



Australian
Competition &
Consumer
Commission

Targeted Review of the Commerce Act 1986

Australian Competition and
Consumer Commission
submission

Ministry of Business, Innovation
and Employment, New Zealand

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Executive Summary

Competition law recognises that the conduct of firms with substantial market power can, in some circumstances, damage the competitive process.

It is a natural consequence of robust competition that more efficient firms damage less efficient firms by attracting customers and increasing their market share. This is a reality for small, medium and large businesses. Striving to grow, succeed and acquire market share and potentially market power is what encourages innovation, and firms should not be punished when they achieve it. Nor, having acquired market power, should they be prevented or discouraged from innovating further.

Section 36 of the *Commerce Act 1986* (CA) seeks to prevent firms with substantial market power from engaging in conduct that prevents other firms from competing on their merits, while ensuring that large or powerful firms are not prevented or discouraged from engaging in fierce competition themselves.

This submission responds to the issues raised in the *Targeted Review of the Commerce Act 1986 - Issues Paper - November 2015* (Issues Paper) in relation to section 36 of the *Commerce Act 1986* (NZ). The Issues Paper seeks views on the appropriateness of section 36, while expressing a preliminary view that the operation of section 36 has not been satisfactory. In particular, the Issues Paper has identified concerns with the operation of section 36 of the CA, in interpretation of the 'take advantage' test by the courts and through the focus of section 36 on the impact on individual competitors.

Australia's equivalent misuse of market power provision, section 46 of the *Competition and Consumer Act 2010* (CCA) is also the subject of a review. The text of the central provisions of section 36 of the CA and section 46 of the CCA are relevantly identical. Further, section 36A of the CA and sections 46A and 46B of the CCA contain a similar prohibition in relation to conduct in a trans-Tasman market. The central provisions are sections 36(2) CA, 46(1) CCA, 36A(2) CA, 46A(2) CCA and section 46(1) of the Competition Code. The trans-Tasman provisions are mutually extraterritorial. That is the New Zealand law operates within Australia's jurisdiction and vice versa. They were enacted to contribute to closer economic relations between Australia and New Zealand.

The Australian Competition and Consumer Commission (ACCC) makes this submission based on its experience enforcing section 46 of the CCA. Given the similarities between section 46 of the CCA and section 36 of the CA, the ACCC's views on the limitations of section 46 of the CCA may assist the Ministry for Business, Innovation and Employment (MBIE) in its review of the operation of section 36 of the CA.

In the ACCC's view, section 46 of the CCA is not fit for purpose (that is, to prohibit misuse of market power) for two reasons:

- i. The current section 46 fails to capture a range of anti-competitive conduct by firms with substantial market power. The Australian Courts have found that conduct by a firm with a substantial degree of market power does not involve a taking advantage of that power if a firm without substantial market power could engage in the same conduct. This ignores the very different consequences that can flow from the same conduct undertaken by a large firm versus a small firm in same the market.¹

¹ Stuck, Cross, Douglas Richards, Weber Waller, *Use of Dominance, Unlawful Conduct, and Causation Under Section 36 of the New Zealand Commerce Act: A U.S. Perspective*, (2012) 18NZBLQ, 'whether firms with or without market power would have engaged in that conduct does not necessarily preclude anticompetitive purpose or effect', noting the court in *Berkey Photo, Inc. v. Eastman Kodak Co* (603 F.2d 263, 275 (2nd Cir. 1979)), 'Such conduct is illegal when taken by a monopolist because it tends to destroy competition, although in the hands of a smaller market participant it might be considered harmless, or even "honestly industrial".'

- ii. The current purpose test in section 46 of the CCA is focussed on the impact of the conduct on individual competitors, not on the impact to the competitive process generally. This is inconsistent with the other sections of the CCA and the rationale for having competition laws, which is to protect the competitive process, not individual competitors.

As a consequence, there are important types of anti-competitive conduct by businesses with substantial market power which are not effectively prevented by the current section 46. Examples include most forms of strategic land banking, many retaliatory threats, capacity dumping and using regulatory and legal mechanisms to increase barriers to entry.

Other examples can be drawn from cases that have been successfully dealt with by misuse of market power provisions in other jurisdictions but would be unlikely to be caught by the current section 46 prohibition, due to the 'taking advantage' requirement. These include the US case against Microsoft to prevent it from forcing Windows users to install other Microsoft products and excluding alternative software, and the European Commission ongoing case against Google which alleges that Google systematically favoured its own comparison shopping product in its search results, thereby preventing other comparison shopping products from entering or participating effectively in the market.

Misuse of market power reduces the competitiveness of an economy. Accordingly, the ACCC has taken the view that reform of section 46 is a necessary step to address the failings in the current provision and to ensure that the CCA is fit for purpose.

The ACCC submission to the Australian Treasury consultation process *Options to strengthen the misuse of market power law* about section 46 of the CCA recommends that the failed take advantage test be replaced with a 'substantial lessening of competition' (SLC) test. This would shift the critical inquiry away from 'taking advantage' to whether the conduct of the firm with substantial market power had the purpose, effect or likely effect of SLC.

The substantial market power requirement will still confine the application of section 46 of the CCA to a small number of corporations, and the SLC test will ensure it only applies to anti-competitive conduct of those corporations. If powerful corporations are competing on their merits, and allowing other firms to compete on their merits, then the SLC test will not cause them any concern. Uncertainty and increased costs will be minimal as the SLC test is already used in the CCA. Corporations already make decisions based on this test every time they enter into a contract or engage in exclusive dealing.

The MBIE may wish to consider whether a similar removal of the take advantage limb and an introduction of an SLC test in section 36 and 36A of the CA would increase the effectiveness of the provisions.

Introduction

The ACCC is an independent statutory authority of the Commonwealth of Australia whose role is to enforce the CCA and a range of additional legislation, with the object of promoting competition, fair trading and regulating national infrastructure for the benefit of all Australians.

In parallel with the New Zealand review of section 36 of the CA, Section 46 of the CCA is currently under review by the Australian Government. The Australian Government announced a review of Australian competition policy on 4 December 2013 (the Review). The Review Final Report was released on 31 March 2015 and the Review has concluded. The Review panel made 56 recommendations covering competition policy, laws and institutional structures.

During consultation by the Review panel and subsequently, stakeholder opinions were divided on whether the current Australian misuse of market power provision is framed in a manner that is effective in deterring anti-competitive behaviour by firms with substantial market power. Many stakeholders supported the recommended amendments and many other stakeholders opposed any change in the provision. Given the diversity of views, the Australian Government announced that it would consult further on options to strengthen Australian misuse of market power provision. In December 2015 the Australian Government released a discussion paper discussing options to strengthen the misuse of market power law.

The current "take advantage of market power" provision – Section 36

A prohibition against misuse of market power is a crucial component of any effective competition law regime.

New entrants or 'challenger firms' and the prospect of new entry are critically important characteristics of most well-functioning markets. U.S. economist and judge Richard Posner has written that most truly exclusionary conduct is engaged in by what he termed the 'fragile monopolist' where substantial market power is under threat from actual or potential competition.² That has been the experience of the ACCC in many investigations it has conducted into the conduct of firms with substantial market power.

Firms with substantial market power can damage the competitive process by engaging in a range of conduct including refusals to supply other market participants, price-based exclusionary conduct (predatory pricing, loyalty rebates, bundling and price squeezes), conduct which raises the costs of rivals, vertical restraints and leveraging of market power across markets. This conduct is only prohibited by the current NZ and Australian provisions if the firm possesses a substantial degree of market power and has taken advantage of that power for the purpose of:

- restricting the entry of person into that or any other market; or
- preventing or deterring a person from engaging in competitive conduct in that or any other market; or
- eliminating a person from that or any other market.

The ACCC considers that there are two issues that limit the efficacy of section 46 of the CCA and mean that anti-competitive conduct by a firm with market power may not be caught:

² Richard A. Posner, 'Keynote Address: Vertical Restrictions and "Fragile" Monopoly' (2005) 50(3) *The Antitrust Bulletin* 499.

- First, the interpretation of the ‘take advantage’ element adopted by the Court. There has been an increased reliance in recent years by Courts on this element, by limiting it to actions that only businesses with that substantial market power could take.
- Second, the structure of section 46 is materially different to, and inconsistent with, the other competition provisions of the CCA that utilise an SLC test. Section 46 focusses on particular proscribed purposes which relate to harming individual competitors, rather than harming competition. This is at odds with usual competition principles because competition often involves harm to competitors. A move to an SLC test would provide more certainty and clarity, as well as harmonisation with other provisions in the CCA and increased consistency with most comparable overseas jurisdictions.

These issues are discussed in more detail below.

Take advantage

The Australian and New Zealand provisions both prohibit a firm with substantial market power from ‘taking advantage’ of that power for the specific anti-competitive purposes which relate to harming actual or potential rivals or otherwise limiting competitive conduct by those rivals.

However, that is exactly what occurs in well-functioning competitive markets. Firms engage in rivalrous conduct (such as price discounting, innovation, enhanced service delivery) with the purpose of winning customers at the expense of their rivals. Given this, it has been necessary for ‘take advantage’ to do the ‘heavy-lifting’ in filtering pro-competitive or benign conduct so that the prohibition applied only to anti-competitive conduct.

However, the courts in both countries have adopted an approach to the interpretation of ‘take advantage’ of market power that has resulted in the misuse of market power provisions having limited capacity to address serious anti-competitive conduct. As in Australia, the ACCC understands that in seeking to distinguish between conduct driven by pro-competitive economic efficiency and anti-competitive conduct, New Zealand Courts have undertaken complex counterfactual analyses.

This counterfactual test³ has meant that to defeat an allegation of misuse of market power, a business with substantial market power need only show that the allegedly anti-competitive conduct it has engaged in is something a small firm could also engage in, despite the very different harm it may cause to the economy and consumers. This leads to a consideration of whether a hypothetical firm facing hypothetical competition could engage in similar conduct, rather than an analysis of the actual conduct engaged in by the actual firm, with substantial market power, in the actual market.⁴

Purpose or effect or likely effect of SLC

Like section 46, section 36 does not address unilateral conduct by a firm with substantial market power when that firm has the purpose, or the conduct has the effect or likely effect of substantially lessening competition. Instead it addresses conduct undertaken for one or more proscribed purposes relating to individual competitors.

The proscribed purpose requirement in Australia’s section 46 has had a material impact on the ACCC’s ability to deal with anti-competitive unilateral conduct, especially at the investigative stage. The ACCC has discontinued a number of investigations into serious allegations of conduct that was likely to have had an anti-competitive effect because the

³ *Commerce Commission v Telecom* (2008) 12 TCLR 168 at para 55.

⁴ *Commerce Commission v Telecom Corporation of New Zealand Ltd* [2010] 12 TCLR 843 at 856.

ACCC considered it was unlikely to have been able to establish that the conduct had been engaged in for a proscribed purpose.

The Issues Paper seeks views on the potential addition of an effects test into section 36 of the CA. Critics of the reframing of Australia's section 46 to include an SLC test argue that doing so would constrain big business from legitimate competition, reduce productivity, chill investment and lead to higher prices. If New Zealand were to further consider amendments to section 36, the ACCC expects that similar arguments will be made. The ACCC's view is that these concerns are unfounded. An SLC test would protect legitimate competition and only target anti-competitive conduct. Conduct that enhances competition, by definition, will not substantially lessen competition and will not be captured.

Suggestions that an SLC test would lead to regulation of a large number of players or prevent widespread conduct that is procompetitive demonstrate a fundamental misunderstanding of the substantial market power element and misconstrue the operation of an SLC test. An amended section with an SLC test would continue to apply only to those firms that possess substantial market power within a market.⁵ This is a filter which restricts the application of the prohibition to a very small number of businesses. The provision would not apply to conduct that is merely fierce competition; under an SLC test, to damage competitors, even to the extent of competitors being forced out of business, is not in itself a basis to establish a "lessening of competition". The SLC element seeks to protect the competitive process. The SLC test targets conduct that prevents or impedes firms from competing on their merits.

Further, if section 36 were to be amended to remove the 'take advantage' limb and include a purpose or effect SLC test, a breach of the revised section 36 will continue to require a significant evidentiary burden. The court would need to be satisfied that a corporation that has a substantial degree of power in a market had engaged in conduct that had the purpose or effect or was likely to have the effect of substantially lessening competition in that or any other market.

Adopting a "purpose or effect or likely effect of SLC test" for section 36 and removing the specific proscribed purposes that focus on harm to competitors and potential competitors rather than the process of competition would bring section 36 into line with the other competition provisions of the CA.

The use of a SLC test into the market power provisions on either or both Australia and New Zealand is unlikely to require a significant change in the way in which businesses assess whether their conduct is likely to breach these competition laws. It is also a test that is familiar to businesses operating in international markets.

Conclusion

The ACCC's experience is that the existing section 46 of the CCA is flawed because it focusses on harm to competitors rather than to competition, and the 'take advantage' limb is an inappropriate and illogical filter to distinguish between pro and anti-competitive conduct. The 'take advantage' limb ignores the very different consequences of conduct by a firm with market power and similar conduct by a firm without market power.

Given the similarities between section 46 of the CCA and section 36 of the CA, the ACCC anticipates that the removal of the 'take advantage' and current proscribed purpose elements, and the substitution of the SLC test would improve the efficacy of section 36 of the CA.

⁵ The Issues Paper does not raise the prospect of removal of this threshold.

Finally, we note that any changes to the Australian or New Zealand misuse of market power provisions will also require consequential amendment of section 36A of the CA and/or sections 46A and 46B of the CCA which each apply to conduct in a trans-Tasman market in a mutually extraterritorial manner.