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26 May 2015

Mr Ben Dolman
Acting General Manager
Small Business, Competition and Consumer Policy Division
The Treasury
Langton Crescent
Parkes ACT 2600
By Electronic Submission

Dear Mr Dolman

Competition Policy Review Final Report

This letter sets out our view on the recommendation that s46 of the *Competition and Consumer Act 2010* (Cth) (***the Act***) be amended by removing the 'taking advantage' element.

1 Executive summary

The Harper Report recommends that s46 be amended in two respects. First, by removing the 'taking advantage' requirement. Second, by replacing the existing 'purpose' element with a requirement that the conduct have the 'purpose or effect or likely effect of substantially lessening competition'.

In our view, s46 should not be amended by removing the 'taking advantage' requirement and subjecting ***all*** conduct engaged in by a firm with substantial market power to a 'substantial lessening of competition' test. It is important, as a matter of policy, to achieve an appropriate balance between ensuring that firms with substantial market power are able to engage in legitimate competitive conduct while protecting the competitive process and ensuring that markets remain competitive. The 'taking advantage' element performs that role.

While there may be some debate as to whether it is currently achieving that function, a 'substantial lessening of competition' test, divorced from any link between a firm's market power and the impugned conduct, is not an adequate replacement. The distinction between vigorous competitive conduct and anti-competitive conduct becomes unclear and the 'substantial lessening of competition' test does not perform an adequate filtering role. Adopting the Panel's recommendations is likely to deter firms from engaging in legitimate, vigorous competitive conduct.

2 Policy considerations

An important policy consideration recognised by both Australian and overseas courts is that it is desirable for firms with market power to compete vigorously even if this harms competitors.[1] The following observations

[1] *Boral Besser Masonry Ltd v Australian Competition and Consumer Commission* (2003) 215 CLR 374; *Commerce Commission v Carter Holt Harvey Building Products Group Ltd* [2004] All ER (D) 235 (Jul); *Brooke Group Ltd v Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993)

made by Gaudron, Gummow and Hayne JJ in the *Boral case* are particularly pertinent:[2]

> The structure of Pt IV of the Act does, despite the considerable textual differences, reflect three propositions found in the United States antitrust decisions. The first is that these laws are concerned with "the protection of *competition*, not *competitors*"…. The third…is that it is in the interest of competition to permit firms with substantial degrees of power in the market … to engage in vigorous price competition and that it would be a perverse result to render illegal the cutting of prices in order to maintain or increase market share.

It is equally clear, however, that it is important to achieve a balance between allowing firms with market power to compete vigorously while protecting the competitive process from anti-competitive conduct.[3] The 'taking advantage' element seeks to play an important filtering role to achieve this balance. It does this by ensuring that s46 does not capture **all** conduct engaged in by a firm with substantial market power but only conduct which is causally connected to the firm's market power. In this respect, it directs the court to address a series of questions including:

- whether a profit maximising firm operating in a workably competitive market could in a commercial sense profitably engage in the conduct in question[4] or whether it is likely the firm would have engaged in the conduct if it did not have substantial market power[5]; and
- whether the conduct was materially facilitated by the firm's substantial market power.[6]

The Harper Panel expressed concerns as to whether the 'taking advantage' element is sufficiently clear so that business is reasonably able to determine, in advance, whether its conduct is likely to contravene the Act. We do not agree with this view. We consider that there is now greater understanding as to the application of the test, having regard to the number of decided cases over the past ten years relating to s46. Further, we do not agree that the amendment proposed by the Harper Report – namely, to capture **all** conduct engaged in by firms with substantial market power subject only to a 'substantial lessening of competition' test – is the solution. For the reasons set out in the following section, such an amendment is likely to result in 'over-capture' and deter firms with market power from engaging in legitimate competitive conduct.

3 The 'substantially lessening of competition' test does not achieve an appropriate balance

We do not think the 'substantial lessening of competition' test is appropriate as the sole filter. The courts have stated on many occasions that the Act is not about protecting competitors but protecting competition or the competitive process. The courts have also indicated that the Act does not seek to deter vigorous competition but anti-competitive conduct. However, there is no bright line as to where the distinction should be drawn. This is made clear by considering the application of the substantial lessening of competition test in two recent cases:

1. In *Baxter Healthcare Pty Ltd*[7], the Full Court (per Mansfield and Gyles JJ, Dowsett J dissenting) held that Baxter had contravened ss46 and 47 of the Act. The decision in relation to s47 is particularly instructive. The Full Court upheld the trial judge's decision that Baxter's conduct did not substantially lessen competition at the 'higher level' in that there was no evidence that Baxter's conduct relevantly resulted in barriers to entry being raised. Baxter's competitors were able to import PD products in the future and compete for contracts upon their expiration. However, the Full Court considered that

[2] *Boral Besser Masonry Ltd v Australian Competition and Consumer Commission* (2003) 215 CLR 374 at [160]

[3] *Commerce Commission v Carter Holt Harvey Building Products Group Ltd* [2004] All ER (D) 235 (Jul).

[4] *Australian Competition and Consumer Commission v Cement Australia* [2013] FCA 909

[5] Section 46(6A)(c)

[6] Section 46(6A)(a)

[7] *Australian Competition and Consumer Commission v Baxter Healthcare Pty Ltd* [2008] FCAFC 141

Baxter's conduct substantially lessened competition because the effect or likely effect of Baxter's offers was to make its rivals' tenders unacceptable to the SPAs on economic grounds.[8]

2. In *Cement Australia Pty Ltd & Ors*,[9] the ACCC alleged that Cement Australia (among others) contravened ss45 and 46 by entering into a number of contracts for the acquisition of flyash. The first contract was referred to as the Original Millmerran contract (entered into on 30 September 2002). The second contract was referred to in the judgment as the Fly Ash Agreement with Tarong Energy Corporation (entered into on 26 February 2003). The Federal Court held that there were legitimate rational business reasons, unrelated to the respondent's market power, for the respondent to enter into the 'Millmerran contract' including the fact that there was no certainty that it would be awarded the Fly Ash Agreement. The Court also concluded that the terms of the respondent's offer for the Millmerran contract was not materially facilitated by its substantial market power. Nevertheless, the Court held that the Millmerran contract contravened s45 of the Act because the purpose or the effect or likely effect of the conduct was to substantially lessen competition. This was on the basis that, if the respondents had allowed a competitor to enter into the Millmerran contract, this would likely have resulted in lower prices in a downstream market.

While ss 45 and 47 require a company that is entering into a contract to give consideration to whether the purpose or likely effect of that agreement is to substantially lessen competition, the cases (and ACCC authorisations) in relation to those provisions illustrate that the number of business agreements that give rise to a real potential of raising concerns is, in practice, relatively limited. An analysis of compliance with those provisions can be structured by businesses into the normal legal process of contract review and internal sign-off.

By contrast, applying a substantial lessening of competition test to any activity at all by a corporation with market power, including where there is no correlation at all between the activity and that underlying position of market strength, presents a markedly different compliance exercise for a company. It is unclear, for example, whether, in the light of the decisions to date, the following conduct will be prohibited if it results in a firm with substantial market power gaining market share at the expense of its competitor or competitors or in a competitor or competitors exiting the market:

- aggressive discounting such that a firm's prices are above its costs but at a level which competitors cannot meet – e.g. because there are economies of scale not available to competitors;
- vertically integrating upstream into the production of an input in order to reduce costs and secure greater control over the quality of the final product, resulting in existing suppliers of the input exiting the market, but lower final prices to consumers;
- launching a better quality product with which competitors cannot compete e.g. because of patent protection;
- in a market characterised by tenders - successfully competing for tenders, based on price and quality to the extent that it is no longer economically viable for a competitor to remain in the market;
- vertically integrating downstream into the retail supply of a product and changing distribution arrangements (e.g. reducing number of retail distributors);
- in a concentrated market:
    - refusing to supply a new competitor that consists of a number of ex-employees who have split from the company and launched their own venture but who require supply of some input products/services;

[8] *Australian Competition and Consumer Commission v Baxter Healthcare Pty Ltd* [2008] FCAFC 141 at [247] per Mansfield J

[9] *Australian Competition and Consumer Commission v Cement Australia & Ors* [2013] FCA 909

- refusing to supply a competitor where there are genuine commercial concerns (even if ultimately wrong) about that competitor, such as its credit worthiness or business ethics.

We have real concerns about how companies could implement internal compliance processes that would not create a significant potential to deter legitimate pro-competitive activity, as well as the increase in compliance costs.

The Harper Report proposes that, to reduce the risk of firms being deterred from engaging in competitive conduct, the Act direct the court to consider a range of matters.[10] The Harper report also recommends that the ACCC issue guidelines concerning the operation of s46. It is far from clear that introducing a provision which requires a court to have regard to a number of evidentiary matters will address the fundamental issues identified above concerning the operation of a substantial lessening of competition test. Further, the ACCC guidelines will have no weight in court proceedings and could not safely be relied on by businesses in their decision-making processes.

Yours sincerely

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[10] Harper Report 344-345.