



Law Council
OF AUSTRALIA

Business Law Section

Mr Bruce Cooper
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Via email: s46framework@acc.gov.au

26 October 2016

Dear Mr Cooper,

Framework for Misuse of Market Power Guidelines

I have pleasure in enclosing a submission which has been prepared by the Competition and Consumer Committee of the Business Law Section of the Law Council of Australia in response to the Australian Competition and Consumer Commission's Framework for Misuse of Market Power Guidelines.

If you would like to discuss any aspect of this submission, in the first instance please contact the Committee Chair, Fiona Crosbie, via email: fiona.crosbie@allens.com.au or by phone: 02-9230 4383.

Yours sincerely,

Teresa Dyson, Chair
Business Law Section

Enc.

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Law Council
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Business Law Section

Submission of the Competition & Consumer Committee
Business Law Section
Law Council of Australia

Framework for Misuse of Market Power Guidelines

26 October 2016

Introduction

The Competition and Consumer Committee of the Business Law Section of the Law Council of Australia (the **Committee**) welcomes the opportunity to comment on the ACCC's Framework for Misuse of Market Power Guidelines, ahead of the proposed amendments to section 46 of the *Competition and Consumer Act 2010 (CCA)*.

As the ACCC will be aware, the Committee has made submissions to Treasury in relation to further potential amendments to the proposed form of section 46. These submissions have been framed on the basis that the form of section 46 proposed by the Harper Review Panel will be passed.

1 Responding to Section 4 of the Framework

The ACCC has expressed the objective of a misuse of market power prohibition to be 'to prohibit unilateral conduct by a corporation with substantial market power that interferes with the competitive process *by preventing or deterring rivals or potential rivals from competing on their merits*' (emphasis added).¹ Two important points arise from this:

First, the words highlighted suggest the protection of individual competitors, contrary to the statement two sentences later, that:

The objective is not to protect individual competitors. Conduct ... that harms an individual competitor should only be prohibited if it has a broader detrimental impact on the competitive process itself.

In the Committee's view, the words highlighted above should be deleted, or preferably replaced with the words, '... so as to prevent, hinder or lessen competition'. Such an amendment would tie the text back to the proposed form of section 46, and ensure that the interference with the competitive process referred to is properly understood.

Secondly, and more broadly, the Committee cautions the ACCC against adopting the expression 'conduct which interferes with the competitive process', to paraphrase the description of the conduct prohibited by section 46 (when undertaken by firms with substantial market power). This broad phrase encompasses many forms of conduct which should not be prohibited by the provision, including:

- (a) raising prices to supra-competitive levels (which provides an increased incentive for entry);
- (b) engaging in exclusive dealing (which does not substantially lessen competition); and
- (c) reducing prices to below the cost of less efficient operators (but not to predatory levels).

Rather, the Committee urges the ACCC to describe the conduct which will contravene section 46 in a way which more closely follows the text of the prohibition.

In the penultimate paragraph of section 4, the ACCC might also refer to the proposed form of section 46 as not prohibiting a firm with substantial market power from raising prices to supra-competitive levels.

2 Responding to Section 4.3 of the Framework

While the Committee acknowledges that the references to 'freedom' and 'independence' in the second paragraph in this section are drawn from the authorities, they are intrinsically absolute terms and may mislead the lay reader. In their place, the Committee suggests the amended text below:

¹ See page 4.

Market power comes from the lack of effective competitive constraint. A firm with substantial market power is able to act ~~with a degree of freedom substantially less constrained by~~ competitors, potential competitors, suppliers and customers, than would be the case in a competitive market. Substantial market power enables a firm to make decisions about its prices, product quality and production techniques ~~with a significant degree of independence from~~ less constrained by others in the market, than would be the case in a competitive market

Further on in section 4.3, the Framework cites a passage from the Trade Practices Tribunal in *QCMA*. This is helpful in describing the nature of competition – indeed, the passage is set out in the context of the Tribunal describing the nature of competition – as well as in the context of the Framework. However, the Committee urges the ACCC to include also in the Framework the immediately following paragraph from the Tribunal's *QCMA* decision, which goes to the primacy in this field of barriers to entry. The paragraphs reads:

Of all these elements of market structure, no doubt the most important is (2), the condition of entry. For it is the ease with which firms may enter which establishes the possibilities of market concentration over time; and it is the threat of the entry of a new firm or a new plant into a market which operates as the ultimate regulator of competitive conduct.

This passage is consistent with the view of the High Court of Australia in *Queensland Wire*, which is now orthodoxy, that barriers to entry are the 'sine qua non' of substantial market power.

3 Responding to Section 4.4 in the Framework

The final paragraph of this section reads:

In its assessment of the conduct under the proposed s.46, the ACCC will expressly take into account these statutory factors [set out in subsection 46(2)], along with other factors the courts have recognised as relevant to the substantially lessening of competition test. This would include whether there are legitimate business reasons for engaging in the conduct.

The last sentence of this passage is one of only very few references in the Framework to the ACCC assessing 'legitimate business reasons' for impugned conduct. It is not explained or amplified.

Given that the consideration of whether there are 'legitimate business reasons' for conduct under section 46 has sprung from an assessment of whether a firm has 'taken advantage' of its market power under the current form of section 46, it is not adequate for the ACCC to refer to this consideration in the context of the substantial lessening of competition test without a detailed analysis of how it will be assessed and why. This is potentially a contentious point legally. It is also an important point for any business or lay reader, if the ACCC is to administer the new provision with a clear regard to whether there are 'legitimate business reasons' for particular conduct.

4 Responding to Section 4.5 in the Framework

The first two paragraphs of this section should, in the Committee's view, underline more clearly that the facts of each situation matter, and that the categorisation of conduct in the manner suggested is simply that – not a pointer to conduct which is more likely to constitute a misuse of substantial market power.

The Committee suggests the following amendments:

It is not possible to identify with precision particular types of conduct that necessarily involve a misuse of market power. Whether or not conduct is a misuse of market power will always depend on the detailed factual context and circumstances.

However, while this is the case, some types of conduct which, when engaged in by a firm with substantial market power, may involve a misuse of that market power, have been categorised as

~~have been regarded by competition agencies and courts as having greater potential to involve the misuse of market power, either in isolation or combined. These include:~~

- refusal to deal
- predatory pricing
- tying and bundling, and
- margin/price squeeze.

In the text under the heading 'Refusal to Deal', we suggest the following amendment:

Businesses are generally entitled to choose unilaterally whether or not they will supply or deal with another firm, including a competitor.

The examples then given are unclear. Particularly, the reference to a 'key input' begs more questions than it answers, and the second bullet point has no regard to the firm with market power being more efficient than any of its 'competitors', such that supply to itself is more profitable than supply to a less efficient rival at a price which is not 'excessive'.

The text under the heading 'Predatory Pricing' should be amended along the following lines:

However, in rare circumstances, very low pricing by a ~~firm~~ seller with substantial market power may be ~~predatory a misuse of that market power. Predatory pricing~~. This may occur when a ~~firm~~ seller substantially reduces its prices below a measure of its own marginal cost of supply for a sustained period with the ~~aim purpose or likely effect of~~ substantially lessening competition in the downstream market, potentially by:

- causing competitors to exit the market;
- disciplining or deterring competitors from competing aggressively, or
- discouraging potential competitors from entering the market.'

These suggested amendments are intended to deal with the following important issues:

- (a) predation may also occur on the buy-side of a market and the text should accommodate that possibility;
- (b) pricing below a firm's 'cost of supply' should rarely substantially lessen competition, where that phrase is interpreted to mean 'total cost': the amended text above endeavours to deal with this issue in short form by an unspecific reference to 'a measure of ... marginal cost'; and
- (c) the proposed provision requires a 'substantial lessening of competition', and this element must be expressly referred to: otherwise the three bullet points may mislead as they all refer only to competitors (not to competition).

The text under the heading 'Margin/price squeeze' should be amended along the following lines:

First, the expression 'essential input' is not explained. Is this the same as a 'key input' referred to in the text relating to 'Refusals to Deal'? This important element must be made clear.

Secondly, the concept of relative efficiency is not set out in the description, nor is a substantial lessening of competition referred to. The Committee suggests the following amendments:

However, a ~~firm~~ seller with substantial market power in the supply of an essential input² can disadvantage its competitors in downstream markets by raising its sale prices to those competitors and reducing its prices in the downstream market. ~~reducing the margin available to these competitors. A contravention of section 46 could occur~~ it could do this, for example, by the seller

² For the reasons explained, the Framework would be more helpful if this term were explained and if terms with the same meaning were used consistently eg, 'key' input and 'essential' input (assuming these terms have the same meaning).

charging its competitors such a high an input price that makes it uncommercial for even the most efficient of such competitors ~~them~~ to offer a 'competitive' price in the downstream market, so as to cause a substantial lessening of competition in that market.

5 Responding to Sections 4.6 and 4.7 in the Framework

The Committee welcomes the provision of examples, by which the ACCC's approach and analysis can be explained. However, significantly more work is required on this section, in the Committee's view.

5.1 More accuracy and credibility

In the prefatory text to Table 1, the ACCC has stated that the examples it has given are 'highly simplified and stylised'. However, for the reasons that the ACCC has made clear in the Framework already (viz, 'whether or not conduct is a misuse of market power will always depend on the circumstances', per Section 4.5), simplified and stylised examples may be more likely to mislead than to offer reliable 'broad guidance'.

A case in point is the first example involving a 'cement works in a regional town'. Participants in the construction materials industries in Australia will be familiar with the manufacture and supply of cement in Australia – from several large kilns, imports and grinding facilities which compete across wide-ranging geographic markets.³ Where the example departs so substantially from reality as in this case, it will not serve to provide guidance to industry participants.

Equally, in the second example, if the 'major town' is nearby another town, it is likely that competition between retail petrol sites in those towns will constrain the firm. If the town is more isolated, it is likely that potential sites for retail fuel sites will be more readily available.

In the predatory pricing example, the context of a local newspaper being 'essential' to local businesses, and there being 'no close substitutes', is unlikely to be credible to many readers. Particularly, see the ACCC's own analysis and recent decision in relation to Seven West Media/Sunday Times,⁴ where the ACCC found that 'the various advertising alternatives, including online, radio and TV' imposed significant constraint on newspaper advertising.

5.2 Purpose

The Committee notes that the examples given are all, but one, cases in which the 'purpose' of the firm with substantial market power is determinative (even though there is also some regard as to the likely effect of the firm's conduct). This is a significant concern for the Committee and underlines the concerns expressed by the Committee on several occasions⁵, that misuse of market power cases may be brought by the ACCC where a firm with substantial market power has engaged in conduct which has the subjective purpose of substantially lessening competition in a market, but no such effect or likely effect need be alleged or established. It would be useful for the examples provided to be focused on the likely competitive effect of the conduct. This would reflect a principled approach to prosecuting conduct engaged in by a firm with substantial market power, which is to focus on conduct which is likely 'to harm the competitive process'.

5.3 More specific issues

- (a) More specifically in relation to the examples given in Table 1, the Committee comments as follows:

³ See for eg Public Competition Assessment, Boral/Adelaide Brighton, 12 May 2004, which referred to 'Australian markets for the supply of clinker and finished cement'.

⁴ See ACCC Press release 15 September 2016, and entry in the Mergers register.

⁵ See most recently, the submissions to Treasury on the Exposure Draft of the proposed form of section 46.

- (i) The 'land banking' example is more properly to be considered as a potential contravention of section 50. Its inclusion in this context is unexplained and potentially confusing to readers who are used to dealing with the ACCC in relation to acquisitions under section 50 and the ACCC's informal clearance process. Strategically, the ACCC may prefer to prosecute under the proposed form of section 46, where an anticompetitive effect (and hence a contravention of section 50) may be difficult to establish – but that possibility is not referred to.
 - (ii) Further, in the 'land banking' example, there is a reference to whether the firm has a 'legitimate business reason for acquiring the sites'. This is not explained and yet is obviously an important integer. The Committee urges the ACCC to expand on this concept clearly.
 - (iii) In the 'predatory pricing' example, there is a reference to revenues not 'cover(ing) its costs of printing and distributing its newspaper'. If this is intended to be a reference to the variable or avoidable costs of supplying a newspaper (omitting the administrative and journalist overheads), it would be useful for this to be explained more clearly. Business readers will be particularly interested in the ACCC's proposed approach to price reductions by powerful firms, with a useful 'bright line' for compliance purposes being a measure of cost which can be applied by business. Once again, also, the notion of a 'legitimate business reason for the conduct' is referred to but not explained.
- (b) Some similar issues arise from the examples in Table 2. Specifically:
- (i) In the example entitled 'Standardised or national pricing by large retail chains', the context is clearly described as the firm 'set(ting) the same retail prices at all of its retail stores, including at the new store', even though the new store has been established 'in a regional town'. In that context, there may be quite different costs in terms of rental and payroll (likely to be lower) and product delivery (likely to be higher), and the product range may be smaller and different. In that context, it is odd that the ACCC's analysis hangs on the requirement that the 'retail chain has had an established practice of offering customers at all of its stores a standardised range with standardised prices'. In the Committee's view, it is more likely to be properly to the point as to whether the pricing of the store is 'predatory' (ie, at prices below its total costs, on any view).
 - (ii) In the example entitled 'Investing in new production technology to increase efficiency', the context is described as the incumbent firm first investing in new production technology and then secondly reducing its prices. This suggests that the ACCC will look to the firm maintaining its margins, rather than reducing its margins in offering lower prices. However, drawing from the 'predatory pricing' example in Table 1, the key element was that the firm had reduced its prices so as not 'to cover the costs of printing and distributing the newspaper'. This example in Table 2 simply invites the inquiry whether the firm would escape liability without having made the investment posited, but had reduced its margins/prices to levels which remained profitable. Consistency of analysis along these lines is likely to be helpful for most readers.

In conclusion on these issues, the Committee suggests that the examples be worked around the context and detailed facts of previous cases across these categories, but with an analysis applied which refers to the proposed new provision. By taking this approach there may be less risk of overly stylised factual context or a lack of clarity on several important concepts, and more utility for readers.

6 Responding to Section 5 in the Framework

The Committee strongly supports the ACCC's proposed approach to focus 'on the extent to which matters will, or have the potential to, harm the competitive process or result in widespread consumer detriment', and the stated factors which the ACCC will identify in doing so.