2 Criminal sanctions and increased pecuniary penalties

Summary

The Organisation for Economic Cooperation and Development (OECD) recently examined the problem of cartels in the international economy. It concluded that hard-core cartels (bid rigging, market sharing, output restriction and price fixing) are the worst form of anti-trust breaches because they are highly damaging both to consumers and the economy generally. The OECD estimated that the value of commerce affected by cartel conduct worldwide is many billions of dollars each year.

In 1998 Ministerial Council of the OECD unanimously recommended that member countries enact significant sanctions capable of deterring firms and individuals from participating in cartels. The Commission does not believe that the existing civil penalty regime in Australia is an appropriate means for dealing with hard-core cartels in all cases, nor is it an effective deterrent particularly considering the incentives to collude. This chapter argues for the introduction of criminal penalties and outlines the elements of a model for doing so.

Pecuniary penalties fail to deter the most flagrant and harmful collusive agreements, where competitors agree to fix-prices, rig bids, limit output or share markets.

Hard-core collusion is morally reprehensible. It is usually clandestine and should be recognised as fraud and criminalised accordingly. It does not matter that the perpetrators are pillars of society. The nature and effect of the conduct make it criminal. The current maximum penalty of $10 million for corporations and $500 000 for individuals indicates how seriously Parliament regards such conduct. It is anomalous that hard-core cartel conduct is not criminal, when these penalties are compared with penalties applying to other white collar conduct that is recognised as criminal such as market manipulation and insider trading.

Hard-core cartels can be highly profitable for those involved and are difficult to detect. This makes the incentives high for businesses to engage in such fraudulent and clandestine conduct. It also makes it imperative that significant deterrents exist to counteract these incentives.

The Federal Court has imposed penalties for breaches of s. 45 of the Act in a number of cases when cartel participants, or related companies, have previously been found to have contravened that section. In each case the conduct occurred after 1993 when the maximum pecuniary penalty for a corporation under the Act was raised to $10 million.

There is a long list of other cases that illustrate that multi-million dollar civil penalties are not, by themselves, adequate to deter cartel conduct. One example is the international vitamins cartel. This cartel began operating in Australia after 1993 and it continued to operate after the court imposed penalties exceeding $11 million in the express freight cartel involving TNT and Mayne Nickless in 1994 and $20 million in the pre-mixed concrete cartel involving Pioneer, CSR and Boral in 1995. The

distribution transformer matter is another example of a cartel that continued to operate after the Federal Court imposed these multi-million-dollar penalties. (See section 2.2.3.3 for other examples.)

The Commission considers that a criminal penalty regime (including imprisonment for individual respondents involved in the unlawful conduct) represents international best practice and is the most effective way to deter and prevent this cartel conduct. The Commission proposes a maximum custodial sentence for individuals of seven years. (See section 2.3 for discussion about the Commission's reasons for supporting the introduction of criminal sanctions.)

The Commission proposes a number of legislative safeguards to ensure that criminal sanctions are not applied inappropriately. (See sections 2.4 and 2.5 for details of the proposed safeguards.)

- Sanctions would only apply to hard-core cartels.
- The law would only apply in relation to conduct carried out by, or in, large corporations.
- The Constitution requires that serious criminal offences be tried by a judge and jury.
- To obtain a conviction a unanimous jury verdict is necessary.
- The existing exemptions that protect agreements from civil liability would also operate for criminal convictions and an additional defence could be considered for application to bid rigging when the person requesting tenders was informed of the agreement in question. (See sections 2.6 and 2.7 for discussion about the proposed structure and elements of criminal cartel offences.)

The Commission proposes that the new criminal offences operate concurrently with the existing civil regime. (See section 2.9 for discussion of some practical issues, including how an investigation may be conducted when it is not clear whether a matter will be civil or criminal and the involvement of the Director of Public Prosecutions (DPP).)

The Commission believes that two amendments to existing civil penalty provisions are also important (see section 2.10).

First, the Commission proposes that the Act be amended so that the maximum penalty the court may impose on a corporation be the higher of $10 million or three times the value of any commercial gain from contravention. If it is difficult to estimate the gain, the court should have the option to substitute 10 per cent of the corporation's Australian turnover for the duration of the infringement for a maximum of three years. This measure, will ensure that a penalty can be set at a level that removes the possibility of a company profiting from engaging in illegal conduct is well recognised in overseas jurisdictions.

Second, the Commission proposes that the statutory limitation period for the commencement of proceedings be extended to 10 years. This extension would only operate for contraventions of s. 45.

2.1 Introduction

In Australia, s. 45(2) of the Act prohibits the making, or giving effect to, a contract, arrangement or understanding between firms that are, or should be, in competition with each other, if a provision of the contract has the purpose, effect, or likely effect of lessening competition or if the contract includes an ‘exclusionary provision’.

Cartel agreements, which are agreements that have the effect of price fixing, bid rigging, output restriction or market sharing, will fall for consideration under s. 45 of the Act. Each will usually be illegal per se. A price fixing agreement is deemed (pursuant to s. 45A) to substantially lessen competition and therefore breach s. 45.

An exclusionary provision is defined in s. 4D as one that has the purpose of preventing, restricting or limiting dealings with particular persons (whether absolutely or on particular conditions) by all or any of the parties to the arrangement, which parties are competitive with each other or are potential competitors. Bid rigging, output restriction, and market sharing agreements are usually exclusionary provisions and as such prohibited per se.

A corporation found to have engaged in cartel conduct in contravention of these sections of the Act is liable for a maximum pecuniary penalty of $10 million per contravention. Individuals are liable for penalties of $500 000 per contravention. The Commission considers this does not, particularly in the case of large companies, effectively deter cartel conduct, which is difficult to detect and potentially highly profitable. It also considers that, given the gravity of some contraventions of the Act, as is reflected in the $10 million maximum pecuniary penalty, it is somewhat surprising that the Act does not provide criminal sanctions at least for the worst breaches of the Act.

2.2 Justification for introducing criminal sanctions for hard-core cartel conduct

2.2.1 The impact of cartel conduct

The OECD, which is comprised of the 30 leading market economies that produce two-thirds of the world’s good and services, has labelled hard-core cartels the most ‘egregious violations of competition law’[2] and has called for stronger sanctions against cartel participants to improve deterrence.[3] In 1998 the OECD Ministerial Council

[2] OECD, *Report* on *the Nature and the Impact of Hard-core Cartels and Sanctions against Cartels under National Competition Laws,* 9 April 2002, p. 5.

[3] ibid., p. 2.

Concerning Effective Action Against Hard Core Cartels unanimously recommended that OECD members provide for '… effective sanctions, of a kind and at a level adequate to deter firms and individuals from participating in cartels'.

The 2002 OECD report highlighted some cartel cases prosecuted by member states between 1996 and 2000. The report concluded that the harm caused was often difficult to determine. However, the OECD estimated the total amount of commerce affected in 16 large cartel cases alone, exceeded US$55 billion. The report also showed that in some cases prices were as much as 50 per cent above the competitive price.

The United States Sentencing Guidelines estimate that the average gain from price fixing is 10 per cent of selling price.[4] They suggest that losses exceed the gain because, 'among other things, injury is inflicted upon consumers who are unable or for other reasons do not buy the product at higher prices'. The OECD suggests average gain may in fact be more like 15 to 20 per cent.

The OECD estimates the value of commerce affected by cartel conduct worldwide is many billions of dollars each year. Reports from a number of overseas jurisdictions about cartel investigations confirm that despite heavy penalties being applied in a number of countries to cartels that are detected, national and international cartels continue to flourish. The major reason for this is that cartels are potentially so highly profitable. The Commission is particularly concerned that Australia have penalties in place that will be effective deterring international corporations engaging in cartels in Australia.

On 10 April 2002 the *Financial Times* reported that an 'extraordinary' level of illegal price fixing and market sharing behaviour in the United Kingdom is leading to one cartel a month being uncovered by the Office of Fair Trading. One example reported in a separate article on the same day, involves an allegation of price fixing among six UK drug companies supplying penicillin-based antibiotics and the heart drug Warfarin. This conduct is estimated unofficially to have cost the National Health Service up to £400 million (A$1.08 billion). Australia is not immune to this conduct.

The impact cartels have had on the Australian economy is illustrated by the following examples[5]:

- The participants in the express freight cartel, Mayne Nickless, TNT and Ansett were estimated to hold 90 per cent of a market which was estimated to be worth between $1 billion and $2 billion dollars per year. The agreement operated from the 1970s until the early 1990s.

- The Queensland fire protection cartel is estimated to have affected commerce worth more than a total of $500 million.

4 United States Sentencing Guidelines §2R1.1 cmt. n. 3.

5 These cartels are discussed in more detail below.

- Between 1989 to 1994 the participants in the Queensland pre-mixed concrete cartel accounted for the sale of $1.1 billion worth of concrete.

- market sharing and price fixing by the principal manufacturers and suppliers of electricity distribution and power transformers in Australia is estimated to have effected commerce worth more than $360 million in total.

In Australia in the six years to 2001 the Commission received 2426 cartel and price fixing complaints and conducted 400 investigations (see table 1). The Commission is currently investigating around 20–25 cases that would be classified as potentially relating to hard-core cartels if they were found to involve illegal conduct. The Commission does not suggest that the table indicates that there has been an increase in cartels. However, it does show that the number of complaints has risen. The number of proceedings each year has stayed relatively constant, from three to five.

Table 2.1. Cartel and price fixing investigations and complaints

	Financial year							***Total***
	95–96	96–97	97–98	98–99	99–00	00–01	01–02	
Number of complaints	167	311	328	285	471	422	442	**2426**
Cartels investigations	13	53	75	53	75	70	61	**400**

The trade practices penalty regime in Australia is weak compared with those in other developed countries. The level of deterrence has slipped relative to our trading partners. This has exposed Australians to increased risks from anti-competitive conduct generally and from serious hard-core collusion in particular. Introducing criminal sanctions for the most egregious breaches of competition law—hard-core cartel conduct—and increasing the level of pecuniary penalties will redress this imbalance.

2.2.2 Cartels are blatant frauds that warrant significant sanctions

An objective assessment of the nature and effects of hard-core collusion, and a comparison with other corporate crimes makes it clear that it is inappropriate for Australia’s enforcement regime to be based purely on civil remedies. Indeed, it is anomalous that criminal sanctions do not apply given the hefty civil penalties, $10 million for a corporation and $500 000 for individuals, that currently apply to each contravention. By way of example, insider trading and market manipulation, which are both criminal offences under the *Corporations Act 2001* for which offenders may be gaoled, carry the maximum fines of $220 000 and $22 000 respectively.

Hard-core collusion is morally reprehensible. It is a form of theft and little different from other white collar crimes (including insider trading and obtaining a benefit by deception) that already attract criminal sentences.

Cartels are fraudulent because they enrich participants at the expense of customers. They injure consumers by raising prices above the competitive level and reducing output. Cartels can be very harmful across wide areas of an economy by artificially creating market power and leading to inefficient and wasteful allocations of resources.

By entering a cartel a group of firms can effectively form a monopoly. Cartels are calculated and malevolent attempts to transfer wealth to the cartel operators. They are blatant frauds on consumers. They have no pro-competitive benefits.

A cartel can maximise joint profits by acting in the same way a single-firm monopolist would, that is, by increasing prices and reducing output.

Cartels are also usually highly secretive and difficult to detect. This heightens their distortionary impact.

Competitors have a strong incentive to collude to acquire monopoly power and monopoly rents illegally. Significant sanctions are required to outweigh these incentives.

The potential gains from hard-core collusion are so great, and the chances of being caught are perceived to be so remote, that pecuniary penalties are insufficient deterrents.

In a recent judgment in the transformers matter[6], Justice Finkelstein stated:

> Generally the corporate agent is a top executive, who has an unblemished reputation, and in all other respects is a pillar of the community. These people often do not see antitrust violations as law breaking, and certainly not conduct that involves turpitude, … There are, however, important matters of which the sentencing judge should not lose sight. The first is the gravity of an antitrust contravention. It is not unusual for anti-trust violations to involve far greater sums than those that may be taken by the thieves and fraudsters, and the violations can have a far greater impact upon the welfare of society… Secondly, there is a great danger of allowing too great an emphasis to be placed on the "respectability" of the offender and insufficient attention being given to the character of the offence. It is easy to forget that these individuals have a clear option whether or not to engage in unlawful activity, and have made the choice to do so.

While members of the community, including in the business community place emphasis on having strong law and order policies, it is difficult to argue that criminal sanctions should not apply to business in relation to behaviour as abhorrent as hard-core collusion.

2.2.3 Pecuniary penalties are insufficient deterrents

2.2.3.1 The deterrent role of the Act

The aim of the Act is to promote competition and fair trading by discouraging and punishing commercial conduct that is anti-competitive as defined in the Act. The Commission takes several approaches to achieving compliance. For instance, the Commission informs businesses and consumers of their rights and obligations under the

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6 *ACCC v ABB Transmission and Distribution Limited (No. 2)* [2002] FCA 559, at para. 28.

Act and monitors and reports on developments in specific sectors of the economy. However, the key to the Commission's success has been, and will remain, a successful and high profile enforcement program.

The Commission takes court actions to stop anti-competitive conduct and to have penalties or other remedies imposed on businesses that breach trade practices law.[7] The Commission may also seek to impose remedies on individuals directly involved in illegal conduct. The Commission publicises the outcomes of these matters. The publicity serves both to educate the community and deter anti-competitive conduct.

The general deterrent effect of enforcement is critical because of the impossibility of monitoring all businesses and the difficulty of successfully prosecuting violations.[8] This is especially true for cartel conduct that is clandestine and when participants will often go to great lengths to cover up their conduct. 'Competition law works best where it acts as a real deterrent against individuals and companies engaging in anti-competitive behaviour.'[9]

Commercial enterprises aim to maximise profit by ensuring that the benefits of their conduct outweigh its costs. The Commission believes that given the potential for huge illicit gains arising from cartel conduct, a significant deterrent is required. Indeed, because corporate decision makers are considered rational, deterrence plays a more significant role in commercial and corporate crime than in other areas of criminal law.[10]

General deterrence (the deterrence of others) is generally seen as the fundamental goal of anti-trust penalties. It is the keystone of the anti-trust division of the US Justice Department's sentencing guidelines.[11] Australian case law supports the primacy of deterrence in the Act's penalties but acknowledges that penalties may also be punitive.

Eleven years ago, in *TPC v. CSR Ltd*[12], Justice French found that retribution, rehabilitation and compensation had no part to play in economic regulation of the kind contemplated by Part IV. His Honour considered that the principal and probably the only object of civil pecuniary penalties for violation of Part IV is specific and general deterrence.

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7 In appropriate cases, the Commission may seek to resolve a matter administratively.

8 PJ Kerns, *Criminal Sentencing in Anti-trust Cases,* Loyola University, L.J, 1982, vol. 13, pp. 985, 992.

9 *Productivity and Enterprise—a World Class Competition Regime,* Department of Trade and Industry (UK) White Paper, July 2001, para. 7.1.

10 S Orlansky, 'Developments into Law Corporate Crime: Regulating Corporate Behaviour through Criminal Sanctions', *Harvard Law Review*, vol. 92, pp. 1229, 1234.

11 Kerns, op cit, p. 991. See also Orlansky op. cit., p. 1235.

12 (1991) ATPR 41–076.

This view was also expressed by the Full Court in *N W Frozen Foods v. ACCC*[13], when the majority confirmed that the object of the civil penalty regime under the Act is deterrence. The court stated that 'the penalties imposed by s. 76 are ... not criminal sanctions, and their purpose, established now by a long line of cases, is not punishment.'[14] However, Justice Carr disagreed with this proposition and held that the earlier cases 'have not ruled out or excluded punishment as one of the purposes of s. 76'.[15]

Later decisions have reinforced Justice Carr's comments.[16] Justice Heerey in the *McPhee* case[17] found that while deterrence remained a key objective when imposing penalties, the civil penalty regime also imported concepts of moral responsibility well known to the criminal law.[18] Justice Goldberg in *ACCC v. Australian Safeway Stores Pty Ltd*[19], while following the Full Court in *NW Frozen Foods* also had difficulty with the proposition that imposing a penalty for a contravention of Part IV should not be seen as a form of punishment.[20]

2.2.3.2 The level of pecuniary penalties

The OECD report[21] identified a trend towards stronger sanctions and increasing enforcement efforts in cartel conduct. For example, the OECD reports that in the

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13 (1996) 71 FCR 285.

14 Burchett and Kiefel JJ, at 296.

15 ibid., at 299.

16 Refer also to Nathan Butler, 'Pecuniary Penalties: If Size Really Does Matter, What About Structure?' *Competition And Consumer Law Journal*, 1999, vol. 7, pp. 80, 84. This article suggests that several factors in s. 76 of the Act are more relevant to punishment than deterrence. In particular the direction take into account prior convictions and that sanctions apply to attempted contraventions.

17 *Australian Competition and Consumer Commission v J McPhee & Son (Australia) Pty Ltd (No 5),* (1998) ATPR 41–628.

18 Heerey J said (at 40–891) that while deterrence remains a primary object of the imposition of penalties:

> … nevertheless s. 76 imports into the penalty fixing process concepts of moral responsibility long known to the criminal law. In other words, the sources of the substantive provisions of Pt IV are doubtless economic policy and theory, but the penalties for contraventions are to be applied in a moral universe.

19 (1997) ATPR 41–562 and 43–811.

20 In *ACCC v. Alice Car & Truck Rentals* (1997) ATPR at 41–582, Mansfield J (at 44–049) noted Goldberg J's views, but followed the approach of the majority in *N W Frozen Foods*. In *ACCC v. George Weston Foods* (2000) ATPR at 41–763, Goldberg J repeated his observation that 'a court in an appropriate case where there has been a flagrant and wilful contravention might take the view that a severe penalty was warranted having regard to the deliberateness and wilfulness of the contravention', while again noting that he was bound by the Full Court's decision in N W Frozen Foods not to have regard to punishment in determining the penalty to be imposed

21 OECD, Report on the Nature and Impact of Hard-core Cartels, op. cit., para. 34.

decade to 1997 fines of US$29 million were collected in the US and in the four years from 1997 to 2000 US$1.7 billion in fines was collected. The report notes that similar dramatic increases have been observed in Australia, Canada, the European Union , Germany and South Korea.[22]

At Annex A the OECD report includes a table listing cartel cases and the pecuniary penalties imposed. In the EU, the US and Germany sanctions of more than US$100 million have been imposed. While it is difficult to generalise, the table does show that Australia falls significantly behind these three jurisdictions in terms of the penalties imposed for cartel conduct.

Several OECD countries can fine natural persons for their involvement in cartel conduct. Only Australia, Canada, Germany and the US reported to the OECD that they had imposed monetary penalties on individuals.

2.2.3.3 The deterrent effect of pecuniary penalties

While introducing criminal penalties (or increasing maximum pecuniary penalties) will never prevent all anti-competitive breaches of the Act, the Commission believes that current penalties, on their own, are inadequate as effective deterrents.

In most cases, existing civil penalties are enough to deter contraventions of the Act. However, they fail to effectively deter the worst collusive arrangements.

The prosecution in the United States of Hoffmann-La Roche (HLR) for participating in the international vitamin cartel is an example of how ineffective pecuniary penalties are in overcoming strong incentives to engage in cartel conduct. Two years before HLR’s involvement in the vitamin cartel was exposed, the US Department of Justice (DoJ) was investigating an international cartel in the citric acid industry. HLR admitted involvement in the cartel, cooperated with the DoJ investigation and was eventually fined US$14 million.

At the time the DoJ was also investigating cartel activity in the vitamin industry. It interviewed two HLR executives who were responsible for both the citric acid and vitamin businesses. Both executives denied any knowledge of a vitamin cartel, even though HLR had been engaged in a worldwide vitamin cartel for almost a decade. Following the statements, the executives took steps to further conceal HLR's involvement.

Hoffman-La Roche was prosecuted and fined US$500 million. Both executives were sent to prison. The vitamin cartel was so profitable that even a US$14 million fine arising from the citric acid prosecution was not enough to deter their continuing participation in the vitamin cartel, it merely caused them to re-double their efforts to avoid detection.

In the last few years, the instances of cartel conduct affecting the Australian economy that have been investigated by the Commission has risen. There is little evidence to suggest that increased penalties after 1993 and the large penalties imposed in the mid-

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22 ibid., para. 11.

1990s in the express freight and Queensland pre-mixed concrete cartels have sufficiently deterred collusive agreements. As well as domestic cartels, the number of international cartels being exposed by overseas regulators that potentially effect the Australian market has risen.

The following list of cases in which the court has imposed penalties for price fixing, market sharing and bid rigging illustrate how ineffective the existing penalty regime has been in deterring cartel conduct.

Express freight cartel. Three of Australia's major express freight companies and their senior executives were ordered to pay penalties in excess of $11 million for their involvement in price fixing and market sharing arrangements. The conduct ran for approximately 20 years and occurred prior to the 1993 amendments that increased the maximum penalty from $250 000 to $10 million. Among other things, the participants agreed not to approach each other's customers. On occasion, when a customer decided to change to a new freight carrier, there were instances of freight being lost or damaged deliberately in order to encourage that customer to return to their original carrier. This is surely criminal by any standards. In relation to this behaviour Justice Burchett's[23] view was that:

> an arrangement to maintain a cartel be deliberately providing poor service in order to compel customers to turn or to return to a supplier with whom they might be dissatisfied, must be particularly pernicious.

Pre-mixed concrete cartel case. The Pioneer, Boral, CSR cartel involved price fixing and market sharing in the pre-mixed concrete market in south-east Queensland from 1989 until 1994. The participants had more than 50 regular meetings and phone conversations that in addition to fixing prices, agreed on market shares and not to compete on specified major projects. The participants even engaged an accountant to monitor market shares and enforce compliance with the agreement.

Penalties of $6.6 million were imposed on each company. Penalties were also imposed on six executives, the maximum being $100 000. The conduct was particularly reprehensible because each of the companies or other companies within the groups had previously been found to have engaged in similar conduct. The behaviour did not cease after the introduction of the higher statutory penalties in 1993.

Animal vitamin cartel case. In this case three international pharmaceutical companies fixed the price for animal vitamins A and E, which are used primarily in animal feeds. The Australian arrangements started in 1994 and continued until 1998, even after penalties totalling $21 million in the Pioneer, CSR and Boral concrete price fixing and market share in cartel in 1995. The participants admitted collusion and cooperated with the Commission after exposure by the US authorities.

In a direct reference to their failure to deter collusion that would be difficult to detect and that had the potential to be highly profitable, Justice Lindgren in the animal vitamin cartel case stated:

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[23] *TPC v TNT Australia Pty Limited & Ors* (1995) ATPR 41-375, 40,166.

> In some important respects the collusive arrangements were even more serious than the cartel arrangements in [the pre-mixed concrete cartel] ... The [$20 million] penalties imposed in the Pioneer case appear to have had no effect on the conduct of BAL, Roche Australia and AAN Australia or their offshore affiliates involved in the Overseas Arrangements. In these circumstances, deterrence of similar future conduct and its potential origins is of paramount importance and ... the Court should leave no room for any impression of weakness in its resolve to impose a penalty sufficient to ensure such deterrence.

Fire protection cartel. This cartel ran in Queensland for about 10 years until 1997 and did not end until more than four years after Parliament increased pecuniary penalties. The Commission filed proceedings against 56 companies and individuals—almost the entire fire alarm and fire sprinkler installation industry in Brisbane. The participants referred to the regular meetings that agreed on prices to be tendered for projects as 'the Coffee Club'.

What stopped the participants was not the sudden realisation that they faced massive penalties, but that the Commission had detected their cartel.

Transformer cartels. These cartels involved price fixing and bid rigging in the market for power and distribution transformers and involved the main manufacturers and suppliers in both markets.[24] The collusion that has been admitted in the power transformer market ended in late 1995 and was orchestrated in a series of covert meetings and phone conversations. Similar collusive conduct existed in the distribution transformer market. This conduct did not cease until early 1999, apparently as a result of the failure of one participant to abide by the agreement.

Queensland foam cartel. Three companies, Joyce Corporation Ltd, Foamlite (Australia) Limited and Vita Pacific Australia Limited, were involved, over a period of about 10 years from the mid 1980s, in a price fixing and market sharing agreement in the industrial flexible polyurethane foam market. The agreement developed from a personal friendship between the managers of the three companies who met regularly for lunch. The court imposed penalties totalling approximately the $3.5 million in the case.

Tasmanian frozen food cartel. The Federal Court imposed penalties of approximately $1.5 million on four companies[25] who together held 80–90 per cent of the Tasmania market for the supply of frozen food to catering businesses. The collusion began in 1991 and continued until the Commission commenced investigations in 1996. In his judgment[26] in the case at first instance, Justice Heerey stated:

> It is a depressing thought that the introduction of the vastly increased (and well-publicised) penalties in January 1993 had no effect whatsoever on [the participants]. It was business as usual.

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[24] One company, ABB Transmission and Distribution Limited has contested liability. The other companies Wilson Transformer Company, Schneider Electric, A. W. Tyree Transformers and Alstom Australia did not contest liability and penalties of $2.5 million, $7 million, $3.5 million and $7.1 million respectively were imposed by the court.

[25] Fines were also imposed on the seven managers.

[26] ATPR (1996) 41-515, 42-446.

The fact that many of the cartels, including the distribution transformers cartel and the animal vitamin cartel, continued as long as they did after the large penalties imposed in the express freight and pre-mixed concrete cartels is an indication that the pecuniary penalties are not deterring hard-core collusion. Another graphic illustration of the inefficacy of pecuniary penalties, on their own, to deter hard-core collusion comes from the number of times a corporation has engaged in collusion after it, or a related company, has been prosecuted for engaging in similar conduct. The McPhee, George Weston and Simsmetal cases are three classic examples.

J McPhee & Son. In 1998 the Full Federal Court[27] imposed penalties of $2.6 million against J McPhee & Son (a subsidiary of TNT) for attempting to enter into a price fixing arrangement in the freight industry in 1994 and 1995. The contravention came soon after the maximum pecuniary penalties for breaches of the Act were increased and McPhee was attempting to rig the market at the very time its parent company was negotiating a penalty of many millions of dollars to propose with the Commission to the court for the same conduct. Penalties were imposed on three managers, the highest being $100 000. The managers clearly learned nothing from TNT’s penalty and thought collusion was worth the risk.

George Weston. In May 2000 George Weston was penalised $900 000 for attempted price fixing in relation to biscuit products in Tasmania. The corporation was trying to avoid a price war between retailers of its product. Justice Goldberg said that the conduct:

> ... was a deliberate and conscious attempt to eliminate competition in the relevant market, to disadvantage consumers and to induce two retailers to commit a per se contravention of the Act.

The court recognised that the penalty and the compliance program introduced after an earlier breach had failed to prevent the second offence. This offence was instigated by a senior level manager and occurred only days after George Weston had been penalised $1.25 million for several price fixing and resale price maintenance incidents in Victoria. Justice Goldberg concluded that:

> It is not unreasonable to infer that his attitude was: it is worth a punt to try and get the two retailers to increase their prices. He must have believed that trying to prevent the payment of the markdown claims outweighed the risk which flowed from the attempt to induce the contravention of the Act.

Simsmetal Ltd. In June 2000 the Federal Court fined Simsmetal Ltd $2 million for twice attempting to reach a market sharing agreement with a competitor in South Australia. Simsmetal, the largest scrap metal recycler in the southern hemisphere, tried to bully a small competitor into a market sharing arrangement to insulate itself from competition. On the second occasion, a Simsmetal executive was recorded threatening to ‘destroy’ the competitor's business if the competitor approached any Simsmetal customers. This threat was made less than one year after the Federal Court had imposed a penalty upon Simsmetal and two of its employees for engaging in price fixing in Victoria.

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[27] (2000) ATPR 41-758.

2.3 The benefits of criminal sanctions

The likelihood that imposing heavy pecuniary penalties on participants in a cartel does not deter such conduct led to the recent development and introduction of the Enterprise Bill into the UK Parliament. The Bill proposes to create new criminal offences (with the option for imposing a fine instead of imprisonment). The bill passed the House of Commons on 19 June 2002 and is now before the House of Lords.

Although criminal sanctions and higher penalties in the US or the EU have not prevented corporations or individuals from engaging in hard-core cartel conduct[28] there is a growing consensus that criminal sanctions are more effective deterrents and appropriate in the case of cartels. For instance:

- the UK Government concluded that introducing criminal sanctions would be a more effective deterrent for those involved in cartel conduct.[29]

- In the US, the Director of Criminal Enforcement of the Anti-trust Division of the Department of Justice has stated that:

  > There is no greater deterrent to the commission of cartel activity than the risk of imprisonment for corporate officials. Corporate fines alone are simply not sufficient to deter many would-be offenders. For example, in some cartels, such as the graphite electrode cartel, individuals personally pocketed millions of dollars as a direct result of their criminal activity. The corporate fine alone, no matter how punitive, is unlikely to deter such individuals.[30]

- In a paper delivered in June 2001 Justice Finkelstein said that criminal sanctions, with the possibility of imprisonment for managers, would have a significant effect in reducing anti-trust violations.[31]

- Sweden has proposed to criminalise cartel conduct.[32]

The need for criminal sanctions is subject to active debate in the EU. The Commission believes that it is inevitable that criminal sanctions will be introduced in Australia and believes that the current review offers an important opportunity to consider the issue.

Because anti-trust violators have the option to engage in unlawful activity or not, the knowledge that severe criminal sanctions will be imposed can have a major effect in deterring such conduct.[33]

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28 Kerns, op. cit., p. 994.

29 *Productivity and Enterprise—A World Class Competition Regime*, UK. Government Response to Consultation, December 2001, para. 52.

30 Scott D Hammond, *Lessons, to Detecting and Deterring Criminal Activity*, ABA International Forum: International Cartel Workshop, 2002, vol. 1, p. 4.

31 Notes on Penalties in Antitrust Cases: an Australian/US Comparison, p. 9.

32 OECD, Report on Nature and Impact of Hard-core Cartels, op. cit., para.33.

At the corporate level, vigorous enforcement of stringent penalties, including criminal sanctions is likely to spur corporate efforts to detect and prevent illegal activity.[34]

Individual criminal sanctions also strengthen the deterrence of corporate crime because employees have an added incentive to resist any pressure to act illegally in pursuing higher profits or performance bonuses. If corporate managers are liable for the conduct of employees under their supervision, and are at risk of imprisonment, they have strong incentives to implement procedures that eliminate illegal behaviour and are discouraged from directing employees to engage in conduct that may breach the law.[35]

Of our major trading partners with well-developed anti-trust legislation, criminal sanctions (that include the option of imprisonment and would apply to hard-core collusion) are available in the US, Canada, Japan, Korea, UK (bill only), and Germany.[36] Maximum custodial sentences are five years in Germany, Canada and Japan and three years in the US.[37] In the UK, the proposed maximum sentence is five years.

Maximum sentences, and equivalent fines[38], applying to offences under the Commonwealth Criminal Code that may apply to white collar crimes include:

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33 Kerns, op. cit., p. 993.

34 Orlansky, op. cit., p. 1244.

35 ibid., p. 1259.

36 Criminal sanctions also apply in Ireland, Norway, the Slovak Republic, Mexico and France. The law in each country bar Mexico and France provides for imprisonment of offenders.

37 The US Department of Justice's sentencing guidelines recommend a base sentence of 18 months in all criminal anti-trust cases. After the base sentence is established the guidelines outline factors that will either increase or decrease the recommendation in a specific case. Aggravating factors include the amount of commerce involved; the position of the individual in the corporation and the conspiracy; the existence and degree of predatory coercive conduct; and the duration of the defendant's participation. Mitigating factors include any guilty plea; cooperation; business, family or personal hardship; and factors indicating the conspiracy was small or local.

38 Section 4B of the *Crime Act 1914*, provides a formula that applies unless the contrary intention appears, to calculate a maximum fine from a given maximum gaol sentence. The table uses this formula and the value of the penalty units provided in s. 4AA, to calculate equivalent fines for the offences.

Section 131	Theft	10 years	$66,000
Section 133	Obtaining property or money by deception	10 years	$66,000
	Obtaining financial advantage by deception	10 years	$66,000
Section 135	Obtaining gain or causing loss dishonestly	5 years	$33,000
	Conspiracy to defraud	10 years	$66,000
	Corruption	10 years	$66,000

As already noted, under the Corporations Act, the maximum penalty for insider trading[39] and share market manipulation[40] is five years. Fines of $220 000 and $22 000 also apply respectively.

Considering this range of penalties the Commission proposes a maximum custodial sentence of seven years for cartel conduct.

It may be suggested that such a maximum is longer than applies for anti-trust breaches in other jurisdictions. However, it is important that sanctions are proportionate and consistent. In this context sentences applying to other corporate frauds in Australia are comparable to the maximum sentence proposed.

Another reason for introducing criminal penalties is that it may not be practical to set pecuniary penalties high enough to deter cartel participation; they may affect the financial viability of offending corporations and punish innocent parties such as employees, shareholders or creditors. For instance in the electricity transformer market, AW Tyree Transformers Pty Limited was penalised for price fixing. Since then, the company has entered voluntary administration, reportedly in part because of the size of the penalty. It is also noted that penalties will often ultimately end up being passed on to the consumer in the form of higher prices.

Imposing sanctions on individuals, as opposed to companies, involved in a breach will not affect innocent parties. Appropriate sanctions could include pecuniary, custodial or alternative penalties, such as banning orders.

The Commission proposes that an effective leniency policy be put in place to complement the introduction of criminal sanctions. (See chapter 10, for the rationale for a leniency policy and details of the Commission’s new draft policy.) An effective leniency policy increases detection and makes prosecution easier. It also encourages cartel participants to cease their conduct and cooperate with the enforcement agency.

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39 *Corporations Act 2001*, s. 1002G and s. 1013.

40 ibid., s. 997.

Applying sanctions to individual participants has the further benefit of encouraging individuals to 'blow the whistle'.

Sanctions will over-deter if they lead to business being over-cautious or discourage innovative and pro-competitive arrangements. In the context of hard-core cartel conduct, which is, and is understood to be, illegal per se, it cannot be argued that criminalising such conduct will over-deter competitive conduct.

Other non-custodial sentences applying to individuals upon criminal conviction, such as disqualification from holding office (similar to banning orders under the Corporations Act) and fines (especially if the company cannot indemnify the individual) may also be effective deterrents. However, they must promote deterrence and instil confidence in the legal system.

2.4 Should criminal liability be limited to hard core cartel conduct?

2.4.1 Background

The Commission advocates criminalising only the worst anti-trust offences: hard-core cartel conduct.

2.4.2 What is a hard-core cartel?

The OECD definition of hard-core cartel conduct is:

> … an anti-competitive agreement, anti-competitive concerted practice or anti-competitive arrangement by competitors to fix prices, make rigged bids (collusive tenders), establish output restrictions or quotas, or share or divide markets by allocating customers, suppliers, territories, or lines of commerce.[41]

2.4.3 Proposed definition of new criminal offences

Broadly the Commission proposes that, in addition the existing civil offences, new criminal offences be created to criminalise agreements (contracts, arrangements or understandings) between competitors that would directly or indirectly:

- fix a price of a product or service
- limit or prevent supply or production of a product or service
- restrict the ability of the parties to the agreement to freely supply specified goods or services or to freely supply goods or services to specified customers
- in response to a request for tenders, restrict the freedom of one or more of the parties to the agreement to put in independent tenders.

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41 OECD, *Hard Core Cartels*, Meeting of the OECD Council at Ministerial Level, 2000.

There would of course need to be legislative safeguards to ensure that the new offences were not too wide. Equally, it is important not to narrow the definition of the offence to the point that it fails to catch serious collusion, especially having regard to the many safeguards (see section 2.6).

The Commission's proposal is consistent with the formulation of offences proposed in the UK Enterprise Bill (see appendix 1).

2.4.4 Cartel conduct

This section examines the types of conduct identified in the OECD definition in more detail.

2.4.4.1 Price fixing

Price fixing involves 'an agreement among rivals or potential rivals[42] with the purpose or effect of raising prices or reducing output in order to (a) increase profit or (b) achieve some other result that may result from higher prices or profits'.

In Australia s. 45(2) of the Act prohibits contracts, arrangements or understandings between firms that are, or should be, in competition with each other, and that have the effect of lessening competition. An agreement is deemed to substantially lessen competition (under s. 45A) if it:

> … has the purpose, or has or is likely to have the effect ... of fixing, controlling or maintaining, [or providing therefore] the price for [or a discount, and so on] goods or services supplied or acquired ... by the parties to the contract ... or by bodies corporate that are related to any of them in competition with each other.

Because such agreements are deemed to substantially lessen competition they will breach s. 45(2)(a)(ii) and, to the extent it was given effect, breach s. 45(2)(b)(ii). The Commission's proposal focuses on per se price fixing breaches.

In the US courts can inquire whether a restraint of trade is legitimate (in which case the courts have held the Sherman Act ought not to prohibit the conduct). This test is known as the 'rule of reason'. However, price fixing is so pernicious that it raises a presumption against legitimacy—it is illegal per se.

2.4.4.2 Bid rigging

Bid rigging is an agreement between two or more persons when, in response to a call or request for bids or tenders, one or more of them agrees not to submit a bid or to submit a bid that has been arrived at by agreement between or among themselves.[43]

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[42] However, the Commission's starting point is to use s. 45A and s. 4D as a guide and to limit criminal sanctions to agreements between competitors.

[43] H Chandler and R Jackson, 'Beyond Merriment and Diversion: The Treatment of Conspiracies under Canada's Competition Act, 2000', paper presented to Roundtable on Competition Act Amendments, Toronto, May 2000, p. 5.

While in the past collusive tendering has been a stand-alone offence in Australia[44], such agreements must now be considered under s. 45 of the Act. A collusive tendering agreement is likely to be a per se breach (as an exclusionary provision under s. 4D of subs. 45(2) of the Act[45]) and it is not necessary to show that the agreement has the effect or likely effect of substantially lessening competition.

In the US bid rigging is a restraint of trade under s. 1 of the Sherman Act and is illegal per se. Under US sentencing provisions bid rigging is sometimes seen as more serious (and harmful) than ordinary price fixing because bid rigging is more easily enforced by cartel members.[46]

2.4.4.3 Market-sharing (market division)

There are four forms of horizontal market division agreements. These are agreements to refrain from:

- producing one another's products
- selling in one another's territories
- soliciting or selling to one another's customers
- expanding into a market in which another participant is an actual or potential rival.[47]

Market division is seen as even more harmful than price fixing because it leaves no room for competition at all. By contrast, price fixing leaves firms free to compete on non-price elements such as quality or standard of service.

In Australia there is no specific market sharing offence. However, if two or more firms who are or should be competitive enter into a contract, arrangement or understanding that shares or divides a market by allocating customers, suppliers, territories or lines of

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44 Part X of the *Restrictive Trade Practices Act 1971* dealt specifically with collusive tendering. The *Trade Practices Act 1965* also included a specific provision prohibiting collusive tendering. Section 96 of the 1971 Act defined collusive tendering as:

> (b) any other agreements that has the purpose or effect of preventing or restricting competition among all or any of the parties in respect of tendering for the supply or acquisition of goods or services ...

45 This is because it will be characterised as including a provision that has the purpose or effect, or likely effect, of preventing, restricting or limiting the supply of goods or services from particular persons (that is, those involved in the collusive tendering arrangement) in particular circumstances or on particular conditions, and if the parties to the agreement are, or could be, competitive with each other, the arrangement will be an exclusionary provision (pursuant to s. 4D).

46 Bid rigging must be distinguished from genuine joint bidding, refer H Hovenkamp, ‘Antitrust Law: An Analysis of Antitrust Principles and Their Application’, vol. XII, *Aspen Law and Business,* 1999, at para, para. 2005b.

47 ibid.,para. 2030.

commerce, that arrangement would usually amount to an exclusionary provision under s. 4D. It would thus be a per se breach of s. 45(2) of the Act.

Some forms of market sharing are not as harmful as others. In the US this has led to certain agreements between rivals being treated not as per se breaches but subject to the ‘rule of reason’. For instance, in some industries cooperation among rivals is necessary to make a product, such as rival teams combining to conduct a sporting competition. In Australia, market sharing, if it is caught by s. 45, can be authorised.

Market sharing may also be vertical. Market sharing between manufacturers and distributors or franchisors and franchisees may be in the best interests of consumers. It may increase rather than decrease output. In the US these arrangements are treated in accordance with the rule of reason. They are not characterised as unlawful per se. The Commission has indicated that it does not seek to criminalise vertical agreements. They are not currently covered by s. 4D of the Act.

2.4.4.4 Output restrictions

A price fixing agreement may be accompanied by an agreement to restrict output so that any reduction in sales as a result of higher unit prices is shared between the colluding firms. Output restrictions may also be agreed for their own sake.

Some output restrictions do arise in conjunction with a joint venture—for example limits on the number of teams in a sports competition or the number of games that are televised. These are currently lawful to the extent that such a joint venture would not substantially lessen competition.

2.4.5 What conduct is criminalised in other jurisdictions?

As noted above, participants in a cartel are liable for criminal possible sanctions and imprisonment in at least nine OECD countries.[48]

2.4.5.1 US law and experience

Section 1 of the Sherman Act prohibits any agreement that restrains interstate trade. All conduct that breaches the section is subject to criminal sanctions.

In practice in the US, per se offences are treated as criminal. Criminal prosecutions are confined to situations when the conduct amounts to hard-core cartel conduct and when the accused has acted with ‘specific intent’ to restrain trade.

Criminal proceedings are unlikely if there is a genuine dispute about the existence of the agreement, or if circumstantial evidence is relied upon, there is an innocent reason for the agreement. Criminal proceedings are also unlikely if the amount of commerce affected in small.[49]

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[48] OECD *Report on the nature and the impact of hard-core cartels*, op. cit., para. 27.

[49] R V Hartwell III, *Representing Corporations and Their Officers In Criminal Antitrust Investigations*, ABA Advanced International Cartel Workshop, 2001, vol. 1, tab. 30, p. 44.

They are also unlikely if there:

- are novel issues of law or fact

- is clear evidence that the defendants were not aware of, or did not appreciate, the consequences of their action

- is confusion as to whether the conduct would be categorised as illegal per se.[50]

2.4.5.2 Canadian law and experience

The Canadian Competition Act makes bid rigging and price maintenance illegal per se.[51] It also criminalises price fixing arrangements that 'unduly' lessen competition.[52] The 'unduly' test requires a similar analysis to the US rule of reason.

Because the Crown must prove beyond reasonable doubt that competition has been lessened unduly[53], it has been difficult to prosecute price fixers who have been able to raise 'specious arguments'[54] about the collateral benefits of the arrangement.[55]

2.4.5.3 Proposed UK law

The UK Enterprise Bill would have the effect of criminalising price fixing, market sharing, production limitation and bid rigging (see appendix 1). The Bill has passed the House of Commons.

2.5 Applying criminal sanctions to both individuals and corporations

2.5.1 Criminal sanctions should apply both to individuals and corporations

Section 45 currently prohibits a corporation from making a contract, arrangement or understanding that contains an exclusionary provision or has the purpose, or the effect or would be likely to have the effect, of substantially lessening competition.

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[50] Refer Department of Justice, *Antitrust Division Manual*, section C5, p. III–16. These are administrative guidelines as to when the Department of Justice will seek criminal sanctions. They are not legally binding limits on the scope of the application of such sanctions.

[51] Competition Act, ss. 47 and 49 and s. 61 respectively.

[52] Competition Act, s. 45.

[53] On 23 April 2002 the Canadian Standing Committee on Industry, Science and Technology released its report entitled a Plan to Modernise Canada's Competition Regime. It recommended that the word 'unduly' be deleted from section 45, thereby lowering the threshold of competitive harm.

[54] M J Trebilcock, 'Fixing Price-Fixing Laws', *Canadian Competition Record,* Spring 1996, p. 49.

[55] There is no civil prohibition against price-fixing.

Section 76(1)(a) sets out a pecuniary penalty for a person who has contravened the s. 45 prohibition. The primary penalty applies only to a body corporate—only a corporation can contravene s. 45.

However, under ss. 76(1)(c), (e) and (f) penalties may also be imposed upon persons who have:

- aided, abetted, counselled or procured the contravention, or
- directly or indirectly been knowingly concerned in, or party to, the contravention, or
- conspired with others to contravene the provision respectively.

In the UK it is proposed that criminal liability only be imposed on individuals. The Enterprise Bill provides that 'an individual is guilty of an offence if he dishonestly agrees with one or more other persons to make or implement [an agreement that would give rise to a cartel]'.

Criminal sanctions in the US apply to both corporations and individuals. The Commission acknowledges that the deterrent effect of criminal sanctions is reduced for corporations who cannot be imprisoned.[56] However, the Commission proposes that criminal sanctions apply to corporations as well as individuals for two main reasons:

- the stigma attached to a criminal conviction, and consequently its deterrent effect, can be expected to be greater than for civil offences, even for a corporation, and there is likely to be more negative publicity associated with such a conviction, and
- there are likely to be efficiencies in the investigation phase and in prosecution because it will minimise difficult evidentiary issues that may arise in civil proceedings against a corporation if there are limits on the use of evidence obtained in the course of a criminal investigation of an individual (through which that corporation acts).

Consistent with existing civil sanctions (analogous to paragraphs 76(1)(c), (e) and (f))[57] one way to achieve this is to impose primary criminal liability for entering into or giving effect to a cartel agreement upon a corporation[58] and for individuals who

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56 This was a relevant factor in the UK decision to apply criminal sanctions only to individuals. In addition, the significant difficulties associated with obtaining a criminal prosecution and issues of consistency with the EU persuaded the UK Government that it would be preferable to pursue corporations under a civil standard.

57 It would be possible in Australia for criminal liability to be imposed directly (and solely on individuals) or on both corporations (as primary offenders) and individuals (for aiding and abetting etc.).

58 Section 12.1 of the *Criminal Code Act 1995* provides for corporate criminal liability. If a physical element of an offence is committed by 'an employee, agent or officer' acting within the actual or apparent scope of his employment or authority the physical element is attributed to the corporation.

participate in the conduct to be liable as accessories. Criminal accessorial provisions also exist in s. 5 of the Commonwealth Crimes Act.

A second option would be to have two separate offences. One applying to corporations entering into, or giving effect to, a cartel agreement and a second offence applying to individuals whose actions, on behalf of a corporation, result in the corporation entering into, or giving effect to, a cartel agreement.

The Commission does not express a view on which option is preferable. However, the Commission does not support imposing criminal liability upon a person who is not personally involved in the contravention.

2.5.2 Applying criminal sanctions to large corporations

The Commission considers that the focus of criminal prosecutions should be on conduct by, or in, large corporations. Conduct involving large corporations with a significant market presence will usually have the most harmful economic impact. At the time when many economies are reducing trade barriers and international competition is increasing, the Commission has a particular focus on combating international cartels. These will normally involve large corporations. Of particular concern to the Commission is that Australia has laws in place that can combat international cartels effectively.

By focusing on large corporations, criminal sanctions would not apply to small businesses, professionals in small business, , trade unions and farmers.

This limitation could be achieved in two ways. First, it may be possible to limit liability by statute. Alternatively, the prosecutorial discretion could be exercised to focus on larger corporations. A statutory limit could be achieved by:

Option 1—creating an exemption for businesses below a prescribed size

Option 2—carving out an exemption for conduct with a distortionary impact below a statutory threshold

Option 3—exempting the participants in a cartel when those participants have a combined market share lower than a statutory threshold.

The Commission does not support Options 2 and 3. Both involve complicated assessments of market or quantum of damage as a threshold for criminality. These would make deterrence uncertain and complicate proceedings because matters would need to be proved beyond reasonable doubt as a precondition to liability.

The Commission believes that the most practical method would be to limit liability to large corporations below a prescribed size—Option 1. A similar mechanism is used in

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The fault elements, other than negligence, are also attributed to the corporation when the corporation 'expressly, tacitly or impliedly authorised or permitted the commission of the offence'. This is analagous to s. 84(1) of the Act.

s. 45A of the *Corporations Act 2001* which defines a large propriety company as one that for any financial year satisfies at least two of the following factors:

- the gross operating revenue for the financial year of the company and the entities it controls (if any) is $10 million or more

- the value of the consolidated gross assets in the financial year of the company and the entities it controls (if any) is $5 million or more

- company and the entities it controls (if any) have 50 or more employees at the end of the financial year.[59]

This mechanism could be adapted by ascribing values to each variable appropriate to the trade practices context.

The 2001 *Business Review Weekly* survey of Australia's 1000 largest employers (by revenue) indicated that all had revenues over $149 million. The total asset value of these 1000 companies fluctuated widely with many not ascribed a value. The lowest asset value was around $45 million. The survey included a separate list of the 100 largest employers, all employing more than 4500 employees.

Using these figures as a rough guide, the Commission would propose to apply criminal sanctions to a corporation that alone, or in combination with its related entities, satisfied two or more of the following criteria in the financial year in which a contravention occurs:

- gross revenue in excess of $100 million

- gross asset value in excess of $30 million

- more than 1000 full-time equivalent employees.

This test would be worded to prevent a large corporation avoiding liability by trading through a number of smaller subsidiaries.

An alternative mechanism would be to create an offence of general application but allow the Commission/DPP to exercise the discretion to lay charges in accordance with published guidelines, which give priority to pursuing cartels involving large corporations. The Commission does not support this approach, even though it has been adopted in other jurisdictions including in the US and Canada.

The UK Enterprise Bill also proposes a criminal offence of general application without a *de minimus* threshold. All jurisdictions have (or propose) prosecutor's guidelines to be

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[59] The Corporations Law (s. 45A) includes specific provisions to ensure that a part-time employee is accounted as an appropriate fraction of a full-time equivalent. It also includes a provision to ensure that consolidated gross operating revenue and consolidated gross assets are calculated in accordance with accounting standards. Similar provisions would be appropriate for adoption.

applied case by case and taking into account matters such as the scale and the impact of the conduct.

Investigating authorities (such as the Australian Securities and Investment Commission or the Australian Customs Service) usually have policy guidelines to determine what matters should be given priority for prosecution as criminal matters. This may include monetary thresholds. The DPP will assess a matter that has been referred to determine whether a prima facie case exists. Even if a prima facie case can be established the DPP may determine that there are insufficient prospects of success or that prosecution is not in the public interest.

2.6 Structure of the amendments—elements of the offence

2.6.1 The requirements of the Criminal Code

The Commonwealth Criminal Code will apply to any new criminal offence provisions inserted into the Act. Therefore, a new offence applying to cartel conduct will need to be drafted consistent with the code and will need to specify the relevant physical elements (actus reus) and corresponding fault elements (mens rea).

The criminal consumer protection provisions of the Act were recently redrafted so that civil offences under Part V are now mirrored in Part VC consistent with the requirements of the Criminal Code. This provides the option of civil and criminal penalties for the same conduct.

In practical terms, the code almost certainly requires the drafting of new criminal offences provisions, which the Commission supports. The Commission would not support simply introducing the added option of criminal liability for a breach of the existing ss. 45, 4D and 45A.

Assuming that specific criminal offences are drafted there are various structural options.

Option 1—Part IV could be re-drafted (so it complied with the code) to be substantially the same as the existing Part and so that civil and criminal penalties applied concurrently to the same offences.

Option 2—Alternatively, new offence provisions could be drafted in accordance with the code to mirror current Part IV offences. This option is analogous to the concurrent consumer protection regimes in Parts V and VC. In terms of consumer protection, the intention was that Parts V and VC were to provide parallel civil and criminal regimes. Consequently, the offences in Part VC were drafted in accordance with the requirements of the Criminal Code, but maintaining the substantive interpretations of the existing provisions of Part V.

Option 3—Another alternative would be to create new criminal offences distinct from Part IV that are limited to specific forms of conduct serious enough to be criminalised. Part IV would continue to operate unchanged for civil matters.

The Commission supports Option 3 for several reasons.

- Options 1 and 2 are less well suited to a proposal that only hard-core cartel conduct be criminalised.

- Hard-core cartel conduct is only a subset of what is currently covered by s. 45 conduct. It is therefore sensible to carve out discrete conduct for criminal liability.

- If Option 3 is adopted, the existing provisions in Part IV would not need amending. This would avoid arguments about changes in the interpretation of the existing civil offence provisions.

2.6.2 Elements of criminal offences

This section outlines what should be the elements of a criminal offence for hard-core cartel conduct. It reviews what elements are required in other jurisdictions and whether it should be necessary to prove that the parties acted dishonestly or covertly.

2.6.2.1 Elements of criminal offences in other jurisdictions and regimes

2.6.2.1.1 United States

The US Supreme Court has held that criminal liability can be imposed only when defendants either intended a clearly illegal result such as fixing or raising prices, or acted with knowledge that illegal results, which actually occurred, were probable. When the conduct is clearly illegal (such as price fixing or bid rigging) criminal intent to restrain trade can be presumed. Any facts surrounding the conduct, such as its very secrecy or the willingness of defendants to lie about its occurrence, will support a presumption of criminal intent.[60]

2.6.2.1.2 Canada

In Canada, it is necessary to prove that:

- the accused intended to enter into the agreement

- the accused knew of its terms

- the likely effect of the agreement would be to 'prevent or unduly lessen competition'

- the accused intended it to have this effect.

To prove the accused's intention about the consequences of the agreement it is only necessary to show that a reasonable person familiar with the relevant business would

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60 P Areeda and H Hovenkamp, 'Antitrust Law: An Analysis of Antitrust Principles and Their Application', *Aspen Law and Business,* 2000, Vol. II, 2nd ed., para. 303c.

have presumed that the agreement would have had or been likely to have had the prohibited effect.[61]

In Canada most prosecutions (almost 60 per cent) have resulted in guilty pleas. Only three out of 22 contested prosecutions have resulted in a conviction. Almost two-thirds of these prosecutions are lost because of insufficient evidence of the 'undue' lessening of competition or of the parties' intention that the agreement have that effect.[62]

The Commission does not suggest that a competition test form part of a criminal cartel offence.

2.6.2.1.3 United Kingdom

Under the proposed UK legislation it will be necessary to prove that parties 'dishonestly' agreed to make or implement an agreement and that the agreement, if it operated as intended, would achieve various prohibited outcomes such as fixing prices or limiting output.

2.6.2.2 Should dishonesty be a necessary element of the criminal offence?

Under the Criminal Code fraudulent conduct, particularly relating to property offences and obtaining an advantage by deception, is judged against a standard of dishonesty, as are some Corporations Act criminal offences.

Clause 130.3 of the Criminal Code (which is consistent with English common law)[63] defines 'dishonest' as:

- dishonest according to the standards of ordinary people, and
- known by the defendant to be dishonest according to the standards of ordinary people.

Under clause 130.4 the determination of dishonesty is a matter for the trier of fact—in other words in the case of a jury trial, the jury.

The High Court in *Peters v The Queen* (1998) 192 CLR 493 gave some support to the proposition that when an offence involves conduct that is inherently objectionable (such as price fixing and bid rigging) a more objective standard of dishonesty is applied using the test of what ordinary people would consider to be honest.

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61 *R. v. Nova Scotia Pharmaceutical Society et al* (1992) 2 SCR 66 (referred to in Chandler and Jackson, op. cit., p. 5).

62 Chandler and Jackson, op. cit., p. 9. However, as noted above, (footnote 54) it has been recommended that the 'unduly' requirement be removed from Canadian law.

63 English case law (*R v Ghosh* (1982) 3 WLR 110) has taken the view that the proper approach to determining dishonesty is to:

> first decide whether the accused's conduct was dishonest according to the ordinary standards of reasonable and decent people; and secondly, if it is dishonest by this standard, the jury must then consider whether the accused realised that his or her conduct was by those standards, dishonest.

Dishonesty is an element of the proposed UK offence. However, the Commission does not support the inclusion of dishonesty as an element requiring proof.

Price fixing, bid rigging and market sharing are contrasted to theft. A person can acquire property with a number of different intentions, but it is dishonesty that makes it criminal. A business is highly unlikely to enter a cartel agreement bona fide; this is reflected in the fact that such agreements are illegal per se. Indeed authorisation exists to afford protection in those few cases when parties may have an honest reason for entering a cartel agreement.

On a practical level it is also unclear what the prosecution would need to prove to establish that an agreement was entered into dishonestly.

2.6.2.3 Is secretiveness necessary?

Covert arrangements are the most pernicious and the most likely to corrupt markets. Trebilcock suggests that it is the covert nature of an arrangement that justifies criminality.[64]

It would be very difficult for the prosecution to prove the negative; that the world did not know of the agreement. Although it may be possible to introduce a system where an agreement was deemed not to be secret if the Commission was notified of its existence, the Commission would not support such a mechanism.

The model proposed in Canada by Trebilcock involved immunity from criminal sanctions (at any time) if those involved file a notification before the agreement took effect or within 30 days of its execution. Trebilcock suggested that the competition agency should be able to review a notified arrangement and seek injunctive orders and civil penalties, but that while a valid notification was in place no civil remedies should be available.

Section 45 conduct cannot presently be notified.

In Australia, before the 1976 Swanston Committee recommendations were implemented, ‘clearance’ was available for such conduct. The committee recommended the clearance provisions be abolished for several reasons including that they ‘deprived the community of the sort of self-reliance which competition-oriented legislation might be expected to encourage ...’.[65] The mechanism was also resource intensive for the Commission.

For the reasons it was abolished, the Commission would not support the re-introduction of a clearance system or the requirement to prove secretiveness. Whether or not conduct is clandestine would be an appropriate matter to form part of the discretion to pursue a criminal sanction. (Section 2.9.2. includes an indicative list of the matters that

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64 Trebilcock, op. cit., p. 54.

65 Trade Practices Act Review Committee: Report to the Minister for Business and Consumer Affairs, August 1976, para. 11.10.

the Commission proposes be taken into account in making the decision about clandestine conduct.)

2.6.3 Suggested elements requiring proof for a criminal conviction under the Act

Having regard to the Criminal Code, criminal offence provisions in other jurisdictions and the existing elements of the civil offences in ss. 45, 45A and 4D, the Commission suggests the following approach to the construction of the proposed criminal offences be considered.[66]

2.6.3.1 Price fixing

A corporation commits an offence if:

(a) it enters into an agreement (contract, arrangement or understanding), or gives effect to a provision of an agreement (etc.), that is intended to, or has the effect of, or which, if it operated as it was intended, would have the effect of, price fixing (etc.) of goods or services

(b) the goods and services are supplied or acquired (or proposed to be so) by the parties to the agreement (etc.)

(c) the parties to the agreement (etc.), or bodies corporate related to them, are competitors in relation to the particular goods or services.

Under the Criminal Code, conduct in paragraph (a) would need proof (the mens rea or fault element) of either a subjective intention to fix prices or recklessness as to whether the agreement would be likely to fix prices. Paragraphs (b) and (c) are circumstances for which, the default fault element is recklessness.

2.6.3.2 Bid rigging, market sharing and output restrictions

A corporation commits an offence if:

(a) it enters into an agreement (etc.), or gives effect to a provision of an agreement (etc.), that is intended to share markets, rig bids or limit output of goods or services

(b) the parties to the agreement (etc.), or bodies corporate related to them, are competitors in relation to the particular goods or services.

Under the Criminal Code, conduct in paragraph (a) the fault element (mens rea) would be recklessness as to whether the agreement would have the prohibited effect. For paragraph (b) the default fault element is recklessness.

If it was not possible to prove subjective intention with direct evidence of the parties' intention at the time it may still be possible to infer from the terms of the agreement that the parties must have intended an unlawful result.

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66 The outline of the offence provisions will need to be developed further and is not intended as suggested drafting.

It would of course be necessary to define more specifically what amounts to bid rigging, price fixing, market sharing and output restriction. Section 45A would be the basis for the definition of price fixing. Clauses 179 and 180 of the UK Enterprise Bill also offer useful guidance (see appendix 1).

As an alternative to accessorial criminal liability for individuals it would be possible to create separate offences for individuals who, as employees or agents of a company, participate in making or giving effect to cartel agreements. The Commission does not suggest a preferred formulation at this stage of the inquiry. However, constitutional limitations, which require a sufficient connection between the individual concerned and a 'foreign, trading or financial' corporation, would prevent Australia adopting a definition as 'simple' as that proposed in the UK, absent a referral of powers from the states and territories.

2.7 Structure of the amendments—defences/exemptions and authorisations

2.7.1 What exemptions are appropriate?

To the extent that existing exemptions protect agreements and arrangements from civil liability, they should also give protection against criminal conviction.

The Act implicitly acknowledges that not all horizontal arrangements reduce welfare. It identifies many factors that either prevent an agreement being anti-competitive or overcome the presumption of anti-competitiveness in per se offences.[67] For instance, professional partnerships while amounting to arrangements between competitors or potential competitors, will usually increase welfare[68] and are completely exempted from Part IV by subs. 51(2). Price fixing between joint venture partners is exempted from per se liability under subs. 45A(2).

In the UK, it is intended that the offence of bid rigging not apply when the person requesting the bid is informed at or before the time the bid is made of the arrangement.[69] No similar protection currently exists in Australia. However, the Commission believes that it may be worthwhile to consider affording a similar protection to that proposed in the UK in Australia in relation to criminal sanctions.

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67 Section 45 does not prohibited agreements the only parties to which are related bodies corporate (ss. 45(8)). Nor does it apply to agreements that are authorised (ss. 45(6)) or agreements that deal with the acquisition of shares or assets (ss. 45(7)), nor, broadly speaking, does it prohibit provisions that would amount to exclusive dealing under s. 47, retail price maintenance under s. 48. In addition, s. 45 does not apply to any provision that breaches s. 48 or any provision that is a covenant to which s. 45B applies (ss. 45(5)).

68 Trebilcock, op. cit., p. 49.

69 Subclause 179(6).

The Commission proposes that the treatment of joint ventures mirror that currently applying under the existing civil regime. Joint venture agreements could be authorised and an exemption based on s. 45A would operate for price fixing.

The Commission's proposals do not involve any change to the existing treatment of such agreements for the purposes of civil liability.

2.7.2 Application of authorisation provisions to conduct that may be categorised as criminal

Part VII of the Act allows the Commission to authorise corporations to enter and/or give effect to anti-competitive contracts, arrangements or understandings if the Commission is satisfied that the public benefits outweigh the anti-competitive detriment.

The policy behind this power is twofold. First, it acknowledges that circumstances arise in which conduct that may breach the Act has benefits that outweigh any anti-competitive detriment and that these should be able to be approved case-by-case for the overall benefit of the economy. Second, it acknowledges that an authorisation gives parties to the arrangement some legal certainty by protecting them from legal liability. This is particularly important when there are doubts about whether conduct will breach the Act or if the benefit of the arrangement and the anti-competitive detriment are finely balanced.

Of course, it is highly unlikely that the public benefit of an arrangement that would amount to hard-core cartel conduct would outweigh the anti-competitive detriment. It is thus unlikely that the Commission would ever be asked to authorise such conduct; particularly as cartels tend to be covert. However, there may be cases when it is doubtful that an arrangement amounts to price fixing, bid rigging, output restriction or market sharing. There may also be cases when an agreement to fix prices may actually reduce prices.

To provide some commercial certainty an authorisation under Part VII should offer protection from both civil and criminal sanctions. The possibility of authorisation will enable a corporation who believes a collusive agreement is justified to ensure that it is not exposed inappropriately to criminal penalties.

2.8 Leniency policy

A well-publicised and effective leniency policy would complement criminal sanctions.

The importance of an effective leniency policy has been recognised in recent international studies on the remedies appropriate for cartel conduct.[70] Leniency policies

[70] *Productivity and Enterprise: A World-class Competition Regime*, op. cit., December 2001 para. 60; *Optimal Sanctions in Cartel cases*, New Zealand Report for the OECD Directorate for Financial, Fiscal And Enterprise Affairs Committee On Competition Law And Policy, October 2001, para. 179ff; *Sanctioning Pursuant to the Norwegian Competition Act*, March 2001, OECD, para. 107.

encourage participants in a cartel or criminal conspiracy to inform on other participants; it destabilises agreements.

To be effective the leniency policy should be transparent and certain. (See chapter 10 for discussion about the Commission's soon-to-be-released draft leniency policy.)

The US leniency policy involves a full amnesty for the first person to confess, providing certain conditions are met including the person cooperates fully and is not a ring-leader. In the EU, where criminal sanctions do not apply, there are different levels of leniency for:

- spontaneous confessions (75 to 100 per cent fine reduction)
- confessions during the course of an investigation and before incriminating evidence is discovered (50 to 75 per cent fine reduction)
- partial cooperation (10 to 50 per cent fine reduction).

The Commission proposes that when criminal and civil penalties apply concurrently, the leniency policy clearly states what protection is offered for both forms of penalty. At this stage, the Commission envisages equal protection in civil and criminal matters.

The Commission is currently responsible for conducting proceedings in civil matters and can therefore guarantee that it will not initiate proceedings or will apply for a reduced pecuniary penalty. However, in criminal proceedings while the Commission may investigate conduct, it will be the DPP's responsibility to have charges laid and conduct the proceedings. To ensure the level of certainty necessary for the leniency policy to be effective, the DPP would need to commit to the policy in a transparent way.

The DPP has adopted a strict set of criteria against which it assesses all cases before deciding whether to have charges laid. These criteria include the public interest. It would be necessary to ensure the DPP's view of the public interest was consistent with that of the Commission and took into account the importance of maintaining an effective, certain and transparent leniency policy for breaches of competition law.

2.9 Practical issues in imposing criminal sanctions

Introducing concurrent civil and criminal penalty regimes would raise many practical issues. These are not new to Australian regulators and could be managed to avoid prejudice to the regulated community. Indeed, such a regime already exists in Parts V and VC of the Act. Many of the issues are canvassed in the recently released Australian Law Reform Commission (ALRC) decision paper, on civil and administrative penalties. The paper notes that there is some support for the law offering the option of criminal and civil proceedings for the same conduct, allowing regulators to tailor their response to a particular contravention so that the penalty imposed is appropriate and proportionate.[71]

In these circumstances, the Review Committee should not feel constrained in recommending the introduction of criminal sanctions pending publication of the ALRC's final report.

2.9.1 Jurisdictional issues

Cartel conduct is serious enough to warrant trial on indictment in a superior court, which requires trial by jury under s. 80 of the Constitution. While the Commission would prefer to have competition law matters continue to be tried in the Federal Court, it accepts that it may be necessary to have jury trials in the relevant state court system.

Jury verdicts must be unanimous. Proving an offence beyond reasonable doubt to the satisfaction of a jury will add a degree of complexity to criminal proceedings that does not currently exist in civil proceedings under the Act.

However, the offences proposed by the Commission do not require proof beyond reasonable doubt of complex competition and market definition issues. In these circumstances, the Commission does not believe the additional complexity of prosecuting a criminal offence will weaken the important deterrent effect of criminal penalties.[72] On the contrary, the Commission considers criminalising hard-core cartel conduct will increase the deterrent effect of the Act.

The Commission would expect that most matters would continue to be dealt with civilly. However, for the worst kind of conduct when there is evidence of deliberate and flagrant breaches, the Commission believes that criminal sanctions will be an important additional tool in the armoury of the Commission to promote compliance with the Act.

2.9.2 Investigation decision to pursue a matter as civil or criminal

The different evidentiary standards applying to civil and criminal matters will make it necessary to identify as early as possible in an investigation whether the matter will proceed as a criminal prosecution. In the few cases when the Commission believes criminal proceedings are justified the investigation will need to be conducted in a different way and to a higher standard. As an investigation proceeds it may become clear that criminal proceedings are not warranted and the investigation will need to be adjusted accordingly. This means the Commission must monitor developments in investigations closely and review how the matter should progress.

There may be legitimate concern about the cost and difficulty of collecting evidence from the very beginning of an investigation in a way that is appropriate for subsequent

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71 Australian Law Reform Commission, Securing Compliance: Civil and Administrative Penalties in Australian Federal Regulation, April 2002, Discussion paper 65, paras. 6.13 and 8.11.

72 The introduction of criminal sanctions was rejected in New Zealand because it was considered that it may result in a ' weakened deterrence effect'.

tender in criminal proceedings when there is no expectation that the matter may proceed to a criminal charge. Another concern is having to redo early work to bring evidence up to the criminal standard. These issues are not insurmountable. They are routinely dealt with in tax, customs and Corporations Act cases.

The Commission would develop and publish guidelines on what matters would be appropriately pursued as criminal. The sort of matters that may be included would include:

Are there circumstances surrounding the conduct that warrant criminal prosecution?

Is the conduct clearly illegal?

What was the scale of the conduct? Has it continued for a long time? Do the participants represent a significant part of the market?

What was the impact of the conduct? Has it had a significant economic impact assessed by reference to the volume of commerce affected or the extent of the price rise?

Did the participants go to great lengths to keep the conduct secret or to enforce participation?

Are there characteristics of the participants that warrant criminal prosecution?

Did the participants engage in the conduct in question genuinely, but erroneously, believing that they did so as part of a genuine joint venture?

If the participants are small players in a market, is the arrangement an attempt to obtain some countervailing market power in the face of large competitors with significant market power?

Is there clear evidence that the defendants were not aware of, or did not appreciate, the consequences of their action?

Is there evidence that the participants knew that their conduct was illegal but decided to proceed to engage in that conduct?

Other matters

Would the leniency policy militate against prosecution?

Is the public interest served by prosecution?

Is the matter so complex that a jury may have difficulty understanding it?

2.9.3 Double jeopardy and restrictions upon the use of evidence in criminal and civil proceedings

The ALRC discussion paper notes that laws that provide for both civil and criminal penalties must ensure that defendants are not subject to double jeopardy and that information obtained in the context of one proceeding is not inappropriately used in any subsequent proceedings.[73]

The Corporations Act deals explicitly with both these issues. It provides protections to make sure that civil proceedings are not pursued following a criminal conviction. However, criminal proceedings may be commenced after civil proceedings. This ensures that civil remedies, such as interlocutory injunctions, do not preclude later criminal penalties being imposed when appropriate. However, civil proceedings will be stayed if criminal proceedings are commenced.[74]

It is not proposed that a criminal conviction would prevent a private action for damages.

The Corporations Act also specifically prevents the use of evidence in a criminal proceeding if it has been previously used in civil proceedings and the conduct alleged to constitute the offence is substantially the same. However, the absolute privilege against self-incrimination does not apply—the regulator can use the evidence to follow a chain of inquiry but cannot use it directly.

Should the Review Committee recommend the introduction of criminal sanctions into the Act these important protections could be incorporated in a manner consistent with the final recommendation of the ALRC.

2.9.4 Early involvement with the DPP

The Commission would envisage negotiating a memorandum of understanding with the DPP to reflect a shared understanding of enforcement priorities and leniency issues in criminal cases. It would also have to deal with practical issues such as how and when the Commission would consult the DPP about a complaint and about developments in an investigation. This would maximise the opportunity of identifying those cases that may be appropriate for criminal prosecution—and just as importantly, those that may not. The Commission accepts that it will need to work closely with the DPP to ensure that the merits and evidentiary requirements of a matter are assessed early so that resources can be properly and efficiently deployed. The Commission consulted the DPP on the proposed framework for the application of criminal penalties to hard-core cartels. The DPP did not raise any in-principle objections to the Commission's proposal that such conduct be made subject to criminal sanctions.

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73 ALRC, op. cit., para. 8.21.

74 ALRC, op. cit., para. 8.35ff and *Corporations Act 2001*, ss. 1317N and 1317P.

2.9.5 Who would investigate and prosecute

The Commission proposes that it retain the power to investigate criminal matters and that the DPP would be the prosecuting authority. The Commission considers that it is important to use the expertise of the DPP as prosecutor. It also believes that it is appropriate for the Commission to continue to investigate matters because the Commission has the expertise to investigate competition-related matters. It would also facilitate investigation if it is unclear whether a matter is appropriate for criminal or civil proceedings. This arrangement is already in place under the Act with respect to Parts V and VC matters.

In the UK the Crown prosecutor (the equivalent of the Commonwealth DPP) is the Criminal Prosecution Service. The UK Enterprise Bill proposes that criminal cartel offences be prosecuted by a separate body, the Serious Fraud Office. The Serious Fraud Office will have an investigative function (with coercive powers) and an independent prosecutorial function in those cases it investigates.

2.9.6 Criminal liability and level of penalty

The Commission proposes that both individuals and corporations be liable for criminal conviction.

A corporation convicted of a criminal offence would be liable for a fine at the same maximum level that would apply if the contravention were civil. (See section 2.10.1 for discussion of the Commission's proposal to vary the existing maximum penalty.)

Individuals involved in committing an offence would be liable on conviction for a custodial sentence. The Commission proposes a maximum sentence of seven years. Once convicted, individuals could also be disqualified from being appointed as company directors.

The Commission proposes that a fine could be imposed in lieu of a prison term. However, the formula specified in s. 4B of the *Crimes Act 1914* would convert a prison term to an inappropriately small pecuniary penalty for cartel conduct and consideration needs to be given to this issue.

Whether an individual is sent to gaol or required to pay a criminal penalty would of course be a matter of judicial discretion.

2.10 Civil liability amendments

In addition to the introduction of criminal sanctions, the Commission believes that it is important that civil pecuniary penalties be amended if they are to be effective deterrents. (See section 2.10.1 for details of a proposal to amend the civil penalty provisions to reflect a measure of illicit gain.)

Given that hard-core collusion is highly secretive, the current six-year statutory limitation period in the Act is another concern for the Commission. By the time the Commission becomes aware of possible contraventions and has investigated them to the point when penalty proceedings can commence, it is common that at least some of the conduct falls outside the six-year period. In cases like this courts cannot impose penalties for that conduct. (See section 2.10.2 for details of a proposal to increase the statutory limitation period for the commencement of civil penalty proceedings under s. 45 of the Act to 10 years.)

2.10.1 Increased pecuniary penalties

Existing maximum pecuniary penalties are inadequate, particularly for large corporations who may net substantial gains from their participation in cartels, to deter cartel conduct that is both difficult to detect and potentially highly profitable. The penalties are too low and are arbitrary because they bear no relation to the illicit gain or the harm caused.

The Commission proposes that the Act be amended so that the maximum penalty a court may impose upon a corporation can be as high as three times the value of any commercial gain from the contravention, or in certain circumstances 10 per cent of the corporation's Australian turnover.

The Commission does not propose that the maximum penalty for individuals be increased. However, it is proposed that corporations be prohibited from paying an individual's fine, and that the court be given power to make alternative orders such as banning orders—for some individuals, these may be a more effective deterrent than pecuniary penalties.

2.10.1.1 Deterrence and an appropriate level of penalties

An effective deterrent should minimise the prospect of illegal gain. As detection and punishment are not perfect, effective deterrence requires penalties to be greater than the expected benefit from the illegal activity.[75] As Posner states:

> Concealability drives the probability of being punished for a violation below 100 per cent, and …[t]he correct fine… is calculated by dividing the social cost … by the probability of detection.[76]

Bryant and Eckhart believe that as few as one in six or seven cartels are detected and prosecuted. This would imply a multiple of six.[77] However a multiple of three is more common in other countries.

The recent OECD report on cartels[78] analysed pecuniary penalties in several cartel cases in OECD countries. The fines expressed as a percentage of gain varied from 3 per cent to 189 per cent. Only in four cases were the fines more than 100 per cent of the estimated gain. The OECD report concludes that '… while there is a distinct, if uneven

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[75] OECD, *Optimal sanctions in cartel cases*, op. cit., para. 30.

[76] Richard Posner, *Antitrust Law: An Economic Perspective* (2nd ed., 2001), p. 269.

[77] PG Bryant and EW Eckhart, 'Price Fixing: the Probability of Getting Caught', *Review of Economics and Statistics*, 1991, p. 531.

[78] OECD, *Nature and impact of hard core cartels*, loc. cit.

trend towards more rigorous sanctions in cartel cases, available data indicate that larger sanctions are required to achieve effective deterrence.' [79] An Australian example involves $15 million in fines in the Queensland fire protection case. These fines were estimated to represent only 31 per cent of the total harm caused.[80]

2.10.1.2 Proposal to increase pecuniary penalties—individuals and corporations

In proposing that the maximum pecuniary penalties under the Act be increased the Commission is mindful that legislation regulating competition must balance a number of competing objectives. It must provide an effective deterrent to anti-competitive behaviour but it should not deter efficient commercial activity. The level of penalties and remedies should be clearly known to the market and set to make anti-competitive conduct profitless.[81]

2.10.1.2.1 Increased pecuniary penalties applying to corporations.

In 1993 the maximum penalty that can be imposed on a corporation under the Act was raised from $250 000 to $10 million. The maximum penalty for contravening the Sherman Act is also US$10 million. However, the largest penalty imposed on a corporation for multiple offences in Australia is $15 million. This compares to the largest penalty in the US of US$500 million. US courts are able to impose a penalty of twice the gain or twice the victims' loss, even if that exceeds the maximum $10 million penalty.

A penalty should be flexible enough to take into account that the benefits accruing to a company with a large turnover may be very high. In a recent New Zealand report on the *Optimal sanctions in cartel cases*[82] a maximum penalty of $5 million was seen as too small to be a real deterrent, being less than one day's turnover for many firms. In Australia, a $10 million penalty is less than one-fifth of the daily turnover of our largest corporations.

In response to the New Zealand report the NZ *Commerce Act 1996* was amended[83] to improve enforcement and deterrence measures especially to counter hard-core cartel conduct. Among other things, the amendments increased the maximum penalty for corporations from $5 million to $10 million. As an alternative, they also introduced a pecuniary penalty of three times the value of any commercial gain from the contravention. If the commercial gain cannot readily be ascertained courts can use as a proxy 10 per cent of turnover of the corporation and all its related bodies corporate within New Zealand.

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79 OECD, *Nature and impact of hard core cartels*, op. cit., para. *55.*

80 Calculating the gain realised by a cartel is difficult. Indeed, it is rarely done. Some jurisdictions use a percentage of turnover as a proxy for gain.

81 OECD, *Optimal sanctions in cartel cases*, op. cit., para. 26ff.

82 OECD, *Optimal sanctions in cartel cases*, op cit., para. 12.

83 By the *Commerce Amendment Act 2001*.

New Zealand legislators considered that merely increasing the maximum penalty for corporations from $5 million to $10 million would only substitute one arbitrary upper limit for another and bear no relation to the value of the illicit gain.[84] As such it was not considered to be an effective deterrent.

Many maximum penalties and fines in other jurisdictions are also tailored according to illicit gains, for instance:

- Switzerland—penalties as much as three times the profit (or if the profit cannot be calculated, 10 per cent of the firm's turnover)
- US—maximum fine $10 million or twice the pecuniary gain from the offence, or twice the gross loss to persons other than the defendant
- EU—fines up to 10 per cent of the firm's worldwide turnover in the preceding year
- France—pecuniary sanctions up to 5 per cent of the previous year's turnover (in France)
- Germany—a penalty up to three times the additional profit obtained as a result of the violation, as well as a maximum five years imprisonment
- UK—under existing law, fines up to 10 per cent of UK turnover for the duration of the infringement for a maximum of three years.

New Zealand also introduced exemplary damages for private actions, believing them to be more appropriate than 'treble damages' that apply in the US. New Zealand believes that treble damages may lead to an increase in litigation as plaintiffs commence strategic or speculative claims.

The Commission proposes that the Act be amended so that the maximum penalty for a contravention of the Act would be the greater of $10 million or three times the value of any commercial gain from the contravention. The Commission considers also that it would be appropriate for courts to have the power to substitute a percentage of turnover if it is difficult to quantify the commercial gain from the contravention.[85] The Commission proposes 10 per cent of the firm's Australian turnover for the duration of the infringement for a maximum of three years.

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84 OECD, op. cit., para. 64.

85 The Commission considers that this formulation (consistent with that applying in the UK) would be effective to prevent manipulation of a corporation's accounts in the period between the detection of the contravention and the imposition of a penalty by a court.

2.10.1.2.2 Monetary penalties applying to individuals.

In Australia, the maximum pecuniary penalty for an individual for breaching the Act is $500 000. This compares with US$350 000 in the US, NZ$500 000 in New Zealand, more than €1.5 million in France and Germany and CAN$10 million in Canada.

Only four countries—Australia, US, Canada and Germany—have imposed fines on individuals. The largest in Australia was $150 000 compared with a fine of US$10 million in the US.

The 2001 amendments to the New Zealand Competition Act not only increased penalties applying to corporations but modified how penalties are imposed on individuals. The maximum penalty for individuals was not increased; however the legislation now[86]:

- prohibits firms indemnifying their agents and employees against any pecuniary penalties
- allows courts the discretion to disqualify individuals from being directors or managers
- encourages courts to impose pecuniary penalties on individual perpetrators.

The Commission does not suggest an increase in the maximum pecuniary penalty for individuals but would support the introduction of measures similar to those introduced in New Zealand.

2.10.2 Limitations periods

2.10.2.1 Current law

Pursuant to s. 77 of the Act only the Commission may institute proceedings for recovery of a pecuniary penalty on behalf of the Commonwealth. Proceedings must be commenced within six years of the alleged contravention.

This limitation is inappropriate in the context of hard-core collusion. By their nature, cartel agreements are clandestine. They are shrouded in secrecy and it may be difficult to prove illegal agreements. In the circumstances, it may be many years before illegal conduct is detected and it may take a long time to investigate a matter to a point when the Commission can to commence proceedings.

It is common for cartel conduct to continue for many years. Even if it is possible to commence proceedings for recent contraventions, there will often be conduct resulting from cartel agreements that occurred more than six years before the proceedings started. In these cases, the Commission may plead, but is unable to prosecute

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86 The maximum penalty for individuals remains $500 000.

participants for the making of an agreement, or conduct that gives effect to an agreement, that occurred outside the limitation period.[87].

The Commission has found itself in this situation on a number of occasions for collusive agreements. The express freight, transformer and Queensland fire protection cartels are just three examples. It is not such a problem for other breaches of Part IV including ss. 46, 47 and 48.

2.10.2.2 Proposed amendment

To address these problems the Commission proposes that:

- the statutory limitation period for contraventions of s. 45 of the Act be raised to 10 years, and
- an amendment be made to remove any doubt that when an action is commenced within the limitation period a court may take account of conduct before the limitation period as a factor in understanding the subsequent contraventions and determining an appropriate penalty for those contraventions.

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87 In contrast, in the US, if any conduct giving effect to an illegal collusive agreement takes place in the limitation period, the parties to the agreement may be prosecuted for all conduct related to that agreement, whether or not it occurred outside the limitation period.

3 Misuse of market power

Summary

The Commission believes that both competition and fair trading generally, and the interests of consumers, small business and many big businesses would be promoted by two significant amendments to improve the operation of s. 46:

- the introduction of an ‘effects test’ to supplement the existing ‘purpose’ test, and
- allowing faster action in certain cases under the Trade Practices Act, specifically by the introduction of cease and desist orders.

The objective of the Trade Practices Act (the Act) is to enhance the welfare of Australians, as outlined in chapter 1, by promoting competition and fair trading and provision for consumer protection. The prohibitions in Part IV and specifically s. 46 serve this objective. Each section in Part IV is aimed at conduct that either has the purpose or has the effect of damaging competition in markets—promotion of competitive markets enhances consumer welfare. (See appendix 2 for the reasons why competitive markets enhance the welfare of Australians.)

Section 46 is also expressly directed at fair trading, by protecting smaller businesses from anti-competitive conduct of firms that possess substantial market power. It prohibits firms with substantial market power from taking advantage of that power for the purpose of:

(a) eliminating or substantially damaging a competitor

(b) preventing entry to markets

(c) deterring or preventing a person from engaging in competitive conduct.

The Commission believes that the provisions of s. 46 are generally appropriate and, in general, have been properly applied by courts in accordance with the underlying objectives of the law. However, the Commission believes that it is wrong in principle that when a corporation with a substantial degree of power in a market takes advantage of it in an illegitimate manner (for example, by predatory conduct that involves substantial pricing below cost) with the effect of damaging competition, it is not prohibited. The absence of an effects test in s. 46 constitutes a gap in Australia’s competition law.

The Commission supports the introduction of an effects test to supplement the existing purpose test. Arguments in favour of this amendment include:

- an effects test in s. 46 will more effectively protect the process of competition—promoting competition and fair trading in accordance with the object of the Act

- s. 46 will be brought into line with the balance of Part IV, which is generally directed towards conduct that has the purpose or effect of damaging competition

- the amendment will overcome enforcement difficulties associated with proving purpose in a range of circumstances.

The amendment will also bring s. 46 into line with similar prohibitions in overseas jurisdictions, including Europe and the United States.

At the outset, it should be noted that with a purpose or effects test, or both, s. 46:

- does not prohibit monopoly or market power—it only prohibits abuse of monopoly or market power

- does not prohibit corporations from acquiring a position of monopoly or substantial market power by normal commercial means. The section does not prohibit firms, for example from acquiring enhanced market power as a result of greater efficiency or innovation or better commercial strategies than their competitors or potential competitors. Section 46 only prohibits the use of illegitimate, anti-competitive tactics that go beyond normal commercial practice in competitive markets to achieve these outcomes.

- does not prohibit corporations from taking actions which 'injure' competitors. The High Court and Federal Court have long recognised that this is of the essence of the competitive process. Issues arise only where the means used to 'injure' competitors go well beyond the limits set out in a myriad of cases in Australia and overseas for many years.

Opponents of an effects test amendment claim that it will result in legitimate competitive conduct being prohibited. The Commission disagrees with this assessment. The Commission's view is that s. 46 contains significant safeguards to protect legitimate competitive conduct. Particularly (for the reasons explained in this submission) legitimate competitive conduct will not constitute a taking advantage of market power as that expression is interpreted by the High Court.

To widen enforcement options available under the Act, the Commission also supports the introduction of cease and desist orders. Section 46 contraventions often occur in concentrated markets when a new competitor seeks to enter the market. A firm with market power will act swiftly in an effort to stifle the new entrant before it gains a foothold in the market. The Commission's ability to act to protect the competitive process is often hindered by:

- the need to gather evidence of anti-competitive purpose before intervening, and

- the normal timetable of investigation and court processes, which has resulted in many s. 46 actions taking up to six years to complete.

Cease and desist orders can be designed with safeguards to ensure that they are not abused or used incorrectly. (See section 3.6.1 for discussion about these issues.)

3.1 Overview of section 46

The misuse of market power provision is a key provision of Part IV of the Act. Section 46 is directed at preventing firms with substantial market power from engaging in illegitimate anti-competitive conduct. Situations in which it may arise include: predatory behaviour, anti-competitive refusals to supply, illegitimate leveraging of market power in one market to damage competition in another market and some vertical practices. The law plays a vital role in protecting the process of competition. This section gives a brief overview of the provision and the scope of its application.

3.1.1 The elements of section 46

Section 46(1) currently reads:

> A corporation that has a substantial degree of power in a market shall not take advantage of that power for the purpose of:
>
> (a) eliminating or substantially damaging a competitor of the corporation or of a body corporate that is related to the corporation in that or any other market;
>
> (b) preventing the entry of a person into that or any other market; or
>
> (c) deterring or preventing a person from engaging in competitive conduct in that or any other market

In line with current judicial interpretations, conduct will only breach section 46 if:

(i) a corporation has a substantial degree of power in a market

(ii) the corporation has taken advantage of its market power; and

(iii) the conduct has a proscribed purpose.

The following paragraphs provide a brief overview of these elements of s. 46 and are not intended to provide a definitive analysis of their operation.

3.1.1.1 Substantial degree of market power

Section 46 does not prohibit the possession of monopoly or substantial market power, or the accumulation of that power by competitive means such as superior efficiency or economic performance. However, it does prohibit a taking advantage of market power for a proscribed purpose. Accordingly, for the provision to apply a corporation must have a ‘substantial degree of power in a market’.

The reference to power in s. 46 is a reference to market power (s. 46(4)(a)). However, the Act does not define market power. The concept of market power is an economic concept and has been defined as follows:

> A firm possesses market power when it can behave persistently in a manner different from the behaviour that a competitive market would enforce on a firm facing otherwise similar cost and demand conditions[88]

There tends to be an inverse relationship between the existence of market power and the level of competition in a market. In a competitive market, a firm would be constrained by competitive forces and would have no market power to influence price or output. Further, price may not merely mean the monetary price but also the ability of a firm to supply inferior goods or services and the ability to impose unfavourable terms and conditions.[89]

There are varying degrees of market power. The characteristics that condition or constrain a corporation's conduct and all relevant market factors will inform the court's assessment of whether a corporation has the requisite degree of market power. Courts have also accepted that more than one corporation may have a substantial degree of power in a particular market.

3.1.1.2 Take advantage

The mere possession of a substantial degree of market power does not of itself result in a breach of s. 46. The prohibition is directed at the 'taking advantage' of the power that results from being in such a position. In *Queensland Wire Industries v BHP*[90] the court states that the question is simply whether a firm with a substantial degree of market power has used that power for a proscribed purpose. The expression 'take advantage' does not mean anything materially different from 'use' and does not require conduct which is predatory or morally blameworthy[91]. The appropriate test is whether a corporation would be likely to engage in the same conduct in a competitive market.

The Commission considers that the 'take advantage' limb operates as a critical filter to the application of s. 46—ensuring that only non-competitive conduct is caught by the section. The 'take advantage' limb is discussed in detail at section 3.2.3.

3.1.1.3 Proscribed purpose

The taking advantage of substantial market power is prohibited only if it is for the purpose of eliminating a competitor of the corporation, preventing the entry of a person into a market or preventing a person from engaging in competitive conduct.

The role of the purpose provisions was commented on by Mason CJ and Wilson J in *QWI*:

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88 Kaysen and Turner, *Antitrust Policy* (1959) p.75, cited with approval by Dawson J in *Queensland Wire Industries Proprietary Limited v The Broken Hill Proprietary Company Ltd and Anor* (1989) 167 CLR 177 at 200. Hereafter referred to as 'QWI v BHP.'

89 See Australian Competition & Consumer Commission v Universal Music Australia Pty Limited [2001] FCA 1800, at para 405.

90 (1989) 176 CLR 177 at 191 comments by Mason CJ and Wilson J.

91 *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* (2001) 178 ALR 253 hereafter referred to as 'Melway'.

> [T]he object of s. 46 is to protect the interests of consumers, the operation of the section being predicated on the assumption that competition is a means to that end … the purpose provisions in s. 46(1) are cast in such a way as to prohibit conduct designed to threaten that competition.[92]

The Act contains several interpretation provisions that impact upon the 'purpose' limb of s. 46. Section 4F of the Act provides that where conduct is engaged in for more than one purpose, a proscribed purpose need not be the sole or dominant purpose. Subsection 46(7) permits a court to infer purpose from the conduct of the corporation or other relevant circumstances. Subsection 84(1) allows the state of mind of a director, servant or agent to be imputed to the corporation. However, as discussed in section 3.3.3, the Commission takes the view that the current requirement to establish a proscribed purpose is onerous and is becoming increasingly difficult.

3.1.2 Prohibited conduct

The text of s. 46 does not prohibit specific forms of conduct, however judicial decisions have confirmed that the provision covers a broad range of anti-competitive behaviour. Several examples of potentially anti-competitive conduct include:

- refusals to supply
- predatory pricing
- leveraging from one market into another
- price squeezing
- vertical restraints.

Anti-competitive refusals to supply are the most common type of conduct examined by Australian courts under s. 46. It is accepted that a corporation with a substantial degree of market power is not under a comprehensive obligation to supply all potential acquirers. However, under some circumstances a refusal to supply by a corporation with substantial market power can be anti-competitive and in breach of s. 46.[93]

The term 'predatory pricing' in general terms refers to pricing at a low level by a corporation with market power directed at damaging smaller competitors, driving a competitor from the market, or deterring a potential competitor from entering a market. While the courts have not adopted overseas approaches to predatory pricing, such as the recoupment test, such conduct has been found to fall within the scope of s. 46.[94]

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92 Note 90 *supra*.

93 See for example QWI v BHP Note 90 supra and ACCC v Universal Music Australia Pty Ltd [2001] FCA 1800.

94 See for example *Australian Competition and Consumer Commission v Boral Ltd* (2001) ATPR 41-803. This decision is currently under appeal to the High Court.

The courts have recognised that market power in one market can be used to give rise to market power in another market.[95] This concept is referred to as ‘leveraging’. It occurs most frequently through tying arrangements, where a corporation with substantial market power in one product uses that power to damage competition in the market for the tied product.

Vertical integration can give rise to an anti-competitive practice known as ‘price squeezing’.[96] For example a supplier who has substantial power in a component market may charge excessive prices to both its downstream subsidiary and downstream competitors. The price squeeze may drive downstream competitors from the market, while the vertically integrated corporation merely offsets the subsidiary’s losses in the downstream market against the above normal profits accruing to the upstream supplier.

Vertical restraints involve the imposition of obligations that a buyer deal only with a particular seller or that a seller deals only with a particular buyer or group of buyers. Some forms of vertical restraint are prohibited under s. 47 of the Act where they have the purpose or effect of substantially lessening competition. However, vertical restraints may also have a non-competitive objective and consequence, potentially breaching s. 46. For example a supplier with substantial market power may foreclose distributors by obliging its dealers not to deal in the goods of competing suppliers. This has the effect of forcing rival suppliers either to vertically integrate into distribution, or to secure alternative independent distributors. A second example is that of foreclosure of customers. Customers or end users may accept an obligation to acquire all or a considerable part of their requirements from a supplier with substantial market power.[97] This has the effect of preventing competing suppliers and new entrants from supplying those customers for the duration of the obligation. Such obligations can significantly damage competition in relevant markets.

Section 3.2.3.2 contains further analysis of some of the issues arising under s. 46 and distinguishing between competitive and non-competitive conduct.

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95 In *QWI v BHP*, Mason CJ and Wilson J held that BHP had infringed s.46 by extending its market power from the steel products market to the market for rural fencing products.

96 See for example *Pont Data Australia Pty Ltd v ASX* (1990) ATPR 41-007.

97 See for example *Hoffmann La-Roche v Commission* [1979] 3 CMLR 211 at 289.

3.2 Objectives and framework of s. 46

This section discusses the policy objectives of s. 46 and the legal framework of the section as it is currently drafted. (See appendix 5 for statistics on recent s. 46 cases brought by the Commission.)

3.2.1 Objectives

The Act is a broad statute that regulates many aspects of trade and commerce within Australia. The breadth of the Act is reflected in the objects statement in s. 2:

> The object of this Act is to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection.

The primary objective of Part IV of the Act is to promote competition and fair trading within Australian markets. It does this by prohibiting various types of conduct that are likely to damage competitive and fair market mechanisms. This objective has also been recognised judicially. For example, in *Refrigerated Express Lines (Australasia) Pty Ltd v Australian Meat and Livestock Corporation*, Justice Deane said:

> The general purpose and scope of the Part can be described by saying that it contains provisions which proscribe and regulate agreements and conduct and which are aimed at procuring and maintaining competition in trade and commerce.[98]

This objective can also be expressed in the opposite way. The provisions of Part IV prohibit various types of conduct that are likely to maintain or enhance market power other than by competitive means.

In the context of s. 46, the prohibition is focused on unilateral conduct of firms that have substantial market power. The prohibition can be paraphrased as:

(a) the use of non-competitive commercial strategies by firms with substantial market power (see 3.2.3.1 for explanation of 'non-competitive'), and

(b) to maintain or enhance their market power (thereby damaging other competitors and competition generally).

Perhaps more so than the other prohibitions in Part IV, s. 46 is also directed towards the promotion of fair trading. The precise boundaries of this policy objective are difficult to draw. There continues to be considerable debate about the scope of this policy objective. It has been considered on many occasions in the 100-year history of anti-trust law in the US and has often been discussed in the Australian context. It has been argued that the fair trading objective might include:

- the protection of small business from illegitimate competition by large competitors

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98 (1980) ATPR 40 –156.

- the protection of ease of entry to business or markets

- a concern about the accumulation of economic power by large corporations

- the encouragement of fair trading in business.

Despite frequent policy discussion, the fair trading objective has not yet been given definition through judicial analysis. In *Queensland Wire Industries v BHP*, Chief Justice Mason and Justice Wilson stated:

> The object of s. 46 is to protect the interests of consumers, the operation of the section being predicated on the assumption that competition is a means to that end. [99]

The Commission believes that a fair trading objective is promoted by both s. 46 and the other prohibitions of Part IV and that this is consistent with the competition objectives of Part IV. Smaller and more vulnerable firms are entitled to protection under Part IV from non-competitive conduct of rival firms that is aimed at or has the effect of harming smaller firms. Conduct engaged in by firms that possess substantial market power and that does not conform to the norms of competitive markets is inherently unfair.

It is argued in this submission that if the law does not even prohibit large firms with substantial market power from taking advantage of it with the effect of damaging competition—by virtue of such actions as an anti-competitive refusal to supply, anti-competitive predatory behaviour, anti-competitive leveraging of market power in one market to damage competition in another market—the law is not only deficient as a matter of economic policy, but deficient in relation to the above objectives.

3.2.2 Framework

The basic framework of each of the prohibitions in Part IV is similar. They each prohibit specified conduct that is regarded as detrimental to competitive markets. On the other hand, none of the prohibitions in Part IV prohibits or condemns holding substantial market power by itself. The mere fact that a firm holds substantial market power is not a cause for criticism or regulation under Part IV.

This principle is equally true of s. 46. Section 46 (and all of Part IV) recognises that market power can arise, be maintained and enhanced by competitive means—in other words, by the superior efficiency and economic performance of the firm. This is the economic goal pursued by competition policy. Firms that succeed through greater efficiency are entitled to enjoy the benefits of their success. This is the reward that encourages competition.

The Full Federal Court confirmed this by stating that s. 46 does not strike at monopolists or those in a monopolistic position. In particular, there is no contravention

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99 *QWI v BHP* Note 90 *supra*

of s. 46 by charging a particular price (albeit a high or monopolistic price) provided it does not take advantage of market power for a proscribed purpose[100].

While s. 46 does not prohibit the possession of substantial market power, nor the accumulation of market power by competitive means (the reward for efficiency), it does prohibit the taking advantage of market power for the proscribed anti-competitive purposes. These two elements of the prohibition require comment.

3.2.3 Taking advantage of market power

As noted above, s. 46 does not prohibit the accumulation of market power by competitive means; it only prohibits the taking advantage of market power. What do these words mean?

In discussing this limb of s. 46, the Commission is conscious of the need for care in independently analysing one out of the three limbs of s. 46. The prohibition is a unified section and it is possible to fall into error in deconstructing one part of a composite section. In *Melway*[101], the High Court observed that the 'take advantage' and 'purpose' aspects of the s. 46 prohibition are inter-related. The opposite is also true. The provision of a statute usually includes several elements. Each of those elements must be satisfied before the provision operates. Therefore it is desirable to consider the meaning of the 'take advantage' limb. Again in *Melway* the High Court concluded that Melway had not taken advantage of its market power despite a conclusion that it had a proscribed anti-competitive purpose.

3.2.3.1 High Court interpretation

The High Court considered the meaning of s. 46 in *Queensland Wire* and *Melway*. Both cases were concerned with conduct involving a refusal to supply. In the later *Melway* decision, the High Court affirmed its earlier *Queensland Wire* decision. However, the facts of each case were different and led to different outcomes.

In *Queensland Wire*, all the judges concluded that the words 'take advantage' did not have a pejorative meaning. The words meant nothing more than 'use'. Chief Justice Mason and Justice Wilson said:

> The phrase 'take advantage' in section 46(1) does not require a hostile intent inquiry—nowhere is such a standard specified ... The question is simply whether a firm with a substantial degree of market power has used that power for a purpose proscribed in the section, thereby undermining competition, and the addition of a hostile intent inquiry would be superfluous and confusing.[102]

Justice Deane said:

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100 *Australian Stock Exchange v Pont Data (No 2)* (1991) ATPR 41–109 at 52, 666.

101 178 ALR 253 at 260 per Gleeson CJ, Gummow, Hayne and Callinan JJ.

102 Note 90 *supra*.

> Read in context, the words 'take advantage of ... power' are simply inadequate to superimpose upon the economic notions and objectives which section 46(1) reflects some indefinite moral or public purpose qualification ...[103]

Justice Dawson agreed with the conclusions of Justice Deane stating 'I am of the view that the words "take advantage of" do not have moral overtones in the context of s. 46.'[104] Justice Toohey also concluded that 'take advantage' simply meant 'use'.[105]

It is a relatively easy matter to state that 'take advantage' only means 'use.' However, using market power is necessarily an abstract concept. Market power is not embodied in physical form, and therefore the use of the market power cannot be observed physically. How then can the use of market power be identified?

This problem was recognised and answered by the High Court. As market power is an economic concept, the High Court employed economic tools to determine whether market power had been used. In determining whether BHP's refusal to supply Y-bar to Queensland Wire involved a use of market power, the High Court asked whether BHP would have been likely to engage in the same conduct (refusing to supply) in a competitive market. The High Court concluded that BHP would not refuse supply because this would simply result in reduced sales to BHP and Queensland Wire sourcing the product elsewhere in a competitive market. Chief Justice Mason and Justice Wilson stated:

> In effectively refusing to supply Y-bar to the appellant, BHP is taking advantage of its substantial market power. It is only by virtue of its control of the market and the absence of other suppliers that BHP can afford, in a commercial sense, to withhold Y-bar from the appellant. If BHP lacked that market power—in other words, if it were operating in a competitive market—it is highly unlikely that it would stand by, without any effort to compete, and allow the appellant to secure its supply of Y-bar from a competitor.[106]

Justice Dawson's reasoning was similar. His Honour said:

> ... there can be no real doubt that BHP took advantage of its market power in this case. It used that power in a manner made possible only by the absence of competitive conditions. Inferences in this regard can be drawn from the fact that BHP could not have refused to supply Y-bar to QWI if it had been subject to competition in the supply of that product. BHP supplies all its other steel products without restriction and its practice with regard to Y-bar was not in accordance with its normal behaviour. If there had been a competitor supplying Y-bar, BHP's refusal to supply it to QWI would have eroded its position in the steel products market without protecting AWI's position in the fencing materials market.[107]

Justice Toohey expressed the same conclusion in this manner:

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[103] 167 CLR 177 at 194.

[104] *ibid* at 202.

[105] *ibid* at 213-14.

[106] *ibid* at 192.

[107] *ibid* at 203.

> The only reason why BHP is able to withhold Y-bar (while at the same time supplying all the other products from its rolling mills) is that it has no other competitor in the steel product market who can supply Y-bar ... it is exercising the power which it has when it refuses to supply QWI with Y-bar at competitive prices.[108]

Justice Deane reached the same conclusion although, perhaps, with slightly different reasoning. His Honour focused on the purpose that BHP was trying to achieve by refusing supply. That purpose was to prevent Queensland Wire from competing with BHP's fencing materials subsidiary, AWI. His Honour said:

> That purpose could only be, and has only been, achieved by such a refusal of supply by virtue of BHP's substantial power in all sections of the Australian steel market as the dominant supplier of steel and steel products. In refusing supply in order to achieve that purpose, BHP has clearly taken advantage of that substantial power in that market.[109]

Although Justice Deane's approach to determining whether market power had been used differs from the other judges, the difference may not be material, taking into account the facts before the High Court. The next logical step from Justice Deane's approach is that if BHP was constrained by competition it would not have refused to supply because the refusal would not have achieved its stated purpose. Accordingly, the next logical step of Justice Deane's reasoning is the same as the reasoning of the other members of the High Court.

In *Melway*, the High Court affirmed this approach to the interpretation of the words 'take advantage'. The majority stated:

> The focal point of debate was whether ... Melway's refusal to supply the respondent was a taking advantage of that power for the proscribed purpose. Consistently with the approach of the court in Queensland Wire, much of the argument was directed to a consideration of how Melway would have been likely to behave, if it had lacked the power it had. Section 46 of the Act requires, not merely the coexistence of market power, conduct, and the proscribed purpose, but a connection such that the firm's conduct in question can be said to be taking advantage of its power.[110]

Later, the majority observed of the *Queensland Wire* decision:

> A majority of the court considered that the correct test whether BHP was taking advantage of its power was to ask how it would have been likely to have behaved in a competitive market. Exactly how competitive such a market might be, and the assumed structure of such a market, were open questions. The important thing was that, once it was concluded that in a competitive market BHP would have been constrained to supply QWI, and that BHP's ability to refuse to supply resulted from the absence of such constraint, it followed that, in refusing to supply (for an anti-competitive purpose), BHP was taking advantage of its market power.[111]

The Commission intervened in the *Melway* case and proposed a slightly different formulation of the 'take advantage' test. The Commission submitted that a corporation

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108 *ibid* at 216.

109 *ibid* at 198.

110 178 ALR 253 at 264.

111 *ibid* at 265.

may take advantage of its market power if its conduct has been materially facilitated by that power. This formulation of the take advantage test is based on the language of the Explanatory Memorandum accompanying the 1986 amendments to s. 46:

> The term take advantage in this context indicates that the corporation is able, by reason of its market power, to engage more readily or effectively in conduct directed to one or other of the objectives in paragraphs (a), (b) and (c). It is better able, by reason of its market power, to engage in that conduct. Its market power gives it leverage which it is able to exploit and this power is deployed so as to 'take advantage of' the relative weakness of other participants or potential participants in the market. Whether this is so in a particular case is a matter to be inferred from all the circumstances.[112]

In obiter, the High Court accepted the Commission's submission. The majority concluded:

> Dawson J's conclusion that BHP's refusal to supply QWI with Y-bar was made possible only by the absence of competitive conditions does not exclude the possibility that, in a given case, it may be proper to conclude that a firm is taking advantage of market power where it does something that is materially facilitated by the existence of the power, even though it may not have been absolutely impossible without the power. To that extent, one may accept the submission made on behalf of the ACCC, intervening in the present case, that section 46 would be contravened if the market power which a corporation had made it easier for the corporation to act for the proscribed purpose than otherwise would be the case.[113]

To that extent, it can be considered that the High Court believed there was no significant difference between whether a firm is likely to engage in specified conduct in a competitive market and whether the conduct has been 'materially facilitated' by the firm's market power. The Commission's formulation of the 'take advantage' test was specifically designed to address a potential concern about the meaning of 'take advantage'. Various submissions have argued that conduct does not involve a use of market power if the corporation **could** engage in the same conduct in a competitive market. The Commission considers such a test is inconsistent with the High Court's decisions *of Queensland Wire and Melway*. The appropriate test is whether the corporation 'would be likely' to engage in the same conduct in a competitive market.

Therefore, the 'take advantage' limb focuses on the economic characteristics of the conduct. It requires the conduct in question to be measured against the norms of competitive market behaviour. These norms of competitive market behaviour are defined by economic theory. To what extent, then, is economic analysis a prerequisite to determining whether conduct involves a use of market power or, in other words is unlikely to occur in a competitive market?

The High Court decisions in both *Queensland Wire* and *Melway* indicate that a detailed economic analysis is not always needed. For example, in *Queensland Wire* the High Court concluded that BHP would have been unlikely to refuse supply of Y-bar to Queensland Wire in a competitive market. Two reasons were given. First, in all other comparable markets BHP did not refuse supply. Accordingly, its behaviour towards Queensland Wire was out of the ordinary. Second, if there had been another supplier of

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112 *Trade Practices Revision Bill1986*. Explanatory Memorandum at paragraph 49.

113 178 ALR 253 at 265.

Y-bar in the market, the High Court concluded that BHP would have supplied Queensland Wire. BHP would not have allowed the sales of Y-bar go to its competitor. In other words, if the market was competitive, the profit-maximising strategy for BHP would have been to supply Y-bar. In *Melway*, the High Court reached the opposite conclusion on the facts of the case. It decided that in a competitive market Melway would be likely to refuse supply to the wholesaler Robert Hicks Pty Ltd. Again, there were two reasons. First, in the Sydney market when Melway did not have substantial market power; it maintained a similar selective distribution system (which involved a refusal to supply other distributors). Second, Melway was unlikely to change its conduct even if there were alternative sources of street directories available to Robert Hicks. In other words, the High Court concluded that Melway's selective distribution system was profit maximising regardless of its market power.

In *Melway* the High Court briefly referred to the economic methodology a court might use to determine whether a corporation had used its market:

> An absence of a substantial degree of market power does not mean the presence of an economist's theoretical model of perfect competition. It only requires a sufficient level of competition to deny a substantial degree of power to any competitor in the market. To ask how a firm would behave if it lacked a substantial degree of power in a market, for the purpose of making a judgment as to whether it is taking advantage of its market power, involves a process of economic analysis which, if it can be undertaken with sufficient cogency, is consistent with the purpose of section 46. But the cogency of the analysis may depend upon the assumptions that are thought to be required by section 46. ... In some cases a process of inference, based upon economic analysis, may be unnecessary. Direct observation may lead to the correct conclusion.[114]

The High Court recognised the economic characteristic of the 'take advantage' limb. However, the High Court also recognised that it may not always be necessary to undertake a detailed economic analysis to arrive at the correct conclusion.

Given the High Court's interpretation of the 'take advantage' limb, it is possible to describe s. 46 as a prohibition against 'non-competitive' conduct. The expression 'non-competitive' conduct is used in contra-distinction to the expression 'competitive' conduct. The distinction is simply that competitive conduct is the types or norms of conduct that are expected and desired within competitive markets while non-competitive conduct is the opposite.

3.2.3.2 Identifying a 'taking advantage' of market power—distinguishing competitive and non- competitive conduct

This section makes the distinction between non-competitive and competitive conduct by referring to common issues that arise under s. 46. It is not a definitive exposition of the types of conduct that will be unlawful under s. 46. Rather, examples are used to illustrate the distinction between competitive and non-competitive conduct, in accordance with the High Court's interpretation of the expression 'taking advantage' of market power.

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[114] 178 ALR 253 at 266.

(a) High prices

Is charging a high or 'monopoly' price a use of market power? In one sense, charging prices above the level that would be set in a competitive market involves a use of market power. By definition the price is not one that would be set by a competitive market. In another sense charging high prices or maximising profits is consistent with competitive market behaviour.

In *Pont Data*, the Full Federal Court concluded that s. 46 was not directed at conduct that was merely profit maximising through charging high prices.[115] There are two possible explanations of this. Either the conduct does not involve a use of market power or the conduct does not involve one of the proscribed anti-competitive purposes (absent other circumstances such as price discrimination).

The Commission does not believe that s. 46 should be directed towards the mere charging of prices that are above a competitive level. While the conduct is undesirable from an economic welfare perspective it is not in itself damaging to competition, which s. 46 aims to protect. High prices are the market signal that attracts new entrants to markets, thereby increasing competition.

(b) Price discrimination or price squeeze

In contrast, there are different considerations if a high price is associated with price discrimination or a 'price squeeze'. Price discrimination may occur when a firm with substantial market power is vertically integrated and discriminates in favour of its own downstream subsidiary. In a case like this the discrimination may involve a use of market power. To determine this it is necessary to consider whether a corporation without market power is likely to engage in the same price discrimination in a competitive market. Generally price discrimination is removed in a competitive market unless there is an alternative economic justification for the discrimination. Most commonly, the discrimination is justified by differences in the cost of supply.

Queensland Wire showed the anti-competitive potential of price discrimination. The price for Y-bar offered by BHP to Queensland Wire was set at a level that made it uneconomic for Queensland Wire to purchase and compete in a downstream market. The conduct can be considered either as a form of price discrimination or a constructive refusal to supply.

A price squeeze also occurs when a firm with substantial market power is vertically integrated. In a price squeeze the firm does not discriminate in price between its own downstream subsidiary and a downstream competitor. However, the price of supply offered to both downstream companies is a high or 'monopoly' price. The purpose or effect of the high price is to squeeze the downstream companies' profit margin. It does not matter to the supplying firm that its downstream subsidiary may not make a profit or may even trade at a loss. The above-normal profits being made upstream would compensate for or subsidise the downstream losses.

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[115] Note 100 *supra*.

On the other hand, the price squeeze may drive the competing downstream company out of business. Such price squeeze conduct involves a use of market power. In a competitive market, the downstream competitor would have alternative sources of supply. Accordingly the price squeeze would not be effective and to maximise profits the upstream firm would be likely to supply at a competitive price.

(c) Charging a low price

Low prices or prices at competitive levels are desired outcomes of competitive markets. However, firms with substantial market power may also price at a low level to drive a competitor from a market or deter a potential competitor from entering a market.

Although it has proved difficult for the courts to define the circumstances in which low prices manifest non-competitive conduct, it is possible to distinguish between non-competitive and competitive pricing conduct. Economic research has sought to identify characteristics that will practically and accurately distinguish between non-competitive and competitive pricing conduct. The courts continue to assess this research and attempt to convert it into practical rules that can be applied in the context of Australia's competition law.

In the past 30 years, US courts have considered several tests to distinguish non-competitive and competitive conduct. These tests include various cost-based approaches as well as a recoupment test. In *Barry Wright Corporation v ITT Grinnell Corporation*, Judge Breyer said:

> ... courts have reasoned that it is sometimes possible to identify circumstances in which a price cut will make consumers worse off, not better off. ... Suppose, for example, a firm cuts prices to unsustainably low levels—prices below 'incremental' costs. Suppose it drives competitors out of business, and later on it raises prices to levels higher than it could have sustained had its competitors remained in the market. Without special circumstances, there is little to be said in economic or competitive terms for such a price cut.[116]

The economic reasoning for this conclusion is that corporations in competitive markets are very unlikely to price below avoidable (or incremental) cost and if they do, they will have little or no prospect of recouping foregone profits.

In Australia the Full Federal Court in the *Boral* decision rejected sole reliance on these tests. Instead the Court analysed the issues by applying directly the approach of the High Court in *Queensland Wire* and asking whether the firm would be likely to price at the same level in a competitive market. Justice Merkel said:

> [I]t is clear that to a significant extent, BBM (Boral) was able to behave independently of competition and of the competitive forces in the market. Each of the elements of BBM's exclusionary conduct demonstrate that during the relevant period it persistently behaved in a manner that was significantly different from the behaviour that a competitive market would enforce on the firm facing otherwise similar cost and demand conditions.[117]

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[116] 724F 2d 227 (1983) at 231.

[117] (2001) ATPR 41-803 at 42,690.

Another method of distinguishing between competitive and non-competitive pricing conduct is to consider whether the corporation's conduct is profit maximising in the medium term, assuming no competitor exits the market. In general terms, corporations within competitive markets must set their pricing strategies to maximise profits in the medium term, assuming competitive constraints continues to operate.

By applying this test it is possible to ask why the corporation in question set its prices at a particular level. Was it responding to discounts in the market from other competitors? Was it likely to lose sales to those other competitors if it did not respond? What volume of sales would it have lost? Taking account of all possible reactions in the market and the likely lost sales, was the price or range of prices chosen by the corporation consistent with a profit-maximising strategy? Or did the corporation deliberately forego profits? If so, why? Did it forego profits to drive a competitor from the market or to deter new entry? If it was to deter new entry, was its behaviour may be non-competitive

(d) Refusal to supply

The most common type of conduct examined by Australian courts under s. 46 is refusal to supply. Most of the cases post-date the High Court's decision in *Queensland Wire*. However, very few cases have succeeded.

In a free market economy, firms often choose not to supply products to other firms. Indeed our free market economy is based on the premise that efficiency is enhanced by allowing firms to advance their self-interest by choosing whether or not to supply.

However, the reasons for a refusing to supply can be both competitive and non-competitive. Competitive reasons why firms choose not to supply include:

- the acquirer is unwilling to pay an adequate amount for the product
- the acquirer is at high risk of defaulting on payment
- the acquirer is an intermediate distributor of the products and the supplier believes that the acquirer will not add further value to the distribution process or increase sales of the product to be distributed.

There are also non-competitive reasons for a refusal to supply. The most common reason is vertically integrated corporations refusing to supply a product to a downstream competitor, with the aim of restricting or damaging the competitive position of the downstream competitor. This happened in *Queensland Wire*. The High Court observed that the refusal would not have occurred if there had been competing suppliers of Y-bar.

(e) Vertical restraints

Vertical restraints are relatively common in commercial dealings. Economists have recognised that vertical restraints may have pro-competitive objectives and consequences in certain market settings. However, in other market settings vertical restraints may be anti-competitive. Recognising this, most forms of vertical restraints are only prohibited under s. 47 of the Act if they have the purpose or likely effect of substantially lessening competition.

Vertical restraints may also involve using market power for a proscribed anti-competitive purpose. When do vertical restraints involve a use of market power?

Economic analysis can provide an appropriate framework for distinguishing between competitive and non-competitive vertical restraints. It is helpful to consider whether the restraint is solely directed at improving the efficiency of the firms imposing and accepting the restraint. If it is, it is possible that the firm with substantial market power would engage in the same conduct in a competitive market, and the conduct may not involve a use of market power. Examples of efficiencies that can be created for the firms imposing and accepting the restraint include:

- a manufacturer may agree to supply its products to another person on condition that the person acquires all of its requirements from the manufacturer. This obligation may be efficiency enhancing for the manufacturer if it enables the manufacturer to invest in or maintain its manufacturing capacity where otherwise the manufacturer may not because of commercial uncertainty. The obligation may be efficiency enhancing for the acquirer because it can plan its supply chain with greater certainty, and

- a manufacturer may agree to supply its products to a wholesaler or retailer and promise that it will not supply the products to a competing wholesaler or retailer. The promise may be efficiency enhancing for the manufacturer and the wholesaler or retailer if it is directed to providing sufficient commercial incentive for the wholesaler or retailer to invest in the marketing and sales of the manufacturer's product, where otherwise the wholesaler or retailer may be deterred from investing in marketing and sales because of a free rider problem—the marketing and sales investment may be appropriated by a competing wholesaler and retailer.

In contrast, some vertical restraints may have a clear non-competitive objective and consequence. Several cases have come before the courts. For example, in *TPC v CSR Ltd*[118], CSR refused to supply plasterboard to a Western Australian distributor because the distributor had sourced plasterboard from a competitor of CSR. It was apparent that the conduct of CSR in that case was not directed towards efficiency. Instead, the conduct had an exclusionary objective. In those circumstances, it could be concluded that CSR would have been unlikely to impose the same condition in a competitive market.

It should be noted that the test for legality of vertical restraints under ss. 46 and 47 differs. A restraint may be unlawful under s. 47 because it has the likely effect of substantially lessening competition, regardless of whether the conduct was directed to enhancing the efficiency of the firms imposing and accepting the restraint for the purposes of s. 46.

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118 *Trade Practices Commission v CSR Limited* (1991) ATPR 41-076

3.2.3.3 Purpose or effect

As currently drafted, there is a significant difference between s. 46 and the remaining prohibitions in Part IV of the Act concerning the outcome of the proscribed conduct. Sections 45, 47, 48 and 50 prohibit conduct either:

- absolutely, because it is assumed that the conduct will have an anti-competitive effect, or
- if it can be established that the conduct has the likely effect of substantially lessening competition.

In addition, ss. 45 and 47 prohibit conduct if it has the purpose of substantially lessening competition.

Section 46 differs because it prohibits conduct only if it has one of the three proscribed purposes set out in paragraphs (a), (b) and (c) of subs. (1).

The reason for the distinction between s. 46 and the other Part IV prohibitions is not obvious. The policy objective of s. 46 is fundamentally the same as the other prohibitions in Part IV—that is, the prohibition of specified conduct that will damage competition. As well, Australia’s prohibition on misuse of market power is inconsistent with similar prohibitions in the United Kingdom, Europe and the United States. The Commission believes the distinction between s. 46 and the other Part IV provisions should be removed.

However, this does not suggest that the purpose test in s. 46 is inappropriate. As in ss. 45 and 47 a purpose test is an important element of s. 46 where it can be proved.

The current purpose test promotes the policy objectives of s. 46 and Part IV for three reasons.

- If a firm has substantial market power, takes advantage of that market power (acts in a non-competitive manner) and also has a purpose of damaging a competitor, it is likely that the purpose will be achieved. This is because the firm is in the best position to appreciate the consequences of its conduct. Accordingly, it should not be necessary to wait for the outcome of the firm’s conduct to become apparent.
- If a firm has substantial market power, takes advantage of that market power, and also has a purpose of damaging a competitor, the conduct should be unlawful whether or not the firm is actually able to achieve the purpose (for example, the purpose is misconceived). There is no justification for acting in a non-competitive manner—that is taking advantage of market power—with an anti-competitive purpose.
- Purpose establishes an appropriate standard for liability in those cases when non-competitive conduct is undertaken for a proscribed purpose, but anti-competitive effects will not be immediately apparent. Examples here include strategic but potentially anti-competitive conduct by incumbent firms with market power in

deregulated markets, when purpose may be evident but the immediate effect on competition is difficult to establish.

It can also be observed that US law prohibits both monopolisation and an attempt to monopolise—that is, the purpose test is a similar concept to an 'attempt'.

3.3 The case for an effects test

The Commission supports the inclusion of an effects test in s. 46 for five reasons:

- an effects test in s. 46 would better serve the object of the Act in protecting the process of competition and fair trading
- s. 46 would be brought into line with the balance of Part IV, which is generally directed towards conduct that has the purpose or effect of damaging competition
- the amendment would overcome enforcement difficulties associated with proving purpose in a range of circumstances
- an effects test is better suited to examining conduct in new technology markets when network effects are present
- s. 46 would be brought into line with similar prohibitions in overseas jurisdictions including in the US and Europe.

Importantly, including an effects test would also ensure that various types of non-competitive conduct likely to damage competitors and competition would be prohibited, where it would otherwise be difficult to prove an anti-competitive purpose.

Accordingly, the Commission believes that to the extent that the effects of misuse of market power are excluded from s. 46, the section is based on the wrong principles and provides deficient protection to competition and fair trading.

These reasons are discussed in this section.

3.3.1 Policy objective of Part IV

The prohibitions in Part IV are underpinned by a common policy objective of protecting competition. This is achieved through prohibitions on various types of conduct that are likely to be detrimental to competition and fair trading. (See discussion in 3.2.) Surely if a firm takes advantage of its substantial market power to damage the competitive process, this is of concern to the health of the economy and is contrary to the underlying economic aims of the Act.

The current s. 46 is drafted in terms of anti-competitive 'purpose', and ignores the actual competitive effects of conduct. This omission is inconsistent with a policy objective of promoting competitive markets. The Commission believes that commercial strategies that are both non-competitive (that is, they are inconsistent with competitive market behaviour) and lead to actual damage to competition should be prohibited, even though it may not be possible to demonstrate an anti-competitive purpose motivating the conduct.

It has been argued that prohibiting the use of market power in the absence of an anti-competitive purpose is unfair and a potentially damaging intrusion into competitive market behaviour (see section 3.4 for more discussion on this.) However, these claims sit oddly with the policy objective of Part IV—the protection of competitive markets. Competition can be damaged irrespective of the purpose motivating that conduct. Reference to intention or purpose seems unnecessary when conduct causes anti-competitive effects in a market. An analysis of effects on competition would enable courts to concentrate on the economic context of the conduct, particularly the specific market characteristics and competitive outcomes.

3.3.2 Consistency with the other prohibitions in Part IV

Section 46 is inconsistent with the other Part IV prohibitions because of its sole focus on purpose. Other provisions in Part IV are framed in terms of purpose or effect. This illustrates that the underlying concerns of Part IV are about economic effects and harm to the economy.

From a policy perspective, the Act is intended to encourage increased efficiency—that is, producing the goods and services most wanted by consumers at the lowest cost. It is unnecessary and undesirable for this efficiency motivation to be undermined by conduct having anti-competitive effects. This concern is particularly real in the context of firms with substantial market power.

The introduction of an effects test in s. 46 would bring it into line with most of the other Part IV prohibitions, particularly ss. 45 and 47 (s. 48 is a per se offence and s. 50 is based on an effects test alone).

Sections 45 and 47 prohibit a wide variety of trading agreements and conduct that are likely to have the effect of substantially lessening competition. The big business lobby had concerns about the application of these provisions upon their introduction in the 1970s. Any argument that these prohibitions are unfair or intrude too far into normal business conduct ceased long ago. It seems to be a quirk of legislative history that for so long s. 46 has been directed only at anti-competitive purposes and not at anti-competitive effects consistently with ss. 45 and 47.

3.3.3 Forensic difficulties in proving purpose under s. 46

The Commission’s experience has been that in the absence of ‘smoking gun’documents, proving a relevant purpose under s. 46 to the satisfaction of a court is an onerous forensic process.

In *QWI v BHP*,[119] a private action and the first s. 46 case considered by the High Court, the court found that BHP misused its substantial market power for the purpose of

[119] *QWI v BHP*, Note 88 *supra.*

preventing entry into a market. The case concerned a virtual monopolist and very specific conduct (refusal to supply). The High Court accepted the trial judge's finding of a prohibited purpose from BHP's internal documents and the failure of BHP to call witnesses to give evidence on that issue. In the time since *QWI* the Commission and its predecessor the Trade Practices Commission (TPC) have had limited success in actions under s. 46. In earlier s. 46 cases 'purpose' was not contested and so did not emerge as a significant issue. For example:

- in TPC v Carlton & United Breweries,120 Carlton United admitted contravention of s. 46 so that there was no need to prove 'purpose', and

- in TPC v CSR Ltd,121 again the necessary s. 46 purpose was admitted and there was no need to prove the issue to the satisfaction of the court.

Since those cases, despite an activist approach to litigation, the TPC and the Commission did not institute proceedings under s. 46 for approximately six years. On a number of occasions, the TPC and Commission did not take court action for breach of s. 46 because it was considered that they would not be able to prove the necessary purpose on the available evidence, although the conduct appeared to have anti-competitive effects.

In the last few years the Commission has instituted a number of cases under s. 46, although, as will be discussed further below, none have yet reached final conclusion because they are under appeal.

In more recent cases the Commission did take to court internal company documents have helped the Commission to prove the requisite purpose.

In *ACCC v Boral Ltd*,[122] the Commission proved the necessary s. 46 purpose at first instance, relying heavily on internal Boral documents. That finding was not disturbed on appeal to the Full Federal Court. This matter is now the subject of an appeal to the High Court.

In *ACCC v Rural Press*,[123] the Commission proved the necessary purpose and breach of s. 46 at the first instance. Again, the Commission relied heavily on Rural Press internal documents. This decision is now the subject of appeal to the Full Federal Court.

In *ACCC v Universal Music*, [124] the Federal Court found that Warner and Universal did engage in misuse of market power and exclusive dealing conduct. This matter was of

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[120] (1990) ATPR 41–037.

[121] (1991) ATPR 41–076.

[122] (1999) ATPR 41–715; (2001) ATPR 41–803.

[123] (2001) ATPR 41–804.

[124] [2001] FCA 1800.

particular relevance to the market share element of s. 46. The court found that a market share of 17 to 18 per cent, combined with other factors, can amount to a substantial degree of market power in a market for highly differentiated products like Top 40 CDs. Based on oral evidence and documents obtained through discovery and the s. 155 process, Justice Hill found that a proscribed purpose existed. Warner and Universal have lodged appeals against the substantive decision and the Commission has lodged an appeal on the penalty only.

In contrast, in *ACCC v Australian Safeway Stores*[125] the Commission's claims of breaches of s. 46 were dismissed by Justice Goldberg at first instance. His Honour found a proscribed purpose existed in two of the incidents alleged to be s. 46 breaches and did not exist in five incidents. The Commission has appealed the decision.

These recent matters are all currently subject to appeal. (See appendix 6 for a summary of the timing from the alleged conduct to litigation)

Over the years, the Commission has received complaints concerning a number of industries where there may be anti-competitive conduct by corporations with market power. These complaints have not been pursued for several reasons, often as the Commission has been unable to obtain adequate evidence of proscribed purpose. The relevant sectors include communications and entertainment, energy, financial services, transport and distribution.

The difficulty with establishing sufficient evidence of a proscribed purpose was summarised by Justice Northrop in the CUB case:

> A contravention [of section 46] may take many forms and in many cases a wink, a look or a nod may be more effective than the written or expressed word. Proof of those aspects may be difficult to obtain.[126]

The Commission notes that the Act contains two measures intended to lessen the evidentiary burden of establishing a proscribed purpose. First, by virtue of s. 4F, purpose is not limited to a sole or dominant purpose. Second in some cases purpose may be inferred from conduct that is inconsistent with a corporation's normal business methods or without any good business justification. Subsection 46(7) was inserted into the provision in 1986 to clarify that purpose can be inferred from conduct or other circumstances and subsection 84(1) allows the state of mind of a director, servant or agent to be imputed to the corporation. However, the Commission considers a court is unlikely to draw an adverse inference against a respondent either when there is also credible evidence of an apparently legitimate purpose or when the facts could equally support an inference of an apparently legitimate purpose. Notwithstanding the combination of s. 4F and subs. 46(7), there are several further issues that make the forensic task of proving purpose more difficult for the Commission.

Firms with substantial market power appear to be very much aware of the consequences of 'smoking gun' documents being found in their internal records, such

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[125] (No 2) [2001] FCA 1861.

[126] *Trade Practices Commission v Carlton & United Breweries* (1990) ATPR 41–037 at 51, 549.

as those relied upon in the QWI, Boral and Rural Press proceedings. Some firms appear to take great care to avoid creating or storing potentially incriminating documents. For example, the Commission is aware that some corporations have issued specific instructions about creating or destroying internal documents that display a disregard for compliance with the Act.

Legal firms are also advising clients to pay careful attention to statements contained in corporate documents. A recent competition newsletter of a major law firm advised that rigorous attention should be given to the content of management reports and business plans to eliminate ‘purple prose’ which overstates corporate intentions and achievable objectives. It also advised that all corporate data and business records should be reviewed for accuracy to avoid mistaken objectives and plans, especially for reports going to senior management or to the board for review. Later in the same newsletter it states that organisations should avoid colourful language in documents, emails, etc. which might evidence purpose, as such unhelpful evidence and inferences as to prescribed purpose infected analysis in the lower courts during the *Melways* case.

The recent Tobacco case[127] in the Supreme Court of Victoria demonstrates the lengths to which some corporations may go to destroy potentially incriminating documents. In that case (now subject to appeal), Justice Eames found that there had been a policy designed to ensure the destruction of material which would be harmful to the defence of litigation[128] and stated:

> In my opinion, the process of discovery in this case was subverted by the defendant and its solicitor Clayton Utz, with the deliberate intention of denying a fair trial to the plaintiff, and the strategy to achieve that outcome was successful.[129]

The Commission also has experience in the trade practices context of document destruction to avoid the possible discovery of evidence. In *ACCC v Tyco Australia*[130] Justice Drummond commented on the destruction of numerous files:

> When the Commission issued notices under s 155 of the Trade Practices Act in May 1997 to the first and second respondents, Mr Sproule’s response was to arrange for the destruction of a considerable body of relevant documentation, something which hindered the Commission’s investigation in a number of respects.

The limitations in proving a proscribed purpose are broader than the destruction of primary evidence as to purpose. The Commission also has experience of corporations seeking to create documentation of apparently legitimate purposes. If a corporation actually creates and later adduces credible evidence of apparently legitimate purposes, then a court is unlikely to draw an adverse inference against a respondent.

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[127] *McCabe v British American Tobacco* [2002] VSC 73.

[128] *ibid* at 289.

[129] *ibid* at 384.

[130] (2000) ATPR 41-740

Consequently, the forensic task for the Commission in proving s. 46 breaches is getting more difficult.

As discussed above, corporations and their legal advisers are getting wise about the risk of smoking gun documents. The Commission maintains that proper investigation and effective enforcement of the Act requires s. 155 to be interpreted in a way that includes access to documents that would normally attract legal professional privilege. In the Daniels case the Full Federal Court held that a claim of legal professional privilege is not a valid excuse for refusing to answer a notice served under s 155 of the Act.[131] Justice Wilcox, with whom Justice Lindgren agreed, said:

> Conduct that involves a contravention of the Trade Practices Act, often comprises many separate acts, some of which may be effected through lawyers. Without information about contacts between the person under investigation and that person's lawyer, it may be impossible for ACCC to see the whole picture.[132]

The Daniels decision is currently under appeal in the High Court. If legal professional privilege is a valid answer to a s. 155 notice, the Commission will be even more restricted in properly investigating alleged breaches of s. 46 because relevant information and evidence as to purpose could be withheld.

The current requirement to establish a proscribed purpose is onerous and it is becoming more difficult. The Commission believes there should be an alternative method of establishing a contravention of s. 46 when unilateral non-competitive conduct results in harm to competition.

3.3.4 Flaws in applying the s. 46 purpose test to high technology and network markets

High-technology markets are characterised by rapid innovation, short product life spans and path-dependence because of technology choices. In these markets anti-competitive effects can easily arise out of activities that in other markets, might be viewed more benignly.

Some important characteristics also separate high-technology markets from other markets:

- High-technology markets often involve substantial investment in research and development and competition issues are entwined with intellectual property. For example, research and development joint ventures may create concerns especially if they involve marketing cooperation. Similarly, cooperation in setting technological standards is often socially desirable, although this may create competitive concerns because of the potential for inter-firm collusion and the ability for 'insiders' to a co-operative agreement to exclude 'outsiders'.

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[131] *Australian Competition and Consumer Commission v Daniels Corporation* (2001) ATPR 41-808

[132] ibid at 42,796

- High-technology markets often involve network effects. In other words, there are spillovers between customers so that individual customers benefits by making similar system choices. For example one customer's choice of a computer operating system, game console or video system influences other customers' choices who want to share software. Small shifts in customer volume can 'tilt' markets to a specific system choice. The failure of the Beta video system compared to the VHS system is one example. Choices may also be subject to manipulation. For example in communications systems, differences between on-network and off-network charges may allow a large network to create artificial barriers to entry by new network providers.

- Production in technology-based markets often involves high fixed costs and low marginal costs. The production of computer software is one example. This technology creates competitive issues as firms must recover their fixed costs by either pricing above marginal cost or using non-linear pricing schemes. These schemes may support robust competition but can be abused, for example by locking customers in to specific choices to the detriment of long-term competition.

These features of high-technology markets create incentives for unilateral anti-competitive activities, such as predatory pricing, exclusion or undesirable tying and bundling. These actions are not limited to high-technology markets and have been dealt with under ss. 46 and 47 of the Act. However, the growth of high-technology markets raises the likelihood of these types of anti-competitive behaviour and the difficulties of showing anti-competitive purpose for this behaviour under s. 46. As noted in a recent report to the UK Office of Fair Trading

> What makes the analysis more difficult is that in the complex world of, say, computer software platforms and related software products where there are complex interfaces, network effects, and complex issues of product integration, the potential for undertaking anti-competitive actions, including predation, under the guise of legitimate business decisions may be significantly wider and more difficult to detect.[133]

The UK report recommends a 'first principles' approach to anti-competitive analysis in high-technology industries. This would focus directly on the anti-competitive effects of market conduct. The report also states this approach is not new but 'it is particularly well suited to the analysis of alleged anti-competitive conduct in the new economy.'[134]

The current purpose test in s. 46 is not suited to a first principles approach. By focusing on the intent of a market participant rather than on the effect of their behaviour, the test allows scope for significant harm to high-technology markets.

Further, the fast pace of developments in high-technology markets means that a purpose test can allow significant harm to occur before action can be taken under the

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133 Office of Fair Trading, 'Innovation and Competition Policy', *Economic Discussion Paper 3*, March 2002, p. 14.

134 ibid at pp. 41-42.

Act. The necessity to adduce evidence of purpose slows the investigation and enforcement processes, even when anti-competitive effects are clear and unequivocal.

The potential benefits from introducing an effects test in s. 46 are especially relevant in high-technology and network markets. The anti-competitive effects of market activities can have substantial long-term consequences. For example, if an action 'tilts' the market to one technology choice rather than another then this may be irreversible in the market place. The result is a change in the direction of technological development in Australia. In such circumstances, it is important that firms are held accountable for engaging in non-competitive conduct that causes anti-competitive consequences that are detrimental to consumers and society.

3.3.5 Overseas comparisons

Legislation of overseas competition regimes generally adopts an effects based test in relation to monopolisation and misuse of market power. Section 46 of the Trade Practices Act is out of step with the important economic principles reflected in the laws of many overseas jurisdictions.

Appendix 3 compares equivalent laws in several overseas jurisdictions, including the US, Europe and Canada. Both US and European laws proscribing 'monopolisation' and 'abuse of a dominant position' are directed towards the likely competitive effect of the conduct and are not based on proving anti-competitive purposes. There is an ongoing debate in many countries about the balance to be struck in the law between protecting and deterring competition, but the purpose or effects issue has not been a central issue in most overseas jurisdictions. The general approach to competition law around the world is that it is concerned with outcomes rather than just the purposes of behaviour. Amending s. 46 to include an effects test would bring Australian law into line with European and US law and acknowledge the importance to the Australian economy of the underlying economic principles.

3.3.6 Case studies—the problems with purpose

The most important question is whether the inclusion of an effects test in s. 46 will make a difference. Is it possible to describe conduct that should be prohibited but is likely to escape liability under the current purpose test? The Commission believes it is possible to describe such conduct. This section illustrates the problems with the purpose test in five brief case studies.

Many instances of misuse of market power can be illustrated by two general situations:

- predatory behaviour—this is behaviour engaged in by a firm with substantial market power that harms a competitor at the same level of the supply chain. Its most usual form is predatory pricing but it can manifest in other forms including predator supply for example by overproduction, attempts to raise rivals' costs and erecting barriers to entry, and

- discriminatory behaviour—this is behaviour engaged in by a firm with substantial market power in one market which harms a competitor in a different markets—that is, in upstream, downstream market or collateral markets. The harm occurs because the firm produces a product that is required (an input) in the second market. The firm discriminates in favour of its related company or division in the second market. The discrimination may take the form of differential trading terms or a refusal to deal.

The purpose element of s. 46 is difficult to prove in both these categories. This can be illustrated in the following case studies.

Predatory pricing

Predatory pricing is a well recognised form of misuse of market power. However, distinguishing competitive pricing responses from anti-competitive responses has proved difficult for competition regulators internationally. In Australia the difficulty is compounded by the purpose test in s. 46. This is because the purpose test gives scope for an incumbent firm, responding to new entry, to argue self-interest. In response to an allegation of predatory behaviour, the incumbent firm may say:

> My purpose was only to retain my market share, why should I be forced to relinquish my market share to the new entrant?

An argument based on self-interest presents difficulties under the purpose test. Under the current s. 46 it is necessary to prove a purpose of damaging a competitor or deterring new entry or competitive conduct. But is that established if the incumbent merely says, ‘I wanted to maintain my sales’?

The Commission believes that such an argument based on self-interest should not excuse predatory pricing, or at least not be the basis of determining predatory pricing cases. Such arguments may not be accepted by the courts as an evidentiary matter in any event. But it should not be necessary to overcome such a hurdle. The Commission believes that a more appropriate test of unlawful conduct in these circumstances is to consider:

- whether the firm had substantial market power
- whether the firm took advantage of its market power—as discussed earlier, this is answered by considering all the circumstances of the pricing decisions, and assessing whether the firm would be likely to price in this manner in a competitive market (assuming it would face long-term competitive constraint from the new entrant), and
- the competitive effect of the pricing conduct.

Refusal to deal

Refusals to deal probably lead to the greatest number of misuse of market power complaints. Usually this arises as a form of discriminatory behaviour. A firm with substantial market power favours its own related company or division by refusing to deal with another company that operates in a second market. In response to allegations of predatory conduct a firm may again argue self-interest:

> My purpose is to dedicate my resources to my related company or division. I have no care for my competitors and why should I be forced to look after a competitor?

Again, this response can present difficulties for the purpose test in s. 46. If the firm is focused solely on its own self-interest, has it formed a purpose of damaging a competitor? This raises the problem of primary and secondary purposes or immediate and ultimate purposes, which to some extent has dogged Trade Practices Act jurisprudence.

Recently the problem was discussed in *South Sydney District Rugby League Football Club v News Limited.*[135] The case concerned a clause agreed between the Australian Rugby League and News Ltd in connection with the merger of the rival rugby league competitions. The clause was to the effect that the number of teams in the competition would be reduced over a several years. The question was whether the purpose of the clause was to restrict the supply of services to and the acquisition of services from the excluded team or whether the purpose was to ensure the creation of a viable and sustainable rugby league competition.

The Full Federal Court was somewhat divided on the question. Justice Heerey decided that it was appropriate to look at the ultimate purpose, which was not restrictive. Justice Moore focused on the immediate purpose which was restrictive. Justice Merkel recognised both immediate and ultimate purposes, but decided that if the immediate purpose (or the means of achieving the ultimate purpose) was restrictive, this was enough to attract the prohibition in the Act.

There has been some success in prosecuting the most obvious forms of discriminatory conduct under s. 46. *Queensland Wire* is the best known example. But there are many other cases investigated by the Commission that have not led to prosecution because of ambiguity over purpose. For example, one form of discriminatory conduct is when a firm dominant in one market (1st market) supplies its products to a competing firm in a downstream market (2nd market) in which the dominant firm also competes. When the dominant firm learns that the competitor has decided to enter the 1st market, it decides to cease supplying its competitor or to vary the terms of supply so that they become less favourable. The usual explanation for this conduct from the dominant firm is that if the downstream competitor has decided to enter the 1st market, it no longer needs assistance from the dominant firm. Such companies argue that they should not be forced to assist their competitors as they should be able to look after their own interests. A distinction is purported to be drawn between actually damaging a competitor and simply refusing to assist it.

The Commission believes that such purpose-based arguments should not necessarily excuse this type of conduct, or at least not be the basis for determining whether it is prohibited. In any case, the courts may identify a proscribed purpose from the circumstances of the case. However, liability should not be based on the court's willingness to see through these purpose arguments. Instead, the Commission believes the focus should be on:

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135 (2001) ATPR 41–824.

- assessing the market power of the incumbent firm and whether there are realistic substitutes available to the competing firm

- considering whether the refusal to deal involved a use of market power—that is, asking whether the firm would have been likely to deal if there were other competitors who were willing and able to deal if the other firm did not, and

- assessing the overall competitive effect of the refusal in the market context.

Insisting on better terms than any rival

The third illustration is the commercial practice of firms with substantial market power insisting on receiving better terms of supply than any of its rivals. This practice can raise rivals' costs. However, a firm seeking these terms can argue self-interest:

> My sole focus is to lower my own costs of supply. If I am able to lower my own costs relative to my rivals, I will be a more effective competitor. I have no thought to damaging any competitor or deterring entry. Everyone must simply look after themselves.

Under the current purpose test, propositions like this are given considerable weight. Is there a purpose of damaging competitors? Does the purpose differ from a purpose of lowering your own costs? How is the difference identified in a given case? This kind of analysis also leads to the problems of immediate and ultimate purpose identified above.

The Commission submits that an effects test is a better filter of anti-competitive conduct in these circumstances. If the acquiring firm has substantial market power it is more appropriate to consider:

- whether the demand for better terms than a rival involves a taking advantage of market power—is the behaviour consistent with likely behaviour in competitive markets when no one buyer has substantial market power, or is the behaviour made possible only by the absence of competitive constraint?, and

- what is the competitive effect of the conduct likely to be?

Discriminatory rebate/discount schemes

Discriminatory rebate or discount schemes is another problem that emerges in markets where a firm with substantial market power is vertically integrated and faces competition in an upstream or downstream market. The firm may offer its products to the downstream market with rebates or discounts based on volume or other commercial factors. The effect of the rebate or discount scheme may be to discriminate in favour of the firm's downstream subsidiary or division and against a downstream competitor in the overall price of supplying the products. As well the rebate/discount scheme may have no commercial or economic justification for being framed in a way which discriminates.

However, the firm may not have actively formed an anti-competitive purpose in establishing the scheme. The firm could say:

> This is the rebate/discount scheme that I think is appropriate in the market. I haven't considered whether it is harmful to other firms. I should be free to choose the scheme that I think best maximises my return as a supplying firm.

This creates a difficulty for the purpose test in s. 46 because the firm with market power may not have thought about the scheme's effect on the downstream market. It may be lazy or careless but it has not formed an anti-competitive purpose.

Even without an anti-competitive purpose, the Commission believes rebate/discount schemes like these should be assessable under s. 46. Assuming the supplying firm has market power the conduct should be assessed by asking:

- is the rebate/discount scheme non-competitive in the sense that it would be unlikely to occur in a competitive market? This can be assessed by looking at the commercial and economic basis for the scheme. If there is no such basis, then a conclusion can be reached that such a scheme would not occur in a competitive market, and
- what is the competitive effect of the scheme?

If s. 46 operated with an effects test in this way, it would impose a competitive discipline over the trading conduct of firms with substantial market power. It would also ensure that such firms could not hide behind an excuse that they did not turn their mind to the consequences of their trading conduct.

Discriminatory regulatory burdens

Using regulatory burdens in a discriminatory way is similar to rebate/discount schemes. This problem usually occurs in utility industries (for example, electricity and gas), but can also arise in other industries.

Deregulation in many industries often leaves one supplier in charge of a natural monopoly segment of the industry. Although it is desirable that such a monopoly provider be vertically separated from all contestable industry segments this has not always happened. Also it is common that competition will be encouraged or facilitated in respect of the maintenance, augmentation or expansion of the natural monopoly segment, as a second best option. As well, the natural monopoly service provider has often been left with regulatory responsibilities, including responsibility for safety.

The Commission has received complaints about the imposition of regulatory burdens by original monopoly service providers. The regulatory burdens may have a discriminatory effect because they impose greater costs on a competing service provider, compared with the original monopoly provider. In response to questions about the operation of regulatory obligations, the provider might say:

> These obligations are necessary for safety reasons. I have not turned my mind to the competitive impact on other providers. That is not my responsibility. I am only charged with ensuring the industry is safe.

The Commission considers that while this may be true, it is not a satisfactory answer. Under the current purpose test in s. 46, there is no direct obligation on firms with substantial market power to design regulatory impositions in the least anti-competitive manner. However, if s. 46 included an effects test it would be possible to assess:

- whether the regulatory imposition was commercially justifiable or was extraneous to the relevant regulatory objectives, and
- the competitive impact of the regulatory burden.

An effects test would impose a discipline over firms to justify the regulatory burden and not use these burdens to disguise lazy design or mischievous intent.

3.4 Responses to the case against an effects test

In the past, the inclusion of an effects test in s. 46 has been considered on many occasions and has been rejected. (See appendix 4 for a summary of inquiries and committees that considered this and why they rejected it.)

Previously, the Commission has not fully pursued the issue of an effects test because of higher priorities. It has often simply stated that it believed such a change should be made, but pursued it no more than that because of the difficulty of persuading Inquiries of the need for other changes (for example, the Cooney Committee on mergers and the Hilmer Committee on an access regime and on application of the Act to individuals). With at least one parliamentary committee, it was unenthusiastic about its report being the vehicle for promoting an effects test.

The main reason for past rejections of the amendment appears to be a concern that it would inhibit or stifle legitimate competitive conduct. The Commission understands that those currently opposing the addition of an effects test in s. 46 advance this view.

This is a very significant issue. The Commission fully supports the Act's policy objective that it should not prohibit legitimate competition or 'competition on the merits.' On this fundamental policy issue, therefore, the Commission agrees with many who oppose an amendment to s. 46. But the Commission does not believe that adding an effects test to s. 46 will lead to prohibition of legitimate competitive conduct and that concerns about this stem from a misunderstanding of the jurisprudence of s. 46 as developed by the High Court and the Federal Court.

The argument against an amendment usually proceeds this way. In *Queensland Wire*, the High Court decided that the words 'take advantage' simply mean 'use'. Therefore, any conduct engaged in by a firm with substantial market power that has the effect of damaging a competitor or competition generally would be prohibited by an amendment to s. 46. The assumption is that anything done by a firm with market power must, of necessity, involve a taking advantage of market power.

This argument is fundamentally flawed for two reasons.

First, it ignores most of what was said by the High Court in *Queensland Wire* and *Melway* (see section 3.2.3 for extracts from these cases). In deciding that the words 'take advantage' mean 'use', the High Court rejected that the words 'take advantage' implied an additional element of predatory or hostile intent. However, it is wrong to suggest that the High Court's conclusion means that the words 'take advantage' are devoid of meaning or have little or no role to play in the operation of s. 46. On the High Court's interpretation, these words are fundamental to the application of the section. The High Court interpreted the words 'take advantage' to mean non-competitive conduct—conduct that the firm would be unlikely to undertake in a competitive market, because in a competitive market the firm would be constrained to act in an way that improved efficiency and competition.

In *Melway*, the majority stated expressly:

> Section 46 of the Act requires, not merely the coexistence of market power, conduct, and the proscribed purpose, but a connection such that the firm's conduct in question can be said to be taking advantage of its power.[136]

The High Court clearly rejected the view that all conduct engaged in by a firm with market power constituted a 'taking advantage' of that market power. Mere co-existence of market power and conduct is insufficient.

Second, if opponents of an effects-based amendment are right and the words 'take advantage' had no role to play in the application of s. 46, the current s. 46 would have an extremely precarious policy basis. One would have thought that the business community would be even more concerned about the current operation of the section. It would mean that a firm with substantial market power that engages in **any conduct** with the purpose of taking sales away from a competitor is at risk of liability under s. 46. This would happen even if the firm was more efficient than its competitors and was simply pricing its products at a profitable but competitive level consistent with its efficiency. The Commission has never argued that s. 46 operates or should apply in this way; but this is the logical extension of the argument advanced by opponents of the amendment.

The error of such a proposition is also apparent from the Second Reading Speech accompanying the *Trade Practices Bill* in 1974,where the Attorney-General said:

> …A monopolist is not prevented from competing as well as he is able eg by taking advantage of his economies of scale, developing new products or otherwise making full use of such skills as he has ... In doing these things he is not taking advantage of his market power.

In 1986, the Attorney-General reinforced this in the Second Reading Speech accompanying the *Trade Practices Revision Act.* He said:

> Section 46 in its proposed form, which will be described as misuse of market power rather than monopolisation, is not aimed at size as such or at competitive behaviour as such of strong businesses.

Over the past 10 years in s. 46 cases, the section has been interpreted and applied in the manner described above, and the 'take advantage' element of the section has been decisive in the operation of the section.

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[136] 178 ALR 253 at 264.

In the two High Court cases to consider s. 46—*Queensland Wire* and *Melway*—the purpose element was found to exist. Therefore the cases turned solely on whether the conduct involved a 'taking advantage' of market power. Although both cases concerned a refusal to supply, different conclusions were reached on the basis of the different facts and the assumptions the court was able to make on whether the refusal was consistent with competitive market behaviour in the circumstances of the case.

In each of the following cases, the court concluded that the s. 46 claim could not be sustained, largely because there had been no 'taking advantage' of market power:

- *Melway Publishing v Hicks (2000)*
- *Stirling Harbour Services v Bunbury Port Authority (2000)*
- *Morwood v Chemdata (1998)*
- *Helicruise Air Services v Rotoway Australia (1996)*
- *John S Hayes & Associates v Kimberly-Clark Australia (1994)*
- *Petty v Penfold Wines (1993)*
- *General Newspapers v Telstra (1993)*
- *Natwest Australia Bank v Boral Gerrard Strapping Systems (1992)*
- *Dowling v Dalgety (1992).*

This substantial list of cases demonstrates that this element of s. 46 is critical in the offence of misusing market power.

In summary, the Commission's view is that s. 46 contains significant safeguards to protect legitimate competitive conduct and that the opposition to the amendment proposed is built on an entirely false premise. An effects test amendment to s. 46 will not lead to the prohibition or stifling of efficient and competitive conduct. The safeguards embedded in s. 46 will continue to act as efficient filters to preclude the section from reaching legitimate, lawful competitive conduct, should an effects test be included. Competitive conduct will not constitute a taking advantage of market power and will remain (correctly) immune from s. 46. Instead, the amendment will have the desirable result that inefficient and non-competitive conduct will be prohibited if it is either motivated by an anti-competitive purpose or has that effect.

3.5 How to formulate an effects test

The Commission's preferred formulation is an effects test based on the current paragraphs (a), (b) and (c) of s. 46(1). The Commission believes that this formulation will best advance the policy objectives of s. 46.

The current s. 46 and the existing purpose test would be retained and incorporate an effects test in addition to, and in the same terms as, the existing purpose test. This could be drafted as:

> A corporation that has a substantial degree of power in a market shall not take advantage of that power for the purpose, **or with the effect or likely effect,** of:
>
> (a) eliminating or substantially damaging a competitor of the corporation or of a body corporate that is related to the corporation in that or any other market
>
> (b) preventing the entry of a person into that or any other market, or
>
> (c) deterring or preventing a person from engaging in competitive conduct in that or any other market.

This formulation is preferred by the Commission because it is consistent with the current legal framework of s. 46, a framework that generally works well other than in respect of the omission of the key principle that the effects of behaviour should be considered.

Section 46 applies to conduct directed at harming individual competitors or potential competitors. In this, it differs from the other prohibitions in Part IV, which are directed more broadly towards the competitive environment. The assumption is that if a firm has substantial market power and engages in non-competitive conduct that is damaging to an individual competitor or a potential competitor, that conduct will be sufficiently detrimental to competition and fair trading (and the welfare of Australians) to justify prohibition. The standard or threshold of liability under s. 46 has been consciously set lower by the Parliament than the threshold in the other sections in Part IV. This choice is deliberate and recognises the damage that can be done to competition, fair trading and consumers by firms with substantial market power taking advantage of their market power—that is, acting in a non-competitive manner.

This assumption underlying the drafting of s. 46 has been recognised judicially by the High Court. In *Queensland Wire*, Chief Justice Mason and Justice Wilson stated:

> The object of section 46 is to protect the interests of consumers, the operation of the section being predicated on the assumption that competition is a means to that end.[137]

The Commission believes that the threshold for liability for the purpose test is also appropriate for an effects test. If it is appropriate to prohibit certain forms of conduct engaged in with the purpose of achieving specific anti-competitive outcomes, how

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[137] Note 90 *supra*.

much more should the conduct be prohibited if the same outcomes are actually achieved?

It may be argued that including an effects test in this form will act to prohibit ordinary competitive conduct. After all, a normal consequence of competition and competitive markets is that some firms will succeed and others will fail. If a firm with substantial market power invests in a superior product or is able to set prices below its competitors because of superior efficiency, will its conduct be subject to challenge under such an effects test in s. 46?

The Commission believes amending s. 46 in this manner will not result in competitive market behaviour being challenged or questioned. The ‘take advantage’ element operates as a filter on the operation of s. 46 (see sections 3.2.3 and 3.4). It ensures that only non-competitive conduct is subject to scrutiny under the section—conduct that is inconsistent with the norms of competitive behaviour that are the result of competitive markets. Competitive market behaviour will never be subject to scrutiny or challenge under s. 46.

The Commission supports its proposed formulation of an effects test because it meets the policy objectives of promoting competition and fair trading. It believes that s. 46 deals with a particular problem of unilateral conduct by firms with substantial market power. Such firms have the potential to direct non-competitive conduct at individual competitors and potential competitors. This conduct is both damaging to competition (even though directed at individual firms) and unfair. Accordingly, the Commission believes it is consistent with the objectives and framework of s. 46 to add an effects test based on paragraphs (a), (b) and (c) of subs. (1).

3.6 Enforcement issues

The Commission is concerned that the Act’s object of promoting and protecting competition and fair trading is not always being met because of the significant length of time between anti-competitive uses of market power and the final legal outcomes in these matters. The Act would operate more effectively with appropriate provision to address misuses of market power more expeditiously. The Commission’s preferred approach to the problem is the introduction of cease and desist orders.

3.6.1 Cease and desist orders

To widen the available enforcement options under the Act, the Commission supports the introduction of cease and desist orders applying to anti-competitive uses of market power. The Commission proposes a model similar to that contained in the New Zealand Commerce Act.

Cease and desist orders provide interim administrative orders restraining corporations from engaging in specified anti-competitive conduct. A decision to issue an order would be based on the Commission’s reasonable satisfaction of prima facie anti-competitive use of market power, if urgent action was required in the public interest. Judicially imposed penalties and injunctions would be available for breach of a cease and desist order.

3.6.2 Issues supporting cease and desist orders

3.6.2.1 Speed

The ability to take fast enforcement action is becoming extremely important in the new economy and the global marketplace. Effective enforcement of competition laws requires powers to put an **immediate** temporary stop to anti-competitive conduct by corporations. Cease and desist orders provide a practical and effective tool to stop anti-competitive conduct quickly—avoiding irreversible damage to competition while matters are fully investigated and pursued through the judicial process.

Only the courts have the power to determine whether there has been a breach of s. 46. The demands of bringing a misuse of market power case are such that there is a considerable delay in enforcing a breach of s. 46. The Commission's recent experience is that the time between alleged breaches occurring and final court orders being handed down can be up to eight years. (See appendix 6 for a summary of the timing issues in recent s. 46 investigations by the Commission). Apart from making it more difficult to fashion an appropriate remedy, such delays can extend the damage to markets caused by the conduct.[138]

Cease and desist orders would allow early intervention to maintain the market status quo until judicial enforcement proceedings can be brought for alleged breaches of s. 46. This power is likely to provide significant assistance to small businesses that are targeted by anti-competitive conduct. Early intervention to stop anti-competitive conduct would allow small business competitors with limited resources to avoid bankruptcy before a matter can be fully investigated and enforcement proceedings instituted.

For example, new entrants are especially vulnerable to misuses of market power, often having limited resources to withstand anti-competitive conduct while attempting to establish a foothold in the market. If anti-competitive conduct can be stopped quickly, market participants would have the opportunity to compete on their merits until the matter can be brought before the court. Further, the recipient of a cease and desist order would not be in a position to unjustly profit from the anti-competitive conduct during the period of investigation by the Commission. Where there is no early intervention, competitors can be eliminated from the market and the court may not be able to remedy such damage to competition.

3.6.2.2 Informal resolution

The issue of cease and desist orders may benefit all relevant parties by promoting a faster and less costly resolution of disputes than litigation. A possible outcome from the issue of a cease and desist order may be that the conduct is stopped quickly and any damage is avoided or satisfactorily remedied. It may then not be necessary to proceed to litigation. Such an outcome would benefit the public interest by obtaining a less costly resolution of alleged anti-competitive conduct. However, in cases where for

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138 See for example Telecom Corporation of New Zealand Ltd v Clear Communications Ltd [1995] 1 NZLR 385.

example the conduct is serious, advertent, continuing or widespread the Commission may proceed to institute court actions.

The knowledge that a cease and desist order may be issued may also act as a deterrent to relevant anti-competitive conduct being engaged in, thereby improving standards of acceptable competitive conduct. However, cease and desist orders could not be used oppressively by the Commission to define standards of conduct because they would remain subject to review by the courts and companies would be entitled to defend the lawfulness of particular conduct in substantive proceedings.

If cease and desist orders were added to the range of regulatory tools available under the Act, the Commission could select the most appropriate options to deal with a specific issue.

3.6.3 Model for cease and desist orders

The cease and desist model supported by the Commission would operate in the following way:

i Where the Commission is satisfied that

(a) a corporation

(b) has a substantial degree of power in a market

(c) is engaging in conduct

(d) the conduct involves a use of its power in a market

(e) the conduct is anti-competitive

(f) the conduct is likely to cause loss or damage to particular persons or consumers generally

(g) there is an urgent need to prevent the continuation of the conduct in order to prevent such loss or damage, and

(h) the conduct is contrary to the public interest

the Commission may, after considering any submissions by the corporation, issue a cease and desist order prohibiting the corporation from engaging in conduct the subject of the order.

ii Cease and desist orders would operate for a limited duration (for example, up to 90 days). During this time damage to markets would be restrained while the Commission would have the opportunity to fully investigate and gather information and evidence to support issuing proceedings for contravention of the Act.

iii The cease and desist order would expire at the specified time or on the institution of court proceedings by the Commission, whichever is sooner.

iv The issue of an order would be subject to review before or at the time of proceedings for non-compliance in (v). However, when there is a challenge to the validity of the order it should remain on foot pending final determination of the issues. Only in exceptional circumstances could a court stay the operation of a cease and desist order, pending determination of a challenge to the issue of the order, or

v A corporation to whom a cease and desist order is issued shall not engage in the conduct or conduct of a kind specified in the order during the period in which that cease and desist order is in operation. On application by the Commission, a court may impose penalties and issue injunctions for non-compliance with the order.

Legislation should also confirm that the Commission retains s. 155 powers in the period after a cease and desist order is issued and before any contravention proceedings are instituted in the court.

3.6.4 Other considerations

3.6.4.1 Interlocutory injunctions

To prevent certain conduct from continuing or occurring the Commission can seek interlocutory injunctions by application to the Federal Court.[139] It has been argued that because of the availability of urgent interlocutory injunctions, cease and desist powers are not warranted. However, the Commission's view is that interlocutory injunctions do not provide a sufficient remedy to stop anti-competitive conduct quickly in the context of detailed s. 46 investigations that require the collection and preparation of complex evidence.

To grant interlocutory injunctions a court must be satisfied that the evidence shows that:

- there is a serious question or issue to be tried
- the balance of convenience is in favour of granting injunctive relief
- there are no discretionary reasons for refusing the grant of the relief sought.[140]

Section 46 cases require substantial time and resources to investigate and prepare for litigation (see appendix 5). For example, issues of market power require preparation of detailed economic evidence. Section 46 actions also require evidence of subjective purpose, which is problematic regardless of the period of time or resources available (see 3.3.3). The time from commencement of the alleged conduct, through investigation

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139 Subsection 80(2) empowers the court to grant an interim injunction pending determination of an application under s. 80(1). Equitable principles apply to the grant of injunctions under the Act.

140 The principles are well established, for discussion see Gibbs CJ in *Australian Coarse Grains Pool Pty Ltd v Barley Marketing Board of Queensland* (1983) 57 ALJR 425.

and on to filing of court proceedings, is likely to be measured in years, not days or weeks.

The evidentiary requirements for the grant of an interlocutory injunction make it difficult to stop anti-competitive conduct at the investigation stage. To satisfy the 'serious question to be tried' test, the applicant needs to adduce a level of cogent evidence that is unlikely to be available in the necessary timeframes. The 'balance of convenience' test can also operate against the applicant because of the difficulties in establishing a strong case in a short time. Particularly, it is difficult for the Commission to quickly gather evidence of anti-competitive purpose in support of an application for an interim injunction.

The recent *South Sydney Rugby League* case highlighted the problems with interlocutory injunctions in the Part IV context. Having found a serious question to be tried, Justice Hely held that the balance of convenience was heavily against the grant of interlocutory relief, even after allowing for the public interest in observing the Act.[141] However, in the following substantive proceedings the majority of the Full Federal Court found contraventions of ss. 45(2)(a)(i) and 45(2)(b)(i).[142]

A further important limitation on the utility of interlocutory injunctions is that after it has commenced court proceedings, the Commission is not able to issue a notice under s. 155 of the Act where the answer to the notice is relevant to those proceedings.[143] Consequently if the Commission seeks an interlocutory injunction upon learning of anti-competitive conduct, its subsequent ability to fully investigate the matter is limited and the prospects for success in substantive proceedings are hindered. Accordingly, the public interest would be better served by a cease and desist power under the Act to temporarily stop conduct damaging to competition and consumers, pending a full investigation of the matter.

3.6.4.2 Constitutional issues

The Commission is aware of suggestions that legislation creating cease and desist powers may be invalid under the Commonwealth Constitution. The validity issue arises from the separation of administrative and judicial powers under the Constitution. The contention appears to be that the issue of a cease and desist order may involve the exercise of judicial power contrary to Chapter III of the Constitution.

The Commission has carefully considered these issues and consulted with the Australian Government Solicitor's Office of General Counsel. The proposed model outlined above has been designed as an interim administrative measure with such Constitutional considerations in mind. The Commission takes the view that a cease and desist power can be drafted in accordance with the High Court's approach to Chapter III issues and that such legislation is likely to withstand Constitutional challenge.

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141 *South Sydney District Rugby League Football Club Ltd v News Ltd* (1999) 169 ALR 120.

142 South Sydney District Rugby League Football Club Ltd v News Ltd [2001] FCA 862; (2001) 181 ALR 188.

143 See Brambles Holdings Pty Ltd v TPC (1980) ATPR 40-179.

3.6.4.3 Safeguards on the use of cease and desist orders

The cease and desist model proposed by the Commission adopts rigorous safeguards to ensure that such orders would operate appropriately, balancing the interests of recipient corporations against the object of protecting competition.

(i) Preliminary thresholds

A cease and desist order could only be issued where numerous preliminary thresholds are satisfied. The Commission would be required to be satisfied that a corporation has used its substantial market power to act anti-competitively, that the conduct is likely to cause loss or damage and that there is an urgent need to prevent the continuation of the conduct in the public interest.

(ii) Natural justice requirements

Prior to the issue of a cease and desist order, the relevant corporation would have the ability to make submissions to the Commission providing reasons why an order should not be made. The Commission would take those submissions and other relevant information into account in determining whether the requirements for the issue of an order have been satisfied.

(iii) Ability to issue orders rests solely with the Commission

The ability to issue a cease and desist order would rest only with the Commission. The Commission expects that matters where cease and desist orders would be warranted are likely to be infrequent. When considering how the Commission would approach the use of a cease and desist power, it is instructive to consider the Commission's use of the power to issue Competition Notices under the telecommunications-specific competition provisions in Part XIB of the Act. This is because the Commission's power to issue competition notices is arguably akin, although with some clear differences, to a cease and desist power.[144]

The Commission has conducted 17 major investigations under Part XIB since 1997—and has issued competition notices in relation to only three of these matters. This demonstrates the Commission's careful and considered approach to utilising such a regulatory tool—balancing the potential exposure of the recipient to considerable liabilities against the potential permanent damage to competition (and ultimately consumers) if the conduct continues.

In relation to certain matters, the Commission formed the view that it did not have a 'reason to suspect' that a contravention of the competition rule[145] had occurred. In some

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[144] A competition notice does not require that the party the subject of the Competition Notice cease engaging in the conduct as it is described in the competition notice. Rather, it essentially acts to put the recipient of the competition notice 'on notice' that the Commission has a reason to believe that the relevant conduct is anti-competitive. Particular effects flow from the issuing of a competition notice, which it is not suggested would or should flow from a cease and desist power.

[145] The Commission's determination of whether it has a reason to suspect a breach of the competition rule is part of the preliminary phase of its consideration of whether there has been a contravention of the Act. If the Commission has reason to suspect that a carrier or carriage service provider has

instances, the Commission discontinued the investigation once it had formed the view that there had been no contravention of the competition rule. Other matters were resolved through further commercial negotiation without the need for continued involvement by the Commission. The three matters when competition notices were issued relate to Internet peering agreements, commercial churn, and ADSL. In each matter, the change in conduct brought about by the Commission's action has been vital to ensuring competitive conditions in a number of telecommunications markets.

The Commission has a considerable incentive not to proceed with unmeritorious claims. The resources of the Commission are limited and it would bear the other party's costs in the event that the Commission loses the court proceedings.

(iv) Limited duration

Cease and desist orders would operate for a strictly limited time period. Such orders are intended to maintain the status quo while the Commission gathers information and evidence to support instituting judicial proceedings in relation to the conduct. Accordingly, cease and desist orders would expire upon withdrawal, at the end of the specified period or upon the institution of court proceedings by the Commission.

(v) Oversight of the courts

Importantly, the courts would provide the ultimate check on the use of cease and desist orders. The proposed model provides for explicit judicial oversight of cease and desist orders. Notwithstanding that cease and desist orders would be subject to the original jurisdiction of the High Court, the proposed model confers on recipient corporations an additional statutory right of review as to the validity of an order. A cease and desist order that was issued without proper regard for procedural fairness may be impugned in judicial review.

Further, cease and desist orders would only be enforceable by the courts. Where a party fails to comply with an order, the Commission would be required to institute enforcement proceedings for a penalty and injunctions.

3.6.5 Overseas comparisons

Virtually all competition regimes include a provision for orders to cease or correct abusive conduct. In some overseas jurisdictions, the orders are issued by the enforcement agency. In others, the agency must apply to a court for orders.

3.6.5.1 European Union

Where the European Commission's (EC) reaches a decision finding a violation of Art. 82, the EC can issue a cease and desist order requiring termination of the offending conduct as well as imposing a fine for the violation. The order may also call for positive actions, although the scope of a mandatory (rather than prohibitory) order could be limited.

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contravened, or is contravening, the competition rule, the Commission must act expeditiously in deciding whether to issue a competition notice in relation to that contravention: section 151AQ.

The European Court of Justice has said that an order of termination must be connected to the specific violation, and accompanying requirements of positive action must be to correct its particular effects, for example to provide something that was wrongfully withheld. The EC's orders are self-executing. The EC need not apply to a court for a preliminary or permanent order. Violation of the EC's order exposes a firm to sanctions.

The regulation that prescribes the EC's powers does not provide for interim relief, but the European Court of Justice has found that such a power is implicit in it. Interim measures may be ordered if there is immediate danger of irreparable harm. They must be temporary and designed to maintain the status quo and no more. The EC must consider the interests of all sides and apply the general jurisprudential principle of proportionality. And it must act by formal decision—that is, the Commissioner of Competition cannot issue an interim order on its own authority, but it must be an action of the EC. Interim measures cannot be ordered *ex parte* and the party affected has the right to appeal the decision to the Court of First Instance.

3.6.5.2 United Kingdom

After finding a violation of the Chapter II prohibition, the Director General of Fair Trading has the power to issue mandatory orders to bring the infringement to an end—that is, to modify or cease conduct (Competition Act, s. 33(1)). The same power is provided to deal with the Chapter I prohibition against restrictive agreements under s. 32(1). The directions are not self-enforcing. If a firm did not comply, the Director General would have to go to court for an order, and only if the court order were disobeyed would there be consequences for contempt such as financial penalties or imprisonment.

Similarly, the Director General may give 'interim measures directions' if there is reasonable suspicion that the prohibitions have been infringed and he considers that it is necessary to act urgently to prevent serious, irreparable damage to particular persons or to protect the public interest (Competition Act, s. 35). These interim measures are enforced by a court in the same way as ordinary directions in final decisions.

3.6.5.3 Germany

In Germany, the Federal Cartel Office (FCO) generally has the power to issue orders prohibiting conduct that violates the Act against Restraints of Competition (GWB—s. 32). These orders are especially significant in Germany because restrictive agreements are not necessarily void *ab initio* and an order may be a necessary predicate for effective private action. If a party continues a wilful or negligent violation after being served with an order, the FCO can make a claim to recover the additional proceeds (s. 34—'skimming off'). Wherever the FCO can issue a final order or decision it can also issue a preliminary injunction to regulate the situation temporarily until it reaches a final decision (s. 60). The FCO need not apply to a court for these orders but it may need to apply to the court for sanctions if the order is violated.

3.6.5.4 Italy

The Italian Competition Authority's power to set a deadline by which offenders must bring their conduct into compliance with the law is interpreted to authorise both mandatory and prohibitory orders (s. 15 Competition and Fair Trading Act). Failure to conform by the deadline results in fines. In serious cases fines can be imposed without first giving the parties a chance to reform. There is no specific provision in the competition statute about interim or preliminary relief—except about mergers when the Authority can order the ‘temporary suspension’ of the transaction until the Authority’s investigation is completed (s. 17).

3.6.5.5 France

In France the *Conseil* can generally order parties to cease anti-competitive practices by a set deadline and can impose specific conditions (Art. 13 of the Ordonnance of 1 December 1986). Also on the authority of the *Conseil*, the order is backed by a fine for non-compliance. As well, fines can be imposed without giving the parties a chance to correct their behaviour. The *Conseil* may issue interim measures at any time if the practice poses a serious and immediate threat to the general economy, to the sector concerned, to the interests of consumers or to the complainant (Art. 12). Interim measures must be limited to what is ‘indispensable’ to handling the emergency. They are not issued *ex parte*. The parties must be heard. As with final orders, interim orders can be enforced by fines imposed by the *Conseil*.

3.6.5.6 United States

In the US, the Federal Trade Commission (FTC) has the power to issue orders to cease and desist from violations of the Federal Trade Commission Act, at the conclusion of the administrative process after a finding of actual violation. These orders are not self-enforcing. If a respondent does not obey, the FTC must apply to a district court for an order imposing civil penalties or other equitable relief. The courts have permitted the FTC to issue orders that extend somewhat beyond the bare facts of the misconduct found, for example by prohibiting similar conduct in other markets. And some orders mandate affirmative actions as well, for example licensing intellectual property or disclosures to correct misleading advertising.

Courts are empowered to issue injunctions under the Sherman Act (s. 4) and the Clayton Act (s. 15). Generally, there are applicable rules of civil procedure providing for preliminary injunctive relief pending the completion of full judicial proceedings.

The FTC can also apply for a court order under s. 13(b) of the FTC Act to preserve the status quo pending the completion of the FTC’s administrative proceedings. The FTC Act authorises the FTC to act where it has ‘reason to believe’ that there is a violation or potential violation of one of the laws it enforces and that enjoining it pending the FTC’s own complaint and decision would be in the public interest.

The US district court may issue a temporary restraining order or preliminary injunction if it is persuaded that ‘weighing the equities and considering the Commission’s likelihood of ultimate success, such action would be in the public interest’. A court may issue a temporary restraining order *ex parte*. In practice, the most important consideration is the likelihood of success on the merits. These criteria do not include the usual equity jurisprudence requirement of irreparable damage from delay. The FTC must issue its own complaint within 20 days except in actions to enjoin false advertising, which are brought under subs. 13(a).

The court may also issue a permanent injunction, which amounts to a judicial ‘cease and desist’ order, enforceable by the court’s criminal contempt powers. By contrast the FTC’s own cease and desist orders are enforceable by civil penalties. Court orders under s. 13(b) are issued after notice to the parties. The applicant must show a risk of imminent irreparable injury. The order may only last for 10 days and may be renewed only once. The FTC has used the s. 13(b) procedure to enjoin mergers pending final decisions, to stop consumer frauds, and to obtain special relief such as disgorgement of improper profits, which the court can order in a permanent injunction under US equity rules.

The scope of permanent injunctions is set by the course of decisions and to some extent by the statutes’ terms, founded though on equity jurisprudence generally: to ‘prevent and restrain violations,’ issuing ‘such orders and decrees as are necessary or appropriate’ to accomplish the statutory purposes. Orders have included divestitures and requirements to buy from particular suppliers. The courts’ powers are the same, whether a case is brought by the Antitrust Division or by a private party (or state official).

3.6.5.7 Canada

The Canadian Commissioner of Competition has cease and desist powers under s. 104.1 of the Canadian Competition Act for abuse of dominance in the domestic aviation sector. A new s. 103.3 proposes temporary order powers for other industries.

Under s. 104.1, the Commissioner makes the ‘temporary order’ subject to review by the Canadian Competition Tribunal. Under the proposed s. 103.3, the Tribunal would make the order on *ex parte* application by the Commissioner.

A three-stage test is to be applied before a temporary order will be made:

Stage 1—the Commissioner has commenced an inquiry under the Competition Act

Stage 2—there is evidence on which to base a preliminary opinion that a firm is engaged in anti-competitive conduct

Stage 3—there is evidence of harm including injury to competition, the likely elimination of a competitor or a competitor suffers significant loss of market share or revenue that cannot be remedied by the Tribunal.

Temporary orders under s. 104.1 have effect for 20 days and can be extended up to a maximum of 80 days. Judicial review of the Commissioner’s order is very limited. The only avenue is an application to the Competition Tribunal.

3.6.5.8 Japan

In Japan an order to cease and desist issued by the Japan Fair Trade Commission (JFTC) is the basic sanction for ‘unreasonable restraints of trade.’ A financial ‘surcharge’ can be imposed in response to violations affecting price and criminal fines are also possible in theory. The sanctions for private monopolisation can be orders to stop exclusion or eliminate situations that restrain competition. Generally the orders are prohibitory rather than mandatory. In cases of ‘urgent necessity’ to maintain conditions during the enforcement and decision process and when it is difficult to restore competitive conditions if relief must await the end of that process, the JFTC may ask a court to order the temporary cessation of the conduct that is alleged to have violated the Antimonopoly Act (s. 67).

3.6.5.9 New Zealand

Section 74A of the New Zealand Commerce Act empowers a Commissioner to make cease and desist orders by consent or following a hearing by a Commissioner, where there is a prima facie case that a person has engaged in anti-competitive conduct and it is necessary in the public interest to act urgently to prevent serious loss or damage. The New Zealand cease and desist orders apply broadly to restrictive trade practices and merger provisions. Where there is non-compliance with an order, the Commission can apply to the Court for the imposition of pecuniary penalties.

3.6.6 Divestiture

The Commission believes that an amendment introducing the remedy of divestiture for a contravention of s. 46 warrants consideration, although it is not actively pursuing such an amendment at this time. For a discussion of the remedy of divestiture, see the Commission’s February 2002 submission to the Senate Legal and Constitutional References Committee’s Inquiry into the *Trade Practices Act 1974*.

4 Collective bargaining and small business

Summary

In light of recent discussion about whether the authorisation process provides an effective mechanism to address small business collective bargaining issues under the Act, chapter 4 focuses on:

- how collective bargaining is dealt with in Australia through the authorisation process
- how small business collective bargaining issues are dealt with in some key overseas jurisdictions
- the Commission's assessment of the main policy options for improving the Trade Practices Act (the Act) and its administration to achieve a more efficient, fair, timely and accessible competition law framework, in light of concerns raised by small businesses regarding collective bargaining.

The Commission's preferred option is a notification process for collective bargaining modelled on the existing notification process for exclusive dealing. Access to this process should be restricted to small businesses dealing with large businesses with a substantial degree of market power.

While the authorisation process has been used for many years to facilitate collective bargaining in the public interest, a number of factors—including deregulation in key agricultural industries and the extension of the Act to apply to individuals and unincorporated associations—has led to an increased focus on the role of the authorisation process as a way of enabling collective bargaining under the Act.

Since 1 July 1995 the Commission has only denied two applications for authorisation of collective bargaining conduct. As well, there has been only one application for review by the Australian Competition Tribunal (the Tribunal) of a Commission determination on collective bargaining.

A survey of competition law regimes as they apply to small businesses in New Zealand, Canada, the United States, the European Union and the United Kingdom shows that with the exception of NZ, which has an authorisation process like Australia’s, they provide no mechanism for allowing small business collective bargaining on broad public benefit grounds.

The survey shows that compared to these overseas jurisdictions, Australia's competition law, incorporating an authorisation process, has more flexible mechanisms for dealing with small business collective bargaining and it is likely to be more responsive to the needs of small business.

Nevertheless, some small business groups have said that the authorisation process does not offer a timely and cost effective mechanism to obtain immunity from the Act to facilitate collective bargaining on public interest grounds.

There are several policy options for addressing small business concerns about the way in which collective bargaining is dealt with under the competition provisions of the Act. The main options considered in this chapter are:

- a range of administrative improvements
- amendments to the existing authorisation process
- new processes for granting immunity for collective bargaining, including a modified notification process
- a block exemption process
- a registration processes modelled on Part X of the Act as suggested by the Motor Trades Association of Australia (MTAA)
- a general legislative exemption for small business collective bargaining.

Following is a summary of the Commission's assessment of these options.

- There is scope for the Commission to better use its resources to assist small business through the authorisation process.
- The Act could be amended to:
  - require the Commission to consider the public benefit of having an efficient small business sector when assessing applications for authorisation
  - give the Commission a discretion to waive the authorisation application fee where the fee imposes an unreasonable burden on the applicant

  However, time limits imposed on the authorisation process are likely to operate to the detriment of small business. This is because large businesses and their industry associations often have the resources to better manage consultation processes with tight deadlines than small businesses and small business industry associations with limited resources.
- A modified notification process for small business collective bargaining has the potential to provide an appropriately streamlined mechanism for granting immunity from the competition law. At the same time, there should be adequate checks and eligibility criteria to ensure that access to the process is limited to small businesses collectively bargaining with large businesses with a substantial degree of market power. Under this process, the Commission would effectively revoke any notification of conduct that is not likely to operate in the public interest. A process of this type is the Commission's preferred option for reform.

- While there are potential administrative efficiencies associated with a block exemption power, adopting it would constitute a significant departure from Australia's competition law framework.

- The Commission considers the MTAA's proposal to provide immunity for small business collective bargaining based on the registration mechanism set out in Part X of the Act would be quite inappropriate, given the potentially significant effects of collective bargaining arrangements across a wide range of Australian industries. The lack of transparency, public consultation and an effective public interest test associated with a Part X style process would be of particular concern in relation to primary boycotts that have the potential to cause significant commercial damage to businesses.

- The Commission would also be particularly concerned about any general legislated exemption for small businesses collective bargaining and would not support this option. Small businesses play a substantial role in the Australian economy, representing 95 per cent of all private sector businesses in 1998–99 and accounting for 30 per cent of the total sales of goods and services of all businesses in 1997–98.

  A general exemption for small businesses to collectively bargain would exempt an extremely large section of the Australian economy from the operation of competition law. This would undermine the fairness, legitimacy and effectiveness of the competition provisions of the Act and could lead to significant increases in inefficiency across all sectors of the economy. An exemption would also reduce consumer welfare and undermine the efficiency and international competitiveness of the Australian economy to the detriment of all Australians.

  An unfettered ability by primary producers to collectively bargain has the potential to unwind the deregulation process across a range of agricultural industries. It would give primary producers the power to set an industry wide price for their produce in a manner directly comparable to the price setting functions of the old statutory marketing authorities.

4.1 Collective bargaining and the authorisation process

When negotiating with big business, small businesses often feel that they have little or no bargaining power and that sometimes they are forced to accept unfavourable terms and conditions, including unfavourable prices. In some industries, small businesses see collective bargaining as an effective strategy to redress this imbalance in bargaining power and achieve more appropriate commercial outcomes in their dealings with big business.

Collective bargaining can raise concerns under the competition provisions of the Act. In particular, some collective bargaining arrangements involve agreements between competitors on price, primary boycotts or arrangements that substantially lessen, prevent or hinder competition.

Notwithstanding these competition law prohibitions, the Commission can grant immunity from legal action on public benefit grounds through the authorisation process. Authorisation enables collective bargaining arrangements that would otherwise risk breaching the Act.

The Commission accepts that collective bargaining arrangements can often operate in the public interest and has granted authorisation for collective bargaining arrangements in the vast majority of cases in which authorisation was sought. Since 1 July 1995 authorisations have enabled collective bargaining by chicken growers, dairy farmers, sugar cane growers, lorry owner-drivers and small private hospitals.

Since 1 July 1995 the Commission has only denied two applications for authorisation of collective bargaining conduct. Both of these concerned collective bargaining in the health care industry, an area in which the Commission has had competition concerns.[146]

The Commission is currently considering nine applications for authorisation relating to collective bargaining conduct.

Since 1 July 1995 the Commission has imposed conditions in less than half the cases where it has granted authorisation for collective bargaining arrangements. For instance, in the Australian Dairy Farmers' Federation (ADFF) application, the ADFF applied for an authorisation to enable the ADFF to negotiate on behalf of every dairy farmer in Australia. The Commission considered that the formation of a national collective bargaining group would lead to an industry-wide price fixing arrangement and the imposition of a set of identical supply contracts across the entire industry. This could have substantially distorted competition and allowed dairy farmers to extract a monopoly rent from processors and increase prices to consumers. However, the Commission was prepared to authorise collective bargaining arrangements subject to conditions that restricted the scope and operation of collective bargaining groups to ensure that collective bargaining operated on a more limited basis in the public interest.

Since 1 July 1995 the average amount of time for which authorisation has been granted by the Commission for collective bargaining is approximately four years.[147]

As well, since 1 July 1995 the Commission has not revoked any authorisations dealing with collective bargaining conduct and there has only been one application for review by the Tribunal of a determination by the Commission on collective bargaining. This was the recently lodged application by National Foods Ltd for a review of the Commission's decision to grant authorisation in the ADFF matter. In general terms, National Foods sought review, arguing that the Commission granted authorisation to the ADFF in terms that were too broad and uncertain. They claimed that groups of dairy farmers collectively bargaining with processors may be able to exercise too much market power.

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[146] In the case of the Commission's 1998 decision to grant authorisation to the Australian Medical Association (AMA) to collectively bargain with the South Australian Health Commission on behalf of doctors working in South Australian rural public hospitals, the Commission granted authorisation only for a period of 11 months (from 31 July 1998) to provide the parties with sufficient time to establish a negotiating process that was consistent with the Act.

[147] Excludes the March 2000 Newspaper decision and the July 1998 AMA decision in which the applicants sought authorisation for unusually short lengths of time.

The Commission considers that the relative small number of applications for review by the Tribunal on collective bargaining arrangements reflects well on the rigour and integrity of the Commission's decision making and its administration of the authorisation process.

4.1.1 Small business concerns with the authorisation process

While the authorisation process has been used for many years to make collective bargaining in the public interest easier, several factors—including deregulation in a number of agricultural sectors and the extension of the Act to apply to individuals and unincorporated associations—have led to an increased focus on the role of the authorisation process as a way to enable collective bargaining under the Act.

As a result of legislative changes made in response to national competition policy reviews, deregulation in the agricultural sector has seen a number of statutory marketing authorities dismantled. This has left the price of primary produce to be set by the market. Previously, the price for primary produce was often set by statutory marketing authorities operating under legislation with an exemption from the Act. Following deregulation, producers of several commodities—most notably dairy producers—have seen collective bargaining as a key strategy for negotiating effectively with processors in a deregulated environment.

The extension of the Act to apply to individuals and unincorporated associations has also led to groups of health care professionals seeking authorisation to engage in collective bargaining.

Indeed, around 60 per cent of the authorisation applications lodged with the Commission for collective bargaining arrangements since 1 July 1995 have been in agricultural or health care industries, which have relatively recently had their pricing and supply decisions fully subject to competition law. In this context, some small business groups, particularly primary producer groups and health care professional associations, have criticised the authorisation process as not going far enough to make collective bargaining by small businesses easier.

4.2 Small business collective bargaining under overseas competition law regimes

Many overseas jurisdictions directly or indirectly ameliorate the application of competition law to the activities of small businesses. The main examples are:

- legislated exemptions that directly benefit small business, for example the UK’s Small Agreements and Conduct of Minor Significance Regulations and some US state government exemptions for collective bargaining agreements between medical professionals

- exemptions granted by the competition agency, for example the EC block exemption for horizontal agreements and the Commission’s power to grant authorisation

- safe harbours established by enforcement guidelines of competition agencies, for example the EC's *de minimis* Notice and the US *Antitrust Guidelines for Collaborations Among Competitors*

- court based interpretation of the law, for example application by US courts of the rule of reason

- legislated exemptions for agriculture and primary producers.

4.2.1 Applying competition law to small business in other countries

This section outlines the application of competition law to small businesses in NZ, Canada, the US, the EU and the UK. It is common for one jurisdiction's competition law to incorporate a number of features (see section 4.2).

However, apart from the Australian and NZ authorisation processes, in most cases these approaches offer little or no comfort for price fixing as part of a collective bargaining strategy by small business. Under the NZ authorisation process, the focus of the Commerce Commission's public benefit analysis has increasingly been on gains in economic efficiency. Accordingly, broader, less tangible non-economic public benefits (which are less easily quantified) tend to be given less weight. Such an approach conceivably has the potential to affect the ability of small business applicants in rural and regional areas to establish a net public benefit.

Even in the UK and the EU where prohibitions on anti-competitive agreements can be declared inapplicable by the competition authority if an agreement meets certain cumulative criteria, there is little scope for agencies to consider benefits to the public other than those associated with efficiency. Under the EC and UK competition rules, a party will not qualify for an exemption unless they can establish that the agreement leads to improvements in the production or distribution of goods, or the promotion of technical or economic progress **and** consumers will gain 'a fair share' of the benefits of the efficiency gain. Where this is shown, exemptions are nevertheless unavailable when conduct could potentially eliminate competition for a substantial part of the products involved, whatever the size of efficiency gains.

The UK, the EU and the US each have a system of 'safe harbours' within which agreements are presumed by agencies not to raise competition concerns. However these safe harbours are generally not available for agreements which fix price and they offer little assistance to small business collective bargaining on price.

Compared with these overseas examples, Australia's competition law—incorporating an authorisation process—provides a more flexible mechanism for dealing with small business collective bargaining. It is likely also to be more responsive to the needs of small businesses than the mechanisms used in other jurisdictions.

4.2.2 Exemptions in other countries

4.2.2.1 New Zealand

New Zealand's *Commerce Act 1986* applies to both small and large businesses. Although the Act allows for the creation of statutory exceptions to the restrictive trade practices provisions, generally NZ small businesses that wish to engage in collective bargaining activities (including agreements on price) must seek authorisation from the Commerce Commission on the grounds that the conduct will lead to a net public benefit.

Under the NZ authorisation process, the primary focus is on efficiency gains—the Commerce Commission assesses both benefits and detriments and the focus has increasingly been on economic efficiency.[148] The Commerce Act specifically requires the Commerce Commission, when it determines the extent to which conduct will result in a public benefit, to have regard to any efficiencies that will result from the conduct. Other than an application currently before it involving proposed collective negotiations by pharmacists[149], the Commission understands that the Commerce Commission has not adjudicated in recent years on any applications relating to small business collective bargaining.

4.2.2.2 European Union

The EU competition rules do not contain an explicit small business exemption. However, the European Court of Justice found that agreements between competitors that do not have an appreciable effect on competition or on intra-community trade are not caught by the prohibition on agreements that have the object or effect of preventing, restricting or distorting competition.

The European Commission (EC) considers that conduct will not appreciably restrict competition if the aggregate market share of parties to an agreement is no greater than 10 per cent when the parties are actual or potential competitors, or 15 per cent when they are not.[150] The market share threshold drops to 5 per cent when competition is restricted by the cumulative effects of parallel networks of similar agreements established by several manufacturers or dealers. However, these 'safe harbours' do not apply to agreements which, among other things fix prices, limit output or sales or allocate markets or customers.

In contrast to the broad public benefit test used in the Australian authorisation process, the prohibition on agreements that may prevent, restrict or distort competition can be declared inapplicable only if an agreement or practice meets all these criteria:

- contributes to improving the production or distribution of goods or to promoting technical or economic progress
- allows consumers a fair share of the resulting benefit

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148 NZ Commerce Commission, *The Pharmacy Guild of New Zealand (Inc)* Draft Determination at p. 50.

149 ibid. On 26 April 2002, the Commerce Commission issued a draft determination proposing to deny authorisation to these arrangements.

150 *Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1) of the Treaty establishing the European Community (de miminis),* European Commission, 2001/C, at 368–07.

- does not impose unnecessary restrictions on the parties involved
- does not afford those parties the possibility of eliminating competition in respect of a substantial part of the products in question.

As well as the power to provide parties with exemptions for individual agreements, the EC also has limited power to declare that the prohibition does not apply to certain limited categories of agreements. For example, for horizontal agreements the EC has issued block exemption regulations for research and development (R&D) and specialisation agreements. However these do not exempt the parties if their combined market share exceeds 25 per cent (for R&D) and 20 per cent (for specialisation agreements). They also do not apply to agreements that aim to fix price or limit output or sales.

4.2.2.3 United Kingdom

The UK's *Competition Act 1998* applies to all businesses, whatever their size. Other than price fixing or market sharing, the Director-General of Fair Trading does not regard an agreement as having the requisite appreciable effect on competition if the parties' combined market share does not exceed 25 per cent.[151]

In addition, regulations made under the Act provide limited immunity **from financial penalties only** for 'small agreements' entered into by parties with combined worldwide turnover of less than £20 million, and 'conduct of minor significance' (which may involve an abuse of a dominant position) by a party with combined worldwide turnover of less than £50 million. However, once again immunity under these regulations is not available for price fixing agreements. Nor does it protect businesses involved from any Office of Fair Trading investigations, or any other consequences that may arise from an infringement of the Competition Act.

Competing businesses that wish to collectively agree on price (or engage in conduct that is likely to appreciably prevent, restrict or distort competition) risk contravening the Competition Act unless they obtain an individual or block exemption. The grounds for such an exemption are the same as those applying under EC law.

4.2.2.4 United States

The Sherman Act outlaws 'every contract, combination … or conspiracy, in restraint of trade'. The US Supreme Court found that a reasonable interpretation of this provision is that it only prohibits arrangements that injuriously restrain trade and it does not prohibit arrangements which, although restraining trade, do so in a way that promotes competition, for example through the efficient self regulation of trade.

Under US law, price fixing agreements can be declared per se unlawful without requiring a detailed assessment of actual market power. The US Federal Trade Commission (FTC) has expressed the view that stand-alone 'joint negotiation of price terms by non-integrated competing' small businesses would amount to an agreement

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151 See the UK Office of Fair Trading's publication, *The Chapter 1 Prohibition.*

not to compete on price, and would be per se unlawful.[152] However, where the negotiations on price are reasonably related to 'an efficiency-enhancing integration of economic activity'[153] and are reasonably necessary to achieve the pro-competitive benefits of the integration, an arrangement will fall for consideration under the rule of reason. The FTC considers also that 'mere coordination of decisions on price, output, customers, territories, and the like' is not considered integration and cost savings without integration are insufficient to avoid the per se prohibition.[154] US courts have been prepared to condemn naked price agreements or boycotts by small business even where the participants may not have a particularly large market share.[155] The courts do not recognise countervailing power as a defence.

The FTC and US Department of Justice issued *Antitrust Guidelines for Collaborations Among Competitors*, which provide a safe harbour for competitor collaborations as a matter of enforcement policy. Under the guidelines, neither agency will ordinarily challenge a collaboration where the market shares of the collaboration and its participants collectively account for no more than 20 per cent of each relevant market. These safe harbours do not apply for price fixing or other per se conduct, and so they are unlikely to provide a safe harbour for small business collective bargaining on price.

The US *Small and Medium-Size Business Act 1958* allows exemptions for 'certain narrowly-defined agreements between small "independently owned and operated" firms which are not dominant in their sphere of activity'.[156] However, these exemptions, which have almost never been used, only appear to cover joint R&D agreements and those that in the President's opinion contribute to national defence.

A small number of US states have passed (or introduced) laws enabling medical professionals to collectively negotiate and in some cases require health care providers to negotiate in good faith with medical professionals. For example, since September 1999 Texas legislation has allowed competing doctors to jointly negotiate with health benefit plans where the likely benefits outweigh the likely disadvantages of a reduction in competition. When fees are being negotiated, the Texas Attorney-General is required to determine whether the health plan has substantial market power.

During the Clinton administration, the Campbell Bill was introduced (but not passed) which would have granted doctors and other health professionals an anti-trust

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152 See, for example, the FTC's Advisory Opinion provided to MedSouth Inc.

153 See the FTC and US Department of Justice's *Antitrust Guidelines for Collaborations Among Competitors* (April 2000), p. 8.

154 ibid.

155 For a discussion of this issue, see for example, *FTC v Superior Court Trial Lawyers Association (1990)* 493 US 411.

156 'Exemption for horizontal co-operation agreements for small and medium-sized enterprises (SME) from general cartel ban', background note in *General Cartel Bans: Criteria for Exemption for Small and Medium-Sized Enterprises,* Organisation for Economic Cooperation and Development (OECD) Roundtables on Competition Policy, series no. 10, p. 14. Also see 'Aide Memoire of the Discussion', p. 55.

exemption comparable to that available to labour unions. The Bill was strongly opposed by the FTC and the Department of Justice who argued that boycotts and price fixing by doctors would result in higher health care costs to consumers without any assurance of higher quality of service.

4.2.2.5 Canada

Canada's competition laws apply to all sectors of the Canadian economy, except where specific exemptions exist (under the Competition Act or other legislation). The Competition Act contains no specific exemption for small businesses and accordingly many arrangements between small business, particularly on price, are considered under the prohibition against conspiracies.[157] First, this prohibition involves a consideration of whether the parties to the agreement have market power (that is, the ability to unilaterally affect industry pricing) and second, whether their behaviour is likely to be injurious to competition. While price fixing is generally viewed as injurious to competition, arrangements between small businesses which together do not have power in the relevant market do not contravene the Act.

4.2.3 Collective bargaining in agriculture

The application of competition law to the activities of primary agricultural producers varies considerably. While the EC and the UK approaches are influenced by the competing objectives of the formation of the EU, the US retains traditional protections for agricultural cooperatives and marketing organisations (while devolving more limited anti-trust responsibility to a specialised agency). New Zealand, Australia and Canada have favoured more universal application of competition law. However, by allowing primary producers to seek authorisation for collective bargaining, Australia and NZ have the flexibility to permit anti-competitive conduct where it is in the public interest.

The application of competition law to collective bargaining in rural agricultural industries also varies among key overseas jurisdictions.

Although there is scope for statutory exemptions to be made under the NZ Commerce Act, the Commission understands that there are few NZ regulations exempting arrangements in particular industries. However, following the amalgamation of numerous dairy cooperatives to form one national dairy processor, the NZ Government passed specific legislation giving the Commerce Commission powers to regulate the national dairy processor's operations.

The EC competition rules apply to production and trade in agricultural products. However, a regulation exempts from the rules agreements that form an integral part of a national public market authority or are necessary to meet common agricultural policy objectives (including productivity, efficiency and reasonable prices for consumers).

In particular, arrangements of farmers or farmers' associations in one state—for the production or sale of agricultural products or the use of joint facilities for storage,

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157 'Canada: Criteria for Exemption For Small and Medium-Sized Enterprises From General Cartel Bans', *General Cartel Bans: Criteria for Exemption for Small and Medium-Sized Enterprises,* p. 31.

treatment or processing—are exempt, if they do not fix prices, exclude competition or jeopardise common agricultural policy objectives. To ensure compliance with EC competition rules concerning agriculture, the UK Competition Act excludes certain agreements from the prohibition on anti-competitive agreements, to the extent that they relate to the production of or trade in an agricultural product.

Agriculture is one of a few US industries that are to various degrees exempted from general anti-trust laws. These exemptions are in a number of US statutes, including the Capper-Volstead Agricultural Producers' Associations Act, which allows persons engaged in the production of agricultural products to act together for the purpose of 'collectively processing, preparing for market, handling and marketing' products. However, this exemption is not absolute and the Secretary for Agriculture is authorised to act against cooperatives that monopolise or restrain trade to such an extent that the price of an agricultural product is 'unduly enhanced'.

Canadian competition law applies to rural industries, but not to arrangements and legitimate collective bargaining activities (including agreement on price) between 'fishermen' and persons engaged in buying or processing fish.

4.3 Policy options to address small business concerns about collective bargaining and the Act

There are a number of policy options for addressing small business concerns about the way in which collective bargaining is dealt with under the competition provisions of the Act. The main policy options include:

Option 1—Administrative improvements

The Commission's administration of the existing authorisation process could be improved and streamlined to make small business collective bargaining easier (see section 4.4.1).

Option 2—Amend the existing authorisation process

Options include to:

2a: amend the public benefit test to require the Commission to have specific regard to the public benefit of assistance to efficient small business for example guidance on costing and pricing or marketing initiatives which promote competitiveness (see section 4.4.2.1).

2b: reduce authorisation fees for small businesses and give the Commission discretion to waive authorisation application fees when the fees impose an unreasonable burden on the applicant (see section 4.4.2.2), and

2c: impose time limits on the Commission's consideration of authorisation applications (see section 4.4.2.3).

Option 3—Establish a new process for granting immunity from the Act’s competition provisions for small business collective bargaining

Models that could be used for this process include to:

3a: establish a notification process comparable to the existing process for notifying exclusive dealing conduct (see section 4.4.3.1)

3b: set up a block exemption process similar to that used by the EC (see section 4.4.3.2), and

3c: create a registration process comparable to the process in Part X of the Act for exempting international liner cargo shipping agreements (see section 4.4.3.3)—the MTAA has raised this option

Option 4—Establish a general legislative exemption for small business collective bargaining (see section 4.4.5)

4.4 The Commission's assessment of the policy options

The Commission's assessment of policy options to address small business concerns about the effect of the Act’s competition provisions on their ability to collective bargain is made on the basis that any system for granting small businesses immunity from the competition law to facilitate collective bargaining should:

- provide a mechanism to ensure that immunity is only granted where conduct is likely to operate in the public interest, and
- minimise the regulatory burden on small businesses seeking immunity from the Act to collectively bargain with large businesses with a substantial degree of market power.

In assessing these policy options the Commission is mindful of the following principles that are at the heart of Australia's competition law regime:

- in a market economy, competition is generally the best means of maximising national economic welfare
- the competition provisions of the Act should prohibit market participants from engaging in anti-competitive conduct
- these prohibitions should apply equally to all market participants
- the Act should have sufficient flexibility to ensure it allows conduct that results in a net public benefit

- exemptions for anti-competitive conduct should only be granted when the conduct results in a net public benefit

- any process for granting exemptions for anti-competitive conduct on public benefit grounds should be transparent and offer procedural fairness and natural justice to those affected.

4.4.1 Option 1: Administrative improvements

The Commission's administration of the existing authorisation process could be improved and streamlined to make small business collective bargaining easier.

In recent years, the Commission has put a high priority on helping small businesses and primary producers to understand the Act so they can respond effectively if they become the target of misrepresentation, misuse of market power or unconscionable conduct by larger companies.

The Commission has small business and rural and regional units which have Regional Outreach Officers and Small Business Managers in each state and territory. They run seminars and meetings to distribute trade practices information and to advise small business and rural communities about the Act and the role of the Commission.

In addition, every six months, the Commission also holds the Competing Fairly Forum which is broadcast live by satellite to more than one hundred regional and rural locations, to discuss trade practices issues of particular relevance to small businesses in regional areas. The Commission also has a Regional Network involving more than three hundred organisations in regional communities.

The focus of the Commission’s small business and rural outreach services has been to raise general awareness of the Act. However, because of concerns raised recently by small business and rural organisations about the authorisation process, the Commission recognises that it could better use its small business and rural outreach networks to help small businesses through the authorisation process. This would lead to improved understanding of and access to the authorisation process by small business.

With this in mind, the Commission could:

- publish a small business guide to the authorisation process, which would give small business:

  - a clear explanation of how the authorisation process operates

  - easy-to-understand and practical guidance on how to apply for authorisation for collective bargaining, details of the type of information the Commission expects in supporting submissions and how to present public benefit arguments to the Commission (this could include a checklist and a template submission to help them present their case to the Commission)

  - information about how the Commission has assessed public benefit and competition issues in past authorisation decisions dealing with collective bargaining arrangements to help small business better understand and anticipate the approach the Commission takes to collective bargaining authorisation applications

- run workshops for small business groups to help them manage trade practices issues, including advice on how to apply for authorisation

- establish a unit within the Commission's Adjudication Branch that would specialise in guiding small businesses through the authorisation process and focus resources on streamlining the Commission's assessment of small business collective bargaining authorisation applications. The Commission would draw on its existing small business and regional outreach expertise to support the new unit. The unit's role would be to:

  - develop expertise and understanding within the Commission of small business collective bargaining issues

  - ensure that when seeking authorisation from the Commission for collective bargaining arrangements, small businesses would deal with specialist staff who are aware of their concerns and are able to guide them effectively through the authorisation process

  - focus the Commission's resources on small business collective bargaining authorisation applications so that the applications are dealt with efficiently and promptly.

4.4.1.1 Benefits of Option 1

Professional fees can constitute by far the greatest cost of lodging an authorisation application. Adopting Option 1 could significantly reduce the cost of the authorisation process for small businesses by reducing or eliminating the need to employ expensive professional advisers to assist them through the authorisation process.

Improving the Commission's administration of the existing authorisation process would increase its responsiveness to the needs of small business without undermining the integrity and broad legitimacy of either the existing authorisation process—which offers a uniquely flexible way to balance competition law with broad public interest concerns—or the general application of Australia's competition law regime to all market participants.

4.4.2 Option 2: Amend the existing authorisation process

***4.4.2.1 Option 2a**: Amend the public benefit test to require the Commission to have specific regard to the public benefit of an efficient small business sector*

When determining what amounts to public benefit in assessing an authorisation application for mergers, the Act requires the Commission to regard as a public benefit:

- a significant increase in the real value of exports, and

- a significant substitution of domestic products for imported goods.

The Act also requires the Commission to take into account all other relevant matters that relate to the international competitiveness of any Australian industry.

Similarly, small businesses could be given statutory reassurance that the Commission will give adequate consideration to their interests by amending the authorisation test to require the Commission to have regard to the public benefit of assistance to efficient small business, for example, guidance on costing and pricing or marketing initiatives which promote competitiveness.

4.4.2.2 Option 2b*: Reduce authorisation fees for small businesses and give the Commission discretion to waive authorisation application fees when the fees impose an unreasonable burden on the applicant*

The fee for lodging a non-merger authorisation application with the Commission is $7500. This fee can be a significant financial burden on small businesses, however, the Commission currently has no power to reduce of waive the fee for small businesses. The Trade Practices Regulations could also be amended to reduce authorisation application fees for individuals and proprietary companies which would benefit small businesses. Such a discount currently operates for exclusive dealing notifications.

However, there is benefit in keeping application fees high enough to discourage frivolous authorisation applications, for example when it is highly unlikely that the arrangement will raise trade practices issues. The Commission considers that a discounted fee for individuals or proprietary companies of $500 to $1000 would be appropriate.

The Act could also be amended to enable the Commission to waive authorisation application fees when the fees impose an unreasonable burden on the applicant. This would ensure that the application fee did not prevent small businesses and small business associations with limited resources from applying for an authorisation to enable them to engage in conduct that benefits the public.

4.4.2.3 Option 2c*: Impose time limits on the Commission's consideration of authorisation applications*

The Act could be amended to impose time limits on the Commission's decision making processes. This may appear superficially to offer a relatively simple way to speed up the Commission's assessment of authorisation applications. However, the imposition of inflexible and arbitrary time limits may have adverse effects on both small business applicants and small business interested parties.

- Large businesses and their industry associations often have the resources to better manage consultation processes with tight deadlines than small businesses and small business industry associations with limited resources. Time limits may introduce a structural bias into the authorisation consultation process in favour of large businesses and their industry associations.

- By limiting the time for applicants to satisfy the Commission that their proposal will operate in the public interest—and, in particular, limiting the time available to applicants to amend their proposal in light of concerns raised by interested parties—time limits may compel the Commission to issue more determinations denying authorisation simply because the applicant has been unable to address public interest and competition concerns before the Commission is required by a statutory time limit to make its decision.

- Time limits are likely to hinder or prevent the authorisation process being used by industry to develop workable, industry-based solutions to a range of industry reform and self-regulation challenges. Time limits could restrict and even eliminate the scope for negotiating with interested parties and for amending proposals in light of those negotiations. This could mean that the Commission might have to deny authorisation to proposals which, although they did not satisfy the public benefit test in the form initially proposed, could be improved to meet the public benefit test if there was enough time to make appropriate amendments. The operation of statutory time limits may mean that applicants withdraw their application to avoid an adverse decision by the Commission and then, once appropriate amendments had been made to their proposal, re-applies for authorisation. A new fee would then have to be paid and the entire authorisation process would have to be repeated, resulting in considerable administrative inefficiency, delay and expense.

The Act currently provides a mechanism where the Minister may require the Commission to make a determination on an authorisation application within four months of a date set by the Minister (subs. 90(10)). If the Commission does not make a determination within that time, the Commission is deemed to have granted the authorisation applied for. The four months can be extended if the Commission seeks additional information from the applicant relevant to the determination of the application. The extension lasts for the amount of time taken by the applicant to provide the additional information to the extent that they can.

Should a genuine concern arise that the Commission is unnecessarily delaying the assessment of an authorisation application, this provision allows the Minister to address that concern. In deciding whether to exercise the power to impose a time limit under subs. 90(10), the Minister would be in a position to consider both the positive and negative effects of the imposition of a time limit in the particular case. The Commission considers that such a case-by-case imposition of a time limit offers the most effective way to address this issue.

4.4.3 Option 3: Establish a new process for granting immunity from the competition provisions of the Act for small business collective bargaining

4.4.3.1 ***Option 3a****: Establish a notification process comparable to the existing process for notifying exclusive dealing conduct*

The Act could be amended to establish a process for the notification of collective bargaining arrangements, modelled on the existing exclusive dealing notification process set out in s. 93 of the Act. This is the Commission's preferred option for addressing small business concerns.

The main benefit for small businesses would be a streamlined mechanism for them to gain automatic immunity, subject to appropriate checks, from the relevant competition law prohibitions in the Act. At the same time, the notification process would also ensure that the provision of immunity remains subject to a public benefit test through the Commission's power to revoke notifications if the conduct does not result in a net public benefit.

If a notification process was adopted to address small business collective bargaining, it would need to be modified in response to the significantly greater anti-competitive potential associated with collective bargaining compared with exclusive dealing arrangements that the current notification process was designed to address. Exclusive dealing involves vertical restraints of trade which are generally seen as having less anti-competitive potential than horizontal agreements between competitors that directly restrict competition between those competitors.

The broad features of a notification process modified so that it would be appropriate for small business collective bargaining arrangements are set out in Box 4.4.3.1 and discussed below.

A workable notification process for small business collective bargaining

In the Commission's view, a notification process for collective bargaining arrangements should incorporate the existing notification provisions, including the following features.

- So that the Commission can assess the potential public benefit and anti-competitive effect, the notification should contain certain information, including identifying who is giving the notification, details of the notified conduct and details of the class or classes of persons to which the conduct relates.
- The Commission maintains a public register of notifications.
- The Commission can revoke immunity under a notification if it is satisfied that the likely public benefit from the notified conduct will not outweigh the likely detriment to the public from the notified conduct.
- Before issuing a notice revoking immunity, the Commission must issue a draft notice and give interested parties the opportunity to call a conference to discuss the draft notice.
- If the Commission issues a notice revoking the immunity under a notification, interested persons dissatisfied with the Commission's decision may apply to the Tribunal to review the Commission's decision.
- Immunity under a notification comes into effect automatically following a specified time after the notification is lodged, unless the Commission has formally commenced the process of revoking the notification by issuing a draft notice.
- The Commission may use its powers to obtain information under s. 155 of the Act to obtain information relevant to making a decision to issue a notice or a draft notice revoking immunity.
- Section 87B enforceable undertakings can be provided in relation to a notification.

The Commission considers that some extra features should be incorporated into any new notification process for collective bargaining conduct to ensure that the process is workable and operates in the public interest.

- The notification should provide immunity for s. 45 conduct, including price fixing, but should not provide immunity from the prohibition on primary boycotts. Authorisation would still be available for such conduct.
- Immunity should not come into effect until 30 days (or 45 days in the case of complex matters) after the notification is lodged to ensure the Commission has sufficient time to assess the likely effect of the notified conduct.
- The Commission should be able to prevent a notification from coming into force where substantial competition and public interest concerns are raised by interested parties or where the notification does not contain sufficient information to enable the Commission to make an informed decision about the notification.
- The Commission should be able to impose conditions on notifications.
- Immunity under a notification should operate for three years, after which parties will have to lodge a new notification if they wish the immunity to continue.
- The notification process should be subject to eligibility criteria to ensure that only small businesses collectively bargaining with large businesses with a substantial degree of market power are eligible to lodge a notification.

The notification process is a mechanism for automatic immunity from the relevant competition provisions of the Act unless and until that immunity is revoked by the Commission. Under any new notification process, sufficient checks should ensure that this mechanism cannot be used to gain immunity inappropriately (albeit temporarily) for highly anti-competitive conduct.

This is particularly important in the case of inappropriate collective bargaining arrangements which have the potential to cause significant commercial damage in a relatively short time, especially if used strategically during commercial negotiations.

4.4.3.1.1 Rationale for incorporating extra features

To ensure there are sufficient checks in the process for the notification of collective bargaining conduct, the Commission offers the following rationale for the suggested additional features.

Why not include primary boycotts in the notification process?

Primary boycotts can have particularly significant anti-competitive effects. Under collective bargaining, a right to impose a primary boycott on a party with whom the collective bargaining unit is negotiating can operate in a very similar way to a right to strike in the context of industrial relations (see also section 4.4.4.1). In the context of the commercial supply of goods or services, such a right could enable a collective bargaining unit to inflict significant commercial damage on those with whom they negotiate. If used strategically it could also give a collective bargaining unit a degree of countervailing power that goes well beyond that necessary to address any imbalance in market power issues. Indeed, in some cases such a right could simply reverse any imbalance in bargaining power.

The Commission considers that primary boycotts can significantly increase the potential anti-competitive effect of collective bargaining arrangements and should not be included in any notification process.

Collective bargaining groups wishing to engage in primary boycotts should be required to seek immunity through the full authorisation process. This would give an opportunity to anyone who may be adversely affected by the arrangements to put their views to the Commission and to ensure that immunity is only obtained if there are demonstrable public benefits sufficient to outweigh the anti-competitive detriment associated with such conduct.

Why have a delay of 30 days (and 45 days in complex matters) before immunity comes into force after the notification is lodged?

The existing statutory arrangements for the notification of third line forcing conduct means that immunity does not come into effect until 14 days after the notification is lodged. In the case of collective bargaining arrangements, which are significantly more complex than exclusive dealing arrangements, a longer period would be needed to give the Commission enough time to conduct a preliminary assessment of the notification. As well, if the notified conduct is not likely to operate in the public interest, a longer period would enable the Commission to prevent the immunity under the notification from coming into effect by issuing a draft notice to start the process of revoking the notification. This would provide an effective check on the ability of parties to use the notification process to gain immunity inappropriately to engage in highly anti-competitive conduct, (albeit temporarily) while the Commission goes through the process of revoking the immunity.

Collective bargaining arrangements can be complicated arrangements and can affect wide and disparate sections of the public. The Commission must have enough time to consult interested parties and to make an initial assessment of the likely effect on competition and public benefit associated with notified collective bargaining conduct before immunity comes into operation.

The new arrangements would provide a check to ensure that conduct which has the potential to have significant anti-competitive effects—including significant commercial damage to competitors or other negotiating parties—is not implemented in the absence of a net public benefit simply because immunity is gained automatically and it takes time for the Commission to revoke a notification.

The Commission considers that 30 days (and 45 days in complex matters) would offer an appropriate balance between the need to minimise delays in the notification process and the need to ensure that immunity is not given to arrangements that will not operate in the public interest.

In addition, the Commission could be given the power to prevent a notification from coming into force where substantial competition and public interest concerns are raised by interested parties or where the notification does not contain sufficient information to allow the Commission to make an informed decision on the notification.

Why should the Commission have the power to impose conditions on a notification?

In dealing with collective bargaining arrangements through the authorisation process the Commission has found that imposing conditions is a very efficient and flexible way to ensure that arrangements for which immunity is granted operate in the public interest. Some applicants seek authorisation for very broad collective bargaining arrangements with significant anti-competitive detriment. Imposing conditions on these arrangements can restrict the scope and operation of collective bargaining units so they do not operate against the public interest.

Without the power to impose conditions on a notification that does not pass the net public benefit test, the only way the Commission can respond is to revoke the notification, even if deficiencies in the notification could easily be addressed by imposing an appropriate condition.

In many cases, the power to impose conditions on a notification provides a more efficient, flexible and less costly mechanism for responding to public interest concerns than addressing them through the Commission's power to revoke a notification.

Why should such notifications operate for three years only?

The existing notification provisions for exclusive dealing conduct mean immunity can operate indefinitely until a notification is revoked.

Over time and as market conditions change, the relative public benefit and anti-competitive effect of collective bargaining arrangements can change considerably. A notification process whereby the immunity afforded by the notification operated for three years only would have the effect of requiring notifying parties to regularly update their notification in light of changing market conditions and enable the Commission to review the notification in light of any changes. For instance, in some cases collective bargaining will only operate in the public interest for as long as the participating small businesses need to develop their negotiating and information collection skills.

Why should the right to lodge a notification be subject to eligibility criteria?

The policy objective of a collective bargaining notification process is to enable small businesses to collectively bargain to address an imbalance in bargaining power when dealing with large businesses with a substantial degree of market power. Assisting small business to engage in collective bargaining to counter-balance the bargaining power of big businesses can ensure that harsh or unfair contract terms are minimised and that both sides to an arrangement have equal input. A legislative solution to this problem should minimise the potential for any unintended consequences.

To ensure a targeted approach to legislative change, access to a notification process should only be available to small businesses that are collectively bargaining with large businesses with a substantial degree of market power.

Without eligibility criteria, a notification process could have unintended and undesirable consequences, some of which may operate directly against the policy objective of the notification process.

For example, in the absence of eligibility criteria restricting access to the notification process to small businesses, large businesses could try to use the process to collectively bargain with other business, including small businesses.

An unconstrained notification process could see large businesses attempting to circumvent the Act’s merger provisions by collectively bargaining on price and the terms of supply with their customers. At the same time, small businesses could try to use the notification process to collectively bargain with other businesses that do not have a substantial degree of market power, including other small businesses. Outcomes like these would not be consistent with the policy objectives of such a notification process.

While it is possible the Commission could deal with these concerns through its power to revoke a notification, this would impose a considerable administrative burden on the Commission. The consistent application of appropriate eligibility criteria is far more likely to lead to an efficient and timely mechanism than the revocation procedures.

The Commission recognises that it may be difficult to draft workable legislative provisions that effectively restrict the notification process to small businesses collectively bargaining with large businesses with a substantial degree of market power. Legislated criteria are likely also to be inflexible. For example, a statutory definition of small business according to maximum employee numbers, annual turnover or market share may lead to some small businesses being arbitrarily excluded from collective bargaining arrangements because they fall slightly outside the criteria. However, more general or ambiguous statutory criteria may lead to uncertainty, especially if the primary mechanism for dealing with any ambiguities in statutory criteria would be court interpretation. Litigation about whether a particular group of small businesses are eligible to lodge a notification is likely to be costly and time-consuming and could be used to delay or frustrate attempts by small businesses to lodge a notification.

To ensure that any eligibility criteria are sufficiently flexible to provide a workable means to limit access to the notification process, the Commission considers that notification should be available to parties that satisfy the Commission that the notified conduct concerns small businesses collectively bargaining with large businesses with a substantial degree of market power. This process could operate in the following manner:

- the Commission issuing guidelines, following consultation with interested parties, specifying eligibility criteria that restrict access to the notification process so far as practicable to small businesses collectively bargaining with large businesses with a substantial degree of market power

- notifying parties being required to demonstrate, when lodging their notification, that they meet these criteria

- the Commission having the power to determine that a notification is not valid because it does not satisfy the eligibility criteria set out in the Commission's guidelines

- the Commission being able to amend its guidelines and eligibility criteria following consultation with interested parties.

Parties who were ineligible to lodge a notification for collective bargaining because of the operation of such eligibility criteria would still be able to apply for authorisation. Any eligibility criteria would not operate to prevent parties from gaining immunity for collective bargaining conduct, but rather only to exclude some parties from a streamlined process.

4.4.3.2 Option 3b: Set up a block exemption process similar to that used by the EC

The Act could be amended to give the Commission the power to grant block exemptions to facilitate small business collective bargaining.

The Commission only has the power to grant immunity from prosecution under the authorisations process case-by-case, with the process triggered by an application for authorisation for specific conduct and the onus placed on the applicant to satisfy the Commission that immunity should be granted on public benefit grounds.[158]

Giving the Commission the power to grant block exemptions on broad public benefit grounds to facilitate small business collective bargaining arrangements could reduce the cost to business of seeking immunity compared with the existing authorisation process. Costs to business would be reduced because:

- the Commission could grant immunity for similar types of arrangements in one process, without having to undertake multiple authorisation processes, and

- the immunity gained through a block exemption would not involve the costs of preparing and lodging an application for authorisation.

Because a block exemption would cover both current and future arrangements of a particular type, granting a block exemption for particular conduct would also promote regulatory certainty for business by giving them clear guidance on what conduct would fall within the exemption.

The power to issue a block exemption to certain types of arrangements would also reduce the resources used by the Commission in assessing authorisation applications on similar issues. As well, the power would allow the Commission to play a proactive role in granting immunity for particular types of conduct that operate in the public interest

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[158] The Commission currently has power to authorise contracts that are similar to a contract that is the subject of an authorisation application: s. 88(13). However, the effect of ss. 88(10) and (12) would seem to be that parties to the proposed arrangements must be identifiable to the Commission by the applicant, on the Commission’s request. In practice, this limits the utility of this provision to enable the Commission to extend an authorisation to cover a range of similar arrangements.

rather than being restricted to responding reactively to specific applications for immunity for specific conduct.

While a block exemption power could mean benefits for both business and the Commission, adopting a block exemption power would be a significant departure from Australia's current competition law framework.

***4.4.3.3 Option 3c**: Create a registration process comparable to the process in Part X of the Act for exempting international liner cargo shipping agreements*

In a document published by the MTAA in late 2001, the MTAA suggested the establishment of a legislative exemption or safe harbour for collective bargaining modelled on the process in Part X of the Act. The MTAA proposed that this process would only be available to:

- groups of small businesses with a collective market share of no more than 20 per cent in any relevant market, and
- all small businesses involved in an exclusive buying or selling relationship with the same big business buyer or seller.

The MTAA proposed that the provision would:

- only relate to small businesses when negotiating with large customers or suppliers
- be limited to collective negotiations or bargaining and not cover dealings with other customers and other suppliers
- provide protection from s. 45
- cover collective boycotts—the MTAA pointed out that the Commission would need to issue guidelines on what boycotts were permissible before the amendments became law.

The MTAA considers that protected collective negotiations could include:

- agreements on price, quality, to whom products will be sold, transport arrangements, standard growing agreements and appointing representatives to enter into negotiations
- agreements among sellers to withhold products from sale to particular buyers
- cooperative advertising arrangements and agreements on rates paid to advertising agencies and the media, and
- refusals to accept standard rates of remuneration offered in advance and irrespective of the nature and quality of the work performed.

Part X establishes an extremely complex statutory framework for certain limited exemptions from the competition provisions of the Act. They only apply to agreements on outwards and inwards liner cargo shipping services dealing with the transport of cargo by sea. The unique features of Part X reflect Australia's heavy reliance on foreign shipping lines and the significance of these services for the national interest.

The Commission would have substantial concerns with any process for facilitating small business collective bargaining modelled on Part X of the Act. In particular Part X would not provide:

- an adequate process for public consultation for granting immunity, and
- a mechanism for an effective public interest test to be applied to registered agreements.

A process modelled on Part X would not reassure the community that immunity would only be granted for collective bargaining conduct that operated in the public interest or, if it did not operate in the public interest, that the Commission could revoke it. In addition, a process modelled on Part X lacks the transparency and public consultation processes currently set out in Part VII of the Act.

The Commission considers that, because of the potentially significant effects of collective bargaining arrangements across a wide range of Australian industries, it would be quite inappropriate to base a process for granting immunity for such conduct on Part X of the Act.

However, the Commission considers that some aspects of the MTAA's proposal could be used productively in the development of appropriate eligibility criteria for a notification process for collective bargaining arrangements.

4.4.4 Option 4: Establish a general legislative exemption for small business collective bargaining

The Act could be amended to establish a general exemption from s. 45 of the Act for small businesses collective bargaining. The Commission considers this has significant disadvantages.

An exemption would undermine the fairness, legitimacy and effectiveness of the Act’s competition provisions. The experience of the Swanson Committee, which in 1976 conducted the first inquiry into the Act, is instructive on this point. The Committee's Report made the following comments in relation to exceptions and exemptions from the Act:

> We believe it to be extremely important that the Trade Practices Act should start from a position of universal application to all business activity ... only in this way will the law be fair, and be seen to be fair, and avoid giving a privileged position to those not bound to adhere to its standards ...
>
> The Committee was presented with numerous proposals to exclude from the operation of all or some of the provisions of the Act, both particular organisations, and matters relating to particular industries or affecting different functional levels within those industries ... We refrain from listing the industries and organisations claiming exclusion. However, as already

> indicated, we consider that in general the Act should apply across-the-board and be admissible of exceptions only where a case for public benefit can be made out, or where Parliament has specifically legislated to regulate an area.[159]

This view that the Act should have universal application across all market participants to ensure its fairness, legitimacy and effectiveness and that exemptions should only be granted where a public interest case can be made out has continued to be upheld by Committees of inquiry into the Act over the last twenty five years, most significantly in the Hilmer Committee of Inquiry report in 1993. The Hilmer Committee affirmed that:

> There are compelling efficiency and equity arguments for ensuring that competitive conduct rules ... are applied uniformly and universally throughout the economy, with exemptions or special treatment accorded only on demonstrated public benefit grounds.[160]

A general legislative exemption for small businesses to collectively bargain would have the effect of exempting an extremely large section of the Australian economy from the operation of competition law.

Small businesses play a play a substantial role in the Australian economy. The Australian Bureau of Statistics estimates there were over one million small private sector businesses in Australia in 1998–99, representing 95 per cent of all private sector businesses and accounting for 48 per cent of all private sector employment.

In 1997–98, small non-farm businesses accounted for 30 per cent of the total sales of goods and services of all businesses, and 39 per cent of the operating profit before tax of all businesses. Total sales of goods and services by small businesses in the non-farm sector amounted to over $313 billion in 1997–98. Small businesses are particularly significant in some sections of the economy, representing for example, 55 per cent of the sale of goods and services of all businesses in the construction sector, 47 per cent of sales in the property and business services sector and 43 per cent of sales in the retail sector.

ABS figures also show that 86 per cent of agricultural businesses in 1997–98 were small businesses, accounting for 53 per cent of total turnover and 45 per cent of total wages, salaries and supplements. In 1997–98 the total turnover of small businesses in the agricultural sector in 1997–98 was over $14 billion.[161]

A general legislative exemption would also undermine the fairness, legitimacy and effectiveness of the competition provisions of the Act and could lead to significant increases in inefficiency across all sectors of the economy. This would reduce consumer welfare and reduce the efficiency and international competitiveness of the Australian economy to the detriment of all Australians.

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159 Trade Practices Act Review Committee, *Report to the Minister for Business and Consumer Affairs*, August 1976, pp. 84, 91.

160 Independent Committee of Inquiry (Hilmer Committee), National Competition Policy, Canberra: AGPS, 1993, p. 85.

161 Australian Bureau of Statistics, *Small Business in Australia 1999*, ABS cat. no. 1321.0 , Canberra, May 2000.

Indeed, a general exemption to enable small business to enter into anti-competitive agreements, including price fixing and collective boycotts, could allow small businesses to establish monopolies or near monopolies in key sectors of the economy, particularly in those areas where all or almost all of the market participants are small businesses—for example, in some professions (such as doctors and surgeons), skilled trades (such as plumbers and electricians), drycleaners, newsagents, and so on.

Although a more narrowly defined exemption could reduce the economic damage, exemption of an entire industry sector would undermine the fairness and legitimacy of Australia's competition law which is based on a principle of universal application throughout the economy because effective competition laws contribute to the productivity, efficiency and growth of the Australian economy.

An unfettered ability by producers to collectively bargain could also undermine current efforts to deregulate rural industries.

In the past, the price for primary produce was often set by statutory marketing authorities operating under legislation with an exemption from the Act. Statutory marketing authorities are typically grower controlled and coordinated organisations with a statutory power to compulsorily buy entire crops from growers and to determine crop varieties, qualities, grades and prices. Deregulation in line with national competition policy has seen many of these statutory marketing authorities dismantled leaving the price of primary produce to be set by the market through negotiations between individual primary producers and buyers/processors. This deregulation process has been a key feature of Australia's agriculture policy in recent times.

A general exemption for producers to collectively bargain has the potential to unwind this reform process by allowing producers to set an industry wide price for their produce in a way directly comparable to the price setting functions of the old statutory marketing authorities.

In 1976 the Swanson Committee rejected the need for a general exemption from the competition law for primary producers. The committee's report stated:

> … the Committee accepts the need at this time for certain individual primary producers to be able to act collectively in arranging the sale of their products, including price negotiations. The main reason for this is, of course, the nature of the market in which such producers operate: there are a very large number of sellers which individually have very little or no bargaining power and who sell to comparatively few buyers who further process the product and/or arrange for marketing to the consumer ... **However, we do not think that this reasoning should lead to a sweeping exemption for primary industry** [emphasis added]**.** [162]

More recently in 1993 the Hilmer Committee affirmed the value of the current regime of competitive conduct rules, including an authorisation process, because it provided an appropriate mechanism for dealing with competition and public interest issues arising out of the progressive deregulation of the rural sector and the extension of competition law in these areas. In relation to the deregulation of mandatory agricultural marketing schemes, the Hilmer Committee stated:

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[162] Trade Practices Act Review Committee, op. cit., p. 95.

> As mandatory schemes are deregulated it is likely that the number of voluntary arrangements will increase. Application of competitive conduct rules is particularly important in these circumstances to ensure that the anti-competitive habits which may have developed under a mandatory regime are not perpetuated through private arrangements. Application of such rules may also assist in deregulating these sectors, allowing anti-competitive arrangements that are in the public interest to continue, while phasing out those that are not.[163]

Following implementation of national competition policy, the authorisation process has played an important role in providing farmers with a mechanism to address issues raised by the legislation review process. In this context the National Competition Council stated:

> If a review recommends that compulsory agricultural arrangements be removed, farmers may still develop voluntary arrangements for collective marketing. There are no barriers to collective marketing on export markets. Australia 's Trade Practices Act does apply to domestic sales, however, primary producers can apply to the Australian Competition and Consumer Commission (ACCC) for approval of voluntary collective marketing arrangements. Examples of this are the collective negotiating arrangements which the Commission has approved for the poultry meat industries in several States.[164]

For these reasons, the Commission would be particularly concerned about any general legislated exemption for small businesses and/or collective bargaining by rural producers and would not support this option.

4.4.4.1 Differences between collective bargaining in relation to employment and small business collective bargaining

It has been argued that in some contexts small business collective bargaining should benefit from a similar exemption from the Act as that enjoyed by employees who collectively bargain with their employer over the terms and conditions of their employment.

The competition provisions of the Act contain a general exemption for collective bargaining and collective agreements on employment conditions, including remuneration, hours of work and employee's working conditions. While collective bargaining by employees on the terms and conditions of their employment is not subject to regulation under the Act, this is because employee/employer collective bargaining is subject to detailed regulation under special industrial and workplace relations legislation. Among other things, the legislation regulates the circumstances in which labour can engage in collective bargaining, including providing for a system for the arbitration of industrial disputes over employment terms and conditions.

The special legislative regime for industrial relations has developed over many years and reflects a wide range of social, political and historical factors. It takes account of not only the potential imbalance in bargaining power between large employers and individual employees but also the very significant economic consequences of collective bargaining by employees to individual businesses, industries and for the Australian

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163 Hilmer, op. cit., p. 142.

164 National Competition Council, *Securing the future of Australian Agriculture: overview*, community information paper, July 2000.

economy as a whole. This is particularly true of the substantial economic damage that can be caused by employee boycotts.

In this context, the trend in industrial relations legislation over recent years has been to decrease the scope of collective bargaining on employment conditions. For instance, there is a move from industry-wide negotiation of employment conditions to enterprise specific bargaining arrangements that incorporate opportunities for employees to negotiate individually.

Were small businesses granted a general exemption from the competition provisions of the Act comparable to that for collective bargaining by employees, the exemption would operate without any of the checks and balances governing collective bargaining by employees. In the absence of these checks and balances, the economic consequences of a general exemption could be severe.

The Commission considers that a comparison between small business collective bargaining and collective bargaining by employees in an industrial relations context is ill-founded and does not support the suggestion that small businesses should benefit from an exemption from the Act comparable to that currently available for collective bargaining by employees.

5 Mergers—efficiencies, globalisation and processes

5.1 Introduction

Mergers perform an important role in the efficient functioning of the economy. They allow firms to achieve efficiencies such as economies of scale and scope, synergies and risk spreading. Furthermore, they facilitate an active ‘market for corporate control’ in which under performing firms and managers are replaced by better ones.

Apart from the stock market, there are no objective standards of managerial efficiency. Only takeovers offer some assurance of competitive efficiency among corporate managers. The threat of takeover imposes a competitive discipline on managers to perform, otherwise their companies will be vulnerable to takeover.

Most mergers do not raise any competition issues. However, some mergers may have anti-competitive effects by altering the structure of markets and therefore the incentives for firms to behave in a competitive manner. This is the concern of ss. 50 and 50A of the Trade Practices Act (the Act).

The primary objective of s. 50 is to promote the economic policy which underpins the restrictive trade practices provisions by ensuring that parties cannot avoid restrictions on anti-competitive behaviour through merger.

It is sometimes questioned why s. 50 is a necessary element of the regulatory scheme as monopolisation is already caught within the scope of s. 46. Section 50 is designed to prevent the development of market structures conducive to anti-competitive behaviour that is caught under the conduct provisions of Part IV of the Act. The aim is to prevent the accumulation of market power resulting in higher prices and/or lower quality goods and services for consumers.

Nevertheless, the Act recognises that the impact of mergers on market performance will vary. Hence it has adopted an ‘effects’ test to meet the underlying economic policy objective of socially useful competition. Unlike other provisions of Part IV of the Act, the merger provisions focus on the structure of a market.

Section 50 generally prohibits mergers or acquisitions which would have the effect or likely effect of substantially lessening competition in a substantial market for goods or services.

Mergers law is necessary to ensure that the Australian economy does not evolve into a highly anti-competitive structure with associated harm to business and consumers. Current mergers law recognises the link between conduct in a market and the structure of that market. The decisions firms make about research, production, marketing, pricing and selling are often largely responsive to the structural aspects of the market. While not determinative, higher levels of concentration, absent contestable markets, import competition or other such balance, can often lead to a loss of competitive market discipline.

The Commission recognises the broad benefits that may accrue to mergers, including: disciplining errant or ineffective management; allowing firms to achieve efficiencies otherwise unattainable on their own terms; providing access to capital, better management, additional markets, technical talent or other synergies.

However, they can also lead to an effect on competition such that there is increased scope for price rises, coordinated behaviour and a lessening of the dynamic elements driven by competition that so influence market development.

Mergers law plays a critical role in ensuring competitive conduct by preserving competitive industry structures. An active merger assessment process is necessary to ward off anti-competitive mergers in order to promote and enhance economic efficiency.

If we had no merger law the economy would be vulnerable to the emergence of highly anti-competitive market structures. We could see more monopolies, higher levels of concentration and fewer market participants, to the great detriment of all Australians.

We could see harm to business itself for its suppliers would be uncompetitive, inefficient and costly. In addition to the harm done to business, consumers would also be faced with higher prices and/or deteriorating quality and service. World-class competitiveness is dependent on the development of industries based on innovation and skill. A weakened mergers law is more likely to lead to less competition and higher prices, without developing the world class edge that flows from the response to competitive pressures.

The Commission believes that higher levels of market concentration would also inevitably lead to higher public demand for direct regulation of business in concentrated sectors of the economy.

5.2 Authorisation

The emphasis in Part IV of the Act is on the preservation and maintenance of the competitive markets. However, there may be circumstances when the costs associated with anti-competitive conduct do not exceed the public benefits which also accrue from the conduct.[165] Thus, society is better off if the conduct is allowed to continue even though it is anti-competitive.[166] This is the underlying rationale in the Act for the authorisation process.

In order to grant an authorisation application for a merger, the Commission has to be satisfied in all the circumstances that the acquisition would result in such a benefit to the public that the merger should be allowed to take place.

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165 Rhonda L Smith and Timothy P Grimwade, ‘Authorisation: Some Issues’, *Australian Law Review*, Volume 25(5) October 1997, pp. 351–368.

166 ibid.

Authorisation is a subsequent and separate step from the competition assessment for mergers contained in s. 50. It is a transparent process with a rigorous testing of claims through public consultation with rights of recourse to administrative review. There are good reasons for such a process—effectively, the Commission is granting a dispensation or immunity from a significant economic law that has universal application to business activities. The public interest demands that proper processes and safeguards should apply.

In the case of a merger authorisation application, the Commission is being asked to accede to a merger that may constitute a significant accumulation of market power, even to a monopoly situation in some cases. In such circumstances, the Commission believes that a rigorous public process that enables a thorough testing and examination of public benefit claims is entirely justified and that there should be the scope for participation in the process by parties likely to be affected by such a serious transaction including customers (whether household or business customers), suppliers, competitors and others.

5.3 Efficiencies

5.3.1 Section 50

In the latest edition of its *Merger guidelines*, the Commission specifically recognises efficiencies as one of the factors it will consider in a merger investigation.

Section 50 is concerned with the level of competition in markets and not the competitiveness of individual firms. However, the extent to which any efficiency enhancing aspects of a merger may impact on the competitiveness of markets is relevant in the context of s. 50.

Where a merger enhances the efficiency of the merged firm, for example by achieving economies of scale or effectively combining research and development facilities, it may have the effect of creating a new or enhanced competitive constraint on the unilateral conduct of other firms in the market, or it may undermine the conditions conducive to coordinated conduct. Pecuniary benefits, such as lower input prices due to enhanced bargaining power, may also be relevant in a s. 50 context.

If efficiencies from a merger are likely to result in lower (or not significantly higher) prices, increased output and/or higher quality goods or services, the merger may not substantially lessen competition.

The Commission recognises that the precise quantification of efficiencies is extremely difficult. In its consideration of efficiencies, the Commission will require strong and credible evidence that efficiencies are likely to accrue and that the claimed benefits for competition are likely to follow.

In examining three merger proposals that would rationalise the Australian plastics industry in 1996–97, the Commission recognised that increasing globalisation was putting additional pressure on domestic businesses to seek cost efficiencies. In Dow Chemical/Huntsman Chemical, Kemcor/Hoechst Plastics and ICI Australia/Auseon the Commission decided not to oppose on the basis that import competition would constrain the exercise of any market power, and that the mergers would result in increased efficiencies and generate higher levels of output.

5.3.2 Authorisation

The consideration of efficiencies are generally relevant in the context of an authorisation application.

Section 50 need not prove to be an absolute impediment to mergers that result in a substantial lessening of competition if it can be demonstrated that they generate other public benefits such as increased efficiencies and/or international competitiveness which outweighs the anti-competitive detriment.

The statutory test for merger authorisations directs the Commission to have regard for the public benefits to be achieved from:

- a significant increase in the real value of exports
- a significant substitution of domestic products for imported goods
- matters that relate to the international competitiveness of any Australian industry.

Indeed, Australia's authorisation regime has received critical acclaim for its ability to incorporate efficiency considerations into the merger investigation process. According to Griffin and Sharp:

> Australia, …is currently more progressive in its incorporation of efficiency considerations to proposed mergers than the European Union and the United States.[167]

In comparing the capacity of Australia's competition law regime to incorporate efficiencies within the merger assessment process against that of the European Union and the United States, Griffin and Sharp concluded that:

> Australia now appears to be the most progressive of the three jurisdictions considered here in its application of economic tools and adaption to the globalisation of business.[168]

Efficiency issues are further covered in chapter 8 of the submission.

5.4 International competitiveness

5.4.1 Introduction

The extent of international competition is given full consideration in the Commission's merger assessment process. Section 50(3)(a) requires that the Commission consider the

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[167] Joseph P Griffin & Leeanne T. Sharp, 'Efficiency Issues in Competition Analysis in Australia, the European Union and the United States', *Antitrust Law Journal*, 64(3), Spring 1996, pp. 649–682.

[168] ibid.

actual and potential level of import competition in a market. In a small open economy such as Australia the importance of giving special consideration to the role of actual and potential import competition in considering the likely effect of a merger on competition is widely acknowledged.

The Commission recognises that globalisation is changing the boundaries of many markets. Competition may come from sources other than domestically based firms. The Commission has not objected to any merger where comparable and competitive imports have held a sustained market share of 10 per cent or more for at least 3 years. In reality, even greater flexibility has been made available as it is not the historical share of imports that is significant, but their potential to constrain the price and output decisions of the merged firm. Consequently, the Commission has in some instances, not objected to a merger proposal, even where imports were less than 10 per cent but there was the strong potential for imports to constrain domestic market power.

Examples of mergers which the Commission has not opposed in concentrated markets on the basis of effective or potentially effective import competition are Ardmona/SPC (canned fruit), Manildra/George Weston (starch, starch sugars, flour and gluten), Email/Southcorp (white goods), and Amcor/APPM (paper wholesaling). In the Manildra/George Weston matter, the Commission concluded that the domestic prices of gluten would be constrained by actual and potential import competition as gluten was an internationally traded commodity. In the Ardmona/SPC case, the Commission decided that imports would impose an effective competitive constraint on the merged firm despite the fact that imports of canned fruit accounted for less than 10 per cent of the market at the time of the merger. In regard to Email/Southcorp, the Commission decided not to oppose this merger on the basis that existing and potential import competition within the major product markets was likely to ensure that the merger would not result in a substantial lessening of competition. With respect to the Amcor/APPM matter, the Commission concluded that strong import competition would constrain the merged firm despite Amcor becoming the only domestic manufacturer of paper.

The merger authorisation process also places a heavy emphasis on the international competitiveness of Australian industry. The Commission is under explicit direction in the Act to take into account all relevant matters that relate to the international competitiveness of Australian industry. The Act also directs the Commission to regard as a public benefit:

- a significant increase in the real value of exports
- significant import substitution.

5.4.2 Non-traded sector

The exposure of firms in the traded sector of the economy to the disciplines of international competition has reduced Commission concerns with mergers in that sector. The Commission’s focus has therefore increasingly shifted to mergers in the non-traded sector.

The competitiveness of the trade-exposed sector depends not only on the competitiveness of other trade-exposed firms, but also on the competitiveness of the non-traded sector that supplies the trade exposed sector with many of its essential inputs. The analysis of mergers in the non-traded sector, particularly in service and infrastructure industries, is critically important to ensure firms in the traded sector have competitive input markets so as to be better placed to compete more effectively both domestically and internationally.

5.4.3 Global mergers

Increasingly, the Commission must deal with acquisitions in a global context. This may involve consideration of global competition, or even global markets, and the role of mergers in enhancing efficiency and international competitiveness.

In addition, the mergers themselves may occur on a global scale, often involving multinational corporations. Where these mergers impact on a market in Australia they will generally be subject to the Act. Firms involved in these mergers will often have to deal with multiple competition agencies around the world. It should be borne in mind that many global mergers do not raise competition concerns within Australia.

It is also important to distinguish between firms that operate in global markets and those that operate in overseas markets. The fact that an Australian firm earns significant profits from its overseas operations does not in itself mean that the firm operates in global markets. For example, a ready mix concrete producer may have operations in numerous countries, but unless concrete is globally traded, the relevant market will have a much narrower geographic dimension. Some Australian firms with overseas operations appear to confuse global markets with global activities.

The Commission is increasingly involved in discourse and cooperation with its counterpart agencies around the world. The Commission regularly consults and liaises with the New Zealand Commerce Commission, the Department of Justice and the Federal Trade Commission of the United States, the United Kingdom Office of Fair Trading, the Canadian Competition Bureau, and the European Commission in regard to global mergers.

Recent examples of cooperation between the Commission and its counterparts in overseas jurisdictions have been in regard to the De Beers/Ashton Mining and the Metso/Svedala mergers.

In assessing De Beers proposed acquisition of Ashton Mining, the Commission liaised with the Canadian, United States and European competition authorities. Liaison with the European Commission was particularly extensive and useful, allowing the Commission to develop a better understanding of the global trade in diamonds.

Contact with overseas jurisdictions was also used extensively in assessing the global rock and mineral processing equipment merger between Metso and Svedala. In this case the European Commission obtained divestiture orders which greatly reduced the anti-competitive impact of the transaction worldwide and on Australian markets.

The Commission also liaised extensively with the European Union and United States competition authorities in respect of the global aluminium merger of Alcoa and

Reynolds. This case raised competition concerns with the Commission as well as the European Commission and the US Department of Justice. Alcoa offered undertakings to the US and European Union authorities to divest itself of its interest in the Worsley alumina refinery in Western Australia. These undertakings were sufficient to allay the concerns of the Commission. The Commission's recognition of undertakings given to other competition authorities as an effective remedy shows that cooperation between competition authorities can lead to effective outcomes.

5.4.4 Branch office economy

A common chorus of criticism by big business is that the current mergers law is responsible for turning Australia into a branch office economy.

According to Kirby:

> Dozens of Australian CEOs say [the Trade Practices Act] has stopped them attempting mergers or acquisitions. Firstly, because they believed the ACCC would never approve it. Secondly, even if the deal was approved, companies would have to divest so much that the value of the acquisition would be destroyed. And thirdly, they would be left hanging as the elongated approval process was played out—and other bidders perhaps emerged.
>
> The end result is that Australian companies are being bitten off one by one by larger global firms.[169]

According to the President of the Business Council of Australia (BCA) and former Managing Director of Pioneer International, Dr John Schubert:

> If you get to a certain size in Australia, your growth obviously has to occur outside Australia. And, as you are more and more successful, you will finish up with the majority of your business outside Australia. So, if you finish up, for example, like Pioneer did, … — seventy per cent of our activities and business and people are outside Australia.[170]

In discussing the performance of Australia firms overseas, Dr Schubert has commented:

> the more successful they are offshore, the more likely it is that they will then tend to have a need to move their activities and perhaps their head office, offshore. Now, the reality is, if they can be allowed to be bigger in Australia, then at the very least, that move offshore will be delayed, or the pressures for that move will be delayed. So that's where it gets into the area of competition law.[171]

Schubert’s comments suggest that the BCA recognises that the decision to move offshore is linked to where the majority of a firm’s business is conducted rather than to the application of competition law. Further, the inference is that should Australian merger law be watered down to allow domestic firms to achieve dominance and

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169 Peter Kirby, *Is the Branch Office All We Can Aspire To?*, speech to the Securities Institute of Australia, 21 June 2001.

170 Interview with John Schubert, *Business Sunday*, 25 February 2001.

171 ibid.

exercise monopoly power at the expense of Australian consumers and businesses, at best the move offshore would only be delayed.

The Commission notes that foreign investment is the responsibility of the Treasurer under the *Foreign Acquisitions and Takeovers Act 1975* and beyond the scope of this inquiry. However, in response to claims that the present mergers test is contributing to Australia becoming a branch office economy, the Commission would observe that the assets of a takeover target are always worth more to a potential monopolist than other possible bidders.

A recent survey on offshore investment by Australian firms conducted by the Productivity Commission concluded that:

> Australian mergers regulation did not rate as a major influence on respondents' decisions to produce or relocate offshore.[172]

In addition, the survey found that:

> Australian merger law was ranked lowest among commercial and government-related factors identified in the questionnaire as likely to influence decisions about headquarter relocation.[173]

Of the 200 firms surveyed by the Productivity Commission as part of its study, only 12 per cent of respondents rated mergers law as being a factor of high importance in inhibiting their domestic growth.

Based on the available evidence, claims that the current mergers law regime is a significant contributing factor in turning Australia into a branch office economy may be somewhat exaggerated.

5.4.5 National champions debate

Big business in Australia has expressed the view that in a relatively small economy such as Australia, firms should be given more flexibility to merge to enable them to more successfully compete overseas. According to this line of argument, firms need to reach 'critical mass' in order to achieve economies of scale and scope of sufficient magnitude so that they can be competitive on international markets. In small markets such as Australia, proponents of this argument claim that at best, only one or two firms in any market can achieve this critical mass. They become 'national champions' with domestic dominance sufficient to challenge in global markets.

According to Kirby:

> To be strong offshore, you need a strong home base. You need to have a secure cash and profit flow to take the risks involved in international expansion. You need a home base which does

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[172] Productivity Commission, *Offshore Investment by Australian Firms: Survey Evidence*, Commission Research Paper, AusInfo, Canberra, 2002.

[173] ibid.

> not unduly distract management attention, and which will enable you to train and develop the people you need to lead your overseas expansion.[174]

There is a possibility that national champion type arguments are being pushed to justify the creation of domestic monopolies in Australia. At its simplistic level, the national champions argument suggests that Australia should allow the development of domestic monopolies who take advantage of their market power by charging high prices and use the profits generated to subsidise overseas expansion. Such an approach should be of concern to all interested in an efficient domestic Australian economy.

In response to such concerns, Kirby has argued that:

> The criticism that local consolidation would cause local customers to pay extra, to subsidise overseas expansion, need not be the case. Why can't my subsequent *behaviour* be monitored.[175]

The Commission believes that the most effective form of behavioural monitoring is to maintain competitive market structures in the first instance.

The Australian business community is far from unanimous in its support for the creation of national champions. The results of a survey conducted by Australian Business Limited found that 61 per cent of businesses surveyed said that more big business mergers should not be allowed in order to create national champions.[176] According to this survey, opposition to national champions stems from the perceived reduction in domestic competition and the effect mergers might have on current business activities.[177]

In addition, a number of academic studies have arrived at an entirely different conclusion on the desirability of national champions as compared to big business.

In *The Competitive Advantage of Nations* in which a survey of the international competitiveness of 10 nations was undertaken, Porter found a strong empirical link between vigorous domestic rivalry and the creation and persistence of competitive advantage in an industry. Porter observed that:

> We found … few "national champions," or firms with virtually unrivalled domestic positions, that were internationally competitive. Instead, most were uncompetitive though often heavily subsidised and protected.[178]

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[174] Peter Kirby, *Is the Branch Office All We Can Aspire To?*, speech to the Securities Institute of Australia, 21 June 2001.

[175] ibid.

[176] Press release by Australian Business Limited, *Many businesses wary of mergers changes in Trade Practices Act*, 9 May 2002.

[177] ibid.

[178] Michael E. Porter, *The Competitive Advantage of Nations*, Macmillan, London, 1990.

Porter and Sakakibara undertook a detailed examination of the international competitiveness of Japan.[179] In this work, they examined three competing hypotheses about the effect of domestic competition on international market performance:

- Local collusion and limits on domestic competition enhance international competitiveness whereby the relation between the intensity of local rivalry and international competition is negative.

- The intensity of domestic competition will have little or no association with international competitiveness because the distinction between domestic and international competition has been rendered unimportant by the widespread internationalisation of markets.

- There is a strong association between domestic rivalry and international competitiveness whereby rivalry among domestically based firms offers greater benefits to competitive upgrading than either imports or foreign companies with minimal investment in the nation.

Porter and Sakakibara concluded that their examination provided robust evidence that domestic rivalry is positively associated with international trade performance. They further concluded that:

> protection of the home market, by limiting competitive pressure, works against export competitiveness. Competing at home, then, fosters success abroad.
>
> Contrary to some popular views, our results suggest that Japanese competitiveness is associated with home market competition, not collusion, cartels, or government intervention that stabilises it.[180]

Based on his various studies of competitiveness, Porter has mounted a damning attack on the national champions argument:

> When local rivalry is muted, a nation pays a double price. Not only will companies face less pressure to be productive, but the business environment for all local companies in the industry, their suppliers, and firms in related industries will become less productive. This demonstrates the danger in arguments about the creation of "national champions" in an industry in the home market in order to gain the scale to compete internationally. Unless a firm is forced to compete at home, it will quickly lose its competitiveness abroad.[181]

In conclusion, no empirical evidence exists to support the national champions thesis. As a result, arguments regarding the need to reform merger laws relying on national champions type arguments should be treated with extreme caution. A weak or

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179 Sakariko, M. & Porter, M.E., 'Competing at Home to Win Abroad: Evidence from Japanese Industry', *Fundamental Theory Task Force Report,* American Bar Association 2001.

180 ibid.

181 Professor Michael E. Porter, Competition and Antitrust: Towards a Productivity-Based Approach to Evaluating Mergers and Joint Ventures, *Fundamental Theory Task Force Report*, American Bar Association, 2001.

compromised mergers policy in response to national champion type arguments could actually undermine Australia's international competitiveness.

Beyond these conclusions, the Commission through its administration of the mergers law recognises that in certain instances authorisation may be appropriate when the public benefits can be substantiated in terms of improving Australia's international competitiveness.

In 1992 the Act was amended which directed the Commission when considering merger authorisation applications, to consider as public benefits a significant increase in the real value of exports, and significant import substitution. As part of these amendments, the Commission was further directed to consider any other relevant matters that relate to the international competitiveness of any Australian industry in regard to a merger authorisation application. As noted earlier, the Commission has never opposed a merger where imports constrain the exercise of domestic market power.

5.4.6 Criticisms of Australia's mergers law regime

There have been several claims that the mergers law contained in s. 50 of Act is out of date and in need of reform.

According to the BCA:

> The nature of competition has changed since the Act was last reviewed. The BCA has raised the concern—as have many of its members—that the Act, and its application, do not sufficiently recognise that markets are increasingly global and that the Australian economy has opened up substantially in the past 20 years.
>
> Any weaknesses in the competition regulatory regime have several potential adverse consequences for Australia, particularly if mergers are being prevented that would otherwise deliver net public benefits.[182]

The Trade Practices Act has been subject to a number of substantial reviews and inquiries since it was enacted in 1974. Some of the most prominent reviews and inquiries that have examined s. 50 include the following:

- *Report to the Minister for Business and Consumer Affairs*—Trade Practices Review Committee, August 1976 (Swanson Committee).
- *Mergers' takeovers and monopolies: profiting from competition*—Report of the House of Representatives Standing Committee on Legal and Constitutional Affairs, May 1989 (Griffiths Committee).
- *Mergers, monopolies & acquisitions: adequacy of existing legislative controls*—Report by the Senate Standing Committee on Legal and Constitutional Affairs, December 1991 (Cooney Committee).

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182 Business Council of Australia, *2001 Annual Review: Securing Australia's Future*, Business Council of Australia, p. 19.

- *National Competition Policy*—Report by the Independent Committee of Inquiry into Competition Policy in Australia, 1993 (Hilmer report).

Australian mergers law is fully consistent with that of most major economies. The current mergers test contained in s. 50 of the Trade Practices Act is in fact based on s. 7 of the Clayton Act of the United States.

The competition test for mergers of a substantial lessening of competition (SLC test) as applied in Australia will shortly have universal coverage throughout the English speaking world. If Australia were to move away from a substantial lessening of competition test then it would become the exception among the English speaking nations.

Australia currently joins the United States, Canada, Ireland and New Zealand in having an SLC test. A Bill is currently before the Parliament of the United Kingdom (the Enterprise Bill) that will shortly provide for an SLC test in that country as well.

Aside from the United Kingdom and Ireland, most other members of the European Union as well as the European Commission itself apply a dominance test to mergers. However, the European Commission has published a Green Paper to launch a debate on the respective merits of the dominance test as compared to an SLC test.

Claims and charges that Australia’s mergers law regime is outdated and antiquated in light of overseas experience are without foundation. Australia’s current approach to mergers law arguably represents international best practice.

In addition, any move away from the current SLC test would be a step in the wrong direction towards moves to standardise and harmonise Australia’s business laws with those of major overseas trading partners such as the United States, Canada, the United Kingdom and New Zealand.

Canada

Canada’s mergers law is set out in the *Competition Act 1985*. The basic mergers test is contained in s. 92 of the Competition Act and prohibits a merger or proposed merger that lessens, or is likely to prevent or lessen, competition substantially in a relevant market.

The degree of competitive lessening that will be treated as ‘substantial’ is met when the merged entity can sustain a materially greater price in a substantial part of a relevant market for two years.

Section 93 of the Competition Act specifies seven factors that may be considered in determining the competitive effects of a merger. They are

(a) the extent to which foreign products or foreign competitors provide or are likely to provide effective competition to the businesses of the parties to the merger or proposed merger.

(b) whether the business, or a part of the business, of a party to the merger or proposed merger has failed or is likely to fail.

(c) the extent to which acceptable substitutes for products supplied by the parties to the merger or proposed merger are or are likely to be available.

(d) any barriers to entry into a market, including (i) tariff and non-tariff barriers to international trade, (ii) inter-provincial barriers to trade, and (iii) regulatory control over entry, and any effect of the merger or proposed merger on such barriers.

(e) the extent to which effective competition would remain in a market that is or would be affected by the merger or proposed merger.

(f) any likelihood that the merger or proposed merger will or would result in the removal of a vigorous and effective competitor.

(g) the nature and extent of change and innovations in a relevant market.

(h) any other factor that is relevant to competition in a market that is or would be affected by the merger or proposed merger.

New Zealand

Section 47(1) of the Commerce Act 1986 provides that:

> A person must not acquire assets of a business or shares if the acquisition would have, or would be likely to have, the effect of substantially lessening competition in a market.

One of the main reasons why New Zealand has fairly recently converted its mergers threshold test from dominance to substantially lessening of competition was because the dominance test did not allow for the scrutiny of mergers where market power can be obtained without a single firm gaining a high market share.

United Kingdom

The United Kingdom is in the process of changing its current mergers threshold test.

On 26 March 2002 the UK Government introduced the Enterprise Bill into the House of Commons. The Bill passed through the House of Commons on 17 June 2002 and was introduced into the House of Lords on 19 June 2002.

It is the intention of the UK Government under the Enterprise Bill to reform its current mergers law provision from a public interest test to a competition-based test based around the concept of a substantial lessening of competition. According to the UK Government:

> We see SLC as a test that is fundamentally better adapted to merger control, primarily because it is directly grounded in economic analysis and the impact of a merger on competition in a way that the concept of dominance is not. It is also a more flexible test than dominance, making it particularly well suited to tackling oligopolistic markets.[183]

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183 United Kingdom Department of Trade and Industry, United Kingdom Response to European Commission Green Paper on the Review of Council Regulation (EEC), No. 4064/98, March 2002.

United States

Mergers in the United States at the federal level can be examined under the Clayton Act, the Sherman Act and the Federal Trade Commission Act. In practice, mergers are generally reviewed under the Clayton Act. Under s. 7 of the Clayton Act, stock and asset acquisitions, including mergers and joint ventures may be held illegal where their effect may be substantially to lessen competition, or to tend to create a monopoly in any particular geographic and product market.

Ireland

In April 2002, Ireland enacted the Competition Act 2002 to consolidate and modernise the existing enactments relating to competition and mergers. Under this new legislation, the Irish Competition Authority has to approve or reject mergers based on a competition test. The test applied under s. 20(1)(c) of the Competition Act is whether the result of the merger or acquisition will be to substantially lessen competition in markets for goods or services in the state.

European Union

Mergers law across the 15 member nations of the European Union is governed by Council Regulation 4064/89. Article 2(3) of Council Regulation 4064/89 entitled ‘Appraisal of concentrations’, applies the following test:

> A concentration which creates or strengthens a dominant position as a result of which effective competition would be significantly impeded in the common market or in a substantial part of it shall be declared incompatible with the common market.

The European Union regulation applies either in the form of single dominance or collective dominance.

Although the wording of the test applied in the European Union and that applied in the English speaking world are phrased in quite different language, the practical application of the tests is remarkably similar. The European Union not only takes into account the market power that can be exercised by a single firm in the event of a merger. It also considers whether market power can be exercised by a group of firms able to coordinate their conduct from a position of oligopolistic dominance or collective dominance.

The European Commission has applied the dominance test as laid down in Article 2(3) of the merger regulation in cases where the result of the concentration would be the creation of a position of collective dominance. Both European courts have endorsed the concept of collective dominance with the European Court of Justice and the Court of First Instance supporting the European Commission’s approach.

In view of the increasingly international scope of mergers, the European Commission has recognised that the alignment of the wording of the test used by the main competition authorities worldwide might have some attractions. This is one of the reasons why the European Commission’s *Green Paper on the Review of Council Regulation No 4064/89* explicitly calls for a public debate on the merits of the dominance test, and in particular on how its effectiveness compares with the substantial lessening of competition’ standard used in some other jurisdictions.

According to the European Commission Green Paper:

> From a procedural viewpoint, the main reason proposed in favour of such a re-evaluation is that it could allow an alignment of the Merger Regulation's appraisal criteria with those applied in other major jurisdictions such as the US, Canada and Australia, which rely on a concept of *substantial lessening of competition* (the SLC test). Such an alignment towards a global standard for merger assessment holds certain attractions. It would, for example, facilitate merging parties' global assessment of possible competition issues arising from contemplated transactions, by obviating the current need to argue their case according to differently formulated tests. This would in turn provide competition agencies with a better basis on which to build effective cooperation in cases that are notified in several jurisdictions. Moreover, as a common test would tend to highlight the actual application of the test, rather than the test itself, it would provide for better benchmarking of the activities of competition authorities and courts, as well as facilitating the development of competition-orientated research and modelling.[184]

5.5 Informal notification

Although notification of mergers is not compulsory in Australia, the Commission encourages parties to approach it, on an informal basis, as soon as there is a real likelihood that a proposed acquisition may proceed, and certainly well before the completion of an acquisition.

Unlike many other countries Australia's mergers law contains no formal requirement that parties to a proposed acquisition advise the Commission prior to entering into an agreement to effect an acquisition unless they decide to formally apply to the Commission for authorisation. Australia's position stands in marked contrast to that of most other countries. Around 39 jurisdictions in the world have formal notification requirements for mergers, including the United States, the European Union and Japan. Australia is one of only a handful of countries around the world that does not have any formal notification requirements with respect to mergers.

The Commission relies upon a system of voluntary informal notification. The informal notification system has, on balance, resulted in administrative efficiencies and a comparatively light regulatory burden. Considering the size of the Australian economy and the level of merger activity, the system works well. The merger notification system of other countries has been criticised because of the compliance burden it imposes, especially given that most transactions raise no anti-competitive concerns.

While Australia's system avoids the worst of the compliance burden features of overseas jurisdictions, it poses some uncertainty for the Commission and the business community in that it has no legislative mandated time periods for the notification and clearance of mergers. Neither are there the explicit information requirements that have developed through form and filing requirements in jurisdictions with merger notification.

184 Commission of the European Communities, *Green Paper on the Review of Council Regulation (EEC) No 4064/89*, Commission of the European Communities, 2001.

In December 1999 the Commission undertook extensive consultations with members of the legal profession with whom it deals on a regular basis. The Commission sought the views of the legal profession on possible changes to its timing and notification procedures.

The legal profession strongly endorsed the Commission's informal clearance process with the Law Council of Australia commenting that:

> The Trade Practices Committee of the Law Council believes that the existing informal notification system works very well. … informal clearance is an important service provided by the ACCC to the business community, and plays an important role in the efficient regulation of merger activity in the Australian economy. … The ACCC's record for expedition in non-contentious mergers, is excellent, and in the Committee's view, there is no basis for changing the present system.[185]

The Commission's *Merger guidelines* set out information requirements for those seeking to lodge a submission and also outlines indicative time frames the Commission targets in assessing mergers. Most mergers do not raise significant competition concerns and are handled quickly, with the Commission promptly advising parties that it does not intend to take any action. Most transactions then proceed on the basis of that advice.

In less complex matters the Commission tries to complete its analysis within 10 to 15 calendar days. This is from receiving the formal submission to advising the parties.

More complex matters or those that appear to cross the Commission's merger concentration thresholds require more extensive analysis. It takes about one month for market inquiries and consideration. Within this group are a small number of highly complex and major transactions that raise substantial issues, and these take from six to eight weeks. The Commission may need to request additional information on such matters, which may extend the time frame. Time frames may also be extended if parties put mergers on hold for commercial reasons or to amend proposals.

Confidential proposals are assessed as quickly as possible, within a target of 10 to 15 working days. However, for commercial reasons the parties themselves may delay public announcement. This means that the Commission cannot begin making any necessary market inquiries. If the parties' requirements are such that the proposed acquisition remains confidential, the Commission is unlikely to be in a position to provide a final view about the transaction. The Commission takes the view that a proper assessment requires the views of market participants prior to finalising its response.

A confidential assessment does allow the parties and the Commission to discuss any issues that may be identifiable without market inquiries and provides parties with an opportunity to consider their response prior to the proposal becoming public and market inquiries being undertaken.

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185 Trade Practices Committee, Business Law Section, Law Council of Australia, Response to ACCC Discussion Paper: 'ACCC Merger Assessment—Informal Notification and Timing Issues', 12 April 2000.

Once the Commission arrives at a decision, the parties are notified prior to any public statements being made or press release issued. In confidential matters the parties are informed of the Commission's initial views and no public statements are made unless the parties themselves go public.

The Commission recognises that mergers can be time sensitive. Delay can have adverse consequences resulting in uncertainty for shareholders and employees and, in extreme cases, the competitive position of the commercial entities involved. The Commission is open to any constructive suggestions to help overcome procedural delays flowing from its processes or the way that parties and their advisers bring matters to the Commission for consideration within the context of the informal notification system.

Parties dissatisfied with the Commission's current time frames for the informal clearance process may wish to consider the move to a formal notification system although the Commission is not advocating such a proposal.

5.6 Mergers committee

In order to streamline the decision-making process with respect to mergers, the Commission has established a Mergers Committee that meets weekly to consider most merger matters, reporting its decisions to the Commission. Major matters are referred to the full Commission for further consideration.

The Mergers Committee provides an avenue for a streamlined and fast track merger review process by the Commission. The Mergers Committee provides for a quick turnaround on merger proposals unlikely to raise issues under s. 50.

The Mergers Committee also ensures that in those cases that do raise issues under s. 50, the Commission is able to provide preliminary feedback to parties and quickly identify competition concerns.

5.7 Merger statistics

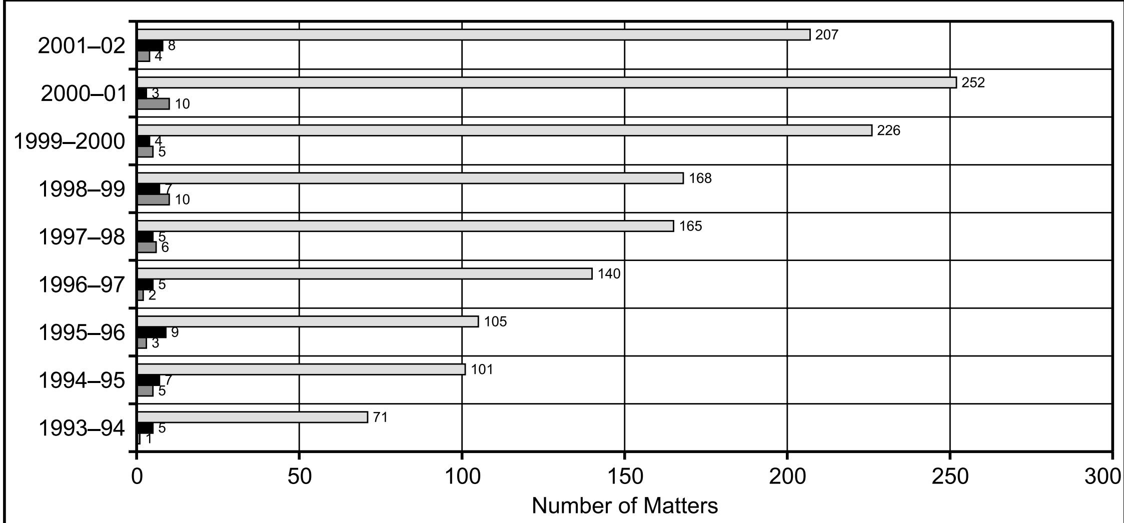
Merger statistics show that while the number of mergers examined has been steadily rising, the number actually opposed by the Commission is very small, averaging between 4 and 5 per cent. Of these, many have been resolved using court enforceable undertakings under s. 87B of the Act. This has resulted in only 2 per cent of mergers in effect being opposed by the Commission between 1999–2000 and 2001–02.

When the Commission has concerns regarding the competition implications of a merger proposal, it can accept a court enforceable undertaking in order to address those concerns. Section 87B undertakings are a flexible alternative to the Commission opposing an acquisition that is likely to substantially lessen competition. Between 1999–2000 and 2001–02 the acceptance by the Commission of undertakings allowed around 3 per cent of mergers to proceed whereby they would have been otherwise opposed.

The following table demonstrates that of the 1227 mergers investigated over the last six years by the Commission, only 69 have been opposed. However, following the acceptance of s. 87B undertakings 37 of these have been allowed to proceed.

Figure 4.1

Mergers not opposed, opposed and resolved with the ACCC



	1993–94	1994–95	1995–96	1996–97	1997–98	1998–99	1999–2000	2000–01	2001–02
Not Opposed	71	101	105	140	165	168	226	252	207
Opposed	5	7	9	5	5	7	4	3	8
Resolved	1	5	3	2	6	10	5	10	4

Note 1: Figures for 2001–02 are only up to 21 June 2002.

Between 1975 and 1992 the Commission examined 38 merger authorisation applications at an average rate of 2.1 applications a year. Of those, 22 were granted, 15 were denied and 1 was withdrawn.

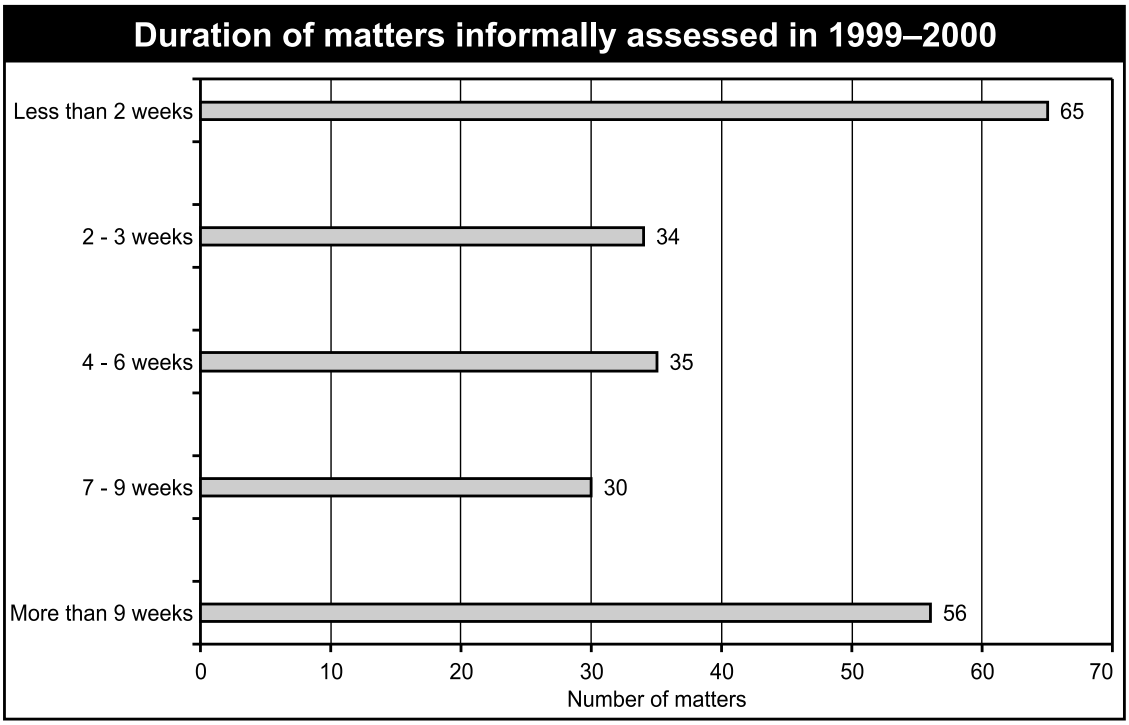
Since 1993 the Commission has examined 12 merger authorisation applications at an average rate of 1.2 applications a year although it has not received a merger authorisation application since 1998–99. Of those 12 applications, 7 were granted, 4 were denied and 1 was withdrawn. Overall, the Commission has granted more than 50 per cent of the merger authorisation applications received.

Table 4.1. Authorisation of mergers, acquisitions and joint ventures assessed by the Commission since 1993

ACQUIRER	TARGET	DECISION	DATE	AUTHORISATION GRANTED SUBJECT TO CONDITIONS
CSR Ltd Mackay Sugar Co-op Assoc Ltd	Newco	Denied	8/12/93	
Foodland Associated Limited / Davids Limited	Independent Holdings Limited / Composite Buyers Ltd	Withdrawn	22/12/93	
Comalco Pty Ltd	Gladstone Power Station	Granted	3/3/94	No
Qantas Airways Limited / British Airways Plc	Joint services agreement	Granted	12/5/95	Yes
Davids Ltd	Composite Buyers Ltd	Granted	29/5/95	Yes
Silver Top Taxi Service Ltd	North Suburban Taxis Ltd	Denied	16/10/95	
Du Pont Aust Ltd	Ticor Chemical Co Pty Ltd and Howson Algraphy Australasia Pty Ltd	Granted	8/5/96	No
Davids Ltd	QIW	Granted	28/3/96	Yes
Wattyll Aust Pty Ltd	Taubmans Industries Ltd Courtaulds Aust Pty Ltd and Pinchin Johnson Aust Pty Ltd	Denied	17/5/96	
Bristile Holdings Limited	Pioneer Building Products (WA) Pty Limited	Denied	3/11/97	
Adelaide Brighton Limited	Cockburn Cement Limited	Granted	30/4/99	Yes
Adelaide Brighton Limited	Adelaide Brighton Cement Limited	Granted	30/4/99	Yes

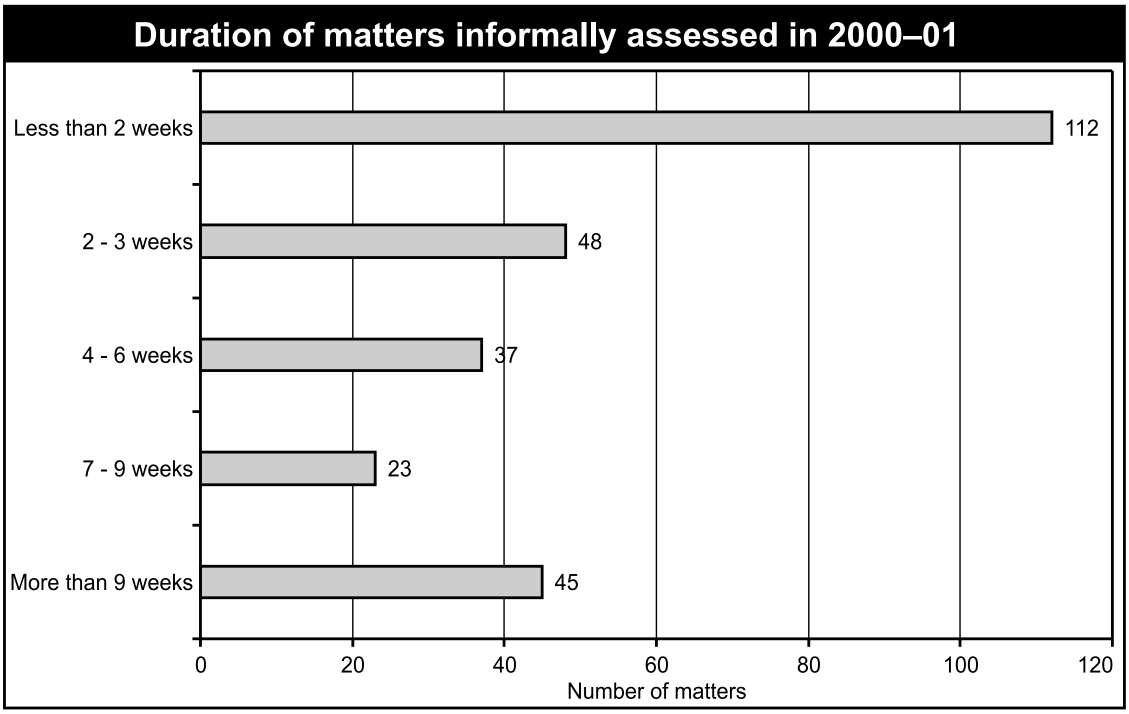
The Commission has a reasonably quick turnaround on merger investigation matters, as the following figures demonstrate.

Figure 4.2



Note: In addition to the matters summarised in figure 4.2, 15 matters (out of those the Commission did not oppose) did not require any detailed consideration given they did not raise any s. 50 issues and so were therefore able to be assessed without being referred to either the Commission or the Mergers Committee.

Figure 4.3



Consistent with the time frames outline in the *Merger guidelines*, the Commission has maintained tight frames for assessing the major proportion of the merger matters it has considered in the past three financial years. In 2000–01, 60 per cent of matters were cleared in under four weeks and a further 14 per cent of matters were cleared within six weeks. In 1999–2000, 45 per cent of matters were cleared in under four weeks and 61 per cent were cleared within six weeks. In 1998–98, 58 per cent of matters were cleared in under four weeks and a further 23 per cent were cleared within six weeks.

There are a number of reasons why time frames can be extended out, and these sometimes relate to matters beyond the Commission's immediate control. More complex matters require further analytical work relating to the application of the *Merger guidelines* and therefore take more time to assess. In these cases the Commission may request additional information and if the parties delay in providing such information in an expeditious manner the time frame will be further extended. The time frame can also be extended when parties put individual merger proposals on hold for commercial reasons or when they amend initial proposals. Offshore mergers and acquisitions which are assessed by the Commission also generally require an extended time frame to assess all of the relevant information.

For an informal clearance process the Commission's time frame compares favourably with other OECD countries. It should also be noted that most overseas jurisdictions operate systems of compulsory notification for mergers, unlike the case in Australia. In jurisdictions which have formal notification of mergers, legislative time periods and information requests are quite common. In the United States, parties must wait a specified period, usually 30 days, before they may complete a transaction. If there is a request for additional information or documentary materials from the parties to a reported transaction this will extend out the waiting period for a further specified period, usually 30 days, after all parties have complied with the request. In the European Union, the European Commission must reach a preliminary decision within one month from the effective date of notification. If the European Commission decides that the concentration maybe incompatible with its mergers regulation, it will commence an in-depth second stage investigation which may last up to a maximum of four months.

The 2000 review of international competition regulators conducted by the Global Competition Review (GCR) found that:

> The ACCC's speed of merger handling is well regarded and its leadership is given an unusually strong endorsement.[186]

In the GCR's 2001 review of international competition regulators, the Commission was also recognised for its fairly quick turnaround on merger investigations. According to the GCR:

> staff are described as "approachable and well prepared", which allows for the process to be essentially "speedy and efficient."[187]

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[186] James Kanter, 'Rating the Regulators', *Global Competition Review*, June/July 2000, Law Business Research Ltd.

Since the current s. 50 was enacted back in 1992, only one company has been prosecuted for breaching s. 50. In that case in December 1996, the Federal Court awarded penalties and costs totalling $5 million against Pioneer International and a subsidiary company for acquiring the assets of a vigorous competitor in the south Queensland concrete masonry market that had the effect of substantially lessening competition.

5.8 Transparency and accountability for merger decisions

As a public organisation, the Commission is subject to an extremely high standard of transparency and accountability.

The Commission's *Merger guidelines* outline the Commission's administration and enforcement policy for dealing with mergers. The purpose of the guidelines is to show the Commission's approach when considering mergers and acquisitions and the types of information which are relevant. They provide guidance for the business community, their advisers and the public generally.

As an organisation established by statute, the Commission is accountable through its Minister to the Parliament of Australia and through this channel ultimately to the community at large. Commission office bearers and staff routinely appear before Parliamentary Committees to answer questions on the operations and decisions of the organisation.

The decisions of the Commission receive wide coverage and scrutiny within the media. The Commission often issues press releases on its merger decisions. The Commission's decisions and the reasons behind them are published on a public register that is posted and accessible from the Commission's Internet site. The register does not include confidential or other sensitive information, but has brief details of a proposed merger (including the names of the acquirer and target), a product description and brief reasons for the Commission's response to that acquisition.

On important merger matters the Commission publishes a detailed statement of reasons behind its decisions, as in the case of Commonwealth Bank/Colonial, Australian Stock Exchange/Sydney Futures Exchange, Email/Southcorp and Westpac/Bank of Melbourne.

The Commission is not the final arbiter on whether or not breaches of the Trade Practices Act have occurred. If parties disagree with the decisions reached by the Commission, then they have the option of challenging the Commission in the Courts. This means the Commission is accountable to the Courts.

In the course of litigation, the Commission is obliged to behave as a model litigant as directed by the Commonwealth Attorney-General.

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[187] John Gledhill, 'Rating the Regulators 2001', *Global Competition Review*, June/July 2001, Law Business Research Ltd, pp. 10–33.

The Commission's determinations in merger authorisations are subject to merits review by the Australian Competition Tribunal. This means the Commission is accountable to the Tribunal.

As is the case with all public agencies, the Commission is subject to additional levels of accountability. It must abide by the provisions of the Commonwealth *Freedom of Information Act 1982*, and its conduct and processes are subject to the scrutiny of the Commonwealth Ombudsman and Auditor-General.

5.9 Does the Commission have an anti-merger bias?

Within the context of the recent public debate over the mergers provision of the Act, many critics of Australia's mergers law have implied that the Commission is predisposed towards opposing mergers. This view has been summarised by John Durie:

> The Australian business community is very good at attacking the ACCC's perceived anti-merger bias but extraordinarily bad at actually using the measures allowed by the existing law to get their plans approved.[188]

The evidence clearly demonstrates that the Commission is not biased against mergers nor has the operation of s. 50 acted as a major impediment to the restructuring and rationalisation of Australian industry.

The Commission opposes relatively few mergers—4–5 per cent on average. Taking into account the acceptance by the Commission of s. 87B undertakings, the Commission's effective rate of opposition to merger proposals falls to only 2 per cent over the past three years.

Even in the Commission's priority area for mergers of the non-traded sector, the Commission in fact opposes very few mergers. Recent examples of mergers in the non-traded sector not opposed by the Commission include: Bunnings and BBC Hardware; Toll and Lang's acquisition of National Rail/Freight Corp; the Grain Pool of WA and Cooperative Bulk Handling Authority; Suncorp/ Metway and AMP/GIO; the acquisition of Wreckair Hire by Coates; Maynes' purchase of Faulding and the Commonwealth Bank's acquisition of Colonial.

A study of large enterprises in the Australian economy conducted by the Department of Foreign Affairs and Trade noted that:

> Weak profit performance and globalisation have been drivers of extensive industry rationalisation in recent years, with a tendency for companies to focus on core strengths. Considerable takeover activity has been prompted by such rationalisation.[189]

The Commission would note that it has not prevented such industry rationalisation from occurring.

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[188] John Durie, 'Looking at the Great Divide', *Australian Financial Review*, 4 June 2002, p. 72.

[189] Department of Foreign Affairs and Trade, *The Big End of Town and Australia's Trading Interests*, Commonwealth of Australia, March 2002.

The current mergers law process has also been criticised for preventing merger proposals with significant public benefits from coming forward in the first instance. In referring to the Act, Peter Kirby has commented that:

> Dozens of Australian CEOs say it has stopped them attempting mergers or acquisitions. Firstly, because they believed the ACCC would never approve it.[190]

It is difficult for the Commission to respond to such claims when no such proposals are brought before it in the first instance. The Commission is therefore unable to comment on the veracity of such claims. However, the Commission does examine merger proposals on a confidential basis and provides a preliminary assessment if requested to do so by the parties concerned.

Given the very small number of merger proposals that are, in fact, actually opposed by the Commission, it is extremely difficult to envisage that the current mergers law is preventing a significant number of additional merger proposals from coming forward that would be rejected by the Commission.

5.10 Conclusions and recommendations

To protect consumers from the ill effects of monopoly, regulation is typically required. The best and most cost effective form of regulation is generally the preservation of competition before a monopoly situation has developed. The danger with any attempts to emasculate Australia’s current mergers law is that the consequent monopolisation of markets could end up generating sufficient community concern to warrant the imposition of far more onerous forms of price regulation than has previously been implemented in Australia.

The Commission believes that Australia’s current mergers law regime has served this country well during the 10 years that it has been in operation. It has played an important role in the maintenance of competitive market structures within the Australian economy and thus ensuring lower prices and higher quality goods and services for all Australians. The Commission is unaware of any compelling arguments supporting a major overhaul of the current arrangements. Therefore, the Commission is not making any recommendations to change the current arrangements. However, the Commission is not averse to change and remains receptive to any constructive suggestions for improvements to its processes in the administration of s. 50.

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[190] Peter Kirby, *Is the branch office economy all we can aspire to?*, speech to the Securities Institute of Australia, 21 June 2001.