The Institute of Public Accountants

Submission to the Senate Standing Committees on Economics – Competition Law Amendments: Misuse of Market Power Bill 2016

January 2017

IPA INSTITUTE OF PUBLIC ACCOUNTANTS
Partnership beyond numbers

9 January 2017

The Secretariat
Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

By email: economics.sen@aph.gov.au

Dear Sir/Madam

Competition Law Amendments:
Competition and Consumer Amendment (Misuse of Market Power) Bill 2016

The Institute of Public Accountants (IPA) welcomes the opportunity to comment on the *Competition and Consumer Amendment (Misuse of Market Power) Bill 2016* which proposes to make changes to section 46, dealing with misuse of market power, in the *Competition and Consumer Act 2010.*

The IPA has been a long-time advocate of the introduction of an 'effects test' into section 46 and supports the passage of the *Bill*.

Our specific comments are set out below.

Our submission has been drafted with the assistance of the IPA Deakin University SME Research Centre.

If you would like to discuss our comments or have any queries, please contact me at either or on mob. .

Yours faithfully

Vicki Stylianou
Executive General Manager, Advocacy & Technical
Institute of Public Accountants

About the IPA

The IPA is one of the three professional accounting bodies in Australia. Representing more than 35,000 members in over 80 countries, the IPA represents members and students working in industry, commerce, government, academia and private practice. More than three-quarters of our members work in or with small business and SMEs.

Submission on the Competition and Consumer Amendment (Misuse of Market Power) Bill

The submission that follows arises out of the IPA's concern that the existing misuse of market power provision (section 46 of the *Competition and Consumer Act 2010*) does not adequately protect small business, and by extension consumers, from the predatory actions of companies with substantial market power.

The IPA accepts that the best form of protection against anti-competitive conduct is for small and medium businesses to face competitive markets when they enter into acquisition or supply transactions, or for them to seek to establish countervailing market power through authorised collective bargaining. The IPA does not seek special protection for them from the ordinary rigours of competition. However, Australia's concentrated market structure means that many markets are not competitive and, where collective bargaining is not possible or sufficiently expeditious, small or medium size businesses are especially vulnerable to exploitation, or exclusion, by firms with substantial market power.

The current prohibition of misuse of market power, continues to be deficient in addressing exploitative and exclusionary anti-competitive conduct by dominant firms.

The IPA has previously supported, and continues to support, the introduction of an "effects test" into section 46 of the Act. The *Competition and Consumer Amendment (Misuse of Market Power) Bill 2016* (**Misuse of Market Power Bill**) is largely consistent with the recommendations made in the Harper Report[1] in relation to misuse of market power. In particular, it provides that a corporation with substantial market power must not engage in conduct having the purpose, effect or likely effect of substantially lessening competition in that or related markets. Passage of the *Misuse of Market Power Bill* would correct the two key deficiencies in the existing legislation:

- The 'take advantage' element, which has been interpreted in such a way as to excuse conduct even where its purpose is to deliberately harm a competitor or the competitive process; and
- The focus on 'purpose' alone, which fails to capture conduct having the effect of substantially lessening competition.

The *Misuse of Market Power Bill* deviates from the Harper Report recommendation to the extent that it restricts the markets in which the purpose or effect of substantial lessening of competition must occur. The IPA is concerned that this deviation introduces unnecessary complexity into the legislation. Nevertheless, as the substance of the *Bill* remains consistent with the Harper Report recommendations and still effectively addresses the key deficiencies in the current provision, **the IPA supports the proposed changes to section 46 set out in the *Misuse of Market Power Bill* and encourages the Committee to recommend its passage**.

1 Competition Policy Review, Final Report, March 2015 (Harper Report).

The need for change: deficiencies in the current law

The current prohibition of misuse of market power in s 46 of the *Competition and Consumer Act 2010*, by focussing on the 'purpose' of conduct alone, and by effectively requiring that the conduct involved not be capable of being, or be likely to be, carried out by a firm without market power, fails to adequately address abuses of market power. As a result, the IPA has been a long-time supporter of an 'effects test' for section 46, which it believes will go some way toward addressing these deficiencies.

The take advantage element

The most significant deficiency with the current test is that, through narrow judicial interpretation of the phrase 'take advantage', it does not catch conduct by firms *with* market power, when the same conduct *could have been* carried out by a firm without market power. This fails to recognise that conduct capable of being engaged in by firms without market power has a greater propensity to foreclose the market and produce economic harm when it is engaged in by firms with market power.[2]

This may be readily illustrated by reference to a few common examples of conduct which *could* and often rationally *would* be engaged in by firms lacking market power without producing competitive harm, but which, when engaged in by firms with substantial market power, is capable of significant harm to competition. Conduct of this nature includes supplying on exclusive or other restrictive trading conditions, loyalty rebates and predatory pricing.

> **Example 1: exclusive dealing and other restrictive supply conditions**
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> In a competitive market with many suppliers and retailers enjoying roughly equal market shares, a decision by one supplier (or even several suppliers) to supply on condition of exclusivity will not harm – and may even enhance - competition. This is because suppliers have other outlets and retailers have other sources of supply and efficient competitors will be able to match the proffered trading conditions should they wish to do so.
>
> By contrast, in a less competitive market featuring high barriers to entry and only a limited number of suppliers and retailers, a decision by a supplier with substantial market power to supply on conditions of exclusivity may have the purpose or effect of substantially lessening competition by foreclosing the market to efficient competitors. This is because a firm with substantial market power has the ability to leverage its market advantage to exclude efficient competitors other than by means of competition on the merits.
>
> A recent decision of the Federal Court serves to illustrate this point. In *Cement Australia*[3] conduct, found by the court to have substantially lessened competition, was nevertheless held not to have contravened the existing misuse of market power provisions because the exclusivity contracts involved *could* have been engaged in profitably by a firm lacking market power. A firm lacking market power may well have been able to engage in the same form of conduct, but it would not have produced the same anti-competitive outcome.

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2 See, for example, Stephen Corones, Submission in response to the Competition Policy Review Committee Draft Report (8 October 2014). See also RBB Economics, Submission in response to the Competition Policy Review Committee Draft Report and Kathrine Kemp, Submission in response to the Competition Policy Review Committee Draft Report, pages 9-12.

3 *ACCC v Cement Australia Pty Ltd* [2013] FCA 909.

Example 2: Loyalty rebates

Loyalty or rebate schemes may, and frequently will be, offered by firms in a competitive market as a means of enhancing competition. Firms operating in a competitive market or otherwise lacking significant market power have no capacity to foreclose efficient or otherwise effective competitors from the market; as a result, their conduct is unlikely to produce competitive harm. However, when offered in by firms with significant market power, the same type of conduct can produce vastly different results. Firms enjoying market power and who are necessary trading partners, either because of their scale or because they stock 'must have' products, are able to leverage this advantage to foreclose even *more efficient* competitors from the market by denying or limiting customer access. As a result, a loyalty or rebate scheme designed to leverage this advantage and capture more of the competitive share of the market is able to substantially lessen competition in a way that the same conduct by firms lacking market power is not.

Example 3: Predatory pricing

Low or below cost pricing can be engaged in by firms lacking market power and in some cases (particularly, for example, to aid market entry) may constitute a rational business strategy. Low or below cost pricing can, however, be used by a company enjoying substantial market power to exclude or deter rivals. The take advantage element does not provide an adequate means of distinguishing between harmful low cost pricing and normal pro-competitive instances of low cost pricing constituting a rational response to competitive conditions.

Although the *Birdsville Amendment* (to be repealed by the *Misuse of Market Power Bill*) was an imperfect response to concerns about ability of section 46 to address predatory pricing conduct, it nevertheless arose from justifiable concerns about the ability of the existing provision to address anti-competitive predation.

These examples illustrate the inadequacy of the current provision in distinguishing harmful from benign single firm conduct. In particular, by using what *could* be done by a firm lacking market power as a threshold for distinguishing anti-competitive conduct, the current interpretations of 'take advantage' fail to recognise that conduct capable of being engaged in by firms without market power has a greater propensity to foreclose the market and produce economic harm when engaged in by firms with market power.[4]

Some have argued that removing the take advantage element would mean that firms engaged in normal competition would risk contravening the provision if their competitive conduct was successful in improving their market share and deterring, eliminating or diminishing rivals. For example, it has been argued that successful new innovation may be interpreted as having the effect of substantially lessening competition if it leads to the exit or reduced share of existing firms or makes new entry more difficult.

The IPA agrees that it is necessary to distinguish pro-competitive conduct, such as successful product innovation, and anti-competitive conduct made possible only by virtue of a party's power in the

[4] See, for example, Stephen Corones, Submission in response to the Competition Policy Review Committee Draft Report (8 October 2014). See also RBB Economics, Submission in response to the Competition Policy Review Committee Draft Report and Kathrine Kemp, Submission in response to the Competition Policy Review Committee Draft Report, pages 9-12.

market. However, the concern that the reform proposed by the *Misuse of Market Power Bill* could stifle innovation and deter other pro-competitive activity is significantly overstated. For example, RBB Economics submitted, in response to these concerns, that:

> Pro-competitive conduct that harms competitors through the superior efficiency of the firm with market power should not … be categorised as creating a [substantial lessening of competition] in the first place. [5]

Successful innovation which may temporarily enhance market power should not be viewed as anti-competitive, notwithstanding the effect it may have on other individual market participants. Indeed, such conduct is an example of competition working effectively in the market. Although successful rigorous *competition* may reduce the number of competitors or deter entry, that is not the same as substantially lessening competition *in the market*.

The Harper Report recognised concerns that the provision may be interpreted broadly by the courts (a risk not justified by the court's interpretation of anti-competitive effects elsewhere in the Act) and proposed including guidance requiring the court to have regard to the extent to which conduct may enhance efficiency, innovation, product quality or price competitiveness. A directive to this effect is incorporated as ss 46(2) of the *Misuse of Market Power Bill.*

The IPA supports this directive, which includes a broad and sensible list of factors that must be regarded as increasing competition; efficiency, innovation, quality and price competitiveness. In addition, it makes general reference to conduct that may lessen competition; that is, conduct which prevents, restricts or deters the potential for competitive conduct or new entry into the market.

These broad references to pro and anti-competitive effects are appropriate and avoid the risk of focussing attention too narrowly on specific forms of conduct which may or may not cause economic harm depending on the particular market structure.

The IPA therefore considers that this directive to have regard to both pro- and anti-competitive purpose or effects and will, thereby, address concerns that pro-competitive conduct would be caught by the new provision.

The purpose/effect element

Section 46 of the Act currently focusses on the purpose for which the firm engaged in the conduct in question. However, it would be more consistent with the object of the Act to focus on the harm to *competition* (which may or may not result from harm to individual competitors); for this reason, the IPA supports the move from a purpose-based approach to misuse of market power to one capable of capturing conduct having either the purpose *or effect* of substantially lessening competition. The substantial lessening of competition requirement is appropriate for a law directed toward protection of competition. Its adoption elsewhere in the Act will also serve to improve consistency with the other competition law prohibitions and assist predictability in the application of the new provision.

Deviation from the Harper Recommendation and Exposure Draft Bill

The proposed s 46(1) in the *Misuse of Market Power Bill* is significantly more convoluted than that proposed in the Harper Report. This has resulted from attempts to define, in some detail, the

5 RBB Economics, Submission in response to the Competition Policy Review Committee Draft Report, page 5

market or markets in which the substantial lessening of competition must occur. In particular, it specifies that the substantial lessening of competition must occur in the market in which substantial market power is held, or any other market in which it, or a related body corporate, supplies or acquires goods or services.

The explanatory memorandum suggests that this change has been brought about following extensive stakeholder consultation (although the relevant stakeholders are not identified) and is designed to ensure that the prohibition is not 'excessively broad'. The explanatory memorandum acknowledges that, in practice, it is unlikely that conduct will have the purpose or effect of harming competition in markets in which the company with substantial market power (or related entities) does not compete or supply or acquire goods or services. It is not obvious that this restriction is needed or that, to the extent that conduct by a firm with substantial market power which has the purpose or effect of substantially lessening competition in another market, should not be caught.

In the IPA's view this amendment is unfortunate; it unnecessarily complicates the law. Nevertheless, as it is not envisaged that this change will significantly diminish the scope of the provision, it does not alter the IPA's support for the *Bill*.

Conclusion: The Bill should be passed

The Harper Report recommendation corrects the two key deficiencies in the existing legislation by:

- removing the 'take advantage' element; and
- expanding the focus of the provision to capture conduct having the *effect* of substantially lessening competition in a market.

These deficiencies have been discussed in detail, above.

The proposed changes to section 46, reflected in the *Misuse of Market Power Bill*, represent a sensible and long overdue improvement to Australia's misuse of market power laws. Importantly, the shift of the focus to *competition* rather than *competitors* will help to ensure that unilateral conduct by firms with market power cannot be permitted whether its design or effect is to substantially lessen competition.

Recommendation

The Committee should recommend passage of the *Misuse of Market Power Bill*.