Article Information

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Which “effects test” for section 46: Europe, USA, or Australia?

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The Competition Policy Review’s final report delivered in March 2015 recommends that section 46 should be amended to introduce an “effects” test in line with overseas jurisdictions, and abandons the earlier draft recommendation of a new defence for conduct that is in the long-term interests of consumers. The final report acknowledges in an appendix that corresponding provisions in the USA and Europe differ regarding “effects” of unilateral dominant firm conduct.

The Review’s final report adopts much of the ACCC’s submission that section 46 should be changed to prohibit conduct that has “the purpose or likely effect of substantially lessening competition”. It is said that Australia is out of step with international approaches to unilateral dominant firm conduct and that this change will bring us into line. Appendix B to the report sets out a brief comparison of Australia’s current “purpose based” provision with the US “conduct based” provision and the controversial guidance issued by the EU Commission some years ago “that is viewed as advocating an effects test”. This article examines the position in the US and EU in more detail, and concludes that the Review’s recommendations for section 46, while a uniquely Australian experiment, do not align Australia more closely with either the US or EU. Reference could be made to the US Antitrust Modernisation Commission report of 2007, the European Commission Guidance on single firm conduct of 2008, and the US Department of Justice report on single firm conduct of 2009 (subsequently withdrawn), to indicate that this is not an harmonious area of competition law or policy.

The Review’s final report abandons the draft proposal to introduce a defence to section 46 if the conduct in question would be rational for a corporation that did not have substantial market power and would be likely to have the effect of advancing the long-term interests of consumers. While the first limb of that defence would be useful, it is a pity that the final report still speaks about the “long-term interests of consumers” as a key objective of competition law without, however, clarifying what the term means. The submission by Frontier Economics on the Review’s draft report suggests that the term refers to the productive efficiency of the economy, but that when applied to conduct of a firm in a market the concept is forensically unprovable, i.e. it is not possible to determine whether given conduct is likely to have a positive or negative effect on productive efficiency. It is clear from the Review’s final recommendation that these concepts will continue to be relevant to the regulation of dominant firm conduct.

The Review proposes that section 46 needs to be amended to “strike the right balance between prohibiting anti-competitive conduct and not interfering with efficiency, innovation and entrepreneurship”. While expressed in the negative, this statement acknowledges the internationally recognised dilemma that it is conceptually and forensically difficult (if not impossible) to distinguish between conduct of a dominant firm in a market which amounts to an unlawful misuse of market power or may be permitted as a normal incident of competition. For example, it is accepted in US jurisprudence that markets and competition may be expected to have the effect of excluding competitors, e.g. if supply exceeds demand it may be expected that less efficient competitors, and equally efficient competitors who cannot supply profitably, will exit the market. It can be inferred that Australian courts have endeavoured to construe the current section 46 to resolve this dilemma (e.g. by interpreting the current “purpose” test to mean “subjective” purpose), though not always to the liking of the ACCC.

The way the Review proposes to clarify section 46 to strike the right balance is to “direct the court to weigh the pro-competitive and anti-competitive impact of the conduct”. The reference to “pro-competitive” effects adds an element not previously considered in the “substantial lessening of competition” test used elsewhere in the legislation. The Review characterises these pro- and anti-competitive effects as binary opposites, and the proposed amending legislation is drafted accordingly. Conduct which "meets competition", or as mentioned above, could be expected as a normal incident of competition, cannot be said to "increase" competition, but is simply the result of the normal competitive process. The benefits (effects) that flow from this facilitate the long-term consequences of competition, i.e. productive efficiency. Thus the focus on "pro-competitive" effects may be too narrow, and even a wider focus on effects on the long-term interests of consumers appears to raise issues that are forensically unprovable.

Under the Review's recommended approach, the court is given no guidance as to how to weigh up "effects" that indicate for or against a contravention. For example, in a market with excess supply and falling prices, a dominant firm may expand production to achieve cost-efficiencies and so maintain or expand market share, with the result that less efficient competitors exit the market. Under the Review's proposed amended section 46, the court must have regard to the extent the conduct has the likely effect of "increasing competition in the market including by enhancing efficiency, innovation, product quality or price competitiveness in the market", and also the extent the conduct has the likely effect of "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 short-term effects are that competitors are excluded, and market structure becomes more concentrated, but that the incumbent firm has increased its efficiency. Is it necessary to determine whether the excluded competitors are more or less efficient, and how can this forensically be proven? If more efficient competitors are excluded we might presume that the competitive process has miscarried. If less efficient competitors are excluded, the market and competition can be seen to work effectively to facilitate long-term productive efficiency. However, it may be that in the long-term new entry would be more difficult. How is a court to weight up these factors that it will be "directed" to consider? The process of weighing up competitive effects under the proposed Australian "effects test" appears to involve consideration of the long-term interests of consumers in productive efficiency, a very similar function to the weighing up of public interest factors that, until now, has been the province of the Competition Tribunal.

We might now ask, if the Australian test has been brought into line with the US and EU, how would these issues be addressed under the law of those places? Starting with the US, it is generally acknowledged that lack of clarity concerning the interpretation and application of section 2 of the Sherman Act, despite over 120 years of case law, has been a long running problem. Section 2 of the Sherman Act is a very simple provision, with no express "effects" test. The US Federal Trade Commission submitted to the Review that there has been a judicial shift in the US over a century from "intent" to "effects". The FTC summarises the US judge-made law as requiring: actual or threatened harm to the competitive process (not merely harm to competitors) and thereby consumers (e.g. restricted market output, higher price levels or reduced innovation); which cannot be justified as "competition on the merits" (e.g. that involves greater efficiency or enhanced consumer appeal). According to the FTC, the plaintiff bears the burden of proving the first element, which can be inferred from available evidence (often circumstantial) and if the defendant proffers evidence of justification, the plaintiff must rebut it to succeed.

The Antitrust Modernisation Commission reviewed section 2 of the Sherman Act in 2007 and found the provision not without its problems (e.g. unclear what types of conduct amount to "competition on the merits") but recommended that further development should be left to the courts. The Commission expressed the hope that then current enquiry by the FTC and Department of Justice into dominant firm conduct would provide useful clarification. These hopes were not realised, as the eventual report was released and subsequently withdrawn in 2009 because the DOJ disagreed with it.

The American Bar Association submitted to the Review that there is no US standard for determining "effects" and that if such a test is adopted in Australia, it should be left to the courts to develop. However, as it is not proposed to adopt the US jurisprudence (or to enquire into and understand the reasons for the shift of judicial thinking in the US over the last 100 years), this may be a recipe for repeating the past 40 years cycle of judicial interpretation of the current section 46 and repeated legislative intervention.

The EU provision, Article 102 of the Treaty for the functioning of the EU (TFEU), is likewise a very simple provision, with no express "effects" test and a considerably smaller body of judicial interpretation. Its purpose is to enhance the operation of the "internal market". The implied "effects" test arises from the European Commission's 2009 Guidance on enforcement priorities which focuses attention on practices that harm the process of competition and thus adversely affect consumer welfare, e.g. in the form of higher prices, limiting quality or reducing consumer choice. Note that "consumer welfare" in this usage has quite a different meaning from the "long-term interests of consumers" as interpreted by Frontier Economics and apparently used by the Review. The EC Guidance refers also to conduct of dominant firms that excludes competitors by means other than "competition on the merits". The guidance indicates that the focus of enforcement should be on cases where exclusionary conduct adversely affects equally efficient competitors, i.e. impact on "less efficient" competitors is of no concern.

The EC's Guidance is not binding on the courts and has had an equivocal reception by commentators (and the courts), in particular its focus on short-term effects on consumers rather than long-term effects on productive efficiency is criticised, and the underlying methodology appears to involve an inference of harmful effects rather than forensic proof of actual effects. The Review is nevertheless confident that, in Australia, "effects" will be a more satisfactory and objective test than the current subjective purpose test. Only time will tell. The forensic difficulties with proving “effects” should not be under-estimated, and may well explain why the ACCC in recent cases such as Cement Australia and Pfizer, where it could have brought a case based on the “substantial lessening of competition” test, chose to base its case on the “purpose” test, i.e. even a subjective “purpose” may be easier to prove than “effects”.

There is no international standard “effects test” to assess dominant firm unilateral conduct. The perceived “trend” in the US and EU towards an “effects test” appears substantially to respond to discredited “structuralist” approaches to assessing lessening of competition in which, e.g. increased supplier concentration is equated with harm to competition regardless of actual competitive dynamics. This is not a problem encountered in Australia with the current section 46. We should not underestimate the consequences of amending section 46 to introduce a test that is not consistently developed in the US or EU legislation and that will rely on Australian courts to develop a distinctly Australian “effects” test over time.

For more information on this topic, contact George Raitt or a member of our Competition & Consumer group.