Chapter 4

Issues relating to subsections 46(1), 46(3A–3C), 46(4A) & 51AC

4.1 This chapter examines the three issues on which the committee received the majority of comment in relation to the bill—the threshold test and the issue of predatory pricing in section 46, and the proposed amendments to section 51AC on 'unconscionable conduct'. The bill's section 46 amendments in particular elicited a range of support and criticism from submitters and witnesses. The committee recognises that these viewpoints are part of the wider polemic in competition law concerning the balance between promoting competition through the market and regulating anti-competitive behaviour.

The threshold test (subsections 46(1), 46(3A), 46(3B) and 46(3C))

4.2 In its submission to the inquiry, the Law Council of Australia (LCA) supported the bill's amendment to subsection 46(1) for removing any doubt that substantial market power and the conduct which takes advantage of it need not occur in the same market.[1] The LCA also supported the amendments to sections 46(3A), (3B) and (3C), although it expressed concern that past judicial interpretation of the word 'control' may undermine new subsection 46(3C).

4.3 Boral Limited, the defendant in the 2003 High Court test case on predatory pricing, agreed with the Law Council's position on the threshold test. Its submission acknowledged that the government is not amending the basic structure of section 46 and that the bill preserves the prerequisite for a firm to have 'market power'. It argued that this threshold 'retains necessary tension between the underlying desire to promote competition and the need to regulate anti-competitive behaviour'.[2]

4.4 The National Farmers' Federation (NFF) supported the bill's measures to broaden the definition of market power. It argued that strengthening the provisions of section 46 was crucial to retaining competition and choice in fuel distribution, retailing and transport suppliers. More pointedly, the NFF's submission stated that '…it is vital that situations such as that highlighted by the Boral case are not allowed to occur into the future'.3 It noted that the High Court had found that Boral Masonry Limited did not have substantial market power in the wider market for walling and paving products, rather than the market for concrete masonry products in Melbourne.

---

1 Law Council of Australia, *Submission 13*, p. 4. The submission was written by a member of the Trade Practices Committee.

2 Boral Limited, *Submission 26*, p. 1.

3 National Farmers' Federation, *Submission 8*, p. 5.

4.5 A contrary view was put by the Business Council of Australia (BCA). The BCA emphasised that 'it is not possible to enshrine every judicial decision into legislation' and argued that the bill's amendments to section 46 'are not required and would indeed be detrimental'. In particular, the BCA argued that the proposed amendment to subsection 46(3C) is overly prescriptive and that the reference to 'absolute' freedom from constraint is ambiguous and may even lower the threshold test. It also claimed that the inclusion of the specific constraints mentioned in the new subsection:

> …risks ascribing those particular factors an importance over and above other important considerations…which are relevant to the assessment of substantial market power – such as the level of imports and the height of barriers to entry.[4]

Ms Melinda Cilento, Deputy Chief Executive of the BCA, told the committee that codifying these factors creates uncertainty which may have the unintended effect of lowering the section 46 threshold. She argued that the TPA in its current form is effective.[5]

4.6 The BCA argued that in the absence of a body of case law which interprets subsection 46(3C), there is a risk that the subsection will be overly prescriptive. It requested that the government clarify in the EM that the intention of the proposed changes is not to lower the threshold of what constitutes a substantial degree of power in the market. In addition, it suggested subsection 46(3B) contain the following clarification:

> Subsections (3), (3A) **and (3C)** do not, by implication, limit the matters to which the Court may have regard in determining, for the purposes of this section, the degree of power that a body corporate or bodies corporate has or have in a market.[6]

4.7 The LCA also noted that the addition of subsections 46(3C)(b)(i) and (ii):

> …may have the limiting effect of 'elevating' those particular constraints above other factors which also form part of an assessment of substantial market power, such as the height of barriers to entry. We suggest that this deficiency be addressed.[7]

4.8 The committee notes the concerns of the BCA and the LCA. It agrees that section 46(3C) should not limit the matters to which courts may have regard in determining a corporation's market power. However, the courts currently consider other factors—such as recoupment—which are not explicitly mentioned in section 46

---

4 Business Council of Australia, *Submission 11*, p. 3. See also Mr Dave Poddar, *Committee Hansard*, 27 July 2007, p. 15.

5 Ms Melinda Cilento, *Committee Hansard*, 27 July 2007, p. 16.

6 Emphasis added. Business Council of Australia, *Submission 11*, p. 4.

7 Law Council of Australia, *Submission 13*, p. 5.

of the Act. The committee suggests that the government further consider the BCA's proposed clarification to the EM regarding the intention of new subsection 46(3C).

Predatory pricing (subsection 46(4A))

4.9 The committee received several submissions commenting on new subsection 46(4A). Some supported this amendment but had concerns about the absence of a method to determine either the price or cost for the goods and services (see paragraph 3.7). Other submitters viewed the subsection as unnecessary, and even counterproductive. The underlying theme of submitters' comment—whether they favoured or opposed the subsection—was the difficulty distinguishing between predatory pricing and strong competition.[8]

4.10 Woolworths Limited, for example, supported the inclusion of subsection 46(4A) provided that key competition principles are preserved. One of these principles is the ability of some companies to capitalise on their lower net variable costs and operational efficiencies. Companies selling at prices that reflect their lower cost structure should not be subject to the predatory pricing clause. Woolworths also argued that this clause should not apply to a company that reduces its prices to match those of a competitor, or to a company that reduces its prices in some locations to meet localised competition.[9] As for the interpretation of a 'sustained period', Woolworths emphasised that the courts must allow 'normal competitive activity including discounting, clearance sales and other stock clearance activities'.[10]

4.11 The Law Council's submission broadly supported the new subsection, but criticised the vagueness of the term 'relevant cost'. It argued that this oversight 'has the potential to lead to protracted litigation and raises the prospect…that the amendments…will lead to increased regulatory costs…'[11] The Law Council did not believe that the bill—in its present form—needed to include any reference to recoupment of costs. It also stated that sustained below-cost pricing ought not to be determinative of misuse of market power, but a consideration 'in the context of all of the surrounding facts and circumstances'.[12] The Council did suggest that the new subsection 46(4A) should broaden the definition of predatory pricing conduct by inserting the words 'offering to supply'.[13]

4.12 The Fair Trading Coalition's (FTC) submission to the committee also welcomed the insertion of subsection 46(4A). It supported the exclusion of a reference

---

8 See also David Liebermann and Associates, *Submission 6*.

9 Woolworths Limited, *Submission 10*, p. 2.

10 Woolworths Limited, *Submission 10*, p. 3.

11 Law Council of Australia, *Submission 13*, pp 5–6.

12 Law Council of Australia, *Submission 13*, p. 6.

13 Law Council of Australia, *Submission 13*, p. 7.

to recoupment, which it believed would be a barrier to a successful 'misuse of market power' case.[14] However, it noted that a number of the FTC's members supported strengthening this provision. The FTC submission did not elaborate on how this subsection might be strengthened.

4.13 The committee did receive a recommendation on this issue from the Pharmacy Guild of Australia, a member of the FTC. The Guild praised the inclusion of a clause on predatory pricing, but proposed an alternative wording—'supplying goods or services for a sustained period at a price that was less than avoidable cost to the corporation of supplying such goods or services'.[15] The Guild also suggested that after subsection 46(4A), the term 'avoidable cost' is defined:

> For the purposes of Subsection 46(4A), a corporation is taken to have priced goods or services below avoidable cost if the revenues it obtains, or could reasonably expect to obtain, from the supply of those goods or services is less than the costs it could have saved, or could reasonably have expected to save, had it not supplied those goods or services.[16]

Criticism of new subsection 46(4A)

4.14 The committee received various critiques of the proposed subsection 46(4A). These ranged from claims that the section is redundant, to fears that less competition and higher prices will result, to concern over the high threshold of 'substantial market power'.

4.15 Associate Professor Frank Zumbo, appearing in a private capacity, argued that the proposed subsection 46(4A) is 'cosmetic'. He claimed that courts already have regard to the question of sustained below cost pricing and the reasons for such pricing, and the amendment therefore 'does not in any way alter the current judicial position regarding predatory pricing'.[17] Associate Professor Zumbo told the committee that the bill needed to clarify the threshold test of 'substantial market power', which at present was preventing the ACCC from bringing section 46 cases to court.[18] He believed that the Act needed greater definition to establish that a corporation may meet the threshold even though it does not have the ability to raise its prices without losing business to rivals.[19]

---

14 Fair Trading Coalition, *Submission 21*, p. 4.

15 Pharmacy Guild of Australia, *Submission 20*, p. 4.

16 Pharmacy Guild of Australia, *Submission 20*, p. 4.

17 Associate Professor Frank Zumbo, *Submission 25*, p. 27. See also *Committee Hansard*, 27 July 2007.

18 *Committee Hansard*, 27 July 2007, p. 5. Associate Professor Zumbo told the committee that the fact that the ACCC had not brought a section 46 case to court since *Boral* suggested that the section was not working as it should.

19 *Committee Hansard*, 27 July 2007, p. 7. Associate Professor Zumbo noted that this amendment would be contrary to the High Court's *Boral* decision.

4.16 The law firm, Addisons, identified that the problem with predatory pricing 'lies…in determining when, in fact pricing crosses the line between legitimate, but hard or aggressive competition and becomes illegitimate and predatory conduct'.[20] It argued that with or without the new subsection, it is difficult to successfully prosecute a case of predatory pricing under the TPA. Unlike Associate Professor Zumbo, Addisons viewed the lack of successful predatory pricing cases as proof that the law was working as it should—to protect competition. This was also the judgement of Justices Gleeson and Callinan in *Boral*, which Addisons' submission cited at length.[21]

4.17 The majority judgement in *Boral* observed that the TPA in its current form does not spell out the concepts that it seeks to uphold. Ms Kathryn Edghill, a partner at Addisons, told the committee that this was one of the strengths of the section.[22] Addisons' submission argued that the bill threatened this flexibility, particularly its reference to 'relevant cost'.[23] It noted that a contradiction may arise where competition law prohibits information sharing among competitors, and yet an allegation under the proposed section 46(4A) can only be established by actual knowledge of a competitor's costs. Further, the submission argued that where the ACCC uses its powers under section 155 of the TPA to investigate a company, it is unlikely that the company will have analysed its costs on a variable basis to the extent that may be necessary to establish or defend a claim of predatory pricing. Given this difficulty, Addisons raised the possibility that a section 155 notice may become a tool for companies seeking to damage their cost-cutting competitors.[24]

4.18 The Australian National Retailers Association (ANRA) argued in its submission that new subsection 46(4) on predatory pricing is unnecessary and liable to result in increased uncertainty and more litigation. It also foreshadowed the possibility of higher prices as businesses 'become fearful of reducing prices lest they become embroiled in a predatory pricing investigation'.[25] ANRA maintained that the current Act ably protects businesses from predatory pricing conduct, and that the proposed amendments codify the courts' current interpretation. Moreover, it argued that there are many legitimate factors that impact on a company's ability to price at low levels, which should not always be visible to competitors. These are the 'operational efficiencies' referred to by Woolworths, including the cost of rent, labour and efficiencies from economies of scale.[26]

---

20 Addisons, *Submission 23*, p. 6.

21 See Addisons, *Submission 23*, pp 7–8.

22 Ms Kathryn Edghill, *Committee Hansard*, 27 July 2007, p. 27.

23 Addisons, *Submission 23*, p. 9.

24 Addisons, *Submission 23*, p. 11.

25 Australian National Retailers Association, *Submission 16*, p. 18. Mrs Margy Osmond, *Committee Hansard*, 27 July 2007, p. 34.

26 Australian National Retailers Association, *Submission 16*, p. 19.

4.19 Another perspective was offered by the Southern Sydney Retailers Association. Its submission argued that section 46 in relation to predatory pricing 'is currently written back to front'. It explained:

> A successful Predatory Pricing…strategy does not require market power when the Predator ***commences*** to engage in Predatory conduct. The only thing needed by the predator ***at the start*** is deeper pockets than that of the competition they are attempting to drive to ruin and bankruptcy or the ability to leverage profits from non-competitive territory.[27]

Unconscionable conduct (section 51AC)

4.20 Several submitters supported the bill's amendments to section 51AC. The NFF, for example, welcomed the greater scrutiny of contract clauses. It argued that many contract clauses in the past have allowed buyers to 'opt out' of their contractual obligations with farmers. The NFF also supported the increase in the transaction threshold from $3 million to $10 million. It argued that many farmers have high turnovers and small margins, often with an increasingly limited number of buyers for their produce. As a consequence, many farmers have increased their exposure to the $3 million threshold.[28]

4.21 Associate Professor Zumbo observed that the test of unconscionable conduct is difficult to satisfy because it is not clear. He suggested that the current interpretation is too restrictive and could be remedied if the following non-exhaustive definition of unconscionable conduct was included under section 51AC:

> …any action in relation to a contract or to the terms of a contract that is unfair, unreasonable, harsh or oppressive, or is contrary to the concepts of fair dealing, fair-trading, fair play, good faith and good conscience.[29]

4.22 The committee does not support this proposal. It reiterates the position put in both the majority and minority March 2004 Senate reports which rejected any rewriting of definitions in section 51AC. The Government Senators' report put the argument in the following terms:

> Government Senators welcome the fact that the Majority Report makes no recommendation for the introduction of vague new statutory language into s.51AC ('harsh', 'unfair' etc.). It is our belief that the consequence of doing so would make the meaning of the section so open to a variety of different interpretations that it would be inimical to the development of a coherent and relatively clear body of law. Furthermore, the transactional uncertainty which the introduction of such language would produce would have

27 Southern Sydney Retailers Association, *Submission 15*, p. 2.

28 National Farmers' Federation, *Submission 8*, p. 7.

29 Associate Professor Frank Zumbo, *Submission 5*, pp 34–35.

> undesirable consequences for commerce, the social cost of which is difficult to assess.[30]

4.23 On the proposal to increase the threshold for unconscionable conduct, Associate Professor Zumbo argued that the monetary level is arbitrary and 'may not be enough to cover all small businesses'. His preference was that the threshold be removed altogether such that all businesses are covered by section 51AC. A second-best option was to increase the level of the threshold beyond $10 million.[31]

4.24 The committee also disagrees with Associate Professor Zumbo's proposal on the threshold. It supports the bill's amendment because it retains the protection offered by section 51AC for smaller businesses. Abolishing the threshold would allow a wider array of businesses to inappropriately use section 51AC for their strategic advantage.[32] This was not the Parliament's intention when the section was introduced in 1998.

Treasury's view of the bill

4.25 Ms H. K. Holdaway, Policy Manager of Treasury's Competition Framework Unit, told the committee that the bill represents 'very careful' consideration of the recommendations made in the March 2004 Senate Economics Committee report. She argued that the bill achieves the fine balance between protecting business from anti-competitive conduct while ensuring that consumers enjoy the benefits of competition.[33] The amendments help to clarify various issues without limiting the factors that courts can take into account in assessing whether the section 46 threshold has been met. Ms Holdaway also told the committee that the term 'relevant cost' allowed greater flexibility for the courts than terms such as 'variable cost'. Further, she noted that in the government's view, there was 'a reasonable level of understanding' as to the term 'take advantage'.[34] Accordingly, the bill proposes no amendment on this issue.

Conclusion

4.26 The committee supports the bill in its current form. Several submitters to this inquiry have noted that it provides greater clarity for the courts in relation to both the threshold test for the misuse of market power and predatory pricing in section 46. It also extends courts' capacity under the terms of section 51AC to protect a greater range of transactions entered into by small businesses. The creation of a second

---

30 Senate Economics References Committee, *The effectiveness of the Trade Practices Act 1974 in protecting small business*, Government Senators' report, March 2004, p. 85.

31 Associate Professor Frank Zumbo, *Submission 5*, p. 34.

32 Explanatory Memorandum, p. 20.

33 Ms H. K. Holdaway, *Committee Hansard*, 27 July 2007, p. 39.

34 Ms H. K. Holdaway, *Committee Hansard*, 27 July 2007, p. 40.

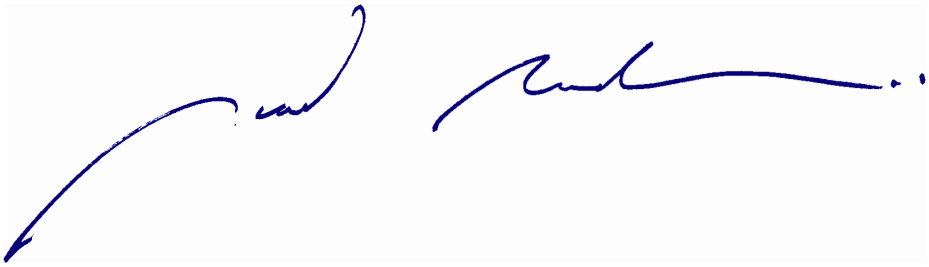
Deputy Chairperson for the ACCC is an important initiative and will elevate the status of, and attention to, small business issues within the Commission.

4.27 The committee emphasises that the bill implements many of the recommendations of a thorough and considered inquiry process into the *Trade Practices Act 1974*. This process revealed public dissatisfaction with the courts' interpretation of the 'misuse of market power' provisions. The bill's amendments on the threshold test were recommended by the 2004 Senate Economics Committee's majority and minority reports, and endorsed by the ACCC. The ACCC remains strongly supportive of these amendments.[35] On predatory pricing, the bill followed the Senate report's recommendation to include reference to a company's capacity to sell below cost. On the issue of unconscionable conduct, the bill implements the Senate report's recommendation on the unilateral variation of contracts and Government Senators' recommendation to increase the monetary threshold to $10 million.

4.28 The committee believes the bill's amendments are important to state expressly the legal principles that have been established by the courts. It is immaterial that some of the amendments permit courts to consider factors they already have the power to consider. The committee also rejects claims that the bill's amendments will create uncertainty as to the operation of the Act. On the contrary, sections 46(3A), 46(4A) and 51AC(3)(j) and 51AC(4)(j) will draw courts' attention to potential areas of contravention. The bill makes clear that the amendments are not included to elevate the importance of these factors over others. Rather, they are included to clarify and to guide, and the courts will continue to rule according the facts and circumstances of the individual case in question.

Recommendation 1

4.29 The committee recommends that the bill be passed.



Senator the Hon Michael Ronaldson
Chair

35 See Graeme Samuel, 'Competition and fair trading: a fair go for small business', National Small Business Summit, 3 July 2007, http://www.accc.gov.au/content/item.phtml?itemId=791291&nodeId=e13ac2c93b89ec9869b59f8d26e4b475&fn=20070703_Small%20Business%20Summit.pdf (accessed 23 July 2007).