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13 February 2019

Mr Jeremy Cox
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Office of the Registrar General
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By email: Jeremy.Cox@finance.nsw.gov.au

Dear Mr Cox

ACCC views on interoperability

Thank you for your letter of 29 January 2019 inviting the ACCC's views on interoperability in relation to the electronic lodgement network operator (ELNO) market.

The ACCC welcomes the opportunity to provide its views on the principles of interoperability. As the competition regulator, the ACCC has expertise with competition issues including the exercise of market power, problems caused by market structures, and developing regulatory solutions. In this letter the ACCC's perspective therefore focuses on competition issues. The ACCC does not have the relevant expertise to comment on the specific technical details of the interoperability mechanisms for the ELNO market.

The benefits of interoperability to competition

The ACCC's overall position is that interoperability is a potentially effective mechanism for ensuring that the benefits of competition are realised while mitigating some of the adverse implications such as market fragmentation and increased operational costs for participants.¹ Interoperability can thereby promote competition in markets where end users need to connect across networks in order to perform a transaction or function, and where there is the potential for an incumbent service provider to leverage the market power of its network.

¹ Council of Financial Regulators, *Minimum Conditions for Safe and Effective Competition in Cash Equity Clearing in Australia* (revised September 2017); *Review of Competition in Clearing Australian Cash Equities: Conclusions*, June 2015.

The ACCC has considered interoperability in other markets, such as the clearing and settlement market, and the related concept of any-to-any connectivity in the telecommunications market in relation to mobile terminating access services. We have considered interoperability to be a mechanism to reduce network effects and facilitate competition.

In the absence of interoperability in the clearing and settlement of Australian cash equities, both participants to a trade must be members of the same cash equity central counterparty (CCP). However, interoperability between two clearing facilities would allow a participant of one CCP to execute centrally-cleared trades with a participant of the other CCP. Without interoperability, network externalities arise since a larger CCP can offer its participants wider access to other traders and hence a deeper market. Participants are more likely to join a large CCP than multiple smaller CCPs due to the costs associated with maintaining multiple clearing memberships. By allowing a CCP to access another CCP's participant network, interoperability minimises the network advantages and market power that accrue to large CCPs, fostering competition between clearing services.² The issues faced in the clearing and settlement market are similar to the issues that may be faced in the ELNO market. Currently, both parties to a conveyancing transaction (and each party's conveyancer and bank) must use the same ELN to conduct the transaction.

In the telecommunications access regime, the ACCC has highlighted the importance of any-to-any connectivity to reduce network effects and facilitate competition. Any-to-any connectivity is a similar concept to interoperability as it enables end-users to communicate with each other regardless of the network to which they are connected.³ The ACCC deemed the mobile terminating access services (MTAS) to be a declared service under the access regime,⁴ to enable access seekers to obtain access on reasonable terms. The MTAS allows one mobile operator to finish a call on another mobile network, and providing all operators with access to the MTAS achieves any-to-any connectivity. The ACCC considers that any-to-any connectivity can reduce network effects, which arise when there are lower costs or greater benefit to the customer being part of a large customer base. If a customer's network cannot connect to another customer's network then customers will prefer to subscribe to networks with a larger customer base.⁵ This is detrimental to competition as it gives the incumbent an unfair advantage over new entrants. Accordingly, where a new operator enters the market, the incentives for the established operators to interconnect with the new operator may be insufficient to ensure any-to-any connectivity. The incumbent may have the ability and incentive to use its existing market power to either deny interconnection or to impose charges above economic cost for these interconnection services.⁶

In the context of electronic conveyancing, the ACCC considers interoperability to be an important pro-competitive feature. Interoperability is essential to facilitating the entrance of new ELNOs into the market and can prevent an incumbent from becoming further entrenched as the dominant service provider in the market due to network effects.

In the absence of interoperability requirements, a new ELNO entering the market will face barriers to entering the electronic conveyancing market. Customers may be reluctant to switch over due to real or perceived costs of switching. Even if the new ELNO can offer a better price or a better service, the incumbent ELNO will already have the network

² Council of Financial Regulators, *Review of Competition in Clearing Australian Cash Equities: Conclusions*, June 2015.

³ ACCC, A guideline to the declaration provisions for telecommunications services under Part XIC of the *Competition and Consumer Act 2010*, August 2016

⁴ *Competition and Consumer Act 2010* Part XIC

⁵ ACCC, Public inquiry into the declaration of the Domestic Mobile Terminating Access Service - Discussion Paper, August 2018

⁶ ACCC, A guideline to the declaration provisions for telecommunications services under Part XIC of the *Competition and Consumer Act 2010*, August 2016

advantage of a greater number of users and will be able to leverage this advantage, as each party to a transaction must use the same ELNO. Without interoperability, a new ELNO will be unable to offer subscribers the ability to complete a transaction with parties who are subscribed to a different ELNO. In order to maximise their opportunity to transact with other participants in the market, customers would need to subscribe to every ELNO in the market and are likely to prioritise ELNOs with large customer bases, further entrenching existing market power. Interoperability will allow market participants (such as conveyancers and lawyers) to choose their preferred ELNO while continuing to participate in transactions with participants who are using a different ELNO.

The ACCC considers that in order to facilitate competition between providers, it is important that it is easy for customers to easily switch between providers. Ensuring switching is as 'frictionless' as possible will drive efficiencies in a market as end users are able to identify and move to the best service. This is likely to create greater incentives for ELNOs to continue to improve their service quality, efficiency and prices to attract customers.

The ACCC emphasises the need for mechanisms to ensure there is competition in the ELNO market. As the key purpose of interoperability is to remove barriers to entry caused by network effects, interoperability is therefore an essential component. The ACCC understands that in relation to customer switching there may be other barriers not resolved by interoperability, however the ACCC considers that interoperability would be a significant step to resolving the likely barriers. While the ACCC does not have views on the specific model of interoperability that should be adopted, the ACCC considers that for any model to be effective it needs to address the specific barriers to entry that are present in the industry. The formulation of interoperability mechanisms accordingly should be informed by consultation with stakeholders, including as part of the current forums conducted by the NSW Minister for Finance, Services and Property.

Regulatory framework for interoperability

The ACCC does not seek to provide comments on the technical aspects of a proposed interoperability model. However the ACCC provides its views on the important aspects of a regulatory framework to facilitate interoperability.

The ACCC considers that an incumbent ELNO has little incentive to voluntarily develop interoperability arrangements. In an emerging market such as the e-conveyancing market, established ELNOs will have an incentive to refuse to provide interconnection to new entrants, or provide it on unreasonable terms and conditions or at a high price.

For interoperability to overcome these incentives and effectively address the network effects problem, regulatory measures should be in place to facilitate the establishment of effective interoperability on reasonable terms between the incumbent and any ELNO seeking to enter the market. These measures should be in place prior to new ELNOs entering the market, to ensure they are able to compete effectively at the outset. Given the market is still evolving, regulatory measures should also incorporate flexibility and review measures to resolve issues that may arise in the future.

The ACCC considers there should be a level of industry-specific up front regulation rather than sole reliance on commercial arrangements to facilitate interoperability. In markets with large entrenched operators from which a new entrant requires access or connecting services, it is the ACCC's experience that the relative bargaining power of the parties is unequal which is not conducive to fair and reasonable commercial negotiations. Regulatory models to solve this problem generally take two overarching forms: upfront requirements, and negotiation with a regulatory backstop of arbitration. Upfront requirements are preferable where measures should be implemented consistently across an industry. However

negotiation, with recourse to arbitration, provides more flexibility to market participants and may better accommodate new and emerging markets and new products.

The ACCC considers that in the context of the ELNO market, an appropriate regulatory framework would likely combine both approaches. The upfront regulation applying to all ELNOs (whether existing or new entrants into the market) should require each ELNO to have in place baseline interoperability functionality. The baseline requirements will depend on the model of interoperability adopted, however the requirements should implement practical measures to ensure that an incumbent has the necessary facilities and capabilities in place to connect with new entrants or to the central hub (depending on the model of interoperability adopted), and therefore prevent it exerting its market power by unreasonably delaying facilitating interoperability. The upfront requirements should also include an obligation to engage with other ELNOs in good faith and on reasonable terms, and to act on a non-discriminatory basis.

An arbitration mechanism could be utilised when parties are not able to reach an agreement in negotiations relating to terms not covered by the upfront requirements (the baseline interoperability functionality). The extent to which an arbitration mechanism is needed will depend on how comprehensive the upfront requirements are. The mechanism can provide for arbitration to be conducted by an independent arbitrator rather than by the regulator, and in a commercial manner to facilitate swift and targeted resolution of disputes.

Both upfront requirements and the process for referring disputes to arbitration should be transparent to ensure new entrants are sufficiently informed about the process for setting up interoperability and their options where negotiations with incumbent operators are unsuccessful. The ACCC emphasises the importance of transparency in the regulatory framework, including information provision obligations to level the negotiation playing field. Transparency increases the effectiveness of dispute resolution arrangements and also boosts the accountability of ELNOs.

It is important that any model of interoperability that is adopted does not entrench any existing market power or contain any anti-competitive aspects. The government or an independent body should be responsible for setting the data and/or service standards required for interoperability to function and have the ability to exercise regulatory control over the interoperability mechanism. It would undermine the competition benefits of interoperability in the ELNO market if the mechanism itself provided market power to a private owner or operator.

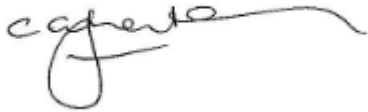
The ACCC understands that NSW is considering the possibility for NSW to introduce a decentralised model of interoperability first and for the other states to opt in over time. The ACCC notes that the terms of the review of the eConveyancing Intergovernmental Agreement (IGA) proposed that interoperability mechanisms would be considered as part of the review. The ACCC understands that this review is ongoing and the review's final report will be issued in April 2019. The ACCC considers that in the long term it may be preferable for there to be consistency in the application of interoperability mechanisms across the industry nationally, for greater efficiency and to avoid duplication of processes. However, as noted above the ACCC also considers it is important for interoperability to be in place prior to new ELNOs entering the market, in order to facilitate effective competition as soon as possible. As with each state's adoption of the MORs, baseline interoperability requirements could be nationally consistent and the application of the mechanism potentially adapted to suit each jurisdiction.

Further engagement

The ACCC looks forward to continued engagement with you on the development of interoperability mechanisms and the broader regulatory regime.

If you have any questions, please contact Matthew Schroder on 03 9290 6924 or matthew.schroder@acc.gov.au.

Yours sincerely

A handwritten signature in black ink, appearing to read 'C. Cifuentes', with a long, sweeping horizontal line extending to the right.

Cristina Cifuentes
Commissioner