COMPETITION POLICY REVIEW COMMITTEE

SUBMISSION

Introduction

1. The Competition Policy Review Committee's Draft Report contains many excellent, long overdue recommendations for the reform of Australia's competition law. This submission is confined to the Committee's draft recommendation 25, which proposes that s 46 of the *Competition and Consumer Act 2010* (Cth) (CCA) should be re-framed "…to prohibit a corporation that has a substantial degree of power in a market from engaging in conduct if the proposed conduct has the purpose, or would have or be likely to have the effect, of substantially lessening competition in that or any other market".

2. Draft recommendation 25 also contains a new substantive defence, that the primary prohibition would not apply if the conduct in question:

    - "would be a rational business decision or strategy by a corporation that did not have a substantial degree of power in the market; and
    - the effect or likely effect of the conduct is to benefit the long-term interests of consumers".

3. Draft recommendation 25 fixes two major defects in the drafting of CCA, s 46(1): first, the primary prohibition makes clear that it is competition that is to be protected, not competitors; and secondly, the defence makes clear that, ultimately, the aim of s 46 is to protect the interest of consumers.

4. The primary prohibition differs from the current CCA, s 46(1) in two important respects. First, it removes the "taking advantage" element from the primary prohibition; and secondly, it introduces an effects-based analytical model.

5. These changes have been criticised on three different bases. First, it is claimed that an effects test will deter major businesses from engaging in vigorous competition which results in lower prices and new and better products for consumers. Secondly, it is claimed that the changes proposed in draft Recommendation 25 do not represent international best practice. Thirdly, it is claimed that the Competition Policy Review Committee's draft report does not make clear what conduct which is currently not caught by the purpose test in CCA s 46(1), would be caught by the proposed effects test. The remainder of this submission examines whether there is any substance to these criticisms.

First criticism

6. In relation to the first criticism, the primary prohibition in draft recommendation 25, places the onus on the applicant to prove two elements: first, the threshold test of a substantial degree of market power, which is unchanged from the present prohibition in CCA, s 46(1); and secondly, that the purpose, effect, or likely effect of the conduct would be to substantially lessen competition in that or any other market. As regards the second element, the various terms used and the method used to establish each of the three limbs are well-established in relation to CCA, ss 45, 47 and 50. These substantive prohibitions adopt the same effects-based analytical model for establishing liability as that proposed in draft recommendation 25. Thus, it cannot be claimed that the proposed primary prohibition gives rise to an unacceptable level of uncertainty as to its meaning.

7. Under an effects- based analytical model, the focus of the prohibition is on competition as a process, not on individual competitors, except to the extent that those competitors are responsible for bringing competition to the relevant market. This is a significant improvement on CCA, s 46(1), where the focus is on the "taking advantage" element. Under the taking advantage element the court is required to hypothesise about what a firm without market power could, or would be likely to do, if it were operating in a workably competitive environment,

rather than focussing on the actual exclusionary, anti-competitive effects of the conduct at issue.

8. The proposed effects test will not deter major businesses from engaging in vigorous competition to any greater extent than the existing substantive prohibitions in CCA, ss 45, 47 and 50. In addition, he inclusion of the defence will allow major businesses to advance pro-competitive justifications for their conduct.

9. In relation to the defence in draft recommendation 25, there is some uncertainty as to its scope. The first limb of the defence is that the conduct would be a rational business decision or strategy if the respondent were operating under competitive conditions. This appears to re-instate the "taking advantage" element of the existing s 46(1); however, as a substantive defence the onus of proof is placed on the corporation engaging in the conduct. The obvious argument in favour of imposing the onus of proof on the corporation engaging in the conduct is that it will be in the best position to know the reason why it engaged in the conduct. If the conduct can be explained as being a rational business decision, and it is the sort of conduct one would expect to find under competitive conditions, it should be permissible.

10. The rational business decision defence does, however, leave a number of important questions unanswered. What might constitute a rational business decision or strategy? Some guidance is provided in that the rational business decision or strategy must be one that a firm that did not have market power would adopt. This suggests that the test is an objective one, and does not depend on the subjective views of the respondent as to what constitutes a rational business decision. However, does it have to be a profit maximising strategy, or could a strategy aimed at increasing market share that was not profit maximising qualify? If the respondent gives reasons for the conduct and the court accepts those reasons as genuine, is the court then required to go behind the reasons, and decide whether the explanations were objectively valid in terms of economic theory or best business practice? Does business intuition

count as a rational business decision or strategy? Does a response along the lines, “We've done this before and it seems to work, so we keep doing it,” count as a rational business decision? Is it “rational” if the respondent cannot explain why it works? Presumably, the respondent would need to call an expert economist to give evidence that the conduct accorded with accepted economic theory and was efficiency enhancing, or to call an industry expert to give evidence that it complied with industry best practice.

11. Under the proposed defence the respondent must also prove, on the balance of probabilities, that “the effect or likely effect of the conduct is to benefit the long-term interests of consumers”. This aspect of the defence is likely to be problematic. It is designed to ensure that a “rational business decision or strategy” that only gives rise to short-term benefits to consumers, does not escape the net of s 46 if, in the long term, it is likely to have the effect of harming consumers.

12. The second limb of the defence will give rise to problems of proof. How are the short-term benefits to be measured? How is the long-term harm to consumers to be measured? Is it envisaged that the respondent will make an assessment about future outcomes and estimate what the likely efficiencies and costs will be? Will it be sufficient if there is some factual basis for the efficiency claims without attempting to quantify them? The ACCC and the Tribunal have experience in relation to these issues in the context of the authorisation process under the CCA. As the original *Trade Practices Act* was conceived, it was envisaged that this type of economically complex, cost/ benefit analysis would be performed by the administrative agencies (the Commission and, on appeal, the Tribunal) rather than the courts.

Second criticism

13. As regards the second criticism, that the proposed amendments in draft Recommendation 25 do not represent international best practice, under both EU competition law and US antitrust law, firms with

substantial market power are provided with the opportunity of demonstrating pro-competitive efficiency justifications for their conduct.

14. The offence of monopolisation in the United States is contained in s 2 of the *Sherman Act, 1890*. Monopolisation requires a showing of monopoly power plus a conduct requirement. The plaintiff must show that the defendant has monopoly power. Then the focus shifts to determine whether the conduct was exclusionary and had an anti-competitive effect. The test was summarised by the Federal Court of Appeals (D C Circuit) in *United States v Microsoft* [2001-1] Trade Cases (CCH) 73,321 (at 90,791):

> From a century of case law on monopolization under s2, however, several principles emerge. First, to be condemned as exclusionary a monopolist's act must have an "anti-competitive effect." That is, it must harm the competitive process and thereby harm consumers. In contrast, harm to one or more competitors will not suffice.

15. In order to determine whether conduct is anti-competitive some courts have adopted an onus-shifting approach. Two decisions of the US Supreme Court in *Aspen Skiing Co v Aspen Highlands Skiing Corp* 472 US 585 (1985) and *Eastman Kodak Co v Image Technical Services Inc* 504 US 451 (1992) adopt this approach.

16. In the *Aspen Skiing* case the Supreme Court cast a duty upon the defendant to provide a business justification for conduct that appeared to the court to be prima facie exclusionary. In that case the owner of ski resorts at three out of four mountains in an area decided to cooperate with a ski resort on the fourth mountain in order to increase profits. Subsequently the joint venture was terminated with no objective business reason being given (at 594). The Supreme Court held unanimously that the conduct violated s 2 of the *Sherman Act*.

17. In the *Eastman Kodak* case, Kodak originally cooperated with independent service organisations (ISOs) which repaired and serviced its photocopiers and they flourished. Subsequently, Kodak adopted a more

restrictive policy as regards the servicing of its equipment and withdrew its cooperation. It sought to justify tis conduct on three different bases:

- promoting inter-brand competition for its copiers by improving the quality of its services;
- enhancing asset management by reducing inventory costs; and
- preventing ISO's from free riding on its investment in equipment, parts and service.

While these pro-competitive justifications may have been legitimate in other circumstances, on the basis of the evidence in that case, they were rejected and the withdrawal of co-operation was subsequently held to be a violation of s 2 of the *Sherman Act*.

18. In *US v Microsoft Corp* [2001 –1] Trade Cases (CCH) 73,321, the Court of Appeals (D.C. Circuit) adopted (at 90,791-792) a four step "burden-shifting" approach for evaluating the lawfulness of Microsoft's conduct. The first step was establishing monopoly power. The onus of proof in relation to this element was on the plaintiff.

19. In the second step, the plaintiff was required to offer a hypothesis to show that the conduct had an "anti-competitive effect" i.e. "it must harm the competitive process and thereby harm consumers…harm to one or more competitors will not suffice." Such anti-competitive effects include an increase in prices, or a reduction in innovation, or a reduction in output.

20. In the third step, if the plaintiff demonstrated this anti-competitive effect, then the monopolist may proffer a "pro-competitive justification," which the court described as "a non-pre textual claim that its conduct is indeed a form of competition on the merits because it involves, for example, greater efficiency or enhanced consumer appeal." For example, it may be trying to prevent free-riding and safeguard the rewards of its investment. If the defendant proffer a "pro-competitive justification," the burden shifts back to the plaintiff to rebut that claim.

21. In the fourth step, "…if the monopolist's pro-competitive justification stands unrebutted, then the plaintiff must demonstrate that the anti-competitive harm of the conduct outweighs the pro-competitive benefit." Finally, the Court of Appeals emphasised (at 90,792):

> …in considering whether the monopolist's conduct on balance harms competition and is therefore condemned as exclusionary for the purposes of s 2, our focus is upon the effect of that conduct, not upon the intent behind it. Evidence of the intent behind the conduct of a monopolist is relevant only to the extent it helps us understand the likely effect of the monopolist's conduct.

Where there is a mix of anti-competitive effects and pro-competitive justifications it is for the court to decide which prevails, the gains or the harms.

22. Under EU competition law, that firms with substantial market power are provided with the opportunity of demonstrating that they have pro-competitive justifications for their conduct. See Case 27/76, *United Brands v Commission* [1978] ECR 207 at [189]; Case 311/84, *Centre belge d'etudes de marche – Telemarketing v SA Compagnie luxembourgeoise de telediffusion* [1985] ECR 1-03261 at [25]; Joined Cases C-241/91 P and C-242/91 P, *RTE and ITP v EC Commission* [1995] ECR I-743 at [52] and *IMS Health GmbH & Co v NDC Health GmbH & Co. KG*, Case C-418/01 [2004] ECR, P 17 (ECJ 29 April 2004). See also the European Commission, *Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses* at [77].

23. In summary, the second criticism, that the proposed draft recommendation 25 would put Australia out of step with international best practice is unfounded. On the contrary, draft recommendation 25 would bring Australia into line with international best practice.

Third criticism

24. The third criticism is that the Competition Policy Review Committee's draft report does not make clear the types of conduct which are not

caught by the purpose test in CCA s 46(1), but would be caught by an effects-based analytical model.

25. This may be illustrated by comparing the outcomes in two cases decided under CCA, s 46(1), and the way those cases would be decided under an effects-based analytical model. The two cases are: *Rural Press Ltd v ACCC* (2003) 216 CLR 53, (*Rural Press*) and *ACCC v Cement Australia Pty Ltd* [2013] FCA 909 (*Cement Australia* case).

26. In the *Rural Press* case, Bridge Printing Office Pty Ltd (Bridge), a wholly owned subsidiary of Rural Press Ltd (Rural Press), published a regional newspaper in the town of Murray Bridge known as the Murray Valley Standard. Its prime circulation covered the Murray Bridge regional newspaper market which extended 300 kilometres north to the town of Mannum. Waikerie Printing House Pty Ltd (Waikerie) published a regional newspaper called the River News with a circulation of about 2000 to 2500. Its prime circulation area was the town of Waikerie in the Riverland area of South Australia. For some time, Bridge and Waikerie had kept out of each other's territories and there was little or no competition between them in the markets for news and advertising services.

27. In July 1997, Waikerie commenced selling the River News and soliciting advertising in the Mannum area. In response, Rural Press and Bridge threatened that unless Waikerie withdrew from Mannum (the Murray Bridge market), they would respond and could commence publishing a newspaper in the Riverland market to be distributed free of charge. Following the threat, Waikerie capitulated and withdrew from Mannum.

28. The High Court majority (consisting of Gummow, Hayne and Heydon JJ, with whom Gleeson CJ and Callinan J agreed) held that the conduct did not contravene s 46. The majority held (at 76 [53]) :

> The Commission failed to show that the conduct of Rural Press and Bridge was materially facilitated by the market power in giving the threats a significance they would not have had without it. What gave those threats significance was something distinct from market power, namely their material and organisational assets.

29. According to the High Court's reasoning in *Rural Press*, strategic predatory conduct by a firm with substantial financial resources does not constitute a "taking advantage of market power" and escapes CCA, s

46(1) even though it was held that the arrangement had the purpose or effect of substantially lessening competition in the Murray Bridge regional newspaper market, contrary to CCA, s 45(2). See p 73 [46] per Gummow, Hayne and Heydon JJ.

30. The finding that that the arrangement had the purpose or effect of substantially lessening competition in the Murray Bridge regional newspaper market, contrary to CCA, s 45(2), means that it would also be a breach of s 46 under primary prohibition of draft recommendation 25. Rural Press and Bridge may have had a rational business reason or strategy for threatening Waikerie to withdraw from Mannum (the Murray Bridge market), but this seems unlikely.

31. In the second case, *Cement Australia*, the court found that Cement Australia Pty Ltd had substantial market power. The conduct at issue consisted of entering into the contracts with four electricity power generation stations between 2001 and 2006 for the supply of unprocessed fly ash that was well in excess of its reasonable requirements. The court held that this not a contravention of CCA, s 46(1). Under the counter-factual, a firm without market power could have engaged in such a strategy, and Cement Australia had not "taken advantage" of its market power. However, the court held that the purpose, effect and likely effect of each contract was to foreclose new entry and lessen competition substantially in the South East Queensland concrete grade fly ash market contrary to CCA, s 45(2).

32. The finding that that the contracts had the purpose or effect of substantially lessening competition in the in the South East Queensland concrete grade fly ash market, contrary to s 45(2) of the CCA, means that they would breach s 46 under primary prohibition of draft recommendation 25. Entering into pre-emptive contracts of the kind at issue in the *Cement Australia* case, by a corporation with a substantial degree of market power, would be likely to have a market- distorting foreclosure effect. Cement Australia may have had a rational business decision for entering into contracts for the supply of unprocessed fly ash well in excess of its reasonable requirements, but this seems unlikely.

33. An effects-based analytical model is more likely to catch strategic entry deterring conduct that can be engaged in by a firm without market

power and thus escape the net of CCA, s 46(1). Such strategies include predatory pricing to build a predatory reputation, where an incumbent reduces its price to damage existing competitors or to deter or prevent new entry, and then raises its price when its rivals leave the market. They also include the strategic building of excess capacity, where an incumbent chooses to invest in new capacity over and above present and anticipated future requirements in order to deter new entry. Another example is the strategic pre-emption of scarce assets through long-term contracting, the conduct at issue in the *Cement Australia* case.

34. Incumbents can derive competitive advantages over new entrants through innocent strategies such as technological leadership arising from successful research and development and greater experience gained over time. Such conduct is pro-competitive, and benefits consumers through new products, and if there is vigorous competition, lower prices. Such conduct would benefit from the defence in draft recommendation 25 even though it had exclusionary effects.

35. Incumbents can also gain advantages over new entrants through predatory strategies such as the pre-emption of scarce assets through long-term contracting. These assets may be raw materials or other process inputs. They also include geographic space such as the prime retailing or manufacturing locations and storage and shelf space in supermarkets and other distribution outlets. Such conduct would be unlikely to benefit from the proposed defence in draft recommendation 25.

Conclusion

36. Some argue that there is nothing wrong with CCA, s 46(1) in its current form, and major businesses should not be punished simply for being big in relation to their competitors. It is asserted that they should be free to engage in the same conduct that a firm without market power can engage in, and that a "taking advantage" element is necessary to determine this.

37. However, such an approach overlooks the fact that conduct engaged in by a firm with substantial market power will have a much greater propensity to have market- distorting foreclosure effects, than the same conduct engaged in by a firm without substantial market power. The need to examine the conduct of major business more closely than those without market power has been recognised in both the United States and the EU.

38. It was recognised by Scalia J in *Eastman Kodak Co v Image Technical Services Inc* 504 US 451 (1992) at 488 who stated:

> Where a defendant maintains substantial market power, his activities are examined through a special lens: Behaviour that might not be of concern to the antitrust laws – or that might be viewed as pro-competitive – can take on exclusionary connotation when practised by a monopolist.

39. It was also recognised by the European Court of Justice (ECJ) in relation to the EU equivalent provision to CCA, s 46(1) which prohibits an abuse of a dominant position. In *Hoffmann-La Roche v Commission of the European Communities* [1979] ECR 461 the ECJ stated:

> The concept of an abuse is an objective concept relating to the behaviour of an undertaking in a dominant position which is such as to influence the structure of the market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which, through recourse to methods different from those which condition normal competition... has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition.

40. In my view, the time for adopting an effects-based analytical model in relation to CCA, s 46 is long overdue.

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8 October 2014