believe that an imputation test is only one potential consideration in determining whether conduct is anti-competitive. The Commission must ultimately have regard to the elements of the relevant section of the Act and applicable case law.

Further the Commission continues to believe that the imputation test using an average cost measure will be an important indicator of the long-run impacts of particular bundling conduct.² If the pricing falls beneath the average cost measure, the Commission would still need to examine other factors. This is described in the report as a ‘grey area’, which requires further examination of the particular reasons for the pricing and its impact in the market.³ If the pricing falls beneath a marginal cost measure, a strong likelihood of anti-competitive harm exists, although the conduct would need to be considered with reference to the relevant provisions of the Act.

² The Commission sought consultancy advice from NERA in relation to imputation testing. While NERA recommended the use of a ‘marginal cost’ basis for the imputation test, it also noted:

- that marginal cost based tests fail to identify some instances of anti-competitive behaviour; and
- that the time period will determine the costs that should be considered ‘marginal’. NERA advised that for a relatively long timeframe, the analysis may approach an average total cost imputation test.

Refer NERA, *Imputation tests for bundled services — a report for the Australian Competition and Consumer Commission*, Sydney, January 2003, pp. 2 and 17.

³ In response to submissions, the Commission has included ‘intent’ as a factor that it may consider when pricing falls in the ‘grey area’. The consideration of intent would also be consistent with the approaches taken in Canada and by the European Courts (refer NERA, above n. 2, p. 20).

Telstra have also expressed concern that the Commission's approach to imputation testing, including the application of 'grey area' factors, provides uncertainty when pricing goods or services and dissuades efficient investment. It is not clear the extent to which this uncertainty exists, or that the Commission should potentially risk 'missing' identifying anti-competitive conduct by creating a higher threshold test. Further, to reduce uncertainty, Telstra is at liberty to approach the Commission with its proposals prior to engaging in any particular conduct.

2.2 Imputation tests and the risk of regulatory gaming

The Commission notes arguments made in many submissions that imputation tests are subject to regulatory gaming. The Commission anticipates that the collection of ongoing price and cost information under the Telecommunications Industry Regulatory Accounting Framework (RAF) and public reporting of some of this information as required by the Minister,⁴ will assist to reduce this risk. However, the Commission accepts that caution may be required when interpreting some information provided to it, in part due to the potential reliance on information provided by a party under investigation.

2.3 Allocation of common costs

Submissions, including that of AAPT, argued that the Commission and NERA's papers did not fully address the issue of common costs.

The Commission notes that the RAF fully allocates all costs and revenues to specified services (except where specifically excluded), including common costs. In any investigation process, the Commission would likely use the RAF data as a starting point to undertake imputation testing. However, the Commission has recognised in the past that the RAF data may need to be modified to address specific issues. The Commission may also undertake sensitivity analysis of the allocation of common costs where appropriate.

This approach to allocating common costs was recently used in the imputation record-keeping rule (RKR) that the Commission issued to Telstra pursuant to a Ministerial Direction, which stipulated that Telstra allocate costs in accordance with the allocations rules in the RAF.⁵

2.4 Weighting in imputation tests

As noted previously, the Commission will assess the effect of conduct over a market. Where the market of concern includes the bundled and unbundled supply of services, the Commission proposed to weight the price and cost information to reflect the proportion of bundled and unbundled supply in the relevant market(s). Optus and PowerTel query whether

⁴ The Minister issued a 'special Telstra Direction' to the Commission under section 151BUAAA of the Act. An overview of this Ministerial Direction is in chapter 5 of the information paper.

⁵ A copy of the RKR issued to Telstra is available from the Commission's website at <www.accc.gov.au>. Follow the links to telecommunications and then to record keeping.

a weighted methodology to bundled and unbundled services, for the purposes of an imputation test, is appropriate.

Optus' concern is that the practice of price discrimination does not apply weighted averages of prices across customer groups. Rather, it contends a firm instead considers what price to charge for each type of consumer and thus the bundled price should be considered the relevant benchmark.

The Commission agrees with NERA that a weighted approach is an appropriate approach for imputing the retail price of a service that is supplied on both a bundled and unbundled basis. This is on the basis that the Commission is considering the impact of competition in a market. Having said that, it may consider focusing on a particular element of the market to determine specific competition impacts.

2.5 When the cost of supplying rivals is higher

Optus considered that NERA's discussion on modifying imputation tests to allow for situations where the cost to the vertically-integrated firm of supplying competitors is higher than supplying itself is inconsistent with the concept of a vertical price squeeze. The Commission agrees with Optus that an imputation test seeks to determine whether competitors are being squeezed at the retail level, and therefore believes it will not generally seek to modify the imputation test for differences in costs of supply. However, any differences may still be relevant to considering whether the conduct contravenes the Act.

3 Issues associated with non-price factors

It is important to note that the information paper has been amended such that the 'addressable market' consideration has been incorporated in the more general assessment of non-price elements. The substance of the comments have remained similar, although the Commission had focused more on identifying whether bundling increases barriers to entry.

Many submissions suggested factors which the Commission should have particular focus on when assessing the effect of particular conduct on the addressable market. For example, submissions suggested that the Commission should have more focus on the complementarity between goods. The information paper has been amended to reflect some of the suggestions.

4 Complaints and investigations

4.1 Corporate market

Comindico and Macquarie Corporate consider that the Commission should focus investigations on bundling in the corporate market. The Commission notes in response that the Ministerial Direction issued to the Commission on 19 June 2003 directs the Commission to write a report on the state of competition in the corporate sector every six months. The Commission will be looking to examine bundling conduct in the corporate market in this report.