SUBMISSION ON THE AUSTRALIAN GOVERNMENT COMPETITION POLICY REVIEW

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Introduction

Competition policy should enhance consumer welfare through the promotion of competition, fair trading, and consumer protection. The Competition and Consumer Act ("the Act") is the primary legal means to achieve these objectives. In order to achieve the desired improvements in consumer welfare and competition, the Act must embody three distinct but interrelated characteristics:

1. It must effectively protect consumers and competitors from anticompetitive and misleading and deceptive conduct, and ensure that to the greatest extent possible consumers are given access to all information necessary to make an informed choice between substitutable, or reasonably interchangeable, products.

2. It must encourage vigorous rivalry between competitors, such that those with the best products at reasonable prices are rewarded, while the inefficient or less effective competitors are not shielded from the competition that the Act is intended to promote.

3. It must be expressed in language that is clear, concise, and easily understood by practitioners, those whom it regulates, and by those who seek its assistance.

In some respects, the Act achieves these objectives; in others, it fails to achieve them. Recent amendments to Part IV have adopted a verbose and unnecessarily detailed style of drafting that makes the core principles difficult to comprehend, and will almost certainly generate bad decisions.[1]

Competition law involves a complex mixture of law and economics, and the application of provisions to address concentration and abuse of economic power. Competition entails vigorous and independent competitive rivalry; most anticompetitive conduct boils down to abuses of market power or collusion between competitors. For that reason, this submission concentrates on misuse of market power, and cartels,[2] and the extraterritorial reach of the Act. The submission concludes with a short discussion of international price discrimination.

The nature of competition and general principles

Effective competition policy encourages independent rivalry between competitors, and prohibits conduct that stifles it. Competition policy should protect competitors and consumers from abuses of

[1] It is also disturbing that the primary consumer protection provision against misleading and deceptive conduct, formerly s 52, is now hidden in a schedule to the Act. Whatever constitutional reasons might have prompted this unwelcome development, reinstating it as s 52, even if mirror provisions are contained in a schedule to extend the provision to "persons" would address this issue.

[2] Although it is submitted that consumer protection should be strengthened as well, for example, in real estate and food labelling.

market power or other anticompetitive activity. But it should not shield inefficient or uncompetitive firms from competition or competitive forces. It should encourage innovation by firms. It should also encourage firms to produce the best product at the lowest reasonable price. It should not encourage production of shoddy goods at the lowest price; it should not encourage production or consumption of shoddy goods at all.[3] It should do what it can to encourage transparency and information about products and their pricing, so that consumers may make the best choice in the circumstances, having been fully informed not only about relative prices, but also about relative qualities and features of potential alternatives. In that regard, properly informed consumers value well-made products that perform better and last longer than cheaper but inferior counterparts. In other words, competition policy is liable to fall into error if it only encourages production at the lowest possible price. The Act should reward innovation, and it should encourage Australian producers to seek a reasonable reward from their productive pursuits where they produce superior products.

Professor Brunt observed that competition is a process, not a situation:

> "Dynamic processes of substitution are at work. Technological change in products and processes, whether small or large, is ongoing and there are changing tastes and shifting demographic and locational factors to which business firms respond. Profits and losses move the system: it is the hope of supernormal profits and some respite from the 'perennial gale' (J.A. Schumpeter's phrase: see *Capitalism, Socialism and Democracy* (2nd ed., 1947), p. 87) that motivates firms' endeavours to discover and supply the kinds of goods and services their customers want and to strive for cost-efficiency. Such a vision tells us that effective competition is fully compatible with the existence of strictly 'limited monopolies' resting upon some short run advantage or upon distinctive characteristics of product (including location). Where there is effective competition, it is the on-going substitution process that ensures that any achievement of market power will be transitory."[4]

Healthy competitive markets guard against the problems of too great a concentration of economic power. In *United States v Aluminium Company of America*[5] Judge Learned Hand summarized the reasons for preferring a competition policy that limits the concentration of economic power:

> "Many people believe that possession of unchallenged economic power deadens initiative, discourages thrift and depresses energy; that immunity from competition is a narcotic, and rivalry is a stimulant, to industrial progress; that the spur of constant stress is necessary to counteract an inevitable disposition to let well enough alone. Such people believe that competitors, versed in the craft as no consumer can be, will be quick to detect opportunities for saving and new shifts in production, and be eager to profit by them…[Congress] was not necessarily motivated by economic motives alone. It is possible, because of its indirect social or moral effect, to prefer a system of small producers, each dependent for his success upon his own skill and character, to one in which the great mass of those engaged must accept the direction of the few…"

These ideals and concerns are equally applicable to Part IV of the Act. The Act must address real world competitive situations. We live in a dynamic, increasingly globalized world. Australian producers face competition from imported goods. Some of them are good; some are bad, but they are here to stay.

Advertising and marketing are powerful tools when skilfully employed. The Act must ensure that Australian consumers are not misled into buying products that claim to be what they are not, or which claim to have qualities they lack. In that regard, the Australian Competition and Consumer Commission has an important role to play in protecting consumers and promoting competition. Likewise, the courts perform a critical role in dispensing justice in cases brought before them, and the Federal and High Courts have an impressive record in so doing, and in developing a coherent body of law. Having said that, there is much good sense, where reasonably practicable, in having judges

[3] Shoddy goods, despite their low cost, usually fail to satisfy consumer wants and needs, and waste resources because of limited longevity.

[4] *Market Definition Issues in Australian and New Zealand Trade Practices Litigation,* (1990) 18 ABLR 86 at 96

[5] 148 F.2d 416, (2d Cir. 1945) at 427. For further discussion, see *The Economics and Law of Section 46 of the Trade Practices Act,* Ian B Stewart, (1998) 26 ABLR 111.

familiar with competition law principles hear competition law cases, given that they involve a matrix of issues of law and economics.

If there is an area in which arbitration of disputes should be encouraged, it may be access disputes under Part IIIA of the Act. Although arbitration may not be feasible (for reasons including public policy considerations) as a method of resolving disputes between regulators and private businesses, there is something to be said for the relative speed with which arbitration can occur, and especially the fact that an arbitral tribunal's decision is final. With the increasing globalization of commerce, greater consideration should be given to arbitration as a means of resolving disputes under Part IV, not only because of the finality of decisions, but the relative ease with which arbitral decisions in arbitrations conducted under widely recognized arbitral principles (such as the UNCITRAL Model Law) are enforceable in member states that are signatories to the New York Convention (or other applicable convention). Cases under Part IIIA often take years before avenues of appeal are exhausted, and further complications arise when considering the terms on which access is to be granted. Consideration might be given to how this process can be expedited.

Any changes to the Act must reflect the realities of competition, and not theoretical models. Perfect competition, for example, is not a benchmark against which competition laws should be judged. As Deane J noted in *Queensland Wire*, in addressing s 46 the object of that section (and competition laws in general) 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, but this is not a tort nor a contravention of s 46."

In *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* (2001) 205 CLR 1 at 23 (par [52]), the High Court stated that:

> "An absence of a substantial degree of market power does not mean the presence of an economist's theoretical model of perfect competition. It only requires a sufficient level of competition to deny a substantial degree of power to any competitor in the market."

J.M. Clark, in *Toward a Concept of Workable Competition*[6], said that perfect competition "does not and cannot exist and presumably never has." Markets in general are riddled with imperfections, and the flow of information is imperfect. Clark preferred the idea that markets should be workably competitive:

> "Competition is rivalry in selling goods, in which each selling unit normally seeks maximum net revenue, under conditions such that the price or prices each seller can charge are effectively limited by the free option of the buyer to buy from a rival seller or sellers of what we think of 'as the same product', necessitating an effort by each seller to equal or exceed the attractiveness of the others' offerings to a sufficient number of sellers to accomplish the end in view."

Whilst guarding against too great a concentration of economic power, we should bear in mind Schumpeter's view that monopolistic and oligopolistic market structures foster innovation due to the possibility of making profit and lead to greater economic growth than perfect competition, thereby more than offsetting the misallocation of resources associated with monopoly. According to Schumpeter, in monopoly there may be less price competition than in perfect competition, but firms would increasingly compete in technical and organizational innovation, thereby sending 'gales of creative destruction' through the economic system - monopolies which failed to innovate would be destroyed by innovators. The more efficient producers will take away market shares from less

[6](1940) 30 American Economic Review 241.

efficient firms. But once they have done so, they will earn monopoly profits, and these profits will thereby induce entry of new competitors, who will in turn erode the existing firm's market shares by producing more efficiently and cheaply. The Act does not and should not prohibit monopoly; it does, and should, prohibit abuses of monopoly power.

Suggestions for reform should be cognizant of the fact that few ideals translate well to the real world. The best course is for our competition laws to promote competition as rivalrous behaviour, to accept that competitors can and should try to injure each other, and that this should be encouraged provided it does not involve a use of substantial market power. Competition laws should protect competition, rather than competitors. In *Brown Shoe Co v United States* 370 US 294 at 320 (1962), the US Supreme Court stated:

> "The antitrust laws…were enacted for 'the protection of competition, not competitors.'"

I will focus in this submission on two aspects of Part IV: misuse of market power (where a firm uses its market power rather than its greater efficiency, or competitive skill to damage its weaker competitors), and cartels (in which contracts, arrangements or understandings between competitors protect them from independent rivalry).

Misuse of market power

When Part IV was introduced in 1974, the then Attorney General in the Second Reading Speech for the Bill stated a truth that appears to have been lost in recent amendments:

> "… other provisions, particularly those describing the prohibited restrictive trade practices, have been drafted along general lines using, wherever possible, well understood expressions. … it is questionable whether detailed drafting leads to more certainty. Often it does no more than obscure the broad purpose of a provision. (Australia, Senate, Parliamentary Debates (Hansard), 30 July 1974 at 542-543).

Since that time, the section's threshold has been lowered from that of a corporation being in a position substantially to control a market (which limited the section's application to monopolists and those in a dominant position), to the possession of a substantial degree of market power in 1986. This reduction in threshold allowed s 46 to apply to major participants in oligopolistic markets, and major participants in other markets. This welcome change has seen s 46 more frequently resorted to, and the High Court has produced a considerable body of jurisprudence explaining the section.

Section 46 is, and has been since its inception, a controversial provision. This is unsurprising given that competition involves a paradox: consumers often benefit most when competitors are ruthless in their desire to win sales from each other. Further, it is a section often invoked by competitors against other competitors, yet it has no function to protect competitors from the injuries of competitive conduct. There have been claims that it is too difficult a provision for successful prosecution of claims by small business against their larger and more powerful competitors. Such claims have resulted in the Birdsville amendments, which apply to below cost pricing.

The Birdsville amendments should be repealed. Although it is important to protect small business against abuses of market power by competitors, competition policy should adopt a principled approach to the protection of small business, recognizing that smaller firms may be more susceptible to damage from abuses of market power, but also recognizing that competition is not a gentlemanly sport. Section 46 is directed to misuse of market power. It is not directed, and should not be directed, to the use of financial power or the use of economies of scale or better innovation or efficiencies to better compete. Nor should it be directed to conduct that might seem ruthless when judged against societal norms but which makes no use of substantial market power. For the same reasons, and due to

the difficulty of distinguishing the results of successful competitive endeavours from abuses of market power, the section should not incorporate an effects test.

Were the section to be redrafted from the ground up, profit would be derived from reference to Article 102 (formerly article 82) of the European Union treaty. The brevity and concision of this provision contrasts starkly with s 46 in its current form. Further, it applies to abuses by undertaking(s) of a dominant position, rather than a misuse of substantial market power. It gives four examples of how such abuse may occur. In several respects, it is applicable to abuses by undertakings in a dominant position towards weaker competitors.

Given the extensive consideration by courts of s 46(1), and the now considerable body of court decisions interpreting it, this provision should not be altered. If, after proper consideration, the review panel concludes that s 46 does not afford sufficient protection to small business, the solution is not to insert or retain confusing provisions like the Birdsville Amendments. If the Panel were minded to supplement the core provision in s 46(1) in some way, consideration should be given to introducing a provision exemplifying the types of conduct that might conceivably constitute a misuse of market power, and these examples could be drawn from Article 102.

But, as with s 46(1) in its present form, in each case it is necessary to establish that the conduct in fact took advantage or used substantial market power. As the review panel is aware, whether or not advantage has been taken of market power is discerned by comparing the impugned conduct with the conduct that a competitive market (i.e. one in which the firm lacks substantial market power) would have been likely to engage in if it faced the same conditions of supply and demand. The equivalence of conditions of supply and demand is crucial to guard against incorrect inferences of the use of market power.

The counterfactual test is a useful tool if properly employed, for it strips the firm of its (presumed) market power, and asks whether it would have been likely to engage in that conduct in a market in which it lacked that market power. Such a market is a workably competitive market; it is not a perfectly competitive market. The Full Federal Court decision in *Boral* is an example of the erroneous conclusions that are liable to result if this equivalence of actual market conditions, and those in the hypothesized competitive market are not maintained. In that case, market conditions explained the below cost pricing, yet the Full Court's decision reflected an unstated assumption that market conditions are to be ignored. This error was subsequently recognized and corrected by the High Court.

Section 46 does not and should not protect competitors from competition and the workings of competitive markets. There should not be a tort or prohibition against unfair competition as such, because that raises too many imponderable questions: how can conduct reflecting normal competitive rivalry rather than use of market power be characterized as "unfair"? If conduct does not involve a use of market power for an anticompetitive purpose, how is "unfair" conduct to be distinguished from fair conduct? Section 46 is not a tool enabling competitors to claim that competitive behaviour that contravenes no law and does not involve a taking advantage of market power affords them a remedy. Were it otherwise, s 46 might become a tool to stifle effective competition, rather than a weapon against abuses of market power.

Section 46(1AA)

Section 46(1AA) adopts a substantial market share threshold for its application. Yet, it provides that a contravention of it is a contravention of s 46(1). This confuses and conflates two distinct concepts. Section 46(1) is concerned with the use of substantial market power for an anticompetitive purpose. It

does not apply to size as such, and does not prohibit the use of substantial financial power. Section 46(1AA) seems to suggest the novel and erroneous idea that a use of substantial market share is somehow to be equated with a use of substantial market power.

Below cost pricing may reflect either the possession, or the absence, of substantial market power. If below cost pricing reflects merely greater staying power by a corporation lacking substantial market power, s 46 should not prohibit such conduct.

Section 46(1AA) ignores the conditions of entry. In *Queensland Wire* (1989) 167 CLR 177*, Boral* (2003) 215 CLR 374, and other decisions, the High Court held that the critical factor in determining the existence of substantial market power was the conditions of entry. Thus, in *Queensland Wire* at 189, Mason CJ and Wilson J held that:

> "significant entry barriers are the sine qua non of monopoly and oligopoly, for ... sellers have little or no enduring power over price when entry barriers are nonexistent."

A substantial market share does not of itself give a substantial degree of market power. The concepts of substantial market share and substantial market power are distinct, but s 46(1AA) ignores this distinction. In *Queensland Wire Industries Pty Ltd v The Broken Hill Proprietary Company Limited* (1989) 167 CLR 177 at 188, Mason CJ and Wilson J said that market power was:

> "the ability of a firm to raise prices above supply cost without rivals taking away customers in due time, supply cost being the minimum cost an efficient firm would incur in producing the product."

The size of a firm's market share may say little or nothing about its ability to raise prices above supply cost without its rivals taking away its customers or sales. That ability depends upon the conditions of entry, which determine whether substantial market power is possible.[7]

Market share has very little in common with market power conceptually: a high market share may or may not coincide with a substantial degree of market power. A firm may have a substantial market share but lack substantial market power: if barriers to entry are low, an attempt by a firm with substantial market share to raise its prices above its supply cost will attract new entry, and the increased competition will drive prices back to a competitive level, causing the firm's market share to fall significantly if the firm attempts to maintain the supracompetitive price. If barriers to entry are low, substantial market power cannot endure.

In *Queensland Wire* (1989) 167 CLR 177 at 200 Dawson J observed that market power:

> "may be manifested by practices directed at excluding competition such as exclusive dealing, tying arrangements, predatory pricing or refusal to deal…. The ability to engage persistently in these practices may be as indicative of market power as the ability to influence prices. Thus Kaysen and Turner define market power as follows:

[7] Section 46(1AA) appears to have been a reaction to misguided interpretations of the *Boral* decision. In that case, the extremely adverse market conditions faced by all competitors resulted in no competitor having substantial market power. Boral priced below its costs, not because of market power, but because of its absence. This was due to the worst recession in the building industry for 50 years, excess supply in part due to the entrance of a new competitor with technologically advanced equipment (whose market share rose to 40% over the period of Boral's alleged predation), strong buyers who were able to force prices down, and a natural desire to stay in business if possible. Critics of the decision place far too much weight on Boral's strategic documents, which revealed a purpose of damaging competitors, but insufficient weight to the objective structural considerations of the market and competitive conditions. Missing from Boral's below cost pricing was the element of election that only the possession of a substantial degree of market power affords. Yet, on the same facts, Boral would probably have had a substantial market share, and would likely have contravened s 46(1AA) if decided today. This is despite the emphatic finding of the High Court that it lacked market power.

> "A firm possesses market power when it can behave persistently in a manner different from the behaviour that a competitive market would enforce on a firm facing otherwise similar cost and demand conditions." (Kaysen and Turner, *Antitrust Policy* (1959), p 75)."

Kaysen and Turner's definition of market power is a very clear one, and one sees the genesis of the counterfactual test for a taking advantage of market power in it. Similarly, in *Boral Besser Masonry Ltd v ACCC* (2003) 215 CLR 374 at 460, McHugh J, in discussing market power, said that:

> "A firm, in the position of BBM, possesses market power when it has the ability to sustain a pricing policy or the terms on which it supplies its product without regard to market forces of supply or demand."[8]

These authorities, like s 46(3) highlight the importance of the due regard for market forces in determining whether or not a firm had substantial market power. Section 46(1AA) potentially penalizes competitive conduct because it ignores market conditions. In a depressed market, no firm may have substantial market power, but several firms may have a substantial market share and may supply their goods for a sustained period below their costs. So much is unremarkable, and occurred in *Boral*. The High Court rightly held there that sustained below cost pricing by a firm with substantial market share did not reflect market power, and on the facts reflected its absence.

Section 46(1AA) may potentially protect competitors from the workings of a competitive market, contrary to principles accepted here and elsewhere. In *Brooke Group Ltd v Brown & Williamson Tobacco Corp,* 509 US 209 (1993), the US Supreme Court held:

> "That below cost pricing may impose painful losses on its target is of no moment to the antitrust laws if competition is not injured: It is axiomatic that the antitrust laws were passed for "the protection of *competition*, not *competitors*." *Brown Shoe Co.* v. *United States*, 370 U.S. 294, 320 (1962). Earlier this Term, we held in the Sherman Act § 2 context that it was not enough to inquire "whether the defendant has engaged in `unfair' or `predatory' tactics"; rather, we insisted that the plaintiff prove "a dangerous probability that [the defendant] would monopolize a particular market." *Spectrum Sports*, 506 U. S., at ___ (slip op., at 12). Even an act of pure malice by one business competitor against another does not, without more, state a claim under the federal antitrust laws; those laws do not create a federal law of unfair competition or "purport to afford remedies for all torts committed by or against persons engaged in interstate commerce." *Hunt* v. *Crumboch*, 325 U.S. 821, 826 (1945)."

Thus, competition laws exist to protect consumers from anticompetitive behaviour; not to protect competitors from the workings of competition. As Deane J noted in *Queensland Wire*, s 46 has to be construed with reference to its object, being:

> "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, but this is not a tort nor a contravention of s 46."

Section 46(1AA) is liable to threaten effective competition, and adversely affect consumer welfare. As noted in the discussion on s 46(1AAA), it has been heavily criticised by the OECD for its replacement of substantial market power with a substantial market share threshold.[9]

Section 46(1AAA)

Section 46(1AAA) is flawed for two reasons. First, its threshold of application is not evident. It provides that below cost pricing may contravene s 46(1) even if recoupment of losses is impossible.

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[8] See further generally, Ian B Stewart, *Misuse of Market Power in Australia,* Amazon Kindle link: http://amzn.com/B00FB3KV64

[9] See *OECD Reviews of Regulatory Reform: Australia 2010*

In so doing it makes reference only to s 46(1), and not to s 46(1AA). Is the provision referring to below cost pricing by a corporation with substantial market power as in s 46(1), a corporation with substantial market share as in s 46(1AAA), or something else?

Section 46(1) applies to a corporation with a substantial degree of power in a market. By contrast, section 46(1AAA) leaves open an argument that it does not require this, or even a substantial market share. This is liable to confuse practitioners and courts, and lead to needless expense as parties argue whether the provision only applies where the other conditions of s 46(1) apply or whether it applies independently of them.

Parliament should repeal s 46(1AAA), and Australian practitioners should be guided in potential contraventions of s 46(1) involving below cost pricing by the High Court decision in *Boral Besser Masonry Ltd v ACCC* [2003] HCA 5; (2003) 215 CLR 374. There, the majority accepted that recoupment is a relevant but not necessarily essential element of a misuse of market power. At 422 in the CLR; (2003) ATPR 41-915 at 46,686; par [130], Gleeson CJ and Callinan J stated:

> "While the possibility of recoupment is not legally essential to a finding of pricing behaviour in contravention of s 46, it may be of factual importance."

McHugh J thought recoupment an essential element, in part because of Easterbrook J's reasoning in *AA Poultry Farms Inc v Rose Acre Farms Inc* (1989) 881 F 2d 1396 at 1401:

> "It is much easier to determine from the structure of the market that recoupment is improbable than it is to find the cost a particular producer experiences in the short, middle, or long run (whichever proves pertinent). Market structure offers a way to cut the inquiry off at the pass, to avoid the imponderable questions that have made antitrust cases among the most drawnout and expensive types of litigation."

There is much to be said for this view, however, Gleeson CJ's and Callinan J's view leaves open the possibility that predation may occur without a possibility of recoupment, depending on the facts of the particular case.

As recognized in US cases, the prospect of recoupment is a reflex of market power. If a corporation has substantial market power, it may increase its prices above its costs, without losing customers over time. The issue of whether the firm *has* substantial market power should be answered prior to asking whether the firm's below cost pricing was predatory. A firm with substantial market power by definition has the ability to raise its price above its costs. If it is engaging in predatory pricing, it chooses to price below its costs, knowing that it has the ability to recoup its losses once its predatory strategy is successful. In other words, the same market power that gives the ability profitably to raise prices above cost without losing sales, also gives the ability to recoup losses intentionally incurred as part of a predatory strategy to drive out competitors. That is the strength of the American requirement of a reasonable prospect of recoupment in order for below cost pricing to be treated as predation. Yet, s 46(1AA)) ignores this logic.

The failure of s 46(1AA) and s 46(1AAA) to reflect sound economic and legal principle is noted by the OECD in its *OECD Reviews of Regulatory Reform: Australia 2010* at p 164:

> "Two recent amendments [to s 46] add uncertainty to the law applied to predatory pricing. At the behest of Parliamentary advocates for the small business sector, the former government introduced a new provision that prohibits sales below cost, for a sustained period for an impugned purpose. The prohibition in this "Birdsville amendment", so-called after the remote pub in which it was supposedly penned, is based on market share rather than market power, and it does not require showing a connection between market share or power and the offending conduct. The intended relationship between the Birdsville amendment and the general prohibition of misuse of market power is not clear. Another recent amendment aggravates the uncertainty, by denying that a predatory pricing

> violation should depend on the alleged predator's ability to recoup its losses from supplying below cost. The true extent of the amendments will be tested if a firm is found liable for below cost pricing in circumstances where it is unlikely that the firm would be found to have substantial market power and there is little prospect of recoupment."

Ideally, s 46(1AAA) should be repealed and guidance sought in the High Court's sound judgment in *Boral*. However, if the provision is to remain, it should be redrafted to clarify that its threshold of application is, like 46(1), a substantial degree of market power. This could be achieved by adding the words "with a substantial degree of power in a market" after the third word, "corporation". Alternatively, s 46 can be amended to clarify that recoupment is a relevant but not necessarily decisive factor.

Below cost pricing, even sustained below cost pricing, without more, does not demonstrate predatory conduct. The early cost based test stated by Areeda and Turner has been criticized for its assumption that a bright line test exists for pricing conduct in relation to costs, above which conduct is fair, and below which conduct is predatory. In *McGahee v Northern Propane Gas Co* 858 F.2d 1487 at 1495 (11th Cir 1988), cert denied 109 S.Ct 2110 (1989), the court drolly observed:

> "The Areeda and Turner test is like the Venus de Milo: it is much admired and often discussed, but rarely embraced."[10]

The reticence of US courts to embrace bright line cost based tests is understandable, given that such tests fail to capture the richness of competition, and fail to appreciate that the complexity of competitive conditions makes it impossible to conclude from a comparison of price with a firm's costs alone, that its conduct uses its market power. Legitimate business reasons may justify such conduct. Whatever the merits may be of theoretical models that a firm will shut down if costs fall below average variable costs, such simplistic reasoning ignores a swathe of real world considerations for any business faced with that situation. Shutting down cedes market share; it might be premature in the event that conditions improve; it may have consequential effects for other elements of the business (especially in a vertically integrated firm where upstream supply is used as an input downstream). Legitimate business reasons may justify the continuation of below cost pricing. Whether or not they do cannot be determined without proper scrutiny of the applicable market conditions.

The inevitable result of competition is for firms to inflict substantial damage on each other in their quest to win sales at competitors' expense. Those injuries are unremarkable, and reflect merely the workings of a competitive market. Whether or not those injuries reflect competitive conduct or predation does not change the moment price falls below cost.

A firm that lowers its prices to win sales, if successful, damages its competitors. A firm may be required to price below cost because of excess supply in the market, or because it does not wish to cede market share to a competitor with lower costs than it. There is much to be said for the view that a corporation with substantial market power has no need to price below its costs at all, and consequently much reason to suspect that its so doing reflects a use of its market power. Market power is a well understood objective concept, and the existing tests are adequate to assess whether or not it exists, and has been used, in a particular case. Below cost pricing, even sustained below cost pricing, does not of itself demonstrate that the firm had market power.

Recommendations as to s 46(1AAA) and 46(1AA)

Sections 46(1AAA) and 46(1AA) should be repealed. Section 46(1AA) is indefensible from any

[10] For further discussion of the problems with cost based tests in predatory pricing claims, see Ian B Stewart, *Misuse of Market Power in Australia,* Chapter 20, Predatory Pricing. Amazon Kindle link: http://amzn.com/B00FB3KV64

perspective. If the words "that has a substantial share of a market" were replaced with the words "that has a substantial degree of market power" its most glaring flaw would be removed. However, the criticism would remain that it is simply unnecessary. Properly construed the High Court's decision in *Boral* did *not* require a reasonable prospect of recoupment, but it accepted that the prospect of recoupment may be of factual significance. Likewise, the Explanatory Memorandum to the 1974 Bill noted that predatory pricing is an example of conduct that *may* contravene s 46(1). The draftsperson saw no need to spell that out. It is likewise better to allow the High Court to develop the jurisprudence in this area, rather than attempt to introduce provisions in piecemeal fashion that, however well intentioned, are misconceived. This way, law can evolve according to the reasoning of some of Australia's best legal minds.

Section 46(1AB)

Section 46(1AB) is superfluous and unnecessary; it should be repealed. To say, in determining whether a market share is substantial, that regard should be had to the number and size of competitors, is as obvious as saying that the sky on a clear day is blue, and bordering on the tautological.

Section 46(1A)

Section 46(1A) is unnecessary. Prior to its introduction, courts had no difficulty with the notion that a reference to "a competitor" and "a person" in s 46(1) embraced competitors generally, as well as particular classes of competitors and persons. The provision simply adds to the wordiness of s 46, without any discernible countervailing benefit.

Section 46(3C) and (3D)

Sections 46(3C) and (3D) should be repealed. A corporation with a substantial degree of power in a market need not "substantially control" it or have "absolute freedom from constraint" by the conduct of competitors and customers. That is evident from the plain language of s 46(1), and is likewise implicit in the reasoning of court decisions interpreting it.

Section 46(1) applies to a corporation with a substantial degree of power in a market. It does not require a corporation to have a dominant position, or a monopoly, in a market. Even a monopolist does not have an absolute freedom of constraint.[11] Section 46(1) speaks of *substantial* market power—not absolute market power; and not even a dominant position.

It follows from the use of "substantial" in s 46(1) that more than one corporation may have a substantial degree of power in a market. Section 46(3D) is superfluous.

Section 46(4A)

Section 46(4A) is misconceived. Section 46(1) requires an examination of a corporation's conduct objectively, in order to determine whether or not it had a substantial degree of market power. Pricing

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[11] H Varian, *Microeconomic Analysis* 2nd ed 1984 p 91-2 notes that unless there are no substitutes at all for the monopolist's product—usually a very extreme assumption—other producers will respond to the monopolist's price. Varian thus states:

> "Presumably, if the monopolist is earning positive profits, other firms would like to enter the industry. *If the monopolist is to remain a monopolist, there must be some sort of barrier to entry.*"

below cost, as the High Court observed in *Boral,* may indicate the possession of market power or its complete absence. Consequently, this provision clouds the relevant and telling factor of market power and its use. Section 46(4A)(b), in requiring consideration of the reasons for below cost pricing, introduces into s 46(1) an unwarranted subjective element. A firm's subjective reasons are relevant to the issue of purpose of conduct; they are not relevant to whether the firm took advantage of its market power.

Nor are subjective considerations relevant to whether a firm has market power. Market power is an objective concept that a firm either has or lacks, regardless of what the firm thinks (or wishes), and regardless of the purpose of its conduct. This provision muddies the clarity of s 46(1) and should be repealed.

Section 46(6A)

Section 46(6A)(d)

Section 46(6A)(d) should be repealed. In determining whether or not a corporation took advantage of its market power, no probative assistance is gained by asking whether its conduct is "otherwise related" to its market power.

Section 46 is entitled *misuse* of market power. It does not embrace any connection between market power and conduct. So much is clear from the numerous High Court decisions on s 46. One does not take advantage of a thing if one's conduct is "related" or "otherwise related" to that thing. Conduct that takes advantage of market power is a much narrower concept than conduct that is related to market power.

The provision is not only unnecessary, but it is also wrong in principle, for it requires no causal link between the conduct and the corporation's market power.[12] It thus adds to uncertainty and serves no useful function.

Although the *ejusdem generis* rule of statutory construction could be invoked to argue that the phrase *otherwise related* imports a causal link between the conduct and market power, s 46(6A)(d) itself lends no support to such construction. Courts and practitioners should not be left to speculate about the meaning and application of statutory provisions. This is unacceptably sloppy drafting. Section 46 should be directed at conduct that uses substantial market power for an anticompetitive purpose, rather than conduct that is *otherwise related* to market power.

Parliament should resist the temptation to add interpretative or expository provisions to s 46(1). The central provision is clear, and several High Court decisions have not only provided an authoritative and easily understood interpretation, but also clarified any doubts as to its operation. In the Senate debates on the Trade Practices Bill, the then Attorney General stated (Hansard – Senate: 14 August 1974 p 923) that:

> "A monopolist is not prevented from competing as well as he is able, eg, by taking advantage of economies of scale, developing new products or otherwise making full use of such skills as he has… In doing these things he is not taking advantage of his market power."

In *Boral Besser Masonry Ltd v ACCC* (2003) 215 CLR 374 at 464, McHugh J referred to *Melway* in doubting whether "use" captured the full meaning of "take advantage of":

[12] As noted above, the European analogue of s 46 involves an "abuse" of a "dominant position".

> "In *Queensland Wire*, this Court held that "take advantage of" market power did not require proof of a hostile intent or use of that power. The Court equated "take advantage" with "use". But the term "use" does not capture the full meaning of "take advantage of", as the later decision in *Melway* shows. There must be a causal connection between the "market power" and the conduct alleged to have breached s 46. Moreover, that conduct must have given the firm with market power some advantage that it would not have had in the absence of its substantial degree of market power. *Melway* could not have been decided as it was unless these propositions were correct."

In *Clear Communications Ltd* [2010] NZSC 111, the New Zealand Supreme Court doubted McHugh J's view that taking advantage involved something more than use at [27]. Whatever be the true position (and I suggest that the Blunt Committee correctly considered that "taking advantage" meant "use"), s 46(6A)(d) muddies the waters, and departs from logical principle. A monopolist enjoys undoubted substantial market power. Any competitive conduct engaged in by a monopolist or a corporation with substantial market power might in some sense be said to be "otherwise related" to that power. This provision is a minefield of speculative and fruitless inquiry that distracts from the key concern of s 46.

Section 46(6A)(a) to (c)

Sections 46(6A)(a) to (c) codify the law on s 46. Yet the principles are more clearly and better expressed in their proper context, in the High Court decisions in *Melway* and others. The provisions are unnecessary and add to the complexity of construing s 46(1). Sections 1 and 2 of the US Sherman Act have been interpreted many times by the US Supreme Court. On each occasion, the US Supreme Court has explained or clarified their application to particular contexts. Yet the United States has not deemed it necessary to codify every pronouncement of its highest court on antitrust law. Nor should Australian legislators find it necessary to codify the High Court's pronouncements. If further exposition of the central provision in s 46(1) is required, it would be better to exemplify the types of conduct that may take advantage of market power along the lines of the European provision, and the Explanatory Memorandum introducing s 46, rather than providing restatements of principle, some of which are accurate but some of which are not. However, these issues are relatively minor compared with the glaring problems caused by the provisions discussed above.

Conclusion on s 46

In introducing the restrictive trade practices provisions into the Act, the Attorney General was right in drawing attention to the fact that detailed drafting only serves to obscure the point of a provision.

By themselves, s 46(1), (2), (3), (4), (5), (6) and (7) were conceived as addressing the mischief of misuse of market power. Section 46(1) has seen amendments to change the test from dominance to a substantial degree of power, and to address problems identified in the *Rural Press* decision as to use of market power in a different market from that where it is held. The Birdsville amendments complicate the provision, detract from its clarity, and introduce inconsistency and confusion. Consideration should be given by the review panel to repealing them.

CARTEL PROVISIONS – DIVISION 1 OF PART IV

The Competition Policy Review Issues Paper asks inter alia the following questions about cartels:

- Do the provisions of the CCA on cartels, horizontal agreements and primary boycotts operate effectively and do they work to further the objectives of the CCA?

- Should the price signalling provisions of the CCA be retained, repealed, amended or extended to cover other sectors?

- Do the joint venture provisions of the CCA operate effectively, and do they work to further the objectives of the CCA?

Cartels are an evil of tremendous damage to the workings of competitive markets. The cartelist, by fixing prices, by restricting choice to consumers, by artificially dividing markets and by bid rigging, wreaks havoc with the independent rivalry vital to effective competition. Cartels are a toxin on the competitive process, and must be eradicated, if the Act is to achieve its object of enhancing consumer welfare.

The inclusion into the Act of provisions directed against cartel behaviour was long overdue. However, Division 1 of the Act is an embarrassing example of bad drafting. The prohibitions should be expressed in language that ordinary business people understand. Practitioners and courts have already struggled to comprehend the appalling complexity of these provisions. Division 1 is certain to result in bad law and is unintelligible to ordinary business people. Further, should the criminal penalty provisions of Division 1 be applied, it will be a remarkable stroke of luck if a jury is able to navigate the myriad complexities of the provisions and comprehend the mischief intended to be addressed, or if the trial judge's charge to the jury survives appeal.

The core provision is s 44ZZRD. This provision's insistence on unnecessary formalism and detail avoids the essential integers of a cartel. Instead of actually defining a cartel provision, it tells us that a cartel provision is one that satisfies the purpose/effect condition or the purpose condition, and satisfies the competition condition. To understand what each of these conditions entails, the reader must trawl over several pages of subsections, before even reaching the explanatory or qualifying provisions in s 44ZZRD(5) and later. It is no excuse for the Division to contain a simplified outline in s 44ZZRA. A simplified outline should be unnecessary; it merely highlights the complexity of the provisions that follow. Other jurisdictions make do much more effectively with vastly simpler provisions.

It may be too early to say whether these provisions will fail to capture relevant cartel conduct, or else extend to conduct that is of no concern to competition law because it is undertaken for legitimate and competition enhancing business reasons. Their insistence, however, in verbosely spelling out various possibilities and permutations suggests that they may miss relevant cartel conduct, or else capture competitive conduct. Perhaps fortuitously, only the *Bradken* case has been decided by the Federal Court, and the trial decision exemplifies the confusion likely to result from this badly drafted division.

What is unexplained is why the Act, the competitive process, and consumer welfare is best served by a series of interlocking provisions containing numerous subsections, qualifications, and cross references, when the basis mischief to be addressed is quite clear. What should be prohibited is a contract, arrangement or understanding (or provision thereof) which has the purpose or effect of fixing or raising prices, restricting output, dividing markets, preventing or limiting competition, or allocating markets or customers.

Some glaring problems with Division 1 are as follows:

a) Why is it necessary for a separate purpose/effect condition to be specified and elaborated in s

44ZZRD(1) and (2)?

b) Why do we need separate subsections for the "fixing, controlling or maintaining" and for the "providing for the fixing, controlling or maintaining" of the price, discount, allowance, rebate or credit of the things specified?

c) Why does it take four subsections (s 44ZZRD(c) to (f) to spell out that the provision applies to goods or services, supplied, acquired, resupplied, or likely to be?

d) Why does s 44ZZRD(3) contain no less than 11 subsections of cases in which the purpose condition might be enlivened? Why is this better than a simple provision prohibiting a provision of a contract, arrangement or understanding which has the purpose or effect of restricting competition, damaging competitors, raising prices, fixing prices, rigging bids, allocating markets and so forth? The provisions should be redrafted in language that business people and consumers can comprehend.

The confusing purpose/effect, purpose, competition conditions should be scrapped, and redrafted in plain language, using well understood expressions. The draftsperson should have regard to analogous provisions in New Zealand, Europe, and the United States.

The following approach would far better serve the community and achieve the Act's objects: state upfront that no person may enter into a contract, arrangement or understanding (these terms are now sufficiently clear in Australian jurisprudence) that contains a cartel provision, or give effect to any contract, arrangement or understanding that contains a cartel provision. Then define what a cartel provision is: namely, a provision that has the purpose or likely effect of fixing prices, restricting outputs, rigging bids, or allocating markets. Then explain what each of these terms means.

This model has been employed in the New Zealand Commerce Act and has much to commend it. Unlike Division 1's approach, this approach accords with the human mind's natural ability to grasp key facts and concepts, and then assimilate further explanatory details. By contrast, Division 1's approach of telling the reader that a cartel provision is one that satisfies the purpose/effect or purpose condition, and then the competition condition, requires the reader to understand what the purpose, purpose/effect, and competition conditions mean, and their relevance to cartel conduct, before the reader can glean the essential integers of cartel conduct. It fails to give the reader an early impression of what conduct might contravene the Division, but requires the reader to trawl through the tongue twisting detail of subsections 2, 3 and 4. By the time readers have reached the end of the provisions, they might be excused for forgetting what a cartel is. The Act should not adopt such an approach to drafting.

The definition of likely in s 44ZZRB

Division 1 should be repealed and replaced by a clear set of provisions prohibiting cartel conduct. If the Review Panel decides against this course, at the very least the definition of "likely", as well as the joint venture exception, should be recast.

The definition of "likely" in s 44ZZRB is contrary to common usage and accepted meaning. To say that something is "likely" does not mean merely that there is a possibility of the thing happening that is not remote. The latter is a "real" possibility, rather than a "likely" possibility. It is inexcusable for any statute to expect a reader or a court to accept a definition of a term that is contrary to its commonly understood meaning. Such a definition also risks overreaching, as courts and parties are led

down the rabbit hole of examining whether there is a more than a remote possibility that two parties would be in competition with each other (if, in fact, the statutory definition of "likely" applies to this very question).

What is required is a provision that prohibits a contract, arrangement or understanding with the purpose or likely effect of fixing prices etc, when those parties are in competition with each other or would likely be in competition with each other in the absence of that provision.

Quite why any definition of "likely" is required is a mystery. The Oxford English Dictionary defines it *inter alia* as "[p]robably, in all probability"). In *Australian Gas Light Co v Australian Competition and Consumer Commission* (2003) 137 FCR 317 at [348], French J (now CJ) said:

> "The meaning of "likely" reflecting a "real chance or possibility" does not encompass a mere possibility. …The word "likely" has to be applied at a level which is commercially relevant or meaningful as must be the assessment of the substantial lessening of competition under consideration – *Rural Press Ltd v Australian Competition and Consumer Commission* [2003] HCA 75; (2003) 216 CLR 53 at [41]."

Further, in *Australian Telecommunications Commission v Krieg Enterprises Pty Ltd* (1976) 27 FLR 400 at 410, Bray CJ said:

> "Here we are concerned with the word "likely" in a statute. As I have said, the ordinary and natural meaning of the word is synonymous with the ordinary and natural meaning of the word "probable" and both words mean, to adopt the expression of Lord Hodson in the passage previously quoted, that there is an odds-on chance of the thing happening. That is the way in which statutes containing the words have usually been construed."

If there is an "odds-on" chance of something happening, its occurrence is likely. If there is more than a remote possibility of something happening, there is nothing more than a real chance of it happening. The two concepts are distinct.

Aside from s 44ZZRB adopting a definition at odds with plain language, the division defines "likely" only in the context of a supply, an acquisition, production, or capacity to supply goods or services. Immediately, we are left to wonder whether the definition applies to the use of "likely" in the competition condition in s 44ZZRD(4). On the one hand, concepts such as supply, production etc of goods might be relevant to competition; on the other, the definition in s 44ZZRB does not in terms apply to the competition condition. So, yet again, we have a provision that is not only confusing in its primary meaning, but leaves uncertainty as to its application. In *Norcast SárL v Bradken Ltd (No 2)* [2013] FCA 235, Gordon J assumed the definition of "likely" applied to the competition condition. Whether or not it does is unclear. Confusion is likely to occur should a jury ever consider the term.

The Joint Venture Exception

Sections 44ZZRO and 44ZZRP respectively exempt cartel provisions for the purpose of a joint venture. Yet again, however, the reason for the exemption is lost in the densely worded provisions. In their very density and complexity, a question arises whether the exemptions will achieve their purpose, or rather will encourage unmeritorious attempts to excuse cartel conduct because it happens in the course of a joint venture of some description.

The New Zealand approach is considerably better. The exemption there provides that the cartel provisions do not apply to a person entering into a contract or arrangement or arriving at an understanding containing a cartel provision, or giving effect to one where the parties are involved in a collaborative activity; the cartel provision is reasonably necessary for the purpose of the collaborative activity; and the collaborative activity is not carried on for the dominant purpose of lessening competition between any 2 or more parties. That is far easier to understand than the confusing joint venture exception in Division 1. Likewise, consideration should be given to appropriate exemptions for vertical supply contracts and joint buying and promotion agreements. Consideration should also be given to the European approach to exemptions set out in the primary provision below.

The European Approach

Reference has already been made the New Zealand legislation. If the panel decides that a complete redrafting of Division 1 is appropriate, reference may perhaps also be made to Article 101 of the European Law, which provides:

> "(ex Article 81 TEC)
>
> 1. The following shall be prohibited as incompatible with the internal market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market, and in particular those which:
>
> (a) directly or indirectly fix purchase or selling prices or any other trading conditions;
>
> (b) limit or control production, markets, technical development, or investment;
>
> (c) share markets or sources of supply;
>
> (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
>
> (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.
>
> 2. Any agreements or decisions prohibited pursuant to this Article shall be automatically void.
>
> 3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:
>
> - any agreement or category of agreements between undertakings,
>
> - any decision or category of decisions by associations of undertakings,
>
> - any concerted practice or category of concerted practices,
>
> which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:
>
> (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;
>
> (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question."

Although caution is warranted before applying the approaches of other jurisdictions, this article demonstrates the brevity and relative clarity that should be aimed for. In the first article, the reader is informed of the four main types of cartel conduct that might infringe the treaty. The unenforceability of such provisions is then spelled out, followed by exceptions and exemptions. This contrasts with Division 1, which runs over several pages of densely worded provisions.

Price signalling

The price signaling provisions of Division 1A impose a burden on businesses and potentially capture competitive conduct. Whether they provide a benefit to competition or consumer welfare is doubtful. The Division should be repealed, or else it should be redrafted in succinct terms that identify concisely the types of price signaling that have anti-competitive purposes or effects.

Extraterritorial operation of the Act

Chapter 5 of the Competition Policy Review Issues Paper asks: "Are the current competition laws working effectively to promote competitive markets, given increasing globalisation, changing market and social structures, and technological change."

One matter for consideration here is that it is too difficult for Australian citizens to seek a remedy under the Act in respect of extraterritorial conduct that has a relevant impact on consumer welfare or competition in Australia.

Section 5 of the CCA extends the provisions of Part IV to conduct engaged in outside Australia by Australian citizens, persons ordinarily resident in Australia, and bodies corporate incorporated or carrying on business in Australia.

Section 5 poses awkward difficulties for Australian consumers and businesses seeking a remedy for anticompetitive conduct engaged in outside Australia that would contravene Part IV if it occurred in Australia. Where conduct engaged in outside Australia has a relevant impact on Australian consumers or businesses, such that the conduct would contravene Part IV if it had been engaged in Australia, too great a hurdle exists for affected Australian consumers and businesses to satisfy the required jurisdictional nexus.

In the 21st century, little justification exists for requiring litigants to establish that a body corporate carried on business in Australia if its conduct engaged in outside Australia adversely affected or was intended to adversely affect, consumer welfare or competition in Australia. If a foreign entity engages in conduct with a relevant effect on competition and consumers in Australia, it should be subject to the Competition and Consumer Act, whether or not it carries on business here.

The carrying on business requirement for "presence" in the field of conflict of laws was developed in the remote past. Whatever its usefulness in the 19th and 20th centuries, in today's age of digital downloads, overnight international shipping and increased world integration in matters of commerce, no convincing reason explains why the existence of a remedy for an Australian citizen for conduct engaged in *outside* Australia but affecting competition and consumer welfare *in* Australia should depend on whether the person engaging in that conduct carries on business in Australia.

The difficulties posed for applicants by the carrying on business requirement were exemplified in *Bray v F Hoffman-La Roche Ltd*,[13] where Merkel J considered that the foreign entities did not carry on business in Australia. Although Merkel J found that the conduct of the foreign parents occurred in Australia, and thus avoided the issue of carrying on business, the question is why it should be necessary to establish that extraterritorial conduct affecting Australian competition or consumer welfare, was engaged in by a corporation carrying on business in Australia? It is bizarre that this question may depend upon such issues as whether a local subsidiary is carrying on its own business or that of its foreign parent's. The nature of the conduct remains the same, regardless of the answer to this question.

Likewise, it is hard to see why comity issues justify the carrying on business requirement. The United States effects doctrine applies its antitrust laws to foreign conduct having a relevant effect on consumers or business in the United States. As Learned Hand J said in *United States v Aluminium Co of America* 148 F 2d 416 at 443 (2nd Cir 1945), "it is settled law… that any state may impose liabilities, even upon persons not within its allegiance, for conduct outside its borders that has consequences within its borders which the state reprehends." There, the Sherman Act applied because the relevant agreements (which involved European and Canadian producers of aluminium agreeing to fix production (and thus prices) of aluminium exports into the United States) affected imports into the United States, and affected consumers in that country. As Learned Hand J said at 444, "Both agreements would clearly have been unlawful, had they been made within the United States; and it follows from what we have just said that both were unlawful, though made abroad, if they were intended to affect imports and did affect them."[14]

[13] (2002) 118 FCR 1.

[14] See also the US Supreme Court decisions in *Union Carbide & Carbon Corp* 370 US 690 (1962), and *Harford Fire Ins v California* 509 US 764 (1993). For further discussion of extraterritoriality, see *Extraterritorial Application of Part IV of the Competition and Consumer Act* by Ian B Stewart, (2014) 42 ABLR 90.

Various countries have introduced blocking statutes to prevent overreaching of antitrust laws, where a foreign state's assumption of jurisdiction in an antitrust matter is contrary to comity or international law.[15] It would be difficult to conceive of a sound basis for a foreign state to complain, however, where a foreign corporation gives effect, one way or another, to a cartel agreement reached outside Australia with the purpose or effect of fixing prices, restricting outputs etc, *in Australia*. These overreach issues are easily avoided by requiring an appropriate nexus of the relevant conduct or its effect or purpose with Australia.

In any event, other choices are available should the review panel conclude that s 5 in its present form should be reformed. The implementation doctrine adopted in the European Commission avoids the distraction of whether the cartelist carried on business (whether itself or through its agents or subsidiaries). As noted above, Article 101 of the European Commission Treaty prohibits agreements between undertakings and concerted practices which may affect trade between EU members which have the object or effect of preventing, restricting or distorting competition.

There are three ways in which article 101 may apply to extraterritorial conduct. By the single economic entity doctrine, different companies (such as parent and subsidiaries) may be treated as single entities. Under this doctrine, the EU has jurisdiction over the entire group as a single undertaking if a subsidiary of the foreign parent is present and active in the EU. The implementation doctrine allows EU states to assume jurisdiction in relation to agreements, concerted practices, decisions, abuses of dominant positions conceived in a foreign place but implemented in the EU. In *A Ahlström Oy*[16] the European Court of Justice recognized that jurisdiction should not depend upon the place where the agreement, decision, or concerted practice was formed; nor should jurisdiction depend on whether the contravenor acted itself in the EU market or used subsidiaries, agents and the like. The third basis upon which European Courts assume jurisdiction is by way of an effects doctrine, which is similar to the effects doctrine applied in the United States, and discussed above.[17]

It is unnecessary here to identify which of these various options should be adopted. Nevertheless, s 5 of the CCA lags behind its international counterparts, and in so doing is unlikely to achieve the Act's object of enhancing consumer welfare. Reform is required to bring s 5 up to contemporary international best practice, so that consumers and businesses may avoid the need to demonstrate that a foreign entity whose conduct adversely impacts, or is intended by it to impact, upon Australian competition and consumers, carries on business here. That requirement often has little to do with the important question of whether the relevant conduct has the purpose or effect of damaging competition or consumer welfare in Australia.

International price discrimination

Section 49 of the Act was repealed in 1995 following the Hilmer Committee's recommendation. It was regarded as redundant, and price discrimination was considered by various inquiries to enhance economic efficiency. In the domestic context, there is much to be said for those views.

Nevertheless, an issue arises whether Australian competition laws work effectively to promote competitive markets given increasing globalisation. Although greater convergence in world commerce has led to improvements in the terms and conditions on which Australian consumers and businesses are able to import goods, anomalies remain. Instances exist where Australian consumers pay

[15] See in Australia, s 9 of the *Foreign Proceedings (Excess of Jurisdiction) Act 1984* (Cth), which empowers the attorney general to declare that the assumption of jurisdiction of a power or the exercise of a power by a foreign court was contrary to international law or inconsistent with international comity.

[16] [1988] ECR 5193

[17] For a succinct summary of the EU approach see the European Commission, *Roundtable on Cartel Jurisdiction Issues, Including the Effects Doctrine* 21 October 2008

significantly more for equivalent goods and services than their counterparts in other countries, although neither transport costs nor exchange rates explain the differential.[18]

The Act presently provides no remedy to Australian consumers in respect of international price discrimination[19], notwithstanding its potential to adversely affect consumer welfare. Perhaps the difficulties of administering and policing a law against such practice are perceived to outweigh the benefits of doing so. Inquiries on a product by product basis as to all the factors that might explain why a particular product costs more in this country than other countries, and whether the factor is a meritorious one, would be complex.

Nevertheless, the increasing importance of digital downloads and the price differentials between Australia and elsewhere suggests that further scrutiny is warranted. The Canadian Government indicated an intention in its Economic Action Plan 2014 to examine why Canadian consumers pay about 25 per cent more than US consumers for goods, after adjusting for differences in exchange rates and tariffs. In October 2011, the Canadian Standing Senate Committee on National Finance suggested that the differences reflected import tariffs, the relatively small size of the Canadian market, differences in product safety standards, lower levels of competition in Canada, and manufacturers engaging in country pricing strategies.[20] Many of the same factors may explain differential pricing between Australia and foreign states (adjusted for exchange rates and differential taxes).

In many instances, a means of ensuring that markets operate more efficiently in pricing products is to permit parallel importation. That way, if markets are functioning efficiently, and unmeritorious price differentials exist, Australian businesses and consumers may import the affected items directly. That would not solve all the problems,[21] but it may be a more convenient and workable approach to the issue than seeking to regulate international price discrimination directly. If this is the preferred course, the Act should provide suitable remedies against conduct designed to limit recourse to parallel importation, and consideration should be given to whether the exclusive dealing provisions of Part IV adequately address this issue, or whether 'geoblocking' provisions, which seek to thwart parallel importation, require specific regulation and prohibition unless a countervailing competitive reason explains their existence.

27 June 2014

[18] In July 2013, the House of Representatives Standing Committee on Infrastructure and Communication released its report on the pricing of IT hardware and software in Australia, finding inter alia that Australian consumers are often charged 50% or more for movies, ebooks, software downloads, and software etc than consumers in foreign countries.

[19] There is unlikely to be a contravention of s 46 for example, because its purpose element is directed to the harming of competitors rather than consumers.

[20] See http://actionplan.gc.ca/en/initiative/cross-border-price-discrimination

[21] Often, foreign sellers will not ship to an Australian address.

Competition Policy Review

Addendum to Submission By Ian B Stewart

Barrister, Victorian Bar

This addendum to my submission considers the counterfactual test and its application in section 46.

Th counterfactual test

The counterfactual test is a useful tool for examining whether a firm has taken advantage of its market power, *provided* it is properly applied. The logic of the test is clear, and its application has been clarified by the High Court in *Queensland Wire, Boral,* and *Melway*. Occasionally, problems arise where the test is wrongly applied. Amendment will not prevent such errors.

To be valid, the counterfactual test should recognize the following:

1. A competitive market for the purposes of the counterfactual test is not a perfectly competitive market, but rather a market in which the firm in question lacks its substantial degree of market power. The test is only relevant *if* the firm has substantial market power, and this question should be affirmatively answered before resort is made to the counterfactual test.

2. The hypothesized competitive market, against which the firm's conduct is compared (to establish whether or not its conduct took advantage of its market power), is one in which the conditions of supply and demand are assumed to be identical with the market in which the firm under investigation operates.

Counterfactual test envisages a competitive market in which the firm lacks substantial market power

In the real world, competitive markets do not, save in exceptional circumstances, exhibit the features of a perfectly competitive market. A perfectly competitive market is a rarity if it exists at all. It is, moreover, ill suited as a benchmark for Australia, with its prevalence of heavily concentrated and oligopolistic markets. The High Court has correctly rejected the theoretical model of perfect competition for the purpose of the counterfactual test.[1]

The Act should encourage workably competitive markets. The concept of a workably competitive market is illustrated in the following remarks by the U.S Attorney General's National Committee to study the Antitrust Laws, Report of 1955, at p 320, which were approved in *Re QCMA* (1976) 25 FLR 169 at 188:

> "The basic characteristic of effective competition in the economic sense is that no one seller, and no group of sellers acting in concert, has the power to choose its level of profits

[1] *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* (2001) 205 CLR 1 at 23.

> by giving less and charging more. Where there is workable competition, rival sellers, whether existing competitors or new potential entrants into the field, would keep this power in check by offering or threatening to offer effective inducements…"

There is much to be said for the proposition that a competitive market in which the firm in question lacks substantial market power would exhibit these characteristics.

Market conditions are assumed to be the same

It is wrong to apply the counterfactual test to a hypothetical market in which market conditions are divorced from the conditions applicable in the actual market under investigation. As the Privy Council said in *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd*[2] -

> "If, as Their Lordships consider, it is legitimate and necessary to consider how the hypothetical seller would act in a competitive market, attention must be directed to ensuring that (apart from the lack of a dominant position) the hypothetical seller is in the same position vis a vis its competitors as is the defendant…otherwise the comparison is a false one."

A similar warning was expressed by the High Court in *Melway Publishing* (2001) 205 CLR 1 at 25:

> "It is one thing to compare what [the firm] has done with what it might be thought it would do if it lacked that power. It is a different thing to compare what it has done with what it would do in circumstances that are completely divorced from the reality of the market."

The logic of these statements is indisputable. The Full Federal Court in *Boral* fell into error because it ignored these considerations.

"Would versus "could"

Suggestions that courts should adopt a "would" versus a "could" type test (or vice versa) are not convincing.[3] The logic and language of s 46(1) do not support a formula giving precedence to either word. The only admissible question posed by s 46(1) is whether the firm in question took advantage of its substantial market power for one of the specified anticompetitive purposes. The counterfactual test assists in answering that question where it is properly applied. To say that "would" is always right or "could" is always right merely distracts from, and potentially avoids, the real issue: did the conduct in question use, or take advantage of, the firm's substantial market power?

The High Court has applied the counterfactual test to address this fundamental question. In answering the question whether the firm took advantage of its market power, the High Court has used the words "would" or "could," depending on whichever word was appropriate in the relevant grammatical context. This point is illustrated by the reasoning of Mason CJ and Wilson J in *Queensland Wire* (1989) 167 CLR 177 at 192:

> "In effectively refusing to supply Y-bar to the appellant, BHP is taking advantage of its substantial market power. It is only by virtue of its control of the market and the absence of other suppliers that BHP can afford, in a commercial sense, to withhold Y-bar from the appellant. If BHP lacked that market power - in other words, if it were operating in a competitive market - it is highly unlikely that it would stand by, without any effort to compete, and allow the appellant to secure its supply of Y-bar from a competitor."

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[2] [1995] 1 NZLR 385 at 403.

[3] For example, some argue that "could" suggests the notion of capacity to act, whereas "would" suggests the idea of likelihood of acting. However, *Queensland Wire* and later cases decided by the High Court do not support this contention.

The counterfactual test is embedded in this passage. Translated into hypothetical terms, it becomes: could BHP have afforded in a commercial sense to withhold Y-bar? If it were operating in a competitive market would it have been likely to stand by without any effort to compete…?" If a firm in a competitive market *could* not afford in a commercial sense to refuse to supply, then it is unlikely that it *would* stand back and allow a competitor to supply that product, because such conduct would be unprofitable for it.

In *Melway Publishing* (2001) 205 CLR 1 at 26, the High Court said "the real question was whether, without its market power, Melway could have maintained its distributorship system." Yet, in the passage at 25 extracted above, it saw no problem in using the word "would." And, at 26 in the same judgment the High Court observed:

> "To ask how a firm would behave if it lacked a substantial degree of power in a market, for the purpose of making a judgment as to whether it is taking advantage of its market power, involves a process of economic analysis which, if it can be undertaken with sufficient cogency, is consistent with the purpose of s 46. But the cogency of the analysis may depend upon the assumptions that are thought to be required by s 46."

Because Melway adopted its distribution system long before it had market power, it "would have been likely," and could have afforded in a commercial sense, to maintain that system in the hypothetical situation envisaged by the counterfactual test. If the firm could have afforded, in a commercial sense, to act as it did if it had been operating in a competitive market—one in which it lacked substantial market power—it follows that the firm "would have been likely" to act in that same way. The test is essentially the same.[4]

To frame the counterfactual as involving a use of market power *unless* the firm *would* have acted in the same way in a competitive market, imports an additional and invalid requirement that the firm *must* have acted in the same way in a competitive market. That is too rigid a stipulation, and it is uncalled for by the language of s 46(1). Conceivably, the firm might have acted in the same way or it might have acted in a different way in a competitive market, but still not used its market power by engaging in the conduct in question. To ask whether the firm could have afforded in a commercial sense to engage in that same conduct in a market in which it lacked substantial power is a much better question, because it better addresses the question posed by s 46(1). It envisages that the firm might, consistently without using its market power, have acted in the way it did, but that it might equally have acted in other ways without using its market power. This is not dissimilar to the question of whether the firm had a legitimate business rationale for its conduct that would remain legitimate in a competitive market in which it lacked its substantial market power.[5]

In conclusion, the counterfactual test as applied by the High Court is clear, and section 46 does not require codification of the test. If the Review Panel does, however, wish to enshrine the counterfactual test into the language of s 46, the matters above merit consideration.

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[4] The remarks in *Rural Press Limited v ACCC* (2003) 216 CLR 53 at 76 on this issue, in which the High Court rejected the ACCC's submission that "could" as used by the Full Federal Court was wrong, should be read in their particular context, rather than supporting the conclusion that "would" is in all cases the appropriate word.

[5] As formulated by Heerey J at trial in *Boral*, and later approved by the High Court and the Privy Council.