Law Council
OF AUSTRALIA

The Hon Chris Bowen MP
Assistant Treasurer and Minister for
Competition Policy and Consumer Affairs
Parliament House
Canberra ACT 2600

Dear Minister,

Proposed Amendments to section 46 of the *Trade Practices Act 1974*

I have pleasure in enclosing a submission regarding proposed amedments contained in the Exposure draft of the Trade Practices Legislation Amendment Bill 2008.

The submission has been prepared by the Trade Practices Committee of the Business Law Section of the Law Council of Australia. Owing to time constraints, the submission has been approved by the Executive of the Business Law Section but has not been reviewed by the Directors of the Law Council of Australia.

The submission addresses two key issues. First, that the Federal Magistrates Court is an inappropriate forum for cases regarding section 46 and, second, difficulties with amendments to section 46(1AA) and the proposed section 46(6A).

GPO Box 1989, Canberra,
ACT 2601, DX 5719 Canberra
19 Torrens St Braddon ACT 2612

Telephone **+61 2 6246 3788**
Facsimile +61 2 6248 0639

Law Council of Australia Limited
ABN 85 005 260 622
www.lawcouncil.asn.au

If you wish to discuss any aspect of the submission, please contact the Committee Chair, Professor Bob Baxt AO, on 03-9288 1628.

Yours sincerely,

Bill Grant
Secretary-General

16 June 2008

Enc.

Introduction

The Trade Practices Committee of the Law Council of Australia is pleased to make a submission on two aspects of the proposed amendments to section 46 of the Trade Practices Act as contained in the Exposure Draft of the Trade Practices Legislation Amendment Bill 2008:

(1) the appropriateness of the Federal Magistrates Court as a forum to hear cases regarding section 46; and

(2) amendments to section 46(1AA) and the proposed section 46(6A).

Section 46 cases to be heard in the Federal Magistrates Court

1. The Government's suite of foreshadowed competition law changes includes amending the legislation "so that appropriate section 46 cases can be heard in the Federal Magistrates Court. The simpler and relatively less costly processes available in the Federal Magistrates Court would assist in the access to justice for many smaller claimants".

2. It would seem that the Government's objective is to make remedies for breach of s 46 more accessible for lower cost to small business. Achievement of the Government's objective would be exceedingly difficult.

3. Of all the provisions of Part IV of the Trade Practices Act, s 46 has proved to be the most difficult. It is arguable that its history is that of a provision the complexity of which has rendered it effectively unenforceable in its present form. The proposed amendments aspire to address this, but it is beyond a reasonable aspiration that they will remove all the problems of enforcement.

4. It is the core jurisdictional policy of Part IV at present, and has been since 1974, that competition law issues should be tried exclusively in the Federal Court. Whatever the measure of success of that policy may be thought to be, it remains central and has not been displaced by the Rudd Government.

5. It is difficult to make a principled case for the concept that all of Part IV should remain within the exclusive jurisdiction of the Federal Court except for jurisdiction under the section which has proved the most difficult and complex.

6. Even if such a case could be made, the central premise upon which the Government proposal is based is that conferring jurisdiction upon the Federal Magistrates Court will reduce costs. The premise is not self evident.

7. Any s 46 case worth the name commenced in the Federal Magistrates Court would be likely to end up on appeal in the Federal Court. It is conceivable that it would have numerous appellate visits there on interlocutory skirmishes. The potential exists for costs and delays to be increased by reason of proceedings having been begun in the Federal Magistrates Court.

8. The proposal does not appear to contemplate a Part IV claim only part of which relied upon s 46. Presumably the Government does not intend to give the Federal Magistrates Court an "accrued" jurisdiction over the whole of Part IV and presumably therefore in such cases the s 46 claim could not practically be brought in the Federal Magistrates Court. In a case where non s 46 issues arose after commencement, presumably the whole case would have to go to the Federal Court.

9. This gloomy prognosis does not take account of another variable. There is no significant experience in the Federal Magistrates Court of trying Part IV cases, much less s 46 cases. The propensity for error must be higher because of both lack of experience and lack of core competence. Judicial error leads to increased costs.

10. Reverting to the Government's ambition, it might be possible for a Part IV case to be tried in the Federal Magistrates Court efficiently if the trial were conducted under directions of the Federal Court, or if the trial were limited to findings of fact which could be reported to the Federal Court, as if by an assessor. Neither of these possibilities would be very attractive to an experienced litigator or judge, because of the inherent dangers of separating fact finding from law finding, to name just one problem. It might however be significant that the Government, in announcing the change used the expression "heard" in the Federal Magistrates Court.

11. It is possible to imagine cases in which there was no issue about whether the conduct was a use of market power for the requisite purpose, but such cases are very uncommon. In such cases, commencing in the Federal Magistrates Court would save a small business costs. The saving would be modest however, and the occasions so rare that from a policy standpoint, any gain would be illusory.

12. In our view, more work needs to be done before the Government's ambition of giving small business low cost access to s 46 enforcement proceedings can be achieved. That work needs to start with a more effective simplification of the requirements of s 46 than the current amendments achieve.

13. There is one area however in respect of which a claim in the Federal Magistrates Court might be well justified and that is in the area of coattail damages for victims of conduct in respect of which the ACCC has obtained a judgment of the Federal Court. The case for such claims to be brought in the Federal Magistrates Court is much more compelling. Damages could not exceed the jurisdictional limit of the Federal Magistrates Court ($750,000).

Amendments to section 46(1AA) and the proposed section 46(6A)

1. The Law Council has reviewed the Exposure Draft and identified a number of concerns with the proposed amendments contained in subsections 46(1AA), 46(1AB) and 46(6A) of Schedule 1. The same concerns apply to Schedule 2.

Section 46(1AA) – pricing below cost which takes advantage of substantial market power

2. In the Law Council's view, s 46(1AA) should simply be repealed, rather than amended.

3. The existing s 46(1AA) prohibits below cost pricing for a proscribed purpose whether or not it takes advantage of substantial market power. The Law Council considers that such test is fundamentally flawed and contrary to s 46(1).

4. The proposed amended s 46(1AA), whilst removing this flaw, introduces another, by providing:

> *A corporation that has a substantial degree of power in a market must not take advantage of that power in that or any other market by supplying or offering to supply goods or services for a sustained period at a price that is less than the relevant cost to the corporation of supplying such goods or services for the purpose of ...*

5. Thus s 46(1AA) will in effect mean that sustained below cost pricing by a corporation with substantial market power *will* take advantage of that power where it is accompanied by a proscribed purpose. Such a test is unsound.[1]

6. All firms cut prices in order to win sales from their competitors and damage them. As was stated by Easterbrook J in *AA Poultry Farms Inc v Rose Acre Farms Inc*[2]:

> *"Firms 'intend' to do all the business they can, to crush their rivals if they can ... a desire to extinguish one's rivals is entirely consistent with, often is the motive behind, competition."*

7. Consequently, if the section deems a taking advantage of substantial market power where a corporation engages in sustained below cost pricing, the only serious issue will be whether the corporation has a substantial degree of market power.

8. The ability to cut prices, even to below costs, does not of itself indicate market power.[3]

9. Below cost pricing may indicate market power where it does not reflect market forces of supply or demand.[4] Or such pricing may instead be a competitive response to market conditions by a firm without market power. For example, in a highly competitive market

[1] On the other hand, if the section is intended to mean that sustained below cost pricing by a corporation with substantial market power *may* take advantage of market power where accompanied by a proscribed purpose but does not necessarily do so, it is ambiguous. If the latter construction is intended, then the section does not add anything to the existing law and is unnecessary.

[2] 881 F.2d 1396 at 1401-2 (1989).

[3] See for instance, *Boral Besser Masonry Ltd v ACCC* (2003) 215 CLR 374 at 420 and at 468.

[4] *Boral Besser Masonry Ltd v ACCC* (2003) 215 CLR 374 at 460.

suffering from excess industry capacity, excess supply may cause market prices to fall below competitors' costs. Far from reflecting the existence or use of substantial market power, the below cost pricing may merely signify that no competitor has the ability to raise its prices above its costs.

10. Likewise, where a firm has a substantial degree of market power, below cost pricing (even on a sustained basis) of itself does not demonstrate a taking advantage of that power. Even where below cost pricing is accompanied by the purpose of damaging competitors and one or more competitors do exit the market, it is wrong to conclude from those facts alone that it had substantial market power or took advantage of it.[5] Before such a conclusion can be reached, market conditions must be examined and the below- cost pricing shown to be independent of, rather than responsive to, them.

11. A corporation with substantial market power may need to price below its costs to meet the market, e.g. to meet a competitor's price where that competitor has a lower cost structure. The proposed s 46(1AA) would have the perverse operation that, where two firms had substantial market power and both intended to win sales from the other and each charged the same price, the firm whose price was below its costs would contravene the section while the firm whose price was above its costs would not. In the Law Council's view, such an outcome is contrary to the object of the Trade Practices Act and benefits neither consumers nor the competitive process.

12. As McHugh J held in the *Boral Besser Masonry Ltd v ACCC*[6] in rejecting an argument that below cost pricing should itself suffice for a contravention of s 46:

> *"...what is required is not a bright line rule about costs but a more sophisticated analysis of the firm, its conduct, the firm's competitors, and the structure of the market not only at the time in which the firm has engaged in conduct allegedly in breach of the Act but also before and after that conduct."*

13. Accordingly, the Law Council considers that s 46(1AA) should be repealed and should not be replaced with the proposed provision. Section 46(1) and s 46(3) provide sufficient statutory guidance for courts to address anti-competitive pricing behaviour. For the same reason, s 46(1AB) should also simply be repealed.

Section 46(6A)

14. This proposed provision permits the Court to have regard to the following factors in determining whether the Corporation has taken advantage of its substantial market power:

    a) whether the conduct was materially facilitated by the corporation's substantial degree of power in the market;

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[5] As the High Court reasoned in *Boral Besser Masonry Ltd v ACCC* (2003) 215 CLR 374 at 420.

[6] (2003) 215 CLR 374 at 462.

b) whether the corporation engaged in the conduct in reliance on its substantial degree of power in the market;

c) whether it is likely that the corporation would have engaged in the conduct if it did not have a substantial degree of power in the market;

d) whether the conduct is otherwise related to the corporation's substantial degree of power in the market.

15. The Law Council considers that the criteria in 46(6A)(a) and (c) merely codify principles of law established by the several High Court decisions interpreting s 46. No worthwhile purpose is served by codification of these principles.

16. In relation to s 46(6A)(b) and (d) the Law Council considers that these criteria should not be incorporated into the legislation because they are unsound in principle, susceptible of differing interpretations, and likely to lead to uncertainty and error in the application of s 46(1).

17. In the Law Council's view it would be preferable to retain s 46(1) in its present form rather than superimposing the criteria proposed in s 46(6A). Alternatively, only criteria (a) and (c) of the present draft s 46(6A) should become law.

Section 46(6A)(a) – the materially facilitated criterion

18. In relation to proposed s 46(6A)(a), the High Court has already addressed the "take advantage" element by asking whether the observed conduct is materially facilitated by a corporation's substantial degree of market power. In *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd*[7] the High Court accepted that there may be a taking advantage of market power where the freedom from competitive constraint makes it possible or easier to refuse supply. In the *Rural Press* decision[8] the High Court applied a test of whether the alleged contravening conduct "was materially facilitated by the market power." The Dawson Committee made similar observations.

19. Consequently, while the Law Council accepts that a relevant inquiry is whether the corporation's conduct was materially facilitated by its substantial degree of market power, that inquiry is already part of the present law.

Section 46(6A)(b) – the reliance criterion

20. In the Law Council's view, proposed s 46(6A)(b) should preferably be removed from the Exposure Draft or else be modified.

21. Whilst a corporation may, by "relying" on market power, use or take advantage of it, the concepts are not necessarily identical. Conceivably, conduct may rely upon substantial

[7] (2001) 205 CLR 1 at 27.

[8] (2003) 216 CLR 53 at 76.

market power without either taking advantage of it or being causally related to it, just as it is possible to rely on something by placing trust or confidence in it without using it or taking advantage of it. The notion of "reliance" may also lead to an erroneous inquiry as to the corporation's subjective motivation in considering the taking advantage element. It is not to the point, for example, that a corporation *believes* that it has substantial market power or that it *believes* that it is taking advantage of its market power. As both inquiries are concerned with objective matters and not the subjective beliefs of the corporation, the question is whether, in fact, the corporation took advantage of its market power.

22. Further, there are many degrees of reliance and the provision fails to specify what degree of reliance should be considered relevant.

23. If "reliance" is to remain in the amended s 46(6A), consistently with the "materially facilitated" criterion in s 46(6A)(a), the provision should be expressed in terms of *material* reliance. Even then, however, it is unclear why Courts would be assisted by asking whether conduct materially relies upon market power, as opposed to simply asking whether the conduct was materially facilitated by, or took advantage of, it.

Section 46(6A)(c) – the counterfactual criterion

24. In relation to proposed s 46(6A)(c), the Law Council notes that a "counterfactual" test is already part of the interpretation of s 46.

25. The counterfactual test developed by the Courts addresses the issue of whether or not the corporation took advantage of its market power by asking whether or not the corporation engaged in conduct that it would be highly unlikely to engage in or could not afford for commercial reasons to engage in if it was operating in a competitive market, i.e. one in which it lacked substantial market power.

26. The proposed section 46(6A)(c) provision is framed in terms of "would". The decisions in *NT Power Generation Pty Ltd v Power and Water Authority*[9], *Queensland Wire*[10], *Rural Press* [11], and *Melway*[12], do not support the use of "would" as opposed to "could". For example, in *Melway* the High Court concluded that "the real question was whether, without its market power, Melway could have maintained its distributorship system." In *Rural Press,* the High Court expressly rejected the argument that the counterfactual test should be framed as one of "would" rather than "could."

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[9] (2004) HCA 48.

[10] (1989) 167 CLR 177 at 192: "it was only by virtue of its market power that "BHP can afford, in a commercial sense, to withhold Y-bar...If BHP lacked that market power – in other words if it were operating in a competitive market – it is highly unlikely that it would stand by, without any effort to compete, and allow the appellant to secure its supply of Y-bar from a competitor."

[11] (2003) 216 CLR 53.

[12] (2001) 205 CLR 1. There, the High Court noted that in refusing to supply Melway was not denying itself sales and "there was no justification for assuming in a competitive market it would be denying itself sales" (at 26).

27. Consequently, the Law Council recommends that this provision be amended to read:

> *whether it is likely that the corporation:*
>
> *(1) could or would have engaged in the conduct; or*
>
> *(2) could not have afforded for commercial reasons to engage in the conduct,*
>
> *if the corporation lacked a substantial degree of power in the market.*

Section 46(6A)(d) – otherwise related criterion

28. As to proposed s 46(6A)(d), the Law Council believes that the introduction of a test as to whether conduct is "otherwise related" to a corporation's market power will result in uncertainty and confusion, and potentially penalize competitive conduct.

29. Conduct may be "otherwise related" to market power despite the fact that the market power has not "materially facilitated" the conduct and despite the fact that a corporation could or would be likely to have engaged in that conduct in a competitive market.

30. As the High Court observed in *Rural Press,* the conduct of taking advantage of a thing is not identical with the conduct of protecting a thing.[13] Conduct which protects market power would be "otherwise related" to market power even though it does not take advantage or use it.

31. For example, a corporation which is the market leader and has substantial power in its market might develop a new and improved product which preserves its leadership and power in that market. By protecting or preserving its power in the market, the corporation's conduct is related to its power in the market in which it is operating. However, the connection is not causal. Innovation of products that consumers value is what firms do regardless of their existing power in the market. It is the very stuff of competition and good for consumers.

32. There is much to be said for the view that, for conduct to take advantage of market power, there must be a causal relationship between the market power and the conduct.[14] The mere fact that conduct is somehow "related" to market power does not necessarily entail a causal link between them. Two things may be related to each other otherwise than causally.

33. For the above reasons, the Law Council considers that the "otherwise related" criterion should not be included.

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[13] (2003) 216 CLR 53 at 76.

[14] In this respect, in *Natwest Australia Bank Ltd v Boral Gerrad Strapping Systems Pty Ltd* (1992) ATPR 41-196, at 40,644 French J held that "There must be a causal connection between the conduct alleged and the market power pleaded such that it can be said that the conduct is a use of that power."

34. If, however, the legislature is of a different view, s 46(6A)(d) should be amended to read:

> *whether the conduct is otherwise causally related to the corporation's substantial degree of power in the market.*

35. A remote or coincidental connection between conduct and market power should not suffice.