Competition law conference

Recent and foreshadowed reforms of the Trade Practices Act

24 May 2008, Sydney
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Introduction

For more than three decades Australia has embraced the fundamental concept that promoting competition is the best way to provide the greatest benefit to consumers.

Competition benefits consumers by providing them goods and services at cheaper prices, increasing the range of products available and also increasing the quality. It encourages increased efficiency and innovation within business and is the driver of productivity improvements and with that economic growth.

For more than three decades our legislators and regulators have worked hard to transform our economy in the face of both international and domestic pressures. We have moved from an economy of sluggish, protected, unresponsive industries to a globally competitive economy where firms and workers can respond quickly and flexibly to changing circumstances.

These reforms commenced in the 70s with the first round of tariff reforms and the introduction of the *Trade Practices Act 1974* (the TPA). They were continued in the 80s with the floating of the exchange rate, further deregulation and tariff reform and the beginning of reforms in government. Further steps were taken in the 1990s with the Hilmer Review, culminating in the Commonwealth Competition Reform Act and the creation of the Australian Competition and Consumer Commission (ACCC).

Part of the challenge of introducing and entrenching competition is striking the balance between exposing firms to the competitive pressures that encourage innovation and growth, while ensuring that those firms that can respond well and adapt to these pressures do not abuse their strength in the market to actually reduce competition. This balance has been struck through section 46 of the TPA – the misuse of market power.

In striking this balance legislators and regulators need to be mindful that the goal of section 46 is to protect competition – not to protect competitors. This fundamental premise is at the core of many of the challenges that we face as the agency charged with enforcing section 46.

A highly competitive environment is not a comfortable place for those trying to make a living in the business world. Focussing on protecting competition, rather than competitors, is to accept that those businesses which are unable to keep up with the best in terms of price and service will suffer and ultimately be weeded out by the system.

This has been largely accepted - although begrudgingly in some quarters – by the business community.

But achieving that competitive environment through legislation is far from simple. It is a process of constantly assessing and removing roadblocks that prevent the legislation from being effective, while at the same time ensuring the basic rights of those affected by changes are not trampled in the process.

The reforms announced recently by the government to section 46 and section 155 of the TPA continue the process of providing the regulator with the tools it needs to vigorously protect competition, while not falling into the trap of protecting competitors from the impact of that competition.

The topic of my presentation today is recent and foreshadowed changes to the Trade Practices Act and what I would like to do is focus on the changes to section 46 that were enacted last year and the changes to section 46 and section 155 that the government has recently announced.

The history of section 46

The original section 46 introduced in 1974 was headed 'Monopolisation' and reflected provisions of the *Sherman Act 1890* in the United States and the *Australian Industries Preservation Act 1906*. While the term monopolisation did not appear in the text of the section, the proscribed conduct involved a corporation in a position to substantially control a market. In this regard it was clearly directed at a corporation operating independently using its market power against a competitor.

The original version of section 46 did not include a purpose test. This was amended in 1977 to include a specific purpose test to allay concerns that businesses may be prosecuted for engaging in genuine competitive activity – delivering benefits in terms of lower prices and better quality – if that competitive activity caused inefficient firms to go out of business.

Striking the balance in section 46 is not a recent phenomenon. In 1984 the effectiveness of section 46 was questioned on the grounds that the requirement that the corporation have 'substantial control' of the market was so strict that it only applied to a few corporations. Following debate this provision was amended to the lower threshold of requiring a corporation only to have a 'substantial degree' of power in the market. At this time the heading of the section was also changed to 'misuse of market power'.

Recent changes to section 46

The second reading of the *Trade Practices Revision Bill 1986* summed up very succinctly what the government was trying to achieve with section 46 of the TPA:

> Section 46 … is not aimed at size or at competitive behaviour as such of strong businesses. What is being aimed at is the misuse by a business of its market power. Examples of misuse of market power may include in certain circumstances, predatory pricing or refusal to supply.

The Senate Economics References Committee inquiry into the effectiveness of the TPA in protecting small business which reported in March 2004, heard evidence from a number of parties that section 46 had been narrowly interpreted by the High Court in the Boral and subsequent cases, thereby limiting the protection it offered to small business against the anti-competitive practices of large competitors.

In its submission to the Senate Committee Inquiry, the ACCC proposed a number of amendments to section 46. These amendments were suggested with a view to ensuring that section 46 was applied by the court in a manner consistent with the original intention of Parliament when the section was enacted in 1986.

The Senate Committee majority accepted most of the ACCC's recommendations with respect to section 46, which was reflected in the Committee's report. In its introduction to its report the Committee said:

> An issue which has been raised during many of these inquiries is the question of whether the Act should seek to protect *competition* or *competitors*. The Committee considers that the Act can best protect competition by maintaining a range of competitors, who should rise and fall in accordance with the results of competitive rather than anti-competitive conduct. This means that the Act should protect businesses (large or small) against anti competitive conduct and it should not be amended to protect competitors against competitive conduct

Following on from the recommendations of the Senate Committee, the former government introduced to Parliament the *Trade Practices Legislation Amendment Bill (No. 1) 2007*. This Bill included a number of the amendments to section 46 which were originally recommended by the ACCC to, and accepted by, the Senate Committee.

The major changes introduced in 2007 were designed to:

- address concerns about establishing when a corporation has a substantial degree of power in a market, which is the threshold requirement for section 46 to apply; and
- specifically prohibit a corporation from leveraging market power from one market to another.

However the bill did not implement the following important recommendations made by the ACCC:

- Section 46 be amended to include a provision outlining the elements the court should consider in determining whether a corporation has 'taken advantage' of its market power under section 46(1).
- Section 46 be amended to make it clear that, in relation to the offence of predatory pricing under section 46(1), it is not necessary to demonstrate a capacity for recoupment.

The proposed reforms to section 46

The legislative reforms to section 46 recently announced by the new government introduce both provisions sought by the ACCC in 2004 – to clarify the concept of take advantage and to remove the need to demonstrate a capacity for recoupment.

'Take Advantage'

The ACCC's ability to litigate misuse of market power allegations has been impacted by the High Court's approach to the interpretation of the concept of 'take advantage'.

In Queensland Wire, all judgments adopted the approach that 'take advantage' means 'use'.

However subsequent interpretations of the phrase in judgments such as Melways, Boral, Safeway, NT Power Generation and Rural Press have raised a number of issues in understanding and applying section 46 to any particular set of facts.

These High Court judgments provide a range of different views as to the analytical methods or modes of inquiry for determining whether a corporation has taken advantage of its market power.

The Court has considered:

- Whether the conduct was materially facilitated or made easier by the substantial market power;
- Whether the corporation would be likely to engage in the conduct in the absence of substantial market power;
- Whether the corporation could engage, or could commercially engage, in the conduct in the absence of substantial market power.

The ACCC is concerned that these various approaches to the interpretation of 'take advantage' by the Court has left the issue unclear and has left open the so-called 'could' test as a way of interpreting take advantage.

What this 'could' test means is that if it is commercially possible for a firm to engage in the relevant conduct without having market power, it will be held not to have taken advantage of its market power. This will be the case even if the firm would have no rational commercial basis to have engaged in the conduct in the absence of having market power.

To address this issue the government is proposing to make it clear that if the corporation's market power drives its conduct, that is sufficient to establish that the corporation has taken advantage of its market power.

Recoupment

There is a lack of clarity over whether the ability to recoup the losses incurred from predatory pricing (by charging higher prices once competition has been eliminated) is necessary to establish that a breach of the law has occurred. Recoupment has become firmly established in US anti-trust jurisprudence and

has made predatory pricing cases very difficult to prove in the US. The ACCC considers that section 46 requires amendment to clarify that a finding of expectation or likely ability to recoup losses is not required to establish a contravention.

This is not to say that an expectation or likely ability to recoup losses flowing from predatory pricing activity is wrong in theory. However, recoupment can take different forms over varying time periods. What might be called genuine predatory pricing can be difficult to prove in practice if there is a requirement to establish an expectation or likely ability to recoup losses.

Section 46 of the TPA, as amended by the *Trade Practices Legislation Amendment Act (No. 1) 2007*, was silent in relation to the issue of recoupment. In not introducing a recoupment provision the then government argued that the benefits from such an amendment were likely to be negligible. It believed the risk of firms being wrongly found to have engaged in predatory pricing in breach of section 46(1) would be increased if a court was discouraged from considering whether a firm had a rational expectation of being able to recoup the losses arising from a price-lowering strategy.

The ACCC believes that a carefully crafted amendment to section 46 along the lines proposed by the current government would not discourage a court from considering whether a firm had a rational expectation of recoupment. It would merely make it clear that such an expectation was not a prerequisite in establishing predatory pricing under section 46.

With these changes in place the ACCC considers that the balance has been adequately struck between ensuring that businesses are exposed to the rigours of competition – with all the associated economic benefits – while being protected from the possible anti-competitive consequences associated with firms gaining power from that competitive process.

This will not put an end to ongoing calls for greater action by the ACCC to protect firms that are struggling to compete with more efficient rivals – whether those rivals greater efficiency comes from economies of scale or the ability to be nimble and innovate quicker. But what it does mean is when firms that have market power are using that power for an anti-competitive purpose the ACCC will be well placed to act.

Predatory pricing and Market Share vs Market Power

You will also be aware of the introduction last year of section 46(1AA) – the so called Birdsville amendment. This amendment was borne out of the frustrations and community concerns that came to light in the Senate Inquiry into the effectiveness of the TPA in protecting small business. There were concerns that the current interpretation of section 46 by the High Court was not providing adequate protections to small business.

At the same time sub section (4A) was introduced into section 46. This subsection said that in determining whether a corporation has contravened the existing subsection (1) a Court could have regard to any conduct of the corporation that consisted of the supply goods or services for a sustained period at a price that less than the relevant cost to the corporation.

This set up a dual track process for considering predatory pricing under section 46 where it could be considered either under subsection (1) as guided by subsection (4A) or under the new section 46(1AA). As each of these sub sections have different concepts in them this raises the possibility that what might be found to be predatory pricing under one subsection would not be found to be predatory pricing under the other.

The intent behind the new section 46(1AA) was a desire for a simpler test – the idea that market share would be easier to understand and litigate than market power. Behind this was the idea that firms with high market share would also have market power.

However, in practice the concept of market share is no clearer than the concept of market power – particularly when the goal is to ensure the forces of competition operate effectively, rather than simply protecting small firms against larger firms.

How does a court determine what constitutes a substantial share of a market – particularly in the context of competition? If a business has a 20 per cent share of a market, does it have a substantial share? How would the answer differ if it had eight competitors each with a 10 per cent share as opposed to, say, a scenario of two competitors both with a 40 per cent share of the market, or one competitor with an 80 per cent share?

Clarifying these sorts of questions through the courts would take time and moves away from the previously tested concept of proving a company has substantial power in a market. There already exists a significant body of case law dedicated to dealing with that question.

The Birdsville amendment also had other difficulties associated with it.

It completely omitted any concept that a firm with a substantial market share had to some how take advantage of that market share, or rely on it, in seeking to damage a competitor through predatory pricing.

This then gave rise to concerns - perhaps overstated by some but nevertheless legitimate - that genuine competitive pricing behaviour could be inadvertently caught by the Birdsville amendment.

The current government has recognised there is a concern in the community about the specific issue of predatory pricing. Accordingly, the government is proposing to keep section 46(1AA) as a specific predatory pricing provision but to couch it in terms that are familiar in section 46, and on which there is a significant body of case law, but with these terms being clarified elsewhere in the section.

Section 46(1AA) will include the new provision that it is not necessary to prove an expectation or likely ability to recoup losses in order to establish predatory pricing. The government is also proposing to repeal subsection (4A) which seeks to clarify subsection 46 (1) as it applies to predatory pricing thereby removing the 'dual track' process for considering predatory pricing. Through these two changes the government is delineating the amended section 46(1AA) as being the predatory pricing provision within section 46.

Effects test

The changes to the ’take advantage’ and ’recoupment’ tests on their own are significant, and when taken with the changes made last year by the previous government are, in the view of the ACCC sufficient. Yet some continue to claim that an effects test is required to make section 46 work.

As the argument goes, proving that the purpose of below cost pricing is to eliminate a competitor is incredibly difficult. Therefore, an effects test would allow courts to examine the actual damage done to a business, rather than having to find a smoking gun proving intent.

Indeed, the ACCC itself recommended the introduction of an effects test in its submission to the review of the competition provisions of the Trade Practices Act completed by the Dawson Committee in 2003.

However, no fewer than nine reviews of the TPA have rejected calls for an effects test. This needs to be acknowledged.

Subsection 46(7) provides a virtual ‘effects test’ in any case. The court is able to infer the existence of the necessary anti-competitive purposes from the conduct of the company, of another person or from "any other relevant circumstances". The "relevant circumstances" in a particular case may well include the effect of the conduct.

The subsection would thereby permit the courts to draw inferences of anti-competitive purpose from an effect. Of course I am not suggesting that in every case it is appropriate to infer an anti-competitive purpose just from the effect of the conduct, but in particular cases the inferences that can be drawn from the effect of the conduct may be an important consideration.

As a consequence of the Boral decision it has become much clearer that the critical issues for the application of section 46 are now what constitutes having a substantial degree of market power and what constitutes taking advantage of that power. Indeed, in the Boral judgment several of the justices indicated that the issue of determining purpose and the issue of separating purpose from effect may not be as difficult as may have previously been contemplated.

It also has to be noted that in the ACCC’s section 46 investigations, establishing purpose has not been as challenging as meeting the substantial degree of market power and take advantage tests, particularly following the recent High Court decisions.

These are among the reasons that the ACCC did not advocate the inclusion of an effects test in its submission to the Senate committee’s 2004 report on the effectiveness of the TPA in protecting small business.

Information gathering powers – section 155

Another issue that has caused some challenges for the ACCC in recent times is the use of its compulsory information gathering powers under section 155 of the Act.

Section 155 gives the ACCC power to obtain information, documents and evidence when investigating possible contraventions of the Act. It is a

powerful tool that can give real teeth to an investigation, especially where the party being investigated is not cooperative.

Difficulties arise where the ACCC seeks to stop harmful conduct quickly.

Where ACCC investigators run into problems is where there is an urgent need to stop conduct due to the serious risk of harm to consumers or other businesses, for example where a business refuses to stop the conduct causing concern.

Where this is the case the ACCC can apply to the court for an interlocutory court order to stop the conduct.

However, once proceedings are instituted for the interlocutory court order, the ACCC can no longer use its investigatory powers pursuant to section 155 to collect evidence in relation to a matter.

Accordingly, once the ACCC seeks an interlocutory injunction, its subsequent ability to fully investigate the matter is limited and its prospects of success in the substantive proceedings for final relief are hindered.

This often leaves the ACCC in a difficult position. On the one hand, it is a disincentive for the ACCC to take action early, because it then loses the ability to fully investigate the matter, which may ultimately allow the trader to re-engage in the conduct. On the other hand, a failure to seek interlocutory relief may allow the trader to continue to breach the TPA to the detriment of businesses and consumers.

The rationale for a limitation on the section 155 powers following the commencement of proceedings is that the court should then be in control of information disclosure and exchange between the parties to those proceedings. The ACCC accepts that it is generally not appropriate for it to have power to issue notices under section 155 after the commencement of proceedings for a contravention of the TPA. However, it is not generally until the issue of interlocutory relief has been determined and preparation for the substantive part of the proceedings has commenced that the court will exercise its information disclosure powers, such as discovery.

This difficulty has led to calls for the ACCC to be granted cease and desist powers which would in effect achieve a similar outcome without limiting the Commission’s information gathering powers.

Any powers that potentially shut down a business at short notice have the potential to do immense harm if abused or used in error. It is my view, and the view of the Commission, that the regulator should not be granted such powers. These are not mere administrative matters, they should remain the jurisdiction of the courts. Those seeking to impose such restrictions on a trader should have to prove they have a prima facie case and argue that these impositions are justified before they are granted.

But that does not get around the problem of court-ordered injunctions inhibiting the ACCC’s ability to further investigate matters.

This is why the ACCC argued to the Senate Committee inquiry into the effectiveness of the Trade Practices Act in protecting small business that its

section 155 powers should be extended beyond their current cut-off to the point of issuing substantive proceedings.

Clearly, there exists a potential for abuse of section 155 if these powers are available during court proceedings. However, that is not what is being proposed. What is being proposed by the government is that the ACCC's ability to use its section 155 powers would cease when it commences substantive proceedings in a matter.

Extending the period where s 155 powers can be used in this way would allow potentially harmful conduct to be stopped quickly without jeopardising any ultimate court outcome against the trader.

The second issue for the ACCC is that of protecting the integrity of section 155. It should be clearly understood that the ACCC will do all it can to protect the integrity of its section 155 powers.

In March this year the Federal Court in Melbourne sent an important message to the business community regarding its attitude towards compliance with section 155 of the TPA. The court sentenced John Paul Rana to six months' jail for his repeated failure to comply with section 155 notices issued by the ACCC, in addition to fining Michael Rana and their company NuEra. Importantly, this reinforced the messages the ACCC has recently sent through the prosecution of Mr John Patrick Neville for not answering questions truthfully in a section 155 examination.

This aggressive defence of section 155 has been necessary not only to remind businesses of the serious consequences of not complying, but also to ensure these powers retain their teeth.

In the Korean Air Line case decided only last week the airline directly sought to test the boundaries of the ACCC's ability to issue section 155 notices by claiming the Commission or some of its staff had already decided to institute proceedings as a result of the alleged cartel investigation, thereby cutting off the ACCC's ability to issue notices. It also asserted that the ACCC was misusing its powers under section 155 of the TPA as it was seeking information to assist in determining the possible penalties it might seek against KAL. Justice Jacobson dismissed all of the airline's arguments.

The court's findings in the above matters were obviously welcomed by the ACCC. They serve as an overdue wake-up call to others who may have disregarded the importance of complying with section 155 notices.

However, the Rana case in particular also highlights one shortfall. Where the ACCC pursues an individual who fails to provide requested information, it is essentially taking a case against that individual for non-compliance, which carries a maximum penalty of 12 months imprisonment.

The ACCC pursues non-compliance with section 155 notices because it is important to protect their integrity. To be an effective enforcement agency the ACCC must take action to counter conduct designed to obstruct its investigation processes.

However, it would rather concentrate on getting access to the information that is required as part of its investigation.

Pursuing non-compliance sends an important message, but does not deliver the actual information that was being sought in the first place.

Conclusion

Our economic situation is tightening – interest rates are higher than they have been for several years and the cost of living is also putting a strain on the discretionary spending of consumers. As spending contracts, businesses are likely to feel this pressure and are increasingly looking to the *Trade Practices Act* to ensure they are being adequately protected from unfair trading practices.

Having long expressed their frustration at the inability of the predatory pricing provisions of the *Trade Practices Act*, and the lack of successful cases, small businesses are having some of those concerns now addressed.

By identifying the real impediments that have prevented the law from functioning properly, the government is promising to clear aside the last remaining major blockages that have prevented more successful cases from flowing.

The ACCC has not changed its stance – it stands ready to take appropriate cases as soon as our legal advice tells us we have reasonable grounds to do so.

The result of more cases now being able to proceed will be a win for all those who look to the *Trade Practices Act 1974* to protect the competitive process.