INVESTMENT & FINANCIAL SERVICES ASSOCIATION LTD
(ACN 080 744 163)

SUBMISSION TO THE COMMITTEE OF INQUIRY INTO THE TRADE PRACTICES ACT 1974

12 July 2002

TABLE OF CONTENTS

EXECUTIVE SUMMARY

---

1. Mergers

- The Australian merger review system should promote the competitiveness of Australian businesses in an effective and efficient manner.
- The system should be consistent, efficient and focused.
- An independent Mergers Panel should be established to determine whether a merger above a certain threshold is anti-competitive.
- The Panel should have appropriate powers to tailor remedies to accommodate any particular merger, with a focus on strengthening competition.
- The decision of the Panel should be final except on limited grounds.

2. Misuse of Market Power

- Section 46 of the TPA should not be amended.
- The ACCC should continue to monitor section 46 either by itself or in conjunction with the Competition Tribunal.

3. Third Line Forcing

- These provisions should be subject to a competition test consistent with other exclusive dealing prohibitions
- Subsections 47(6) and (7) should be amended to treat related companies as one business entity

4. Dual Listed Companies

- The TPA should be reviewed to ensure that dual listing arrangements do not inadvertently breach the provisions.

INTRODUCTION

The Government considers that strong and effective Trade Practices legislation is crucial to promoting a successful and fair business community.

The Government has requested the present Committee to determine whether, amongst other things, the Trade Practices Act 1974 encourages an environment where Australian business can grow and compete internationally.

Key provisions of the Trade Practices Act 1974 are to be reviewed by the Committee to examine the effectiveness of Australia's competition laws in contributing to the productivity, efficiency and growth of an open, integrated Australian economy.

The Government is aware of the following concerns among other things:

- that Australian businesses increasingly face global competition and need to compete locally and internationally;
- that excessive market concentration and power can be used by businesses to damage competitors; and
- the need for businesses to have reasonable certainty about the requirements for compliance with or authorisation under the Trade Practices Act.

This submission is presented by the Investment and Financial Services Association to assist the Committee in making recommendations to improve the framework of Australia's competition law to achieve a more efficient, fair, timely and accessible regime, which encourages a competitive Australian business environment.

1 MERGERS

1.1 Objective

The objective of the Australian merger control system should be to promote the competitiveness of Australian businesses in an effective and efficient manner.

The Australian economy and consumers will benefit from a strong and competitive business environment. This is achieved by healthy competition at a local and foreign level, taking in to account world best practices and standards.

Any merger control system necessarily involves the adjudicator in "second guessing" the competitive effects of a proposed merger. It is important that the adjudicator is respected and that the competitive assessment is consistent, efficient and focused. The adjudicator should be able to make orders or arrangements that are appropriate to the particular circumstances.

- Consistency is not only a matter of fairness. It ensures that business is better able to plan for the future if the outcome can be reasonably assessed. Transparency and disclosure are essential requirements for consistency.
- Merger proposals require prompt decisions. Users of the system must not be subject to unnecessary procedural or cost burdens.
- The competitive assessment should be focused. For example, the assessment should be limited to competitive issues and not involve investment judgment or political issues.
- Appropriate orders - the adjudicator must be able to tailor the remedy to the particular circumstances and ensure that the remedy is enforced.

1.2 Mergers in Australia – The Role of the ASX

Mergers in Australia of any significant size usually involve a party (whether on one side to the merger or on both sides) which is an entity listed on the Australian Stock Exchange ("ASX").

The relative position of listed entities in Australia with respect to mergers may be judged by the fact that the total market capitalisation at 31 December 2001 of listed entities was $1,109,601 million, of which $732,818 million comprised Australian companies (all data provided to IFSA by ASX Ltd).

The significance of mergers of listed entities is not only at the entity level but also at the investor level.

The total dividends received by investors on ordinary shares for the year ended 30 June 2001 from listed domestic companies was approximately $23 billion.

The total sales of shares listed by investors for the twelve month period ended 30 May 2002 from listed entities was more than $500 billion.

It is in the interest of investors to have a range of competing listed entities and investment options in listed entities. It is clearly not in their interests to have limited investment opportunities in a small number of large corporate monopolies.

Likewise it is not in the interest of investors to be locked into inefficient entities where a merger will provide a method of exit and a better reinvestment of their funds.

Mergers are necessary and have an important part to play for investors and the economy as a whole.

It is an essential part of listing that the entities put themselves "up for sale". The purchaser may be an individual, investor, superannuation fund or competitor. Regardless of the identity of the purchaser the entity is up for sale to the highest bidder.

Investors need healthy competition between listed companies and between investments in listed companies. The ability to merge and the threat of merging is essential to investors, and promotes the efficient management of investment capital.

1.3 Constant Public Performance Review of Listed Entities

Today, more than ever, listed entities are publicly judged on their day to day performance. Reporting requirements and benchmarks for performance mean that poor managers do not survive. The market for corporate control of an Australian listed entity is highly competitive and must be balanced by ensuring sound investor and consumer protection. A listed entity and its investment performance must be competitive among its peers on which it is judged daily.

Mergers of listed entities are invariably subject to extensive media, reporting, investment research, analysis and comment in Australia. The investment community quickly forms a view whether a merger is in the best interest of investors and the entities concerned.

Today the investment community in Australia has a healthy suspicion about proclaimed benefits from merging. Mergers are not automatically treated as necessarily beneficial. Rather the pros and cons of a proposed merger are critically examined in order for the market to make an informed judgment.

1.4 The Present Law in Australia on Mergers

Under the Trade Practices Act mergers are outlawed unless either:

- The merger would not substantially lessen competition in a market; or

- The merger is authorised for the public benefit.

The first gateway provides little certainty and carries heavy penalties of up to $10 million (corporations) and $500,000 (individuals) if the parties contravene the provisions.

The second gateway provides certainty but has numerous practical difficulties, not least the heavy onus of proving that the merger would promote the "public benefit".

Neither method meets the objective of providing certainty, efficiency and effective merger regulation.

1.5 Proposals for Reform

It is suggested that the following reforms are consistent with the objective of the adoption of a merger system suitable for Australia.

- **Only mergers above a certain threshold are subject to an inquiry**

  It is suggested that only mergers above a threshold of a specified market share or a specified turnover amount should be subject to review. All others should be able to proceed. We acknowledge that developing an appropriate threshold would require extensive consultation and assessment.

- **The role of the ACCC**

  The role of the ACCC should be to decide, within a specified period, whether it should refer a qualifying merger to a newly constituted Mergers Panel for determination. The proposed merger should be referred if the ACCC considers that the merger may substantially lessen competition. Once referred, the ACCC could make appropriate submissions to the Panel.

  The ACCC should also have the ability to decide not to refer a qualifying merger to the Mergers Panel if it considers the merger is not likely to substantially lessen competition in a market.

  A party to the merger could independently refer the merger to the Panel.

  The ACCC would have the role of investigating a merger and placing its finding before the Panel. If the ACCC had not referred the matter to the Panel within a specified timeframe the merger would then proceed without further restriction.

- **The determination by the Mergers Panel**

  The Mergers Panel would determine whether the merger is anti-competitive within a market in Australia for goods or services.

- **The Mergers Panel would be an independent statutory body**

  The Mergers Panel would be an independent statutory body comprised of a number of suitably qualified business, trade practice and Treasury members. It would have its own resources and staff.

  The Panel would act informally and publish its reasons.

  Only limited appeal would lie from the decision of the Panel.

- **The powers of the Mergers Panel**

  The Mergers Panel would have all the necessary powers to make determinations, including requiring the production of documents and the receipt of submissions. It would also have power to make appropriate orders to remedy a situation having regard to the particular circumstances of the merger.

  Where the Panel determined that the merger would be anti-competitive it would not be obliged to prohibit the merger or to order divestiture where it was satisfied that the merger could proceed on conditions without adverse effect. The Panel could also use its wide powers to tailor orders to prevent any anti-competitive effect of a merger, with an emphasis on strengthening competition and Australian business.

2. MISUSE OF MARKET POWER

2.1 Section 46

Section 46 of the Act is directed at preventing certain anti-competitive conduct engaged in by corporations that have a substantial degree of market power and take advantage of that power. Such conduct is prohibited where it is undertaken for the purpose of eliminating or damaging a competitor, preventing a person entering a market or from engaging in competitive conduct in that market.

Section 46 itself is the subject of a current enquiry by the Senate Legal and Constitutional References Committee. Specifically the terms of reference of that Committee require an examination as to whether the Trade Practices Act should be amended to:

(a) provide for a reversal of the onus of proof under s.46 in actions brought by the ACCC where it can first be shown that the corporation has a substantial degree of market power and has taken advantage of that power; and

(b) give the ACCC a power to order divestiture where an ownership situation exists that has the effect of substantially lessening competition.

As the Committee is authorised to specifically review Part IV of the Trade Practices Act, it is submitted that it is entirely appropriate for the Committee to consider as part of that review the need or otherwise for amendments to s.46 notwithstanding that this is also the subject matter of the current Senate Committee Enquiry. Such a review should include any submissions made to, or recommendations or reports made by, the Senate Legal and Constitutional References Committee in relation to the current enquiry.

IFSA considers that any general review of Part IV of the Trade Practices Act, whilst recognising the objective of the Trade Practices Act "to enhance the welfare of Australians through the promotion of competition and fair trading ….", must also take heed that the excessive regulation of, or administrative intervention into, an area governed by elastic economic concepts can be counter productive. Such intervention itself can bring about a result, which is contrary to those objectives.

That s.46 is primarily concerned with economic concepts was recognised by Mr. Justice Deane in *Queensland Wire Industries Pty Limited v The Broken Hill Proprietary Company Limited and anor (1989) ATPR at page 50,011.*

> *"The starting point …… is the fact that the essential notions with which s.46 is concerned and the objective which the section is designed to achieve are economic and not moral ones. The notions are those of markets, market power, competitors in a market and competition. The objective is the protection and advancement of a competitive environment and competitive conduct."*

The court in that case also recognised that:

> *"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."*

The economic concepts with which s.46 is concerned are necessarily imprecise and, as with the other activities and conduct with which Part IV of the TPA is concerned, it is important that the fine distinction between conduct which is unfairly predatory or uncompetitive in nature not be confused with conduct or market practices which are necessary and inevitable features of a normal and healthy, if robust and vigorous market.

2.2 Arguments for Amending s46

The proponents for the case for amending s.46 TPA put forward a number of propositions including:

(1) The current "purpose" test which must be satisfied to establish a contravention of s46 constitutes a major hurdle for the successful prosecution of cases.

(2) This evidentiary obstacle is compounded by the fact that corporate transgressors are sophisticated in their approach to the retention of "smoking gun" type documents; and

(3) There should be a reversal of the onus of proof with respect to the current "purpose" test or, alternatively, an "effects" test in lieu of the current "purpose" test.

There is no doubt that the current "purpose" test does need to satisfy a significant evidentiary standard. However this might well be seen as appropriate given that healthy competition is always strong and robust. An efficient competitor adopting more innovative or efficient processes will necessarily damage its less efficient competitors and it is consistent with the objects of the TPA and the interests of consumers that this should be so.

It would be regrettable if successful and efficient, although aggressive, competitors were inhibited from engaging in effective competition because in doing so they were faced with the constant need to justify their conduct. If the onus of proof as to "purpose" was reversed, such justification would necessarily involve proving a negative – ie. that the conduct concerned was not motivated or instigated by one of the proscribed purposes. It would be extremely difficult for alleged transgressors to prove such a proposition.

The risk of engaging in conduct where there was a possibility that the TPA had been breached and, if the ACCC intervened, the prospect of protracted litigation accompanied by adverse publicity with a heavy evidentiary burden to discharge, may well inhibit healthy competition by corporations with significant market sectoral share.

It is understood that whilst the ACCC believes that the reversal of onus of proof would be preferable to the current position, the ACCC prefers an "effects" test. Such a test would obviate the need to prove the motivation or “purpose” of the alleged transgressor. Rather it would involve an objective assessment of the effect or consequences of the conduct of a corporation that had a substantial degree of market power and had taken advantage of that power.

This would involve an analysis of the effect of the conduct upon the corporation’s competitors, ie. whether they have been harmed by the conduct, whether the conduct has created new barriers to entry or whether the conduct has prevented competitors or potential competitors from engaging in countervailing competitive conduct.

Whilst such an approach might be seen as overcoming some of the perceived probative difficulties in relation to the current operation of s.46, any amendment of this kind must be approached with extreme caution because of the fine line between healthy competition and the inappropriate or exploitative use of market power in a way, which is unfair and uncompetitive.

2.3 Competition Tribunal

It is suggested that the functions and powers of the Competition Tribunal be expanded to include the power to review complaints about conduct, which is alleged to contravene s.46. Conversely the ACCC would no longer review such conduct but together with any person affected by the conduct would be entitled to apply to the Competition Tribunal for such a review to be undertaken. The Tribunal would assess whether the conduct had resulted in the raising of barriers of entry and/or the preventing of a countervailing competitive response. It would also be able to consider whether there were any countervailing public benefits resulting from the conduct such that intervention by way of injunction or other appropriate remedy was not warranted.

2.4 Divestiture

One of the proposals being considered by the current Senate Enquiry concerning TPA s46 is the granting of divestiture powers to the ACCC. Such powers would enable the ACCC to apply to a court for an order dissolving any major Australian corporation in circumstances where it was contended that the corporation’s ownership of assets was anti-competitive. Such action would not require that the corporation be first shown to have acted illegally or to have misused its position.

IFSA does not support such a proposal. IFSA considers that no case has been made out demonstrating the need for the ACCC to have additional powers and notes that in the United States (where a much more limited form of break up powers apply), the application of those provisions has posed practical problems with the result that the provisions are infrequently applied.

IFSA considers that any such proposal would raise concerns for foreign investors and would not bring economic benefits to the Australian economy.

3. THIRD LINE FORCING

3.1 Third Line Forcing

IFSA believes the Review is an opportunity to modernise some aspects of the TPA provisions and address some anomalies. An area in need of change is Third Line Forcing.

Third Line forcing issues are important to IFSA members with the increase in bundling of products in the Financial Services sector. This practice provides benefits to consumers and promotes competition and is becoming more common in the Financial Services sector as a normal business practice.
The reforms sought are to allow the market to operate more effectively and competitively, by allowing the expansion of product choice and value for customers.

To more readily facilitate this improvement in market efficiency IFSA is recommending two changes to the TPA:

The provisions should be subject to a competition test consistent with other exclusive dealing prohibitions Section 47 (6) and (7) should be amended to treat related companies as one business entity.

3.2 Competition Test

Currently, third line forcing is prohibited as exclusive dealing under Section 47 of the TPA, however, unlike other exclusive dealing provisions, it is a *per se* prohibition, even if it does not substantially lessen competition.

As outlined in the Treasury Discussion Paper [1] the growth in 'shopper docket' petrol discount and similar schemes is not necessarily anti-competitive and can benefit customers.

---

[1] Department of the Treasury (2001) *Discussion Paper: Possible Amendments to the Trade Practices Act 1974*.

The *per se* prohibition does not encourage pro-competitive business arrangements for the public benefit.

It is the view of IFSA that the third line forcing provisions in section 47 of the TPA should be subject to a competition test consistent with the other exclusive dealing provisions of the TPA.

IFSA's view is supported by the 2001 Federal Treasury Discussion Paper that recommended a competition test for third line forcing.[2]

The internationalisation of the Financial service markets over the last 30 years has resulted in a significant increase in competition and consumer choice and the TPA provisions need updating in line with these changes to the Australian markets.

3.3 Related Company Exception

In the Financial Services sector there has been a significant increase in the number of conglomerates being formed as market forces require integrated financial products and services to be offered by Banking/Funds Management /Life and General Insurance operations.

The Financial Services Reform Act 2001 has encouraged the development of a single licensing regime involving conglomerates and their representatives advising, arranging and dealing with respect to a broader range of financial services products and services.

The current third line forcing provisions have the effect of putting conglomerates at a disadvantage compared to single-entity firms. This is because a conglomerate is prohibited from bundling products, supplied through two or more of its companies, under the TPA, whereas a single-entity firm is not, even though both entities may be offering products that provide the same offerings to consumers.

---

[2] Op Cite

In the ACCC 's guidelines for third line forcing,[3] it is noted that a particular bank provided customers a discount on their banking, on condition that the customer also purchased insurance or investment services from a related company in the banking group.

Such conduct is prohibited under the TPA (in the absence of clearance through notification). The particular bank notified the ACCC of the conduct. The ACCC concluded that the arrangement would

"… be unlikely to result in anti-competitive detriment, but would be likely to result in a public benefit through lower product prices and increased competition in the relevant markets."[4]

Such arrangements are pro-competitive and in the public benefit. As a result, conglomerates should be treated equally with that of single-entity firms with respect to third line forcing by amending s47 to treat related companies as effectively one business entity under s 47(6) and (7).

3 ACCC (1998) *Guide to authorisation and notification for third line forcing conduct*, February, p. 15.
4 *Ibid*.

4. DUAL LISTED COMPANIES

4.1 The Dual Listing Arrangement

The dual listed companies (DLC) arrangement is a series of contractual arrangements between two listed entities under which they operate as if they were a single economic enterprise. A DLC is not a merger by definition because it does not involve the transfer of shares and/or assets. However, a DLC does achieve the same practical result, i.e. allowing two companies to operate as a single economic enterprise, while at the same time retaining their separate legal identities, tax residencies and stock exchange listings.

Whilst considered novel, Australian companies are seeing the advantages for cross – border arrangements, including:

- Providing the benefits of scale, merger synergies and continuity of franking, without the need for disposal or transfer of shares
- No capital gains tax or stamp duty issues
- No shareholder is forced to sell or exchange their shares
- No loss of national identity or corporate structure for either DLC entity
- Improved access to capital markets and a choice of currencies for future global acquisition opportunities

IFSA considers that the financial services sector will consider the DLC structure as a viable alternative to straight out mergers in some circumstances. It is therefore important to ensure that companies do not find themselves inadvertently breaching the provisions of the Act.

4.2 Trade Practices Act Anomalies

Because of the unique structure, an entity that is party to the DLC arrangement could find itself in breach of section 45 or 45A of the Act when in fact no anti-competitive conduct is taking place. This leads to the anomaly whereby DLC structures, which are effectively the same as a merged entity for the purposes of their economic perspective, are in fact subject to different tests under the Act.

On the one hand, basic acquisitions of assets or shares are subject to the competition test under section 50. However, arrangements that are in reality the same economic infrastructure but are established under different legal arrangements may be caught by the general provisions of section 45 and/or section 45A.

A fundamental premise is that like cases ought to be treated in the same manner. Distinctions that are not based on appropriate grounds must be removed from the Act in order to allow for economically equivalent structures to be subject to the same test.

It is noteworthy that transactions between bodies corporate that are related to each other and transactions between joint venture partners are specifically exempted from section 45 (by s45(8)) and s45A (by s45A(4)). For the purposes of the Act, a "related party" for the purposes of section 45 is defined in section 4A(5) as:

- the holding company of another body corporate;
- a subsidiary of another body corporate; or
- a subsidiary of the holding company of another body corporate.

Entities entering into a DLC with each other will not ordinarily fall within this definition.

For the purposes of receiving the joint venture exemption of section 45A(4), there must be a provision of a contract, arrangement or understanding, or a proposed contract, arrangement or understanding, which is a provision:

(a) in relation to the price for goods or services to be collectively acquired, whether directly or indirectly, by parties to the contract, arrangement or understanding or by proposed parties to the proposed contract arrangement or understanding;or

(b) for the joint advertising of the price for the re-supply of goods or services so acquired.

The very nature of the DLC would suggest that the parties would be entering into conduct that extends beyond the scope of the protection afforded by this provision.

4.3 Recommendation

IFSA supports the re-examination of the operation of the anti-competitive and price fixing provisions in section 45A, including the supporting definitions and exceptions in light of the increasing importance of dual listed companies in the Australian market.