Senate Economics Legislation Committee

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Budget Estimates 30 May – 1 June 2006

Question: bet 122 (ACCC)

Topic: **Brandis recommendations**

Hansard Page: **E67**

Senator SHERRY asked:

I am advised that the Senate report summarises the ACCC's recommendations on page 11 as follows:

1. the threshold of 'a substantial degree of power in a market' is lower than the former threshold of substantial control;
2. the substantial market power threshold does not require a corporation to have an *absolute* freedom from constraint—it is sufficient if the corporation is not constrained to a *significant* extent by competitors or suppliers;
3. more than one corporation can have a substantial degree of power in a market;
4. evidence of a corporation's behaviour in the market is relevant to a determination of substantial market power.

There is apparently a legislative response in respect of recommendations 4, 5 and 6 of the committee's report. Is that your understanding?

Mr Samuel—I cannot be sure. I would have to say that this has been off our radar screen now for several months, if not a year or two, because the report of the committee was—forgive me, Senator Brandis—was about 18 months ago, wasn't it?

CHAIR—I think it was perhaps two years ago.

Mr Samuel—It has gone off our radar screen at the moment. It is entirely a matter for government. I am sure that, if you put that on notice, we can come back to you and provide you with some advice as to the comparison between the recommendations made by us, the committee—the so-called Brandis recommendations—and the government's response. I do not think we have seen any legislation at this point in time.

Senator SHERRY—The minister might be able to inform us: has legislation been released? I know there was a media report this morning.

Senator Coonan—I do not think so, but I will check that.

Answer:

On 23 June 2005, the Government tabled its response to the Senate Inquiry into 'The effectiveness of the *Trade Practices Act 1974* in protecting small business'. The text of the response related to section 46 is attached.

As at this time, the Government has not introduced a Bill to Parliament to implement its response to the report.

AUSTRALIAN GOVERNMENT RESPONSE TO THE senate inquiry into the effectiveness of the *TRADE PRACTICES ACT 1974* in protecting small business

Introduction

Senate Inquiry

On 25 June 2003, the Senate passed a motion requiring the Economics References Committee to inquire into and report on 'whether the ***Trade Practices Act 1974*** adequately protects small businesses from anti-competitive or unfair conduct'. The Senate Committee was required to have regard to the misuse of market power, unconscionable conduct in business transactions and industry code provisions of the ***Trade Practices Act 1974*** (the Act). The Senate Committee's report was tabled on 1 March 2004. Government Senators provided a minority report.

Dawson Review

The Review of the Competition Provisions of the Trade Practices Act (the Dawson Review) reported to Government in January 2003. At that time, the Dawson Review concluded that there was no need to amend section 46 of the Act, which prohibits the misuse of market power. The Government accepted this recommendation when it announced its response to the Dawson Review on 16 April 2003.

Recent case experience

However, several important Trade Practices Act cases have been considered since the Dawson Review provided its report to Government. The cases have raised questions about the operation of the Act.

The High Court has considered the application and interpretation of section 46 on two occasions, in ***Boral Besser Masonry Ltd v. ACCC*** [2003] HCA 5 (***Boral***) and in ***Rural Press Ltd v. ACCC*** [2003] HCA 75 (***Rural Press***).

The Full Federal Court has also considered section 46 on two occasions, in ***Universal Music Australia Pty Ltd v. ACCC*** [2003] FCAFC 193 and in ***ACCC v. Australian Safeway Stores Pty Ltd*** [2003] FCAFC 149 (***Safeway***).

Trade Practices Act 1974

The object of the ***Trade Practices Act 1974*** is to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection.

The competition laws, including section 46, are in Part IV of the Act. Part IVA of the Act contains laws prohibiting unconscionable conduct, including unconscionable conduct in business transactions. Part IVB of the Act contains laws enabling the establishment of industry codes and includes, in section 51AD, a law that prohibits the contravention of any applicable industry code.

As outlined in the Government's response to the recommendations of the Dawson Review, the Government considers that the competition provisions of the Trade Practices Act are designed to protect the competitive process rather than a specific market structure or individual competitors. The competition laws should also be distinguished from industry policy and should not be seen as a means of achieving social outcomes unrelated to the encouragement of competition, or of preserving businesses that are not able to withstand competitive forces.

The Government considers it is appropriate for the Act to address issues such as unconscionable conduct in business relationships, because the promotion of fair trading enhances the welfare of Australians.

The Government also recognises the importance of small business to the vigour of the Australian economy, and the contribution that small business makes to the growth in employment and innovation.

Against this background, there are a number of measures which the Government considers should be taken in the context of recommendations made in the Senate Committee's report.

Misuse of market power

Misuse of market power

Section 46 of the Act prohibits corporations with a substantial degree of market power from taking advantage of that power for a proscribed purpose, that is, the purpose of eliminating or substantially damaging a competitor, preventing the entry of a person into a market, or deterring or preventing a person from engaging in competitive conduct.

Substantial market power

Only firms with a substantial degree of market power are prohibited from taking advantage of that power for a proscribed purpose. This is because firms that lack substantial market power are rarely, if ever, able to single-handedly harm competition in an enduring way. The prohibition therefore applies only to firms that meet the threshold requirement of possessing substantial market power.

The Act was amended in 1986 to lower the threshold from a requirement that a corporation be 'in a position substantially to control a market' to a requirement that a corporation have 'a substantial degree of power in a market'. The type of power being referred to is 'market power', that is, the ability to behave persistently in a manner different from the behaviour that a competitive market would enforce on a firm. Alternatively, market power may be described as the ability of a firm to raise prices above the supply cost without rivals taking away customers in due time, supply cost being the minimum costs an efficient firm would incur in producing the product or supplying the service.

The change to the lower threshold was motivated by a concern that the previous threshold caught conduct only by a monopolist or monopsonist, and that a lower threshold was necessary to capture corporations with a sufficient degree of market power to seriously harm competition. As the Second Reading Speech noted, the threshold was thus intended to capture not only monopolists, but also major participants in oligopolistic markets and, in some cases, leading firms in less concentrated markets.

In light of the ***Boral*** case, some submissions to the Senate Committee claimed that the majority judgements of the High Court implied that an absolute freedom from competitive constraint was required before a corporation met the 'substantial degree of power in a market' threshold. This was said to have effectively restored the threshold to capture only monopolists or near monopolists and that this was contrary to Parliament's intention in making the 1986 amendments to lower the threshold.

Recommendation 1: The Committee recommends that the Act be amended to state that the threshold of "a substantial degree of power in a market" is lower than the former threshold of substantial control; and to include a declaratory provision outlining matters to be considered by the courts for the purposes of determining whether a company has a substantial degree of power in a market. Those matters should be based upon the suggestions outlined by the ACCC in paragraph 2.16 of this report.

The suggestions outlined in paragraph 2.16 are that:

(1) The threshold of a "substantial degree of power in a market" is lower than the former threshold of substantial control.

(2) The substantial market power threshold does not require a corporation to have absolute freedom from constraint – it is sufficient if the corporation is not constrained to a significant extent by competitors or suppliers.

(3) More than one corporation can have a substantial degree of power in a market.

(4) Evidence of a corporation's behaviour in the market is relevant to a determination of substantial market power.

Government response

The Government does not accept this recommendation. The Government does not agree that the majority judgements in ***Boral*** imply that a corporation must have absolute freedom from competitive constraint before it will be found to have substantial market power. Nor does it agree that the threshold has been returned to one of 'substantial control'.

Market power is a relative concept. As the majority judgements in ***Boral*** note, matters of degree are involved. The majority judgement in the later case of ***Safeway*** makes this especially clear. In that case, Safeway was found to have substantial market power, even with around 16 per cent market share. Safeway was clearly not a corporation in 'substantial control' of the market, yet it was found to have misused its market power.

The Government is also not satisfied that the proposed amendments would clarify the operation of section 46. The Government notes that the first proposal would have no legal effect and merely recites legislative history.

Far from clarifying the section, the second proposal — stating in part that 'it is sufficient if the corporation is not constrained to a significant extent' — would be likely to generate further complexity and uncertainty by adding another layer of interpretation to section 46.

The third proposal is redundant because both the courts (see, for example, the majority judgement in ***Safeway***) and the explanatory material accompanying the 1986 amendments make it clear that more than one firm may have substantial market power in a given market.

The fourth proposal is also unnecessary because firm behaviour is already taken into account in assessing substantial market power. For example, in ***Boral***, the High Court considered whether the firm's behaviour operated as a strategic barrier to entry, thus bolstering its market power.

Taking advantage

Section 46 prohibits corporations with a substantial degree of market power from 'taking advantage' of that power for a proscribed purpose.

Some submissions were made to the Senate Committee expressing concerns about the application of the 'take advantage' element of section 46. In particular, these submissions claimed the High Court's interpretation of 'take advantage' in ***Rural Press*** had narrowed the application of section 46.

Recommendation 2: The Committee recommends that the Act be amended to include a declaratory provision outlining the elements of "take advantage" for the purposes of section 46(1). This provision should be based upon the suggestions outlined in paragraph 2.28 of this report.

Paragraph 2.28 outlines a proposal to amend section 46 to clarify that, in determining whether a corporation has taken advantage of its market power, the courts should consider whether:

(1) the conduct of the corporation is materially facilitated by its substantial degree of market power;

(2) the corporation engages in the conduct in reliance upon its substantial degree of market power;

(3) the corporation would be likely to engage in the conduct if it lacked a substantial degree of market power; or

(4) the conduct of the corporation is otherwise related to its substantial degree of market power.

Government response

The Government does not accept this recommendation. It is not accepted that the interpretation of 'take advantage' requires any statutory clarification.

While consideration of substantial market power involves a sophisticated economic analysis, the 'take advantage' requirement in section 46 simply establishes the requisite causal relationship between market power, conduct and a proscribed purpose.

As the High Court noted so concisely in ***Queensland Wire Industries Pty Ltd v. Broken Hill Proprietary Co Ltd*** (1989) 167 CLR 177, 'take advantage' merely means 'use' and there is no requirement to assess intent.

In ***Melway Publishing Pty Ltd v. Robert Hicks Pty Ltd*** (2001) 205 CLR 1, the High Court said that a corporation takes advantage of its market power if it does something that is materially facilitated by the power, even if that behaviour is not absolutely impossible without the power. The High Court also underscored the need to accurately characterise the causal relationship by assessing whether a corporation could ordinarily engage in that conduct in the absence of market power.

In ***Rural Press***, the leading judgement of the majority applied 'take advantage' by considering whether the corporation with substantial market power could engage in the same conduct in the absence of that power and by considering whether the conduct was materially facilitated by that power. This is consistent with previous cases and, therefore, there is nothing about the High Court's application of 'take advantage' in ***Rural Press*** that suggests a narrowing of section 46.

The Government therefore agrees with Government Senators that there is no significant ambiguity in the meaning or application of 'take advantage' and that the current interpretation does not hinder the operation of section 46.

Predatory pricing

The ***Boral*** case was the first opportunity for the High Court to consider the issue of predatory pricing under section 46. In light of the High Court's decision, some submissions were made to the Senate Committee expressing concern about the ability of section 46 to address predatory pricing.

Recommendation 3: The Committee recommends that the Act be amended to provide that, without limiting the generality of section 46, in determining whether a corporation has breached section 46, the courts may have regard to:

- the capacity of the corporation to sell a good or service below its variable cost.

The Committee recommends that the Act be amended to state that:

- where the form of proscribed behaviour alleged under section 46(1) is predatory pricing, it is not necessary to demonstrate a capacity to subsequently recoup the losses experienced as a result of that predatory pricing strategy.

Government response

The Government accepts this recommendation in part.

To provide further guidance to courts in the consideration of predatory pricing cases, the Government agrees that section 46 should be amended to ensure that the courts may consider below cost pricing when determining whether a corporation has misused its market power. Costs are to be measured in a manner determined by the courts in each case and below cost pricing is not to be legally essential to a finding that a corporation has breached section 46.

However, the Government does not favour an amendment that examines a corporation's capacity to price below cost in isolation. Assessing a firm's capacity to engage in conduct is not the same as examining whether the conduct was engaged in or not. The Government also does not favour an amendment that refers to variable cost because it is not always the most appropriate cost measure and because it can be difficult to routinely quantify, potentially making compliance more expensive for corporations that wish to ensure they are not engaging in predatory pricing.

The Government also considers that section 46 should be amended so that a court may consider whether a corporation has a reasonable prospect or expectation of recoupment as a relevant factor when assessing whether a corporation has misused its market power. Although a reasonable prospect of recoupment is not to be legally essential to a finding that a corporation has breached section 46, it often provides a good test of whether price-cutting is predatory, as Government Senators noted. It is therefore appropriate that the section clearly state that a reasonable prospect of recoupment is a factor that may be taken into account.

Financial power

Some submissions were made to the Senate Committee expressing concerns about statements in ***Rural Press*** that distinguished between a corporation's market power and material and organisational assets, which the Senate Committee describe as 'financial power'.

Recommendation 4: The Committee recommends that section 46 of the Act be amended to state that, in determining whether or not a

corporation has a substantial degree of power in a market for the purpose of section 46(1), the court may have regard to whether the corporation has substantial financial power.

'Financial power' should be defined in terms of access to financial, technical and business resources.

Government response

The Government does not accept this recommendation. As Government Senators noted, if this recommendation were to be adopted, it would considerably extend the scope of section 46 to a degree that is both uncertain and undesirable. This is because 'financial power' (that is, access to financial, technical and business resources) is simply not the same as market power.

Leveraging market power

Section 46 does not explicitly state whether the market in which substantial market power is misused must be the same as the market in which that market power is established. Some submissions to the Senate Committee raised concerns about the lack of comment by the High Court on this point in ***Rural Press***. This is significant because, in that case, the Full Federal Court implied that section 46 requires the establishment of substantial market power, and its misuse, to occur in the same market.

Recommendation 5: The Committee recommends that section 46 be amended to state that a corporation which has a substantial degree of power in a market shall not take advantage of that power, ***in that or any other market***, for any proscribed purpose in relation to that or any other market.

Government response

The Government accepts this recommendation. The Government agrees that section 46 should be amended as recommended. It is entirely appropriate for section 46 to proscribe the leveraging of substantial market power from one market into another.

Co-ordinated market power

Corporations may obtain market power in their own right or as a consequence of their interactions with other corporations in the market. Subsection 46(2) of the Act recognises, for example, that the market power of a corporation should not be assessed in isolation of any related subsidiaries or holding companies in the same corporate group.

Some submissions to the Senate Committee questioned the court's ability to take account of interactions between a corporation and other firms in a market, where those firms are not related to the corporation, that is, where they are not in the same corporate group.

Recommendation 6: The Committee recommends that section 46 be amended to clarify that a company may be considered to have obtained a substantial degree of market power by virtue of its ability to act in concert (whether as a result of a formal agreement or understanding, or otherwise) with another company.

Government response

The Government accepts this recommendation in part. The Government agrees that section 46 should be amended so that, in assessing whether a corporation has 'a substantial degree of power in a market', a court may

take account of any market power the corporation has that results from contracts arrangements or understandings with others. This amendment amounts to a statutory restatement of the principle set out by Justice Lockhart in Dowling v. Dalgety Australia Limited and Others (1992) 34 FCR 109.