MinterEllison

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BY EMAIL

Mr Mark Fitt
Committee Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Mr Fitt

Senate inquiry into the Competition & Consumer Amendment (Misuse of Market Power) Bill 2016

Thank you for the opportunity to make a submission to the current inquiry into the Competition & Consumer Amendment (Misuse of Market Power) Bill 2016 ('**the Bill**').

MinterEllison's observations are based on practical experience advising companies on the application of s46. We hope that these comments will assist your consideration of how well the proposed form of s46 will permit appropriate and workable ex ante guidance for common business conduct in realistic cost and timeframes.

Summary

1. In summary:

    a. If the policy objective is to expand the scope of prohibited conduct then the Bill will do so. In favour of such expansion is the idea that as a theoretical matter there may be some situations where 'take advantage' provides a safe harbour for conduct which may have bad competition effects. MinterEllison has seen such situations, but it is our experience that these situations are in practice few and far between. The cost of closing that gap in the manner proposed by the Bill, however, is that:

        i. the purpose of conduct will become determinative of s46 liability for any firm with market power. That would both amplify the inappropriate forensic focus of the section on company communications and lead in all likelihood to over-capture of conduct. Purpose is relevant, but alone ought not be determinative of liability for companies with market power.

        ii. there is a real risk that removing the 'take advantage' element and so relying on a competition test as the only filter sorting good from bad conduct for firms with market power will not give sufficient certainty for businesses to be able confidently to proceed with normal pro-competitive conduct. That follows because it may take some time for business to be able to be fully confident that the competition test by itself applied in this new context will unambiguously catch only 'exclusionary' conduct and will not catch conduct competing on the merits.

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b. We suggest an approach for consideration which may better allow businesses to be confident that they can sort between good and bad conduct. Adopting something like the Canadian law approach by identifying an adjectival qualification such as "exclusionary" conduct or "anti-competitive" conduct would establish a genus of bad conduct to better guide business as to what the statute is directed to prohibiting – conduct which makes it more difficult for competitors to compete rather than conduct which forces competitors to be more effective.

Purpose

2. Under the Bill, the purpose of conduct will be determinative of s46 liability for any firm with market power. As a matter of logic, liability should attach to conduct which is or is likely to be in effect bad for competition. Identifying conduct which is somehow engaged in with a purpose of being bad is only a proxy for this. A company's purpose may properly be relevant to proof of harmful economic effect - because companies often know what they are doing. But in a real world practical sense, the 'purpose' focus means advisers and business people often spend more time and money up front trying to control internal communications about conduct than they do actually thinking about the basis for, and competitive consequences of, their actions. The *Competition and Consumer Act* is an economic statute, not a test of internal corporate communication protocols.

3. The centrality of subjective purpose in the current s46 in our experience typically leads to a forensic focus in investigations on trawling many thousands of internal company emails for indications of a 'bad' subjective purpose. That quest for 'smoking gun' expressions of purpose in internal communications very often elevates the status of the unusual, the random, the poorly expressed or the downright wrong in company communications.

4. Of course, as s46 stands, purpose is not by itself determinative of liability because to be liable a company also needs to be taking advantage of its substantial market power. However, the Bill would remove the taking advantage element so that any company with substantial market power can be found liable based merely on its purpose. That would make purpose not only necessary for liability as it now is for those with substantial market power but in fact sufficient for liability. The Bill would therefore exacerbate the practical problem of focusing on 'purpose'.

5. Accordingly, a new s46 which removes the "take advantage" element should not allow purpose by itself to be sufficient for liability. To do otherwise will lead to situations in which poorly expressed internal communications could cause pro-competitive conduct or competitively benign conduct either to be abandoned on advice before it happens or successfully prosecuted after it happens. The proposed mandatory 'guidance' factors in s46(2)(a) and (b) will not avoid this issue – potentially setting an inopportunely expressed purpose against a pro-competitive effect will not provide a safe basis for pro-competitive or competitively benign conduct to proceed.

6. Imagine a poorly expressed or indeed flat out wrong internal email from a junior employee suggesting an anti-competitive rationale for a proposed course of commercial conduct which is in reality highly efficient and competitive – if that email can trigger liability irrespective of the effect of the conduct and without the protection of a 'taking advantage' filter then the risk of liability may be such that pro-competitive conduct would have to be abandoned.

Take advantage

7. Under the existing form of s 46, a company with substantial market power is prohibited from engaging in conduct which makes sense for it only because of the market power it holds – that is "taking advantage" of market power required by s 46. In other words, a company with market power is not prevented from conducting itself (even aggressively) in the same way as any firm without market power would.

8. There has been extensive public debate as to whether, as a result of the application of that 'taking advantage' filter, firms with substantial market power may be improperly permitted to engage in potentially "anti-competitive" conduct, in circumstances where firms without substantial market power do or would engage in such conduct. Many of the concerns relating to the take advantage test appear to centre on whether the section is engaged if a defendant "would" or "could" have engaged in the impugned conduct in a workably competitive market. Dissatisfaction with the existing law is understandable if conduct which, on its face, is anti-competitive might be excused because a defendant could show there is a theoretical counterfactual where the impugned conduct would have a commercial rationale.

9. There is, we believe, at least some risk of 'false negatives' – that is, of harmful economic conduct being safe from s46 as it stands by virtue of the application of the 'taking advantage' element. That is because as a matter of economic logic, the 'taking advantage' limb removes from section 46 liability any conduct which is also typically engaged in by players without market power. It is commonly accepted as a matter of economics that conduct can be harmfully anti-competitive when it is pursued by a firm with market power even if it is unproblematic in situations when market power is absent. There is therefore a theoretical risk of conduct being harmful which is safe from s46 by virtue of the application of the 'taking advantage' element as it has been applied.

10. As has been observed by others, MinterEllison agrees that it is difficult to pin down real life examples in practice of unambiguously economically harmful conduct by a company with market power which has been excused from section 46 because a company without power also does it (and which is not regulated by any other provision of the Act such as specific provisions regarding exclusive dealing in s47). MinterEllison has been involved in s46 advice and investigations over time and within the obvious constraints of confidentiality can indicate that while such situations are not entirely theoretical, they are in practice extremely rare. Indeed, there has been only one situation in the past few years where we can recall counselling in a situation where there was substantial market power and an anti-competitive purpose apparently co-existing, but because there was another supplier (who faced competition in an adjacent geographic market for the same service) doing the same thing we could be reasonably confident there was no 'taking advantage'. That conduct (a refusal to supply) seemed on the face of it to have the potential to reduce output and harm competition. It was not caught by any other provision.

11. In short then, as a theoretical matter there may be some situations where 'take advantage' provides a safe harbour for conduct which may have bad competition effects, but it is MinterEllison's experience that and these situations are in practice few and far between.

12. Removing the 'take advantage' element, however, risks undermining the confidence with which businesses holding substantial market power can approach company strategy. The lack of any qualification to the broad noun "conduct" in s46(1) leaves all the work sorting between good and bad conduct by firms with substantial market power to the competition test.

13. Will such companies know what they can or cannot do while not chilling 'good' conduct? MinterEllison shares some of the concerns expressed by others about whether the competition test alone would be fit for purpose to sort bad from good conduct. The competition test is pretty well understood in Australian competition law, so the sky will not in our view fall down (as some have suggested) if such a test were introduced, but there inevitably remains some doubt about how it will be applied in this different context. The reality is that the 'take advantage' element provides a rational and reasonably predictable basis to distinguish between conduct that is evidence of a workably competitive market and conduct that seeks to damage that competition. A large part of the debate that has followed the publication of the final Harper Report is a testament to the fact that there is no other obvious distinguishing factor which serves this purpose as well.

14. There is a risk that a business may not act competitively because it fears a claim, may itself believe or claim that the competition test applies to normal aggressive competitive conduct which happens to

have the consequence of making the resultant structure of the market less competitive for a time, for example by improving a product or reducing price above cost to take share from a competitor which can then no longer survive in the market. That is not a risk that should be lightly taken.

Adjectival qualification of conduct

15. In those circumstances we see benefit in considering meaningful adjectival qualification of the noun "conduct" in s46(1). In other words, it would be helpful to express generically what type of conduct the Act is aiming to catch – not just in an ACCC guideline or explanatory materials - but in the statute itself. Identification of some adjectival qualification such as "exclusionary" conduct or "anti-competitive" conduct for example could assist with the issues around certainty and chilling risks, giving some comfort to businesses on those issues that 'normal' competitive conduct is not intended to be caught by the competition test.

16. Canadian law[1] illustrates such an approach – it applies to a so-called "practice of anti-competitive acts" by a dominant firm with the effect or likely effect of substantially preventing or lessening competition. There is a non-exhaustive list of conduct which are deemed to be anti-competitive acts, such as margin squeezing, pre-emption of scarce facilities, incompatible product specification, predatory pricing and so forth[2]. It is not a closed list but it establishes a genus of bad conduct to guide what the statute is directed to prohibiting – namely, conduct which makes it more difficult for competitors to compete rather than conduct which forces competitors to be more effective.

17. In truth what the Act should be directed at is embedded in the guidance factor in proposed s46(2)(b) (which the EM describes as the "*Anti-competitive factor*"): namely, conduct "*preventing, restricting, or deterring the potential for competitive conduct or new entry*". Elevating that idea from mere guidance factor to a central part of the prohibition would mean s46 targeted firms:

    a. with substantial market power;
    b. from engaging in 'anti-competitive conduct' (where that term is defined to mean conduct "*preventing, restricting or deterring the potential for competitive conduct or new entry*";
    c. with the effect or likely effect of substantially lessening competition.

18. The 'Pro-competitive factors' in proposed section 46(2)(a) could remain for guidance but with less work to do given the proper delimitation of 'anti-competitive conduct' in the manner outlined.

19. In our view, if it is decided to remove 'taking advantage' then explicitly delimiting the central 'conduct' concept in that way would workably cut through much of the risk of chilling pro-competitive conduct.

Yours faithfully
MinterEllison

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[1] Section 79 *Competition Act* RSC 1985, C-34 (as amended)
[2] Section 78 of the *Competition Act*