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| Dear Mr Rogers |  |

**Discussion Paper: Options to strengthen the misuse of market power**

We refer to the Commonwealth’s discussion paper ‘Options to strengthen the misuse of market power,’ dated December 2015 (**Discussion Paper**).

We welcome the opportunity to make a submission in response to the Discussion Paper, in which the Government seeks further public consultation on the recommendations of the Competition Policy Review (**Harper Review**) to amend the prohibition of misuse of market power in s 46 of the *Competition and Consumer Act 2010* (Cth).

We were extensively involved in the Harper Review. Many of our submissions were endorsed by the Harper Review, and subsequently by the Government. We addressed the proposed amendments to misuse of market power in our previous submissions (**Previous Submissions**):

* dated 17 November 2014 to the Harper Review on its Draft Report; and
* dated 26 May 2015 to Treasury on the Harper Review’s Final Report.

This submission follows on from those submissions, copies of which are **enclosed**, and is divided into two parts: (a) general comments and (b) responses to the questions posed in the Discussion Paper.

As stated in our Previous Submissions, we do not support the proposed amendments to s 46. For the reasons set out below, the current section should be maintained (apart from s 46(1AA), which should be abolished).

**A. General comments**

We do not support the proposed amendments to s 46 because:

* There is a lack of evidence of a need for change.

The Harper Review’s reasons for amending s 46 were based on a preference for a prohibition based on a general economic concept, rather than any identified practical situations not addressed appropriately by the current law. It remains unclear what conduct the changes are trying to capture that is not already captured by the current law.

It is remarkable that the Discussion Paper proposes six options but does not define the problem those options are seeking to address. This prevents any serious cost-benefit analysis of those options, and means the debate must be conducted at the level of general principles around the drafting of competition laws.

* The arguments for change are inconsistent and reflect inconsistent objectives and expectations about what the amendments would achieve.

One line of argument, made by various lobby groups, is that the amendments would somehow protect small businesses and address the problem of oligopolies in certain industries (in particular, supermarkets).[[1]](#footnote-1) However, those types of concerns were expressly rejected by the Harper Review, which instead took the conventional economic position that businesses should be allowed to compete vigorously, even if this would have an adverse effect on competitors. The same position is taken in the Discussion Paper, which states:[[2]](#footnote-2)

“*firms are entitled, and indeed encouraged, to succeed through competition, even if they put competitors out of business and achieve a position of market dominance through their success. This ‘Darwinian’ process of aggressive rivalry is what drives efficient outcomes and benefits to consumers.*”

The Harper Review proposed amending s 46 because it considered the law should be based on an economic test — whether there is a purpose, effect or likely effect of substantially lessening competition (**SLC test**). The SLC test would seemingly make it easier for the ACCC or other claimants to prove a misuse of market power, as they would no longer be required to prove the current “take advantage” and “purpose” elements, even though this would be at the expense of increased uncertainty for businesses.

However, the fact that the ACCC has not proved some s 46 cases is not in itself a valid reason to overhaul the provision. It has not been demonstrated that those cases should have, or would have been, decided differently under the proposed amendments. In two cases frequently referred to — *Rural Press*[[3]](#footnote-3) and *Cement Australia*[[4]](#footnote-4) — the Court held that the conduct in question was already prohibited by the Act, even though it was not a misuse of market of power.

* The proposed changes would increase uncertainty for businesses, facilitate unmeritorious claims and inhibit legitimate competitive conduct.

The proposed changes to s 46 do not correspond with the Harper Review’s statement in its Final Report that a “fit for purpose” competition policy includes “competition laws and regulations that are clear, predictable and reliable.”[[5]](#footnote-5) While the proposed amendments may simplify drafting, they fail to simplify the process of applying the law to real-life situations.

Currently, businesses can be confident that they will not breach the law provided they do not have one of the prohibited anti-competitive purposes listed in s 46. They also know they will not breach the law if they do not “take advantage” — that is, use — any market power they might be considered to have.

Under the present law, the SLC test is confined to prohibitions on dealings between two or more parties (**bilateral conduct**) — a merger, acquisition, exclusive supply arrangement or some other contract, arrangement or understanding between two or more parties (ss 45, 47 and 50). When that test is applied in court, it requires (usually conflicting) expert evidence from economists. It is no simple thing to determine whether competition is likely to be substantially lessened.

When the test is applied by the ACCC in merger clearance applications, the process can take several months of consideration, the provision of information, market consultations and sometimes the negotiation of enforceable undertakings before the ACCC is able to reach a decision. Even then, the ACCC’s decisions are not always upheld on appeal, as shown by, for example, the Federal Court’s decision in *Franklins v Metcash*.[[6]](#footnote-6)

The proposed s 46 would apply the SLC test to each and every aspect of a business’ unilateral conduct — such as how it sets its prices, what products it decides to make (or not make), how it makes its products, and where it chooses to supply them. Such business decisions would be open to scrutiny by the ACCC, competitors, or other commercial players in an open-ended inquiry into the potential long-term effects in any market. While such scrutiny may be justifiable and workable for a major and infrequent business event like a substantial merger, it is completely unworkable in the context of routine, ordinary business decision-making.

The Harper Review itself acknowledged that the proposed s 46 risked over-capture — prohibiting legitimate competitive conduct that should not be prohibited.[[7]](#footnote-7) In its Draft Report, the Harper Review initially proposed a defence to try to address that concern. In its Final Report, problems with the proposed defence led to it being dropped.[[8]](#footnote-8) The concerns with over-capture remained, but the Harper Review considered those concerns were outweighed by the perceived benefits of the proposed s 46.[[9]](#footnote-9) With respect, there is simply no evidence to support that assessment.

We strongly disagree with the Harper Review’s assessment. As lawyers, we see clearly the potential for the proposed s 46 to facilitate unmeritorious claims that are designed to hinder, not protect, competitive conduct. It would be all too easy to allege that any vigorous competitive conduct that adversely affects competitors would be “likely” to have the effect of substantial lessening competition at some stage in the future.

It has been asserted that it is inherent in the SLC test that the test does not prohibit competitive conduct. That view is incorrect. The Harper Review acknowledged that, in applying the SLC test to any conduct, the potential pro- and anti- competitive implications of the conduct would need to be weighed up.[[10]](#footnote-10) That means businesses and their advisers would need to undertake the same exercise, and hope that their judgment about the likely impact on competition is not challenged by the ACCC, competitors or other private parties.

Even where a business considers its conduct would not breach the SLC test, the inherent uncertainty of that test means the business must take into consideration the risk of an ACCC investigation or legal claims. The consequence will be that, in many cases, it will be safer and easier for businesses not to pursue aggressive competitive strategies. That would be a poor outcome for competition and consumers.

Despite the desire of the Harper Review and the ACCC to make s 46 easier to prove, and focussed on an economic concept, a high threshold is necessary and appropriate given the serious nature of the prohibition, the significant penalties attached to it, and the fact that it applies to a wide range of unilateral, competitive business activities.

**B. Questions posed by the Discussion Paper**

*1. What are examples of business conduct that are detrimental and economically damaging to competition (as opposed to competitors) that would be difficult to bring action against under the current provision?*

As noted above, the Harper Review did not identify examples of situations that were not appropriately addressed by the current law — including prohibitions other than misuse of market power.

The Act already prohibits, among other matters:

* cartel conduct (Div 1 of Part IV) — which the Court found in *Rural Press*,[[11]](#footnote-11) even though there was no misuse of market power;
* contracts, arrangements and understandings that have the purpose, effect or likely effect of substantially lessening competition (s 45) — which the Court found in *Cement Australia*,[[12]](#footnote-12) even though there was no misuse of market power;
* exclusive dealing that has the purpose, effect or likely effect of substantially lessening competition (s 47);
* mergers and acquisitions that have the purpose, effect or likely effect of substantially lessening competition (s 50);
* unconscionable conduct (Part 2-2 of the *Australian Consumer Law*) — a key consideration of which is the the relative strengths of the bargaining positions of the parties; and
* unfair contract terms (Part 2-3 of the *Australian Consumer Law*) — when used against small businesses with no effective opportunity to negotiate those terms.

Unless and until clear examples of problematic situations are identified, the Government cannot sensibly weigh up the pros and cons of any proposed particular measures, or whether those measures will effectively address those identified problems.

*2. What are examples of conduct that may be pro-competitive that could be captured under the Harper Panel’s proposed provision?*

As explained above, the proposed s 46 is extremely broad and it could be alleged that pro-competitive conduct has the purpose or likely effect of substantially lessening competition.

Examples of conduct that could be prohibited, on the basis that it has the purpose or likely effect of substantially lessening competition, include:

1. A computer/technology company launches a new and innovative product that takes substantial market share away from its competitors.
2. A petrol company with low petrol prices in the city offers the same prices in rural and regional areas, which other rural and regional petrol companies are not able to match.
3. A supermarket pays higher prices to farmers or other suppliers for their produce/products, but other competing retailers cannot afford to do so.
4. A bank branch in a country town offers extended trading hours, but it is not profitable for the local credit union branch to do so.
5. A hardware store promises to give consumers a discount if they find another store selling the same product for a lower price.
6. A supermarket promotes fresh local produce in its stores, at the expense of imported products.
7. A telecommunications company offers a free handset of the latest mobile phone to every new customer.
8. As part of its service, an internet service provider offers free access to television programs (eg, international sports coverage) currently only available through pay television.
9. An online seller of school uniforms offers free delivery to regional and rural areas.
10. A manufacturer of power tools refuses to supply to a hardware store that has a bad credit rating and is suspected to be on the verge of insolvency.
11. A manufacturer of power tools stops manufacturing a product that has few competing products but is no longer selling well.
12. A petrol wholesaler refuses to supply petrol to a remote area in which it has no distribution arrangements in place.
13. A bank closes an unprofitable branch in a small town which has a couple of other bank branches.
14. A bank donates money to a local football club to pay for improved equipment and facilities — the club gains members from a neighbouring local football club, which struggles to keep going.

Many other similar examples could be given.

Each of the above examples involves pro-competitive and legitimate commercial conduct. However, under the proposed s 46, competent lawyers could, based on a possibility of significant harm to competitors (not competition), draft a Statement of Claim that would likely survive a preliminary strike out application, and expose the defendant to an expensive and wide-ranging exercise of producing relevant documents on discovery. Such an outcome is not good for competition or consumers.

*3. Would removing the take advantage limb from the provision improve the ability of the law to restrict behaviour by firms that would be economically damaging to competition?*

The “take advantage” limb is fundamental to s 46 and it is essential that it be retained. In this context, “take advantage” means no more than use. To “take advantage” of a substantial degree of market power is to use that market power.

Without the “take advantage” limb, s 46 would no longer be a prohibition on misuse of market power. It would apply in situations where there was no use of market power at all and the existence of market power was wholly irrelevant to the conduct complained of.

In all of the debate over s 46, there has been no serious argument that s 46 should no longer be about misuse of market power, or that it should prohibit some other form of economically damaging conduct (which has not been identified).

In *Rural Press*,[[13]](#footnote-13) the defendant used its financial strength to protect its market power, but there was no use (or “taking advantage”) of market power. Financial strength is not the same as market power. In short, market power means not being constrained by competitors, and so being able to act like a monopolist. A firm may have significant financial resources but not have market power because it is constrained by competitors. Further, trying to protect existing market power is not one of the prohibited purposes in s 46. However, in any event, the Court held that there was cartel conduct in breach of the Act.

Following that decision, amendments were made to s 46. Section 46(6A) was inserted to make clear that, in assessing the “take advantage” limb, the Court could have regard to whether the market power:

* “materially facilitated” the relevant conduct;
* was relied on by the corporation in engaging in the conduct;
* made the conduct more “likely”; or
* was “otherwise related” to the conduct.

It is difficult to see how the concept of “taking advantage” or “using” market power could be made any broader.

It has been asserted, including in the Discussion Paper, that the Courts have narrowly interpreted “taking advantage” such that the limb cannot be satisfied if a corporation without market power *could* (not *would*) commercially have engaged in the same conduct.[[14]](#footnote-14) That proposition is incorrect. As shown above, it is inconsistent with s 46(6A). The High Court itself used the words “materially facilitated” in the *Rural Press* decision.[[15]](#footnote-15) Further, in the *Cement Australia* case, Greenwood J considered not only whether a corporation without market power could have engaged in the relevant conduct, but also whether the conduct was “materially facilitated” by market power.

For example, in *Cement Australia*, which involved conduct that occurred before the 2008 amendments following *Rural Press*, the Court said (emphasis added):

* *“[T]he use of market power … must be such that the method of use is made possible only by the corporation’s market power, that is, only by the absence of competitive conditions: Queensland Wire, Dawson J and Mason CJ and Wilson J, or materially facilitated by the absence of competitive conditions”* (at [1908]).
* “*[T]he financial terms of the Millmerran contract, put to the Directors, were not so far beyond the bid of Transpacific as to lead to the conclusion that Pozzolanic’s bid was either only made possible by its market power or that Pozzolanic’s bid was necessarily materially facilitated by Pozzolanic’s market power*” (at [2300]).

As noted above, the Court held that, in any event, a contractual term was for the purpose of substantially lessening competition and therefore in breach of s 45 of the Act.

*4. Is there economically beneficial behaviour that would be restricted as a result of this change? If so, should the scope of proscribed conduct be narrowed to certain ‘exclusionary’ conduct if the ‘take advantage’ limb is removed?*

As noted above under question 3, if the “take advantage” limb is removed, s 46 would prohibit conduct that is not a misuse of market power — and, in fact, conduct to which market power is entirely irrelevant. No case has been made that s 46 should prohibit some form of unspecified exclusionary conduct that is not a misuse of market power.

An example of what might be considered exclusionary conduct that does not involve a use of market power is the current prohibition on predatory pricing in s 46(1AA). For the reasons given in our Previous Submissions,[[16]](#footnote-16) we agree with the Harper Review’s recommendation that that prohibition should be abolished.

The “take advantage” limb should not be removed.

*5. Are there alternatives to removing the take advantage limb that would better restrict economically damaging behaviour without restricting economically beneficial behaviour?*

As explained above, “taking advantage” means a “use” of market power. The meaning of “taking advantage” is broad: s 46(6A). No case has been made that s 46 should prohibit something other than misuse of market power.

It is not clear what economically damaging behaviour is sought to be restricted. In those circumstances, it is not sensible to try to formulate any alternative amendments to restrict such behaviour.

*6. Would including ‘purpose, effect or likely effect’ in the provision better target behaviour that causes significant consumer detriment?*

The current law applies only where the corporation has one of the specific purposes prohibited in s 46. Adding “effect” or “likely effect” would mean the section could apply to conduct that did not have the prohibited purpose. However, simply because more conduct might be prohibited does not mean the law would be better targeted.

It might seem desirable, in theory, to prohibit all conduct that has an anti-competitive purpose, effect or likely effect but, for the reasons given above, this would, in reality, increase uncertainty for businesses, facilitate unmeritorious claims and inhibit legitimate competitive conduct. Ultimately, this would be bad for competition and consumers.

The current requirement of purpose assists businesses to distinguish between what is prohibited and what is not. It provides an important measure of certainty for business. It also helps maintain the rule of law. It is far from ideal for compliance with such a serious law, which can apply to such a wide range of unilateral conduct, to depend on an economic concept open to great contention.

*7. Alternatively could retaining ‘purpose’ alone while amending other elements of the provision be a sufficient test to achieve the policy objectives of reform outlined by the Harper Panel?*

No. As noted above, the Harper Review’s policy objective in amending s 46 was to base the prohibition solely on the economic concept of whether there was a purpose, effect or likely effect of lessening competition. Whether that objective is desirable or not, it cannot be achieved by retaining ‘purpose’ alone.

Further, for the reasons given above, any prohibition on misuse of market power must involve a “use” of market power. Therefore it is essential that the “take advantage” limb be retained.

*8. Given the understanding of the term ‘substantially lessening competition’ that has developed from case law, would this better focus the provision on conduct that is anti-competitive rather than using specific behaviour, and therefore avoid restricting genuinely pro-competitive conduct?*

No. There is no developed understanding in the case law about when unilateral conduct — such as discounting, launching new products, and otherwise competing vigorously — has the effect or likely effect of substantially lessening competition. As explained above, the existing prohibitions in the Act that involve a test of substantially lessening competition apply only to forms of bilateral conduct.

Further, it is an inherent problem with using a test of “substantially lessening competition” for unilateral conduct that vigorous pro-competitive conduct may ultimately lead to the elimination of rivals and therefore reduced competition. This means that pro-competitive conduct is restricted and inhibited by the prohibition itself and by the risk of an ACCC investigation and/or claims of breach by competitors or other parties.

Critics of the current purpose test have stated that it focuses inappropriately on harm to individual consumers rather than competition. While the words of s 46 may give such an impression, the High Court has firmly established in decisions such as *Queensland Wire*,[[17]](#footnote-17) *Melway*[[18]](#footnote-18) and *Boral*[[19]](#footnote-19) that the section is ultimately concerned with competition and consumers.

As Mason CJ and Wilson J explained in *Queensland Wire*:[[20]](#footnote-20)

*“The object of s 46 is to protect the interests of consumers, the operation of the section being predicated on the assumption that competition is a means to that end. Competition by its very nature is deliberate and ruthless. Competitors jockey for sales, the more effective competitors injuring the less effective by taking sales away. Competitors almost always try to ‘injure’ each other in this way. This competition has never been a tort ... and these injuries are the inevitable consequence of the competition s 46 is designed to foster.”*

This passage shows that the current s 46 is aligned with the philosophy of competition contained in the Discussion Paper, and there is no need for the proposed amendments.

*9. Should specific examples of prohibited behaviours or conduct be retained or included?*

We are not aware of any proposals to prohibit specific behaviours or conduct. Certainly, that was not part of the Harper Review’s recommendations.

In our view, the current s 46 (apart from s 46(1AA), which should be abolished) is workable and addresses specific conduct that may be exclusionary — predatory pricing (see s 46(1AAA)) and refusals to supply. This has been shown by cases in which the ACCC has successfully enforced s 46, such as against Cabcharge[[21]](#footnote-21) and Ticketek.[[22]](#footnote-22)

*10. An alternative to applying a ‘purpose, effect or likely effect’ test could be to limit the test to ‘purpose of substantial lessening competition’. What would be the advantages and disadvantages of such an approach?*

The advantage of a test based on purpose, but not effect or likely effect, is that the prohibition would not capture conduct where the corporation did not intend to reduce competition substantially. This would make it easier for business to comply with the law, because business would know there would be no contravention unless it had an anticompetitive purpose.

However, the problem with a test based on purpose is that the prohibition would still apply where there was no actual or likely adverse impact on competition. This is excessive, and would not address the issue of misuse of market power, which is what s 46 is all about.

Accordingly, even if a test of purpose alone was used (instead of the SLC test), the “take advantage” limb should still be retained.

*11. Would establishing mandatory factors the courts must consider (such as the pro- and anti- competitive effects of the conduct) reduce uncertainty for business?*

The Harper Review considered that s 46 should include legislative guidance directing courts and firms to weigh the pro-competitive and anti-competitive impact of conduct. The Harper Review’s Final Report attempted to address the broad nature of their proposed s 46(1) by including legislative guidance in s 46(2) “with respect to the section’s intended operation.”

The proposed guidance would direct Courts to address numerous complex matters (which are expressed not to be exhaustive) including efficiency, innovation, product quality and price competitiveness. Furthermore, the inclusion of those factors makes it unclear whether the test for determining whether there has been a substantial lessening of competition under s 46(1) is somehow different to the same test where it appears in other sections of the Act (ss 45, 47 and 50) where the guidance is not present.

Mandatory factors for consideration may be of some assistance at trial to the extent that they indicate that the prohibition is not intended to capture pro-competitive conduct. However, being only matters for consideration by the court, mandatory factors would not:

* reduce the uncertainty created by the SLC test;
* prevent ACCC investigations or unmeritorious claims;
* avoid the inherent problem that the SLC test captures pro-competitive conduct that is ultimately likely to substantially lessen competition.

*12. If mandatory factors were adopted, what should those factors be?*

Although they would be inadequate for the reasons given above, any mandatory factors should make as clear as possible that the prohibition is not intended to capture pro-competitive conduct, and that the Court should have regard to the undesirability of inhibiting vigorous competitive conduct, even if this causes competitors to exit the market and thereby substantially lessen competition.

*13. Should authorisation be available for conduct that might otherwise be captured by section 46?*

On balance, authorisation should be available for conduct that would otherwise breach s 46 but that procedure is by no means an answer to the problems with the proposed amendments to the section. It is unrealistic to expect a business to divulge to the ACCC its commercially-sensitive strategies to engage in vigorous competition, and then have those strategies subject to scrutiny and critique by its competitors and other market participants over a period of months, as occurs under the ACCC’s informal merger clearance process. Authorisation as a process is far more workable for one-off major transactions that must be public in any event, such as mergers.

The availability of authorisation also carries a risk that the ACCC will try to pressure a business to seek authorisation, and thereby exercise an inappropriate degree of control over the business’ competitive strategies. We do not consider that level of regulatory intervention and interference with business to be generally appropriate.

*14. If quantitative data on the regulatory impact of alternative options on stakeholders (including the methodologies used) can be provided.*

None.

*15. Are there any other alternative amendments to the Harper Panel’s proposed provision that would be more effective than those canvassed in the Panel’s proposal?*

For the reasons set out, we strongly support retaining the current s 46 (apart from s 46(1AA)).

*16. Which of options A through F below is preferred? What are the relative strengths and weaknesses of each option? What information can you provide regarding the regulatory impact of each option on businesses?*

For the reasons given above, we strongly recommend Option A (no change) and do not support any of the other Options (B-F). Apart from Option A, all of the other Options involve removing the “take advantage” limb and would apply to conduct that is not a misuse of market power.

*17. Are there any other options (not outlined below) that should be considered?*

If the Government were to consider seriously any other option, the Government should provide interested parties with an opportunity to make comment on that proposed option.

Yours sincerely

**Zaven Mardirossian Matthew Lees**

Partner     Partner

1. Peter Strong, ‘Why Australia’s love affair with oligopolies needs to end,’ *Smart Company,* 3 February 2016. [↑](#footnote-ref-1)
2. Discussion Paper, p 3. [↑](#footnote-ref-2)
3. (2003) 216 CLR 53. [↑](#footnote-ref-3)
4. (2010) 187 FCR 261. [↑](#footnote-ref-4)
5. Harper Final Report, p 7. [↑](#footnote-ref-5)
6. (2009) 264 ALR 15. [↑](#footnote-ref-6)
7. Harper Draft Report, p 44. [↑](#footnote-ref-7)
8. Harper Final Report, p 345. [↑](#footnote-ref-8)
9. Harper Final Report, p 347. [↑](#footnote-ref-9)
10. Harper Final Report p 345. [↑](#footnote-ref-10)
11. (2003) 216 CLR 53. [↑](#footnote-ref-11)
12. (2013) 210 ALR 165. [↑](#footnote-ref-12)
13. (2003) 216 CLR 53. [↑](#footnote-ref-13)
14. Discussion Paper, p 5. See also: Lucy Barbour, “Competition watchdog ACCC head Rod Sims denies claims an 'effects test' would be 'economically dangerous'”, *ABC Rural*, 19 August 2015, http://www.abc.net.au/news/2014-08-18/accc-effects-test/5678036. [↑](#footnote-ref-14)
15. (2003) 216 CLR 53. [↑](#footnote-ref-15)
16. See paragraphs 12–24 ABL Submission to Competition Policy Review Final Report, 26 May 2015, See paragraphs 16–31 ABL Submission to Draft Report, 17 November 2014. [↑](#footnote-ref-16)
17. (1989) 167 CLR 177. [↑](#footnote-ref-17)
18. (2001) 205 CLR 1. [↑](#footnote-ref-18)
19. (2003) 215 CLR 374. [↑](#footnote-ref-19)
20. (1989) 167 CLR 177 at [24]. [↑](#footnote-ref-20)
21. [2010] FCAFC 111. [↑](#footnote-ref-21)
22. [2011] FCA 1489. [↑](#footnote-ref-22)