WESFARMERS' SUBMISSION TO TREASURY ON OPTIONS TO STRENGTHEN THE MISUSE OF MARKET POWER LAW ('SECTION 46' OF THE *COMPETITION AND CONSUMER ACT 2010*).

FEBRUARY 2016

Our recommendation: Retain the current version of Section 46 (Option 'A').

Wesfarmers is a member of the Business Council of Australia and strongly supports the BCA's response to the Treasury's options paper. Like the BCA, we urge the government to allow sufficient time for the efficacy of recent initiatives - the Food and Grocery Code, the Unfair Contract Terms protections for business to business transactions and the Small Business and Family Enterprise Ombudsman – to be tested before assessing whether further legislation is required.

Our business in context

Wesfarmers is a publicly owned company and Australia's largest private sector employer. Wesfarmers owns Coles, Kmart, Target, Bunnings, Officeworks, fertiliser works, chemical plants, energy businesses, industrial and safety supplies, and we mine coal. Most Australian communities of more than a few hundred people have a Wesfarmers presence.

- Our businesses employ in excess of 200,000 Australians.
- Last year we paid $7.8 billion in wages.
- We have approximately 500,000 shareholders.
- We paid $2.3 billion in dividends to those shareholders.
- We paid $50 billion to our suppliers.
- We invested more than $2 billion to grow our existing businesses.
- We paid $1.8 billion to Governments in taxes, fees and charges - no offshore tax shelters.
- And, Wesfarmers made more than $90 million in community contributions – direct and indirect.

In short, we make a very significant contribution to the Australian community. We played an active and constructive role in the Harper Review of competition policy and support the overwhelming majority of its recommendations which, if implemented, we believe will produce considerable benefit to the national economy. We do not however, support the recommendations made relating to section 46 of the Competition and Consumer Act which, in our consideration, were unnecessary, will be significantly detrimental if implemented, and have unfortunately distracted attention from the value in many of the Review's other recommendations.

Since the Harper Review report was handed to government, we have continued to be part of the public discussion on its merits and attended the Federal Government's roundtable on proposed changes to section 46 held in Tamworth on January 29. It was an instructive experience.

No case for change has been made

Wesfarmers' position on proposals to change section 46 of the Competition and Consumer Act 2010 is very simple: the case for legislative change has not been made. Despite more than two years of intense debate and discussion, including the 'root and branch' review led by Professor Ian Harper, no compelling examples of how the current law has failed have been provided. No examples of egregious anti-competitive conduct that had not or would not be captured by the current provisions of the Competition and Consumer Act have been presented. Indeed, many of the concerns raised in the course of public debate have not been relevant to section 46, and can and have been properly dealt with under other sections of the Act. In the absence of clear evidence of the need for change, we are strongly of the view that no changes to the Act should be legislated. It is not enough for advocates of changes to section 46 to simply say businesses such as those owned by Wesfarmers, along with Woolworths, Telstra the banks and others are simply 'too big' and that smaller businesses 'can't compete'.

Proposed amendments to the Competition and Consumer Act 2010 should be assessed on the basis of whether they truly protect the competitive process and enhance the outcome for consumers. New laws should only be introduced where there are clear public benefits in doing so.

No consensus exists among proponents of change

It is clear from the discussions at the roundtables that no consensus exists among proponents of change to section 46 on the impact of amendments to insert 'effect or likely effect', delete the 'take advantage' limb or introduce 'substantially lessening competition'.

The lack of any consensus on how such changes to the law would actually play out, what they would achieve, or the degree to which they would satisfy the demands of proponents for change, should be disturbing to any government contemplating legislation. In our view, all options under consideration, other than Option A, (the no change option), would result in uncertainty, undermine rather than improve the competitive process and create a disincentive to invest and innovate. This cannot be good for the economy.

If one of the key policy challenges for Australia is to generate new investment by the non-mining sector, how is that cause advanced by dulling the appetite to take risk and by undermining the certainty to invest?

We whole-heartedly agree with the Prime Minister's stated view that Australia needs to lift productivity through innovation. In our view, governments need to resist imposing new and more onerous regulations which will only stifle innovation.

National businesses must already grapple daily with a cumbersome patchwork of different rules and regulations applied within and between jurisdictions across all states and territories. Poorly-considered regulation is bad for the consumer and bad for the economy. In this case, best-practice regulation should require thorough analysis of the potential net benefit of any change in competition law.

Policy should aim to encourage globally-competitive businesses, and world-class performance in productivity and innovation. It should encourage strong and productive firms to thrive. In our view, these are the important signals to generate growth in investment and jobs, and to secure long-term economic success.

Insufficient consideration of consumer benefit.

Wesfarmers considers the first priority of competition policy should be to ensure the best interests of consumers are protected and furthered by continued promotion of competition. The objective of good competition policy and competition law should not be to protect businesses from competition where that competition is legitimate. Any reform agenda, therefore, should be based only on the application of sensible regulation that does not discriminate against or in favour of an individual business or group of businesses. It is our contention that much of the debate around competition law currently is driven by the desire of some businesses to be protected from vigorous competition, or confusion about other issues, such as supply chain disputes, so-called land-banking and anti-competitive contracts, which properly relate to and can be dealt with under other sections of the Act.

In that context, it may be helpful to briefly consider the performance of the Wesfarmers-owned Coles in the last seven years. Coles has delivered record cumulative food and liquor deflation of more than five per cent since. That means, compared to 2009, an average Australian household would now save approximately $600 a year by shopping at Coles. Competitors have responded by lowering their own prices. There has not been a period in Australia's history when a comparable benefit has been provided to Australian consumers. And yet, it was largely political reaction to complaints from vested interests about that performance which led to the establishment of the Harper Current review. Australians are buying 70 per cent more fruit and vegetables from Coles compared to six years ago. Coles is buying 30 per cent more produce volume from Australian suppliers than in 2009.

Coles' performance in that time has increased, not decreased, competitive tension in the supermarket sector where it has often been asserted that insufficient competition exists. Woolworths has felt the pressure of that competition, as has IGA, but the consumer has benefitted through lower prices. In the same period, Aldi has grown to a network of more than 400 Australian stores with up to 100 more being rolled out, and another, even bigger, German giant, Lidl, has indicated intentions to enter the Australian market. In South Australia, Foodland continues to hold about 30 per cent of the market. There are clearly no prohibitive barriers to entry.

In assessing the competitiveness of markets, it is not the number of competitors in a market but their behaviour that is relevant. A small number of competitors might be engaged in fierce competition while a larger number of competitors might be engaged in collusive behaviour. Collusive behaviour should be and is illegal, regardless of the number of businesses in a market.

Importantly, though, the ultimate interests of consumers must remain front and centre of debate about changes to competition law and, in our view, those interests have too often been relegated to the interests of individual competitors.

Effects test

As set out in our earlier submissions on competition policy (see the relevant extracts attached as appendices A and B to this submission), Wesfarmers is deeply concerned by the potential impact the proposed introduction of an effects test into section 46 may have on our capacity to invest, innovate and generate growth and jobs. Many other significant Australian businesses have shared those concerns publicly in the course of debate over this issue.

Currently, the economy urgently requires businesses large and small to invest. Securing strong investment, and the jobs and confidence that come with it, is essential for the economy to grow and living standards to rise. At a time when Australia faces the challenge of lifting investment, innovation and productivity in the non-mining sector, it is neither prudent nor sensible policy-making to experiment with the overhaul of a basic tenet of competition law unless there is a clear and demonstrable net benefit to consumers and the economy.

The proposed amendment to section 46 has become a recurring theme of the competition policy debate. It has been rejected by 10 previous policy reviews, for the very good reason that it risks capturing pro-competitive behaviour, including genuine price competition.

"Take advantage" limb

We believe the risks outlined above are heightened further by proposals to delete the 'take advantage' limb from section 46.

Section 46 is about 'misuse of market power'. The shift in focus in the debate from earlier demands for an effects test to a proposal to delete the 'take advantage' provision of the Act is of significant concern. All but Option A in the Treasury options paper remove the words 'take advantage' from the section. Such a deletion would radically alter the law by severing the link between business behaviour and market power. Similar concerns have been well articulated by Professors Stephen King and Graeme Samuel at the Monash Business School (Australian Financial Review Jan 13, 2015) who wrote:

> *"This link is critical. Remove it and large businesses risk breaking the law every time they innovate, compete hard and help consumers but harm competitors. As the High Court has stated: "Competition by its very nature is deliberate and ruthless. Competition damages competitors. If the damage is sufficiently serious, competition may eliminate a competitor."*
> *So remove the link, and we potentially have an anti-competition law. The link in section 46 is two words: "take advantage". The Harper report recommended removing these two words. This would take Australia out of line with other developed countries and may make some competitive behaviour illegal. So the debate is easily*

summarised. The Harper recommendation and its supporters wish to remove the critical link in the law that makes a misuse, and only a misuse, of market power by big business illegal. In our view, this risks harming competition and hurting consumers."

Under the proposals being examined by government, it would no longer be necessary to show a nexus between the company's market power and its conduct. The whole concept of misuse of market power is turned on its head. The change would deprive those with market power of the defence that they were simply engaging in conduct a competitor without market power might equally engage in and hence had not 'taken advantage' of or misused market power.

With uncertainty over how the courts will interpret these proposed changes to the law, it will be difficult for business to anticipate in advance what these effects might be on existing or potential competitors and whether a new strategy to invest or expand falls foul of the law.

Unintended consequences

At the very least, the changes to section 46 proposed in Options B to G risk creating significant uncertainty. The current framework of competition policy is well understood by business, as reinforced by numerous rulings from the bench, including the High Court of Australia

In our view, the introduction of these changes in the law will effectively force boardrooms to second-guess basic business decision-making. Under an amended section 46, business across all sectors of the economy will be exposed to the risk of investigation and prosecution due to the potential impact of legitimate commercial decisions on existing or potential competitors.

To help illustrate our concern, it was asserted by proponents of change at the Tamworth roundtable that pricing policies that benefit customers in regional Australia could be an activity potentially in conflict with the proposed new law. That would be a matter of great concern to a business like Wesfarmers whose retail divisions operate state-wide or national pricing policies, charging the same prices in regional and metropolitan areas. As nearly a third of Australians live outside our major cities, the benefits of these pricing policies to the families of regional Australia can be seen every day at the checkout. These policies help to ease cost-of-living pressures in parts of the country where disposable incomes may on average be lower than in the cities. In Wesfarmers' view, this represents entirely legitimate and inherently pro-competitive commercial activity: easing cost of living pressures in regional communities, and helping generate strategic investments that bring new jobs and export opportunities.

Some proponents of the changes have sought to downplay the risk an amended section 46 may have the unintended consequence of capturing activity such as this. Of more concern is that others appear to advocate that the conduct which should be targeted is merely competitive conduct which they believe they cannot match without affecting their profits, even where that conduct arises from greater efficiencies to drive lower prices, availing of strategic investment opportunities in site acquisitions, or innovating in private labelled products. That aspect of the debate concerns us greatly. Ultimately, it would be for the courts to determine the reach and impact of any changes to the law, and that would undoubtedly take several years, even decades to determine. In the meantime, the ability of businesses to compete would be constrained by the need to continually seek legal advice or, as another option, seek explicit authorisation from the ACCC for a wide range of otherwise ordinary commercial decisions.

It will undoubtedly bring uncertainty to business decision-making. Aside from the potential impacts on investment decisions, paramount in the government's consideration should be the potential for the changes to flow on to consumers as higher prices. If, as an example, the proposed change in law discouraged businesses from competing aggressively on price, this would serve only to increase cost-of-living pressures on many Australian families.

Legislative risk

Wesfarmers believes the misuse of market power provisions work satisfactorily, with the exception of the provision at section 46 (1AA), which refers to predatory pricing by a corporation "with a substantial share of the market." This so-called Birdsville amendment was inserted into the competition law in 2007. The original amendment bill provided for relatively minor changes to section 46 to give further clarification about matters the court might consider in determining whether a company has market power. The amendments were not controversial. During its passage through the Senate, in the weeks leading up to the 2007 election, the bill was amended to provide for a completely new provision relating to predatory pricing. The amendment was highly controversial and added at the last minute.

The point here is not to revisit the merits of the Birdsville amendment – we believe it should be repealed – but to highlight the precarious and unexpected outcomes that could arise from legislating contentious amendments to section 46 in the run-up to another federal election when some of the main proponents, as they did at the Tamworth roundtable, have already indicated they will not be satisfied with the options being presented.

We believe the genesis of the Birdsville amendment provides an example of the potential risk in the legislative process should the government proceed along the lines proposed.

Conclusion

Wesfarmers does not believe any case has been made for the proposed changes to section 46. As numerous past reviews have concluded, there is no need to change the Act, although we understand there is political pressure to do so. This is not the way to deal with that political pressure and will only serve to create real economic problems for Australia by making our businesses less efficient, more risk averse and costly to run. Significantly, no benefit for consumers has been identified and, from the proponents' side, none discussed. Industry policy, not competition policy, would be a more appropriate vehicle for providing assistance to small business.

Further contact

We will be pleased to further engage on the issues raised here, particularly as they relate to the detail of potential impacts on individual Wesfarmers businesses. Should you wish to clarify any particular issue raised in our submission, please contact Wesfarmers' Executive General Manager Corporate Affairs, Alan Carpenter acarpenter@wesfarmers.com.au (08) 9327 4267.

APPENDIX A

EXTRACT FROM WESFARMERS' SUBMISSION TO COMPETITION POLICY REVIEW ISSUES PAPER

JUNE 2014

COMMENTS ON PROPOSED AMENDMENTS TO PART IV OF THE COMPETITION AND CONSUMER ACT 2010

An effects test

Much has been written on this subject and we would urge the panel to consider the views articulated in the excellent treatises on this subject by Sir Daryl Dawson and his colleagues in the Dawson Report (April 2003) and the more recent analysis by Dr Alexandra Merrett and her colleagues on their web-based The State of Competition Report (issue 14, November 13). Both recommend against inserting an effects test into Section 46 of the Act. In rejecting a submission from the ACCC for an effects test (recommendation 3.1, box 3.2), Sir Daryl Dawson provided the table reproduced below:

History of the effects test

In 1976, the Trade Practices Act Review Committee (the Swanson Committee) recommended that the section should only prohibit abuses by a monopolist that involve a proscribed purpose.

In 1979, the Trade Practices Consultative Committee (the Blunt Review) rejected an effects test because it would give the section too wide an application, bringing within its ambit much legitimate business conduct.

The 1984 Green Paper, *The Trade Practices Act Proposals for Change*, recommended the introduction of an effects test because of difficulty in establishing purpose.

In 1989, the House of Representatives Standing Committee on Legal and Constitutional Affairs (the Griffiths Committee) concluded that there was insufficient evidence to justify the introduction of an effects test into section 46.

In 1991, the Senate Standing Committee on Legal and Constitutional Affairs (the Cooney Committee) concluded that an effects test might unduly broaden the scope of conduct captured by section 46 and challenge the competitive process itself.

In 1993, the Independent Committee of Inquiry into Competition Policy in Australia (the Hilmer Committee) rejected an effects test because it would not adequately distinguish between socially detrimental and socially beneficial conduct.

In 1997, the House of Representatives Standing Committee on Industry, Science and Technology (the Reid Committee) noted the effects test and the views of the Hilmer Committee, but did not recommend its introduction.

In 1999, the Joint Select Committee on the Retailing Sector (the Baird Committee) rejected an effects test on the basis that such a far reaching change to the law may create much uncertainty in issues dealing with misuse of market power.

In 2001, the House of Representatives Standing Committee on Economics, Finance and Public Administration (the Hawker Committee) noted significant opposition to an effects test and that five inquiries since 1989 had not recommended its introduction. The Committee expressed a preference to await the outcome of further cases on section 46 before considering any change to the law.

Dr Merrett and her colleagues have made the point:

> *"To date, no-one has come forward with a real-life example of conduct which should be caught by s46 but escapes because of purpose …. Agitators for an effects test tend to provide examples where competitors or even competition are adversely affected, but where there has been no use of market power." (The State of Competition Report issue 14, November 2013, p. 8)*

Under an effects test, Section 46 of the Competition and Consumer Act 2010 relating to the misuse of market power would be amended so that a corporation with a substantial degree of power in a market must not take advantage of that power not only with the purpose of but with the effect or likely effect of eliminating or substantially damaging a rival, preventing the entry of a rival into a market or preventing a rival from engaging in competitive conduct in that market or any other market.

It has been argued that since such an effects test is included in other sections of the Competition and Consumer Act 2010 it should be readily capable of being included in Section 46. An effects test is included in Section 45 relating to contracts, arrangements or understandings that restrict dealings or affect competition, in Section 47 relating to exclusive dealing, in Section 49 relating to dual listed companies and in Section 50 prohibiting mergers and acquisitions that would result in a substantial lessening of competition. Section 50, which also covers so-called creeping acquisitions, was amended in 2011 to clarify that it related not just to a market, but to any market, whether national, state or regional.

In the operation of Section 50, a company proposing to buy a store or a vacant site can choose to advise the ACCC in advance. If the ACCC does not raise concerns that the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market, the company at least has some level of comfort that the proposed acquisition is unlikely to breach the law. If the company chooses not to advise the ACCC in advance, it runs a greater risk that, in some cases, the ACCC might subsequently find that, after the transaction has been completed, the acquisition breaches the Act. Coles, within the Wesfarmers group, has adopted the practice of notifying the ACCC in advance of proposed acquisitions of stores and vacant sites.

However, it does not follow that, since an effects test is included in Section 50 and other sections of the Act, it can be inserted seamlessly into Section 46 with clearly pro-competitive consequences.

A business that competes hard on price, to the benefit of consumers, can damage or eliminate a rival, or make it uncommercial for a potential rival to enter a market. Since the competitively behaving business cannot know in advance what effect its competitive behaviour might have on an actual rival or on a potential rival that is not even in the market at the time, it could breach the law by behaving competitively.

The competitive business could be deterred from keeping its prices low, from finding efficiencies that enabled it to drive prices lower and possibly even from offering quality and service that had the effect or likely effect of damaging a rival or preventing a potential rival from entering a market. The offering by a supermarket of a private-labelled product could have the effect of damaging a competitor, including the manufacturer of a branded product, or preventing the entry of a competitor into that or any other market. Opening a new Bunnings store could increase competition in the home improvement market in an area, provide a great outcome for consumers in range and value, but also have the eventual effect of seeing an existing competitor hardware business close.

Boards and managers of businesses with a substantial degree of market power could be breaching the law by competing hard on price, and possibly also on quality and service. However, they would not know at the time they were making these decisions whether they were acting unlawfully, since under an effects test it could depend on the response of actual or potential competitors, including rivals that might not even exist at the time management decisions were made. Management of a business may

be reluctant to put itself in such a position, with a consequent lessening, not strengthening, of competition.

Management could conceivably seek some sort of indication or authorisation from the ACCC for pricing, promotional and branding decisions prior to making any such decisions. Numerous decisions are made every year by businesses with a substantial degree of power in a market about pricing, discounting, branding and offerings under loyalty programs. Seeking prior guidance or authorisation of these would insert the ACCC into the day-to-day or at least the weekly decisions of company management. Apart from the question of whether a regulator should be so involved in such decision-making, ACCC delays in responding would be inevitable.

Rather than promoting competition, the inclusion of such an effects test in Section 46 could easily stifle competition, causing consumer prices to be higher than necessary, as management and boards sought to comply with the law.

It is sometimes claimed that purpose is difficult to prove, and that Australia is unique in adopting a purpose test for misuse of market power. But purpose is a familiar concept across Australia's competition law, and proscribed purposes have been found by the courts in many cases. Where section 46 cases have failed, it has rarely been on the element of purpose. Further, although the primary competition instruments of some other jurisdictions do not refer explicitly to purpose, an element of purpose, intent or wilfulness has frequently been applied by courts and regulators in these jurisdictions.

Further contact

We will be pleased to further engage the Review panel directly on the issues raised here, particularly as they relate to the detail of potential impacts on individual Wesfarmers businesses. Should you wish to clarify any particular issue raised in our submission, please contact Wesfarmers' Executive General Manager - Corporate Affairs, Alan Carpenter acarpenter@wesfarmers.com.au (08) 9327 4267.

APPENDIX B

EXTRACT FROM WESFARMERS' SUBMISSION TO TREASURY ON THE COMPETITION POLICY REVIEW FINAL REPORT

MAY 2015

Misuse of market power

Wesfarmers remains concerned at the Panel's proposal to replace section 46 with a new section that:

- adds an "effects" alternative to the current "purpose" test;
- removes the "take advantage" element; and
- replaces the enumerated categories of exclusionary conduct with a general "substantial lessening of competition" test.

The proposal to add an "effects" test to section 46 has been closely associated with the Review since it was first detailed by the Coalition, with specific reference to retail industries including those in which Wesfarmers operates.

Although the scope and ambition of the Competition Policy Review has greatly expanded since then, the intersection between retail markets, small business and an "effects" test for section 46 has remained a focus of the Review. It is disappointing that the Final Report has not been able to move beyond the origins of the Review in this area, given its findings that key retail markets are competitive and benefit consumers and the Review's desire to ensure entrepreneurship and innovation.

In Wesfarmers' view, the recommendation in the Final Report in relation to section 46 fails to achieve the Panel's stated goals of establishing competition laws that are clear, predictable and reliable and that make markets work in the long-term interests of consumers.

Amendments to section 46 have been considered in 12 reviews and discussion papers since 1976. All of them recommended against the introduction of an "effects" test into section 46 with two exceptions: the Government's 1984 Green Paper – which invited discussion on a proposed effects test – and now the Harper Review. In Wesfarmers' view, the recommended amendments to section 46 are unwarranted and undesirable for the following reasons.

(a) No case for change has been made

The Final Report does not argue that the current section 46 is failing to deter or capture any anti-competitive conduct that it should be deterring or capturing. Nor does it argue that any cases under the current section 46 have been decided wrongly or have allowed any competitive detriment or consumer harm to go unrestrained or unpunished.

(b) The "take advantage" element should be retained

The Final Report argues that the "take advantage" element is the primary concern with the current section 46, and that it is difficult for courts to interpret and apply. As evidence for this proposition it points out that, in a number of cases, trial and appellate courts have reached different views on whether particular conduct met the test.

The fact that judges reached different conclusions on the facts says little about the test – except that it is designed to make sometimes difficult judgments about whether a company's behaviour represents legitimate competition on the merits or anti-competitive conduct. Any proposed change to section 46 – and in particular the general test and broad directions proposed by the Final Report – would be subject to even greater judicial divergence and would significantly increase uncertainty compared to the current section.

The established interpretation of the "take advantage" test is that a firm will not take advantage of its market power if it would, or could profitably, have engaged in the same conduct without that market power. That test was again confirmed and applied without apparent difficulty in the recent *Pfizer* case.

The Panel expresses concern that this interpretation may not recognise that conduct engaged in by a firm with market power may have a greater impact than the same conduct engaged in by a firm without market power, and that:

> Business conduct should not be immunised merely because it is often undertaken by firms without market power. Conduct such as exclusive dealing, loss-leader pricing and cross-subsidisation may all be undertaken by firms without market power without raising competition concerns, while the same conduct undertaken by a firm with market power might raise competition concerns.

However, the fact that conduct by a firm with market power may have a greater impact than the same conduct by a firm without market power does not justify the removal of the "take advantage" or "misuse" element of the provision. This element of the provision creates a crucial causal connection between the market power and the conduct under consideration. It does not operate to immunise categories of conduct on the basis that they are also undertaken by firms without market power, but involves a consideration of the market power and the relationship of that market power to the relevant conduct.

The existing wording of section 46 makes it clear that having market power itself is not the issue; it is the **misuse** of that market power for a proscribed purpose that is inappropriate.

Companies with substantial market power are already examined with particular scrutiny (firms without market power do not fall under section 46 at all), but that does not mean that firms with substantial market power should be restrained from engaging in conduct that has no connection to their market power. There is no evidence of widespread misapplication of the existing test.

(c) The "purpose" test is essential and appropriate

The Final Report describes the debate over purpose and effect "unproductive" and argues that it "tends to obscure a more significant issue":

> Presently, the purpose test in section 46 focuses on harm to individual competitors – conduct will be prohibited if it has the purpose of eliminating or substantially damaging a **competitor**, preventing the entry of a **person** into a market, or deterring or preventing a **person** from engaging in competitive conduct.
>
> Ordinarily, competition law is not concerned with harm to individual competitors.

Wesfarmers agrees that competition law should not be concerned with harm to individual competitors. But section 46 is not concerned with harm to individual competitors. It is concerned with protecting the competitive process by preventing the **misuse** of market power for a predatory or exclusionary purpose.

As the Federal Court noted in the *Eastern Express* case:[1]

> Part IV of the Act is designed to promote competition, and the role of Section 46 is to maintain competitive markets by restraining misuses of market power that will produce a non-competitive market.

To suggest that section 46 is intended or likely to protect individual competitors is to ignore decades of clear and consistent interpretation and application by both courts and regulators. In fact, the proposed amendments to section 46 increase the focus on competitors, by prohibiting conduct by some competitors but permitting other competitors to engage in the identical conduct. ,

[1] *Eastern Express Pty Limited v General Newspapers Pty Limited* (1992) ATPR ¶41-167

(d) Section 46 is not out of step internationally

The Final Report also argues that the focus of section 46 is inconsistent with comparable provisions in international jurisprudence, but the examples it gives are not convincing.

In relation to the **United States,** the Final Report cites the American Bar Association's opinion that:

> Modern U.S. decisions hold that it is not subjective intent but objective intent that is relevant, and that intent can be inferred from conduct and effect. The focus of the U.S. courts is on evidence of monopoly power and proof of exclusionary conduct.

Not only does the ABA acknowledge that intent – that is, purpose – remains an essential element in the United States, but it continues:

> Similarly, in Australia it appears that "purpose" is considered broadly under an objective—not a subjective—standard… it seems clear that Australian courts can and do consider the totality of the circumstances in determining whether a corporation possesses the requisite anticompetitive purpose, including analysing the nature of the conduct and its likely effect.

That is, the submission concludes that the current Australian position is closely aligned to that of the United States.

Similarly, in relation to **Canada** the Final Report notes that:

> [S]ection 79 of the Competition Act prohibits anti-competitive conduct by a dominant firm that has the effect or likely effect of substantially lessening competition.

However, "anti-competitive conduct" is defined in the Act to include a number of acts with particular purposes directed against actual or potential competitors. As the Federal Court of Appeal has confirmed: [2]

> First, an anti-competitive act is identified by reference to its purpose. Second, the requisite purpose is an intended predatory, exclusionary or disciplinary negative effect on a competitor.

The key difference between the Canadian law and the section 46 is that the Canadian law requires not only an anti-competitive purpose but *also* an effect of substantially lessening competition. In Wesfarmers' view, this is an appropriate use of that test.

Finally, in relation to **Europe**, the actual position in practice is, in Wesfarmers' view, much closer to the current Australian position than reflected in the Final Report. European law refers to an "abuse" of a dominant position – that is a dominant position is not itself anti-competitive, but, as the European Commission explains, if the company *exploits this position to eliminate competition,* it is considered to have abused it.[3]

Although early European decisions have been interpreted to query the need for a causal connection between the dominant position and the conduct in question,[4] more recent cases have confirmed that the law "presupposes a link between the dominant position and the alleged abusive conduct".[5]

This principle is also expressed in the European defence of objective justification in the form of legitimate business conduct or efficiency gains, which operates to exempt conduct that has no connection with market power. Similar to the "take advantage" element in the existing section 46, and inherent in the

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2 *Canada (Commissioner of Competition) v. Canada Pipe Co* (2006) FCA 233.

3 European Commission website at http://ec.europa.eu/competition/consumers/abuse_en.html

4 eg *Europemballage Corporation and Continental Can Company v Commission,* Case 6/72 R [1972] ECR 215.

5 eg *Tetra Pak International SA v Commission,* Case C-333/94 [1996] ECR I-5951; *Konkurrensverket v TeliaSonera AB*, Case C-52/09 [2011] ECR I-00527

concept of "misuse", there must be a causal or facilitating relationship between market power and the conduct in question.

The Panel's proposal for section 46 would be broader and more interventionist than that of Europe or indeed of any antitrust jurisdiction.

(e) The "substantial lessening of competition" test is not appropriate

The Final Report argues that the "standard test" of the CCA asks whether conduct "has the purpose, or has or would be likely to have the effect, of substantially lessening competition." Although the Panel's recommendations, if implemented, would go some way towards establishing that test as a standard, there remain a wide range of tests throughout the CCA. For example:

- sections 45 (anti-competitive agreements) and 47 (exclusive dealing) require a purpose, effect or likely effect of substantially lessening competition;

- section 50 (mergers) requires an effect or likely effect of substantially lessening competition;

- Division 1 (cartels) requires a purpose, effect or likely effect of fixing prices, a purpose of restricting output, a purpose of market-sharing or a purpose of bid-rigging;

- Division 1A (price signalling) requires a private disclosure to competitors outside the ordinary course of business or a public disclosure for the purpose of substantially lessening competition;

- sections 45D, and 45DA (secondary boycotts) require a purpose **and** likely effect of causing substantial loss or damage to a person, or a purpose **and** effect of substantially lessening competition, respectively.

The key difference between the "effect of substantially lessening competition" provisions and section 46 is that only section 46 deals with the unilateral conduct of a single firm acting alone. The Dawson Review recognised the significance of this distinction:

> [T]hose other provisions are, as is noted above, concerned with conduct involving competitive relationships between two or more corporations, whereas section 46 is concerned with unilateral anti-competitive behaviour on the part of a corporation with a substantial degree of market power.
>
> It is the behaviour which gives rise to the prohibition rather than its effect although, of course, the ultimate object of the section is to protect and advance a competitive environment and the competitive process rather than to protect individual competitors. The section pursues that object by restraining the misuse of market power. Misuse occurs when a corporation takes advantage of the power for a proscribed purpose, regardless of the actual effect of the conduct, whether it be the achievement of a proscribed purpose or the substantial lessening of competition.

On this last issue, it has been suggested that previous rejections of "effects" tests for section 46 have only considered adding an "effects" alternative to the existing section, and have not considered a test that looks for a purpose, effect or likely effect of substantially lessening competition. In fact the test proposed by the Final Report has been considered and explicitly rejected many times:

- the **Dawson Review** (2003) considered that a "substantial lessening of competition" test for section 46 would be worse than simply adding "or effect or likely effect" and that "*since the effect of legitimate competitive activities may result in the lessening of competition in a market, the section, as amended, would be likely to catch pro-competitive as well as anti-competitive conduct*".

- the **Hilmer Review** (1993) considered that a "substantial lessening of competition" test in section 46 "*does not address the central issue of how to distinguish between socially detrimental and socially beneficial conduct.*"

- the **Cooney Review** (1991) considered a "substantial lessening of competition" test for section 46 but considered that "purpose is an essential element of the contravention" and that an effects test would "*force corporations to evaluate the potential effect of their every action on their competitors and potential competitors*".

- the **Griffiths Review** (1989) considered proposals to replace section 46 with "*a provision which prohibits a corporation with a substantial degree of power in a market from engaging in conduct which has the purpose or has or is likely to have the effect of lessening competition in any market*" but found that no change to the law was necessary.

It is common internationally to have quite different tests for unilateral conduct and arrangements between market participants. Articles 101 and 102 of the Treaty for the Functioning of the European Union maintain this distinction, as do Sections 1 and 2 of the US Sherman Act. Applying the same test to unilateral and multilateral conduct in Australia would be arbitrary at best.

(f) The proposed court directions will not protect legitimate commercial conduct

The Final Report recognises the need to distinguish between competition on the merits and harmful anti-competitive conduct and proposes to assist in this distinction by directing the court to take into account:

- the extent to which the conduct has the purpose, or would have or be likely to have the effect, of increasing competition in the market including by enhancing efficiency, innovation, product quality or price competitiveness in the market; and

- the extent to which the conduct has the purpose, or would have or be likely to have the effect, of lessening competition in the market including by preventing, restricting or deterring the potential for competitive conduct in the market or new entry into the market.

It is not clear that this provision adds any clarity. As Stephen King and Graeme Samuel note:

> The proposed legislative guidance will not help the courts. Rather it just restates obvious principles. If actions are pro-competitive then they are not anti-competitive.

Nor will this guidance help business to understand or predict whether its conduct may be considered to have the purpose or effect of substantially lessening competition. In fact, it attempts to clarify one competition test by adding two more competition tests, compounding the confusion and the likelihood of error.

Wesfarmers is concerned that efficiency and innovation may only be relevant to the competition test where they affect the competitive structure of a market, such as by allowing smaller businesses to compete more effectively against a larger incumbent. It is not clear whether an efficiency gain or significant product or service innovation by a large incumbent – the kind of business likely to be subject to the new section 46 – would be seen as increasing competition for the purposes of such a test.

By contrast, it seems much clearer that preventing, restricting or deterring the potential for competitive conduct in the market or new entry into the market will be considered a *lessening* of competition. The result of this asymmetry would be that conduct that made it more difficult for competitors to remain in or enter a market would usually be considered a lessening of competition, while the efficiencies that resulted in those circumstances might not be taken into account as an increase in competition.

Even if both were taken into account, it is difficult to predict how they would be weighed against each other. It is particularly unclear how a *purpose* of enhancing efficiency would be weighed against an *effect* of preventing new entry (or vice versa) in assessing whether conduct has the *purpose or effect* of substantially lessening competition. What seems clear is that requiring the court to take these factors into account is a long way from the defence of a legitimate business purpose provided in overseas jurisdictions and effectively replicated in the current "take advantage" element.

Further, the proposed court directions are unclear as to the outcome if conduct reduces competition in one market, but increases it in another. The proposed court directions appear to contemplate only considering benefit and detriments in a single market (by use of the term "the market") and does not contemplate different effects in different markets.

(g) The change would act as a deterrent to innovation and efficiency.

If the amendments to section 46 recommended in the Final Report are implemented, businesses that may be considered to have market power will need to think twice before engaging in any conduct that is intended to increase efficiency and benefit consumers, but which may make it more difficult for smaller competitors to compete. This caution and delay will have costs to business and consumers, particularly in the increasingly dynamic market conditions faced by the retail industry among many others.

The proposed amendments do not take into account that a multitude of decisions to enhance efficiencies and lower costs are made daily in the operations of a large business where it is impossible to know the effect or likely effect of that decision in any one or more of the many markets that the decision may impact. Further, it is arguable that this illustrates how the provisions may be manipulated to stifle competition, price efficiencies and value to the consumer. For example, if a business decides that it will diminish the number of its suppliers from three to two in a particular goods market, and that market is already concentrated, the affected supplier may complain that the decision has substantially lessened competition.

The competitive business may therefore be deterred from keeping its prices low, finding efficiencies that enable it to drive prices lower, offering quality and service or innovating to develop new products and services, which is all conduct that has the lawful purpose of improving business performance and outcomes for consumers, employees and shareholders. Equally, such conduct may later be judged as having the effect or likely effect of substantially lessening competition in a market.

In Wesfarmers' view, the proposed amendments to section 46 will result in a lessening of innovation and risk taking by Australia's most successful companies by creating uncertainty as to whether conduct may be found to have the effect or likely effect of substantially lessening competition even if it was for a legitimate (i.e. not anti-competitive) purpose.

The actual effect (or even likely effect) of conduct is often difficult to predict, and easy to judge in hindsight. There is a real and significant risk that well-intentioned conduct will be judged at a later point to have had an unacceptable outcome or effect, even if it could not be predicted. Businesses may be unwilling to take on the financial and operational risks of investment and innovation if the regulatory outcome is uncertain.

A legislative amendment that would require a court (or the ACCC through an authorisation process) -- to consider the extent to which unilateral conduct is likely to increase competition, including by enhancing efficiency, innovation, product quality or price competitiveness in a market (or multiple markets), before it can be confirmed to be lawful will inevitably result in a reduction in desirable and pro-competitive investments and innovations.

As Stephen King and Graeme Samuel note:

> This will drown the commercial activity of big business in a sea of uncertainty. One can only wonder how a committee that on one hand recommends pro-competitive reforms to commerce can then proceed to urge a significant intrusive constraint on the commercial activities of big business. The only winners will be the lawyers and economists who will need to sit at the right hand of business CEOs to guide them on the legality of every significant transaction and the ACCC, which will need a big budget increase to deal with the mass of authorisation applications.

Wesfarmers does not agree that there will be a mass of authorisation applications, as few businesses can afford to wait the six months of the authorisation process before they respond to changes in

competitive dynamics or consumer preferences. But we agree that the new section would impose a significant and intrusive constraint on commercial activities and on competition.

The Panel suggests the new test will be worth any costs that may arise due to transitional uncertainty:

> The Panel's proposed reform to section 46 is an important change, which will (like all regulatory change) involve some transitional costs, as firms become familiar with the prohibition and as the courts develop jurisprudence on its application. In the Panel's view, the change is justified as transitional costs should not be excessive and will be outweighed by the benefits.

Although Wesfarmers believes that transitional costs would be significant and protracted, the proposal involves more fundamental costs and uncertainties that would persist no matter how familiar firms may become with the prohibition or how extensive the courts' jurisprudence may grow.

Further contact

We will be pleased to further engage the Review panel directly on the issues raised here, particularly as they relate to the detail of potential impacts on individual Wesfarmers businesses. Should you wish to clarify any particular issue raised in our submission, please contact Wesfarmers' Executive General Manager Corporate Affairs, Alan Carpenter acarpenter@wesfarmers.com.au (08) 9327 4267.