COMPETITION PANEL DRAFT REPORT

FURTHER SUBMISSION BY IAN B STEWART

I limit this response to the Panel's draft recommendations in the areas of cartel conduct and misuse of market power. Whilst I have a particular interest also in the area of Part IIIA, I am unable to provide a response to the Panel's Draft Report on this area as the Draft Report raises a number of issues but does not address them in sufficient detail for a response.

CARTEL CONDUCT

Simplification

I agree with the Panel's recommendations for the simplification and general reform of Division 1 (Cartel Conduct) of Part IV of the CCA. The law on cartels should be redrafted in its entirety using well-understood language that is readily grasped, unlike the present Division 1. It must be redrafted in language that is clear, logical and concise, so as to convey the mischief addressed to those governed by the law and those who may be called upon to interpret or apply it. As noted in my primary submission, due regard should be given to European and New Zealand approaches to cartel conduct and other concerted practices in formulating the appropriate Australian response. I would be happy to engage in further dialogue with the Panel as to the form of the cartel conduct legislation when draft legislation is in place.

Competition test and meaning of likely

As the Panel recommends, the competition test should be redrafted so that only corporations who are, or are likely (on a balance of probabilities) to be, in competition with each other should be subject to the cartel prohibitions.

Application of Part IV to extraterritorial conduct

I agree with the Panel's Draft Recommendation 21 that the present test in s 5 of the CCA should be repealed.

The present test relies on residence, incorporation, or carrying on business in Australia. This test evidently originates in jurisprudence from a bygone era, when commerce lacked the international dimension that now permeates it.

The present test fails the object of the CCA and lets down Australian consumers and businesses. International commerce is now a common (in some areas universal) feature of the world economy, and the countries in which goods and services are

supplied may bear little or no connection with the country or countries in which the supplier carries on business or is resident.

A residence or presence test is inappropriate in the contemporary sphere of commerce: it provides a loophole that potentially enables foreign businesses who do not carry on business here or are not resident here to engage in anticompetitive conduct that affects prices or the terms of supply in Australia without being subject to the CCA. Australian consumers and businesses should not have to go through the arduous task of demonstrating that extraterritorial conduct affecting the prices or terms of supply of goods or services supplied in this country has been engaged in by a corporation that is resident or carrying on business here. The residence or carrying on business aspect of this test has usually been a major impediment to the prosecution of claims by Australian businesses and consumers relying upon extraterritorial conduct. As was seen in the cartel involving vitamins that Merkel J heard, too many resources of parties and courts are consumed in the task of demonstrating (or rejecting) presence or carrying on business in this country – a disputed issue whose resolution usually bears little connection with the inherent effect (or otherwise) of the relevant conduct on Australian consumers and businesses, or the good sense in ensuring that extraterritorial conduct that adversely affects prices or the terms of supply in Australia should be subject to our competition laws regardless of whether or not the perpetrator of that conduct is resident or present in Australia.

There is much to be said for the view that if a corporation chooses to do business in this country, and supply goods or services to this country's citizens, it should be subject to our laws if it engages in anticompetitive conduct (whether within the jurisdiction or outside it) which results in Australian consumers or businesses being disadvantaged. Naturally, as discussed below, appropriate safeguards are required to ensure that Australian competition laws do not impinge upon the sovereignty of other nations, but the requisite jurisdictional connection is usually provided by the extraterritorial conduct being anticompetitive and adversely affecting prices or the terms of supply in Australia or its markets.

Should the law adopt a jurisdictional connection that requires extraterritorial conduct to affect prices or the terms of supply in a market in Australia?

The appropriate jurisdictional nexus is independent of whether or not a corporation engaging in extraterritorial conduct carries on business in Australia or is otherwise resident here.

The logical jurisdictional connection lies somewhere between extraterritorial conduct that affects prices or terms of supply of goods or services supplied in a market in Australia (which the Panel appears to favour), and extraterritorial conduct that affects prices or terms of supply of goods or services supplied into Australia (regardless of whether or not a market in Australia for those goods or

services can be said to exist).[1] The former test is more difficult to satisfy, and this carries with it an advantage and a disadvantage. The advantage of the "market in Australia" test is that it minimizes any risk that Australia might be seen to be overreaching its proper jurisdiction: it is difficult to think of a convincing argument why Australian courts should not have jurisdiction with respect to extraterritorial conduct that affects prices or terms of supply in an Australian market. Further, it is now tolerably clear that global markets may include markets in Australia. [2]

Yet, notwithstanding judicial authority that a market in Australia may exist although not all competition in that market occurs in Australia, requiring applicants to prove a market in Australia exists and that anticompetitive conduct engaged in outside Australia takes place in that market, may be unduly onerous in certain cases. Such requirement may deny a remedy to Australian consumers or businesses when the prices or terms of supply of goods in Australia are adversely affected by extraterritorial conduct, but such conduct cannot be said to occur in a market in Australia. *ACCC v Air NZ Limited* [2014] FCA 1157 is an example of how a "market in Australia" nexus may leave Australian consumers and businesses without a remedy even where extraterritorial conduct adversely affects prices or terms of supply in Australia (and would attract the operation of Part IV if such conduct occurred in Australia).

The United States has at times witnessed collisions between its effects doctrine and principles of international comity. As noted by the US Supreme Court in *Hartford Fire Ins v California* 509 US 764 (1993) at 796, "the Sherman Act applies to foreign conduct that was meant to produce and did in fact produce some substantial effect in the United States." The United States legislature introduced the Foreign Trade Antitrust Improvements Act of 1982 so as to exclude from action in the United States anticompetitive conduct that causes only foreign injury.[3] The logic of such requirement is clear, and the Australian test should likewise exclude from the jurisdiction of Australian courts conduct that does not cause injury to Australian consumers or businesses.

Various countries have introduced blocking statutes to stop foreign States using antitrust laws to further trade policy, or too eagerly assuming jurisdiction in cases involving extraterritorial conduct, especially where the effect of the foreign conduct on local consumers or businesses is very slight. This may be one reason why the Panel appears to prefer a "market in Australia" test. However, this potential problem should not result in legislation that deprives Australian consumers and businesses of a remedy where extraterritorial conduct affects the prices paid or the terms of supply, regardless of whether or not such conduct occurred in a market in Australia.

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[1] Some of the issues that arise for consideration are discussed in Ian B Stewart, *Extraterritorial application of Part IV of the Competition and Consumer Act*, (2014) 42 Australian Business Law Review 90.
[2] See for example *ACCC v Qantas Airways Ltd* [2008] FCA 1976; *Auskay International Manufacturing v Qantas Airways Ltd (No 5)* [2009] FCA 1464.
[3] For further discussion see Stewart op cit at p 94-97.

MISUSE OF MARKET POWER

The Panel recommends s 46 be redrafted, yet the Panel's reasons for this recommendation are difficult to discern.

To say that courts have wrestled with the concept of 'take advantage' merely begs the question. Our laws addressing unilateral conduct must balance the desirability of prohibiting anticompetitive conduct and the harm to the competitive process (and consumer welfare) of laws that encourage inefficient competitors or that punish vigorous but effective competition. Our laws should prohibit the misuse of market power; they should not prohibit vigorous competition.

Take advantage

The concept of 'take advantage', notwithstanding McHugh J's doubts in the *Boral* High Court decision, means "use." In substance the present s 46 prohibits the use of substantial market power for one of the three proscribed anticompetitive purposes. The Privy Council has rejected the notion that a distinction between the two terms exists [4].

Although purpose and use of market power are separate elements, they are not easily separated, such that it is difficult to envisage a case where a corporation will have used its market power for other than an anticompetitive purpose (as the Privy Council has observed). 'Purpose' has in practice not been an area of difficulty: either a subjective purpose may be recorded for conduct, or a purpose may be inferred under s 46(7). For this reason, perceptions that it is difficult to establish one of the listed purposes in s 46(1) are not substantiated by the history of judicial consideration. The core of s 46 has always been the issue of whether or not conduct uses or takes advantage of substantial market power; not whether a corporation has held one of the proscribed purposes.

Difficulties with the element of take advantage of substantial market power reflect the nature of competition and not a flaw in the concept

Whilst it may be accepted that courts have wrestled with the application of 'take advantage', this difficulty stems from the concept of use of market power itself, rather than the language used in s 46(1). The reason for this difficulty lies in the very nature of competition itself. This was appreciated by Mason CJ and Wilson J in the seminal case of *Queensland Wire Industries Pty Ltd v BHP* (1989) 167 CLR 177 at 191:

> "It is perhaps not surprising that lawyers would be tempted to incorporate an element of intent into the statutory tort of a s 46 infringement… But the

[4] See for example, the Privy Council decision in *Commerce Commission v Telecom Corporation of NZ* [2010] NZSC 111 at [27].

> object of s 46 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 always try to 'injure' each other in this way…."

The cases listed by the Panel do not illustrate difficulties with s 46(1). *Melway* rested on the fact that Melway adopted its distribution system at a time when it lacked substantial market power. Its conduct was a rational business decision at the time, and so it could be said that its conduct had a legitimate business rationale that would be valid in a market in which it lacked its substantial market power. Understandably, this made it difficult for the maintenance of that system once Melway enjoyed substantial market power to constitute a taking advantage of market power.

Boral is a case that generates much controversy; yet the decision was correct. The case rested on the finding that Boral lacked market power. This was due to a severe economic downturn in the building industry, the existence of powerful customers who were able to bargain down prices offered by competitors in the concrete masonry products market, the entry of a new competitor with advanced and low cost production equipment whose market share rose to approximately 40 per cent during the period of alleged predation, and an excess of capacity in the market. That the decision may be unpopular is not to the point if it is correct, which it is.

Substantial market share threshold does not address use of market power

I do agree with the Panel, however, that the Birdsville amendments have complicated s 46. Moreover, they have rendered it contrary to sound economic logic and should be repealed. For example, parts of s 46 now mistakenly suppose that substantial market power can be equated with substantial market share. Yet, as the High Court in *Queensland Wire* noted, with reference to leading economic theory, the sine qua non of enduring market power is barriers to entry, for without effective impediments to new entry any attempt to raise price above a competitive level will attract new entry and result in a reduction in price to a competitive level again. In *Rural Press*, the real difficulty was that the conduct in question did not take advantage of any power held in the applicable market, but in a different market. This provoked the insertion into the section of the words "in that or any other market".

Why the Panel should not recommend its proposed replacement for the taking advantage element of s 46(1)

The Panel concludes that "a serious question arises whether 'take advantage' is a useful expression by which to distinguish competitive from anti-competitive unilateral conduct." Yet, the Panel's suggested replacement is unlikely to address perceived problems with s 46.

Instead, the Panel's suggested replacement is likely to introduce an entirely new set of problems into s 46. It will be many years before the suggested replacement of s 46

has obtained anything like the relative certainty of the present s 46(1). Courts and practitioners will struggle with concepts such as whether unilateral conduct has the purpose or likely effect of substantially lessening competition or whether it is pro-competitive. The Panel does not explain why this test addresses the difficulties of, or improves upon, the take advantage test. There are likely to be lengthy arguments over whether conduct in fact has the purpose of substantially lessening competition, or whether it has the purpose of winning sales from competitors. Similar arguments will arise over whether the conduct has the effect of substantially lessening competition. Further, a test that looks for an "effect" of unilateral conduct on competition will inevitably fall into the trap of commencing with an assumption that because a competitor has been harmed or collapsed, another competitor has engaged in anticompetitive conduct, when it may have failed because of vigorous competitive conduct (which did not use market power) or because it was an inefficient competitor.

The Panel's proposal reintroduces the take advantage element into the first limb of the proposed defence

Although the Panel recommends removal of the taking advantage element, it reintroduces it in the first limb of the proposed defence by providing a defence if the conduct "would be a rational business decision by a corporation that did not have a substantial degree of power in the market". This is the language of the counterfactual test, which distinguishes conduct which uses market power from conduct which does not by positing whether such conduct would have been a rational business decision by a corporation in a competitive market in which it lacked its substantial market power. The test proposed is essentially a way of ascertaining whether the conduct in question uses or does not use market power. Thus, all the supposed problems of the 'taking advantage' test in the present s 46(1) will exist in the proposed revision.

In fact, the counterfactual test is not difficult to understand. As the Privy Council stated in *Commerce Commission v Telecom Corporation of NZ* [2010] NZSC 111 at [31]:

> The essential point is that if the dominant firm would, as a matter of commercial judgment, have acted in the same way in a hypothetically competitive market, it cannot logically be said that its dominance has given it the advantage that is implied in the concepts of using or taking advantage of dominance or a substantial degree of market power.

The Panel's insertion of what, in substance, is the counterfactual test for determining whether use has been made of substantial market power illustrates that what is required is not the removal of the taking advantage element, but its clarification or a reconsideration of how this element fits within the section. If s 46 is regarded as requiring too high a hurdle for litigants to successfully prosecute claims, rather than drastically reformulate it as the Panel's Draft Recommendation proposes, a better solution would be to retain s 46(1) as it presently stands, but

introduce a new subsection reversing the onus in appropriate cases, as discussed below.

Vague and complex nature of second limb of proposed defence

The second limb of the defence asks whether the effect or likely effect of the conduct is to benefit the long-term interests of consumers. This is a vague and ill-defined a standard that will be a nightmare for courts and practitioners if adopted. This proposed defence will result in lengthy and protracted economic evidence as to the meaning of "long term interests of consumers", and expensive debate whether or not their long term interests are likely to be benefited by the conduct. To take just one example, in predatory pricing cases, US courts have held that lower prices absent the element of recoupment benefit consumer welfare.[5] The proposed reform will likely result in debate whether or not prices below a relevant measure of costs are predatory or whether they would be a rational business decision without market power, or whether they may benefit the long-term interests of consumers.

An alternative suggestion for reform of s 46

I urge the Panel to reconsider whether s 46(1) should be reframed in the manner suggested, and whether it is wise to abandon the effort and learning of the courts on s 46(1). If after due consideration the Panel concludes that some reform is required, I submit that instead of the proposed reform (which replaces well-understood concepts with concepts that have not in recent history been used in this area), the Panel work with the existing language of s 46(1), so that the legal community has the benefit of courts' pronouncements on the statutory language to date.

In place of the Panel's suggested reform, I suggest that if any change is made to s 46(1) it is made along the following lines. These would both simplify the section and address perceptions that s 46 is too hard for litigants to succeed on.

First, the words "take advantage of" in s 46(1) can be replaced by the word "use" to give effect to the reality that there is little if any distinction between the two concepts. Alternatively, a new subsection should be inserted to the effect that to "take advantage of" substantial market power in s 46(1) means simply to "use" that power.

Secondly, the Panel effectively recommends the reversal of onus on the taking advantage element in the first limb of its defence. This is, no doubt, intended to address perceptions that s 46 is overly difficult to successfully bring a case under.

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[5] See for example *Brooke Group Ltd v Brown & Williamson Tobacco Corp* 509 US 209 (1993), where Kennedy J stated: "*Atlantic Richfield Co.* v. *USA Petroleum Co.*, 495 U.S. 328, 340 (1990). "Low prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition. . . . We have adhered to this principle regardless of the type of antitrust claim involved." *Ibid.* As a general rule, the exclusionary effect of prices above a relevant measure of cost either reflects the lower cost structure of the alleged predator, and so represents competition on the merits, or is beyond the practical ability of a judicial tribunal to control without courting intolerable risks of chilling legitimate price cutting. See Areeda & Hovenkamp ¶¶ 714.2, 714.3. "To hold that the antitrust laws protect competitors from the loss of profits due to such price competition would, in effect, render illegal any decision by a firm to cut prices in order to increase market share. The antitrust laws require no such perverse result." *Cargill*, *supra*, at 116."

But a better way to achieve this object is to keep the existing language of s 46(1), and introduce a new subsection to the effect that where a corporation has a substantial degree of power in a market, and there is evidence on the balance of probabilities that it engaged in the relevant conduct for one of the three proscribed purposes, it bears the onus of proof of showing its conduct did not use or take advantage of its market power.

A reformulation of s 46 along these lines would preserve the sense of "use" of substantial market power, retain the relevance of existing judicial pronouncements on s 46, and address perceptions that s 46(1) is too difficult for applicants to successfully prosecute claims.[6]

The Birdsville amendments should in any event be repealed. They needlessly complicate misuse of market power, and are flawed in conception and economic principle. As stated in my primary submission, s 46(1AAA), s 46(1AA), s 46(1AB), s 46(4A) should be repealed. Further, s 46(6A)(d) is a meaningless provision that ought be removed from s 46.

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[6] I note also that the "abuse" of a dominant position under the European analogue of s 46 highlights the good sense of any misuse of market power provision only capturing conduct that "uses" substantial market power, although the notion of "abuse" entails a moral element rather than a purely objective one (compared with the taking advantage element in s 46(1)).