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Business Council of Australia

The Secretary
Senate Standing Committee on Economics
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Canberra ACT 2600

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Dear Sir/Madam

**BUSINESS COUNCIL OF AUSTRALIA SUBMISSION**

The Business Council of Australia (BCA) welcomes the opportunity to make a submission to the inquiry by the Senate Standing Committee on Economics into the provisions of the *Trade Practices Legislation Amendments Bill (No.1) 2007* and *Trade Practices Amendments (Predatory Pricing) Bill 2007.*

In May 2005, the BCA released the *Business Regulation Action Plan*[1] outlining a series of recommendations on how to reduce the unnecessary costs of poor regulation. Those recommendations were aimed at not only fixing the current stock of poor regulation, but also at systemic improvements to the regulation making system to ensure that further poor regulation is not imposed on business.

Following the release of the Action Plan, the federal government commissioned the Banks Taskforce[2] to assess regulatory compliance costs to business. The BCA welcomed both the Banks Taskforce's and the government's[3] recognition that it is failings in the systemic regulation processes that are contributing to the unnecessary costs of red-tape for business.

The BCA therefore welcomes efforts by the government to consult widely on the proposed changes to the *Trade Practices Act 1974* (TPA) and to ensure that regulations responses do not impose unnecessary burdens on business or the economy.

**Trade Practices Legislation Amendments Bill (No.1) 2007**

In general, the bill proposes to amend sections 46 and 51AC of the TPA.

[1]Business Council of Australia, *Business Regulation Action Plan for Future Prosperity*, May 2005 (available www.bca.com.au).
[2]See Regulation Taskforce 2006, *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business,* Report to the Prime Minister and Treasurer, Commonwealth of Australia, Canberra, January 2006.
[3]See Australian Government, *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business – Australian Government's Response,* August 2006.

The Commonwealth Government's review of the competition provisions of the TPA, chaired by Sir Daryl Dawson (the Dawson Review) found that changes to the misuse of market power provisions of the TPA were not required, in part because the Dawson Review noted that there were a number of cases before the courts at that time that would provide an opportunity for the section to be further clarified. The government accepted this recommendation when it announced its response to the Dawson Review on 16 April 2003.

Judicial decisions since the Dawson Review, such as the High Court decision in *Boral v ACCC,* have resulted in disagreement in the community about whether the TPA, as it currently stands, provides adequate protection to small business from anti-competitive conduct.

The Senate Economics Committee tabled a report on 1 March 2004 making recommendations to change the TPA.

The BCA agrees with the findings of the Dawson Review. The BCA strongly advocates that amendments should only be made to regulation where those changes are going to be effective, proportional to the problem being addressed, and where the benefits outweigh the costs. As a primary matter of policy, the BCA believes that even if the proposed amendments are implemented to codify the law as it currently stands, there is a risk that this in itself will impose an additional burden on business, competition and the economy.

Competition produces important economic and consumer benefits in terms of choice and prices. Competition and competition policies are increasingly impacted by and must reflect the influences of global markets and competitors. Reflecting these factors, competition laws need to strike a balance between preventing businesses with substantial power from misusing their status, while ensuring that all businesses are able to compete through ordinary business behaviour.

From a practical perspective, it is not possible to enshrine every judicial decision into legislation. More fundamentally, regulation must be clear in its objectives, in this instance the promotion of competition (not competitors or classes of competitors) and must be proportionate to the problem being addressed. Heavy-handed responses risk stifling genuine competition and innovation, in turn raising the real prospect of significant adverse consequences in the form of limiting choice and product/service availability, as well as higher prices

It is for these reasons that the BCA believes that amendments to section 46 are not required and indeed would be detrimental. The BCA is very concerned that while intended to codify the law and provide guidance, any amendments pose a real risk of changing the law by how they are interpreted by judges in a way that will prevent businesses operating competitively in the market. If trade practices laws act as a break on legitimate business competitiveness, this will weigh on business and economic outcomes (as noted above), adversely impact consumers and weigh on future prosperity.

The BCA recognises, however, that there are concerns about competitive pressures facing small business and that this is likely to result in some amendments being made to sections 46 and 51AC of the TPA. Against this backdrop, and with a view to limiting any adverse consequences flowing form amendments, the BCA is prepared to accept changes that seek to clarify and codify the existing legislation, noting the risks outlined above in doing so.

That said, the BCA has concerns with the amendments to proposed subsection 46(3C) as they currently stand and which follow:

"*For the purposes of this section, without limiting the matters to which the Court may have regard for the purpose of determining whether a body corporate has a substantial degree of power in a market, a body corporate may have a substantial degree of power in a market even though:*

*(a) the body corporate does not substantially control the market; or*

*(b) the body corporate does not have absolute freedom from constraint by the conduct of:*

*(i) competitors, or potential competitors, of the body corporate in that market; or*

*(ii) persons to whom or from whom the body corporate supplies or acquires goods or services in that market.*"

Subsection 46(3C) is intended to deal with the concerns that some judicial decisions - notably the High Court decision in *Boral* - have raised the "hurdle" of what constitutes a "substantial degree of market power".

We consider that the proposed subsection 46(3C) addresses certain aspects of Recommendation 1 of the Senate Economic References Committee's report into the effectiveness of the Act in protecting small business. Recommendation 1 stated, amongst other matters, that section 46 should be amended to include a declaratory provision outlining the matters to be considered by the Courts when determining whether a corporation has a substantial degree of market power.

Although the proposed subsection 46(3C) provides that a corporation ***may*** have substantial degree of power in a market in certain circumstances, the BCA believes that the drafting remains overly prescriptive.

For example, the word "absolute" in paragraph (b) creates an ambiguity in the test of what constitutes a "substantial degree of market power". A court could construe the provision in such a way that the threshold of a "substantial degree of market power" is lowered. This would, in turn, capture the behaviour of a greater number of legitimate businesses where there is no risk of competitive harm and risk deterring pro-competitive conduct which would otherwise be to the benefit of the Australian economy and Australian consumers.

In addition, although proposed subsection 46(3C) contains language which provides that a court is not limited in the matters to which it may have regard when determining whether a corporation has a substantial degree of market power, there remains a risk that the drafting in paragraphs 46(3C)(b)(i) and (ii) may, nevertheless, have a limiting effect on a court's determination of when a corporation has a substantial degree of market power. This is because the specific reference in paragraphs (b)(i) and (b)(ii) to the constraints exerted on a corporation by its competitors or potential competitors, or its customers or its suppliers, risks ascribing those particular factors an importance over and above other important considerations and dynamic factors which are relevant to the assessment of substantial market power - such as the level of imports and the height of barriers to entry.

If a court were to attribute a particular importance to the constraints a corporation faces from its competitors, customers, or suppliers, but a lesser importance to other factors, this could have the effect of lowering (even if unintentionally) the threshold of what constitutes a "substantial market power". In turn, the competitive process may be dampened, if corporations were to become more risk averse and less willing to engage in vigorous, legitimate competitive conduct.

Until there is a body of case law which interprets this provision, thereby providing businesses with guidance on how this provision operates in practice, we consider that there is some uncertainty as to how subsection 46(3C) would operate and, moreover, a risk that subsection 46(3C) is overly prescriptive.

The BCA's preference is therefore to substitute the current proposed subsection 46(3C) with wording that carries less prescription and therefore less risk of unintended consequences. Alternative wording for subsection 46(3C) and 46(3B) is proposed as follows:

*Section 46(3C)*

"*For the purposes of this section, a corporation may have a substantial degree of power in a market where:*

*(a) the corporation does not substantially control the market; or*

*(b) the corporation is not absolutely free from constraint in the market."*

This subsection would be supplemented with clarification:

*Section 46(3B)*

*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.*

If the proposed amendments in the bill are introduced without change (and in particular without change to subsection 46(3C)), the BCA requests the government to provide very clear information in the explanatory memorandum to the bill about the operation of these provisions, and to clarify that the intention of the proposed changes is not to lower the threshold of what is a substantial degree of power in the market.

In addition, the BCA strongly opposes any further amendments to the TPA, such as those proposed by Senator Fielding and Senator Barnaby Joyce. The BCA's specific concerns regarding these proposals are outline in detail below.

**Trade Practices Amendments (Predatory Pricing) Bill 2007 (Predatory Pricing Bill)**

Senator Fielding introduced the Predatory Pricing Bill with the intention of prohibiting predatory pricing by a corporation in various markets such for groceries, a market for the sale of fuel, and a market for pharmaceutical products, proprietary medicines and toiletries.

The BCA has significant concerns about this bill and strongly opposes its implementation. Significant uncertainty is introduced by the proposal for multiple reasons, including through the adoption of a sectoral approach which is discredited by the OECD.[4] and the introduction of new and problematic definitions and concepts. The bill also goes well beyond the scope of the TPA.

The effects of uncertainty in predatory pricing laws have been recognised overseas, and in particular in the recent United States Supreme Court decision *Weyerhaeuser Co v Ross-Simmons Hardwood Lumber Co. Inc (2007)* delivered on 20 February 2007. In reviewing the proposals contained in the Predatory Pricing Bill, it is worthwhile revisiting the overall concerns expressed in that decision. In that decision the US Supreme Court dealt with a predatory buying case and restated the position in *Brooke Group Ltd v Brown & Williamson Tobacco-Corp* 509 US 209 in relation to misuse of market power by predatory pricing. The US Supreme Court noted that:

> *"We described the two parts of the Brooke Group test as 'essential components of real market injury' that were 'not easy to establish' Id., at 226. We also reiterated that the costs of erroneous findings of predatory pricing liability were quite high because '[t]he mechanism by which a firm engages in predatory pricing - lowering prices - is the same mechanism by which a firm stimulates competition', and therefore, mistaken findings of liability would "chill the very conduct the antitrust laws are designed to protect."*

Senator Fielding's proposals introduce significant uncertainty and subjectivity into the law, ultimately placing at risk ordinary business behaviour and potentially coming at a cost to consumers.

The BCA therefore strongly opposes the bill as it risks stifling the very competition that the laws are supposed to encourage and support.

### *Sectoral approach*

The identification of sectors in the bill goes against the objectives of the TPA and the approach in which behaviours are to be judged on a case-by-case basis, and analysed according to the individual circumstances. There are businesses that operate in different markets and different products or services, and behaviours will be influenced by multiple factors including competitive pressures, economic environment, business cycles and environmental conditions. Accordingly a sectoral approach to the TPA provisions is unduly prescriptive and fails to achieve the aims of the TPA in terms of ensuring that all factors are considered when examining individual cases.

### *Substantial financial power*

At present the TPA prohibits companies misusing 'a substantial degree of power' in a market. The aim is to prevent companies that have such a power, from behaving in a way that is deliberately trying to harm competitors, or the competitive process.

The introduction of a new concept of 'substantial financial power' will be very problematic for business. This is a concept that is uncertain, and could potentially capture organisations that are not intended to be captured by the TPA.

[4] For example, see OECD *Guiding Principles for Regulatory Quality and Performance 2005*- Principle 5.

A primary goal of the competition laws must be to create clear standards, such as what is meant by substantial market power. Business must be able to understand and identify those standards so they can understand what behaviours are appropriate. If the standards are uncertain, then this may stifle legitimate business conduct. Likewise, competition regulators can only enforce standards if there is clarity and certainty in their application and operation.

For example, Senator Fielding's proposal involves a suggestion that:

> "*Predatory pricing occurs when a corporation that has a substantial degree of power in a market, or substantial financial power in a market, offers goods or services for sale in a market at unreasonably low prices, with the purpose or effect of substantially lessening competition in that market or the purpose or effect of eliminating competitors*."

The concepts of 'substantial financial power' as well as 'unreasonably low prices' do not provide clear and predictable guidance to business, the Courts or regulators. The concept of 'unreasonably low prices' is discussed separately below.

The concept of 'substantial financial power' is not one that has previously been considered in Australian competition laws. This concept has the potential to capture many types of businesses, for example, based on an ability to obtain loans or access to significant superannuation or life savings. It is equally unclear whether the concept of "substantial financial power" would extend to a corporation's parent company, or to the wealth of industrial proprietors who have the same role as parent companies. Large and small business may satisfy these forms of financial criteria. The hypothetical scenario outlined in Box 1 below highlights the potential for ordinary business conduct to be captured by the concept of 'substantial financial power'.

**Box 1: Farm Fresh Greengrocers Pty Limited**

Farm Fresh Greengrocers is one of the largest fruit and vegetable stores in Australia. Farm Fresh Greengrocers is ultimately owned by the wealthy Smith family, which is a significant land owner and also has a number of other business interests. Last year, Mr Smith was ranked as one of Australia's richest individuals.

While Farm Fresh Greengrocers owns a large number of outlets throughout the country, it accounts for an estimated market share of only 20%. That being said, Farm Fresh Greengrocers enjoys a solid negotiating position vis-à-vis its suppliers and purchases most of its products from suppliers at a discount. Farm Fresh Greengrocers is also highly efficient and as a result, it is able to keep its costs down. There are a number of other key players in the market, which is characterised by vigorous competition between Farm Fresh Greengrocers and its competitors. A key area of competition between Farm Fresh Greengrocers and its competitors is in relation to mandarins.

Due to an unexpectedly good mandarin crop and an oversupply of mandarins, a price war has erupted between Farm Fresh Greengrocers and its competitors. As a result of the extremely low prices charged for mandarins for the duration of the mandarin season, one of Farm Fresh Greengrocers' competitors is forced into liquidation. However, Farm Fresh Greengrocers survives, largely for the reason that the Smith family provided substantial financial assistance to the company.

Under the current approach to section 46, even assuming Farm Fresh Greengrocers has substantial market power, Farm Fresh Greengrocers' conduct is unlikely to constitute predatory pricing. Courts have recognised that corporations often price below their cost as part of vigorous competitive behaviour and in response to market factors. Such pricing can be pro-competitive and enable consumers to benefit from low prices.

By contrast, under the proposed amendments in the Predatory Pricing Bill, there is considerable uncertainty as to whether Farm Fresh Greengrocers has "substantial financial power", by virtue of its access to financial assistance. This uncertainty therefore exposes Farm Fresh Greengrocers to the risk that its pricing conduct might constitute predatory pricing.

As a consequence, corporations which ostensibly have "substantial financial power", such as Farm Fresh Greengrocers, may be reticent to engage in vigorous, competitive conduct, which may be construed as anti-competitive. In turn, this is likely to have a "chilling" effect on the competitive process, to the detriment of consumers.

### *Unreasonably low prices*

The introduction of a definition of 'unreasonably low prices' introduces a very subjective and uncertain concept into the legislation. The introduction of a concept with such a high degree of subjectivity means that the threshold for when a company is engaging in predatory pricing is likely to be lowered. This has the potential to capture ordinary business behaviour, and therefore cannot be supported.

A broader economic perspective of the aims of the TPA must be considered when assessing proposed amendments to our competition laws. Proposed amendments must be considered in light of promotion of healthy competition and ordinary business behaviour, and the flow on benefits to Australian consumers and Australia in general, rather than primarily in terms of what is "good for small business".

In assessing proposed amendments to legislation, the government has recognised that the benefits must outweigh the costs. Accordingly, the legislation should not come at an unreasonable cost to consumers who are the ultimate beneficiaries of efficient and healthy competition. The promotion of healthy competition means that to be successful companies must innovate, adapt and provide the best possible service to consumers. If competition laws prevent desirable competitive behaviour such as innovation and competition, then ultimately consumers will suffer, in the form of higher prices and less product differentiation.

A balance must be sought in the predatory pricing provisions to ensure that only businesses that have little constraint on their behaviour and "misuse" such power are caught by the provisions. For example, if large businesses need to offload old stock at discounted prices, then they should be able to do so without recrimination from the law. If the legislation goes too far, by introducing a concept of 'unreasonably low prices' then consumers may no longer be able to benefit from buying discounted stock or participating in "sales".

In addition, ordinary pricing differentials may be captured. Consumers should be able to benefit from lower prices which can be offered by larger organisations because of their ability to capture economies of scale. For example, a recent study of grocery

prices in NSW by the consumer organisation Choice showed that the most expensive supermarket chain was IGA, with Coles and Woolworths being cheaper than that chain.[5] Consumers will suffer if organisations are forced to standardise prices due to the uncertainty created by what is meant by 'unreasonably low prices'.

The hypothetical example in Box 2 below demonstrates that ordinary discounting could be captured by the concept of 'unreasonably low prices'.

**Box 2: Chic Convenience Stores Pty Limited**

Chic Convenience Stores is a large chain of upmarket convenience stores, located primarily in Melbourne's CBD and surrounding areas. Chic Convenience Stores, which sell groceries and toiletries, cater primarily for young professionals, who have high disposable incomes and enjoy the benefits of inner city living. The "flagship" store is located close to the Docklands Area, its key customers being the residents of the nearby apartments.

Chic Convenience Stores competes with other convenience stores and specialist grocery outlets (such as delicatessens) within very small geographic markets. This is because most customers do not own cars and will only shop at convenience stores, or other grocery retailers, within a short walking distance of their homes. For this reason, Chic Convenience Stores tends to have a reasonably high market share of at least 40% in each of the geographic markets in which it operates.

Based on some research into consumer shopping patterns, Chic Convenience Stores at Docklands recently introduced a line of chilled convenience foods, believing that the new product line would be a success with its core customer base. However, the new product line does not prove to be popular, given the high number of reasonably priced restaurants in the locality. As a result, the new product line is unprofitable and Chic Convenience Stores decides to discontinue the product line once existing stocks have been sold.

Given that the chilled convenience foods are perishable, Chic Convenience Stores decides to reduce the prices of the product significantly, in order to clear stocks and to create refrigerated cabinet space for other, more profitable product lines. Chic Convenience Stores does so, even though the prices charged will be less than their cost.

Under the current approach to section 46, even assuming Chic Convenience Stores has substantial market power, the conduct of Chic Convenience Stores is unlikely to constitute predatory pricing. Courts have recognised that corporations often price below their cost for legitimate commercial reasons, such as sales of perishable goods.

By contrast, under the proposed amendments in the Predatory Pricing Bill, there is serious uncertainty as to whether Chic Convenience Stores' conduct would constitute predatory pricing. Under the bill, there is a risk that Chic Store's pricing conduct may constitute offering goods for sale at "unreasonably low prices". Accordingly, there is a risk that Chic Convenience Stores' conduct, even though it was limited in time and in response to consumers' expenditure patterns, may

[5] Kelly Burke, *NSW shoppers paying more at the supermarket*, Sydney Morning Herald, 2 July 2007, page 3

constitute predatory pricing. The proposed amendments may therefore lead industries with perishable or time sensitive goods being disadvantaged.

***Effect of substantially lessening competition, or purpose or effect of eliminating competitors***

The TPA should only capture behaviour that is deliberate and unconscionable in intention. The proposed amendments introduce a focus on the 'effect' of behaviour in a market but there are some forms of legitimate business conduct such as the traditional Australian stock clearance or sales in December or June that may have an unintended effect on other competitors. Stifling this sort of conduct would have a detrimental effect on consumers.

Indeed, the Dawson Inquiry concluded that the addition of an effects test would increase the risk of regulatory error and render "purpose" ineffective as a means of distinguishing between pro-competitive and anti-competitive behaviour. The Dawson Inquiry also noted that overseas experience, insofar as it is of assistance, did not indicate that the introduction of an effects test in Australia would be appropriate.

The hypothetical example in Box 3 below, highlights that focusing on the 'effects' of behaviour may capture ordinary business conduct.

**Box 3: Bill's Pharmacy**

Suzy's Chemist and Olivia's Pharmacy are the only two pharmacies located in a large, country town approximately two hours from Sydney. Suzy's Chemist and Olivia's Pharmacy are the only pharmacies in the area. For this reason, the goods and services that they supply are in incredibly high demand. As a result, the levels of service could be much improved and their prices are well in excess of prices for comparable products retailed in Sydney.

Bill's Pharmacy is a franchise with several hundred pharmacies throughout Australia. Realising that there was a high demand for a new pharmacy in the town in which Suzy's Chemist and Olivia's Pharmacy operate, Bill's Pharmacy recently opened a large pharmacy in the town. Bill's Pharmacy also transferred several of its staff from other pharmacies to work in the newly opened outlet to ensure that its service levels would be superior to those offered by Suzy's Chemist and Olivia's Pharmacy.

In order to attract customers away from the incumbent pharmacies to its new store, Bill's Pharmacy offered a number of product lines at promotional prices, which were less than its costs. As a result of that pricing strategy, as well as the high levels of service, a significant proportion of customers switch permanently to Bill's Pharmacy. Once established, and to ensure pricing was consistent with Bill's Pharmacy national pricing policy, the new Bill's Pharmacy outlet increased its prices by more than 10%. The prices its charges for its goods and services were still lower than the prices offered by Suzy's Chemist and Olivia's Pharmacy for comparable goods and services. However, as Suzy's Chemist had not been operating efficiently for some time and was unable to compete with the prices offered by Bill's Pharmacy during the introductory period, Suzy's Chemist went into liquidation approximately nine month's later.

Under the current approach to section 46, even assuming that Bill's Pharmacy has substantial market power, the conduct of Bill's Pharmacy is unlikely to constitute predatory pricing. Courts have recognised that corporations often price below their

costs as part of vigorous competitive behaviour. Such pricing can be pro-competitive and, as in this example, enable consumers to benefit from low prices.

By contrast, under the proposed amendments in the Predatory Pricing Bill, there is serious uncertainty as to whether Bill's Pharmacy engaged in predatory pricing.

There is an argument that the ***effect*** of Bill's Pharmacy's conduct was on substantially lessening competition, or the ***effect*** of that conduct was to eliminate competitors - either of Suzy's Chemist or Olivia's Pharmacy. Accordingly, there is a risk that Bill's Pharmacy's conduct may be caught by the Bill, even though Bill's Pharmacy's conduct has also been to improve the welfare of consumers by stimulating price competition.

The proposed amendments may therefore stifle competition.

**Conclusion**

The BCA welcomes the opportunity to make written contributions in relation to the proposed amendments.

While the BCA believes that amendments to section 46 of the TPA are not required, the BCA also recognises the significant community pressure for clarification and codification of the laws. Accordingly, if the proposed amendments contained in the *Trade Practices Legislation Amendments Bill (No.1) 2007* are implemented, then the BCA strongly recommends changes to subsections 46(3B) and 46(3C) as outlined above. If the proposed amendments in the government's bill are introduced without change (and in particular without change to subsection 46(3C)), then the BCA requests that the government provides very clear information in the explanatory memorandum to the bill about the operation of these provisions, and that the intention is to codify the law and not to lower the thresholds contained in the provisions.

The BCA strongly opposes any changes such as those outlined in the *Trade Practices Amendments (Predatory Pricing) Bill 2007* proposed by Senator Fielding. Senator Fielding's proposals introduce significant uncertainty and subjectivity into the law and go beyond the scope of the aims of the competition laws, ultimately placing at risk ordinary business behaviour and potentially coming at a cost to consumers. In addition, while the amendments proposed by Senator Joyce are not a part of the terms of reference for this inquiry, the BCA also opposes those proposed amendments for similar reasons.

If you have any further questions or require any additional information, please contact me or Leanne Edwards, Assistant Director – Regulatory Affairs on (03) 8664 2614.

Yours sincerely

**Melinda Cilento**
Acting Chief Executive