Bulletin

Water
Energy
Transport
Financial services
Telecoms
Media
→ Competition policy
Policy analysis and design
Regulation
Strategy
Contract design and evaluation
Dispute support services
Market design and auctions

AUGUST 2016

Fixing competition policy?

IS AUSTRALIA'S COMPETITION POLICY 'BROKEN'?

Earlier this year, a joint media release by the Australian Treasurer (Scott Morrison), Prime Minister (Malcolm Turnbull) and the Minister for Small Business (Kelly O'Dwyer) was headed "Fixing competition policy to drive economic growth and jobs". The first paragraph reads: "The Turnbull Government will legislate to fix competition policy in Australia through implementation of the Harper Review's recommendation to amend Section 46 of the Competition and Consumer Act – the misuse of market power provision."

The claim that the proposed changes will fix competition policy implies that current competition policy is broken – or that, at least, the abuse of market power provision (section 46 of the Competition and Act) is broken and that the changes will repair the breaks. Now that the Coalition has been returned to power in Australia, will Prime Minister Malcolm Turnbull implement these changes? This bulletin from Frontier Economics looks at the government's implication that the current s 46 is broken. If so, will the proposed changes make the necessary repairs?

→

AIMS OF THE POLICY

Section 46 is directed at the misuse of market power. A business with substantial market power can increase its profit in one of two ways:

1. It can create extra value by introducing new products that consumers want or new production processes that reduce costs of production. These changes increase economic efficiency. They increase the size of the economic pie that is available for distribution to Australians.
2. It can capture more of the available economic pie by harming competition in order to enhance the market power that it already has. This second stage is generally regarded as a misuse of market power because one result of reduced competition is often a reduction in the size of the economic pie that is available for distribution. The enterprise in question benefits because it gets a much larger slice of the smaller pie; but the community as a whole loses because the total pie has diminished in size.

A good policy with respect to misuse of market power will:

- do little to inhibit value-creating actions of the first kind
- limit the extent to which firms with substantial market power can benefit by action of the second kind.

These are the standards against which any policy concerning the misuse of market power should be assessed.

The changes proposed by the Harper Committee (and accepted by the Federal Government) fall into three broad categories. How do they measure up against the standards of a good policy?

INTRODUCTION OF A TEST OF SUBSTANTIAL LESSENING OF COMPETITION

The first change suggested by the Harper Review and embraced by the Government is to change the criterion for distinguishing value-creating from value-destroying conduct. The current test does this by proscribing conduct undertaken by an enterprise with substantial market power only if the conduct is causally related to the market power – the language of the statute is that the conduct must constitute a taking advantage of the market power.

Economic theory suggests that this is a sound way of distinguishing between value-creating conduct and value-destroying conduct. Economics teaches that, in general, firms with little market power can only generate profit by actions that create value. Under the current test, a firm with substantial market power is permitted to do things that create value – because these actions are of the kind that would be undertaken by a firm without substantial market power.

The meaning of the phrase 'take advantage' has been explained by a series of leading cases in our courts, starting with the 1989 decision of the High Court in

Queensland Wire. Following *Queensland Wire*, a leading commentator (Michael O'Bryan – who subsequently became a member of the Harper Review) wrote that the way to analyse taking advantage according to Queensland Wire 'is straightforward and puts efficiency and competition at the heart of s 46.'[i] Although the meaning of the phrase 'taking advantage' seemed straightforward to Michael O'Bryan, he observed in the same paper that the courts were encountering difficulties in applying the phrase in particular cases. This difficulty was a key reason why the Harper Review recommended a change in the test that distinguished value-creating from value-destroying conduct.

A SOLUTION?

To address this difficulty, the Harper Review recommended that the test be changed from the taking advantage test to the substantial lessening of competition test. That is, conduct undertaken by a firm with substantial market power would be assessed according to whether its purpose, effect or likely effect was to substantially lessen competition. Is this change likely to fix one of the breaks in s 46?

MAYBE NOT…

The problems the courts have encountered in applying the take advantage test were catalogued by Michael O'Bryan in his 1993 paper; and he was able to add many other cases to the list when the Harper Report came to be written. However, Australian courts have not been alone in finding it difficult to distinguish value-creating conduct from value-destroying conduct. The difficulty has been encountered in all competition law jurisdictions. This suggests that the problem is not that the test is broken but rather that courts will always find it difficult to apply this distinction to a particular set of facts. As Michael O'Bryan observed in 1993, the taking advantage test as enunciated by the High Court in *Queensland Wire*, put efficiency and competition at the heart of s 46. The change proposed by the Harper Review and accepted by the Federal Government attempts to do the same thing using different language.

CHANGING THE FOCUS OF THE PURPOSE

The current version of s 46 condemns conduct by a firm with substantial market power that both:

1. constitutes a taking advantage of that power – as we have discussed above; and
2. is undertaken for the purpose of eliminating or damaging a competitor, preventing entry to a market or deterring or preventing a person from engaging in competitive conduct.

The Harper Committee has proposed (and the Federal Government accepted) that this second element be removed and that conduct only be condemned if it has the purpose or effect of substantially lessening competition. This change seems to be a tidying up rather than a fundamental change.

The requirement to prove purpose has rarely been of critical importance to the outcome of misuse of market power cases. The focus of debate in the courts has been on taking advantage rather than the purpose. As the High Court stated in Queensland Wire, competition by its very nature is deliberate and ruthless. The object of s 46 cannot be the economic well-being of competitors, it must be to protect the interests of consumers.

The change in the focus of the purpose from the current list to the substantial lessening of competition is consistent with the reasoning of the High Court in Queensland Wire. For this reason, the change is unlikely to lead to substantially different outcomes in cases.

REMOVING THE RUBBISH

The Harper Committee proposed (and the Federal Government accepted) that the current version of s 46 be removed and replaced by the provision that we have been discussing. This will result in a much simpler provision than currently exists. Over the years, various sub-sections have been added to s 46 in an effort to remedy gaps that interest groups and politicians have detected as a result of particular decisions by the courts.

This tendency to amend Australia's competition statute in response to a decision by the courts seems to be a peculiarly Australian response. It has contributed much to the complexity of the statute; and some of these additions are inconsistent with the principles that underpin the general structure of the Act. Australia would have much clearer legislation if we left it to the courts to iron out problems with the drafting of legislation and we did not attempt further amendments whenever we do not like the reasoning of one court in one decision.

IN THE END

The ground surrounding the principal provision in s 46 contains many broken shards that are remnants from battles over previous decisions by the courts. Clearing the site of these broken pieces may well prove to be the most significant recommendation of the Harper Review concerning the misuse of market power.

---

[i] Michael O'Bryan, "Section 46: Law or Economics?", Competition and Consumer Law Journal, Vol 1, Number 1, August 1993, p 67.

CONTACT	**Philip Williams** philip.williams@frontier-economics.com.au
	Frontier Economics Pty Ltd
	FRONTIER ECONOMICS ASIA-PACIFIC BRISBANE | MELBOURNE | SINGAPORE | SYDNEY
	www.frontier-economics.com.au