Submission to the Committee of Inquiry for the Review of the Competition Provisions of the *Trade Practices Act 1974*

Enertrade, a Queensland government owned corporation involved in trading wholesale electricity in the National Electricity Market, respectfully submits the following comments for the Committee's consideration.

EXECUTIVE SUMMARY

In summary, Enertrade:

1. opposes the introduction of an 'effects test' into the provision governing misuse of market power (ie section 46). The need for this test has not been persuasively demonstrated. Such a test could also capture legitimate and pro-competitive conduct and increase uncertainty about the section's potential application;
2. disagrees that the onus of proof in misuse of market power cases should be reversed, thereby obliging an alleged offender to prove that it did not use its power for an unlawful purpose. Such a reversal is improper and unwarranted, and would significantly increase business' legal risk and administrative costs;
3. denies that the ACCC should be given power to issue 'cease and desist' orders where it considers a misuse of market power may be occurring. Such orders could effectively foreclose commercial activity that might be quite legitimate if considered by a court;
4. is concerned that the ACCC at times uses the authorisation process as a vehicle to create and impose its own vision of competition policy. Such activity is inappropriate, and exceeds the ACCC's proper role in the authorisation process;
5. disagrees that the Act's remedies should be strengthened to include 'turnover penalties' and jail sentences for individual offenders. Existing remedies are sufficient; and
6. considers that the Act should be amended to explicitly preserve the application of the doctrine of legal professional privilege where the ACCC issues notices under section 155 allowing it to gather information. Failure to do so will undermine compliance programs by discouraging corporate reporting of compliance breaches to senior management and counsel.

Misuse of market power issues

1. Introduction of an 'effects test'

Currently, a corporation that takes advantage of its market power behaves unlawfully *only* where it does so with the purpose of producing one of three anti-competitive outcomes described in section 46. The ACCC claims that this prohibition is inadequate because:

1. potential litigants have difficulty proving that a company used its market power for the prohibited purpose;[1] and
2. it is directed at protecting individual competitors and not necessarily the process of competition that the Act is intended to promote.

The ACCC has therefore called for the introduction of 'an effects test' into section 46. This would make use of market power unlawful if it had the purpose, effect or likely effect of producing one of the three prohibited outcomes.

---

[1] See Senate Legal and Constitutional Affairs Committee, *Inquiry into sec 46 and 50 of the Trade Practices Act 1974*, May 2002 at 17.

Amending section 46 in this fashion would be a radical change, suggested and rejected in no fewer than six previous reviews of the Act.[2] It would be justifiable only if the case for it (outlined above) was conclusively proven and if it was certain that such a change would not produce other negative consequences such as the deterrence of legitimate business conduct or the creation of business uncertainty. In Enertrade's view, and for the following reasons, this has not been shown.

Alleged difficulties of proof

It has not been conclusively demonstrated that it is hard to prove a prohibited purpose. Recent cases indicate that courts are more than willing to infer prohibited purpose where a misuse of market power is alleged. In the last year alone, courts confirmed the existence of anti-competitive purpose in the *Boral*,[3] *Melway*,[4] *PAWA*[5] and *Universal Music*[6] cases. Further, as the ACCC has itself acknowledged,[7] these decisions have generally lowered the barriers to proving a misuse of market power and widened the application of section 46.[8]

In any event, the alleged difficulties in proving prohibited purpose should have been substantially overcome by the introduction of section 46(7). This provision facilitates proof of purpose in misuse of market power cases. It allows courts to infer from surrounding circumstances that a prohibited purpose did in fact exist, even where an alleged offender has adduced direct evidence of a legitimate purpose.

It has also not been shown that it will in fact be easier for a potential litigant to prove the relevant effect than the relevant prohibited purpose. Some evidence suggests the converse. For example, one study shows that, over an eighteen year period, the ACCC had a higher success rate in proceedings it commenced under section 46 (which contains a purpose test) than in proceedings it commenced under section 47 (which contains an effects based test).[9] Further, there is no evidence that the ACCC has been any more successful in proving anti-competitive conduct under the telecommunications Part of the Act - which contains an effects based test - than it has under section 46.[10]

Focus of section 46

The wording of section 46 does, on its face, focus on the impact of conduct on individual competitors, rather than on competition. Even if this situation is undesirable, as contended by the ACCC, it has been overcome by judicial interpretation. Just last year,

---

[2] For a summary of the respective reviews, see Landrigan M et al, "An effects test under s 46 of the Trade Practices Act: Identifying the real effects", 9 (3) *Competition & Consumer Law Journal* March 2002

[3] *ACCC v Boral Limited* (2001) ATPR ¶41-803

[4] *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* (2001) ATPR ¶41-805

[5] *NT Power Generation Pty Ltd v Power & Water Authority* (2001) ATPR ¶41-814

[6] *ACCC v Universal Music Australia Pty Ltd* (2002) ATPR ¶41-855

[7] ACCC Media release, *Increased support for Regions*, 12 July 2001

[8] For example, in the *Universal Music* case cited in Note 6, the court decided that a market can exist over a short period of time – a finding which effectively will magnify the market power of many corporations – and that a corporation can have market power with a market share of as little as 17%

[9] Henricks S, "The Likely Effect of Amending section 46 of the Trade Practices Act", 11 May 2002, *2002 Trade Practices and Consumer Law Conference, Sheraton on the Park Hotel, Sydney* at 10. The ACCC had a 60% success rate in relation to the former compared to a 50% success rate in relation to the latter

[10] Note 2, at 276

the High Court made it clear that section 46 "aims to promote competition, not the private interests of competitors".[11]

Negative consequences of introducing an 'effects test'

The major problem with an effects test is that it may damage competition by capturing unilateral conduct that is desirable and competitive. The Hilmer Report explicitly acknowledged this possibility, saying:

> the very essence of the competitive process is conduct which is aimed at injuring competitors. A firm that succeeds in aggressive competition may drive other firms from the market and achieve a position of pre-eminence for an extended period. It does not necessarily follow, however, that the competitive process will be damaged by the conduct or that the potential for competition will be diminished, even if the immediate manifestations of the successful competitive conduct may suggest it. Firms should be encouraged to compete aggressively by taking advantage of new and superior products, greater efficiency and innovation. There is a serious risk of deterring such conduct by too broad a prohibition of unilateral conduct. The Committee takes the view that an effects test is too broad in this regard.[12]

The Cooney Committee also accepted that "the process of effective competition involves engaging in conduct the potential effect of which is to produce the very ends proscribed in s 46 ... and considers that prohibiting such conduct by reference to its effect may challenge the competitive process itself."[13]

In practice, an effects test might damage competition in a number of ways. For example, it might inhibit the practice of price discounting. This practice can clearly have a pro-competitive effect benefiting consumers. It will not always be engaged in with a predatory purpose of driving a competitor out of business or discouraging a new entrant. However, such pricing might inadvertently lead to an 'anti-competitive' effect, such as the exit from the marketplace of a less efficient competitor. Under an effects test, it might therefore be unlawful. This indicates that introducing an effects test could reduce supplier's incentives to compete robustly on price.

Under an effects test, the expansion of production capacity might also be questionable, even if undertaken to increase efficiency. If the expansion results in an improvement to the supplier's capacity to compete, and a consequent elimination of a less efficient competitor, the effects test again might capture it. These outcomes would be absurd.

The ACCC would doubtless disagree with this analysis. It states that those who object to an effects test misunderstand the law relating to misuse of market power.[14] It contends that section 46 will not capture efficiency enhancing commercial conduct if an effects test is introduced because of a control on the section's application recently developed by the High Court. That control is allegedly constituted by the Court's interpretation in the *Melway* case[15] of one of the elements of the offence of misuse of market power – that is, whether or not a firm has 'taken advantage' of its market power. The High Court there found that a firm with market power will not 'take advantage' of its power, and so will not

---

[11] Note 4, at 42,752
[12] *National Competition Policy: Report by the Independent Committee of Inquiry*, AGPS, Canberra, August 1993 (the Hilmer Report)
[13] Senate Standing Committee on Legal and Constitutional Affairs, *Mergers monopolies and acquisitions: adequacy of existing legislative controls*, AGPS Canberra 1991 (the Cooney Report) at 96
[14] ACCC, *Submission to the Trade Practices Act review,* June 2000, at 91
[15] Note 4

breach the Act, provided it would have been likely to have engaged in the impugned conduct even if the market in question were competitive.

This decision will not prevent an effects test catching pro-competitive conduct. A firm alleged to have misused market power would, under an effects test, have to prove that it would have engaged in the impugned conduct even if it had not possessed market power. Such proof would be extremely difficult because it concerns hypothetical behaviour in a hypothetical market.

In any event, introducing an effects test would force firms to evaluate the potential effect of their every action on competitors and likely competitors. This would be a risky undertaking as the effect of conduct on competition is frequently ambiguous and often hard to determine.[16] Introducing an effects test into section 46 would therefore exacerbate the uncertainty already surrounding that section's application. Such uncertainty can be expected to dampen aggressive but legitimate competitive activity with associated costs for the Australian economy.

Finally, if an effects test is introduced, it is not clear whether high pricing could amount to a misuse of market power. High pricing, of itself, and engaged in without the intent to preclude competition by a downstream competitor, should not amount to a misuse of market power because high prices are the economic signals that attract new entrants to a market, thereby increasing competition. The ACCC acknowledges this in its own submission, and agrees that high prices should not be the focus of section 46.[17]

However, Enertrade is concerned that a supplier could be convicted of misusing market power under an effects test merely for charging high prices. Such conduct might be construed as having an anti-competitive effect merely because it erodes a purchaser's profit margins. A customer of a powerful corporation could allege that it suffered 'substantial damage', or was 'prevented from engaging in competitive conduct' in another market simply because the supplier affected its ability to compete by raising its input costs. If these claims were upheld, powerful corporations would effectively be prevented from profit maximising.

Such an outcome is unacceptable because charging high prices is entirely consistent with competitive market behaviour.[18] Blunting the ability of powerful corporations to raise prices by regulatory intervention can only blunt the economic signals on which free markets depend.

2. Reversal of onus of proof

Prior to this review, the ACCC has argued that the onus of proof should be reversed in cases where it alleges a misuse of market power. It has contended that an alleged offender should prove, on the balance of probabilities, that it did not use its market power for an improper purpose.[19]

---

[16] Buffier B, "Shoot First, Ask Questions Later: The Rapid Response powers of the ACCC to Regulate Anti-competitive conduct in Telecommunications Markets", 10 (2) *Trade Practices Law Journal* at 20

[17] Note 14, at 74

[18] Profit maximisation can be economically efficient. For instance, it allows corporations to cover high fixed costs or upgrade facilities, and so remain viable in the face of increasing competition. If powerful corporations cannot profit maximise, they may be unable to achieve either objective, and so may ultimately exit the market, thereby reducing competition.

[19] See the Senate Legal and Constitutional References Committee, *Inquiry into s 46 and 50 of the Trade Practices Act 1974*, Canberra, The Parliament of the Commonwealth of Australia, May 2002 at 15. Because the ACCC did not reiterate this proposal in its submission to the current review, it

Enertrade opposes this suggestion. A reversal of the legal onus of proof is unprecedented[20] and improper because it conflicts with the basic legal principle that one is innocent until proven guilty. It is unwarranted because it has not been demonstrated that proving anti-competitive purpose is insurmountably difficult. Enertrade believes the burden of proof should remain entirely with the ACCC. If it is shifted to potential defendants, there is little to prevent the institution of essentially frivolous proceedings on the basis of scant evidence. In any event, the ACCC already possesses extensive powers to mount successful prosecutions. For instance, it has broad information gathering powers under section 155 of the Act which currently override any right to silence.[21]

Implementation of this proposal would also increase business' administrative costs, with a consequent effect on prices ultimately charged to customers. Prudent corporations would be forced to create and maintain a paper trail to justify their every commercial decision. While this is an impracticable task, it is conceivably the only means of providing a defence if the onus of proof is reversed.

The ACCC itself has acknowledged that reversing the onus of proof creates an undue administrative burden. In a recent draft authorisation, it declined to apply to the electricity industry a reversed onus of proof that would have required generators to prove their price bids were made in good faith. The ACCC instead decided that the National Electricity Code Administrator should bear the entire burden of proof by undertaking 'such investigations as are necessary to build a substantive case before making ... allegations'.[22] In doing so, it denied another body the very measure sought for itself in relation to section 46.

3. Cease and desist orders

The ACCC has argued that it should be entitled to issue administrative 'cease and desist' orders. These would prevent corporations from engaging in conduct that the ACCC was 'reasonably satisfied' was a misuse of market power. Such orders would stay in effect for 90 days or until a court determined the legality of the impugned conduct, whichever occurred sooner.

Enertrade strongly opposes the introduction of such orders because they may be used to permanently restrain pro-competitive and legitimate conduct. Many recipients of cease and desist orders would not attempt to contest the legality of their conduct in court even if the conduct was in fact lawful. They may instead undertake to refrain from the conduct to avoid the major costs and adverse impact upon reputation that inevitably accompany litigating against the ACCC.

---

appears it supports a reversed onus of proof only if an effects test is not inserted into section 46. The following comments are predicated on that assumption.

[20] The only other section in the Act that shifts any portion of the burden of proof is section 51A(2). That section reverses only the evidentiary burden by requiring a defendant to adduce some exculpatory evidence showing it had reasonable grounds for making representations about future matters. If it does not, the defendant will be deemed to have engaged in misleading conduct. If it does, then the complainant must still satisfy the legal burden of proof by showing on the balance of probabilities that the impugned conduct was misleading. If the current proposal was to shift only the evidential burden of proof, then a defendant would only have to introduce evidence that its purpose was not improper. The complainant would then still have to prove improper purpose on the balance of probabilities.

[21] This issue is discussed further at pp 9-10.

[22] ACCC, *Draft Authorisation numbers A90797, A90798, A90799*, Canberra, ACCC, 3 July 2002, at 57

In many instances, then, the ACCC and not the courts would effectively determine the legality of impugned conduct. This is tantamount to giving judicial power to the ACCC. Clearly this is inappropriate. In any event, such orders are not necessary. The ACCC is already free to seek urgent interlocutory injunctions restraining a misuse of market power.[23]

In addition, in cases where a cease and desist order was issued restraining conduct ultimately determined by a court to be lawful:

a) the market would be denied the benefits of that legitimate competitive conduct for the stipulated period; and

b) substantial damage could be inflicted upon the recipient of the order. For example, the ACCC might suspect that legitimate discounting was in fact unlawful predatory pricing and issue an order to restrain it. The recipient could lose significant market share by being prevented from discounting. Yet, under the model for cease and desist orders proposed by the ACCC, no compensation would be payable to the innocent recipient.

Authorisation issues

Enertrade does not object to the authorisation process set out in Pt VII of the Act. However, Enertrade is concerned that the ACCC uses the authorisation process as a vehicle to create and impose its own vision of competition policy. This is not an appropriate role for an independent statutory body not subject to the public accountability regime accompanying policy-making responsibilities.

A recent draft authorisation relating to the electricity industry contains an example of attempted policy-making by the ACCC.[24] In this draft authorisation, the ACCC indicated that it favoured authorising a rule that could effectively impose a cap on the price of electricity offered by generators. The purpose of this rule is apparently to contain the prices at which generators are offering their energy to the national electricity market.[25] Such a rule would equate to an industry-specific competition rule more stringent than any contained in the Act. In fact, it sounds a lot like a price cap.[26]

Enertrade does not support price controls. However, if they are to be imposed, it is the government, and certainly not the ACCC, which should make such a decision as a matter of public policy. The ACCC is supposed to enforce and administer the Act, not create de facto extensions to it via authorisations.

It is particularly important to electricity industry participants that the ACCC strictly adhere to its proper role in the authorisation process because the ACCC performs a critical role in the regulation of the National Electricity Market ('Market'). All changes to the rules regulating Market operations must be authorised by the ACCC. However, it is not the ACCC's job to propose rule changes; that is up to the Market's rule administrator, the National Electricity Code Administrator.

Nevertheless, the ACCC has occasionally taken an active role in Market development by imposing conditions on authorisations that fundamentally alter changes proposed to it. This has significantly increased regulatory uncertainty for Market participants. It has also

---

[23] under section 80 of the Act
[24] Note 22
[25] Note 22, at 65 and 73.
[26] In taking this stance, the ACCC has also contradicted its own assertion that high prices should not be regarded as anti-competitive but as economic signals for investment. The ACCC made this assertion in its submission to the current review: see Note 14.

led to a very long rule change process. Enertrade has therefore suggested to another government review that the ACCC be prevented from using its 'conditions power' in the authorisation process to replace proposed rule changes with fresh ones that it prefers.[27]

Remedies

The ACCC has proposed significant increases in the maximum pecuniary penalties for breach of the Act's competition provisions.[28] It has also proposed that:

- it become a criminal offence for a 'large corporation' to engage in 'hard core' cartel behaviour (such as price fixing, bid rigging and market sharing), and
- individual executives and employees of large corporations be liable to incarceration for up to seven years if directly involved in such conduct.

Enertrade objects to these proposals because it believes existing remedies for breach of the Act's competition provisions are sufficient to deter unlawful conduct. Current maximum pecuniary penalties for each anti-competitive offence are $10 million for corporations and $500,000 for individuals. Where there are multiple offences, penalties will be aggregated, so aggregate penalties might far exceed the stipulated maximums. Few corporations or individuals would take lightly the prospect of such penalties.

Further, the ACCC has not shown that existing penalties fail to secure compliance. There is certainly no evidence that courts feel frustrated by the inadequacy of the existing maximum penalties. In fact, maximum penalties for breach of the Act's competition provisions have not yet been awarded.

The only necessary amendment to the penalty provisions is one permitting courts to consider an offender's ability to pay. As observed in the recent *ABB Transmission* case,[29] it would be incongruous if a penalty imposed for an offence was to have an anti-competitive effect by precluding the offender from trading in the relevant market.

Jail sentences

Imprisonment is an unacceptably draconian measure to visit upon individuals for breaching what is essentially an economic law (the application of which is not always clear, even to economists). The ACCC's proposal for selective imprisonment, applicable only to the executives and employees of 'large corporations', is also discriminatory. It is unfair to imprison employees of 'large corporations' but not employees of small corporations for contravention, particularly as a 'large corporation' might be nearly identical in structure to a small corporation.[30] It is also inequitable to criminalise conduct of a large corporation but not the identical conduct of a small corporation. In addition, the definition of "hard core" offences, while it may offer a politically appealing sound bite, is virtually impossible to delineate as compared with non "hard core" offences. To suggest

---

[27] Enertrade, "Submission in Response to Energy Market Review Issues Paper", *Council of Australian Government's review of the National Electricity Market* at 2.

[28] It has suggested that the maximum penalty for breach should be up to three times the value of any commercial gain made from the breach, or, if that amount cannot be estimated, 10% of the corporation's Australian turnover.

[29] Finkelstein J in *Australian Competition and Consumer Commission v ABB Transmission and Distribution Ltd* (2001) ATPR ¶41-815

[30] Under the ACCC proposal, a 'large corporation' will be one that fulfils two of the following criteria: has an annual turnover exceeding $100 million a year; has a gross asset value exceeding $30 million; has 1000 or more employees. Accordingly, a firm of only 30 staff could be classified as a 'large corporation', because it might have an annual turnover exceeding $100 million a year and gross assets exceeding $30 million

such a vague standard in the context of criminal sanctions suggests political positioning rather than reasoned suggestions.

In any case, trade practices compliance could be enhanced without imposing jail terms. For example, it could be improved by increasing corporate education about the Act's effects. It might therefore be more productive to extend the ACCC's information dissemination powers[31] than to allow it to seek imprisonment for offenders.

Section 155 notices and legal professional privilege

Section 155 of the Act gives the ACCC the power to enter premises, copy documents or compel the provision of oral information if it has reason to believe the persons issued with the notice have evidence relating to a possible contravention of the Act. A person issued with a notice under section 155 used to be able to refuse to supply documents containing communications about possible breaches with its lawyers by invoking the common law doctrine of legal professional privilege. This doctrine protects communications between a client and its legal advisers, enabling the client to seek and receive advice and give instructions without the fear that the communication will subsequently be used in evidence.

However, since the *Daniels* decision[32] last year, recipients of section 155 notices have not been able to claim the privilege. They have instead been forced to disclose the ACCC all legal communications regarding possible trade practices infringements.

This position should be reversed by a statutory amendment permitting corporations to claim the privilege. If corporations can claim the privilege, they are far more likely to record and report possible trade practices breaches to senior managers and legal advisers. Such reporting should be encouraged because it is an essential part of any effective compliance program. Removing the privilege will only force compliance reporting underground, thereby generally undermining compliance with the Act.

---

[31] under section 28

[32] *ACCC v The Daniels Corporation International Pty Ltd* (2001) ATPR ¶41-808. This decision is currently on appeal to the High Court.