

## Chapter 2

### Background to the bill

#### **The threshold test, predatory pricing and leveraged and coordinated power**

2.1 In its original form, section 46 of the *Trade Practices Act 1974* prohibited a firm that was in a position to 'control' a market from taking advantage of its market power. There was concern, however, that this provision only caught conduct by a monopolist or a monopsonist, and not corporations with a sufficient degree of market power to seriously harm competition.<sup>1</sup> Accordingly, a 1986 amendment established the lower threshold test of having 'a substantial degree of power in a market'. In addition, the Australian Competition and Consumer Commission (ACCC) must prove that the company has taken advantage of that power and that it did so with the 'purpose' of damaging competitors.

2.2 In February 2003, the High Court delivered its finding on the *Boral Besser Masonry v ACCC* case.<sup>2</sup> This was the first opportunity for the High Court to consider the issue of predatory pricing under section 46. The ACCC claimed that Boral was guilty of predatory pricing—using its market power to drop its prices below cost to protect or advance its market share. It argued that one of Boral's competitors had left the market as a result. The High Court disagreed, noting that Boral did not have the market power to recoup the losses it sustained when it dropped its prices.

2.3 In April 2003, the Review of the *Competition Provisions of the Trade Practices Act* ('the Dawson Report') inquired into, among other matters, the misuse of market power provisions in section 46 of the Act. The ACCC highlighted the difficulty of demonstrating a company's anti-competitive purpose, and proposed that the section take into account the anti-competitive effect of company behaviour.<sup>3</sup> However, the Dawson Report argued against amending section 46. It noted the High Court's decision in the *Boral* case and recommended that interpretation remain a

---

1 Explanatory Memorandum (EM), p. 7.

2 [2003] HCA 5

3 Australian Competition and Consumer Commission, 'Dawson Report—Preliminary response: criminal sanctions major step forward for competition policy', Press Release, no. 74, 16 April 2003, <http://www.accc.gov.au/content/index.phtml/itemId/347733> (accessed 10 July 2007).

matter for the High Court. The government agreed, acknowledging the 'extensive consideration' given to the section in past reviews.<sup>4</sup>

2.4 There have been three important court cases that have defined the interpretation of 'take advantage' in section 46. In 2001, the High Court found that Melway Publishing Ltd had not taken advantage of its market power because the conduct in question had preceded the company's acquisition of market power.<sup>5</sup> In 2003, the Federal Court ruled in *ACCC v Safeway Stores* that the intent of the conduct in question was important to whether it has taken advantage of its market power.<sup>6</sup> It found that Safeway had not intended to act to take advantage of its market power, and therefore was found to be not in breach of section 46.

2.5 In December 2003, the High Court delivered its finding on *Rural Press v ACCC*. The majority decision held that one test of whether a company had taken advantage of its market power was whether it could have acted in the way it did in the absence of market power.<sup>7</sup> The ACCC argued that this finding increased the section 46 threshold—if a firm *could* engage in the conduct in the absence of having market power, it will be held not to have taken advantage of its market power.<sup>8</sup> The case was also significant for the High Court's ruling that Rural Press was not in breach of section 46 because it relied on its 'economic and financial power', not its market power.

### ***The Senate Economics References Committee Report—section 46***

2.6 In March 2004, the Senate Economics References Committee reported on the effectiveness of the *Trade Practices Act 1974*.<sup>9</sup> Many witnesses and submitters to the inquiry criticised the High Court's decision on *Boral*, deducing that a successful prosecution under section 46 would only be possible if the corporation was near dominant in the market.<sup>10</sup> The ACCC argued not that the Courts had got the *Boral* decision wrong, but that the Parliament's 1986 amendment of 'a substantial degree of

---

4 The Hon. Peter Costello, 'Commonwealth Government response to the review of the competition provisions of the Trade Practices Act 1974', Commonwealth of Australia, <http://www.treasurer.gov.au/tsr/content/publications/TPAResponse.asp> (accessed 10 July 2007).

5 *Melway Publishing Ltd v Robert Hicks Pty Ltd* (2001)

6 *ACCC v Safeway Stores* (2003)

7 Senate Economics References Committee, *The effectiveness of the Trade Practices Act in protecting small business*, p. 12.

8 Senate Economics References Committee, *The effectiveness of the Trade Practices Act in protecting small business*, p. 13.

9 Senate Economics References Committee, *The effectiveness of the Trade Practices Act in protecting small business*, March 2004.

10 Senate Economics References Committee, *The effectiveness of the Trade Practices Act in protecting small business*, p. xi.

power' was unclear and that the original policy intent of the provision had not been realised.

2.7 The Senate committee agreed and adopted many of the recommendations suggested by the ACCC. On the question of the section 46(1) threshold test, the committee supported amendments based on the ACCC's suggestions. It proposed that in establishing whether a company has 'a substantial degree of power in the market':

- the substantial market power threshold does not require a corporation to have an absolute freedom from constraint;
- more than one corporation can have a substantial degree of power in a market; and
- evidence of a corporation's behaviour in the market is relevant to a determination of substantial market power.<sup>11</sup>

2.8 The Senate committee also supported the ACCC's suggestion that the Act should outline the elements of 'take advantage' for the purposes in section 46(1). Specifically, the Act should clarify whether:

- the conduct of the corporation is materially facilitated by its substantial degree of market power;
- the corporation engages in the conduct in reliance upon its substantial degree of market power;
- the corporation would be likely to engage in the conduct if it lacked a substantial degree of market power; and
- the conduct of the corporation is otherwise related to its substantial degree of market power.<sup>12</sup>

2.9 On the question of predatory pricing, the committee's majority report recommended that the Act be amended to state that it is not necessary to demonstrate a capacity to subsequently recoup the losses experienced as a result of a predatory pricing strategy.<sup>13</sup> Government Senators' disagreed. Their dissenting report stated:

The issue of recoupment is important, in particular because it often provides the best test of whether price-cutting is a genuine exercise in competition or has a predatory intent. (A firm which is genuinely competing on price does not plan to recoup its foregone revenue from the elimination of its competitor; a firm which is engaged in a predatory pricing strategy almost

---

11 Senate Economics References Committee, *The effectiveness of the Trade Practices Act in protecting small business*, p. 11.

12 Senate Economics References Committee, *The effectiveness of the Trade Practices Act in protecting small business*, p. 14.

13 Senate Economics References Committee, *The effectiveness of the Trade Practices Act 1974 in protecting small business*, pp xiii and 19.

invariably will.) Rather, Government Senators consider that recoupment should be one of the criteria to which the court may (and ordinarily will) have regard in determining whether price-lowering behaviour is predatory.<sup>14</sup>

2.10 The majority report made two recommendations relating to factors that a court may have regard to in determining whether or not a corporation has a substantial degree of power in a market for the purpose of section 46(1). The first is 'the capacity of the corporation to sell a good or service below its variable cost'.<sup>15</sup> The second is whether the corporation has substantial 'financial' power (material and organisational assets).<sup>16</sup> Government Senators agreed on the matter of 'variable cost' but disagreed that the courts may have regard to 'financial power'.<sup>17</sup>

2.11 The committee's majority report also made two recommendations relating to the context of the threshold test. It recommended that the Act be amended to state that a corporation with a substantial degree of power in a market must not take advantage of that power in its own market, or leverage this power from one market to another.<sup>18</sup> The committee also recommended that a company may be considered to have obtained a substantial degree of market power by its ability to act in concert with another company.<sup>19</sup> This is referred to as coordinated market power.

#### ***The government's response to the Senate committee report—section 46***

2.12 The government's response rejected the majority report's (and the ACCC's) recommendations to clarify the definition of 'take advantage' and insert a reference to substantial 'financial' power. On predatory pricing, the government favoured the minority report's position:

The Government...considers that section 46 should be amended so that a court may consider whether a corporation has a reasonable prospect or

---

14 Senate Economics References Committee, *The effectiveness of the Trade Practices Act 1974 in protecting small business*, p. 87.

15 Senate Economics References Committee, *The effectiveness of the Trade Practices Act 1974 in protecting small business*, p. xiii.

16 The committee recommended that "'financial power" should be defined in terms of access to financial, technical and business resources'. Recommendation 4, see page xiv.

17 Senate Economics References Committee, *The effectiveness of the Trade Practices Act 1974 in protecting small business*, p. 88.

18 These recommendations were based on the majority judgement in *Rural Press v ACCC*.

19 Senate Economics References Committee, *The effectiveness of the Trade Practices Act 1974 in protecting small business*, p. xiv.

expectation of recoupment as a relevant factor when assessing whether a corporation has misused its market power.<sup>20</sup>

2.13 The government accepted the committee's recommendation that section 46 should proscribe the leveraging of substantial market power from one market into another. It also agreed 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.<sup>21</sup>

2.14 The Trade Practices Legislation Amendment Bill (No. 1) 2007 implements amendments on predatory pricing, leveraging market power and coordinating market power (see Chapter 3).

### **Section 51AC and unconscionable conduct**

2.15 The bill's other main component relates to Section 51AC of the *Trade Practices Act 1974*, which prohibits corporations from engaging in 'unconscionable conduct' in their transactions. The section was introduced as a consequence of a 1997 report by the House of Representatives Committee on Industry, Science and Technology, which noted that information asymmetries in the bargaining power of parties was a critical factor that allowed firms to engage in unfair conduct.<sup>22</sup>

2.16 Section 51AC was introduced in 1998 specifically to protect small business. It establishes legal remedies for smaller businesses when they are subjected to unconscionable conduct. This redress is limited by subsections 51AC(1) and 51AC(2), which excludes publicly listed companies, and subsections 51AC(9) and 51AC(10), which excludes dealings in excess of \$3 million. The factors that may constitute 'unconscionable conduct' are listed under sections 51AC(3)—relating to suppliers—and 51AC(4)—relating to acquirers. These factors include any relative imbalance in bargaining power and the ability of the smaller business to understand the terms of the transaction.<sup>23</sup>

2.17 Since 1998, the ACCC has brought only 15 cases before the courts relating to unconscionable conduct. In a July 2007 speech, Mr Graeme Samuel, Chairman of the

---

20 Australian Government response to the Senate inquiry into the effectiveness of the Trade Practices Act 1974 in protecting small business, p. 7, [http://www.treasurer.gov.au/tsr/content/publications/pub\\_downloads/TPA\\_small\\_business.pdf](http://www.treasurer.gov.au/tsr/content/publications/pub_downloads/TPA_small_business.pdf) (accessed 10 July 2007).

21 Australian Government response to the Senate inquiry into the effectiveness of the Trade Practices Act 1974 in protecting small business, p. 8, [http://www.treasurer.gov.au/tsr/content/publications/pub\\_downloads/TPA\\_small\\_business.pdf](http://www.treasurer.gov.au/tsr/content/publications/pub_downloads/TPA_small_business.pdf) (accessed 10 July 2007).

22 Explanatory Memorandum, p. 8.

23 Explanatory Memorandum, p. 8.

ACCC, noted that proving cases of unconscionable conduct was far more difficult than cases of misleading and deceptive conduct. He added:

As a result there has been a tendency for us to say, 'let's just tackle the misleading and deceptive conduct rather than take the more difficult route of going after the unconscionable conduct elements of a case'. While this approach often works in shutting down the conduct, it is sometimes a bit too easy for our investigators to let the unconscionable behaviour slide. Well, no more. We are changing our focus to take a much more aggressive attitude to pursuing unconscionable conduct, and this means pushing to get more matters before the courts. By doing so we will not only test the law, we will firm up a better definition of what constitutes unconscionable conduct, thereby providing more guidance to businesses.<sup>24</sup>

### ***The Senate Economics References Committee report—section 51AC***

2.18 The Senate Economics References Committee report recommended that subsections 51AC(3) and 51AC(4) be amended to include a provision where the supplier or acquirer imposes or utilises contract terms allowing the unilateral variation of a contract.<sup>25</sup> This followed the ACCC's evidence that 'unfettered unilateral variation clauses be added to the list of factors to which the court may have regard'. The committee acknowledged the concerns of some organisations, such as the National Farmers' Federation, which argued that a unilateral variation of standard form contracts may be competitive and necessary.<sup>26</sup> However, it emphasised that the recommendation serves to discourage, rather than proscribe, the unilateral variation of contracts.<sup>27</sup>

2.19 The Senate Committee report recommended that subsections 51AC(9) and 51AC(10) of the Act be repealed. It argued that the removal of the thresholds will not reduce the protection for small businesses, and will enhance protection for businesses involved in transactions over \$3 million.<sup>28</sup> Several submitters, including the ACCC, had put the case that the thresholds in these subsections were inappropriate. The

---

24 Mr Graeme Samuel, 'Competition and fair trading: a fair go for small business', *Speech*, National Small Business Summit, 3 July 2007, p. 3.

25 Senate Economics References Committee, *The effectiveness of the Trade Practices Act 1974 in protecting small business*, p. 40. See also Senate Standing Committee on Rural and Regional Affairs and Transport, *Operation of the wine-making industry*, October 2005, pgs. xi and 47, Recommendation 2.

26 Senate Economics References Committee, *The effectiveness of the Trade Practices Act 1974 in protecting small business*, p. 38.

27 Senate Economics References Committee, *The effectiveness of the Trade Practices Act 1974 in protecting small business*, p. 40.

28 Senate Economics References Committee, *The effectiveness of the Trade Practices Act 1974 in protecting small business*, p. 37.

ACCC argued that the \$3 million transaction threshold was 'a sudden cut-off'. It added:

...the context of the section is dealing with unconscionable conduct between larger businesses that are in a superior bargaining position compared to businesses that may be in a lesser bargaining position.<sup>29</sup>

***The government's response to the Senate committee report—section 51AC***

2.20 The government's response was that removal of the cap 'would broaden the focus of the provision in a way unintended by the government'. It did agree to extend the \$3 million threshold to \$10 million, as recommended by government Senators.<sup>30</sup> The government also accepted the majority report's recommendation on the unilateral variation of contracts (sections 51AC(3) and 51AC(4)). It noted that while this conduct may be an indication that unconscionable conduct has occurred in the bargaining process, it may also indicate healthy competition. The bill implements these amendments on unconscionable conduct (see Chapter 3).

---

29 Transcript of Evidence, Mr Graeme Samuel, 7 November 2003, p. 16.

30 Government Senators' Report, *The effectiveness of the Trade Practices Act 1974 in protecting small business*, March 2004, p. 88.

