Harper Review recommendations on s.46 – purpose and effect

23 April 2015
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In brief

- The Final Report of the Federal Government's independent review of competition policy in Australia – the so called "Harper Review" - was released on 31 March 2015. The Final Report's recommendations for a new section 46 of the Competition and Consumer Act 2010 (CCA) will likely be the most contentious and receive the most scrutiny given the significant risk and uncertainty that it presents.
- Section 46 is the main provision in the CCA concerned with unilateral conduct by firms with a substantial degree of market power (e.g. predatory pricing, refusal to supply). The current provision prohibits the "taking advantage" of that market power for an anti-competitive purpose. The Harper Review recommends:
    - removing the take advantage requirement and prohibiting a corporation from engaging in conduct that has the purpose or effect, or likely effect, of substantially lessening competition in a market;
    - directing the court to have regard to whether, on the one hand, the conduct enhances efficiency, innovation, product quality or price competitiveness, and, on the other hand, whether the conduct prevents, restricts or deters the potential for competitive conduct in the market or new entry into the market;
    - providing for authorisation for conduct that would otherwise breach the section, as well as guidelines from the ACCC as to how they would approach enforcement.
- Clients with market power may be concerned that these changes will introduce greater uncertainty as to the legality of their business dealings. If so, they should consider engaging with the consultation process on the recommendations. **Written submissions are due by 26 May 2015.**

In detail

The proposed changes

Section 46 of the CCA prohibits a corporation that has a substantial degree of power in a market from taking advantage of that power in that or any other market for the purpose of eliminating or substantially damaging a competitor, preventing the entry of a person into a market, or deterring or preventing a person from engaging in competitive conduct.

This test has been in place for almost 40 years. While it is well understood by business and regulators, the section has been the subject of criticism, particularly in relation to the term "take advantage" as the courts have interpreted the taking advantage of market power as engaging in conduct that would not be

undertaken in a competitive market due to the constraints of competition. This interpretation has made it difficult to identify such behaviour. The Harper Review panel noted that business conduct should not be immunised merely because it is often undertaken by firms without market power and that the same conduct undertaken by firms with market power might raise competition concerns[1].

Another frequent criticism is that the current test focuses on purposes that affect particular competitors rather than the competitive process itself. Other forms of prohibited conduct in Part IV of the Competition and Consumer Act seeks to prevent a substantial lessening of competition in a market. This is arguably more in line with the economic objectives of competition law which is said to be concerned with protecting the process of competition rather than with protecting particular competitors[2].

Taking into account these two criticisms of the existing test (noting that responses to the consultation process for the Harper Review were divided on both) then a reformulation of section 46 might look like the following:

> "A corporation that has a substantial degree of power in a market shall not engage in conduct if the conduct has the purpose of substantially lessening competition in that or any other market."

However, the reformulated test recommended in the final report of the Harper panel also included an effects test, such that it proposed the following:

> "A corporation that has a substantial degree of power in a market shall not engage in conduct if the conduct has the purpose, **effect or likely effect**, of substantially lessening competition in that or any other market."

The justification for introducing an effects test into the section provided by the Harper Review panel was that: "*The Panel considers that the current form of section 46, … is misdirected as a matter of policy and out of step with equivalent international approaches. The prohibition ought to be directed to conduct that has the purpose or effect of harming the competitive process*."[3]

The Final Report provides a scarcity of reasoning for reaching this conclusion. It does outline some information on comparative provisions from international jurisdictions but query whether they provide the justification claimed by the Harper Review panel. The Canadian test is clearly an effects test. However, the Final Report itself notes that the courts interpret section 2 of the Sherman Act with respect to objective intent with intent able to be inferred from conduct and effect. Therefore, not merely effect. The position in Europe is far more nuanced. Depending on the kind of conduct the subject of complaint, the test varies from a presumption of harmful effects where the object of the conduct is to distort competition to a test of analysing whether the conduct would exclude an equally efficient competitor from the market.[4] This more nuanced view of the position in the EU is recognised at page 524 of Appendix B of the Final Report, although not sufficiently clearly at page 340 of the main body of the Final Report where the International Bar Association is quoted. Note that the test in New Zealand's is a purposive test.

The Harper Review Panel recognised in their draft report of September 2014 that an effects test raised the risk of inadvertently capturing pro-competitive conduct, thereby damaging the interests of consumers[5]. To remove any concerns about over-capture, in their draft report the Harper Review Panel proposed a defence be introduced so that the primary prohibition would not apply if the conduct in question:

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[1] See page 339 of the Final Report.

[2] Ibid.

[3] At page 340.

[4] Lovdahl Gormsen, Liza, "Are Anti-competitive Effects Necessary for an Analysis under Article 102 TFEU?", World Competition 36, no.2 (2013): 223-246. At page 243: "*However, since case law allows for other approaches than the one advocated in the Guidance Paper, there is no legitimate expectation that the Commission will apply an effects-based test in future cases*."

[5] Competition Policy Review, Draft Report, September 2014, page 210.

- would be a rational business decision by a corporation that did not have a substantial degree of power in the market; and
- would be likely to have the effect of advancing the long-term interests of consumers.[6]

It was suggested that the onus of proving that the defence applied should fall on the corporation engaging in the conduct.[7]

In the Final Report, the Harper Panel conceded that their proposed defence was not generally supported by submissions, including for the following reasons:

- the first limb replicates the existing problems with the "take advantage" test' and shifts the onus of proof to the respondent;
- the second limb is too vague and is not properly capable of practically workable ex ante application;
- the defences are unnecessary; and
- providing a defence would be inconsistent with sections 45, 47 and 50 where there is no express defence.[8]

The Harper Panel then refers to arguments submitted to it that firms should be able to demonstrate the pro-competitive efficiency of their conduct and that this should be a matter that the court should take into account. They conclude that the preferable approach is to include in section 46 legislative guidance with respect to the section's intended operation, with the legislation directing the court, when determining whether conduct has the purpose, effect or likely effect of substantially lessening competition in a market, 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
- of **lessening** competition in the market, including by preventing, restricting or deterring the potential for competitive conduct in the market or new entry in the market[9].[10]

In an acknowledgement that an effects test may produce business uncertainty, the Harper Panel noted that any residual concerns about business uncertainty can be further mitigated by:

- authorisation being made available to exempt conduct from the prohibition in section 46; and
- the ACCC issuing guidelines on its approach to enforcing section 46, prepared in consultation with business stakeholders, legal experts and consumer groups, and issued in advance of the commencement of the revised prohibition.[11]

Observations

The existing test is well understood. Removing key aspects of the test in relation to what constitutes anti-competitive conduct creates risk and uncertainty. As acknowledged by the Harper Panel, a move to an effects based test for unilateral conduct under section 46 raises the prospect that legitimate commercial conduct, in the absence of any anti-competitive purpose, will be captured by the prohibition. The proposed directions to the court arguably do not add to the overall concept of substantially lessening competition and query how, in their application, the two limbs of the direction will interact with each other.

In an attempt to mitigate such concerns about business uncertainty, the recommendations include making authorisation available to exempt conduct from section 46 and guidelines from the ACCC on its approach to enforcement. With respect, the first is likely to cause delay in business dealings, and an abundance of

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[6] Ibid.

[7] Ibid.

[8] Final Report, pages 342 to 344.

[9] Ibid, page 344.

[10] These factors are similar to the defences contained in section 8(d) of the South African Competition Act 1998 which prohibits a dominant firm from engaging in certain exclusionary acts unless the firm concerned can show technological, efficiency or other pro-competitive, gains which outweigh the anti-competitive effect of its act. Note that the onus rests with the firm.

[11] Ibid, page 345.

caution from business and practitioners, while the second may be unlikely to provide the degree of comfort envisaged. In the absence of anti-competitive purpose, is it appropriate for firms with significant market power to have the ACCC determine whether their conduct will have the effect or likely effect of substantially lessening competition?

The takeaway

Given the potential for increased regulatory intervention and less proactive and dynamic commercial activity from business as a consequence of the proposed changes, we anticipate that engagement with the Government during the consultation process will be lively and robust. The recommendations in the Final Report on section 46 should be a focus for clients with market power. Clients should consider whether they wish to engage with the consultation process, with the Government's call for submissions closing on 26 May 2015.

Let's talk

For a deeper discussion of how these issues might affect your business, please contact:

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