Submission – Competition Policy Review: section 46

September 2014

IPA INSTITUTE OF PUBLIC ACCOUNTANTS

Partnership beyond numbers

Forward

The Institute of Public Accountants (IPA) welcomes the opportunity to present our submission to the Competition Policy Review.

The IPA is one of the three professional accounting bodies in Australia, representing over 26,000 accountants, business advisers, academics and students throughout Australia and in 57 countries worldwide. The IPA prides itself in not only representing the interests of accountants but small business and their advisers.

The IPA takes an active role in the promotion of policies to assist the small business and SME sectors, reflecting the fact that two-thirds of our members work in these sectors or are trusted advisers to small business and SMEs. The IPA also pursues fundamental reforms which will result in easing the disproportionate regulatory and compliance burden placed on small businesses.

In developing this submission we acknowledge the contribution made by IPA members and the IPA Deakin University SME Research Partnership.

We welcome the opportunity to discuss our submission in more detail if required and we look forward to ongoing participation in the Review. Please address all further enquiries to Vicki Stylianou, Executive General Manager, Public Affairs at either vicki.stylianou@publicaccountants.org.au or on 0419 942 733.

Yours faithfully

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Introduction

This submission responds to paragraphs 5.8-5.10 of the *Competition Policy Review Issues Paper*, of 14 April 2014 and in particular to the questions asked in paragraph 5.10.

> Given structural changes in the economy over time, how should misuse of market power be dealt with under the CCA?

The submission and recommendations that follow arise out of the Institute's concern that the existing misuse of market power provision does not adequately protect small business from the predatory actions of companies with substantial market power.

The Institute accepts that the best form of protection against anti-competitive conduct is for small and medium businesses to face competitive markets when they enter into acquisition or supply transactions, or for them to seek to establish countervailing market power through authorised collective bargaining. The Institute does not seek special protection for them from the ordinary rigours of competition. However, Australia's concentrated market structure means that many markets are not competitive and, where collective bargaining is not possible or sufficiently expeditious, small or medium size businesses are especially vulnerable to exploitation by firms with substantial market power.

The current prohibition on misuse of market power, embodied in s 46 of the CCA, continues to be deficient in addressing exploitation and anti-competitive conduct by dominant firms. In particular:

- by focussing on purpose alone it fails to capture conduct having the effect of substantially lessening competition; and
- the 'take advantage' requirement in the s 46(1) has been interpreted in such a way as to excuse conduct even where its purpose is to deliberately harm a competitor or the competitive process.

The Institute believes section 46 should be amended to extend to single firm conduct that has the effect of substantially lessening competition *and* that the 'take advantage' element be removed from the existing prohibition.

Summary of recommendations

The Institute recommends that section 46 be amended to:

- Prohibit conduct engaged in by firms having substantial market power using that market power with the purpose or effect of substantially lessening competition;
- Remove the 'take advantage' element from the existing prohibition in s 46(1).

Object of section 46

Before addressing these recommendations in more detail, it is necessary to say something about the object of the provision.

Section 2 of the CCA states that the purpose of the Act is 'to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection'. The IPA submits that the object of section 46 has never been, and should not now be, considered as limited to conduct which produces significant anti-competitive harm in an economic sense. That this was not the original object of the provision is apparent from its focus on the *purpose* of conduct and on harm to specific competitors or persons, irrespective of the effect of the conduct on the broader competitive process.

The second reading speech accompanying the introduction of the Act in 1974 made clear the provision was designed to capture *improper* use of market power[1] and this broader objective for the provision was further highlighted in the second reading speech accompanying the 1986 amendments: [2]

> A competitive economy requires an appropriate mix of efficient businesses, both large and small. … an effective provision controlling misuse of market power is most important to ensure that small businesses are given a measure of protection from the predatory actions of powerful competitors. …
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> Section 46 in its proposed form … is not aimed at size or at competitive behaviour as such of strong businesses. What is being aimed at is the misuse by a business of its market power.[3]

Prohibiting conduct having the purpose or effect of substantially lessening competition

The current misuse of market power provision requires proof that the corporation holding substantial market power also had a prescribed exclusionary *purpose*. Although it is possible to infer this in appropriate cases, it is clear that the provision, as currently drafted, will not capture conduct which has the effect of substantially lessening competition while lacking one of the specified purposes in s 46(1)(c).

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1 Mr Enderby, House of Representatives, Hansard, 16 July 1974, page 229; Senator Lionel Murphy, Senate Hansard, 30 July 1974

2 The 1986 amendment reduced the threshold market power test from one of market control to the current 'substantial market power' test and made clear that a court could infer requisite purpose from surrounding circumstances (s 46(7)))

3 Attorney-General, Mr Lionel Bowen, House Hansard), 19 March 1986, page 1626

The absence of an 'effects' test renders s 46 inconsistent with other provisions of the CCA,[4] with international trends and with one of the core objectives of the Act – the promotion of competition. It is also clear that, while purpose has not proven a significant hurdle in the limited number of s 46 cases that have been litigated, difficulties in obtaining evidence of purpose has hindered the capacity of the ACCC to bring some matters to court.[5]

The Institute recommends that s 46 be amended to capture unilateral conduct by a firm with substantial market power which has, or is likely to have, the effect of substantially lessening competition. It is recommended that a connection between the market power and the anti-competitive effect be retained to ensure that there remains an appropriate mechanism for distinguishing between pro-competitive conduct, such as successful product innovation, and anti-competitive conduct made possible only by virtue of a party's power in the market. The addition of an 'effect' alternative without such a connection would unduly widen the provision and capture pro-competitive conduct which might incidentally impact on market competition.

Example

Company A, which has substantial market power, invests in the development of a new widget. In doing so it believes that the new product will be so popular that it will easily win market competition. If successful, Company A's conduct is, therefore, likely to produce the effect of substantially lessening competition (by attracting significant custom from its competitors). Absent a connecting mechanism between the conduct and the market power this would be unlawful and would constitute an inappropriate impediment to pro-competitive activity.

Recommendation

The Institute recommends that a new prohibition be added to section 46 in the following form:

> "A corporation that has a substantial degree of power in a market shall not take advantage that power in that or any other market if the effect or likely effect would be to substantially lessen competition in that or any other market"

Removing the take advantage requirement from the existing provision

The addition of an effects test in the form recommended above would ensure that unilateral conduct having an anti-competitive effect that is referable to market power is captured by the legislation. However, it would not address they key limitation of the existing misuse of

[4] For example, sections 45 and 47 which refer to conduct having a particular 'purpose or effect'.

[5] See, for example, ACCC Submission to this inquiry, page 76.

market power provision; the 'take advantage' element. Recent attempts to address concerns about this element through the inclusion of guidance provisions have been cosmetic only and fail to address the real issue.[6]

The Institute is of the view that conduct by corporations with substantial market power which has the purpose of

- eliminating or substantially damages a competitor;
- preventing entry of a person into a market; or
- deterring or preventing a person engaging in competitive conduct

should be unlawful, regardless of whether it involved a 'taking advantage of market power.' The level of concentration in many of Australia's markets means that conduct of this kind will frequently fail to 'substantially lessen competition' precisely *because* of the market power held by the firms engaging in the predatory conduct. Such conduct should be prohibited, not to protect small business per se, but because it is appropriate for a law aimed at the protection of competition to prohibit conduct which has as its object the elimination of rivals and, by extension, harm to the competitive process.

The current prohibition in s 46(1) requires that there be a connection between substantial market power and the prescribed purpose; in particular, it requires that a firm 'take advantage' of its market power. Although such a link is important when attached to an objective 'effects' test, for reasons explained above, it is not necessary or appropriate in the context of conduct having as its object the exclusion of an existing or potential competitor. The difficulties associated with this requirement in the existing provision have long been recognised, as highlighted by Alan Griffiths MP during the course of the Griffiths Review:[7]

> 'It puts a great limitation on the operation of section 46 by insisting that the proscribed purpose alone is not sufficient; the nature of the activity also has to fall within the terms of section 46 … a corporation which has a statutory monopoly, such as Telecom … would all be capable of characterising activities as the exercise of a right given to it by statute, rather than taking advantage of the market power which it has by virtue of its position … [130] … The real problem with the drafting … is that it enables a corporation to engage in anti-competitive conduct which breaches the proscribed purposes provision of section 46 but the conduct itself does not fall within the narrow definition of taking advantage of the market power'.[8]

These comments were made prior to the decision of the High Court *Qld Wire*[9] which rejected the attempt to introduce a pejorative element into the 'take advantage'

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6 The *Trade Practices Legislation Amendment Act 2008* inserted sub-section 46(6A), which sets out a list of matters the court may have regard to when assessing whether a corporation has taken advantage of its market power.

7 'Mergers, Takeovers and Monopolies: Profiting from Competition?' (Report of the House of Representatives Standing Committee on Legal and Constitutional Affairs) 1989

8 Hansard Report of the House of Representatives Standing Committee on Legal and Constitutional Affairs (Reference: Mergers, takeovers and monopolies) Canberra 25 October 1988, page 129-130.

9 Queensland Wire Industries v BHP (1989) 167 CLR 177.

requirement and found that BHP had misused its market power in refusing to supply Y-Bar to Qld Wire. The Griffith Committee considered that that decision had resolved the 'debate about the interpretation of the take advantage provision' and that it should 'make it easier for aggrieved parties to establish a breach of section 46.'[10] As a result they recommended against a significant redrafting, preferring to leave it for the courts to resolve any further potential difficulties with the section. Unfortunately the Committee's predictions about the future of the provision proved too optimistic. Subsequent decisions, particularly those in *Rural Press*[11] and *Cement Australia*, have abandoned the neutral and holistic approach to s 46 and the 'take advantage' element which were exemplified in *Qld Wire.* Instead, the courts in these cases have engaged in a 'complex, disaggregated form of analysis' which has rendered the provision of 'limited utility'.[12] Legislative intervention is now needed to resolve the problem caused by the 'take advantage' requirement.

The Institute recommends that the 'take advantage' element be removed entirely from the prohibition. Despite some concerns expressed to the contrary, we do not consider that this will unduly broaden the scope of the provision. We accept that competition is often 'deliberate and ruthless' and that successful competitors will necessarily injure those who are less successful.[13] However, removing the take advantage element from the existing prohibition would not capture *competitive* conduct, such as development of more efficient processes or improvements to products through innovation and investment in research and development, which may have the effect of eliminating less efficient or innovative competitors.

Removal of the 'take advantage' element would, however, protect against conduct which unfairly impedes normal competition; that is, conduct which has as its *object* the exclusion or deterrence of others from the market. In addition to harming competition, one competitor at a time, such conduct carries with it moral opprobrium for which purpose remains an appropriate and effective mechanism for distinguishing *predatory* conduct from normal and benign *competitive* behaviour.

If it is accepted that conduct having as its *object* the exclusion of elimination, deterrence or exclusion of competitors, should be prohibited, the need for a 'take advantage' link to market power is negated. Neither the anti-competitive purpose nor effect are altered by the source of the power utilised to bring about the outcome. A firm with substantial market power may eliminate a competitor by burning down their shop or by refusing to supply them with essential materials; the former is clearly not referable to market power while the latter may be. There is no obvious reason for distinguishing between the two; the purpose and outcome remain the same.

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10 'Mergers, Takeovers and Monopolies: Profiting from Competition?' (Report of the House of Representatives Standing Committee on Legal and Constitutional Affairs) 1989 paragraph 4.6.26

11 *Rural Press Ltd v ACCC* [2003] HCA 75

12 ACCC Submission to this inquiry, pages 79-80.

13 *Queensland Wire Industries v BHP* (1989) 167 CLR 177 (per Chief Justice Mason and Justice Wilson at para 24)

In the event the Committee considered that a link between market power and exclusionary purpose was required to ensure pro-competitive conduct was not captured by the provision, the Institute suggests that the 'take advantage' element be retained, but that it be *presumed* to be satisfied whenever the requisite market power and purpose have been established. This would cast the onus on the party with the market power and exclusionary purpose to prove the absence of a link between their purpose and the market power they hold.

> **Recommendation**
> The Institute recommends that the words 'take advantage of that power in that or any other market' in s 46(1) be replaced with the words 'engage in conduct'.

Suggested amendments to section 46

In light of the above recommendations the Institute suggests the following amendments to section 46:

1. Section 46(1) be repealed and replaced with the following provision:

   (1)(a) A corporation that has a substantial degree of power in a market shall not engage in conduct for the purpose of:
   (i) eliminating or substantially damaging a competitor of the corporation or of a body corporate that is related to the corporation in that or any other market;
   (ii) preventing the entry of a person into that or any other market; or
   (iii) deterring or preventing a person from engaging in competitive conduct in that or any other market.

   (1)(b) A corporation that has a substantial degree of power in a market shall not take advantage that power in that or any other market if the effect or likely effect would be to substantially lessen competition in that or any other market.

2. Subsection (1A) should be amended to replace references to subsection (1)(a)(b)(c) with references to subsection (1)(a)(i)(ii)(iii) respectively.

3. Sub-section (7), which allows purpose to be inferred, should be amended as follows:

   (7) Without in any way limiting the manner in which the purpose of a person may be established for the purposes of any other provision of this Act, a corporation may be taken to have a purpose referred to in subsection (1)(a) notwithstanding that, after all the evidence has been considered, the existence of that purpose is ascertainable only by inference from the conduct of the corporation or of any other person or from other relevant circumstances

4. The remaining sub-sections be retained in their current form.