BAKER & McKENZIE

Submission on Draft Report released by the Competition Policy Review Panel

1. Introduction

1.1 Baker & McKenzie welcomes the opportunity to present this submission in response to the Draft Report released by the Competition Policy Review Panel (**Panel**).

1.2 In this submission, we identify and discuss a few key aspects of Australian competition laws which have been considered by the Panel and present feedback on the draft recommendations based on our experiences and those of our clients.

2. Support for draft recommendations

2.1 We understand the Panel seeks submissions that support particular draft recommendations as well as those identifying issues that may impact on the effectiveness of draft recommendations. In this context, we note the following recommendations appear to advance the clarity, certainty and alignment with policy principles of the competition provisions of the CCA:

(a) draft recommendation 17 relating to competition law concepts;

(b) draft recommendation 18 relating to the simplification of the competition law;

(c) draft recommendation 20 relating to the definition of a market;

(d) draft recommendation 22, relating to the simplification of the cartel prohibitions;

(e) draft recommendation 23 relating to the removal of the prohibition of exclusionary provisions;

(f) draft recommendation 24 relating to the repeal of the price signalling prohibition and the introduction of a concerted practices prohibition (subject to there being a clear definition as to what constitutes "concerted practices");

(g) draft recommendation 26 relating to price discrimination;

(h) draft recommendation 27 relating to the introduction of a competition test for third line forcing conduct;

(i) draft recommendation 28 relating to the amended categories of exclusive dealing conduct;

(j) draft recommendation 29 relating to the extension of the notification process to resale price maintenance;

(k) draft recommendation 34 relating to simplifying the authorisation and notification process; and

(l) draft recommendation 35 relating to the introduction of a block exemption power.

3. Mergers and acquisitions

3.1 The Panel has rightly recognised the appropriateness of the current substantial lessening of competition test and the value of the ACCC informal merger clearance process in efficiently dealing with the vast majority of mergers.

3.2 However, in our submission, the Panel's discussion of merger process options and the conclusions in draft recommendation 30 do not appear to have taken into account some important contextual issues arising in merger regulation.

3.3 Questions of effective merger process only arise with respect to a small number of highly contentious mergers and it is in this context that the informal merger clearance process can sometimes be found wanting. This is not primarily due to the presence or absence of strict information requirements, the ACCC or Tribunal acting as decision-maker at first instance or the ability of efficiencies or other public benefits to be taken into account.

3.4 What is lacking from the informal clearance process is the ability to have evidence relevant to contentious mergers tested objectively and transparently to a high standard, including both the ACCC and the merger parties having access to witnesses. In fact, it is the very benefit of the informal clearance process in the form of the ACCC's highly efficient approach to gathering and testing relevant information that make it inappropriate for some highly contested mergers. This is because by their nature contentious mergers require a forum in which the evidence can be tested to a standard that approaches that applied by a Court or Tribunal.

3.5 It is also important that the merger review process be efficient both in terms of cost and time. Further, lengthy merger review processes can cause significant uncertainty and have adverse impacts on the companies and employees involved. In this context, we recommend that further consideration be given to whether introducing a further level of decision making with appeal rights is the best approach. An effective merger process should be one that gives all parties an opportunity to arrive at the right outcome at first instance.

3.6 In our submission, proposals for merger process reform should be considered in this context. The proposed reforms in draft recommendation 30 are at risk of changing aspects of the various merger processes without delivering an efficient process to best deal with contentious mergers.

3.7 We have not sought to formulate a complete proposal for merger process reforms that would seek to address these issues. However, we note that the broad approaches for dealing with contentious mergers could include either:

(a) including the ability to have evidence tested objectively and transparently as part of a revised formal merger clearance process administered by the ACCC, for example through a public forum; and/or

(b) retaining the ability of merger parties to apply for authorisation directly to the Tribunal.

4. Misuse of market power

4.1 The Panel has set itself the challenge of striking the right balance between prohibiting anti-competitive conduct and allowing pro-competitive conduct. This cannot be achieved unless there is clarity as to the nature of any problem with the current law and the manner in which this problem is proposed to be addressed. In our submission, the Panel's approach to both of these aspects would benefit from refinement before changes to the law are recommended.

4.2 On the current provision, the Panel identifies concerns with:

(a) the taking advantage of market power element being difficult to interpret; and

(b) a focus on competitors instead of the competitive process.

4.3 The "taking advantage" element has been the source of much conjecture and we could only agree that it has presented a significant hurdle for persons seeking to establish a misuse of market power. However, it remains the central element of the misuse of market power prohibition such that its removal from the primary prohibition seems at odds with an appropriate framing of the "mischief" the provision seeks to regulate. The misuse of market power prohibition is intended to target a particular form of anti-competitive conduct by corporations with market power. The fact that it is narrower in scope than that addressed by sections 45, 47 and 50 of the CCA and more difficult to establish should not necessarily be seen as a problem or a failure of the current law.

4.4 In terms of a focus on competitors, the fact that section 46(1)(a) to (c) of the CCA mentions competitors does not mean that it is focused on the protection of competitors (a notion that appears to have gained momentum contemporaneously with the Panel review). When read in conjunction with the purpose element of section 46, references to competitors in the proscribed purposes have the effect of identifying unilateral conduct that is likely to impact on competition. Any confusion created at a superficial level by references to competitors has not infected the application of the current provision by the courts and should not be identified as a basis for reform.

4.5 In this context, we have concerns with the proposed reforms in draft recommendation 25. They appear to represent a hybrid between the current provision and section 45 of the CCA in circumstances where a basis for this approach has not been fully identified.

4.6 We also have concerns with the proposed defence to the new prohibition against misuse of market power. The proposed defence has two elements which must be established by any company seeking to rely upon it:

(a) the conduct would be a rational business decision by a corporation that did not have market power (thereby effectively retaining the criticised "take advantage" requirement but shifting it to the respondent to establish in defence); and

(b) the conduct would be likely to have the effect of advancing the long term interests of consumers.

4.7 The logic of the first limb of the defence is not apparent. As stated above, the concept of taking advantage is the central element of the misuse of market power prohibition. Having determined that this concept is too difficult to establish, it is then removed from the primary prohibition to re-emerge as "someone else's problem", namely the firm with market power. It must prove what some other hypothetical firm without market power would do. It is not clear why this has been chosen as the relevant touchstone for identifying legitimate commercial conduct by a firm with market power that should be permitted from anti-competitive conduct that should be prohibited.

4.8 In relation to the second element, namely the long term interests of consumers, this raises significant issues in its potential application and is likely to impose a significant burden on a respondent. First, this requirement will mean that the defence is unlikely to apply all legitimate commercial conduct by firms with market power which could potentially have an adverse impact on competition. For instance, a firm with market power may have a legitimate reason for refusing to deal with another firm (such as concerns regarding that firm's credit or trustworthiness) notwithstanding that that refusal may not be able to be established as being in the long-term interests of consumers. Second, this element would appear to require a weighing up of all the aspects of the conduct that are in the long-term interests of consumers against those aspects that are not. This would impose a significant compliance burden on firms with market power, as well as a very significant evidentiary burden on respondents. Third, there is a question as to who is a "consumer" for the purpose of this test and whether it includes purchasers of primary inputs in the supply chain.

4.9 Finally, we believe that further consideration should be given to the appropriateness of extending the substantial lessening of competition test to section 46. The fact that it may be appropriate for other prohibitions in Part IV of the CCA does not mean that it is appropriate for section 46. Section 46 is not intended to duplicate those other sections but is intended to deal with specific conduct by firms with market power. Such firms are of course subject to the prohibitions in section 45 and 47 and to the extent that they engage in conduct that has the purpose or effect of substantially lessening in breach of those sections then such conduct is already prohibited under the CCA. There is however no reason why such conduct should also

constitute a breach of section 46 and why cases where such conduct has been found to breach those sections but not breach section 46 somehow demonstrate a failure with section 46. The relevant question is what conduct by firms with market power is not currently captured by the existing prohibitions but should be prohibited under section 46.

5. Exclusive dealing

5.1 The proposed simplification of the exclusive dealing provisions, and of their interaction with the cartel conduct provisions, is welcomed. However, for the reasons set out in paragraphs 4.5 and 4.6 of our initial submission, it is important that the law make it much easier for businesses, especially those without specialist legal teams, to self assess whether or not vertical restrictions which are commonly found in many standard contractual arrangements run any real risk of contravening the "substantial lessening of competition" test. The relatively limited case law to date does not provide sufficient certainty in this regard.

5.2 For this reason, the creation of an appropriately defined safe harbour for exclusive dealing conduct that carried no real anti-competitive risk is very important. Recommendation 35 related to the introduction of a block exemption framework as applies in the UK and EU. We suggest that this framework should include defined dafe harbours in respect of vertical agreements as is the case in the EU vertical agreements block exemption (regulation 330/2010). Where parties have low market share and no market power this will help them manage compliance much more efficiently. They will be able to self assess quickly and cheaply and to make decisions with greater confidence in relation to exclusive arrangements.

6. National access regime

Overview

6.1 Baker & McKenzie fully supports the Panel's comments in relation to maintaining Part IIIA of the CCA (**National Access Regime**).[1]

6.2 The National Access Regime plays an important role in facilitating productivity in the Australian economy. It is, therefore, essential that the Panel considers the fundamental rationale for third party access regimes and then decides whether the National Access Regime as a whole (as interpreted by the courts) is designed to achieve that rationale.

6.3 In general terms there are a number of rationales for third party access regimes, including:

(a) the traditional economic rationale that natural monopolies generally involve a market failure where there are high sunk costs and economies of scale, and that market failure can result in monopoly pricing and/or a decrease in incentives for the monopolistic firm to innovate;

[1] See the Review Panel's comments in Australian Government, *Competition Policy Review Draft Report* (September 2014) 264-265, 269; specifically citing previous comments of the Productivity Commission and the Hilmer Review.

(b) that bottleneck infrastructure can result in a vertically integrated owner of that infrastructure refusing to allow access to the infrastructure to gain an advantage in an upstream or downstream market; and

(c) inefficient duplication of natural monopoly infrastructure should be avoided to, amongst other reasons, ensure the international competitiveness of Australian businesses and to increase productivity.

6.4 In our view, all three rationales are entirely appropriate for the fundamental reasoning behind the National Access Regime. If it is accepted that these three rationales are appropriate then the National Access Regime will need to be reformed, particularly in light of the High Court's decision and interpretation of the National Access Regime (in particular the declaration criteria) in the Pilbara railway cases.

6.5 The Panel has specifically invited further comment on the categories of infrastructure to which the National Access Regime might be applied in the future. While Baker & McKenzie notes that the Panel has singled out the mining sector, it believes that there are broader categories of infrastructure to which the National Access Regime should not be restricted from applying to in the future.

6.6 To return to the traditional rationale for access regulation, the National Access Regime should apply where a facility exists in a market where there is a significant market failure (as described above). One recognised category of market failure is where there is a natural monopoly.

6.7 Baker & McKenzie believes that this is increasingly important in the recent tough economic climate, particularly with respect to Australia's major mining and natural resource export markets. Due to the vast scale of Australia's natural resource base, a large percentage of the essential infrastructure supporting that natural resource base is monopolistic in nature because of massive sunk cost investments, as well as significant maintenance and upkeep fees. Baker & McKenzie does not believe that the impact of a natural monopoly on essential supply chain infrastructure should cause detriment to upstream or downstream competitive markets which ensure the efficiency and global competitiveness of Australia's resource and mining industries.

6.8 In respect of the declaration criteria (contained in section 44G(2) of the CCA), Baker & McKenzie believes that it is essential that the declaration criteria and the methods for interpreting those criteria are clearly outlined and administered by the relevant regulator as soon as possible, otherwise the prevailing uncertainty around how to interpret and apply the declaration criteria will also create uncertainty and risk in relation to investing in major monopoly infrastructure, or in upstream or downstream markets which rely on that major monopoly infrastructure. This in turn is likely to impact on the potential competitiveness of many of Australia's major markets at a global level.

6.9 Because of this potential impact, Baker & McKenzie agrees with the Panel that a detailed analysis of the declaration criteria is required. Baker & McKenzie's views regarding the declaration criteria are outlined below.

Criterion (a): a material increase in current competition

6.10 Baker & McKenzie agrees with the Panel's decision to support the Productivity Commission's recommendation regarding criterion (a); i.e., the analysis of the current status for access to the service compared with the outcome that declaration would have on the service. In particular, we support the focus on access to infrastructure on reasonable terms and conditions through declaration would promote a material increase in competition in an independent market.

6.11 Baker & McKenzie agrees that in any instance where a facility owner is already providing reasonable terms and conditions of access on a contractual basis, the status quo should be assessed rather than imposing the burden of regulation because of a hypothetical test assessing no access at all. This recognises the reality that there are now contractual access regimes being developed which provide appropriate third party access. For example, third party access to the Wiggins Island Coal Export Terminal is available under the Wiggins Island Terminal Access Policy. As such, Baker & McKenzie believes that in circumstances where the existing contractual access regime facilitates third party access at reasonable prices there is no need for the statutory access regime to apply.

6.12 The proposed amendment to criterion (a) is particularly appropriate in these circumstances.

Criterion (b): uneconomic to duplicate

6.13 Baker & McKenzie notes that the Panel has made a draft recommendation to accept the alternative test for criterion (b) proposed by the Productivity Commission; i.e., that it will be uneconomical to develop another facility where it is privately profitable for anyone, except the incumbent infrastructure service provider, to duplicate the facility. Baker & McKenzie does not agree with this recommended approach. Baker & McKenzie does not believe that this recommended test is appropriate at either a practical or theoretical level.

6.14 At a practical level, even though it may be privately profitable for anyone other than the incumbent infrastructure service provider to duplicate the existing facility, this does not mean that any third party has an interest or intention to do so. This could result in a situation where a supply chain is subjected to monopoly pricing and economic hold-up because there is only one infrastructure service provider and, although the facility is unable to be declared because there is another company that could duplicate the facility, no company does have an interest in doing so. That is, if there is one railway in a regime and BHP has sufficient marketable resources in that regime to build an alternative railway, the fact that BHP chooses to develop another region in another country means that all junior miners who cannot build their own railway are unable to have the existing railway declared.

6.15 Further, even if a second railway is developed, there is no reason to assume that the second owner will adopt an open access policy meaning that the natural exclusion of operators that do not have the capital available to build their own major export or transport infrastructure will continue, even though the act envisaged by the private profitability test (i.e., duplication) has occurred. Indeed, the experience in the Pilbara would lead one to the alternative conclusion. The result of such a situation is damage to Australia's supply chains and global competitiveness because of the inflexibility of criterion (b).

6.16 At a theoretical level, the test which best addresses the original economic justification for third party access regimes is the "natural monopoly" test. This test leads to the circumstances that the only infrastructure which can be declared is that which displays natural monopoly characteristics (and, therefore, market failure). It also has the benefit of discouraging inefficient duplication of assets, which is not in the interests of companies investing in Australia, the Australian economy or the Australian public.

6.17 As such, Baker & McKenzie supports the first test proposed by the Productivity Commission and does not agree with the Panel's draft recommendation regarding the private profitability test.

Criterion (f): promote the public benefit

6.18 As stated above, Baker & McKenzie believes that the Panel should consider the threshold for the application of the National Access Regime as a whole. This includes considering the role of criterion (f) in relation to the other declaration criteria.

6.19 Baker & McKenzie believes that the threshold imposed by the other four declaration criteria is already sufficient to ensure that only situations of market failure are addressed by the National Access Regime. Therefore, Baker & McKenzie does not agree with the proposed amendment to criterion (f).

6.20 Criterion (f) is drafted, and has previously been appropriately interpreted as, a final "catch-all" style provision to prevent declaration of a facility. That is, if declaration of a facility meets all the other substantive declaration criteria but is contrary to the public interest it will not be permitted. This operates as a final protection for the public and, while normally not a major hurdle, is nevertheless an essential safeguard on the declaration process.

6.21 With the Panel's proposed amendments, however, criterion (f) becomes a positive step that the declaration applicant must prove in order to ensure the declaration of the facility. Baker & McKenzie believes that any instance where the other four declaration criteria are met (meaning that a facility promotes competition in a dependent market, is uneconomic to duplicate, is of national significance and is not otherwise regulated by an approved regime) surely promotes competition and economic development, something which is likely to only ever be in the public interest.

6.22 Baker & McKenzie notes the comments of the Panel that "all factors that bear upon the overall public interest should be taken into account in the declaration decision."[2] Baker & McKenzie does not believe that the existing negatively-framed test for criterion (f) necessarily excludes a consideration of these factors. Rather, the existing test requires the National Competition Council and the Minister to consider all those factors to ensure that declaration of a facility is not contrary to the public interest. Either way, the public interest is adequately protected and the only differentiating factor is that the positive test requires an applicant to prove some advantage, rather than just proving that the public is not adversely impacted.

6.23 As such, Baker & McKenzie believes that criterion (f) is appropriately framed as a catch all to ensure that there is not a specific issue in respect of the particular infrastructure which would make access contrary to the public interest. Indeed, it is questionable that criterion (f) is appropriate at all where the Australian Competition Tribunal has merits review. The relevant Minister under the legislation is the person best placed to assess issues of public benefit and it should only be in exceptional circumstances that a decision of the Minister on public interest issues should be overturned.

7. Intellectual property

Regular review of IP laws

7.1 We agree with the draft Report when it notes (at page 84) the importance of the extent and content of IP laws being regularly reviewed to check that it is in the best interest of Australians, particularly in the context of an increasingly digital economy. We note that the Ergas Committee Report in 2000 made a similar comment and noted that an extension of the copyright term would not be in Australia's best interests. The Government nevertheless extended the term by 20 years. The Productivity Commission has recently confirmed that this was not in Australia's best interests.

A fair use exception to copyright

7.2 In its first submission to this review the ACCC noted that the introduction of a broad fair use exception to copyright would be pro-competitive and in Australia's best interest. The ALRC has also recently recommended the introduction of such a right to properly balance the rights of owners and users and to facilitate innovation. We submit that the final report should support such a measure on competition and efficiency grounds. The lack of such an exception restricts the opportunities to use technology to create new products and services in a digital economy. As a result copyright is having a chilling effect on creativity in Australia and puts Australian businesses at a competitive disadvantage to their peers in the USA and many other parts of the world. At the same time strong measures to address piracy using the internet are very important in order to ensure that copyright remains an incentive to invest in Australia's

[2] Review Panel, *Competition Policy Review Draft Report* (September 2014) 272.

creative industries and there are good competition law reasons to support tougher measures in this area, which the government is considering.

Section 51(3) CCA

7.3 The draft Report recommends the repeal of section 51(3) of the CCA without clearly articulating why it departs from the conclusions that the NCC and the Ergas Committee reached in their more detailed consideration of the same issue 15 years or so ago. To equate intellectual property with other property, as the ACCC does in its submission (Part 1) with which the draft Report agrees, ignores some important differences.

7.4 An IP right confers on the owner in return for its investment a right (subject to limitations, such as the right of a third party to seek compulsory licensing of a patent) to choose whether and how to exploit their IP. Unlike other property, often licensing or assignment will be the best ways to exploit IP because the owner will not have the means to do so themselves. Unlike real or personal property, it is possible for both the owner and others to exploit most IP rights. In refusing to let others exploit the right, or to grant an exclusive licence to only one competitor, the IP owner acts consistently with its ownership of the right. If they have market power then section 46 CCA will constrain their decision.

7.5 The Ergas Committee recommended that licences or assignments that created horizontal arrangements that extended the power of the IP owner should not be exempted by section 51(3), as the NCC also suggested. Likewise any condition which had any substantial anti-competitive effect. We agree with such limits on the exemption in section 51(3). But the repeal of section 51(3) would also mean that if a patent owner, without any market power, imposed a vertical condition on a licence for the purpose of preventing competitors getting access to use its invention (arguably an anti-competitive purpose) it may breach sections 45 or 47 of the CCA. This puts IP owners in a difficult position which is inconsistent with their rights as owners. To suggest, as the ACCC does in its submission, that the notification or authorisation regimes are a solution is unrealistic. These are time consuming, expensive, public processes which an IP owner should not have to go through in order to implement arrangements which have no anti-competitive effect and are vertical arrangements.

7.6 For these reasons, we submit that the recommendations on section 51(3) need to be more granular and that a blanket repeal is not appropriate. The efficiency costs of unnecessarily hindering the licensing and assignment of IP are very significant (see H. Ergas, "The (Uneasy and Somewhat Messy) Interaction of the IP Laws and the Competition Laws", unpublished, http://www.greenwhiskers.com.au/index.php/intellectual-property/406-297, at pages 12 and 13). At the very least the reason for departing from the Ergas Committee's suggested approach should be articulated so that those that follow can properly evaluate the Harper Committee's recommendation and whether to implement it.

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