15 February 2016

Mr Scott Rogers
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The Treasury
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By email: competition@treasury.gov.au

Dear Sir,

Options to strengthen the misuse of market power law: Submission of nbn to Treasury in response to Discussion Paper issued 11 December 2015

nbn welcomes the opportunity to respond to Treasury's Discussion Paper on options to strengthen the misuse of market power law.

nbn considers that the misuse of market power provisions play an important role in promoting competitive markets. This role is particularly important in industries such as the telecommunications, media and high technology industries where innovation, including by recent entrants, is critical to the long-term development of competition.

Innovation may be led not only by recent entrants but also by existing firms as they seek to differentiate their product offerings from those of their competitors (both actual and potential). In this respect, it is important that an appropriate balance be achieved between the goal of protecting smaller firms and ensuring that the Competition and Consumer Act 2010 does not discourage vigorous, competitive and innovative conduct by larger firms.

The Harper Panel recommended two substantial changes to section 46: first, the removal of the requirement that conduct involve a 'taking advantage' of market power, and second, replacing the current purpose test with the more general test of whether the conduct has the 'purpose, effect or likely effect of substantially lessening competition'. The Discussion Paper outlines a range of specific options for amending section 46 having regard to the Harper Panel's recommendations. All of these options, except for Option A, propose the removal of the 'taking advantage' element from section 46.

nbn is concerned that removing the 'taking advantage' element could result in over-capture by prohibiting (or at the very least discouraging) vigorous competitive conduct by existing firms in the market. **nbn** does not consider that replacing the 'taking advantage' element with a test of whether the conduct has 'the purpose or effect or likely effect of substantially lessening competition', as proposed by the Harper Panel, will address **nbn**'s concerns.

nbn sets out in greater detail in this submission the basis of its concerns and the reasons why **nbn** does not support any such change to section 46.

1. The proposed amendment may result in over-capture

The role of the 'taking advantage' limb

The 'taking advantage' limb is intended to act as a filter for distinguishing between competitive and anti-competitive conduct by requiring there to be a causal connection between a firm's conduct and its market power. It does so by asking the court to have regard to whether:

1. a profit-maximising firm operating in a workably competitive market could profitably (in a commercial sense) engage in the conduct in question;
2. it is likely that the firm would have engaged in the conduct if it did not have substantial market power;
3. the conduct was materially facilitated by the firm's market power; or
4. the firm engaged in the conduct in reliance on its market power.

The important role the 'taking advantage' element plays is best demonstrated by considering the High Court's decision in Boral Besser Masonry Ltd v ACCC [2003] HCA 5. In that case, The High Court agreed with the trial judge's decision that Boral did not have substantial market power and did not take advantage of any power it had. A central aspect of the Court's decision was the fact that Boral was simply seeking to 'meet the competition' in difficult market conditions in making the offers that were the subject of the proceedings.

The Harper Panel criticises the fact that, under the existing provision, a firm may be found not to have 'taken advantage' of its market power if its conduct would or could have been engaged in by a firm without market power. The Harper Panel states that conduct 'should not be immunised merely because it is often undertaken by firms without market power', and argues that conduct that does not harm competition when undertaken by a firm without market power can in fact harm competition when undertaken by a firm with market power.

However, it is this application of the 'taking advantage' element that enables the misuse of market power provision to distinguish between competitive and anti-competitive conduct. Without the 'taking advantage' element, section 46 would capture all unilateral conduct engaged in by a firm with market power that has the requisite purpose or effect, regardless of whether that conduct is in any way related to the firm's market power.

Removing the 'taking advantage' element could prohibit a firm with substantial market power from engaging in conduct which for firms without market power is lawful, competitive and ordinary. It could prohibit a firm with substantial market power from engaging in the same conduct as a smaller player in order to meet a competitive challenge from that smaller player. Further, firms which newly obtain substantial market power may have to change their ordinary competitive behaviour on the basis that it was only lawful when they did not have market power.

To take an example – the High Court concluded in Melway Publishing Pty Ltd v Robert Hicks Pty Ltd (2001) 205 CLR 1 that the respondent did not take advantage of its market power in refusing supply. This was on the basis that the refusal reflected the operation of the respondent's segmented distributor model, which the respondent had operated before it secured its position of market dominance. It seems an odd result, as a matter of policy, if

the Act would require a respondent to change arrangements which it implemented when it did not have market power and formed an important pillar in its ability to compete successfully in the market.

In summary, without the 'taking advantage' limb requiring a causal connection between a firm's market power and its conduct, the misuse of market power provision does not filter between competitive and anti-competitive conduct. Accordingly, **nbn** is concerned that such a change may result in the misuse of market power provision capturing and discouraging legitimate, competitive conduct. For these reasons, **nbn** does not support the Harper Panel's recommendation; nor does it support options B to F set out in the Discussion paper.

Removing taking advantage, including a 'substantially lessen competition' test

Option E of the Discussion Paper proposes removing the 'taking advantage' limb and replacing the current purpose test with the test of whether conduct has the 'purpose, effect or likely effect of substantially lessening competition'. Option E reflects the Harper Panel's recommendations. This version of section 46 would prohibit any unilateral action taken by a firm with substantial market power that results in a substantial lessening of competition. For the reasons set out below, **nbn** does not consider the 'substantial lessening of competition' test to be a suitable replacement for the 'taking advantage' element.

There is often no clear dividing line between competitive and anti-competitive conduct. An increase in market share or the exit of a firm may be the outcome of either vigorous competition or anti-competitive conduct. The 'substantial lessening of competition test' does not contain any mechanism for distinguishing between competitive conduct and anti-competitive conduct – the test will prohibit vigorous competitive conduct if the effect of that conduct is to substantially lessen competition.

The ACCC rejects this point in its submissions to the Harper Review, arguing that a 'substantial lessening of competition' test would not capture ordinary competitive conduct, even if it results in the elimination of competitors, because such conduct would not lessen the process of competition. However, in practice it is difficult to tell the difference between anti-competitive conduct which lessens the 'process' of competition and ordinary competitive conduct which results in increased market share or the exit of competitors. Indeed, the courts have historically been unable to make a principled distinction between the two when applying a 'substantial lessening of competition' test.

The proposition may be tested by reference to a simple example – aggressive price competition. At what point does aggressive price competition by a firm with market power lessen the 'process' of competition rather than amounting to simply vigorous price competition? Is it when the firm with market power charges a price below its marginal costs; or below the marginal costs of its competitors, which may well be higher than the firm's own marginal costs? The benefit of the 'taking advantage' limb is that it at least posits a test that business can apply in order to answer such questions and determine whether conduct is anti-competitive, namely, determining whether the conduct is materially facilitated by the firm's market power or otherwise is conduct which a firm without substantial market power could profitably (in a commercial sense) engage in. A provision which relies solely on a 'substantial lessening of competition' test offers no guidance on how to resolve such questions.

Given this uncertainty, **nbn** is concerned that such a provision could prohibit legitimate competitive conduct by a firm with substantial market power that results in that firm gaining market share or the exit of competitors. The amendment proposed in Option E may therefore discourage large firms from engaging in innovative or vigorously competitive behaviour.

The proposed legislative guidance would not mitigate the risk of over-capture

The Harper Panel has acknowledged the concerns that relying solely on a 'substantial lessening of competition' test may result in over-capture, noting that business conduct can have both competitive and anti-competitive effects. To address the risk of over-capture, the Panel in its Draft Report proposed a defence based on whether the conduct would be a rational business decision by a firm without market power and be in the long-term interests of consumers. The Panel did not recommend this defence in its Final Report, and instead proposed that the risk of over-capture be mitigated by including legislative guidance on the provision (Option F). Specifically, the Panel recommended that the amended legislation should direct the court, in determining whether conduct has the purpose, effect or likely effect of substantially lessening competition, to have regard to the extent to which the conduct has the purpose, effect or likely effect of:

- increasing competition in the market (including by enhancing efficiency, innovation, product quality or price competitiveness); and
- lessening competition in the market (including by preventing, restricting or deterring the potential for competitive conduct in the market or new entry into the market).

The Harper Panel asserts that, in having regard to these factors, the court will be required to 'weigh the pro-competitive and anti-competitive impact of conduct'. **nbn** submits that this direction to the court will not mitigate the risk of over-capture for the following reasons:

- the direction to the court does not provide any test for distinguishing between competitive and anti-competitive conduct – it merely begs the question the courts have to grapple with in the first place, by asking the court to consider the extent to which conduct increases competition and lessens competition;
- the court is only required to 'have regard' to these factors – the factors are not a defence. The court would be obliged to find a firm in breach of section 46 if its conduct substantially lessened competition (for example, by causing firms to exit the market), irrespective of whether the conduct 'increased competition' by increasing the firm's efficiency, innovation, product quality or price competitiveness.

2. Compliance burden of a 'substantial lessening of competition' test for unilateral conduct

Existing provisions of the Act require corporations to consider, when making or giving effect to contracts and other arrangements, whether the purpose or likely effect of that contract or arrangement is to substantially lessen competition. Such consideration is typically part of a corporation's normal process of contract review and sign-off, and from **nbn**'s perspective is an accepted cost of conducting business in Australia.

In contrast, the cost of complying with a misuse of market power provision which relies solely on a 'substantial lessening of competition' test in respect of all acts or omissions would be unduly burdensome. For any unilateral conduct – any marketing campaign, pricing strategy or product release – corporations would be required to assess whether they have substantial market power in the markets relevant to that conduct, and whether the conduct has the likely effect of substantially lessening competition.

The options set out in the Discussion Paper indicate that the 'substantial lessening of competition' test would require the courts to have regard to the effect of competition not only in the market in which the firm has substantial market power but also any other market. This imposes an even greater compliance burden on business as it needs to assess whether any of its conduct has an effect in another market such as downstream

markets in which the firm at issue may not compete. By contrast, section 45 is limited to the purpose or effect of competition in a market in which a party to the contract, arrangement or understanding supplies or acquires goods or services.

If a corporation considered its conduct was likely to result in increased market share or the exit of competitors, it would have to assume there is a real risk the conduct may contravene section 46, given there is no clear dividing line between such conduct and conduct which lessens the 'process' of competition. Further, a corporation may be unable to determine the likely effect of its conduct on competition in a market, given such a determination would require access to the confidential information of its competitors and, in the case of upstream and downstream markets, its suppliers and customers. This includes information relating to costs, financial position and market strategies. This type of uncertainty would exacerbate **nbn**'s concerns that the amendments to section 46 proposed by the Harper Panel could discourage legitimate competitive conduct.

3. Removing taking advantage, maintaining purpose: Option B

nbn has addressed above its concerns with a misuse of market power provision that relies solely on a 'substantial lessening of competition test'. Option B of the Discussion paper does not propose the introduction of a 'substantial lessening of competition' test, and instead proposes only removing the 'taking advantage' limb from the existing provision, such that section 46 would prohibit firms with substantial market power from engaging in conduct which has a prescribed anti-competitive purpose.

Such a provision is also likely to result in over-capture, given that the existing purpose element of section 46 is very narrow and sets a low threshold for prohibited conduct – for example, in Boral, the purpose element was satisfied even though Boral was pricing to meet its competition. Removing 'taking advantage' from the existing provision would result in section 46 capturing conduct with the requisite purpose, regardless of its effect and whether other firms are legitimately engaging in the same conduct.

If you would like any further information about **nbn**'s views on this issue please do not hesitate to contact me.

Yours sincerely

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