Market and Competition Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

Submission in relation to the Harper Review's recommendation regarding the misuse of market power

Professor Allan Fels AO

Much has been written on this subject. I myself did a technical analysis of the issues at the beginning of the Inquiry in a lecture at the University of Melbourne which was subsequently lodged as a submission with the Harper Inquiry.

I thought it might be more useful and interesting if I passed on some general thoughts and experiences concerning s 46.

The *Trade Practices Act 1974* (Cth)
The 1974 Act provided as follows:

46. (1) A corporation that is in a position substantially to control a market for goods or services shall not take advantage of the power in relation to that market that it has by virtue of being in that position-

(a) to eliminate or substantially to damage a competitor in that market or in another market;

(b) to prevent the entry of a person into that market or into another market; or

(c) to deter or prevent a person from engaging in competitive behaviour in that market or in another market.

It is clear why, at that time, the words "shall not take advantage" were inserted. If they had not been inserted, then there would have been a prohibition on corporations with market power from engaging in behaviour that by virtue of provisos (a)-(c) damaged competitors, not necessarily competition. At that time it was clearly necessary to put in some words that limited the kind of behaviour that would be prohibited by s 46; with the benefit of hindsight it might have been wiser to have put in a general proviso in 1974 at the end of s 46 that said that the behaviour was only prohibited if it had the purpose or effect of substantially lessening competition. In defence of what was done in 1974 there was some uncertainty about what meaning the courts would attribute to certain words in the Act, so we should perhaps not judge the inclusion of the words "take advantage" so harshly as we would now.

In the current context that if a substantial lessening of competition test is added to s 46 in the way that Harper has proposed, there is no need for there to be additional words about taking advantage of market power. Once you put them in and you, as well, have a substantial lessening of competition test, as Harper recommends, it's clear that the words "take advantage" add an additional test over and above the test of "substantial lessening of competition".

Swanson Report 1976 and after
There was a very big fightback by big business against the whole 1974 Act, bringing about the 1976 Swanson Review. I myself knew the business members, both Mr Swanson (who had a senior role at ICI) and Mr Jim Davidson (CEO of Commonwealth Industrial Gases). They both came from dominant firms. At that time I was involved in regulating prices of dominant firms under *Prices Justification Act*. Both mentioned to me that the Committee had

proposed a considerable watering down of s 46. Mr Davidson made a number of colourful analogies with a big fish swimming in the pool and waggling its tail and inadvertently killing some small fish without having had the intention of doing so. On the basis of that analogy, there should be a purpose test. To be fair, at that time there was little case law on the meaning of s 46 and not much understanding of what “abuse of market power” was about, and all this indicated a need for caution.

1977 was also the occasion on which the merger test was changed from a test of prohibiting mergers that substantially lessened competition to a test which only prohibited mergers if they gave rise to dominance or increased dominance.

In the next 15 years the Trade Practices Commission (TPC), particularly after the era of Chairmanship by Bob McComas and then Bob Baxt, advocated the adoption of an effects test in s 46 but did not push the matter very hard.

1991

When I became chairman of the TPC in 1991, I was the first economist appointed to that role (albeit I did have a law degree). I gave early thought to the Act and to what needed to be reformed, as well to what the appropriate economic role of the TPC was.

As I saw it there were a number of priorities:

- to change the merger test from dominance back to substantial lessening of competition;
- to increase the penalties and at a later point get criminal sanctions for cartels, as in the USA;
- to change the very badly worded s 46 and, in particular, to overcome the obvious deficiencies of it. My major concern was that s 46 was based on the wrong principle (purpose) and that it thus deviated from what applied and was generally agreed in North America and Europe. Under competition law nothing would be done to break up monopolies or regulate their prices. All that would be done would be to prohibit them from taking action that harmed competition. This was a universal political compromise that made economic sense. As an economist I had long understood that the purpose of the Act was to stop harmful economic behaviour irrespective of its intent, so it was clear to me that the emphasis on purpose was misplaced and the words "or effect" should be added. I considered the inclusion of the word "effect" as a very simple, basic piece of economics. At that time I was a bit less aware of the problems caused by the words "take advantage", but of course now I see the big problem they cause.
- to have a more vigorous Trade Practices Commission;
- to get more economics into the Commission; and to
- do something about the many restrictions imposed by governments on competition (that is, to “do a Hilmer”)

Each of these reforms looked difficult. Big business has had a long history of always fiercely opposing any changes which looked as if they would strengthen the competition law. They bitterly opposed the original Barwick/Snedden reforms of the 1960s, the 1974 Trade Practices Act (TPA), the change in the merger law in the 1990s, the effects test of course, the increase in fines and the criminalization of cartels. Big business also bitterly complained about anyone who vigorously enforced the Competition Act. The only changes it has supported were the Hilmer reforms which essentially extended the Act to public utilities, the professions and so on. The Law Council of Australia also opposed nearly all of these changes, and certainly did not actively support them.

I was aware of how difficult it was to get reforms and the best one could do was to get a big reform through every few years. So the sequence was higher penalties, mergers and

criminalization of cartels, with s 46 having to drop off the list of top priorities. The Dawson Review was principally about criminalization of cartels and also the vigorous law enforcement and associated publicity brought about by the ACCC.

Dawson Report

However, there was a debate about s 46. As ACCC Chair I personally held a very interesting and substantial discussion with Mr Dawson in which we discussed at some length the question of whether we should scrap the whole of s 46 and start all over again with exactly the same proposition that the Harper Committee has now proposed. We both saw the logic. He asked me how I felt about it and, after acknowledging the logic of the proposal, I confess that I blinked and said that I was not pressing that reform now. My reason was that from the perspective of getting results as a law enforcer, s 46 in its form then (and now) is drafted in a way that makes getting court results easier than under the Harper test. This is because, as noted above, the rather long provisions of s 46 refer specially to certain forms of behavior that damage competitors (not competition). Whilst it is true that the High Court has imposed an underlying competition test into s 46, the fact is that in one case after another it was obvious that judges liked to look very carefully at whether the behavior breached conditions (a), (b) and (c) in s 46(1) (those are the provisions that refer to damage to competitors) and use it as a major hook in determining guilt under a s46 even if they also conducted a substantial lessening of competition test.

Dawson did not go on to ventilate the matter. His report however on s 46 was marred by some errors. The first involved a misstatement of US law. It does have an effects test (incidentally it basically has a purpose test, principally via the attempted monopolisation test). The second was that he conceded that in the EU there was an effects test (there is also a 'purpose' test based on objective purpose) but said that the EU was different because the law only related to dominant firms whereas in Australia it relates to firms with substantial market power. He seemed to be unaware that in Europe the term "dominance" covers "collective dominance", which brings it very much into line with the Australian law. In any case, that distinction is not relevant to the debate about purpose or effect.

Changes after Dawson

Subsequently, the Parliament took two actions. First, the Howard Government with apparent support from the then Chair of the ACCC introduced a number of amendments to s 46 which did not amount to a change of the law at all. They simply embodied conclusions of the High Court in some of the s 46 cases and put their conclusions into statutory form. The most interesting was the "materially facilitates" proviso. Any claims that this was a change in the substantive law were quite wrong. Those words were used by the High Court. Essentially, these words don't change the "take advantage" test, they merely make it sound a little softer.

In the Melway Case the ACCC had intervened and successfully got the words "materially facilitated" adopted into the reasons. This gives a softer application to "take advantage" but does not change its essence, namely that not only does the firm's behaviour have to lessen competition but it must also have a causal link with it. I made the point to the *Australian Financial Review* after the decision that the ACCC saw some benefit from the High Court endorsement of "materially facilitate". That night I happened to see a member of the Court at the airport who had noticed the article and, in passing, he said I should take very limited comfort from it. He was right.

Second, the Birdsville Amendments were introduced; this meant, rather amazingly, that within s 46 there are now two separate tests of abuse of market power. This is a "world first".

It was partly the Birdsville Amendments that led me to believe it was best to go down the path I had discussed with Mr Dawson.

At the political level it is worth noting that the small business advocates of changes to s 46 are effectively accepting the removal of the strongly pro-small business provisions that are incorporated in the Birdsville Amendments. Personally I have never been a fan of those amendments. However, I just cannot see how the government would deserve any support from small business if they dropped the Birdsville Amendments and then failed to implement the full Harper provisions. I believe that going halfway on Harper would be an unacceptable outcome for the small business community if they were going to lose the Birdsville Amendments as well. They would also lose something if (a), (b) and (c) were removed, and half of Harper was adopted.

International experience

Probably more than anyone in Australia I have attended meetings of international regulators since 1991 and I have a good knowledge of the law in nearly all countries around the world. Regarding abuse of dominance laws, as they are known in Europe (or "monopolization laws", as they are known in the US), there is a virtually complete consensus on what the essence of the law should be: any firm with dominance (or substantial market power) should be prohibited from engaging in behavior that has the purpose or effect of substantially lessening competition. Only Australia and New Zealand are exceptions to that. It is true that within these countries there is a great deal of argument about the application of these principles in specific cases, but no one contests the underlying principle. I have been to countless international discussions on this topic and I have never heard anyone, whether regulator or practitioner, who opposes the principle (except Australia and New Zealand).

I would like to comment in passing that in the last 40 years one good thing and one bad thing has happened to Australian jurisprudence. The good thing is that we have developed a substantial body of our own jurisprudence on competition law; the bad thing is that there is very little reference these days to cases overseas and to international jurisprudence on competition law. One consequence of this is that the Trade Practices professional community of lawyers and economists is not really as aware as it should be of the law as it stands in North America and Europe. This is reflected in a number of the submissions to the Harper Inquiry. Very few of the critics acknowledge what the state of the law is overseas and in some cases they have misstated the law. Go to any international gathering and you will be told that the law all over the world is "a firm with market power may not engage in behaviour that harms competition". You will be told that there will be only two questions: 1) does the firm have market power and 2) does the behaviour harm competition? Nothing more. One of the big advantages of the Harper proposal is that it brings Australia into line with the rest of the world and we can use its jurisprudence. Some of the compromise options being floated now will perpetuate a situation where Australia will have its own idiosyncratic law, with that law frankly being messy, especially regarding "take advantage" which no one else has.

The fact is that Australia and New Zealand have put two additional hurdles to the standard abuse of market power laws around the world: (a) the anti-competitive behavior must be demonstrated in a court of law to have had that purpose and (b) it must also be demonstrated in a court of law that the firm took advantage of its market power to get the result it did – a proviso which the courts have had a great deal of difficulty in interpreting.

One key reason for the difficulty the courts have got into is that there is no international jurisprudence to draw upon in relation to either proviso, and it has been particularly damaging and difficult in relation to the "take advantage" provisions.

General deficiencies of section 46

The Act is very unusual by international standards. Part IV alone takes 20,000 words. The US and EU laws are less than a page. Even if you add on a few bells and whistles (the US

Clayton Act, for example, has provisions about price discrimination, exclusive dealing and so on) the totality of those laws is still about 1,000 words compared with Australia's 20,000 words.

However, regarding s 46 specifically, the fact is that it is very long by international standards and it has got longer as a result of the amendments introduced by the Howard Government and the Birdsville Amendments.

The drafting of s 46 contains several undesirable features:

- it refers to behavior that damages competitors, not competition;
- it includes a "take advantage" provision, which no-one else in the world except New Zealand has;
- it contains two tests: the original 1976 test plus the Birdsville tests; and
- unlike elsewhere in the world it has a purpose test, not an effects test

It could be added that one form of abuse of dominance – that is, exclusive dealing – is dealt with in a separate section of the Act with a substantial lessening of competition test! And s 47 prohibits third line forcing without a competition test being required. And rather oddly, resale price maintenance (which is sometimes an abuse of dominance) is at the other extreme, with a *per se* prohibition.

A cleanup of sections 46 and 47 is needed.

And finally, there is no question (and I can say this, having urged it upon the Hilmer Review) that a major factor in the introduction of the access regime was the belief that because of the purpose test in s 46 there was no way that an access to essential facilities law could possibly develop in Australia under s 46 so we should have a whole part of the Act about access.

I believe this would not have happened if there had been a clean, clear s 46.

I mention that s 49 (which prohibited price discrimination subject to a substantial lessening of competition test) was repealed in the 1990s following the Hilmer Report, on the basis that the matter would be covered by s 46. Whilst I am no fan of s 49 I think it is now obvious that the anticompetitive price discrimination provision was softened considerably by its abolition and by the happy assumption that it would be covered by s 46 when in fact s 46 contains additional tests ("purpose" and "taking advantage").

Harper has gone a long way to clearing up the mess!

Big business attitudes

The main opposition to s 46 comes from Wesfarmers, with a fair bit of support from Woolworths. Most other members of the BCA are not particularly concerned, and of those who are, many don't understand what is happening.

The fact is that big business has a history of reflex opposition to anything that is seen as strengthening the competition law, even if it represents an economically rational strengthening of it.

What is disturbing about the big business opposition to changes to s 46 is its lack of understanding of the proposed changes.

If the aim of big business is to make s 46 as weak as possible – and that is a fair inference – it overlooks that there are two factors that, other things equal, will make it more difficult for the ACCC or anyone else to win cases under s 46 if the Harper amendments go through.

They are:

- The removal of the language which refers to behavior that damages competitors (that is, clauses (a), (b) and (c) of s 46(1)) and the replacement of the whole proviso with a substantial lessening of competition test. Most people acknowledge that it is harder to prove a substantial lessening of competition test in a court of law than, other things being equal, applying under the present s 46 (if you exclude the purpose test and the taking advantage test); and
- The Birdsville Amendments will be removed. It is true these have not yet generated litigation but I believe that if they remain they will do so one day and they may prove to be potent.

What is really happening is that he crude big business concerns are justified to an extent by the removal of the "take advantage" test and the addition of the effects test, but alleviated to a significant extent by the fact that there is a substantial lessening of competition test and by the Birdsville Amendments.

It is very clear from correspondence by the Business Council to cabinet ministers (which has found its way into the public arena) that the Business Council does not understand the proposed law. A number of hypothetical cases are cited where it is claimed that the new law would prohibit them. These concern such matters as a big retailer entering a country town or the emergence of Apple. These examples are simply untrue. All around the world there have been no cases on these matters under the law which Harper recommends. Nor could they be supported by Australian jurisprudence.

The claim that legal uncertainty will be increased is also incorrect. The fact is that the greatest legal uncertainty comes from the fact that the law contains two provisos that are unique to Australia. This means there is no international jurisprudence to draw upon. To make it worse, the courts have been making extremely heavy weather, somewhat understandably, of the "taking advantage" test. In this situation there is more uncertainty than if we followed standard international practice. Claims that big business will need to have lawyers at its side every time it does something competitive are as false now as they always have been and as they are in other countries.

The role of the government

I am concerned that the government is considering compromises. The Harper proposal is very clear conceptually, conforms with international practice, and uses words that are used elsewhere in the Act and are well-understood. I fear great confusion if the government introduces some "half-baked" measure. In the early 1990s, when there was a feverish debate about changing the merger law from a test of "dominance" to a test of "substantial lessening of competition", the debate was clearly won by the then Trade Practices Commission and various supporters, but the pressure on the government was enormous and it asked me to explore a compromise to " keep big business happy". The main ideas that were considered were to replace the words "substantial lessening of competition" as a prohibition based on "collective dominance" or "shared dominance" or "joint dominance" . All of these concepts were highly problematic and the government decided it simply had to go with the cleaner, clearer approach. The horror stories about its likely effects all proved to be untrue. also, if there is a half-baked solution, there will be enormous pressure to retain the Birdsville Amendments, and possibly (a), (b) and (c).

Broader ramifications

The Harper Inquiry has 56 recommendations. The other recommendations have been largely adopted. Strangely, the big business lobby has been given a special hearing. The fact is that if big business "gets off", there will be enormous resistance to the rest of the Harper Report by smaller entities.

Both the Hilmer and the Harper Reports are based on the simple concept, of universal application, that no one in Australia, whether a business or government, can engage in behavior that has the effect of substantially lessening competition. This has been the bedrock of the Hilmer process as it has applied in all sectors and all levels of government, and the same principle underlies the whole of Harper. If big business, however, is treated in an exceptional way, it is difficult to see how the rest of the Harper recommendations will have any credibility when time comes to apply them.

Specific cases

It is sometimes asked whether one can name cases where the current law would not apply but the new law could matter. One only has to look at overseas cases to see what the difference is. The three main categories of case are predatory behavior, especially predatory pricing; refusals to deal; and margin squeeze. I acknowledge that exclusive dealing and tying are more or less covered by s 47, although I mention that the highly defined character of s 47 means that some forms of tying and exclusive dealing are probably not picked up.

If one goes through the vast amount of European and North American case law it's quite obvious that more of these cases would apply in Australia were it not for the two special Australian hurdles that exist. I am not close enough to Australian cases these days to name cases. What I can say is that looking over European and American cases it is obvious that with respect to a number of cases where illegality was established, they would probably not have been found illegal in Australia because of "take advantage". A quick read of the main texts (Whish etc) makes it clear.