

# National Competition Policy

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# NATIONAL COMPETITION POLICY REVIEW

Chairman: Prof Frederick G Hilmer  
Members: Mr Mark Rayner  
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Secretary: Mr Warrick Smith

25 August 1993

## Heads of Australian Governments

In October 1992 the Prime Minister asked us to undertake an independent Inquiry into a national competition policy, following the agreement by Australian Governments on the need for such a policy.

We take pleasure in presenting our report. It reflects written submissions from nearly 150 organisations and individuals from around Australia as well as consultations with senior representatives of all Australian Governments and many industry, professional, trade union, consumer and other organisations.

The Inquiry found strong and widespread community support for implementing an effective national competition policy. There is a significant awareness of the opportunities such a policy offers Australia to improve our international competitiveness and hence living standards.

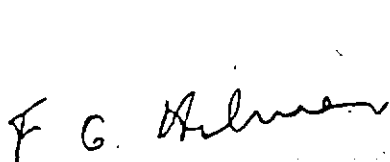
Governments, both individually and together, have made important progress along the path of making Australia a more competitive economy. The Committee sought to build on the lessons learned in cooperative economic reform in areas such as mutual recognition, electricity and rail. But we have taken a bolder stance because of the urgency of the reform task and the belief that precedents should be considered as steps forward, rather than as desirable models in and of themselves.

Australia is increasingly a single integrated market, and this should be reflected in our competition policy, as it is in other important areas of economic and commercial policy. We consider that our proposals are a logical and necessary progression from the national reforms recently implemented in other areas, and that governments should give them early attention in the national interest.

Our report proposes that a national competition policy comprise a combination of laws, principles and processes, as well as two key institutions. Implementation of our proposals would involve a substantial role for all Australian Governments, working together to achieve common national objectives.

We commend our report for your consideration.

Yours sincerely



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(Chairman)



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(Member)



Geoffrey Q Taperell  
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The Hon J Kennett, MP  
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The Hon R Follett, MLA  
Chief Minister of the  
Australian Capital Territory

The Hon W Goss, MLA  
Premier of Queensland

The Hon M B Perron, MLA  
Chief Minister of the  
Northern Territory

The Hon R F Court, MLA  
Premier of Western Australia

# Preface

This Report recommends implementation of a national competition policy for Australia. The Committee of Inquiry was established in October 1992 by the Prime Minister following agreement by all Australian governments on the need for a national policy and its basic principles. It is recognised that Australia, for all practical purposes, is now a single integrated market, increasingly exposed to domestic and international competition. A national competition policy aims to promote and maintain competitive forces to increase efficiency and community welfare, while recognising other social goals.

Competition policy is a broad topic comprising rules governing the conduct of firms such as those in Part IV of the Trade Practices Act, and a wide range of legislation, policy and government action. Competition policy affects sectors of the economy in different ways, depending upon the nature and level of competition existing in each sector. To deal with this complexity, the Committee concentrated on developing a framework of principles, processes and institutional structures which would be sufficiently flexible to deal with the scope of the subject and different sectors of the economy. The Committee has not sought to develop detailed policy prescriptions for each sector of the economy, believing that this is an inappropriate approach for developing a national policy.

The Committee is confident that implementation of its proposals provides an opportunity to consolidate the many reforms already undertaken by governments over the last decade, and to advance and accelerate this process. While most areas of the economy will be affected, there will be greatest impact on sectors previously sheltered from competition such as major infrastructure industries and some areas of agricultural marketing and the professions.

The report has been organised for two kinds of readers. Those wishing a full discussion of the background and recommendations are urged to read the entire Report. Those readers wishing to cover only the central features of the Committee's findings and proposals will probably find that the Executive Overview and Chapters 1, 2, 8, 14 and 15 will suffice. These Chapters provide overviews of the

substantive issues addressed in the Report and the proposed implementation arrangements.

The Committee would like to thank the many individuals and organisations who have made submissions to the Inquiry, and those who have met with the Committee and Secretariat to assist our understanding of the many issues we have considered.

The Committee would also like to thank the Secretariat for the high quality of its assistance and support throughout the Inquiry and in the preparation of this Report. This group was led by Warrick Smith, and included Roger Brake, Daryl Quinlivan, Michael Warlters and Kirsten Embery. Kerrie Ebner, Bim Engler and Orginia Charteris provided administrative support. Eugene Goyne, Jane Lye and Andrew McPadden also assisted the group during the course of the Inquiry.

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# Executive Overview

Australia is facing major challenges in reforming its economy to enhance national living standards and opportunities. There is the challenge of improving productivity, not only in producing more with less and deploying scarce assets wisely, but also in becoming better at making and exploiting new discoveries, whether in technology, resources, fashion or ideas. A possibly more difficult challenge is to develop in a way that creates new jobs and growth rather than see the economy shrinking to an efficient but diminishing core of activity.

Coping with these challenges is an enormous task for any country, and Australia is not alone in finding the process of reform testing and early benefits elusive, particularly when world economic growth is negligible. However, Australia faces an additional complexity in tackling these challenges, as most reforms require action by up to nine governments. This is particularly true in competition policy, an area central to micro-economic reform which aims at improvements at the front line of the economy.

## A. TOWARDS A NATIONAL COMPETITION POLICY

As the Prime Minister has observed, "the engine which drives efficiency is free and open competition".<sup>1</sup> Competition is also a positive force that assists economic growth and job creation. It has triggered initiative and discovery in fields ranging from the invention of the telephone to the opening of new retail stores and small manufacturing operations. In fact, it is these developments in smaller firms, prompted by the belief of these firms in their ability to compete, that are the main source of both new jobs and value-added exports.<sup>2</sup>

The benefits of fostering more competitive markets are being increasingly recognised by governments around Australia, and indeed around the world. Within Australia, all levels of government have made important reforms to enhance competition. Trade barriers

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<sup>1</sup> The Hon PJ Keating MP, *One Nation* (Statement by the Prime Minister, 26 Feb 1992) at 15.

<sup>2</sup> See Australian Manufacturing Council, *The Challenge of Leadership: Australia's High Value-Added Manufacturing Exporters* (1993).

have been lowered to increase international competition, and restrictions on competition within Australia have been relaxed in sectors as diverse as telecommunications, aviation, egg marketing and conveyancing. Consumers are already obtaining substantial benefits through these reforms, and businesses which rely on these inputs are better placed to compete successfully in international markets. Reforms of these kinds also foster innovation and make the economy more flexible, improving its capacity to respond to external shocks and changing market opportunities.

## **Competition Policy**

Competition policy is not about the pursuit of competition *per se*. Rather, it seeks to facilitate effective competition to promote efficiency and economic growth while accommodating situations where competition does not achieve efficiency or conflicts with other social objectives. These accommodations are reflected in the content and breadth of application of pro-competitive policies, as well as the sanctioning of anti-competitive arrangements on public benefit grounds.

Australian competition policy is sometimes seen as solely comprising the provisions of Part IV of the Commonwealth *Trade Practices Act 1974* (TPA). While laws of that kind are an important part of competition policy, the relevant field of policy interest is much wider. In its broadest sense, competition policy encompasses all policy dealing with the extent and nature of competition in the economy.<sup>3</sup> It permeates a large body of legislation and government action that influences permissible competitive behaviour by firms, the capacity of firms to contest particular economic activities and differences in regulatory regimes faced by different firms competing in the one market.

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<sup>3</sup> Policy governing the the extent of competition from international sources — an important part of trade policy — is treated as distinct from competition policy, notwithstanding its similar effects in terms of competition in the domestic market. Policy governing the protection of consumers as a group (such as provisions like Part V of the *Trade Practices Act 1974*) is also treated as distinct from competition policy, notwithstanding that both policies benefit consumers and some consumer protection provisions improve the efficiency of markets. The Committee's understanding of competition policy is consistent with the emphasis of its terms of reference and the overwhelming majority of submissions received by the Inquiry.



The Committee has considered competition policy in terms of six specific elements, each of which is supported by laws, policy and/or government action as illustrated in Box 1.

<b>Box 1: Elements of Competition Policy</b>	
<b>Policy Element</b>	<b>Example</b>
1. Limiting anti-competitive conduct of firms	Competitive conduct rules of Part IV of the Trade Practices Act
2. Reforming regulation which unjustifiably restricts competition	Deregulation of domestic aviation, egg marketing and telecommunications
3. Reforming the structure of public monopolies to facilitate competition	Proposed restructuring of energy utilities in several States
4. Providing third-party access to certain facilities that are essential for competition	Access arrangements for the telecommunications network
5. Restraining monopoly pricing behaviour	Prices surveillance by Prices Surveillance Authority
6. Fostering "competitive neutrality" between government & private businesses when they compete	Requirements for government businesses to make tax-equivalent payments

### **The Need for a National Competition Policy**

The imperative for developing a national competition policy rests on three main factors.

First, there is increasing acknowledgment that Australia is for all practical purposes a single integrated market. The economic significance of State and Territory boundaries is diminishing rapidly as advances in transport and communications permit even the smallest firms to trade around the nation. The increasing national orientation of commercial life has been recognised by a series of significant cooperative ventures by Australian Governments. The 1990s have already seen national progress on reforms including the National Rail Corporation, road transport regulation, the

Corporations Law, the mutual recognition of product standards and occupational licensing, and the regulation of non-bank financial institutions. There are also moves towards greater interstate trade in electricity and gas. Business and the community generally are impatient for much more rapid progress by governments in reforming our infrastructure and regulatory systems.

Second, while trade policy reforms have markedly increased the competitiveness of the internationally traded sector, many goods and services provided by public utilities, professions and some areas of agriculture are sheltered from international and indeed domestic competition. In this regard, recent micro-economic reforms have highlighted that an important part of Australian competition policy — the Trade Practices Act — remains limited in its application to these sectors, with coverage depending on ownership or corporate form rather than considerations of community welfare.

Third, the domestic pro-competitive reforms implemented to date have all been progressed on a sector-by-sector basis, without the benefit of a broader policy framework or process. Reforms undertaken in this way are typically more difficult to achieve, with the ground rules — including the respective roles of Commonwealth, State and Territory Governments — having to be negotiated on a case-by-case basis. A national competition policy presents opportunities to progress reform more broadly, to promote nationally consistent approaches and to avoid the costs of establishing diverse industry-specific and sub-national regulatory arrangements.

Considerations of these kinds led Commonwealth, State and Territory Governments to agree on the need to develop a national competition policy which would give effect to the principles set out below:

- (a) *No participant in the market should be able to engage in anti-competitive conduct against the public interest;*
- (b) *As far as possible, universal and uniformly applied rules of market conduct should apply to all market participants regardless of the form of business ownership;*

- (c) *Conduct with anti-competitive potential said to be in the public interest should be assessed by an appropriate transparent assessment process, with provision for review, to demonstrate the nature and incidence of the public costs and benefits claimed;*
- (d) *Any changes in the coverage or nature of competition policy should be consistent with, and support, the general thrust of reforms:*
  - (i) *to develop an open, integrated domestic market for goods and services by removing unnecessary barriers to trade and competition;*
  - (ii) *in recognition of the increasingly national operation of markets, to reduce complexity and administrative duplication.*

Agreement on these principles, and the support of all Australian Governments for the establishment of this Inquiry in October 1992, represents a significant step toward an effective national competition policy. Submissions to this Inquiry showed strong and widespread community support for implementing such a policy.

### **The Committee's Approach**

The Committee saw its task as proposing the most effective form, content and implementation approach for a national competition policy that will support an open, integrated domestic market for goods and services.

It approached this task at a broad policy level, looking for common themes and issues rather than developing detailed prescriptions for each individual sector of the economy. At the same time, the Committee considers that its proposals are flexible enough to address all of the main issues presented in submissions.

The Committee also sought to build on the lessons learned in cooperative economic reform in areas such as mutual recognition, electricity, rail and gas. But the Committee is taking a bolder stance because of the urgency of the reform task and the belief that precedents should be considered as steps towards more effective national reform rather than as desirable models in and of themselves.

## **The Inquiry Process**

The Committee took account of a wide spectrum of community views, with written submissions received from nearly 150 organisations and interests.<sup>4</sup> In October 1992 the Committee invited written submissions from interested persons and organisations through advertisements in the national and major regional newspapers. In February 1993 the Committee published an issues paper to elicit further comments on the issues under consideration. Submissions were received from major business, industry, professional and consumer organisations, trade unions, small and large businesses and private individuals, as well as Australian Governments.

The Committee met with Premiers, Chief Ministers, Ministers and senior officials of each State and Territory and senior representatives of several Commonwealth Departments and agencies. The Committee also consulted with a number of business, industry, professional and consumer organisations.

In accordance with its terms of reference, the Committee took account of overseas approaches where they were thought to offer lessons for Australia. Particular attention was given to other countries with federal systems of government and to the European Community. New Zealand approaches were of particular interest, not only because of its similar competition laws and the desirability of harmonising business laws in accordance with the Australia/New Zealand Closer Economic Relations Trade Agreement, but also because of New Zealand's recent experiences in pro-competitive reforms.

In its initial terms of reference the Inquiry was to have reported in May 1993. However, the Committee's reporting date was extended until August 1993 to permit further consultations, particularly with State and Territory governments.<sup>5</sup>

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<sup>4</sup> A list of submissions is set out in Annex B.

<sup>5</sup> The Hon P J Keating MP, Media Release, 24 May 1993 (62/93).

## B. KEY FINDINGS & RECOMMENDATIONS

The Committee has recommended a national competition policy covering each of the six main elements highlighted in Box 1. These elements, and the Committee's findings and recommendations, are dealt with in three parts.

- **Part I** deals with the generally applicable conduct rules, including the content of those rules, their sphere of application and aspects of the enforcement regime. It argues that a slightly modified version of the rules currently contained in Part IV of the Trade Practices Act should apply universally to all business activity in Australia.
- **Part II** outlines specific policy proposals and mechanisms for the five additional policy elements the Committee proposes should form part of a national competition policy. These include principles and processes governing the reform of regulatory restrictions on competition, the structural reform of public monopolies, and competitive neutrality between government and private businesses; a general access regime; and a more focussed prices oversight mechanism.
- **Part III** outlines issues associated with the implementation of the Committee's policy proposals, including institutional, legal, transitional and resource matters. Two new institutions are proposed: a National Competition Council, formed jointly by Australian Governments to assist in progressing cooperative reforms, and an Australian Competition Commission, which would administer the competitive conduct rules and some other aspects of the new policy.

### I. Competitive Conduct Rules

Every modern market economy has a set of rules designed to ensure that the competitive process is not undermined by the anti-competitive behaviour of firms, whether acting collusively or individually. Typically, these rules prohibit agreements or arrangements that increase the market power of firms and prohibit firms which individually possess substantial market power from using that power in an anti-competitive way. In Australia these rules are contained in Part IV of the Commonwealth *Trade Practices Act 1974*.

The Committee's work uncovered two major misconceptions about the TPA, which ultimately proved pivotal to its recommendations.

The first is the extent to which particular entities or activities are exempt from the Act. While the Committee found that many of the current exemptions from the Act are not justified on considered policy grounds, there are no general exemptions favouring government businesses, the professions or agricultural marketing authorities, and many of these groups are already subject to the Act to some degree or in some circumstances.

The second misconception relates to the impact of applying the Act to currently excluded sectors. Application of the TPA would have only limited impact on many sectors that are partially excluded from its reach. Important as it is in protecting competition, the Act only prohibits certain kinds of voluntary conduct that may restrict competition, and will generally have little or no impact on matters such as market structure or restrictions imposed by laws or other government policies. For this reason, the Committee recommends other means for addressing these competition issues, which respond to the main concerns raised in submissions. The Committee's proposals in these areas are outlined in Section B.

The Committee reviewed the provisions of the Act in some detail and for the most part found them to be operating satisfactorily, to be broadly consistent with overseas approaches, and to be appropriate for application to currently excluded sectors without substantial revision. The most pressing issue is to ensure that unjustified gaps in their application are filled in a way that promotes a nationally consistent legal framework for business activity.

#### Content of the Rules

The rules contained in Part IV of the Trade Practices Act are intended to protect the competitive process by prohibiting anti-competitive agreements, the misuse of market power, resale price maintenance and certain mergers or acquisitions. There is also a specific prohibition on anti-competitive price discrimination.

The Committee reviewed the current rules in light of submissions received, overseas approaches and any possible new issues that might

arise in applying the rules more broadly in the Australian economy. The Committee is mindful that unnecessary tinkering with the current rules could create uncertainty and delay extending the application of the rules, which is seen as the more pressing objective. Accordingly, the Committee has adopted a deliberate policy of limiting proposed changes to those areas where the current rules were found to be clearly deficient from the standpoint of a national competition policy. The Committee's main recommended changes to the current rules are:

- strengthening the prohibition on price fixing arrangements by removing the distinction between goods and services, which potentially allows agreements relating to services to be authorised, thus sending an unambiguous signal about the undesirability of collusive price-fixing;
- relaxing the prohibition on third line forcing by requiring that it substantially lessen competition, thus bringing it into line with the Act's treatment of other forms of exclusive dealing;
- permitting authorisation of resale price maintenance where it can be demonstrated to offer net public benefits;
- repealing the specific prohibition on price discrimination, with any anti-competitive conduct in this area addressed under the prohibition on the misuse of market power; and
- removing unjustified distinctions between goods and services in the Act.

### Exemptions from the General Conduct Rules

Gaps in coverage of market conduct rules can allow excluded firms to engage in anti-competitive conduct with impunity, impairing efficiency and equity. At the same time, there may be cases where application of the market conduct rules should be suspended or adjusted on public interest grounds, primarily where the benefits of the conduct in question are found to outweigh the anti-competitive detriments. The current Australian regime involves the interaction of up to seven often overlapping exemption mechanisms, many of which are unrelated to any question of public benefit and can fragment application of the rules according to State borders. The Committee

sees a need for substantial reform in this area, with fewer and more rigorous and transparent exemption processes.

The Committee concluded that the general conduct rules of a national competition policy should, in principle, apply to all business activity in Australia, with exemptions for any particular conduct only permitted when a clear public benefit has been demonstrated through an appropriate and transparent process. Indeed, this much has already been agreed by Australian Governments. The Committee's findings on each of the current exemption processes are summarised below.

- *Authorisation By An Independent Body*

The Committee concludes that the primary basis for permitting exemptions from the rules should be an authorisation process of the kind currently administered by the Trade Practices Commission. The proposed successor to that body — the Australian Competition Commission — should be directed to give primacy to economic efficiency considerations in determining questions of public benefit, and the new regime of user-pays fees should be reviewed.

- *Specific Exemptions Set Out In the TPA*

The Committee sees a continuing role for some specific exemptions in the Act itself. The current limited exemptions for *labour agreements, standards, restrictive covenants, export contracts and consumer boycotts* should be retained. The current exemption for certain *intellectual property* matters raises issues which warrant a separate review by appropriate experts. The current exemption for *overseas shipping* is considered a clear candidate for sweeping reform, although the Committee has not made comprehensive recommendations in light of a separate Inquiry on this matter.

- *Exemption By Regulations Under the TPA*

The current provision permitting exemption by regulation of certain conduct of *primary commodity marketing bodies, Commonwealth businesses and contracts or conduct engaged in pursuant to international agreements* is not currently in use. This provision should be replaced by a regulation power unlimited as to subject matter but strictly limited as to time. The primary role of such a



mechanism would be to provide urgent protection pending the consideration by Parliaments of alternative legislative proposals.

- *Exemption By State or Territory Statute or Regulations*

The significance of the current provision which permits State or Territory statutes or regulations to specifically authorise or approve conduct otherwise in breach of the Act (subject to a power for the Commonwealth to over-ride such exemptions) was found to be misunderstood in many quarters. Although there were suggestions that removal of this provision would of itself see a large range of anti-competitive regulations being over-ridden, particularly in agricultural marketing and professional regulation, this is not borne out by a close analysis of the State and Territory laws in question.

The overwhelming majority of laws examined by the Committee in areas such as these were found to achieve their anti-competitive effect in a way that did not involve conduct that would otherwise have contravened the Act, making the current exemption provision irrelevant to their future operation. Some of the subtleties in this area are illustrated in Box 2.

In the Committee's view, the current exemption mechanism in the Act permitting State and Territory Acts to specifically authorise conduct that would otherwise contravene the Act is inappropriate. It discourages the development of nationally-consistent rules and is not readily transparent. No future exemptions of this kind should be permitted, and all existing exemptions should be deemed to expire at the end of three years.

- *Exemption By Other Commonwealth Statutes or Regulations*

The current provision permitting other Commonwealth statutes and regulations to specifically authorise or approve conduct otherwise in breach of the Act was also subject to misunderstanding in some quarters. However, the significance of the Commonwealth provision differs from the State and Territory provisions in two respects.

**Box 2 : Government Regulation & the TPA**

The Trade Practices Act operates by prohibiting certain *conduct* by market participants, generally requiring a degree of collusion or anti-competitive purpose. It does not prohibit anti-competitive *outcomes* per se. Three situations in the price fixing area can be contrasted:

**(a) A group of competing firms enter an agreement to fix prices**

Prima facie, arrangements of this kind are prohibited by the TPA as a contract, arrangement or understanding between competitors with the effect of fixing, controlling or maintaining price.

**(b) The same firms engage in the same conduct as (a), but with a statute or regulation specifically authorising them to agree on prices**

Prima facie, there is still conduct prohibited by the Act, although the current Act permits Commonwealth, State and Territory Governments to effectively immunise such conduct.

**(c) Rather than authorising a private agreement between firms, a statute or regulation provides that the goods in question shall only be sold at a price declared by a Minister or a marketing board**

In this case, the same result (ie, a fixed price) is achieved without the need for firms to engage in conduct of the kind prohibited by the TPA. Statutes and regulations of this kind are unaffected by the TPA.

*Comment*

The different status of situations (b) and (c) is not merely one of legal form. In situation (c), a governmental authority is directly responsible for particular prices, and the extent of benefit afforded the firms in question will be apparent through the legislative or regulation-making process. Similarly, the firms in question have no choice but to comply with the regulation. In situation (b), in contrast, governments have essentially delegated responsibility to the firms in question, and the reasonableness or otherwise of their pricing conduct is not subject to the same degree of public scrutiny.

First, unlike State and Territory laws, this provision does not have the potential to impede national consistency. Second, a provision of this kind provides greater certainty as to the interaction of Commonwealth statutes — in the absence of such a provision there may be difficult questions of interpretation to determine whether a later Commonwealth Act had impliedly repealed part of the TPA to the extent of any inconsistency. This issue does not arise in relation to State and Territory laws, where the TPA would override even subsequent State and Territory laws.

The provision should be amended to improve the transparency of any specific exemptions: exemption under other laws should be limited to statutes, rather than regulations, and the exempting provision should be required to state specifically that its purpose is to authorise conduct for the purposes of the TPA.

- *Shield of the Crown Doctrine*

This doctrine provides that a statute will only be found to bind the Crown by express words or necessary implication. Since 1977 the Trade Practices Act has expressly bound the Crown in right of the *Commonwealth* in so far as it engages in business. This provision should be amended to remove any doubts as to the application of the Act to commercial transactions between Commonwealth businesses in competition with private firms.

The Act's silence on the question of whether it is intended to bind the Crown in right of the *States and Territories* led it to be interpreted as not binding these entities. Whether or not a particular State or Territory business is entitled to take advantage of the immunity is often a difficult question of statutory interpretation: certainly, there is no blanket exemption for all such businesses. The High Court has recently questioned the relevance of the doctrine to contemporary circumstances, and several submissions pointed to the uncertainties for government businesses in this area. This uncertainty should be removed by amending the TPA to ensure that the Act applies to State and Territory businesses to the same extent it applies to Commonwealth businesses.

- *Constitutional Limitations*

The final gap in application of the Act flows from the constitutional limitations on the Commonwealth Parliament. As currently drafted, a business may escape the operation of the Act by virtue of its non-corporate status unless it engages in interstate or overseas trade or commerce. Exemptions of this kind cannot be justified in policy terms and have no place in a national competition policy.

## Remedies and Enforcement

The Committee reviewed the current remedies under the TPA and considers that they are appropriate for the general conduct rules of a national competition policy. The Committee also reviewed broader issues associated with the enforcement of the Act. Opportunities to improve courts' capacity to deal with economic issues were considered and should be pursued further. At the same time, these are not considered to be of sufficient importance to warrant delay in implementation of a national policy.

## **II. Additional Policy Elements**

Rules of the kind contained in the TPA do not address the full range of issues associated with building a more competitive economy, particularly when impediments to that goal arise through other government regulation or government ownership.

While application of the Act has many benefits, more is required if effective competition is to be fostered in many sectors of the economy. Regulatory restrictions on competition may need to be removed or modified. The structure of public monopolies may need to be reformed. Competitors may need to be assured of access to certain facilities that cannot be duplicated economically. Concerns over monopoly pricing may require attention. And the special advantages enjoyed by some government businesses when competing with private firms may need to be addressed. An effective national competition policy requires measures to respond to each of these issues.

Policy measures addressing these issues have important implications for governments, as it is their laws and businesses that will be affected most directly. As well as concerns over the prerogatives of governments — always a sensitive matter in a federal system — there are concerns over the potential impact on profits from government monopolies, and on the delivery of certain non-commercial functions by government businesses.

The Committee was cognisant of these concerns and sensitivities in framing its recommendations, but has balanced these against the important national interests involved. Where possible, the Committee has focussed on cooperative approaches, based on principles and processes implemented by individual governments,

rather than proposing national laws. Where national laws are considered essential, the Committee recommends that the interests of the States and Territories be protected through various safeguards, the most important of which is the establishment of a **National Competition Council**. This body would be established jointly between the Commonwealth, State and Territory Governments, and would play a key role in each of the additional policy areas.

The Committee's recommendations in respect of each of the five additional policy elements are summarised below.

### Regulatory Restrictions on Competition

The greatest impediment to enhanced competition in many key sectors of the economy are the restrictions imposed through government regulation — whether in the form of statutes or subordinate legislation — or government ownership. Examples include legislated monopolies for public utilities, statutory marketing arrangements for many agricultural products and licensing arrangements for various occupations, businesses and professions.

Compliance by a business (private or public) with government regulation is not prohibited by the TPA, however anti-competitive the consequences. Nor is imposition of the regulation. Application of the Act will not be sufficient to overcome regulatory arrangements that establish monopolies, provide for the compulsory acquisition of crops, regulate prices, restrict the performance of certain activities to licensed occupations or a host of other regulatory restrictions on competition. Even if all exemptions from the Act were eliminated — including the potential for Commonwealth, State or Territory laws to authorise certain conduct<sup>6</sup> — these regulatory arrangements would be disturbed little if at all.

If Australia is to take competition and competition policy seriously, a new mechanism is required to ensure that regulatory restrictions on competition do not exceed what is justified in the public interest. The Committee recommends that all Australian governments adopt a set of principles aimed at ensuring that statutes or regulations do not restrict competition unless the restriction is justified in the public interest. This would involve:

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<sup>6</sup> See s.51(1) of the Act, discussed in Chapter 6 of the Report.

- acceptance of the principle that any restriction on competition must be clearly demonstrated to be in the public interest;
- new regulatory proposals being subject to increased scrutiny, with a requirement that any significant restrictions on competition lapse within a period of no more than 5 years unless re-enacted after further scrutiny through a public review process;
- existing regulations imposing a significant restriction on competition being subject to systematic review to determine if they conform with the first principle, and thereafter lapsing within no more than 5 years unless re-enacted after scrutiny through a further review process; and
- reviews of regulations taking an economy-wide perspective to the extent practicable.

While implementation of these principles is left largely to individual governments, the National Competition Council could be given references to undertake and/or coordinate nation-wide reviews in specified areas and to provide guidance on any transitional issues involved. The Council could also assist governments in developing more detailed principles covering individual sectors.

### Structural Reform of Public Monopolies

The removal of regulatory restrictions on competition may not be sufficient to foster effective competition in sectors currently dominated by public monopolies. Recent work by the OECD has highlighted the importance of creating competitive market and industry structures if effective competition is to emerge.<sup>7</sup> As governments have recognised through reforms in place or under consideration in a number of sectors, structural reform of existing public monopolies may be required. The TPA does not address concerns of this kind and an effective competition policy must include a mechanism that does so.

The Committee recommends that all Australian Governments adopt a set of principles aimed at ensuring that, as part of reforms to

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<sup>7</sup> OECD, *Regulatory Reform, Privatisation & Competition Policy*, (1992) at 43.

introduce competition to a market traditionally dominated by a public monopoly, the public monopoly be subject to appropriate restructuring. The principles deal with:

- the separation of regulatory and commercial functions of public monopolies;
- the separation of natural monopoly and potentially competitive activities; and
- the separation of potentially competitive activities into a number of smaller, independent business units.

While the implementation of these principles is left largely to individual governments, the National Competition Council could be given references to advise governments when required.

Structural reforms of these kinds are even more important if a substantial monopoly is to be privatised. While the Committee also favours cooperative approaches in this area, it recommends that a process be established to deal with the unlikely event that a government privatises a substantial monopoly without appropriate restructuring. The process would involve an inquiry by the National Competition Council that could be triggered by any government before a privatisation was effected or, if no sufficient notice of the intended privatisation had been given, within a reasonable time after the privatisation. The Council would report to Australian Governments recommending what action, if any, should be taken. In an extreme case, it may be appropriate for specific legislation to be passed, possibly by the Commonwealth Parliament, to prevent privatisation of the monopoly or to effect a divestiture of the privatised monopoly.

### Access to Essential Facilities

Introducing competition in some markets requires that competitors be assured of access to certain facilities that cannot be duplicated economically — referred to as "essential facilities". Effective competition in electricity generation and rail services, for example, will require firms to have access to the electricity transmission grid and rail tracks.

While the misuse of market power provision of the Act can sometimes apply in these situations, submissions to this Inquiry confirmed the Committee's own assessment that something more is required to meet the needs of an effective competition policy.

The Committee recommends that a new legal regime be established under which firms could in certain circumstances be given a right of access to specified "essential facilities" on fair and reasonable terms. The regime would operate by specific declaration applying to designated facilities under a general law, provide safeguards to the owner of the facility and to users, and have the flexibility to deal with access issues across industry sectors and facilities. Key features of the proposed regime include:

- the regime could only be applied to a facility without the owner's consent if declaration was recommended by the National Competition Council after a public inquiry;
- the access declaration would specify pricing principles for the individual facility; thereafter, actual access prices would be determined through negotiation between the parties and, if need be, through binding arbitration;
- the access declaration would specify any other terms and conditions relating to access designed to protect the legitimate interests of the owner of the facility; and
- all access agreements would be required to be placed on a public register; if additional safeguards were considered necessary to protect the competitive process they could be specified as part of the declaration process.

The National Competition Council would play a central role in advising on whether access rights should be created and, if so, on what terms and conditions. The regime would only be applied to the limited category of cases where access to the facility was essential to permit effective competition and the declaration was in the public interest having regard to the significance of the industry to the national economy and the expected impact of effective competition in that industry on national competitiveness. An access right under the proposed regime could not be created without the recommendation of the Council, although the designated Minister would have the



discretion to decline to declare access notwithstanding the recommendation of the Council.

### Monopoly Pricing

In markets characterised by workable competition, charging prices above long-run average full costs will not be possible over a sustained period, as above-commercial returns will attract new market participants or lead consumers to choose a rival supplier or substitute product. Where the conditions for effective competition are absent — such as where firms have a legislated or natural monopoly or the market is otherwise poorly contestable — firms may be able to charge prices above efficient levels for periods beyond a time when a competitive response might reasonably be expected. Such “monopoly pricing” is detrimental to consumers and to the community as a whole. The TPA does not address this issue, and the Prices Surveillance Act has a limited reach.

The Committee considers the primary response of competition policy in these markets should be to increase competitive pressures, including by removing regulatory restrictions, restructuring public monopolies and, if need be, providing third party access rights. Where measures of this kind are not practical or sufficient, some form of price-based response may be appropriate.

The Committee recommends that a national competition policy should include a carefully targeted prices monitoring and surveillance process to apply in such cases. The regime would operate by declaration of a designated Commonwealth Minister and include the following features:

- a firm could only be subject to the prices oversight mechanism without its consent if the National Competition Council has recommended declaration after a public inquiry into the competitive conditions in the market *and* it was found to have substantial market power in a substantial market in Australia;
- powers would be limited to prices oversight or monitoring — there would be no price control power;

- declarations would lapse automatically after a period of no more than three years unless renewed following a further public inquiry; and
- existing declarations should lapse within two years unless renewed through the new declaration process.

Pricing issues affecting State and Territory government businesses would be dealt with according to the following principles:

- governments should generally progress pricing reform of their businesses through cooperative processes aimed at improving transparency and fostering appropriate and consistent approaches: Governments might consider the establishment of expert pricing bodies like the NSW Government Pricing Tribunal;
- governments could agree, on a case-by-case basis, to subject their businesses with substantial market power to the national prices oversight mechanism; and
- application of the national prices oversight mechanism to State and Territory government businesses should generally be by consent; however, consent may be waived if a government has failed to progress effective pricing reform in an area with a significant impact on interstate or international trade.

### Competitive Neutrality

Moves to increase the efficiency of government businesses through commercialisation and the introduction of competition have raised a new set of issues for competition policy, particularly where those businesses continue to enjoy net advantages vis-a-vis private competitors. As competition of this kind is likely to increase over the next decade, there is a growing need to find some mechanism to deal with "competitive neutrality" concerns. While removal of any exemption from the TPA is part of this process, application of the Act will not of itself address all concerns over the cost advantages and pricing policies of some government businesses.

The Committee recommends that Commonwealth, State and Territory Governments adopt a set of principles aimed at ensuring government-owned businesses comply with certain competitive

neutrality requirements when competing with private firms. The principles distinguish between government businesses competing in their traditional markets which are now being exposed to competition, and competition in new markets. While the argument for neutralising any net competitive advantage is the same in both situations, a transitional period should be permitted in the first case but not the second.

The National Competition Council would be charged with assisting governments develop and refine principles in this area.

### **III. Implementation**

The implementation of a national competition policy raises questions of the most appropriate institutional arrangements, the relevant legal and transitional issues, and the resource implications of the Committee's recommendations.

#### **Institutional Arrangements**

The Committee's views on the appropriate institutional structure for implementing a national competition policy were shaped by the detail of its policy proposals, and by its judgments on two key issues.

The first is the role of industry-specific versus more general regulators in the competition policy area. The Committee began its task with a sceptical bias against the need to establish separate regulators for individual industries. Apart from the risk of "capture" by the regulated industry, approaches of this kind fragment the application of competition policy and raise issues of consistency as between industries. There are also forgone opportunities to develop and apply the insights gained in one industry to analogous issues in other industries, a fragmentation of regulatory and analytical skills, and typically greater administrative costs. Overall, the Committee is satisfied that all aspects of its proposed policy framework can be fully and effectively performed by an economy-wide body with access to appropriate expertise through use of consultants or through development of internal expertise.

The second and more difficult issue concerns the respective roles of the Commonwealth, State and Territory Governments. While the Committee supports the adoption of cooperative models, this view is

tempered by the need to provide streamlined decision-making processes where important national interests were at stake and the importance of ensuring competition regulators could operate independently. The Committee was also influenced by the extent to which particular elements of its proposed policies impinged upon the prerogatives of individual governments. The Committee was mindful that it seems likely that the Commonwealth could implement substantially all of the Committee's recommendations unilaterally.

Based on these considerations, the Committee distinguished between administrative and policy roles, and between the general conduct rules — which already apply to most of the the economy and will have negligible impact on the prerogatives of States and Territory Governments — and the additional policy elements, where the impact is potentially more significant.

As indicated above, the Committee recommends that a **National Competition Council** be established jointly by the Commonwealth, State and Territory Governments to play a key role in policy decisions relating to the additional policy elements. While the composition of the body would be settled by all governments, the objective is to provide a high level and independent analytical and advisory body in which all governments would have confidence. As well as participating in its formation and agreeing on its composition, all Governments could give references to the body — either individually or collectively — on regulation review, structural reform of public monopolies, access regimes, monopoly pricing, and competitive neutrality.

Where it is proposed that a Commonwealth Minister could act unilaterally in certain circumstances — such as in relation to access regimes and, in even more limited cases, the application of the national prices oversight mechanism — a recommendation of the Council would be a necessary pre-condition to that action. The Council would also have a specific mandate to report on transitional issues associated with its recommendations.

The Council would comprise a full-time chairperson and perhaps up to four other members, some of whom might be part-time. While the Council would have its own Secretariat of perhaps 20 persons, in many cases it would be appropriate for it to contract out analytical work to other bodies, such as the Industry Commission, the Australian

Bureau of Agricultural and Resource Economics (ABARE) or State or private bodies. The Council could also draw on consultants or relevant experts from member governments on secondment. For example, the Industry Commission may be an appropriate source of analysis on structural reform issues, while a body such as ABARE may have a comparative advantage in analysing the impact of regulatory restrictions in the agricultural marketing area. Accordingly, while the body would be economy-wide in focus, there would be ample opportunity for it to draw on industry-specific expertise without duplicating the resources of other specialist bodies.

An **Australian Competition Commission** should be established to administer relevant aspects of the proposed competition policy. These include enforcement of the general conduct rules; administration of the authorisation process under those rules; oversight of declarations under the access regime and administration of any associated pro-competitive safeguards; and administration of the prices oversight mechanism. The body could also play a complementary role with respect to regulation review, with its work program in this area settled in consultation with the National Competition Council. There are also support roles in reporting to governments on alleged instances of non-compliance with agreed competitive neutrality principles; reporting on legislated exemptions from the Act; and promoting public education on competition matters, as well as any other functions specified under the Act.

The body would be formed from the existing Trade Practices Commission and Prices Surveillance Authority.

The Trade Practices Tribunal, which might be re-named the **Australian Competition Tribunal**, would continue to provide an appellate jurisdiction for authorisations under the competitive conduct rules.

### Legal Issues

Although the Committee understands that the Commonwealth could implement most of its recommendations through greater use of its existing heads of constitutional power, it favours a cooperative approach to extending the coverage of the general conduct rules in the interests of comity, simplicity of legal drafting and certainty. A referral of powers from the States is the preferred implementation

model, although an application model is not ruled out. The Committee considers that unilateral Commonwealth legislation would be preferable to mirror legislation and any unreasonable delay in progressing cooperative reform.

### Timetable for Implementation & Transitional Arrangements

Immediate implementation is recommended with respect to:

- Establishment of new institutional arrangements;
- Agreement on principles governing regulatory restrictions, structural reform of public monopolies and competitive neutrality;
- Enactment of amendments to Commonwealth legislation relating to:
  - content of conduct rules, other than price fixing;
  - modification of provision for regulatory exemptions under the Act;
  - imposition of more rigorous requirements for any new matters to be specifically authorised or approved under other Commonwealth laws; and
  - a prices oversight mechanism.

Application of the new arrangements should be delayed for specified periods with respect to:

- Extension of general conduct rules to areas excluded through constitutional limitations or the shield of the crown doctrine : 2 years;
- Extension of general conduct rules to areas specifically authorised or approved by Commonwealth regulations or State and Territory laws and regulations : 3 years; and
- Removal of administrative authorisation for price-fixing : within 4 years.

Implementation should be determined on a case-by-case basis with respect to:

- Reviews of particular regulatory restrictions on competition;
- Examination of particular structural reform proposals;
- Application of access regime to particular facilities; and
- Application of national prices oversight mechanism to newly declared firms.

### Resource Issues

The resource requirements arising from the Committee's proposals would appear to be modest, and relate mainly to the creation and maintenance of the National Competition Council.

The Australian Competition Commission would progressively assume a slightly larger jurisdiction, as well as some new functions. However, the resource implications will depend on a variety of factors and will be expected to evolve over time.

## **C. CONCLUSION**

The Committee has been impressed with the level of support for a national competition policy from governments and the business and wider community. There is widespread recognition of the critical role effective competition can play in the transformation of the Australian economy necessary to meet our current and future challenges.

The Committee has observed frustration at the pace of reform and its uneven incidence, and considers that early implementation of the Committee's proposals would assist in addressing these concerns.

Finally, full implementation of this report will require a level of cooperation between the Commonwealth, States and Territories which has only rarely been achieved in the past. The Committee, and most of the groups with which it consulted during this Inquiry, would encourage governments to see these recommendations in a positive light and reach early agreement on their implementation. Failure to do so will forgo urgently needed benefits for the Australian economy and community.





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# 1. Towards a National Competition Policy

If Australia is to prosper as a nation, and maintain and improve living standards and opportunities for its people, it has no choice but to improve the productivity and international competitiveness of its firms and institutions. Australian organisations, irrespective of their size, location or ownership, must become more efficient, more innovative and more flexible.

Over the last decade or so, there has been a growing recognition, not only in Australia but around the world, of the role that competition plays in meeting these challenges. Competition provides the spur for businesses to improve their performance, develop new products and respond to changing circumstances. Competition offers the promise of lower prices and improved choice for consumers and greater efficiency, higher economic growth and increased employment opportunities for the economy as a whole.

For much of this century, competition policy was seen as limited to laws dealing with the anti-competitive conduct of firms. Particularly over the last decade, however, competition policy has been understood in a wider sense, embracing a range of laws and policy actions that influence the role of competition in the economy. Recent examples of pro-competitive reforms of these kinds range from the the introduction of competition into telecommunications to the deregulation of egg marketing.

Competition policy has been increasingly recognised as a key element of national economic policy. The national significance of competition policy was recognised by the establishment of this Inquiry<sup>1</sup> in October 1992 by the Prime Minister in consultation with the Premiers and Chief Ministers of the States and Territories. Drawing upon written submissions from nearly 150 organisations and interests, and discussions with all Australian Governments and a broad range of individuals and representative groups, this report presents the Inquiry's proposals for a national competition policy for Australia.

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<sup>1</sup> The Inquiry's terms of reference are set out at Annex A.

This Chapter provides a general introduction to the Committee's report.

**Section A** reviews the concept of competition and its relationship to community welfare and considers the bounds of competition policy.

**Section B** provides an outline of the evolution of national competition policy in Australia, including the new pressures for developing a more comprehensive competition policy framework that is truly national in application.

**Section C** discusses the approach adopted by this Inquiry.

**Section D** provides an outline of the Committee's report.

## **A. COMPETITION & COMPETITION POLICY**

As a basis for developing its views on competition policy, the Committee has considered the concept of competition and its relationship to community welfare, and examined the wide range of policies relevant to competition.

### **1. Competition & Community Welfare**

Competition may be defined as the "striving or potential striving of two or more persons or organisations against one another for the same or related objects".<sup>2</sup> Some aspects of this definition have been found to be particularly important by recent economic research:

- **Striving or potential striving:** It was once thought that markets would be efficient only when a number of firms were actually competing. Recent work suggests that the real likelihood of competition occurring (potential striving) can have a similar effect on the performance of a firm as actual striving.<sup>3</sup> Thus, a market which is highly open to potential rivals — known as a

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<sup>2</sup> Dennis F G, *'Competition' in the History of Economic Thought* (1977).

<sup>3</sup> See Baumol W, "Contestable Markets: An Uprising in the Theory of Industry Structure", *American Economic Review* (March 1982), 72, 1-15; and Gilbert R J, "The Role of Potential Competition in Industrial Organisation", *Journal of Economic Perspectives* (Summer 1989) 107-127.

highly "contestable" market — may be of similar efficiency as a market with actual head-to-head competition.

- **Two or more persons or entities:** Early economic work suggested that large numbers of competitors were important for the effective working of competitive forces. However, in some cases competition between a few large firms may provide more economic benefit than competition between a large number of small firms. This may occur due to economies of scale and scope, not only in production but also in marketing, technology and, increasingly, in management.
- **Against one another:** While the simplest notion of competition sees firms providing identical products or services and competing largely on price, work in business strategy suggests that this is the exception rather than the rule. In practice, competition occurs through firms seeking to provide different mixes of benefits to consumers, some of which are already reflected in price and others of which are reflected in other elements of value to the customer such as service, quality or timeliness of delivery.<sup>4</sup>
- **Related objects:** Competition need not be between identical products or services. Economics has long recognised competition between substitutes. It is the striving to meet the same consumer need that is the essence of competition and this is reflected in the ways in which this is met by different market participants.

The relationship between competition and community welfare can be considered in terms of the impact of competition on economic efficiency and on other social goals.

(a) Economic Efficiency

Efficiency is a fundamental objective of competition policy because of the role it plays in enhancing community welfare. There are three components of economic efficiency:<sup>5</sup>

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<sup>4</sup> Hilmer F G, *Coming to Grips with Competitiveness and Productivity* (1991).

<sup>5</sup> See Treasury (Sub 76), published separately as: *Treasury Submission to the National Competition Policy Review* (1993) at 3-5.

- **Technical or productive efficiency**, which is achieved where individual firms produce the goods and services that they offer to consumers at *least cost*. Competition can enhance technical efficiency by, for example, stimulating improvements in managerial performance, work practices, and the use of material inputs.
- **Allocative efficiency** is achieved where resources used to produce a set of goods or services are allocated to their highest valued uses (ie, those that provide the greatest benefit relative to costs). Competition tends to increase allocative efficiency, because firms that can use particular resources more productively can afford to bid those resources away from firms that cannot achieve the same level of returns.
- **Dynamic efficiency** reflects the need for industries to make timely changes to technology and products in response to changes in consumer tastes and in productive opportunities. Competition in markets for goods and services provides incentives to undertake research and development, effect innovation in product design, reform management structures and strategies and create new products and production processes.

Economic efficiency plays a vital role in enhancing community welfare because it increases the productive base of the economy, providing higher returns to producers in aggregate, and higher real wages. Economic efficiency also helps ensure that consumers are offered, over time, new and better products and existing products at lower cost. Because it spurs innovation and invention, competition helps create new jobs and new industries. The impact of increased competition on efficiency is illustrated by the recent entry of Optus into the Australian telecommunications market, which has already resulted in consumers being provided with a wider choice of services at lower cost.

Increased economic efficiency also means that firms are better able to adjust to changes, including unforeseen changes. This makes the economy more resilient and robust, and better able to adjust to changes in global economic conditions.

The promotion of effective competition and the protection of the competitive process are generally consistent with maximising

economic efficiency. However, there are some situations where unfettered competition is not consistent with economic efficiency. Examples of such "market failure" include situations where participants in a market have imperfect information about products, producers or suppliers, and the existence of so-called "natural monopolies" where a single firm can supply an entire market significantly more efficiently than two or more firms.

(b) Other Social Goals

The promotion of competition will often be consistent with a range of other social goals, including the empowerment of consumers.<sup>6</sup> However, there may be situations where competition, although consistent with efficiency objectives and in the interests of the community as a whole, is regarded as inconsistent with some other social objective. For example, governments may wish to confer special benefits on a particular group for equity or other reasons.

In some cases competition in a particular activity may be restricted to allow a public monopoly to pursue these wider objectives. Thus, for example, public monopolies in areas such as electricity, water and ports have often been directed to provide goods or services to particular groups at prices below the full costs of production, with the resulting deficits often funded through higher charges applied to other users. Arrangements of this kind would be difficult to sustain in a more competitive market.

Similarly, particular firms may seek exemption from rules governing competitive conduct to allow them to increase their returns relative to those that would be available in a more competitive market. Thus, for example, some agricultural producers have been permitted to collude to restrict output or fix prices at least in part to raise farm incomes or regional employment at the expense of consumers or other producers.

In a third situation, some suggest that rules governing competitive conduct should aim to protect competitors, rather than the competitive process, and should prevent larger firms from engaging in efficient competitive conduct where that would cause less efficient firms to become non-viable.

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<sup>6</sup> Federal Bureau of Consumer Affairs (Sub 136). There is some evidence that competition tends to promote equal treatment of workers according to race and sex, as competitive firms cannot "afford" to discriminate: see TPC (Sub 69).

In each of these cases, however, it is possible for governments to achieve objectives of these kinds in ways that are less injurious to competition and the welfare of the community as a whole.

## 2. Competition Policy

In its broadest sense, competition policy encompasses all policy dealing with the extent and nature of competition in the economy.<sup>7</sup> It permeates a large body of legislation and government actions that influence permissible competitive behaviour by firms, the capacity of firms to contest particular economic activities and differences in the regulatory regimes faced by firms competing in the one market.

Traditionally, rules prohibiting the anti-competitive behaviour of firms have been seen as the cornerstone of competition policy. In Australia, rules of this kind are contained in Part IV of the Commonwealth *Trade Practices Act 1974* (TPA), which prohibits certain anti-competitive agreements; misuse of market power; exclusive dealing; resale price maintenance; anti-competitive price discrimination; and certain mergers.<sup>8</sup>

But competition policy is much wider than these provisions of the TPA. Based on the submissions received by this Inquiry, the Committee has concluded that an effective competition policy for Australia should address all six of the concerns outlined in Box 1.1.

Competition policy is not about the pursuit of competition for its own sake. Rather, it seeks to facilitate effective competition in the interests of economic efficiency while accommodating situations where competition does not achieve economic efficiency or conflicts with other social objectives. These accommodations are reflected in the content and breadth of application of pro-competitive policies, as well as in the sanctioning of anti-competitive arrangements on public benefit grounds.

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<sup>7</sup> Policy governing the the extent of competition from international sources — an important part of trade policy — is treated as distinct from competition policy, notwithstanding its similar effects in terms of competition in the domestic market. Policy governing the protection of consumers as a group (such as provisions like Part V of the *Trade Practices Act 1974*) is also treated as distinct from competition policy, notwithstanding that both policies benefit consumers and some consumer protection provisions improve the efficiency of markets. The Committee's understanding of competition policy is consistent with the emphasis of its terms of reference and the overwhelming majority of submissions received by the Inquiry.

<sup>8</sup> The content of Part IV of the Act is reviewed in detail in Chapters Three and Four.

**Box 1.1 : Six Elements of a National Competition Policy**

Concern	Current Approaches
1. <b>Anti-Competitive Conduct of Firms</b>	• Competitive conduct rules in Part IV of the Trade Practices Act (Cth), but with numerous exemptions.
2. <b>Unjustified Regulatory Restrictions on Competition</b>	• Reviews by individual governments without a systematic, national focus.
3. <b>Inappropriate Structure of Public Monopolies.</b>	• Mostly examined on a case-by-case basis by individual governments; recent inter-governmental work on electricity and rail.
4. <b>Denial of Access To Certain Facilities That Are Essential For Effective Competition</b>	• Some arrangements in place or being developed on an industry-specific basis (eg telecommunications); no general mechanism capable of effectively dealing with these issues across the economy.
5. <b>Monopoly Pricing</b>	• Surveillance of declared firms' prices under Commonwealth Prices Surveillance Act with important exemptions; various mechanisms in the States and Territories.
6. <b>Competitive Neutrality When Government Businesses Compete With Private Firms</b>	• Largely addressed on an ad hoc basis by individual governments; increasing moves towards corporatisation but on disparate models.

A key policy tool in this regard is the notion that the costs and benefits of alternative policy options should be evaluated in an open and rigorous way. Transparency has been recognised as a key feature for permitting exemptions from the TPA, and is specifically endorsed in the principles forming part of this Inquiry's terms of reference.<sup>9</sup> The Committee has sought to extend this principle to its policy proposals wherever practical and relevant.

<sup>9</sup> See principle (c) of the agreed principles forming part of the Inquiry's terms of reference, which are set out in full at Annex A.

## B. THE EVOLUTION OF NATIONAL COMPETITION POLICY

The evolution of national competition policy in Australia can be traced back at least as far as 1906, when the first national law dealing with restrictive business practices was enacted. During much of this century competition policy was regarded as synonymous with such laws, and a recurring theme has been the difficulty of achieving uniform coverage of competition laws due to constitutional constraints on the Federal Parliament.

The notion of competition policy has expanded in more recent times, giving rise to the need for a more comprehensive and durable competition policy framework to meet the needs of an integrated national market.

### 1. The Development of Australian Competition Law

The first national law dealing with restrictive business practices was the Commonwealth *Australian Industries Preservation Act 1906*.<sup>10</sup> It was inspired by the United States' Sherman Antitrust Act of 1890, and prohibited "monopolization" and "combinations" which restrained trade or commerce, or destroyed or injured Australian industries by unfair competition. The effect of the Act was substantially limited by a restrictive interpretation of the Commonwealth's constitutional powers in 1910,<sup>11</sup> however, and it thereafter fell into general disuse.<sup>12</sup> The Commonwealth made unsuccessful attempts to overcome the limitations of constitutional interpretation through a series of referenda in the first half of the century.<sup>13</sup>

During the 1950s and 1960s, there was growing disquiet with the cartelisation and concentration of Australian industry. Royal Commissions appointed to enquire into restrictive business practices

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<sup>10</sup> Early State laws dealing with competition issues include the NSW *Monopolies Act 1923*; the Queensland *Profiteering Prevention Act 1948*; the Western Australian *Unfair Trading & Profit Control Act 1956*, which was replaced by the *Trade Associations Registration Act 1959*; and the Victorian *Collusive Practices Act 1965*.

<sup>11</sup> See *Huddart, Parker & Co Pty Ltd v Moorehead* (1910) 8 CLR 330.

<sup>12</sup> The Act was briefly revived with its first successful invocation in *Redfern v Dunlop Rubber Aust Ltd* (1964) 110 CLR 694, but by the time that decision was made the Commonwealth had announced its intention to enact new trade practices legislation.

<sup>13</sup> Referenda were held in 1913, 1919, 1929 and 1944. See Nieuwenhuysen J P, *Australian Trade Practices* (2 ed, 1976) at 300.



highlighted the extent of restrictive business practices.<sup>14</sup> In 1961, there were over 600 trade associations in Australia, of which an estimated 58-66% operated restrictive trade practices.<sup>15</sup>

In 1962, the Commonwealth Attorney-General proposed a Restrictive Trade Practices Act. In the ensuing debate the proposed legislation was emasculated at the behest of various business lobby groups,<sup>16</sup> but ultimately the first TPA was enacted in 1965. The Act was relatively weak, requiring registration of certain agreements, with the possibility of eventual disallowance of those agreements if contrary to the public interest.<sup>17</sup> There was no provision dealing with resale price maintenance until 1971.

In 1971, the High Court held the 1965 Act invalid on constitutional grounds but, significantly, the Court provided a new interpretation of the Commonwealth's constitutional powers which permitted a greater involvement by the Commonwealth in the regulation of business conduct.<sup>18</sup>

The Parliament enacted replacement legislation,<sup>19</sup> but the election of a new Government in 1972 saw a new approach to competition law, based on prohibition rather than administrative investigation of conduct and permitting authorisation of conduct in the public interest. The current TPA became law in 1974 and was amended in 1977 following the report of the Swanson Committee.<sup>20</sup>

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<sup>14</sup> Royal Commissions on Restrictive Trade Practices were conducted in Western Australia and Tasmania. See Walker G de Q, *Australian Monopoly Law* (1967) at 15.

<sup>15</sup> Hunter A, "Restrictive Practices & Monopolies in Australia" (1961) 37 *Economic Record* 25.

<sup>16</sup> See Pengilley W, "The Politics of Anti Trust and Big Business in Australia" (1973) 45 *Australian Quarterly* 53.

<sup>17</sup> Collusive tendering and bidding were prohibited, but a defence was available if the agreement was registered and not made for the purposes of a particular auction or tender — a general practice of collusive tendering was permissible.

<sup>18</sup> See *Strickland v Rocla Concrete Pipes & Ors* (1971) 124 CLR 468.

<sup>19</sup> The Restrictive Practices Act was enacted in 1971. A Restrictive Trade Practices Bill and a Monopolies Commission Bill were introduced into Parliament in 1972, but these Bills lapsed with the 1972 election.

<sup>20</sup> See Trade Practices Act Review Committee (Swanson Committee), *Report to the Minister for Business and Consumer Affairs* (1976). The principal amendments made in response to the Swanson recommendations were: replacement of provisions dealing with "restraint of trade" by a new test of "substantially lessening competition"; introduction of tougher provisions dealing with price fixing agreements; introduction of special provisions dealing with collective boycotts; the purposive element of s.46 (monopolisation — as it was then known) was made explicit; the exclusive dealing provisions were extended to cover restrictions imposed by buyers on sellers; the merger provision was amended to prohibit mergers which achieve or strengthen a position of

Prohibition of anti-competitive arrangements and judicial enforcement have remained the basic approach of competition law in Australia. Although there has been some ongoing re-examination and fine-tuning of the Act since, the basic form of the prohibitions has remained.

In 1986, the prohibition on misuse of market power was amended and the merger provisions were extended to certain overseas mergers.<sup>21</sup>

In 1992; following the reports of the Griffiths Committee<sup>22</sup> and the Cooney Committee,<sup>23</sup> the merger test was amended to prohibit mergers which substantially lessen competition and penalties for contraventions of the competition provisions were increased substantially.

Ongoing fine-tuning of the Act continues. In addition to this Inquiry, three other reviews are currently being conducted into various aspects of the Act:

- The Senate Standing Committee on Education, Employment and Training is enquiring into the operation of the secondary boycott provisions of the Act, and is to report in September 1993.
- An independent committee chaired by Mr Patrick Brazil, AO, is reviewing Part X of the Act, which governs international liner cargo shipping, and is to report by 31 October 1993.

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market control or dominance; the authorisation tests were simplified so that authorisation would be granted if, in all the circumstances, public benefits outweighed anti-competitive detriments.

<sup>21</sup> *Trade Practices Revision Act 1986.*

<sup>22</sup> See House of Representatives Standing Committee on Legal and Constitutional Affairs (the Griffiths Committee), *Mergers, Takeovers and Monopolies: Profiting from Competition?* (1989). The Committee's main recommendations were that the misuse of market power provision be maintained in its existing form; that the penalties be substantially increased; and that mergers be prohibited if they create or enhance market dominance.

<sup>23</sup> See Senate Standing Committee on Legal and Constitutional Affairs (the Cooney Committee), *Mergers, Monopolies & Acquisitions Adequacy of Existing Legislative Controls* (1991). The Committee agreed that the misuse of market power provision be maintained in its existing form and that penalties be substantially increased. In contrast to the Griffiths Committee, it considered that mergers should be prohibited if they substantially lessen competition.

- The Australian Law Reform Commission is enquiring into the remedies available under the Act, with particular emphasis on remedies available under the consumer protection provisions of Part V of the Act, and is to report by 30 June 1994.

## 2. Developments In Wider Competition Policy

Over the last decade, Australians have come to appreciate the necessity of building a flexible, dynamic and efficient economy, and of the important role competition can play in meeting these goals.

Trade policy reform since the early 1980s has substantially improved competition in the domestic economy. The average level of effective assistance to manufacturing was reduced from 25% to 15% of the value of manufacturing output between 1981-82 and 1991-92.<sup>24</sup> Reductions in import barriers exposed many industries to the rigours of international competition, providing increased incentives to improve product quality, costs and innovation. For example, abolition of import quotas and phased tariff reductions in the motor vehicle industry has seen the average level of faults per vehicle fall by 39% since 1988.<sup>25</sup>

While trade policy reforms have increased the exposure of the internationally traded goods sector to competition, many goods and services provided by government businesses, some areas of agriculture, the professions and other important sectors are sheltered from international competition. Increasing competition and efficiency in these sectors requires more sustained attention to domestic constraints on competition. Application of the TPA is not of itself sufficient to enhance competition when the restrictions flow from government regulations or public ownership.

**Government businesses** account for 10% of Australia's GDP,<sup>26</sup> with rail, electricity, gas and water utilities alone accounting for nearly 5% of GDP.<sup>27</sup> Improving the efficiency of these sectors remains a national priority.

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<sup>24</sup> INDECS, *State of Play 7, The Australian Economic Policy Debate* (1992).

<sup>25</sup> EPAC (Sub 126) at 15.

<sup>26</sup> EPAC, *Productivity Growth for Government Business Enterprises and the Private Sector*, 21 July 1993 (Media Release 8/93).

<sup>27</sup> See Industry Commission, *Rail Transport* (1991); *Energy Generation & Distribution* (1991); *Water Resources & Waste Water Disposal* (1992).

Reforms in these sectors have ranged from commercialisation and corporatisation<sup>28</sup> to privatisation. While there have been some encouraging improvements — with productivity growth of government businesses now outstripping that in the private sector<sup>29</sup> — progress is being made from a low base, and Australian public enterprise productivity levels remain well below international best practice. For important industries such as rail, electricity and telecommunications, most Australian enterprises are achieving only 75% or less of the productivity levels achieved elsewhere.<sup>30</sup>

There is growing acceptance that introducing or enhancing competition will provide a substantial spur to improved performance in many of these sectors. While many public utilities were traditionally considered to be “natural” monopolies, so that a single producer could supply the entire market at least cost, technological changes and other developments have shown that the area of genuine natural monopoly is relatively small and diminishing. For example, it is now clear that long-distance telecommunication services are not a natural monopoly, and the introduction of competition into this area has already seen prices fall sharply.<sup>31</sup> Efforts to facilitate competition in electricity generation are also being progressed.<sup>32</sup>

The agricultural sector accounts for some 4% of Australia’s GDP. While the export-oriented part of the sector is efficient, more domestically-focussed industries often rely on a range of anti-competitive arrangements to restrict competition and raise prices to

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28 “Commercialisation” usually refers to efforts to introduce commercial arrangements, including the application of user fees; it does not necessarily involve a change in the formal structure of the organisation (such as corporatisation). “Corporatisation” usually refers to the process of establishing a government business as a separate legal entity with more clearly specified objectives and usually a requirement to operate along private sector lines, including the payment of tax or tax-equivalent payments. The introduction of competition is not a necessary element of either reform, although the concepts can be subject to different interpretations in different jurisdictions.

29 EPAC, *Productivity Growth for Government Business Enterprises and the Private Sector*, 21 July 1993 (Media Release 8/93).

30 Forsyth P, *Public Enterprises: A Success Story of Microeconomic Reform?* (1993) at 32.

31 For example, STD peak rates on the Melbourne-Sydney route fell by over 20% between June 1992 (when Optus entered the market) and May 1993: AUSTEL advice based on published Telecom and Optus rates.

32 See NGMC, *National Grid Protocol* (First Issue - 1992).

consumers.<sup>33</sup> There have already been some significant reforms of statutory marketing arrangements at the Commonwealth and State levels.<sup>34</sup> For example, deregulation of egg production and marketing in NSW led average retail prices to fall by 38 cents per dozen, with savings to consumers of \$21 million in a full year.<sup>35</sup> Nevertheless, many rural products remain subject to restrictive production or marketing arrangements.

Competition in many **professional services and occupations** has also been enhanced by recent reforms. In the case of the legal profession, for example, restrictions on advertising have been relaxed and several jurisdictions have removed the monopoly over conveyancing services,<sup>36</sup> and remaining restrictions face increasing public scrutiny.<sup>37</sup>

The benefits of enhancing competition in the economy are by no means limited to these three sectors. However, recent and ongoing reforms in these sectors highlight the opportunities that may be realised by a careful scrutiny of anti-competitive arrangements and regulations across the economy.

### 3. The Need for a National Competition Policy

The case for developing a national competition policy rests on a number of related considerations.

First, the pro-competitive reforms advanced to date have largely been progressed on a sector-by-sector basis, without the benefit of a broader policy framework or process. Reforms undertaken in this way are typically more difficult to achieve, with the ground rules — including the respective roles of Commonwealth, State and Territory Governments — having to be negotiated on a case-by-case basis. A national policy presents opportunities to progress reforms across a

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<sup>33</sup> The IC estimated that in 1988-89 statutory marketing schemes effectively taxed users and consumers by some \$550 million: See Industry Commission, *Statutory Marketing Arrangements for Primary Products*, (1991).

<sup>34</sup> For an outline of recent Commonwealth and State reforms see submissions from the Queensland Govt (Sub 104), NSW Govt (Sub 117) and the DPIE (Sub 50).

<sup>35</sup> NSW Egg Corporation, *Annual Report, 1990-91*.

<sup>36</sup> See TPC, *The Legal Profession, Conveyancing & the Trade Practices Act* (1992) at Attachment B.

<sup>37</sup> See, for example, Law Reform Commission of Victoria, *Restrictions on Legal Practice*, (1992); NSW Attorney-General's Department, *The Structure & Regulation of the Legal Profession: Issues Paper* (1992); TPC, *Study of the Professions: Legal Profession* (1992).

broader front, promote nationally consistent approaches and reduce the costs of developing a plethora of industry-specific or sub-national regulatory arrangements. It also presents important opportunities to increase the pace of reform, which is a question of considerable interest to businesses and consumers.

There is also increasing acknowledgment of the reality that Australia is for most significant purposes a single national market. The economic significance of State and Territory boundaries are diminishing rapidly as advances in transport and communications permit even the smallest firms to trade around the nation. Goods increasingly flow across State borders; the volume of interstate road freight has more than doubled in the last decade.<sup>38</sup> The number of passengers travelling on domestic airlines — typically interstate — trebled between 1971 and 1992.<sup>39</sup> And advances in communications have also reduced the significance of distance considerably.

The increasing national orientation of commercial life has been recognised by a series of significant cooperative ventures by Australian Governments. The 1990s have already seen national progress on a range of matters including the National Rail Corporation, road transport regulation, non-bank financial institutions, the Corporations Law and the mutual recognition of product standards and occupational licensing. Developing a nationally consistent approach to competition policy issues presents opportunities to further integrate the national market, reduce complexity and possibly achieve savings through reduced duplication.

At present the nearest Australia comes to nationally consistent competition policy principles are the competitive conduct rules contained in Part IV of the TPA. In this regard, the progress that has been made is readily illustrated by a comparison of the manner in which business was conducted in the early 1960s with the manner in which most business is conducted today. As one commentator recently observed of the Act, "this one piece of legislation has wrought a revolution in the way commerce is carried out in Australia".<sup>40</sup>

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<sup>38</sup> ABS Interstate Freight Movements (various) Cat.No.9212.0.

<sup>39</sup> ABS Yearbook 1992 & Dept of Transport & Communications AVSTATS.

<sup>40</sup> Butler A, "The Quiet Revolution - Assessing the Impact of the Trade Practices Act" (1993) 7 *Commercial Law Quarterly* at 4.

But the most pressing deficiency in the Act is that it remains limited in its application, with coverage often depending on questions of ownership or corporate form rather than considerations of community welfare. While the Act applies to Commonwealth businesses, the exemption of some State- and Territory-owned businesses appears increasingly anomalous in light of commercialisation and similar reforms.<sup>41</sup> The continuing exemption of some agricultural marketing arrangements also affects efficiency, and runs counter to efforts to increase our export income through further processing of primary products in Australia. Similarly, the costs to consumers and the community generally of anti-competitive practices engaged in by professions such as lawyers has been receiving increasing attention.<sup>42</sup>

Inconsistent application of competitive conduct rules can allow exempted firms to engage in anti-competitive behaviour with effects reaching across State borders to the economy generally. For example, immunity in one State from, say, a merger rule could allow a business to acquire sufficient market power to deter competitive entry from firms located in neighbouring States. Similarly, allowing rural producers in one jurisdiction to engage in anti-competitive agreements can distort the operation of markets to the detriment of consumers and other producers wherever they may reside. Exemptions arising through constitutional limitations also harm consumers and firms within the same State; for example, intrastate unincorporated businesses can engage in price-fixing or other anti-competitive behaviour with impunity, to the detriment of consumers and other firms.

The absence of a consistent national approach to the other main areas of competition policy noted in Box 1.1 can also act as a source of inefficiency.

**Regulatory restrictions on competition imposed by State and Territory law can have important inter-state and national implications. Firms enjoying statutory protection from competition in**

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<sup>41</sup> This assessment is reflected in the findings of the NSW Regulation Review Unit, *Application of the Commonwealth Trade Practices Act to NSW State Government Instrumentalities* (1988); Law Reform Commission of Victoria, *Competition Law: The Introduction of Restrictive Trade Practices Legislation in Victoria* (1992); and an overwhelming number of submissions to this Inquiry.

<sup>42</sup> See *supra*, n.37.

one State can impose extra costs on consumers and businesses, including businesses that must contend with international competition, thus ultimately influencing the trading success of the nation as a whole.

The **structural reform of public monopolies** is also becoming a matter of inter-state and national interest, with the work of the National Grid Management Council on an inter-state electricity grid providing a recent example. Inter-governmental cooperation is required to allow open competition into the grid system. However, structural reform issues may remain important even once the market has been opened up to competition. For example, failure of an electricity utility in one State to undergo appropriate structural reform may allow that utility to cross-subsidise competition against utilities from other States, with consequent distortions in the emerging inter-state market.

Questions of **third-party access to facilities** which cannot economically be duplicated — such as major pipelines, electricity grids or rail tracks — are also increasingly raising issues at the inter-state and national level. Regulation of access arrangements to inter-state facilities at the State level would create administrative duplication and raise concerns over regulatory overlap.

Responses to **monopoly pricing issues** can also involve inter-State or national implications in some circumstances. Even where the pricing issues are predominantly within a single State, there may be advantage in developing nationally-consistent approaches to many issues, as well as in progressing pricing reforms in particular sectors in a coordinated way.

Government businesses sometimes enjoy special advantages when competing with private firms, giving rise to concerns over **competitive neutrality**. Inconsistent approaches to this issue between jurisdictions may distort inter-state markets, and may raise particular difficulties if government businesses from different jurisdictions engage in direct competition. This may be a feature of inter-state competition in electricity generation, for example.

Taken together, these considerations suggest significant benefits from developing nationally-consistent approaches to competition policy issues.



## C. THE COMMITTEE'S APPROACH

The need for a national competition policy has been agreed by all Australian Governments.<sup>43</sup> The Governments have further agreed that a national competition policy should give effect to the principles set out in Box 1.2.

### **Box 1.2 : Agreed Principles for a National Competition Policy**

- (a) No participant in the market should be able to engage in anti-competitive conduct against the public interest;
- (b) As far as possible, universal and uniformly applied rules of market conduct should apply to all market participants regardless of the form of business ownership;
- (c) Conduct with anti-competitive potential said to be in the public interest should be assessed by an appropriate transparent assessment process, with provision for review, to demonstrate the nature and incidence of the public costs and benefits claimed;
- (d) Any changes in the coverage or nature of competition policy should be consistent with, and support, the general thrust of reforms:
  - (i) to develop an open, integrated domestic market for goods and services by removing unnecessary barriers to trade and competition; and
  - (ii) in recognition of the increasingly national operation of markets, to reduce complexity and administrative duplication.

These principles comprise an important part of the terms of reference for this Inquiry.

The Committee approached its task at a broad policy level, looking for common themes and issues rather than seeking to develop detailed proposals for each sector of the economy. At the same time, the proposals are designed to have the flexibility to apply sensibly to all the main issues presented to the Committee.

The Committee sought to build on the lessons learned in cooperative economic reform in areas such as mutual recognition, electricity, rail and gas. But the Committee is taking a bolder stance because of the

<sup>43</sup> See Communiqué of Premiers & Chief Ministers' Meeting, Adelaide, 21-22 November 1991.

urgency of the reform task and a belief that precedents should be considered as steps towards more effective national reform rather than as desirable models in and of themselves.

The Committee's task raised three main challenges.

- *How should a national policy address cases where the benefits of competition are seen to be out-weighed by other factors?*

The Committee has not taken a blinkered or dogmatic view over the role of competition in society; in some cases competitive market outcomes will not meet the national interest, because they fail to deliver either efficiency or some other valued social objective. However, the Committee is satisfied that the general desirability of permitting competition was so well established that those who wish to restrict or inhibit competition should bear the burden of demonstrating why that is justified in the public interest. This principle is already reflected in the agreed principles dealing with anti-competitive market conduct, and the Committee proposes that it should apply equally to the actions of governments.

- *How should a national policy address the challenges of implementing micro-economic reform, recognising possible equity issues and that smaller and more concentrated groups often have powerful incentives to resist reforms that deliver substantial but sometimes more dispersed benefits to the wider community?*

The Committee responded to this issue by recommending processes that would increase the transparency of the costs of restricting competition; more closely aligning policy with the reality of the national market, giving more explicit priority to national interests; and placing particular emphasis on transitional measures where appropriate. In the case of extending the application of market conduct rules, where transitional impacts will be modest, currently exempt businesses will have time to adjust to new regulatory requirements. In the case of other reforms that may have more significant implications, the Committee's proposals include the establishment of an independent and expert body able to guide the transitional process.

- *How should the interests of nine governments be accommodated in a single national policy?*

The Committee approached this issue by supporting cooperative approaches between governments wherever these were considered capable of achieving the important national interests at stake. In some cases, principles are proposed that would be implemented by individual governments. In other cases, a single legal and administrative regime is seen as required, but cooperative processes for applying these regimes are given high priority. Importantly, the Committee also proposes participation of all Australian governments in the key policy-making institutional arrangements.

### **The Inquiry Process**

The Committee took account of a wide spectrum of community views, with written submissions received from nearly 150 organisations and interests.<sup>44</sup> In October 1992 the Committee invited written submissions from interested persons and organisations through advertisements in the national and major regional newspapers. In February 1993 the Committee published an issues paper to elicit further comments on the issues under consideration. Submissions were received from major business, industry, professional and consumer organisations, trade unions, small and large businesses and private individuals, as well as Australian Governments.

The Committee met with Premiers, Chief Ministers, Ministers and senior officials of each State and Territory and senior representatives of several Commonwealth Departments and agencies. The Committee also consulted with a number of business, industry, professional and consumer organisations.

In accordance with its terms of reference, the Committee took account of overseas approaches where they were thought to offer lessons for Australia. Particular attention was given to other countries with federal systems of government and to the European Community. New Zealand approaches were of particular interest, not only because of its similar competition laws and the desirability of harmonising business laws in accordance with the Australia/New Zealand Closer Economic Relations Trade Agreement, but also

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<sup>44</sup> A list of submissions is set out in Annex B.

because of New Zealand's recent experiences in pro-competitive reforms.

In its initial terms of reference the Inquiry was to have reported in May 1993. However, the Committee's reporting date was extended until August 1993 to permit further consultations, particularly with State and Territory governments.<sup>45</sup>

#### **D. STRUCTURE OF THIS REPORT**

This Report comprises 15 chapters organised into three parts.

Part I deals with the competitive conduct rules that should operate under a national competition policy. These rules are designed to prevent firms from undermining the competitive process through anti-competitive conduct. The current rules, contained in Part IV of the TPA, include prohibitions on anti-competitive conduct such as anti-competitive agreements; misuse of market power; resale price maintenance and mergers that substantially lessen competition. The Committee considers that, with some relatively minor amendments, these should form the basis of the competitive conduct rules of a national competition policy.

At present, there are numerous mechanisms for exemption from the Act, many of which cannot be justified on any public interest grounds. The Committee considers that the coverage of the conduct rules should be broadened significantly and that remaining exemptions should be based more clearly on public benefit grounds.

Part II covers the five additional policy elements the Committee recommends should form part of a national competition policy. The Committee has found that application of the general conduct rules will not address many important competition policy issues facing Australia, particularly where competition is impeded through government regulation or ownership. An effective national competition policy must:

- facilitate the modification of unjustified regulatory restrictions on competition;

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<sup>45</sup> The Hon P J Keating MP, Media Release, 24 May 1993 (62/93).

- facilitate the structural reform of public monopolies;
- enable firms to have assured access to certain "essential facilities" where such access is required to compete in markets;
- deal with "monopoly pricing" issues where measures to enhance competition are not practicable or sufficient; and
- address "competitive neutrality" issues arising where government businesses enjoy net advantages by virtue of being government-owned when competing with private firms.

These measures are vital to enhancing competition and efficiency in those sectors of the economy currently sheltered from competition.

**Part III** covers the implementation of the Committee's proposals. It deals with institutional, legal, transitional and resource issues. The Committee proposes that two key institutions would assist to implement the Committee's proposals. A National Competition Council would be created jointly by Commonwealth, State and Territory Governments to assist in coordinating reform and would provide independent and expert advice on the additional policy elements, including transitional issues. An Australian Competition Commission would be formed from the TPC and PSA to administer the general conduct rules and parts of the additional policy elements.



# **PART I: COMPETITIVE CONDUCT RULES**





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## 2. Overview of Competitive Conduct Rules

Every modern market economy provides a set of rules intended to ensure the competitive process is not undermined by the anti-competitive behaviour of firms. Typically, these rules prohibit agreements or arrangements that increase the market power of firms and prohibit firms which possess substantial market power in their own right from using that power in an anti-competitive way. In Australia, these rules are contained in Part IV of the Commonwealth *Trade Practices Act 1974* (TPA).

This Part considers the content, scope of application and enforcement of competitive conduct rules proposed for general application to business transactions throughout the economy. There are a number of markets where there is a case for these rules to be supplemented to ensure effective competition, and the additional measures proposed for these markets are discussed in Part II.

This Chapter presents a brief overview of the key issues raised in developing a regime of competitive conduct rules intended to be of general application.

**Section A** considers the possible objectives of the regime and concludes that the appropriate role for these rules is the protection of the competitive process, rather than conferring benefits upon particular sectors of society.

**Section B** outlines the types of market conduct addressed by competitive conduct rules, including agreements between parties and unilateral conduct.

**Section C** reviews the main types of rules which may be used to address anti-competitive conduct, including outright prohibition, prohibition based on competitive effect or purpose, and prohibition dependent on an assessment of the public interest. The section also discusses proposals for simplification of the existing competitive conduct rules.

**Section D** considers the range of mechanisms under which it is currently possible to obtain exemption from conduct rules.

**Section E** discusses the regime for enforcing conduct rules.

## **A. THE OBJECTIVES OF COMPETITIVE CONDUCT RULES**

In broad terms, competitive conduct rules could have two possible objectives. First, they could be designed to protect the competitive process *per se*. In such a regime, the effective functioning of the competitive process, and hence economic efficiency and the welfare of the community as a whole, is the primary objective. Consumers and competitors benefit from such rules to the extent that their interests coincide with the interests of the community as a whole.

Secondly, such rules might be cast so as to confer special benefits on a particular sector of the community, whether that be consumers or a particular class of competitors, such as small businesses. Under a regime of this kind, the benefits to the community as a whole are subordinated to the interests of a particular category of beneficiaries.

The Committee unhesitatingly embraces the objective of protecting the competitive process as that most appropriate for the competitive conduct rules of a national competition policy. The rules themselves should not be aimed at favouring particular sectors of society. If such objectives are to be achieved it should be through accommodations to the rules according to the principles and exemption mechanisms discussed in Chapters Five and Six. To the extent that protecting the competitive process does not promote economic efficiency in a particular market, or where other policy goals conflict with economic efficiency and require some trade-off to be made, exemptions from the general rules should also be granted through those exemption mechanisms, such as authorisation.

## **B. TYPES OF MARKET CONDUCT ADDRESSED**

While there are probably no limits to the kinds of behaviour a firm might conceive as a means of subverting the competitive process; conduct involving agreements between firms can be distinguished from other forms of conduct.

Agreements between firms at the same level of the business chain, such as between suppliers or between consumers, are referred to as "horizontal agreements". These agreements may relate to price or to other matters, and it is useful to distinguish these two categories for the impact of the former on competition is usually quite clear. Agreements between firms at different levels of the business chain, such as between suppliers and customers, are referred to as "vertical agreements". Again, the distinction between agreements on price and agreements on other matters will usually be important. The rules addressing horizontal and vertical agreements are discussed in Chapter Three, where it is argued that the rules contained in the TPA are generally appropriate but warrant some fine-tuning.

Other forms of conduct are of concern from a competition perspective. These include instances where a single firm misuses its market power, certain mergers and acquisitions, and in some circumstances price discrimination. Conduct of these kinds will generally involve agreements between firms but, as in the case of refusals to deal or hostile takeovers of listed companies, need not always do so. The rules for addressing these kinds of conduct are discussed in Chapter Four, which argues that the current rule against price discrimination should be repealed but that the other rules in this category are appropriate for inclusion in a national competition policy.

In reviewing the current rules the Committee has been mindful that unnecessary tinkering could create uncertainty for business and delay extending the application of the rules, which is seen as the more pressing policy objective. Accordingly, the Committee has adopted a deliberate policy of limiting proposed changes to those areas where the current rules were found to be clearly deficient from the standpoint of a national competition policy.

### **C. TYPES OF COMPETITIVE CONDUCT RULES**

Because of the wide range of competitive and efficiency consequences of different forms of business conduct, different types of rules are appropriate for different types of conduct.

### **Per Se Prohibition**

The anti-competitive impact of some kinds of conduct may be so unambiguous that they should be prohibited outright without having to demonstrate their impact in each particular case. Where this conduct can be defined with sufficient certainty, prohibition of it *per se* will often be warranted. *Per se* prohibitions remove the need to prove effects on competition, and thus provide savings in enforcement costs, and greater certainty for firms seeking to comply with the law. This is the approach taken, for example, to price-fixing agreements by the TPA.

### **Competition Test**

Other forms of behaviour, such as certain cooperative arrangements between firms, are more ambiguous in their impact on competition. In these circumstances a *per se* prohibition would be inappropriate, for it might prevent behaviour that is potentially socially useful. Accordingly, conduct of this kind will generally only be prohibited if it is shown to have a particularly adverse impact on competition. This is the approach taken by the majority of competitive conduct rules of the TPA, where the proscribed impact on competition is a "substantial lessening of competition in a market".

When assessing the effect on competition of particular conduct, it is necessary to define the markets which may be affected by it. A "market" is an area of close competition or rivalry in which one product or source of supply may be substituted for another in response to changing prices. Markets have product, geographic, temporal and functional dimensions. Appraisals of market limits have important implications for levels of competition or market power, for narrowly defined markets are more likely to support findings of adverse effects on competition.<sup>1</sup>

Some submissions received by the Inquiry expressed dissatisfaction with judicial interpretations of markets in some cases.<sup>2</sup> While

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<sup>1</sup> "Market" is defined in s.4E to mean a market in Australia, and to include goods or services which are substitutes for products in the market. In assessing competition in a market, regard should be had to import competition (s.4 definition of "competition"), either actual or potential (*Queensland Wire Industries* (1989) 83 ALR 577 at 588). This approach has recently been reinforced in relation to the mergers provision (see new s.50(3)).

<sup>2</sup> Australian Institute of Petroleum Ltd (Sub 22); Unilever (Sub 28); Coopers & Lybrand (Sub 42); Mr R Copp (Sub 107); NSW Govt (Sub 117).

acknowledging the difficulties in this area, the Committee is not convinced that they are so great as to warrant a fundamental departure from the existing methodology. The principles of market definition set out in landmark decisions such as *QCMA*<sup>3</sup> and *Queensland Wire*<sup>4</sup> accord with sound economic principles, and some dissatisfaction with particular decisions is inevitable in an adversarial context, particularly when the key concepts are not subject to exact proofs.<sup>5</sup> Opportunities to improve the court's access to and use of economic material are considered in Chapter Seven.

### Authorisation and Notification

Where conduct breaches the competition rules, under either a *per se* prohibition or a competition test, there may nevertheless be offsetting public benefits which indicate that the conduct should be permitted. For example, there may be cases in which conduct which adversely affects competition nevertheless promotes economic efficiency and community welfare.

An authorisation or notification scheme provides a mechanism for consistent and cost-effective resolution of these conflicts on a case-by-case basis. The existing authorisation scheme permits an independent body, the Trade Practices Commission (TPC), to "authorise" certain conduct where the public benefit of the reviewed conduct exceeds the anti-competitive detriment. Notification is a similar procedure, which confers automatic immunity from the competitive conduct rules upon notification of particular conduct to the TPC, with that immunity continuing until such time as the Commission revokes the notification on public benefit grounds. Appeals from the TPC's authorisation and notification decisions can be made to the Trade Practices Tribunal (TPT).

Administrative authorisation is the most direct mechanism for resolving possible conflicts between protecting the competitive process and achieving other policy goals, and is examined in Chapter Five. It provides a flexible and transparent means of dealing with possible new issues posed by extending market conduct rules to a

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<sup>3</sup> (1976) 25 ALR 169.

<sup>4</sup> *Queensland Wire Industries* (1989) 83 ALR 577.

<sup>5</sup> For a discussion of the principles of market definition see Norman N, "Markets and Competition: A Note on Economic Concepts Imported from Economic Analysis" *Australian Trade Practices Reporter* ¶2-500.

wider range of market participants. Nevertheless, some forms of conduct may be so inherently anti-competitive and contrary to economic efficiency that administrative authorisation should not be permitted. In such circumstances, accommodation of conflicting policy goals should be achieved through alternative policy instruments such as specific legislation.

### **Simplifying Principles**

The TPC has proposed that the competitive conduct rules could be more simply expressed by a single provision that "all conduct which substantially lessens competition is prohibited unless authorised."<sup>6</sup> While seeing some merit in the idea behind this proposal, the Committee has come to the view that such a sweeping simplification would not be appropriate.<sup>7</sup> The competitive consequences of different types of conduct warrant different types of rules, and it is not always appropriate to permit authorisation. The proposal would also present significant problems in the area of unilateral conduct.<sup>8</sup>

International experience with "simple" statements of competition rules, such as in the United States (US) and the European Community (EC), suggests that a considerable body of case law or regulations inevitably develops to interpret the simple propositions and their application to specific types of conduct, so that legal complexities are not eliminated.

Despite proposing some minor modifications to the existing rules, the Committee has concluded that the operation of the existing rules has been largely satisfactory, with the principal concern relating to their scope of application. In these circumstances, the Committee sees benefit in preserving existing approaches where possible to avoid any unnecessary uncertainty for those to whom the rules do and will apply.

Cooperation between the Commonwealth and the States in extending the application of competitive conduct rules to currently exempt areas presents opportunities to simplify the drafting of the

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<sup>6</sup> TPC (Sub 69).

<sup>7</sup> See also Trade Practices Committee of the LCA (Sub 65).

<sup>8</sup> See discussion in Chapter Four relating to proposals for an "effects test" under a misuse of market power provision.

legislation.<sup>9</sup> For example, currently complex drafting to tie the operation of each rule to the Commonwealth's heads of legislative power could be removed if there were a referral of powers from the States. Apart from simplification in this respect the Committee does not propose any drafting changes other than those necessary to give effect to its recommendations.

#### **D. EXEMPTIONS FROM COMPETITIVE CONDUCT RULES**

There are a range of exemptions from the current TPA of both a general and a specific nature.

Administrative authorisation and notification procedures provide one general source of exemption. Other general exemptions arise through constitutional constraints on Commonwealth power; the legal doctrine of "shield of the Crown"; exemption by regulation made under the Act or by specific authorisation by other Commonwealth, State or Territory laws or regulations. The TPA also includes a number of specific exemptions, including certain standards, intellectual property matters and overseas shipping. Chapter Five reviews these exemptions and concludes that a national competition policy should rely on a narrower range of more rigorous and transparent exemption processes. Chapter Six considers the application of the Committee's recommendations to a range of individual sectors and activities and reviews the specific exemptions set out in the Act itself.

The Committee's work uncovered two major misconceptions about the TPA, which ultimately proved pivotal to its recommendations.

The first is the extent to which particular entities or activities are exempt from the Act. While the Committee found that many of the current exemptions from the Act are not justified on considered policy grounds, there are no general exemptions favouring government businesses, the professions or agricultural marketing authorities, and many of these groups are already subject to the Act to some degree or in some circumstances.

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<sup>9</sup> See Trade Practices Committee of the LCA (Sub 65); Centre for Plain Legal Language (Sub 138).

The second misconception relates to the impact of applying the Act to currently excluded sectors. Application of the TPA would have only limited impact on many sectors that are partially excluded from its reach. Important as it is in protecting competition, the Act only prohibits certain kinds of voluntary conduct that may restrict competition, and will generally have little or no impact on matters such as market structure or restrictions imposed by laws or other government policies. Some of the complexities in this area are illustrated by the discussion in Box 1.<sup>10</sup>

While the Act's prohibitions of anti-competitive conduct are an important part of competition policy, their inability to address the full range of conduct and market structures of concern from a national competition policy perspective prompted the Committee to propose the additional policy elements discussed in Part II of the Report.

## **E. ENFORCEMENT REGIME**

The Committee proposes that, leaving aside questions of what bodies should perform what functions the enforcement regime for competitive conduct rules should be substantially based upon the existing enforcement regime under the TPA. Chapter Seven explores various elements of an enforcement regime: remedies; public versus private enforcement; and the processes by which judicial determinations are made. Some opportunities to improve courts' capacity to deal with economic issues are discussed.

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<sup>10</sup> See Executive Overview



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### 3. Anti-Competitive Agreements

Agreements which restrict firms from competing are among the central concerns of competition law.<sup>1</sup>

“Horizontal” agreements are those between competing firms. They will be of concern where competitors agree to refrain from particular forms of competitive conduct, such as agreeing not to charge below a specified price. The *Trade Practices Act 1974* (TPA) distinguishes between different forms of horizontal agreements. They are here discussed as price fixing agreements, boycotts and other horizontal agreements. In general the Committee is satisfied that the existing provisions operate effectively, but proposes some minor amendments in relation to price fixing agreements.

“Vertical” agreements are those between firms at different levels of the chain of production such as, for example, wholesalers and retailers. Vertical agreements are of concern where a firm at one level (eg, a retailer) agrees to restrictions on competitive conduct imposed by a firm operating at another level (eg, a wholesaler). The TPA distinguishes between non-price vertical agreements and resale price maintenance. Again, the Committee is generally satisfied with the operation of these provisions, but proposes some minor amendments in relation to certain non-price vertical agreements and resale price maintenance.

#### A. PRICE AGREEMENTS BETWEEN COMPETITORS (ss.45A & 45C)

Pricing decisions lie at the heart of the competitive process, and the Committee strongly supports the Act's *per se* prohibition of agreements between competitors which fix, control or maintain prices.

At present, administrative authorisation is available for price fixing agreements for services but not for goods. Because of the central

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<sup>1</sup> The term “agreement” is used here to describe informal arrangements and understandings as well as legally binding agreements: see the discussion of the expression “contract, arrangement or understanding” in Pengilly W, “Anti-Competitive Agreements” *Australian Trade Practices Reporter* ¶13-280.

importance of price competition, and to remove any ambiguity over the undesirability of price-fixing, the Committee proposes that the treatment of goods and services be brought into line by removing the potential for authorisation for price-fixing agreements for services.

While the Committee supports the current provision for certain recommended price agreements to be authorised, such agreements should no longer be specifically excluded from the *per se* prohibition.

### **Background**

Seeking the profits of a single-firm monopoly, competitors may agree to refrain from competing against each other, and instead collude to raise prices and thus restrict output. Such cartels must please most members to maintain their allegiance, and typically perform even less efficiently than single-firm monopolies because they fail to minimise the costs of production. With less external pressures on firms, technical and organisational inefficiency can also emerge. Situations in which cartels are likely to be effective are fairly rare, but they are more likely to succeed in industries with relatively few competitors and significant barriers to entry. Most cartels break down because of organisational difficulties in obtaining and maintaining agreement, cheating by cartel members or because high profits attract new entry. Nevertheless, while cartels survive they are likely to impose substantial costs upon the community, and some may survive for extended periods.

Unlike other horizontal agreements, price agreements are generally unambiguously detrimental to economic efficiency. Further, removing price agreements is unlikely to undermine the internal efficiency or organisational integrity of the cooperating firms, so that there is generally no case against prohibiting price agreements. There are thus sound reasons for prohibiting price fixing agreements *per se*, without any inquiry into the competitive effects of such agreements.

### **Current Approach**

Agreements<sup>2</sup> and covenants<sup>3</sup> between competitors which have the purpose or effect of fixing, maintaining or controlling prices are *per se*

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<sup>2</sup> Sections 45, 45A(1).

<sup>3</sup> Sections 45B, 45C(1), 45C(2).

illegal under the Act. Joint venture pricing,<sup>4</sup> price recommendation agreements between 50 or more persons<sup>5</sup> and buying groups' pricing<sup>6</sup> are exceptions to the *per se* prohibition, but will be prohibited if they substantially lessen competition. Authorisation is not available for price fixing in relation to goods but is available in relation to services and the three forms of price agreements excepted from the *per se* prohibition.<sup>7</sup>

### Overseas Approaches

International experience indicates strong support for a *per se* prohibition of price fixing agreements. In the countries where *per se* prohibitions are not a general part of competition law, a strong line is nevertheless taken against such agreements.

In the United States, all agreements to fix prices are illegal *per se*,<sup>8</sup> unless ancillary to the achievement of another pro-competitive purpose in which case they are subject to a 'rule of reason' which balances the opposing competitive detriments and benefits.<sup>9</sup>

In New Zealand, price fixing agreements are illegal *per se*,<sup>10</sup> but can be authorised. The *per se* prohibition does not apply in respect of inputs to joint ventures,<sup>11</sup> price recommendations by groups of 50 or more<sup>12</sup> or joint buying promotional arrangements.<sup>13</sup>

In the United Kingdom, although not legally subject to absolute prohibition,<sup>14</sup> no price fixing agreements have been permitted by the Restrictive Practices Court since 1966, and earlier decisions have been criticised. Price recommendations by trade associations are treated in the same way as explicit agreements as to price.<sup>15</sup>

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4 Sections 4J, 45A(2).

5 Section 45A(3).

6 Section 45A(4).

7 Sections 88(1), 88(2), 88(5). Authorisation is generally unlikely to be granted in relation to price fixing of services: Heydon J D, *Trade Practices Law* [4.900]-[4.920].

8 Section 1 Sherman Act (US), *US v Socony-Vacuum Oil Co* 310 US 150 (1940).

9 *Eg Board of Trade of City of Chicago v US* 246 US 231 (1918).

10 Sections 27, 30, 34 Commerce Act (NZ).

11 Section 31 Commerce Act (NZ).

12 Section 32 Commerce Act (NZ).

13 Section 33 Commerce Act (NZ).

14 Sections 6(1)(a), 11(2)(a) Restrictive Trade Practices Act (UK).

15 Sections 8(2), 8(3), 16(3), 16(4) Restrictive Trade Practices Act (UK).

In the EC, price fixing agreements are prohibited to the extent that they affect trade between Member States.<sup>16</sup> The prohibition extends to recommended price agreements.<sup>17</sup> There are no *per se* rules in EC competition law. Exemptions may be granted by the Commission where certain conditions are demonstrated, although few exemptions have been granted in relation to price fixing agreements.<sup>18</sup>

In Canada, agreements which unreasonably enhance prices, which prevent, lessen or otherwise restrain or injure competition unduly are prohibited.<sup>19</sup> Bid rigging is prohibited *per se*.<sup>20</sup> Agreements between banks on, amongst other things, interest rates or loan terms, are prohibited *per se*.<sup>21</sup> There is no provision for authorisation.

#### Submissions

Submissions to the Inquiry indicate no major concerns with the current provisions. There were suggestions that authorisation be available for all price agreements;<sup>22</sup> that a clearance or notification procedure be introduced in respect of the three excepted classes of price agreements;<sup>23</sup> that recommended pricing should be available to groups of less than 50 parties;<sup>24</sup> and that the operation of the joint venture exception be clarified.<sup>25</sup>

#### Consideration

##### *Per Se* Prohibition vs Competition Test

The current *per se* prohibition of price fixing is warranted on the basis that the occurrence of efficiency-enhancing price fixing agreements is rare, that the benefits of identifying and permitting efficiency-enhancing price fixing agreements in a court setting are outweighed

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<sup>16</sup> Article 85(1), *Treaty of Rome* (EC).

<sup>17</sup> *Cementhandelaren v Commission* (Case 8/72) [1972] ECR 977, [1973] CMLR 7.

<sup>18</sup> Article 85(3) *Treaty of Rome* (EC). Van Bael I & Bellis J-F, *Competition Law of the EEC* (1987) at 231.

<sup>19</sup> Section 45 Competition Act (Canada).

<sup>20</sup> Section 47 Competition Act (Canada).

<sup>21</sup> Section 49 Competition Act (Canada).

<sup>22</sup> TPC (Sub 69); NFF (Sub 90); Assn of Consulting Engineers Aust (Sub 127).

<sup>23</sup> Small Business Coalition (Sub 12).

<sup>24</sup> IC (Sub 6); NFF (Sub 90); BCA (Sub 93).

<sup>25</sup> BHP (Sub 133).

by the enforcement and judicial costs of a competition test and the benefit from the certainty induced by such clear rules.

*Per se* prohibition or a competition test are not the only possible approaches to price fixing. Following a recent review of the Commerce Act, the New Zealand Government has decided to replace the provision deeming price fixing agreements to substantially lessen competition with a rebuttable presumption: agreements to fix, maintain or control prices would be presumed to substantially lessen competition unless the defendant could show otherwise.<sup>26</sup> The argument against such a test is that it may involve a wasteful analysis of evidence which is ultimately unlikely to rebut the presumption, thus increasing enforcement costs. It also signals to firms that putting resources and effort into price fixing may be rewarding behaviour.

### Authorisation

The *per se* prohibition against price fixing is qualified by the availability of authorisation for price fixing agreements involving services (as well as the three exemptions from the *per se* prohibition: joint venture pricing; recommended pricing for groups of 50 or more; buying groups' pricing). There seems to be no reason in principle for the distinction between goods and services: price fixing in relation to services is no less capable of diminishing economic efficiency than price fixing in relation to goods.

Options for dealing with this inconsistency are:

- (i) removing authorisation in relation to services;
- (ii) permitting authorisation in relation to goods; or
- (iii) maintaining the status quo.

The Committee strongly favours the first option. Removing authorisation in relation to services would provide a clear and simple message that price fixing is not acceptable business behaviour. Although some authorisations have been granted for price-related agreements concerning services, most of these have involved agreements which did not require compliance with the relevant price. The most significant line of authorisations has been in road transport, involving agreements between owner-drivers to collectively negotiate

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<sup>26</sup> The Hon Philip Burdon, New Zealand Minister of Commerce, "Review of the Commerce Act", Press Statement 16 February 1993.

rates of remuneration with freight owners, and in this area the Trade Practices Commission (TPC) now seems less likely to grant authorisation.<sup>27</sup>

Permitting authorisation in relation to goods is the course urged in some submissions. It could be argued that firms wishing to demonstrate the public benefits of their price fixing agreements should at least have the opportunity to do so. Against this, it would be wasteful of resources to provide such opportunities where the ultimate result should almost always be a refusal of authorisation. Further, the availability of authorisation would undermine the normative effect of the legislative prohibition, encouraging firms to think that price fixing may be acceptable in some circumstances.

The status quo is inconsistent in the treatment of goods and services, is not supported in principle, sends conflicting messages to businesses about the acceptability of price fixing and unnecessarily increases the complexity of the law.

#### Price Recommendations

Recommended pricing by groups of 50 or more competitors is currently exempt from the provision of the Act that deems pricing agreements to substantially lessen competition<sup>28</sup> and can be authorised. The Committee proposes removal of the exemption but continuing the availability of authorisation.

- *Per Se Prohibition vs Competition Test*

Price "recommendations" may be a cloak for underlying price fixing agreements, and may in reality have the effect of "fixing" price. With a large group, maintaining adherence to underlying agreements will be difficult, so that an agreed price is more likely to be a "genuine" recommendation. Nevertheless, even genuine recommendations may have the effect of encouraging greater price uniformity, that is, controlling or maintaining price. If a price recommendation does have the effect of "fixing, controlling or maintaining" price there seems little reason to treat it differently from other price fixing agreements. If the price recommendation does not have this effect, the *per se* prohibition does not apply in any event.

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<sup>27</sup> See *Re Lamont* (1990) ATPR ¶41-035.

<sup>28</sup> See s.45A(3).

Removing the exemption from the *per se* prohibition will not render illegal price recommendations which do not have the purpose, the effect or the likely effect of fixing, controlling or maintaining price. Nor will it prohibit many information sharing arrangements, such as information on the most recent trades, or recommended pricing in a vertical relationship, such as where a manufacturer recommends a price to retailers. It will, however, underline the message that price competition is central to effective competition and will prohibit agreements, however described and comprising however many firms, which have an adverse effect on price competition.

• *Authorisation*

The most common arguments in favour of permitting price recommendations to be authorised are that in some cases the task of setting prices can be complex (eg, small grocery retailers with a wide range of products), and in some cases the market price can be unclear (eg, primary produce may be subject to fluctuating world prices). The argument that setting prices is too complex for some businesses seems weak: at the very simplest, retailers can unilaterally adopt a cost plus mark-up pricing policy. The argument that market prices for commodities are unclear may have had greater strength in bygone days, but seems weak today in light of developments in information and communications technology.

In the case of genuine price recommendations, however, it may not be immediately apparent whether the agreement has the effect of fixing, controlling or maintaining price. In such cases, business certainty might be enhanced by the availability of authorisation. But to permit authorisation for a 'recommended' price agreement between a small number of parties might allow firms to use the cloak of price "recommendations" to seek authorisation for price fixing agreements. As already observed, for a large number of parties it seems likely that an agreement would be a genuine price recommendation, and it is only in such circumstances that authorisation should be permissible. While 50 is perhaps an arbitrary number, it represents a fair assessment of the minimum number of parties required to ensure that a recommended price is no more than that.<sup>29</sup> Thus the Committee

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<sup>29</sup> It is not possible to simply add otherwise uninvolved parties to an agreement, to achieve the desired 50 persons. Section 45A(3) relates to the parties to an agreement, being an agreement which falls within s.45A(1) (the deeming provision). Section 45A(1) deals with price agreements

supports retention of the current provision which permits authorisation for recommended price agreements between 50 or more competitors.

#### Joint Ventures

Joint venture pricing is exempt from the provision of the Act that deems pricing agreements to substantially lessen competition.<sup>30</sup> Joint venture pricing remains subject to the competition test, but authorisation is available where net public benefit can be demonstrated. The Committee considers that the operation of the joint venture pricing exemption should be clarified, but otherwise proposes no change to the provision.

Joint ventures are an emerging legal concept, and may take the form of a separate company formed for the purpose of a common enterprise, a partnership or an unincorporated joint venture which is not a partnership.<sup>31</sup> In trade practices cases, joint ventures have generally involved the development and marketing of natural resources,<sup>32</sup> but this is not the only recognised area of joint ventures.<sup>33</sup> Joint ventures are frequently used where there is difficulty in a single firm raising the necessary capital, or bearing all the risk, associated with a particular business venture. In the absence of joint venture agreements some projects simply would not occur.

The joint sale of joint venture products could constitute a price agreement between competitors, technically falling within the terms of s.45A(1), but it is simply a natural extension of the joint venture process and should thus not be prohibited *per se*. Nevertheless, scrutiny under the substantial lessening of competition test is appropriate for such agreements, given the anti-competitive potential of all price agreements between competitors. The potential benefits of

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between competitors. Thus, parties to a recommended price agreement would need to be competitors, competing within a particular market.

<sup>30</sup> See s.45A(2).

<sup>31</sup> See s.4j; *Brian Pty Ltd v United Dominion Corporation Ltd* (1985) 60 ALR 741; and Chetwin M C, "Joint Ventures — A Branch of Partnership Law?" (1990) 16 *Uni of Queensland Law Journal* 256.

<sup>32</sup> See, eg, the TPC's authorisation decisions in *West Australian Petroleum & West Australian Natural Gas Pty Ltd* (1979); *Woodside Petroleum Development Pty Ltd — North West Shelf Venture* (1977); *Santos Ltd* (1988) ATPR (Com) ¶150-074; *Bridge Oil Limited* (1988) ATPR (Com) ¶150-073; *Delhi Petroleum Pty Ltd and Santos Ltd* (1988) ATPR (Com) ¶150-076.

<sup>33</sup> See, eg, the TPC's authorisation decisions in *Bankcard Scheme: Interbank Agreement* (1980); *Electric Lamp Manufacturers (Australia) Pty Ltd* (1982) ATPR (Com) ¶150-033.



joint venture arrangements suggest that authorisation should be available where net public benefit can be demonstrated.

There have been suggestions that the joint venture pricing exemption does not operate in respect of a price agreement relating to the joint venture's product where not all of the joint venture parties are parties to the price agreement.<sup>34</sup> It would be a simple matter of legislative drafting to resolve this uncertainty, and the Committee considers that the existing provision should be redrafted to make clear that not all the joint venture parties need to be parties to a pricing agreement to qualify for the exemption.

### Joint Buying Groups

As with joint ventures, joint buying groups are exempt from the provision which deems price agreements between competitors to substantially lessen competition.<sup>35</sup> Joint buying groups remain subject to the substantial lessening of competition test, and authorisation is available where net public benefit can be demonstrated.

Joint buying arrangements can permit small businesses to take advantage of economies of scale or scope in purchasing and advertising, while continuing to compete at the retail level. The exemption from the deeming provision relates to the purchasing and advertising activities of such groups and is warranted, given the potential benefits of such arrangements.

### Conclusion

The Committee is satisfied that the provision which deems price fixing agreements to substantially lessen competition is warranted, and should be incorporated into the competitive conduct rules of a national competition policy.

The Committee supports retention of the exemptions from the deeming provision of joint venture and joint buying groups but not that for recommended pricing agreements. The operation of the joint venture exemption should be clarified.

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<sup>34</sup> BHP (Sub 133).

<sup>35</sup> See s.45A(4).

Subject to appropriate transitional arrangements,<sup>36</sup> the Committee supports the removal of administrative authorisation for price agreements for goods and services, with the only exceptions being the existing ones for joint ventures, joint buying groups and recommended pricing agreements with 50 or more parties. The Committee does not support extending the recommended pricing exception to groups of less than 50 parties.

## **B. BOYCOTTS (ss.4D, 45D & 45E)**

Boycotts are agreements between competitors aimed at restricting the ability of a target firm to either buy or sell in a market. A number of countries have adopted stringent approaches to boycotts. The operation of the secondary boycott provisions is currently the subject of a Senate Inquiry. On the basis of submissions received by this Inquiry, the Committee has not been persuaded of the need to amend the current provisions dealing with boycotts.

### **Background**

A primary boycott occurs when a group of people agree not to deal with (either sell to or buy from) a target person, or class of persons.

A secondary boycott occurs when a group of people who may not themselves deal with the target person persuade an otherwise uninvolved party (such as a supplier) not to deal with the target person. A secondary boycott could occur because a group of competitors wished to discipline or eliminate a competitor. In the Australian context, the most common secondary boycotts involve industrial action by unions and union members with no direct complaint against the target employer.

### **Current Approach**

Primary boycotts are prohibited *per se*,<sup>37</sup> but can be authorised.<sup>38</sup>

Secondary boycotts which have the purpose and effect of causing substantial loss or damage to the business of a target corporation, or

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<sup>36</sup> See Chapter 15.

<sup>37</sup> See s.4D and s.45. Note also s.45D(1A).

<sup>38</sup> Section 88(1).

substantial lessening competition in a market in which the target operates, are prohibited by s.45D(1).<sup>39</sup> Section 45D(1A) prohibits two or more people from engaging together in conduct with the purpose and effect of preventing or substantially hindering a target from engaging in inter-State or overseas trade.

An exemption from both these provisions applies if the the dominant purpose of the relevant conduct is substantially related to remuneration, conditions of employment, hours of work, working conditions, or termination of employment.<sup>40</sup> While it is possible for the employees of one employer to pursue similar claims to those made by other employees against another employer, a boycott pursued for purposes related to the remuneration, employment conditions, etc of another group of employees would not generally satisfy the requirements for exemption.<sup>41</sup>

Where a union attempts to persuade a person not to deal with a target, the person is also prohibited from agreeing to the union demands unless the target is a party to the agreement, consents in writing to it, or the TPC authorises it.<sup>42</sup>

The Australian Industrial Relations Commission has jurisdiction under Part VI, Division 7 of the Industrial Relations Act to conciliate in ss.45D and 45E disputes where there is an application in the Federal Court for an injunction to restrain a boycott. No other provisions of the Industrial Relations Act deal with such behaviour.

Authorisation is available for conduct which contravenes the secondary boycott provisions.<sup>43</sup>

### Overseas Approaches

International experience indicates support for prohibiting boycotts through competition or industrial relations policy.

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<sup>39</sup> Additional requirements apply if the target is not a corporation.

<sup>40</sup> Section 45D(3).

<sup>41</sup> *Concrete Constructions Pty Ltd v Plumbers and Gas Fitters Employees' Union of Australia* (1987) 115 FCR 31 at 57-58; ATPR ¶40-766 at 48-309. See also *Meat & Allied Trades Federation of Australia (Qld Div) Union of Employers v Australian Meat Industry Union of Employees (Qld Branch)* (1989) ATPR ¶40-986 at 50,750 and 50,755; *Ascot Cartage Contractors Pty Ltd v Transport Workers' Union of Australia* (1978) 32 FLR 148 at 154; ATPR ¶40-766 at 48,309.

<sup>42</sup> Section 45E.

<sup>43</sup> Sections 88(7), 88(8).

In the US, boycotts are prohibited *per se*.<sup>44</sup> While the anti-trust laws operate subject to a labour exception, secondary boycotts in an industrial context would usually be caught under specific industrial legislation.<sup>45</sup>

In New Zealand, primary boycotts are prohibited *per se* and are authorisable. There is no specific legislative provision equivalent to ss.45D and 45E, but secondary boycotts fall under the general prohibition against agreements which substantially lessen competition. Industrial secondary boycotts may be challenged under industrial legislation.<sup>46</sup>

In the UK, boycotts may, depending on the form of the relevant agreement, be registrable under the *Restrictive Trade Practices Act 1976*, although not where the boycott relates to certain matters of employment. Common law economic torts may have application to boycotts in an industrial context.<sup>47</sup>

Canada's *Competition Act 1986* does not deal specifically with boycotts, although some boycotts may breach the general prohibition against conspiracies, agreements and arrangements that lessen competition unduly.

#### Submissions

The current provisions dealing with primary boycotts received little attention. One submission suggested that they should be subject to the substantial lessening of competition test, rather than *per se* prohibition.<sup>48</sup>

Recognising that the secondary boycott provisions were not a major focus for this Inquiry, the arguments for reform were not fully canvassed in submissions to this Committee. Nevertheless, some proposals were advanced, including support for the current regime,<sup>49</sup> a proposal that boycott laws should only prohibit arrangements where

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<sup>44</sup> *Klors Inc v Broadway Hale Stores Inc* (1959) 359 US 207.

<sup>45</sup> National Labour Relations Act (US).

<sup>46</sup> See ss.63 and 64 of the Employment Contracts Act (NZ).

<sup>47</sup> Section 224 Trade Union and Labour Relations (Consolidation) Act (UK).

<sup>48</sup> NSW Govt (Sub 117).

<sup>49</sup> Trade Practices Committee, LCA (Sub 65); Small Business Coalition (Sub 100).

a group of competitors restrict or limit dealings with other potential or actual competitors,<sup>50</sup> and a proposal that unions should be exempt from ss.45D and 45E.<sup>51</sup>

### Consideration

Prohibitions on primary and secondary boycotts were inserted in 1977, following recommendations of the Swanson Committee.

Section 45D had its origins in a recommendation of the Swanson Committee that “the law provide an effective avenue of recourse for the trader directly affected, by allowing him access to an independent deliberative body.”<sup>52</sup> The Committee pointed to the examples of boycotts by bread delivery drivers against retail outlets which were selling cut-price bread and boycotts by petrol tanker drivers against service stations advertising cut-price petrol. The Swanson Committee made no recommendation as to whether secondary boycotts should be dealt with in trade practices or industrial relations legislation.<sup>53</sup>

Section 45E arose out of a dispute in 1980 when a union placed a black ban on an oil company from supplying petrol to a company. The oil company, to keep its depots open, agreed to the union’s demands that the target firm not be supplied. The Government felt that companies should not succumb to such pressure, and enacted s.45E in response.<sup>54</sup>

The major field of operation for ss.45D and 45E has been in industrial disputes, but there have also been a number of purely commercial disputes involving the secondary boycott provisions.<sup>55</sup> The operation of these provisions is currently the subject of an inquiry by the Senate Standing Committee on Employment, Education and Training, which is to report by the end of September 1993.

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<sup>50</sup> Dr W Pengilly (Sub 11).

<sup>51</sup> ACTU (Sub 113). Note that unions are not directly affected by s 45E, but that they could conceivably be prosecuted for aiding and abetting a contravention of s 45E.

<sup>52</sup> Trade Practices Act Review Committee, *Report to the Minister for Business and Consumer Affairs*, (1976), recommendation 10.19 at 86.

<sup>53</sup> *Ibid*, para 10.20, at 86.

<sup>54</sup> See Debate, 15 May 1980, Hansard, H of R, p.2827 et seq.

<sup>55</sup> Eg *White Industries v JD Trammell and Ors* (1983) ATPR ¶40-429; *Jewel Food Stores v Hall and Ors* (1991) ATPR ¶41-098; *Trazland Pty Ltd v Bousafeld & Ors* (1984) 6 ATPR ¶40-484 and ¶40-497; *Hamburg-Suedamerckanisse v J Fenick and Ors* (1984) (unreported); and *Refrigerated Express Lines (A'Asia) Pty Ltd v Australian Meat & Livestock Corporation & Ors* (1980-81) 3 ATPR ¶40-137 and ¶40-156.

### *Per Se* Prohibition vs Competition Test

Both primary and secondary boycotts are subject to *per se* prohibition. Secondary boycotts have an alternative competition test, which is frequently irrelevant given the existence of the other most commonly applied test of damage to the business of the target corporation. The Committee was not presented with compelling evidence that would suggest an alternative approach to primary or secondary boycotts.

### Authorisation

Primary and secondary boycotts are authorisable. No evidence was presented to the Committee of practical problems which have arisen as a result of this facility.

### Conclusion

The Committee did not receive any compelling evidence supporting reform of the primary or secondary boycott provisions, which appear broadly consistent with overseas practice. In these circumstances, the Committee does not propose any amendment to the current provisions.

The secondary boycott provisions have been controversial in Australia, largely because of their industrial relations role. The provisions are currently the subject of a separate review by the Senate Standing Committee on Employment, Education and Training, and may be reconsidered in the context of reforms to the industrial relations system.

## **C. OTHER HORIZONTAL AGREEMENTS (ss.45, 45B)**

The Committee has found the current treatment of other agreements between competitors to be soundly based in policy. In these circumstances no changes are recommended to these provisions.

### Background

In a cartel's pursuit of monopoly profits, price agreements and output restrictions are two sides of the same coin, and the observations made above in relation to price agreements can also apply to agreements

between competitors to restrict output. Some agreements between firms which do not compete can also adversely affect competition.

But there are many reasons why different firms, including competing firms, might enter into agreements that contain restrictions but are not intended to have and do not have any substantially adverse impact on competition. For example, agreements on procedures for resolving consumer complaints might have no discernible affect on competition. Equally, however, agreements on matters other than price can facilitate tacit price collusion, as well as providing constraints on product differentiation and technological improvement. Even restrictions that limit important elements of competition, such as advertising, might be argued to have offsetting public benefits in some circumstances.

Trade or industry associations can provide a useful forum for exchange of information which may enhance technical efficiency. For example, monitoring and reporting on cost information between firms may facilitate moves towards international best practice and encourage "yardstick competition" between firms. Information exchanges may also serve to lessen competition, however, particularly where the information relates to prices. Market sharing by territorial restrictions or allocation of customers and products can create local monopolies.

### Current Approach

Agreements and covenants which have the purpose or likely effect of substantially lessening competition are prohibited by sections 45 and 45B respectively.<sup>56</sup> Such agreements or covenants can be authorised.<sup>57</sup>

### Overseas Approaches

International experience strongly supports a competition analysis of non-price horizontal agreements, rather than a *per se* prohibition.<sup>58</sup> Of the countries examined, the only divergence from this approach is in the US, where some types of agreements seeking indirectly to limit

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<sup>56</sup> Vertical agreements and mergers are excluded from the operation of these provisions: ss.45(5),(6) and (7).

<sup>57</sup> Section 88(1).

<sup>58</sup> Section 1 Sherman Act (US); ss.27, 28 Commerce Act (NZ); Article 85 *Treaty of Rome* (EC); s.45 Competition Act (Canada).

price competition, such as agreements to restrict output, or to divide markets territorially, are subject to *per se* prohibition. As such agreements may fall within the *per se* prohibition of price-fixing under the Australian Act, the US approach is only a limited divergence.

#### Submissions

Submissions generally supported the current approach to these agreements.<sup>59</sup> One submission<sup>60</sup> suggested that efficiency should act as the general test in cases of horizontal agreements, while another<sup>61</sup> argued that s.45 currently prohibits economically efficient conduct which would not be authorised but gave no examples of its concerns. A technical amendment to s.45(6) was also proposed.<sup>62</sup>

#### Consideration

##### *Per Se* Prohibition vs Competition Test

A *per se* prohibition of all agreements between competitors would catch much economically efficient conduct. A case-by-case analysis of the impact on competition of horizontal agreements, other than price-fixing and boycotts, is clearly appropriate.

#### Authorisation

The Committee was not presented with evidence that economically efficient conduct would not be authorised. The current authorisation scheme operates effectively to ensure that conduct which lessens competition but nevertheless enhances economic efficiency can be permitted, and the Committee's proposed amendments to the scheme, discussed in Chapter Five, should reinforce the primary role of efficiency considerations.

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<sup>59</sup> Eg. National Institute of Accountants (Sub 88); Small Business Coalition (Sub 100).

<sup>60</sup> Metal Trades Industry Association of Australia (Sub 59).

<sup>61</sup> NSW Govt (Sub 117).

<sup>62</sup> It was argued that s.45(6) does not recognise that s.6 of the Act might prevent intrastate conduct by an unincorporated entity from infringing s.47 whilst not preventing conduct being covered by s.4D. It was therefore proposed that s.45(6) should also specify "conduct that would, but for the operation of s.6(2), infringe s.47": Mr P Argy (Sub 60). This point has been referred to the Treasury for consideration.



## Conclusion

The Committee considers that no need has been demonstrated for amendments affecting the rules contained in ss.45 and 45B, and believes that these rules should be incorporated into a national competition policy.

## D. NON-PRICE VERTICAL AGREEMENTS (S.47)

There is a wide range of vertical agreements under which firms at one stage in the production process impose restrictions, other than price restrictions, on the conduct of firms at another stage. Economic analysis provides no simple rules for the treatment of vertical restraints, including such tying arrangements as "third-line forcing". As a consequence a test which enquires into the effects of individual agreements on competition is required. The Committee thus proposes that the provisions relating to third-line forcing should be made consistent with the other provisions dealing with vertical agreements, by replacing the *per se* prohibition with a competition test, and permitting notification.

## Background

Vertical restraints are restrictions a firm at one stage in the production process imposes upon the conduct of firms at another stage. For example, a manufacturer may impose various restrictions on retailers of its products.<sup>63</sup>

Vertical restraints may reduce or eliminate intra-brand competition, that is, competition among dealers in the product of a particular manufacturer. And if all manufacturers in an industry adopt similar practices, inter-brand price competition (among sellers of different brands) may also be affected.

In a "tying arrangement", the sales of two or more products are tied: the seller will only sell unrelated products as a bundled package, or offers one product only on the condition that the buyer also purchases one or more other products. In "full-line forcing", a seller requires a buyer to purchase an entire line of products in order to acquire any

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<sup>63</sup> For a discussion of the economics of vertical restraints see Scherer F M & Ross D, *Industrial Market Structure and Economic Performance* (1990) Chapter 15.

(eg, a car manufacturer might require dealers to carry all of its models). "Third-line forcing" involves a requirement that a third party's product be bought in conjunction with the seller's product. Tying arrangements may enable firms to extend market power from one market with low elasticity of demand into an unrelated market; may permit price discrimination which would otherwise be impossible; may be used to raise entry barriers;<sup>64</sup> or may facilitate avoidance of price regulations on one good. There is a broad spectrum of tying arrangements, with many having a positive implication for economic welfare. For example, a supplier may be able to achieve production or distribution efficiencies or technical superiority by tying together two or more particular products.

Territorial restrictions or restrictions as to the types of customers which may be served can be used to restrict competition. For example, a manufacturer might grant exclusive territories to its retailers, resulting in increased profits for those retailers at the expense of consumers. In some circumstances, however, the grant of an exclusive territory might be warranted to encourage retailers to provide an appropriate level of services, such as where there are free-rider issues.<sup>65</sup> A case-by-case approach is necessary to determine the effects on competition and efficiency of territorial or customer restrictions.

Exclusive dealing entails a requirement by one firm that another firm it supplies, or from whom it purchases, not deal with its competitors.<sup>66</sup> The potential anti-competitive element in exclusive dealing is market foreclosure, removing distribution outlets or supply sources from use by potential competitors. Exclusive dealing may also enhance efficiency where, for example, a manufacturer finds it less costly to deal with a relatively small number of dedicated distributors, or where distributors will not promote a new product unless they have the security of knowing that the product of their promotional efforts will not be reaped by others.

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<sup>64</sup> Eg, a computer manufacturer requires that it provide all maintenance, thus forestalling the entry of rival service organisations.

<sup>65</sup> A free-rider problem can arise where, for example, one retailer provides considerable advice to customers, while another provides no such service and can thus sell at a lower price. Customers can obtain the advice from one retailer and then buy from the lower priced retailer. For a discussion of free-rider problems in vertical relationships see Hanks F & Williams P L, "The Treatment of Vertical Restraints Under the Australian Trade Practices Act", (1987) *ABLR* 147.

<sup>66</sup> Note that the Act calls all vertical restraints "exclusive dealing".

## Current Approach

Section 47 prohibits third-line forcing *per se*<sup>67</sup> and other forms of tying, territorial restrictions and exclusive dealing if they substantially lessen competition.<sup>68</sup> Authorisation is available for conduct which would otherwise contravene s.47.<sup>69</sup> Notification, which provides immediate and automatic immunity from legal proceedings, is available for all conduct covered by s.47 except third-line forcing.

## Overseas Approaches

International experience supports a competition analysis of vertical arrangements, as opposed to a *per se* prohibition.

New Zealand, the EC and Canada prohibit vertical agreements only where an adverse effect on competition can be proved.<sup>70</sup> New Zealand and the EC have mechanisms for obtaining exemptions from these prohibitions.<sup>71</sup>

The UK permits a balancing of costs and benefits of vertical agreements,<sup>72</sup> either by the Restrictive Practices Court or by administrative investigation.<sup>73</sup>

In the US, certain forms of tying arrangements, including third-line forcing, are illegal *per se* but otherwise non-price vertical restraints are judged according to their competitive effect on the market, which at least requires a weighing of effects on intra-brand and inter-brand competition.<sup>74</sup> None of the countries examined singled out third-line forcing in the manner adopted by Australia.

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67 Sections 47(6), 47(7), 47(8)(c), 47(9)(d).

68 Section 47.

69 Section 88(8).

70 Sections 27, 28 Commerce Act (NZ); Article 85(1) Treaty of Rome (EC); s.77 Competition Act (Canada).

71 In New Zealand authorisation is available, under s.58 Commerce Act. In the EC exemptions, including "block exemptions" for classes of agreements, are available under Article 85(3) Treaty of Rome (EC).

72 Sections 10, 19, 21 Restrictive Trade Practices Act (UK).

73 Anti-competitive practices: ss 2-10 Competition Act (UK); monopoly references and general references: Pts I, IV and s.78 Fair Trading Act (UK).

74 Sections 1, 3 Sherman Act (US).

## Submissions

Very few submissions raised difficulties with the operation of the current provisions relating to vertical agreements. The main issue was whether third-line forcing should be made subject to the substantial lessening of competition test, rather than *per se* prohibition. Some submissions supported this proposal,<sup>75</sup> while one submission supported retaining *per se* prohibition for third-line forcing.<sup>76</sup> One submission suggested that provisions dealing with the re-supply of goods should be extended to the re-supply of services.<sup>77</sup>

## Consideration

### *Per Se* Prohibition vs Competition Test

As noted in the background discussion, the effects on competition and economic efficiency of vertical agreements need to be examined on a case-by-case basis.<sup>78</sup> The US has *per se* prohibitions against tying arrangements, but these rules have come under increasing scrutiny and criticism.<sup>79</sup> The Australian rules applying to vertical agreements generally adopt a competition test, and thus accord with economic principles.

The basis for a distinction between third-line forcing and other forms of tying is not clear. *Per se* prohibitions are appropriate where conduct has such strongly anti-competitive effects that it is almost always likely to lessen competition. Third-line forcing does not fall into this category. For example, the practice of building societies requiring borrowers to take out property or life insurance with a nominated insurer provides insurers with large captive markets and less incentives to compete.<sup>80</sup> However, where borrowers are permitted to choose from a list of insurers who are prepared to enter into concession agreements with the lenders, and who are operating with

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<sup>75</sup> IC (Sub 6); Trade Practices Committee, LCA (Sub 65); NSW Govt (Sub 117).

<sup>76</sup> TPC (Sub 69).

<sup>77</sup> Mr P Argy (Sub 60).

<sup>78</sup> See Tirole J, *The Theory of Industrial Organization* (1988) at 186; Waterson M, "Vertical Integration and Vertical Restraints" (Summer 1993) 9 *Oxford Review of Economic Policy* 41.

<sup>79</sup> "Chicago School" theorists have stressed the situations in which vertical restraints can enhance economic efficiency. The most extreme of these positions is that of Bork, who maintains that "every vertical restraint should be completely lawful" *The Antitrust Paradox* (1978) at 288.

<sup>80</sup> See United Permanent Building Society Ltd and Others (TPC determination, 30 June 1976). The TPC found a tendency for tied insurance rates to exceed market rates.

the authority of the Insurance Commissioner, competition is unlikely to be substantially lessened.<sup>81</sup>

In some cases third-line forcing will be less restrictive than full-line forcing conduct. It is anomalous that a supplier tying in favour of a wholly owned subsidiary, or related company, is subject to a *per se* prohibition, but a supplier tying in favour of one of its divisions is subject only to a competition test. The *per se* prohibition may catch some arrangements whereby a group arranges discounts for its members from specified suppliers. Further, there is an artificiality about distinguishing between the forcing of a third party's products and the sale of a package of goods or services.<sup>82</sup>

The variety of problems and anomalies arising from the divergent treatment of third-line forcing and other forms of tying suggests that a more consistent approach would be appropriate. Accordingly, third-line forcing should only be prohibited if it substantially lessens competition.

#### Authorisation/Notification

Authorisation is currently available for all forms of vertical restraints, including third-line forcing. Notification is available for vertical restraints other than third-line forcing. Notification effectively places the onus on the TPC to establish that particular vertical agreements are against the public interest. As there appears to be no significant policy rationale for distinguishing between third-line forcing and other vertical agreements, notification should be extended to third-line forcing.

#### Goods vs Services

Some of the provisions of the current s.47 are directed at restrictions imposed upon one party concerning the re-supply of goods.<sup>83</sup> To come within these provisions, the goods which are initially sold to retailers would need to be the very goods which are re-supplied. The personal nature of many services means that they cannot be resold, and issues of re-supply do not arise. There are other cases in which in

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<sup>81</sup> See Association of Co-operative Building Societies of New South Wales Ltd and Others; (TPC determination, 8 June 1977).

<sup>82</sup> See, eg, *Castlemaine Tooheys Ltd v Williams & Hodgson Transport Pty Ltd* (1986) 162 CLR 395.

<sup>83</sup> See ss.47(2)(e),(f); 47(3)(e),(f); 47(8)(a)(ii); and 47(9)(b).

a loose sense re-supply of services seems to occur, but it may often be the case that the bundle of legal rights which is transferred from wholesalers to retailers is different from the bundle of legal rights which is transferred from retailers to consumers. In such cases, it may not be the same service which is passed on, and there may be no "re-supply" to be addressed. Bearing in mind the wide definition of services in s.4, there may be other cases in which the re-supply of services is possible. For example, the rights to intellectual property might be capable of being re-supplied.

Whether in a legal sense the same service is passed on, it is possible to impose vertical conditions on the re-supply of services. There is no reason in principle why such conduct should not be treated in the same manner as vertical conditions on the re-supply of goods.

### **Conclusion**

The Committee does not believe that third-line forcing is so significantly anti-competitive as to warrant treatment which differs from other forms of tying and recommends that third-line forcing be subject to a competition test and notification.

The Committee considers that the provisions dealing with vertical restrictions on the re-supply of goods should be extended to cover the situation where one person supplying services to a second person imposes conditions on the re-supply of those services, or on the supply of services provided in connection with those services.

Otherwise, the Committee considers that the TPA's treatment of non-price vertical restraints should be incorporated into the competitive conduct rules of a national competition policy.

### **E. RESALE PRICE MAINTENANCE (s.48, Part VIII)**

Resale price maintenance (RPM) is the practice whereby a supplier requires retailers to sell at or above a minimum price. RPM has historically been associated with collusive retailing practices, and the raising of consumer prices. Modern economic thinking, however, recognises that in some circumstances RPM could enhance economic efficiency. For example, a producer who guarantees minimum retail prices may in some situations be promoting economic efficiency by

encouraging the distributors to increase the level of their pre- or post-sales services in relation to the product.

The Committee proposes that the current *per se* prohibition be maintained, and extended to cover practices solely involving services, but that authorisation be made available.

## Background

While it is not generally in a profit-maximising manufacturer's interest to raise dealers' margins above the competitive level, there are a number of possible reasons for the imposition of minimum resale prices.

Dealers' market power may permit a colluding group to fix the resale price and require the manufacturer to enforce it on their behalf. Alternatively, a group of competing manufacturers may use RPM to facilitate collusive or tacit price-fixing arrangements. Such occurrences of RPM are generally recognised as efficiency-reducing.

Other situations in which firms have an incentive to engage in RPM may give rise to efficiency-enhancing behaviour. An efficiency-enhancing role for RPM occurs where it enables producers to improve sales by enhancing customer services or product quality. Where there are problems with "free-riding" on provision of services, RPM can encourage all retailers to provide desirable services which may increase the desirability of manufacturers' products. Manufacturers might adopt RPM to attract dealers or to maintain their loyalty, particularly where dealers are easily able to change allegiance. RPM can be used to enhance a reputation for product quality, at least during the initial period of the product's life cycle. Manufacturers with reputations for high quality and value may adopt RPM to prevent loss leader sales because such sales detract from the product's reputation and lessen incentives for other retailers to carry the product.

## Current Approach

Specification of minimum resale prices is prohibited *per se* in relation to goods, or services sold in connection with goods, but not in relation to services alone.<sup>84</sup> The prohibition does not apply where RPM is used

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<sup>84</sup> Sections 48, 96-100, 4C(b), 4C(c).

in response to loss leader selling.<sup>85</sup> Authorisation is not available for RPM.

#### Overseas Approaches

International treatment of RPM generally supports *per se* prohibition. New Zealand and Canada, have each recently reviewed their legislation, and prohibit RPM *per se*,<sup>86</sup> although New Zealand now permits authorisation. In the UK, resale price agreements which come within the proscribed forms are illegal although exemption mechanisms are available in relation to resale price restrictions imposed by a firm acting unilaterally.<sup>87</sup>

In the EC, while RPM is subject to a general competition test,<sup>88</sup> the practical approach has been fairly stringent. RPM has been considered illegal in cases where groups of suppliers agree to impose resale prices on their purchasers and in cases where a single supplier agrees with its resellers that they will not resupply a product below a certain price.

In the US, resale price maintenance agreements in a vertical relationship, as between a manufacturer and a retailer, are illegal *per se*.<sup>89</sup>

#### Submissions

Several submissions argued that the current prohibition on RPM should be relaxed, either by subjecting it to a competition test<sup>90</sup> or by permitting authorisation<sup>91</sup> or notification.<sup>92</sup> Other submissions suggested that the prohibition be extended to services.<sup>93</sup>

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<sup>85</sup> Section 98(2).

<sup>86</sup> Sections 37 - 42 Commerce Act (NZ); s.61 Competition Act (Canada).

<sup>87</sup> See ss.1 and 9 Resale Prices Act (UK). Classes of goods can be exempted by the Restrictive Practices Court where public interest criteria are satisfied. These exemptions are not available in relation to collective agreements to enforce the maintenance of resale prices.

<sup>88</sup> Article 85 *Treaty of Rome* (EC).

<sup>89</sup> Section 1 Sherman Act (US), *Dr Miles Medical Co v John D Parl & Sons Co* 220 US 373 (1911); *Monsanto Co v Spray-Rite Service Corp*, 465 US 752. It is not illegal, however, for a manufacturer acting unilaterally to announce in advance its resale prices and refuse to do business with non-complying customers: *United States v Colgate & Co* 250 US 300 (1919).

<sup>90</sup> IC (Sub 6); Pacific Dunlop (Sub 112).

<sup>91</sup> IC (Sub 6); Trade Practices Committee of the LCA (Sub 65); TPC (Sub 69); Pacific Dunlop (Sub 112).

<sup>92</sup> Mr P Argy (Sub 60).

<sup>93</sup> DOTAC (Sub 58); Mr P Argy (Sub 60); TPC (Sub 69).



## Consideration

### *Per Se* Prohibition vs Competition Test

Economic theory indicates that there are circumstances in which RPM could enhance economic efficiency. For example, it may be that consumers will buy more of a certain good if there are associated pre-sales services, such as explanation of certain technical matters. Retailers who do not offer those services may operate at lower cost, and thus offer lower prices. Customers may be able to obtain the services from the high cost retailer and buy the goods from the low price retailer. In such situations competition among retailers could result in less than optimal provision of pre-sale services, and thus less than optimal total sales of the manufacturer's product. To increase sales, the manufacturer may wish to encourage all retailers to provide increased services. This might be achieved by RPM because if retailers are unable to compete on price they will be forced to compete in other ways, such as the level of services provided.

There are disputes about the frequency of efficiency-enhancing RPM, both as a matter of theory<sup>94</sup> and as a matter of empirical observation,<sup>95</sup> and it is not clear what sorts of practices would emerge with a modified legislative approach to RPM. Historically RPM in Australia was frequently linked with horizontal agreements to fix prices, either by suppliers or retailers, and this link helped to foster a strong policy stance against RPM. It is clear that such practices should be prohibited.

The uncertainty surrounding the effects of RPM presents a choice between *per se* prohibition and a competition test. The current provision has helped to eliminate many inefficient trade practices, has simplified the task of enforcing the prohibition against such undesirable activities and does not prevent recommended retail prices. The Committee has not been presented with convincing evidence that efficiency-enhancing RPM occurs with such frequency that the *per se* prohibition should be relaxed.

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<sup>94</sup> Scherer FM & Ross D, *Industrial Market Structure & Economic Performance* (1990) at 550 - 558.

<sup>95</sup> Wang Y & Davison M, "Resale Price Maintenance: Is the Per Se Prohibition Justified?", (1992) 14 *Adel LR* 35; Hanks F & Williams P L, "The Treatment of Vertical Restraints Under the Australian Trade Practices Act", (1987) *ABLR* 147.

#### Authorisation/Notification

The economic theory associated with RPM does, however, present a convincing argument that RPM can, in certain circumstances, enhance economic efficiency. These arguments are highly technical, and could appropriately be examined in an authorisation context. Permitting applicants to argue their case before an expert authorising body would permit a better assessment of the practical extent of efficiency enhancing RPM. The empirical evidence of the frequency of such instances of efficiency enhancing RPM is not considered sufficient to warrant the introduction of a notification system, however.

#### Goods vs Services

The RPM provisions as currently drafted refer to resale of goods, but not to resale of services. As with other vertical restrictions noted in relation to s.47, it is possible for manufacturers to impose vertical pricing restraints where services are sold, even if in a legal sense it is not precisely the same service which is resold. There is no reason in principle why services should be treated differently from goods.

#### Conclusion

The Committee considers that a *per se* prohibition of RPM should be included in the competitive conduct rules of a national competition law, and that authorisation should be available to permit firms to argue their case if they believe that their proposed RPM would enhance economic efficiency or provide other net public benefits.

The Committee further considers that the provisions dealing with RPM should cover the situation where one person selling services to a second person requires the second person to re-sell those services at or above a specified price; or where one person selling goods or services to a second person requires the second person to sell other services, provided in connection with the resale of the original goods or services, at or above a specified price.

## F. RECOMMENDATIONS

The Committee recommends that:

- 3.1 The provisions of the Trade Practices Act ("the Act") dealing with non-price horizontal agreements (ie, ss.4D, 45, 45B, 45D and 45E) provide the basis of provisions dealing with such agreements as part of the competitive conduct rules of a national competition policy.
- 3.2 Sections 45A and 45C of the Act provide the basis for the competitive conduct rules governing price-fixing agreements between competitors under a national competition policy, subject to the following amendments:
  - subject to appropriate transitional arrangements, authorisation not be permitted for price fixing agreements covering services;
  - recommended price agreements with 50 or more members be removed as an exemption from the deeming provision of s.45A; and
  - the operation of the joint venture exemption from the deeming provision of s.45A be clarified.
- 3.3 Section 47 of the Act provide the basis for the competitive conduct rules governing non-price vertical agreements under a national competition policy, subject to the following amendments:
  - third-line forcing be made subject to a substantial lessening of competition test and be capable of notification; and
  - provisions dealing with vertical restrictions on the re-supply of goods be extended to transactions involving services.
- 3.4 Section 48 and Part VIII of the Act provide the basis for the competitive conduct rules governing resale price maintenance under a national competition policy, subject to the following amendments:
  - authorisation be available; and
  - the provision be extended to the resale of services.



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## 4. Misuse of Market Power, Mergers & Other Rules

As well as agreements by which firms accept restrictions on their competitive conduct, competition law is concerned with unilateral conduct which adversely affects the level of competition in markets, and with mergers and acquisitions.

Unilateral conduct includes misuse of market power and price discrimination. Misuse of market power embraces a wide range of forms of conduct, and the Committee has come to the conclusion that the existing provision dealing with such conduct should be maintained.

Price discrimination involves the charging of different prices to different customers. The Committee considers that the existing provision, which prohibits price discrimination in certain circumstances is not warranted and should not form part of the competitive conduct rules of a national competition policy.

Mergers and acquisitions are a means whereby the conduct of individual firms affects the structure of the market. The provisions dealing with mergers and acquisitions have recently been amended and the Committee considers that any further review of these provisions should await further experience with the new provisions.

### A. MISUSE OF MARKET POWER (SS.46 & 46A)

*The difficulty in determining what conduct constitutes taking advantage of market power and what conduct does not, stems inevitably from the need to distinguish between monopolistic practices, which are prohibited, and vigorous competition, which is not. Both here and in the United States the search continues for a satisfactory basis upon which to make the distinction. For the most part, all that emerges are synonyms which are not particularly helpful. Words such as "normal methods of industrial development", "honestly industrial", "anti-competitive", "predatory" or "exclusionary conduct" merely beg the question.<sup>1</sup>*

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<sup>1</sup> *Queensland Wire Industries Pty Ltd v Broken Hill Proprietary Company Ltd & Anor* (1989) ATPR ¶150,010, per Dawson J.

The role of a provision dealing with misuse of market power is to distinguish between vigorous competitive activity, which is desirable, and economically inefficient, monopolistic practices, which are undesirable. The difficult task facing legislatures attempting to address misuse of market power is to develop a process which will make the appropriate distinctions while providing businesses with the necessary certainty as to the limits of legal conduct. In one specific area, that of refusals to permit access to facilities of national significance, the Committee sees a case for special processes (discussed in Chapter 11), but in the general case the Committee favours maintaining the form of the current rule so as to avoid dampening desirable competitive vigour and to avoid further uncertainty in an extremely difficult area.

### **Background**

It is the essence of competition that firms should attempt to outperform competitors in a manner which, if successful, could have adverse consequences for those competitors. For example, the introduction of a new and better product might put competitors at a disadvantage or in extreme cases even put them out of business, but is not the sort of conduct which should be prohibited.

Firms with market power may be able to engage in conduct which exceeds the limits of vigorous competition, and thereby entrench their market positions to the detriment of the competitive process. For example, in the *Queensland Wire Industries* case, the High Court found that BHP used its market power to deter or prevent Queensland Wire from engaging in competitive activity in the rural fencing products market, by refusing to supply Queensland Wire with Y-bar, an input for the manufacture of star pickets.

A central difficulty for competition policy, in Australia and elsewhere, lies in distinguishing between vigorous competitive activity by firms with market power, and conduct by such firms which in some way oversteps the mark and prevents the competitive process from continuing to operate effectively. The challenges are to define conduct which is "excessive" in a policy sense, and to develop a mechanism which can identify practical instances of such "excessive" conduct. In addressing these challenges, the need to deter egregious behaviour must be balanced against the need to encourage competitive activity.

There are considerable difficulties in identifying precise categories of conduct which are to be viewed as "excessive." "Predatory pricing" provides an example of these difficulties. Where a firm has greater financial staying power than actual or potential rivals, and there are high barriers to market entry, it may be feasible to temporarily sell below cost, driving competitors out of the market. The firm can then recoup its losses through unconstrained monopoly pricing which may continue for an extended period or even indefinitely. Such predatory pricing is a risky strategy, given that the losses from cutting prices are certain but the gains are dependent upon the uncertain ability to successfully drive competitors out and keep them out of the market.

Predatory pricing provides consumers with lower prices in the short run, but may lead to higher prices in the long term. Predatory pricing is difficult to distinguish from strong competitive behaviour. Industrial organisation theory has not provided a clear definition of what is meant by selling "below cost". There is significant dispute as to whether measures such as marginal cost, average variable cost or average total cost are appropriate or practical, and to what extent long run or short run costs should be emphasised. It seems that no test invariably allows one to predict which particular conduct, when applied to realistic market situations, will lead to higher social welfare in the long run.<sup>2</sup>

Another area of difficulty is that of refusals to deal. The refusal by a firm with market power to deal with others can exclude or eliminate them from markets, or at least raise their costs. Firms with market power may have a number of incentives to refuse to deal with others, particularly where they control essential facilities. Possible reasons for refusing to deal could include restriction of output linked to monopoly pricing;<sup>3</sup> elimination of competitors in downstream markets who undermine the ability to price discriminate in the downstream markets;<sup>4</sup> or avoidance of price regulation.<sup>5</sup> On the other hand, there

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<sup>2</sup> Ordover JA & Saloner G, "Predation, Monopolisation & Antitrust" in Schmalensee R & Willig R, *Handbook of Industrial Organization Vol I*, (1990) at 590.

<sup>3</sup> However, restriction of customers might permit some degree of countervailing power. An alternative strategy would be simply to deal with all comers, but only at the monopoly price.

<sup>4</sup> Eg, a monopolist would like to extract maximum prices from each of its customers, by charging high prices to customers who place a high value on the product and low prices to other customers. The ability to do so is constrained by the existence of competitors who offer lower prices to the high value customers. In response the monopolist may refuse to provide its competitors in the downstream market with an input, driving the competitors out of the market or raising their costs to the point where there is only competition for the high value customers.

may be circumstances where refusals to deal can be justified on efficiency grounds, such as where vertical integration is the most efficient means of operation.

Associated with both refusals to deal and predatory pricing are “price squeezes” by vertically integrated firms who supply competitors. By temporarily raising the price at which it sells to competitors, and lowering the price at which it sells to final customers, such a firm could eliminate its competitors, leaving it free to monopoly price. It may be, however, that the lower price to customers is the result of greater efficiency in the downstream market.

Firms with market power may be able to engage more readily in other restrictive practices, such as exclusive dealing.<sup>6</sup> Exclusive dealing arrangements can raise the barriers to entry because potential competitors must establish their own distribution networks rather than benefiting from the existing one. Other forms of vertical restraints may also be induced by firms with market power. As with vertical restraints generally, there may or may not be a lessening of efficiency as a consequence of such conduct.

Firms with substantial market power may be able to charge monopolistic prices. Such pricing policies are not usually the subject of generally applicable market conduct rules, although they may raise competition policy concerns in some situations. Possible means of addressing these concerns are discussed in Chapter 12.

### Current Approach

The current Australian approach to identifying “excessive” conduct focuses on the purpose of that conduct. Section 46 of the *Trade Practices Act 1974* (TPA) prohibits taking advantage of a substantial degree of power in a market for the purpose of:

- (a) eliminating or substantially damaging a competitor;
- (b) preventing the entry of a person into a market; or

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<sup>5</sup> Eg, where a vertically integrated monopolist is regulated in its monopoly market, but not in its downstream market, it may deny competitors access to the downstream market so that it reaps monopoly profits in the unregulated market. See also, the discussion of the “essential facilities problem in Chapter 11.

<sup>6</sup> See discussion of Vertical Agreements in Chapter Three.



- (c) deterring or preventing a person from engaging in competitive conduct in a market.<sup>7</sup>

Purpose may be ascertained by inference from the conduct of the firm with market power or of any other person, or from any other relevant circumstances.<sup>8</sup> Misuse of market power cannot be authorised, but where particular conduct, such as exclusive dealing, is authorised or notified it will not be taken to contravene s.46.<sup>9</sup>

### Overseas Approaches

A consideration of international experience indicates that there is no universally accepted method of dealing with misuse of market power, although many nations have adopted a purpose-based approach.

The history of the United States (US) prohibition of "monopolisation"<sup>10</sup> is illustrative of the difficulties in this area. The offence has traditionally required the possession of monopoly power and the intention to acquire or maintain that power, but over the past century different courts have been more or less willing to infer the necessary purpose from objective circumstances. At times interpretation of the law has come close to prohibiting the possession of monopoly power *per se*.<sup>11</sup> In more recent years there has been a greater tendency to focus upon the effects of particular conduct,<sup>12</sup> although the purpose element remains a basis of liability. Jurisprudential development has been influenced by political intervention in the enforcement processes. While the prohibition may have discouraged particularly rapacious conduct it may also have deterred desirable competitive activity, and does not appear to be a suitable model for providing business certainty.

New Zealand has adopted a purpose-based approach which is very similar to the Australian approach. The use of a dominant position in

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<sup>7</sup> See also s.46A which provides essentially the same prohibition in relation to trans-Tasman markets. Note also that following a recommendation of the Cooney Committee, ss.46 and 46A were amended in 1992 to provide that references to 'a competitor' or 'a person' include references to competitors or persons generally or particular classes of competitors or persons (ss.46(1A), 46A(2A)). This amendment merely confirmed existing interpretation of s.46.

<sup>8</sup> Section 46(7).

<sup>9</sup> Section 46(6).

<sup>10</sup> Section 2 Sherman Act (US)

<sup>11</sup> Eg, *United States v Aluminium Co (America)* (1945) 148 F 2d 416.

<sup>12</sup> Eg, *MCI Communications Corp v American Telephone & Telegraph Co* (1983) 708 F 2d 1081.

a market for the purpose of restricting entry, preventing or deterring competitive conduct or eliminating a person from a market is prohibited.<sup>13</sup> Authorisation is not available.

The Canadian approach provides a non-exhaustive list of proscribed conduct, but retains a purposive element in all the listed examples (see Box 4.1). Anti-competitive acts, which include the listed forms of conduct, may be prohibited if they substantially lessen competition.<sup>14</sup> Predatory pricing is the subject of a special prohibition addressed at selling at different prices in different areas of Canada with the effect or purpose of substantially lessening competition, or "selling products at prices unreasonably low".<sup>15</sup>

The European Community's (EC) prohibition against the abuse of a dominant position<sup>16</sup> has very wide scope, which it seems has not yet been fully explored. Under this prohibition a number of different types of anti-competitive conduct have been identified by the Commission and the Court, including mergers, price discrimination, tying arrangements and refusal to supply. To distinguish abusive behaviour from legitimate behaviour the Court and Commission have developed a concept of "objective justification". A non-exhaustive list of proscribed conduct is provided.<sup>17</sup>

The United Kingdom (UK) has not defined the circumstances which might constitute a misuse of market power. Conduct may be investigated administratively,<sup>18</sup> and these investigations can lead to orders being made by the Secretary of State for Trade and Industry, prohibiting the conduct. There is some dissatisfaction with this approach, with the Government having recently canvassed various options for an improved approach, including introducing a

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13 Section 36 Commerce Act (NZ).

14 Section 79 Competition Act (Canada).

15 Competition Act s.50(b),(c).

16 Article 86, *Treaty of Rome* (EC).

17 The list includes matters such as unfair prices; limiting production, markets or technical development to the prejudice of consumers; applying dissimilar conditions to equivalent transactions placing other firms at a competitive disadvantage; and imposing contractual conditions which by their nature or according to commercial usage have no connection with the subject of the contract.

18 Anti-competitive practices: s.2-10 Competition Act (UK); monopoly situations or general reference: Pts I, IV, s.78 Fair Trading Act (UK).

prohibition against abuse of market power such as the EC's prohibition.<sup>19</sup>

**Box 4.1: Abuse of a Dominant Position in Canadian Law**

Section 79 of Canada's *Competition Act* provides that where a person substantially or completely controls a "class or species" of business, and has engaged in or is engaging in a practice of "anti-competitive acts" and the practice has the effect of preventing or lessening competition substantially in a market, the Competition Tribunal may make an order prohibiting the practice.

Section 78 defines "anti-competitive act" to include any of the following:

- (a) squeezing, by a vertically integrated supplier, of the margin available to an unintegrated customer who competes with the supplier, for the purpose of impeding or preventing the customer's entry into, or expansion in, a market;
- (b) acquisition by a supplier of a customer who would otherwise be available to a competitor of the supplier, or acquisition by a customer of a supplier who would otherwise be available to a competitor of the customer, for the purpose of impeding or preventing the competitor's entry into, or eliminating the competitor from, a market;
- (c) freight equalisation on the plant of a competitor for the purpose of impeding or preventing the competitor's entry into, or eliminating the competitor from, a market;
- (d) use of fighting brands introduced selectively on a temporary basis to discipline or eliminate a competitor;
- (e) pre-emption of scarce facilities or resources required by a competitor for the operation of a business, with the object of withholding the facilities or resources from a market;
- (f) buying up of products to prevent the erosion of existing price levels;
- (g) adoption of product specifications that are incompatible with products produced by any other person and are designed to prevent his entry into, or to eliminate him from, a market;
- (h) requiring or inducing a supplier to sell only or primarily to certain customers, or to refrain from selling to a competitor, with the object of preventing a competitor's entry into, or expansion in, a market; and
- (i) selling articles at a price lower than the acquisition cost for the purpose of disciplining or eliminating a competitor.

<sup>19</sup> See UK Department of Trade & Industry, *Abuse of Market Power: A Consultative Document on Possible Legislative Options* (Nov 1992).

## Submissions

Although several submissions supported Australia's current approach to this issue,<sup>20</sup> there were several proposals for new approaches.

One submission proposed an administrative regime which would investigate the economic efficiency of particular conduct, as opposed to a legal prohibition.<sup>21</sup> Other submissions supported retention of the prohibition approach, but suggested possible amendments.

A proposal to extend the prohibition to *effects* on competition, as well as purpose, was supported by some submissions,<sup>22</sup> but was specifically opposed by others.<sup>23</sup>

Several submissions supported the purpose-based prohibition but proposed some variation. Proposals included: minor amendments to the existing proscribed purposes to clarify that the provision protects competition rather than individual firms;<sup>24</sup> the introduction of a rebuttable presumption of intent in defined circumstances;<sup>25</sup> the addition of a requirement that the proscribed conduct be conduct which a firm in a competitive market would not have engaged in without economic loss to itself;<sup>26</sup> and provision for authorisation of misuse of market power.<sup>27</sup>

Some submissions saw difficulties in principle in the application of the current provision in cases of refusal to deal, proposing special regimes to deal with such problems.<sup>28</sup> Others saw practical difficulties in the provision of pricing remedies in misuse of market power cases.<sup>29</sup>

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20 Eg, IC (Sub 6); Treasury (Sub 76); National Institute of Accountants (Sub 88); BCA (Sub 93); BHP (Sub 133).

21 PSA (Sub 97).

22 Prof R Baxt (Sub 18); TPC (Sub 69); Mr C Sweeney (Sub 119).

23 IC (Sub 6); Trade Practices Committee of the LCA (Sub 65); Treasury (Sub 76); BHP (Sub 113).

24 Prof R Baxt (Sub 18); PSA (Sub 97); NSW Govt (Sub 117); Mr C Sweeney (Sub 119).

25 IC (Sub 6).

26 Mr C Sweeney (Sub 119).

27 Trade Practices Committee of the LCA (Sub 65).

28 DOTAC (Sub 58); Dr S Corones (Sub 86).

29 IC (Sub 6); Dr W Pengilly (Sub 11); Mr M Corrigan (Sub 72); Dr S Corones (Sub 86); PSA (Sub 97); NSW Govt (Sub 117).

## **Consideration**

The central conundrum in addressing the problem of misuse of market power is that the problem is not well defined nor apparently amenable to clear definition. There is considerable debate about what sorts of conduct should be prohibited. Even if particular types of conduct can be named it does not seem possible to define them, or the circumstances in which they should be treated as objectionable, with any great precision. For example, it may be possible to say that "predatory pricing" is undesirable, but it does not seem possible to give a clear definition of what will amount to predatory pricing in all circumstances.

Faced with this problem, but recognising that there are clearly some cases which do go beyond the limits of vigorous competitive conduct and extend into the realm of conduct by which firms damage the competitive process, the challenge is to provide a system which can distinguish between desirable and undesirable activity while providing an acceptable level of business certainty. In this respect it is important to stress that uncertainty over the bounds of legally acceptable behaviour may deter efficient and socially useful competitive behaviour.

In addressing this challenge, the Committee starts from the position that there is already in place a regime which provides a basis for making the appropriate distinctions, that the regime is broadly consistent with approaches in comparable overseas jurisdictions, and that it has been sufficiently interpreted by the High Court to provide a reasonable degree of business certainty as to the limits of acceptable conduct. Moreover, none of the submissions presented to the Inquiry gave practical examples of any particular behaviour that was not proscribed by the current law and yet was clearly unacceptable. The Committee thus considers that proposals for alternative mechanisms for dealing with misuse of market power should offer a demonstrable improvement over the current regime to justify introducing further uncertainty in this difficult area.

### **Prohibition Approach vs Administrative Approach**

Perhaps the boldest proposal for dealing with misuse of market power was that administrative investigation should replace legal prohibition.

The approach of prohibiting misuse of market power has been adopted by, inter alia, Australia, New Zealand, the US, the EC and Canada. An administrative approach has been adopted in the UK, whereby misuse of market power is investigated and undertakings are sought to restrain future conduct contrary to the public interest. The disadvantages of the UK scheme have been seen as relatively weak deterrence flowing from the absence of a prohibition; the absence of third party rights, leaving affected parties without remedies such as damages or injunctions; and reliance on potentially slow government inquiries.<sup>30</sup> A body with wide investigatory powers also has the potential to be highly intrusive. Australian courts have a strong reputation for consistency and fairness, and the notion of judicial precedent enhances business certainty. Overall, the Committee was not satisfied that any deficiencies in the current law warranted so bold a departure in approach.

#### Purpose Test vs Effects Test

The TPC proposed that unilateral conduct should be prohibited if it has the effect of substantially lessening competition.<sup>31</sup> Such a test would not, in the Committee's view, constitute an improvement on the current test. It does not address the central issue of how to distinguish between socially detrimental and socially beneficial conduct.

As the High Court has observed, the very essence of the competitive process is conduct which is aimed at injuring competitors. A firm that succeeds in aggressive competitive conduct 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. The courts might develop a gloss upon an effects test to ensure that it did not prohibit

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<sup>30</sup> See UK Department of Trade & Industry, *Abuse of Market Power: A Consultative Document on Possible Legislative Options* (Nov 1992).

<sup>31</sup> TPC (Sub 69). Also note Mr C Sweeney (Sub 119).

economically efficient conduct, but it is not clear that the final result would differ from the existing interpretation of s.46, or that any such difference would constitute an improvement.

Section 46 has been interpreted by the High Court in a manner which accords with the policy intention of distinguishing between a misuse of market power and aggressive competitive behaviour. In an oft-cited passage, Mason CJ and Wilson J noted that:

Competition by its very nature is deliberate and ruthless. Competitors jockey for sales, the more effective competitors injuring the less effective by taking sales away. Competitors almost always try to "injure" each other in this way. This competition has never been a tort and these injuries are the inevitable consequence of the competition section 46 is designed to foster.<sup>32</sup>

The courts have indicated that they are alert to the distinctions which the legislature has attempted to make. There is a growing body of case law dealing with misuse of market power, and over time the limits of the existing provision will be explored. The current provision has the advantages over an effects test of an appropriate interpretation and a greater level of certainty for businesses.

#### Modifications of Current Purpose-Based Approach

One submission suggested that there may be specific circumstances in which the burden of proof should be reversed by a rebuttable presumption of proscribed purpose. The difficulty is determining what those circumstances might be. For example, the Industry Commission suggested that where price discrimination which substantially lessens competition has been demonstrated, the presumption could operate.<sup>33</sup> Given the difficulties associated with proving that price discrimination substantially lessens competition, this might not greatly advance an applicant's cause.<sup>34</sup> To simply reverse the onus of proof when price discrimination is proven would threaten much efficient behaviour.

It was suggested that, although the High Court's interpretation of s.46 as protecting the competitive process, rather than competitors, was

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<sup>32</sup> *Queensland Wire Industries Pty Ltd v Broken Hill Proprietary Company Ltd & Anor* (1989) ATPR ¶50,010.

<sup>33</sup> IC (Sub 6). The IC's proposal was based on the assumption that s.49 would be repealed.

<sup>34</sup> See the discussion of price discrimination below.

appropriate, it would be desirable to amend the words of s.46 to confirm that interpretation. The Committee was not convinced that such an amendment would enhance the operation of s.46, and could serve to increase, rather than decrease, uncertainty in this area.

Another proposal was to introduce an additional criterion of liability, that the conduct in question be conduct which a firm in a competitive market would not have engaged in without economic loss to itself.<sup>35</sup> The Committee was not persuaded that this proposal would add much to the existing interpretation of the phrase "take advantage of" market power,<sup>36</sup> but it could increase uncertainty over the operation of the provision.

Finally, there have been suggestions that s.46 might be amended to include a non-exhaustive list of proscribed purposes, which would include more closely defined practices such as predatory pricing. This is the approach adopted in Canada and outlined in Box 4.1. Such an approach could suggest a greater degree of precision concerning proscribed practices than is warranted. To take predatory pricing, for example, there is considerable controversy over the appropriate level of price below which pricing should be regarded as "predatory". Greater precision in the language of the prohibition might intimate a non-existent nexus between particular conduct and purpose. Explicit specification of particular purposes could lead to the exclusion of conduct which should be caught, either because litigants are less likely to bring actions or because courts are more reluctant to find a contravention where the relevant conduct does not occur in the proscribed list. As with other proposals for change in this area, the proposal would undermine existing certainty, without putting forward a regime which would be any more certain in its operation.

### Authorisation

It has been suggested that there should be the capacity to authorise conduct which would contravene s.46, particularly if there were to be an "effects" test. However, the potential for authorisation would not resolve the difficulties with that test. The outcome would be to require consultation with the competition authority for a wide range

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<sup>35</sup> Mr C Sweeney (Sub 119).

<sup>36</sup> The High Court in *Queensland Wire* indicated that taking advantage of market power required the use of that power in a manner made possible only by the absence of competitive conditions.



of normal business activities, such as the decision to introduce a new and better product or to embark on an aggressive marketing campaign. Such regulatory intrusion into daily business activities goes well beyond the purpose of a prohibition on misuse of market power.

More generally, the Committee was not persuaded of the need for or desirability of authorisation in misuse of market power situations. Conduct which contravenes other provisions can be authorised, and while such an authorisation remains in place, will not be taken to contravene s.46.<sup>37</sup>

### Refusals to Deal

There have been a number of cases under s.46 involving refusals to deal. Although there have been criticisms of courts' ability to provide remedies in such situations, the Committee is not convinced that alternative proposals for a generally applicable duty to deal are capable of being sufficiently specific in their application to ensure they would not themselves lead to inefficient results. Nor has the Committee been satisfied that these alternatives would avoid the difficulties inherent in this area, or lead to "better" outcomes.

In the US, an "essential facilities" doctrine has developed in the interpretation of the Sherman Act. Under this doctrine, a person who controls an "essential facility" is obliged to provide access to the facility to competitors.<sup>38</sup> To illustrate the limits of the US law, courts have found football and basketball stadiums to be essential facilities,<sup>39</sup> and a small photographic company has argued (albeit unsuccessfully) that it should have access to the products of Kodak's research to enable it to compete with Kodak.<sup>40</sup> The limits of the US doctrine are not yet clear, and it has been observed that "the doctrine has not developed with clarity, coherence or consistency, let alone with strong economic foundations".<sup>41</sup> The Committee is not satisfied that the

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<sup>37</sup> See s.46(6).

<sup>38</sup> The most concise definition of the doctrine is given in *MCI Communications v American Telephone & Telegraph Co* (1983) 708 F 2d 1081; cert denied 464 US 891; but this definition has never been adopted by the Supreme Court.

<sup>39</sup> *Hecht v Pro-Football, Inc*, 570 F 2d 982 (DC Cir 1977), cert denied 436 US 956 (1978); *Fishman v Estate of Wirtz*, 807 F 2d 520 (7th Cir 1986).

<sup>40</sup> *Berkey Photo v Eastman Kodak Co* 603 F 2d 263 (2d Cir 1979), cert denied 444 US 1090 (1980).

<sup>41</sup> See Vautier K M, *The "Essential Facilities" Doctrine* (1990) at 65. See also Areeda P, "Essential Facilities: An Epithet in Need of Limiting Principles" (1990) 58 *Antitrust Law Journal* 841.

doctrine has sufficiently developed to provide a suitable model for Australian law.

Nevertheless, the national importance of some industries may require that a positive duty to deal be created, albeit in carefully circumscribed circumstances. The Committee's proposals in this area are detailed in Chapter 11.

### Pricing Issues

A number of submissions noted that there were difficulties with pricing remedies under s.46, particularly in relation to refusals to deal. These issues are considered in Chapter Seven.

### Conclusion

The Committee sees a need to strike a balance between deterring undesirable unilateral conduct, encouraging business certainty and minimising the regulatory interference in daily business decisions. The Committee is not satisfied that any perceived difficulties with the current operation of s.46 are sufficient to warrant an amendment that would create additional uncertainty and thus potentially deter vigorous competitive activity. The Committee recommends that the current misuse of market power provision should be included in the conduct rules of a national competition policy.

## **B. PRICE DISCRIMINATION (s.49)**

The prohibition against price discrimination prevents the sale of like goods to different persons at different prices, where such discrimination substantially lessens competition. The provision is contrary to the objective of economic efficiency and has not been of assistance to small businesses. The Committee does not believe that it is the role of the competitive conduct rules to protect any particular sector of society, and does not believe that the competition rules should be used to achieve objectives contrary to economic efficiency.

### Background

Price discrimination is the sale or purchase of different units of a good or service at price differentials not directly corresponding to

differences in supply cost.<sup>42</sup> In general, sellers can only profitably engage in systematic price discrimination where they have some degree of market power, are able to segregate their customers into distinct groups, and the opportunities for resale from low priced customers to high priced customers ("arbitrage") are limited.

Price discrimination can enhance competition by encouraging price experimentation<sup>43</sup> or by helping to undermine an oligopolistic pricing discipline.<sup>44</sup> Certain forms of systematic price discrimination, such as Ramsey pricing,<sup>45</sup> can enhance economic efficiency in some circumstances.

On the other hand, price discrimination can be anti-competitive where it enables a firm to entrench its position of market power by creating strong buyer-seller ties and thus raising barriers to the entry of new competitors. Extreme forms of price discrimination can amount to predatory pricing.<sup>46</sup>

#### Current Approach

Price discrimination is prohibited by s.49 where a firm discriminates between purchasers of like grade and quality in relation to the prices charged for the goods, or discounts or other matters in relation to the supply of the goods; and the discrimination is of such magnitude or of such a recurring or systematic character that it is likely to substantially lessen competition.

There are two defences to s.49. The first is where the discrimination makes only reasonable allowance for differences in the cost of manufacture, sale or delivery resulting from the different places to

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<sup>42</sup> Scherer F M & Ross D, *Industrial Market Structure & Economic Performance* (1990) at 489.

<sup>43</sup> A firm might not wish to jeopardise its profits, or provoke adverse competitor or rival reactions by cutting price across its whole market, but might be willing to experiment with the effects of a price cut if it can lower price in respect of a small test area.

<sup>44</sup> Where it becomes known that one of the oligopolists has been granting secret discounts to a few aggressive buyers, other firms may try to match or undercut the discounts, price concessions spread and the prices to all buyers are eventually reduced.

<sup>45</sup> In general, an economically efficient outcome will be achieved if a firm sets price equal to marginal cost. Where a firm faces increasing returns to scale over a large range (usually associated with substantial fixed costs) to do so would ensure that the firm makes a loss. Ramsey pricing provides a formula whereby firms remain profitable, but price relatively efficiently. It relies on being able to discriminate between different classes of customers each of which has different demand characteristics.

<sup>46</sup> Predatory pricing was discussed in relation to misuse of market power.

which, methods by which or quantities in which the goods are supplied to the purchasers. The second is where the discrimination occurs in good faith, to meet a price or benefit offered by a competitor.

Instances of anti-competitive price discrimination might also contravene s.45 (agreements which substantially lessen competition) or s.46 (misuse of market power).

Industry-specific provisions dealing with price discrimination exist in relation to outwards liner cargo shipping,<sup>47</sup> petroleum retail franchising<sup>48</sup> and telecommunications.<sup>49</sup>

### Overseas Approaches

New Zealand has no provision equivalent to s 49. Charging different prices to different customers will only be illegal if it contravenes the general prohibition against agreements which substantially lessen competition, or amounts to a misuse of market power.

In the UK, price discrimination could be investigated administratively,<sup>50</sup> but there is no prohibition against unilateral price discrimination.

In the EC, Article 85(1)(d) prohibits agreements which "apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage".

In Canada, price discrimination between competitors who purchase similar volumes of a product is prohibited.<sup>51</sup> The supplier must know that the purchasers are in competition and make a practice of discrimination for this to be an offence.

In the US, price discrimination is prohibited by the *Robinson-Patman Act* 1914. The US law differs from the Australian law in that conduct may be prohibited where adverse effects on particular competitors are

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<sup>47</sup> Section 10.05.

<sup>48</sup> Section 20 *Petroleum Retail Franchising Act* 1980 (Cth).

<sup>49</sup> Part 9 Division 4 *Telecommunications Act* 1991 (Cth).

<sup>50</sup> Under the *Fair Trading Act* 1973 (UK) or the *Competition Act* 1980 (UK).

<sup>51</sup> Section 50 *Competition Act* (Canada).

proven. There has been considerable criticism of this law over a number years.<sup>52</sup>

### Submissions

Several submissions called for the repeal of section 49, suggesting that anti-competitive price discrimination can be dealt with under other provisions, particularly s.46.<sup>53</sup> The Small Business Coalition suggested that the provision be amended to prohibit price discrimination that disadvantages individuals without the requirement to show damage to competition in a market.<sup>54</sup>

There were opposing views on the extension of the provision to services. Some engaged in service industries argued that the provision should not be extended to them.<sup>55</sup> Others suggested that if the provision were to be retained there was no logical basis for treating goods and services differently in this respect.<sup>56</sup>

### Consideration

There are considerable practical difficulties with s.49. It is not clear what degree of similarity is required for goods to be regarded as being "of like grade and quality"; it is not clear what might constitute a "reasonable" allowance for differences in cost; and it is not clear whether, when meeting a competitor's price, the goods must bear the same degree of similarity to the competitor's goods as is required by the phrase "of like grade and quality". The cost defence does not necessarily correspond with those factors which firms would monitor or consider significant.

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<sup>52</sup> Professor George Stigler has been quoted as saying: "if all economists in favour of [the US price discrimination law] were put into a Volkswagen, you'd still have room for a portly chauffeur": (1984) 53 *The Antitrust Law Journal* at 845.

<sup>53</sup> Dr W Pengilly (Sub 11); Trade Practices Committee of the LCA (Sub 65); Treasury (Sub 76); BCA (Sub 93); PSA (Sub 97); TPC (Sub 69); NSW Govt (Sub 117); BHP (Sub 133).

<sup>54</sup> Small Business Coalition (Sub 100).

<sup>55</sup> National Institute of Accountants (Sub 88).

<sup>56</sup> DOTAC (Sub 58); TPC (Sub 69); Australian Federation of Travel Agents Limited (Sub 96); Small Business Coalition (Sub 100).

More importantly, there are concerns that the prohibition on price discrimination may discourage pro-competitive conduct. As Corones<sup>57</sup> has observed:

If prices must be equal, suppliers will be prevented from granting discounts to purchasers with large requirements such as grocery chains in the absence of a cost justification. The public generally will be denied the lower retail price the purchaser with large requirements would have been able to offer its customers, and prices may tend to go up to the level of the corner store rather than down to the level of the chain store.

In 1976 the Swanson Committee gave similar reasoning for recommending the repeal of s.49. It observed:<sup>58</sup>

In the Australian context the conduct of a large buyer who is endeavouring to secure price cutting in its favour, whether it be discriminatory or not, may be more pro-competitive than anti-competitive. Indeed such price cuts as a large buyer is able to obtain can trigger off competition from rival suppliers or can trigger off competition in a market, where other forces are unlikely to produce active competition.

... [T]he prohibition on price discrimination has, in our view, operated substantially to limit price flexibility. The Committee believes that in the Australian context, s.49 has produced such price inflexibility that the detriment to the economy as a whole outweighs assistance which small business may have derived from it. It is price flexibility which is at the heart of competitive behaviour.

As indicated by the Swanson Committee, there may be perceptions that s.49 offers particular protection to small businesses. In the US, the Robinson-Patman Act was initially enacted, at least in part, in response to concerns that the discounts for large volumes which chain stores obtained from manufacturers were threatening the existence of local corner stores and independent operators. In a 1977 review of the Robinson-Patman Act, the US Department of Justice condemned the Act as having failed to achieve any of its aims, and as having actually harmed competition by imposing rigid pricing in oligopolistic

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<sup>57</sup> Corones S G, *Competition Law and Policy in Australia* (1990) at 291, summarising the reasoning in *O'Brien Glass v Cool & Sons* (1983) ATPR 40-376.

<sup>58</sup> Trade Practices Act Review Committee (Swanson Committee), *Report to the Minister for Business and Consumer Affairs* (1976) at 45-46.

markets, where firms have used the law to prevent competitors from engaging in price-cutting.<sup>59</sup>

The Australian provision is more limited than the US provision. Section 49 only applies where there is an adverse effect on competition in a market, while the US law applies where there is a probable adverse effect on particular competitors; and there are other aspects of burden of proof and level of required probability which provide s.49 with a more limited operation than its US counterpart. Where the US provisions have been ineffective it seems likely that the more limited operation of s.49 would similarly offer little comfort to small businesses. Indeed, in 1979 the Blunt Committee recommended repeal of s.49, notwithstanding that it was required by its terms of reference to explore avenues for the improvement of the market position of small business.<sup>60</sup>

It has been suggested that if s.49 were not repealed it might require amendment to permit Ramsey pricing or the price discrimination relied on by some government businesses to deliver community service obligations. Although it seems unlikely that Ramsey pricing or the delivery of community service obligations would cause a substantial lessening of competition in a market, repeal of the section would have the added advantage of overcoming any remaining concerns of this nature. This may be particularly important given the imperative to ensure the competitive conduct rules of a national competition policy receive full application, particularly to currently excluded government businesses.

## Conclusion

The Committee considers that price discrimination generally enhances economic efficiency, except in cases which may be dealt with by s.45 (anti-competitive agreements) or s.46 (misuse of market power). To the extent that s.49 has had any effect it seems to have been to diminish price competition. The Committee does not consider that competition policy should be distorted to provide special protection to any interest group, including small business, particularly where this is potentially to the detriment of the welfare of the community as a

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<sup>59</sup> Cited in Trade Practices Consultative Committee (Blunt Committee) *Small Business and the Trade Practices Act* (1979) at Vol I, 96-97.

<sup>60</sup> Trade Practices Consultative Committee (Blunt Committee), *Small Business and the Trade Practices Act* (1979).

whole. Sectoral assistance policy of this sort is generally most efficiently implemented by more open and direct assistance, including budgetary and taxation measures of various kinds. In any event, it seems clear that small businesses have not achieved any significant benefit from the presence of s.49.

Concerns about the implications of the current provision for some currently excluded sections — particularly government businesses — make the case for repeal overwhelming. The Committee recommends that a provision such as s.49 should form no part of a national competition policy, and that the existing provision should be repealed.

### **C. MERGERS AND ACQUISITIONS (SS.50 & 50A)**

The role of a merger provision is to distinguish between welfare enhancing and welfare reducing mergers and acquisitions. The current provisions dealing with mergers are the result of considerable public consultation and the Committee proposes that they form the basis of the merger provisions of a national competition policy.

#### **Background**

Mergers between firms can be an effective way of developing competitive advantage, optimising the benefits of complementary strengths and taking advantage of economies of scale and scope. Mergers can also operate as an important discipline upon poorly performing management. Merger activity can thus improve efficiency to the benefit of consumers and the community generally.

At the same time, mergers, by definition, result in a reduction in the number of participants in an industry, at least in the short term. In some cases, and particularly where there are significant barriers to market entry, mergers can lead to increased industry concentration and possibly increased market power which may be against the community interest. For this reason, most modern western economies include in their competition law a mechanism for distinguishing between welfare enhancing and welfare diminishing mergers.

#### **Current Approach**

Section 50 of the TPA was amended in late 1992 to prohibit mergers or acquisitions which have, or are likely to have, the effect of



substantially lessening competition unless authorised. Interpretation of the merger test has been buttressed by the inclusion of a set of non-exhaustive factors.<sup>61</sup> Between 1977 and the 1992 amendments, the relevant test was "market dominance".

The test for authorisation is currently administered by the TPC and requires the showing of a net public benefit. A significant increase in the real value of exports, or a significant substitution of domestic products for imported goods, is to be regarded as a public benefit and consideration must also be given to any other relevant matter relating to the international competitiveness of any Australian industry.<sup>62</sup>

The Government has announced plans to introduce a pre-merger notification scheme.

### Overseas Approaches

Of the countries examined, international treatment of mergers was evenly divided between a "substantial lessening of competition" test and a "dominance" test.

In the US, mergers which substantially lessen competition are prohibited.<sup>63</sup>

In New Zealand, mergers which result in or strengthen a dominant position are prohibited, unless authorised.<sup>64</sup>

In the UK, mergers are dealt with administratively and may be prohibited where found to be contrary to the public interest, having regard to matters such as competition, consumer interests, efficiency, regional employment and export growth.<sup>65</sup>

In the EC, the Merger Control Regulation provides that mergers with a Community dimension (assessed by reference to turnover of the merging firms) are assessed by the Commission to determine whether they are compatible with the common market. A merger which creates or strengthens a dominant position as a result of which

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61 Section 50(3).

62 Section 90(9A).

63 Section 7 Clayton Act (US).

64 Sections 47, 50, 66-69, 88(9). Commerce Act (NZ).

65 Sections 57-77, 84 Fair Trading Act (UK).

effective competition would be significantly impeded in the common market, or in a substantial part of it, will be declared incompatible with the common market.

In Canada, mergers may be prohibited if they are likely to prevent or lessen competition substantially, but will not be prohibited if they are likely to bring about efficiency gains which outweigh any lessening of competition.<sup>66</sup>

Pre-merger notification exists in various forms in the US, the EC and Canada.<sup>67</sup> New Zealand abandoned its pre-merger notification requirements in 1990.

### Submissions

A number of submissions indicated opposition to the new "substantial lessening of competition" test,<sup>68</sup> while others indicated support.<sup>69</sup>

### Consideration

The evidence concerning the benefits or detriments of mergers is equivocal.<sup>70</sup> Studies which have examined share market values have indicated that target firms' shareholders benefit, while bidding firms' shareholders are likely to at least break even. Studies which have examined returns on investment have found returns to be negative, on average, in the two years after merger, and declines in profitability have been observed following mergers. A study in 1990 by the Bureau of Industry Economics found only modest benefits from the studied mergers, and that the benefits were much less than had been expected prior to the merger. These studies have obviously not included analysis of mergers which have not proceeded because they contravened competition laws. It could be expected that the competitive detriments of mergers would be greater in cases which create or enhance market power, or have significant adverse effects upon the level of competition, although these detriments might be offset by increased returns to shareholders.

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<sup>66</sup> Sections 91-100 Competition Act (Canada).

<sup>67</sup> Hart Scott Rodino Antitrust Improvements Act (US); Article 4 Merger Control Regulation (EC); Part IX Competition Act (Canada).

<sup>68</sup> Prof R Baxt (Sub 18); Caltex Aust (Sub 27); Carlton & United Breweries (Sub 34); MTIA (Sub 59); Pioneer International (Sub 81); BCA (Sub 93).

<sup>69</sup> IC (Sub 6); TPC (Sub 69).

<sup>70</sup> See EPAC (Sub 126) for a survey of recent studies.

Debate concerning the appropriate test for mergers has focused on the alternatives of "dominance" or "substantial lessening of competition". Relevant factors include the regulatory and compliance costs of different tests, the need to encourage industry efficiency and scale economies, the desirability of consistency in tests between the mergers provisions and other provisions in the Act, the need for business certainty and the benefits or detriments flowing from mergers which are not caught by one or the other of the tests.

The issue of the appropriate merger test has been canvassed extensively in recent years, and was the subject of detailed inquiry by the Griffiths Committee in 1989 and the Cooney Committee in 1991. The amendments flowing from the Cooney Committee recommendations only commenced in late 1992, and have yet to be subject to judicial consideration. Against this background, the Committee is satisfied that any review of the merger provisions should await more practical experience with the operation of the amended provisions.

Details of the Government's proposed pre-merger notification scheme have not been released. The benefit of such a scheme is that it will ensure that the competition authority is always given sufficient notice of mergers to examine them and take appropriate action before their consummation. The potential detriment of such a scheme is that it may impose substantial burdens upon businesses, through information requirements and through delays to mergers while notifications are considered. The Committee would be concerned if the benefit of the scheme were outweighed by the burdens imposed upon businesses. An essential criterion in the evaluation of the scheme will be whether it is administratively simple and imposes minimal reporting obligations on businesses.

## **Conclusion**

The Committee considers that a form of merger regulation is an important part of a national competition policy. It is also satisfied that any more detailed review of the merger provision of the TPA could best be undertaken with the benefit of more practical experience with the amended provisions.

## **D. RECOMMENDATIONS**

The Committee recommends that

- 4.1 The provisions in the Trade Practices Act relating to misuse of market power and mergers provide the bases for provisions on these matters in a national competition policy; and
- 4.2 A specific prohibition on price discrimination not be included in a national competition policy, and s.49 of the Act be repealed.

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## **5. Scope of Application: Principles & Issues**

There are compelling efficiency and equity arguments for ensuring that competitive conduct rules of the kind proposed in this Part are applied uniformly and universally throughout the economy, with exemptions or special treatment accorded only on demonstrated public interest grounds. Despite this, the conduct rules of the *Trade Practices Act 1974* (TPA) are subject to a number of significant gaps and limitations, some of which are not so justified.

The operation of these limiting exceptions is complex, with some sectors of the economy potentially subject to more than one possible exception. This Chapter examines each of the current exemption mechanisms and concludes that only four of the existing seven mechanisms should be retained, and that the remaining three be limited in important respects. The following Chapter reviews the impact of the current exceptions and the Committee's findings on particular sectors of the economy.

**Section A** of this Chapter explores the rationale for universal application of competitive conduct rules and the bases for permitting exceptions in some circumstances, and presents an overview of the extent of current exceptions.

**Section B** examines the current exception mechanisms on a case-by-case basis, considering their conformity with principles already agreed by Heads of Australian Government, overseas approaches and submissions, and presents the Committee's conclusions on each.

**Section C** presents the Committee's recommendations.

### **A. UNIVERSAL APPLICATION & POSSIBLE LIMITS**

This Section outlines the rationales for universal and uniform national application of market conduct rules; considers possible rationales for limiting the application of those rules in some cases; and provides a brief overview of the exceptions to the current Act.

## 1. Rationales for Universal & Uniform Application

The two main rationales for the universal and uniform application of competitive conduct rules of the kind proposed in this Part are efficiency and equity.

First, the competitive conduct rules are aimed at protecting the competitive process and thereby avoiding misallocation of resources and inefficiency which adversely affects community welfare. Exemption of particular businesses, sectors of business or kinds of conduct has the potential to induce inefficiency and disadvantage consumers.

Second, exemption from market conduct rules can be inequitable as between businesses. As the Swanson Committee observed:<sup>1</sup>

We believe it to be extremely important that the Trade Practices Act should start from a position of universal application to all business activity, whether public sector or private sector, corporate or otherwise. Only in this way will the law be fair, be seen to be fair, and avoid giving a privileged position to those not bound to adhere to its standards.

The efficiency rationale has never been more important. Australia is under increasing pressure to improve its international competitiveness so as to maintain and improve living standards. In this environment, pleas for special treatment warrant the closest scrutiny. This is particularly so in respect of many of the current exemptions from the TPA — including some government-provided services such as electricity and port services and private professional services — which are largely sheltered from international competition, yet provide key inputs to businesses that must contend with domestic and international competition.

Several of the sectors currently excluded from the TPA are being exposed to competition to various degrees to improve their efficiency. Individual enterprises are being given increasing autonomy over pricing, marketing and other business decisions. In this environment, it is important to ensure that anti-competitive habits acquired while under a regulated regime are not perpetuated after deregulation through anti-competitive practices by individual firms. For example,

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<sup>1</sup> Trade Practices Act Review Committee, *Report to the Minister for Business and Consumer Affairs* (1976) at 84.

the expected benefits of introducing competition to electricity generation, and of deregulating agricultural production, would be lost if producers remained free to collude to fix prices, use their market power to limit consumer choice, or to engage in other anti-competitive activity.

The equity rationale is also attracting increasing attention, particularly in relation to the continuing exemption of some government businesses, which are becoming increasingly commercial and now often compete directly with firms that must comply with competitive conduct rules. Submissions received by this Inquiry indicate that this has become a major concern across the community.<sup>2</sup>

These considerations have already been recognised by the Heads of Australian Governments, who agreed in 1992 that a national competition policy should, as far as possible, apply universal and uniformly applied rules of market conduct to all market participants.

The Committee thus approaches its task with a strong presumption favouring universal and uniform coverage of the market conduct rules proposed in this Part. Moreover, consistent with the principles agreed to by the Heads of Governments,<sup>3</sup> it will be seeking to ensure:

- that any exceptions from such universal coverage are only permitted on public interest grounds;
- that claims of public interest are assessed by an appropriate transparent assessment process, with provision for review; and
- that reforms in this area are consistent with the development of an open, integrated domestic market for goods and services and, in recognition of the increasingly national operation of markets, reduce complexity and eliminate administrative duplication.

## **2. Possible Grounds For Providing Exemptions or Special Treatment**

In view of the efficiency and equity objectives considered above, it is clear that any exemptions from the application of competitive conduct

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<sup>2</sup> Some wider issues associated with “competitive neutrality” in these settings are discussed in Chapter 13.

<sup>3</sup> The principles are set out in the Terms of Reference (Annex A) and later in this Chapter.

rules should only be justified on the showing of a clear public interest. In broad terms, possible “public interest” grounds can be seen as falling within two main categories.

First, some markets or economic activities may have special features which suggest that competitive market conduct will not maximise economic efficiency. Possible examples of such “market failure” relevant to market conduct rules include cases where there are unusual information problems in the market and, in limited circumstances, where the existence of monopoly power on one side of a commercial transaction warrants permitting the formation of countervailing market power.

“Market failure” cases are usually capable of expert adjudication to determine whether the alleged market failure exists, and what degree of departure from competitive conduct norms is required to respond to the identified failure. Thus, not all restrictions on the competitive conduct of professionals may be justified because of information difficulties, and the circumstances in which rural producers should be permitted to increase their market power to countervail the power of their customers on market failure grounds are quite rare.<sup>4</sup>

Second, there are some situations where competitive market conduct may achieve economic efficiency, but at the cost of other valued social objectives. For example, providing special benefits to particular sectors of society, on equity or other grounds, might lessen economic efficiency, but nevertheless accord with community values. The values which determine these alternative social objectives are not immutable, and vary over time.

Determination of instances where economic efficiency should give way to alternative social objectives may involve more difficult judgments. However, consistent with the principles agreed between Heads of Government, all claims to special treatment on such grounds should be assessed in an open and transparent manner, with the costs and benefits of particular anti-competitive behaviour subject to public scrutiny.

In both categories, it is also important to recognise that there will usually be a host of policy instruments by which governments can

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<sup>4</sup> Eg, see IC (Sub 6); TPC (Sub 69) at 113-115; and ABARE (Sub 95).



pursue their particular economic or social objectives. Permitting particular market participants to engage in anti-competitive activity is usually only one option, and will not always be the most efficient. For example, if a government chose to favour a particular sector or activity for strategic, social or political reasons, it will generally be more efficient to provide direct budgetary assistance. While subsidies of this kind may impact on competition between subsidised and non-subsidised sectors or activities, the efficiency losses will often be less than those associated with permitting anti-competitive behaviour. Moreover, the transparency of the assistance will ensure that the desirability of that special treatment is subject to regular scrutiny.

### **3. Overview of Current Exceptions**

Some of the current limitations on the application of the TPA are only loosely related to the evaluation of public interest arguments of the kind discussed above. Constitutional limitations and the shield of the Crown doctrine, in particular, provide blanket exemptions for important parts of the economy without any conscious evaluation of the costs and benefits involved. The other exceptions do involve a more conscious attempt to deal with the trade-offs involved, although the mechanisms vary in their transparency, flexibility and in the extent to which they reflect a national perspective.

The seven kinds of exemption mechanisms under the current Act can be considered within two main categories — those which are, and those which are not, based on an assessment of the circumstances in which exemption is granted.

#### **(a) Exemptions Based on an Assessment of Particular Circumstances**

These exemptions operate by specifically exempting or authorising conduct that might otherwise offend the TPA. There are five main processes, with the main differences being the identity of the decision-maker and the transparency of the assessment process.

- *Specific Authorisation by an Independent Body*

Under the TPA, some conduct that would otherwise contravene the Act can be subject to authorisation by the Trade Practices Commission (TPC) on the showing of a net public benefit. Some types of agreements can receive exemption from the Act by simple

notification to the Commission, but this exemption can be revoked when such agreements lack sufficient public benefit. Exemptions of these kinds have been granted to a wide range of market participants, including the professions and agricultural marketing arrangements.<sup>5</sup>

- *Exemption by Specific Provision in the Act Itself*

The TPA provides special treatment to aspects of arrangements governing employment conditions,<sup>6</sup> standards,<sup>7</sup> restrictive covenants,<sup>8</sup> export contracts,<sup>9</sup> consumer boycotts,<sup>10</sup> licensing or assignment of intellectual property rights<sup>11</sup> and arrangements governing international liner cargo shipping.<sup>12</sup>

- *Exemption by Regulation Made under the Act*

The TPA makes provision for regulation-based exemptions in relation to primary product marketing arrangements; prescribed conduct of the Commonwealth or its agencies; and certain arrangements made pursuant to international arrangements.<sup>13</sup> These provisions have not been used in recent years, however, and all previous exemptions under this regulation-making power have expired.

- *Specific Exemption by Other Commonwealth Act or Regulation*

The TPA provides that other Commonwealth Acts (other than an Act relating to patents, trademarks, designs or copyright), or regulations made under those Acts, can specifically approve or authorise conduct that would otherwise offend the Act.<sup>14</sup>

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5 See examples noted in Chapter Six.

6 See s.51(2)(a).

7 See s.51(2)(c).

8 See s.51(2)(b),(d) & (e).

9 See s.51(2)(g).

10 See s.51(2A).

11 See s.51(3).

12 See Part X of the Act.

13 See s.172(2).

14 See s.51(1)(a).

- *Specific Exemption by State or Territory Act or Regulation*

The TPA provides that State and Territory statutes and regulations can specifically authorise or approve conduct that would otherwise offend the Act, although the Commonwealth can over-ride such exemptions by regulation.<sup>15</sup>

In considering the last two categories, it is important to emphasise that not all Commonwealth, State or Territory legislation that has anti-competitive effects is relevant to the operation of these provisions. Competitive conduct rules of the kind contained in the TPA are directed to voluntary conduct of market participants, acting either individually or collectively, and do not affect anti-competitive arrangements that are imposed by legislation. Thus, for example, legislation may provide for statutory monopolies, impose licensing regimes, vest the ownership of a commodity in a marketing body, regulate prices or restrict other competitive conduct without involving conduct of the kind prohibited by the Act. Some of the subtleties that can arise in this area are outlined in Box 2.<sup>16</sup> Although regulations of this kind are a critical part of competition policy, they are unaffected by the prohibitions contained in the Act and are discussed separately in Chapter Nine.

- (b) Exemptions that arise without evaluation of particular circumstances

This category comprises two main limiting principles that operate independently of any assessment of particular costs or benefits.

- *Constitutional Limitations*

The Commonwealth's legislative power in the competition law area is not unlimited. As the TPA is currently drafted,<sup>17</sup> it applies to trading and financial corporations and to persons engaging in interstate or overseas trade or commerce, operating in a

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<sup>15</sup> See s.51(1)(b) and (d).

<sup>16</sup> See Executive Overview.

<sup>17</sup> As discussed in Chapter 15, it seems likely that some of these limitations could be overcome by greater reliance by the Commonwealth on its existing heads of constitutional authority.

Territory or supplying the Commonwealth.<sup>18</sup> There are also constitutional limitations on the Commonwealth's capacity to regulate state banking and state insurance.<sup>19</sup> The effect of constitutional limitations can be seen in relation to three main areas: some government owned businesses; some professions; and other unincorporated businesses.

- *Shield of the Crown*

Under the legal doctrine of "shield of the Crown", the Crown and its instrumentalities are not bound by a statute without express words or necessary implication. Express words have been provided in the TPA in relation to the Crown in right of the Commonwealth, so that Commonwealth instrumentalities are bound by the Act to the extent they engage in a business.<sup>20</sup> The TPA has been interpreted as not being intended to bind the Crown in right of the States<sup>21</sup> and the Territories.<sup>22</sup> Whether or not a particular entity is entitled to the shield of the Crown is frequently a matter of considerable uncertainty, requiring a close examination of the legislation establishing the entity and the activities undertaken pursuant to it.

The operation of all these various limitations or exception mechanisms can be very complex and uncertain, particularly where more than one is applicable to a single sector or economic activity. For example, a single State government-owned business may be able to rely on the shield of the Crown doctrine, the constitutional limitation (if it is not a trading or financial corporation or engaged in interstate or overseas trade) and State legislation specifically approving particular conduct. The relevant activity may also be capable of authorisation by the TPC, although the other grounds for exclusion will generally obviate the need for such a transparent evaluation of the costs and benefits associated with anti-competitive behaviour. Box 5.1 provides an overview of the applicability of these various exceptions.

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18 The TPA is drafted to apply to corporations, and the extended operation, relying on various constitutional heads of power, is provided by s.6 of the Act.

19 See Constitution s.51(xiii) & (xiv) and *Bourke v State Bank of NSW* (1990) 64 ALJR 406.

20 See s.2A of the Act.

21 *Bradken Consolidated Ltd v BHP* (1979) 145 CLR 107.

22 *Burgundy Royale Investments Pty Ltd v Westpac Banking Corporation* (1988) 18 FCR 212.

<b>Box 5.1: Exceptions by Primary Area of Significance</b>							
<b>SECTOR/ ACTIVITY</b>	<b>Possible Auth. by TPC</b>	<b>Specific Exempt in TPA Itself</b>	<b>Exempt by Reg Made Under TPA</b>	<b>Exempt by Other Cth Laws</b>	<b>Exempt by State /Terr. Law</b>	<b>Constit- utional Factors</b>	<b>Shield of Crown Doctrine</b>
Cth Govt businesses	X		X				
State Govt businesses	X				X	X	X
Territory Govt businesses	X				X		X
Professions	X				X	X	
Unincorp. Businesses	X					X	
Agricultural Marketing	X		X	X	X	X	X
Overseas Shipping	X	X					
Intellectual Property	X	X					
Labour	X	X		X	X	X	
Standards	X	X					
Restrictive Covenants	X	X					
Export Contracts	X	X					
Consumer Boycotts	X	X					
International Agreements etc	X		X	X			

The impact of the current exceptions and of the Committee's conclusions on particular sectors or activities is considered in the following Chapter, while this Chapter concentrates on general exemption mechanisms.

## **B. EVALUATION OF CURRENT EXEMPTION MECHANISMS**

As part of the lead up to the current inquiry the Prime Minister, Premiers and Chief Ministers agreed to a set of principles to which a national competition policy should give effect. These principles comprise an important part of the inquiry's terms of reference and are set out in Box 5.2:

### **Box 5.2 : The Agreed Principles**

- (a) no participant in the market should be able to engage in anti-competitive conduct against the public interest;
- (b) as far as possible, universal and uniformly applied rules of market conduct should apply to all market participants regardless of the form of business ownership;
- (c) conduct with anti-competitive potential said to be in the public interest should be assessed by an appropriate transparent assessment process, with provision for review, to demonstrate the nature and incidence of the public costs and benefits claimed;
- (d) any changes to the coverage or nature of competition policy should be consistent with, and support, the general thrust of reforms:
  - (i) to develop an open, integrated domestic market for goods and services by removing unnecessary barriers to trade and competition; and
  - (ii) in recognition of the increasingly national operation of markets, to reduce complexity and eliminate administrative duplication.

This Section reviews each of the current exemption mechanisms against the agreed principles, submissions and other considerations relevant to the implementation of a national competition policy and concludes that a number of amendments are required.

#### **1. Authorisation by an Independent Body**

Conduct which would otherwise contravene the TPA may be exempted from the its prohibitions through approval by the TPC.

The TPC can authorise many types of conduct that would otherwise contravene the Act, if it is satisfied that there is a net “public benefit”.<sup>23</sup> The conduct is prohibited until the Commission grants an authorisation. At present, authorisation can be granted for most horizontal and vertical agreements but not for unilateral conduct such as a misuse of market power. In Chapter Three the Committee recommended that the scope for authorisation be extended to resale price maintenance, but be removed from price fixing agreements for services after an appropriate transitional period.

In addition to authorisation, a limited class of vertical agreements<sup>24</sup> may be given exemption under the notification procedure. Persons wishing to make such an agreement can notify the TPC, and the agreement will gain automatic immunity from the time of notification.<sup>25</sup> The immunity can be revoked by the Commission on “public benefit” grounds. The types of conduct for which notification is available, such as the appointment of a sole distributor in a country town, may be differentiated from other forms of conduct prohibited under the Act, on the basis that while these vertical agreements have an adverse effect on competition, the adverse effect is often offset by economic efficiency or other public benefits. Notification avoids the potential delays associated with the authorisation process for this limited class of anti-competitive conduct. In Chapter Three the Committee recommended that notification be extended to third-line forcing.

“Public benefit” is not defined in the Act<sup>26</sup> and has been interpreted to comprise both economic efficiency and a range of other considerations. In *Re ACI Operations Pty Ltd* the TPC listed examples including economic development; fostering business efficiency; supply of better information to consumers and businesses to permit informed choices in their dealings; growth in export markets; expansion of employment in efficient industries; and steps to protect the environment.<sup>27</sup> However, the achievement of economic goals of efficiency and progress will commonly be paramount.<sup>28</sup>

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23 See s.90.

24 See Chapter Three for a discussion of vertical agreements.

25 See s.93.

26 Although note s.90(9A) in relation to merger authorisations.

27 (1991) ATPR (Com) 50-108.

28 See *Re Rural Traders Co-Operative (WA) Ltd* (1979) 37 FLR 244 at 262.

The current authorisation and notification processes permit the Commission to consider submissions from any interested person, and the Commission presents applicants and other persons with the opportunity to discuss a draft determination at a conference before a final decision is made.<sup>29</sup> An appeal is available to the Trade Practices Tribunal.<sup>30</sup>

### Conformity With Agreed Principles

This exemption mechanism has the benefit of independent adjudication and the flexibility to address concerns specific to individual industries or activities on a case-by-case basis. As authorisations can be limited as to time, conditional or granted on the basis of specific enforceable undertakings, it is possible to ensure that the costs and benefits of anti-competitive conduct are reviewed in light of changing circumstances without the need for legislative amendments. Similarly, notifications can be revoked in the public interest.

The authorisation and notification processes are consistent with the agreed principles. Specifically:

- the public benefit test ensures exceptions are limited to public interest considerations (principle a);
- that public interest is assessed by a transparent assessment process to demonstrate the nature and incidence of the public costs and benefits claimed (principle c);
- the assessment process includes provision for review (principle c);
- as it is administered through a national process, it is consistent with the goals of developing an open, integrated domestic market for goods and services, reducing complexity and eliminating administrative duplication (principle d).

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<sup>29</sup> See ss.90, 90A, 93 and 93A of the Act. In light of the tight time constraints in merger authorisation cases, there is no requirement to provide a draft determination in such cases.

<sup>30</sup> See Part DX of the Act.



## Overseas Experience

New Zealand has an authorisation process along the lines of the Australian scheme.<sup>31</sup>

## Submissions

Submissions which addressed the authorisation and notification processes uniformly supported their retention.

Some submissions argued that efficiency should be the sole objective for the Act,<sup>32</sup> which has implications for the scope of the "public benefit" test.

One submission argued that the Commission's practice of limiting authorisations as to time was onerous on business and involved the Commission becoming a *de facto* regulator for particular industries.<sup>33</sup> Other submissions were also critical of the time and resources involved for business in the TPC's review of previous authorisations.<sup>34</sup>

## Consideration

The current authorisation and notification procedures are an important feature of the current Act, conform to each of the agreed principles and appear to enjoy general support in the community.<sup>35</sup>

Although the Committee had some sympathy with those submissions urging that public benefit considerations should be limited to matters of economic efficiency, it did not feel that parties should be denied the opportunity to demonstrate other dimensions of community welfare. Nevertheless, the Act should be amended to confirm that primary emphasis should be placed on economic efficiency considerations.

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31 See Part V of the *Commerce Act 1986*.

32 Eg, IC (Sub 6); MTIA (Sub 59); DITAC (Sub 101).

33 Dr W Pengilly (Sub 11).

34 Eg, REIA (Sub 68).

35 Eg, Australian Dairy Farmer's Fedn (Sub 10); Trade Practices Committee of the Law Council of Australia (Sub 65); REIA (Sub 68); TPC (Sub 69); Treasury (Sub 76); National Inst of Accountants (Sub 88); NFF (Sub 90); BCA (Sub 93); DITAC (Sub 101); Qld Govt (Sub 104).

The Committee does not support time-limited authorisations being used as a means of imposing unjustified regulation or other compliance costs on business. At the same time, it accepts that this more flexible approach may be necessary to manage transition to less restrictive trading arrangements or to keep the anti-competitive consequences of authorised conduct under review in appropriate circumstances, particularly where the alternative to a time-limit might be failure to allow authorisation at all.<sup>36</sup> Whether any particular time-limit or subsequent review is justified on public interest grounds is properly a matter for the Commission, however, and the Trade Practices Tribunal provides a review mechanism if a particular time-limit is considered unjustified.

The TPC suggested that the Committee consider the need for greater flexibility in revoking or re-examining past authorisations.<sup>37</sup> The Committee considers that the current criteria relating to a change in material circumstances in an industry are adequate, particularly when the resource costs for both business and the TPC in conducting reviews of past authorisations is taken into account. The Committee does not propose any changes in this area.

The Government has recently announced the introduction of user-fees for authorisation and notification proceedings.<sup>38</sup> While the Committee supports the general principle of user-pays, it is concerned that the new regime does not appear to include provision for fees to be waived in exceptional circumstances, such as where an applicant could reasonably claim financial hardship and the public benefits of the conduct far outweighed any anti-competitive detriment. The Committee recommends that this matter be considered further by the Government.

## Conclusions

The Committee recommends that a national competition policy should include authorisation and notification processes along the lines of those under the TPA. As noted above, however, the

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<sup>36</sup> The TPC (Sub 69) notes that time-limited authorisations have been particularly useful in industries undergoing rapid economic change or deregulation (such as the rural and aviation sectors).

<sup>37</sup> TPC (Sub 69).

<sup>38</sup> R.28 *Trade Practices Regulations*. The fees are: notifications \$2,500; merger authorisations \$15,000; other authorisations \$7,500.

Committee recommends that the legislation be amended to confirm that, in determining questions of "public benefit", primary emphasis should be placed on economic efficiency considerations. The application of the new "user pays" regime also warrants further consideration.

As discussed in Chapter 14, the Committee recommends that the authorisation process under the competitive conduct rules of a national competition policy be administered by a new body — the Australian Competition Commission.

## 2. Specific Exemption In the Act Itself

A number of matters are subject to specific exemption or special treatment in the TPA itself, including aspects of arrangements governing employment conditions,<sup>39</sup> standards,<sup>40</sup> restrictive covenants,<sup>41</sup> export contracts,<sup>42</sup> consumer boycotts,<sup>43</sup> licensing or assignment of intellectual property rights<sup>44</sup> and arrangements governing international liner cargo shipping.<sup>45</sup>

### Conformity With Agreed Principles

Legislated exceptions of this kind conform to the agreed principles. Specifically:

- any exceptions are limited to public interest considerations, as determined by the elected (and accountable) Parliament (principle a);
- the means of assessing that public interest — the legislative process — is transparent and allows the nature and incidence of the public costs and benefits involved to be demonstrated (principle c);

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<sup>39</sup> See s.51(2)(a).

<sup>40</sup> See s.51(2)(c).

<sup>41</sup> See s.51(2)(b),(d) & (e).

<sup>42</sup> See s.51(2)(g).

<sup>43</sup> See s.51(2A).

<sup>44</sup> See s.51(3).

<sup>45</sup> See Part X of the Act.

- the assessment process includes some provision for review, including through the role of the Senate and any subsequent inquiries (principle c); and
- the national reach and focus of the Commonwealth legislative process is consistent with the development of an open, integrated domestic market for goods and services, the increasingly national operation of markets, the reduction of complexity, and the elimination of administrative duplication (principle d).

### Submissions & Overseas Experience

Most systems appear to have the capacity for specific legislated exemptions in the competition statute itself. The detail of specific exceptions, and relevant submissions, are considered in Chapter Six.

### Consideration

There may be some cases where governments believe that the grounds for providing special treatment to a particular sector or activity are sufficiently clear-cut, or politically sensitive, that they would rather stipulate that special treatment in the Act itself, rather than require each individual case to be subject to adjudication through the authorisation process. This approach has the advantage of maximising certainty for business, although it does so at the expense of the flexibility of an assessment on a case-by-case basis.

Legislatively based exceptions may also not be as amenable to regular review according to changing circumstances — for example, many of the exceptions contained in the current Act have not been subject to review since the Swanson Committee reported in 1976.<sup>46</sup>

### Conclusions

The Committee supports the principle of legislated exemptions but considers that they should be subject to regular review to ensure they remain justified on public interest grounds. The Committee's conclusions on the contemporary justification of each of the existing legislated exemptions are set out in Chapter Six.

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<sup>46</sup> See Trade Practices Act Review Committee, *Report to the Minister for Business and Consumer Affairs*, (1976), especially Chapter Ten.

### 3. Exemption by Regulations Made Under the Act

The current Act makes provision for regulation-based exemptions in relation to primary product marketing arrangements; prescribed conduct of the Commonwealth or its agencies; and certain arrangements made pursuant to international arrangements.<sup>47</sup> Significantly, no new exemptions under this provision have been made for some time, and all previous exemptions have expired.

#### Conformity With Agreed Principles

Regulation-based exceptions conform to the agreed principles to a reasonable degree. Specifically:

- exceptions are limited to public interest considerations, as determined by the Parliament in the first instance (in prescribing the scope for such exemptions) and thereafter by the Executive, subject to supervision by the Parliament (principle a);
- the evaluation of the costs and benefits of particular exceptions are evaluated within the Executive branch of government, and will often be less transparent than either legislation or authorisation (principle c);
- the assessment process includes some provision for review, including through administrative law and the supervisory role of the Parliament (principle c); and
- the national focus of the Commonwealth Executive is consistent with the goal of developing an open, integrated domestic market for goods and services, the increasingly national operation of markets, reducing complexity, and eliminating administrative duplication (principle d).

#### Overseas Experience

The US, Canada and New Zealand do not have a special provision permitting exceptions by subordinate legislation made under the competition statute, although New Zealand permits exceptions made under other statutes.<sup>48</sup>

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<sup>47</sup> See s.172(2).

<sup>48</sup> See s.43 of the *Commerce Act 1986*.

## Submissions

Some submissions proposed that regulated exemptions be given an expanded role in a national competition policy.<sup>49</sup> Other submissions proposed that the current provision be wider in terms of subject matter but limited to the transitional period in a market.<sup>50</sup>

## Consideration

Exemptions under regulations can be seen as a compromise between the flexibility of case-by-case determinations under the authorisation process and the certainty and direct political accountability provided by legislated exceptions. Subject to any conditions on the scope for possible regulations in the legislation itself, the decision on whether or not to allow an exception ultimately depends on policy judgments by governments. The regulation-making process is not necessarily as open and transparent as either the legislative or authorisation processes, although there is scrutiny by the legislature and decisions may be reviewed through administrative law processes or by direct appeal to the political process.

The Committee noted that no regulations had been made under this provision for some time, and that all previous regulations have expired. As discussed in the following Chapter, the Committee's review of the current areas for exemption by regulation suggest no compelling case for retaining the provisions. In these circumstances, the Committee was inclined to recommend the repeal of the provision, leaving all such matters to be left to legislation or the authorisation process.

However, it is conceivable that some matters may arise — such as those relating to inter-governmental agreements currently covered by the existing provision<sup>51</sup> — which the Government considers are not appropriate for the authorisation process but for which the passage of relevant legislation may be delayed. To deal with situations such as this, the Committee considered it might be appropriate to replace the current regulation-making power with one that is unlimited as to

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<sup>49</sup> TPC (Sub 69); NFF (Sub 90); DITAC (Sub 101).

<sup>50</sup> Eg. Treasury (Sub 76).

<sup>51</sup> See s.172(2)(b) and discussion in Chapter Six.

subject matter but which is strictly limited in duration to (say) two years.

### Conclusion

The Committee proposes that the current regulation-making power be replaced by one that is unlimited as to subject matter but strictly limited as to duration. The duration in question should be that time sufficient to permit the Parliament to consider appropriate legislation, or no more than two years. Regulations under this power should not be extended without a public inquiry.

The proposed Australian Competition Commission should be required to monitor such regulations and publish a list as part of its annual report.

### 4. Exemption by other Commonwealth Statute or Regulation

The TPA provides that any other Commonwealth Act (other than an Act relating to patents, trademarks, designs or copyright) or regulations made under such an Act, may specifically approve or authorise conduct that would otherwise offend the TPA.<sup>52</sup> The provision appears to have been used only once, in relation to the special competition policy provisions established for the telecommunications sector.<sup>53</sup>

As noted above, legislation of the kind relevant to this provision must be distinguished from other legislation which, although involving anti-competitive consequences, does so without involving conduct in breach of the Act. Thus, for example, legislation could create a legislative monopoly<sup>54</sup> or regulate prices<sup>55</sup> without requiring a business to engage in conduct prohibited by the Act. The current provision relates to business conduct that is voluntary and deliberate, as opposed to mandated, but which is specifically approved by another Commonwealth Act or regulation.

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<sup>52</sup> See s.51(1)(a) of the TPA. The requirement for specificity is interpreted strictly: see *In re Ku-ring-ai Building Society (No.12) Ltd & Anor* (1978) ATPR 40-094.

<sup>53</sup> See *Telecommunications Act 1991*, Pt.8 & Pt.11.

<sup>54</sup> Eg. s.29 of the *Australian Postal Corporation Act 1989* (Cth).

<sup>55</sup> Eg. s.140 of the *Telecommunications Act 1991* sets out pricing principles to govern charging for access agreements relating to the interconnection network.

### Conformity With Agreed Principles

The relevant strengths and weaknesses of this mechanism are akin to those of legislative exceptions in the Act itself and regulations made under the Act. Specifically:

- any exceptions are limited to public interest considerations, as determined by the elected Parliament and/or Executive (principle a);
- the transparency of the evaluation process, and the scope for review, depends on whether legislation or regulation is involved. While the legislative process is more transparent, regulations are often subject to more regular review (principle c).
- the national reach and focus of the Commonwealth Parliament and Executive is consistent with the development of an open, integrated domestic market for goods and services, the increasingly national operation of markets, the reduction of complexity, and the elimination of administrative duplication (principle d).

### Overseas Experience

New Zealand exempts conduct which is specifically authorised or approved by any Act or Order in Council.<sup>56</sup>

The United States relies on judicial mechanisms for resolution of conflicts of laws where the antitrust laws come into conflict with other federal laws. Antitrust law defers to other laws where "conduct seemingly within the reach of the antitrust laws is also at least arguably protected or prohibited by another regulatory statute enacted by Congress."<sup>57</sup>

Canada also relies on judicial doctrine to resolve conflicts of laws.<sup>58</sup>

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<sup>56</sup> See s.43(1) *Commerce Act*.

<sup>57</sup> *Rica v Chicago Mercantile Exch.* 409 US 289, 300 (1973).

<sup>58</sup> *Jabour v Law Society of British Columbia* (1982) 2 SCR 397.



## Submissions

Some submissions proposed that the current provision be repealed, and that primary emphasis be placed on authorisation by an independent body.<sup>59</sup> Others proposed that the provision be retained but that new and existing exemptions be subject to a more formal review process to aid transparency.<sup>60</sup>

## Consideration

The current provision provides a useful means for Parliaments to clarify that conduct required as part of some other regulatory regime is immune from the TPA.

The Commonwealth Parliament cannot, under the principle of sovereignty of Parliament, bind itself. In the absence of the current provision, difficult legal issues would arise as to whether subsequent Commonwealth laws were inconsistent with the Act, and which law should prevail. The current provision provides a mechanism to guide statutory interpretation, indicating the circumstances in which subsequent laws will prevail over the Act. In doing so, it avoids uncertainty. In fact, the Commonwealth has only once enacted legislation which specifically authorises conduct which might otherwise contravene the Act.<sup>61</sup>

The rationale of providing guidance in statutory interpretation does not apply, however, in the case of subsequent regulations, which in the absence of the current provision would not over-ride the Act. There are also a number of difficulties associated with placing exemptions in statutes or regulations distinct from the Act.

First, an approach of this kind fragments the coherence of the competition policy regime to some degree, requiring a range of legislation to be consulted. While this may be acceptable where statutes are involved, it may be difficult to uncover the extent of regulations contained under different Acts.

Second, even where statutes are involved, there is no requirement for the provision that purports to authorise conduct to state that it is

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<sup>59</sup> Eg, Prof R Baxt (Sub 18); TPC (Sub 69); DPIE (Sub 50); BCA (Sub 93).

<sup>60</sup> Eg, Trade Practices Committee of the LCA (Sub 65); Mr M Corrigan (Sub 72).

<sup>61</sup> See s.236 Telecommunications Act.

doing so for the purposes of exempting particular conduct from the general conduct rules. This has two consequences. First, the legislature may not be fully apprised of the consequences of its action when passing legislation containing a provision of this kind, which in turn weakens the transparency of the process. Second, the extent of exceptions from the general conduct rules may be difficult to uncover and, even when a possible provision is uncovered, its relationship vis-a-vis the TPA may be unclear. This may in turn add unnecessary uncertainty and complication.

Finally, the dispersed and relatively non-transparent nature of such exemptions may inhibit regular scrutiny of the continued justification for the exemption.

### Conclusions

Given the constitutional reality that it is not possible to prevent the Commonwealth from passing laws which exempt particular conduct from the Act, the Committee considers that the current provision plays a useful role in directing statutory interpretation, at least in respect of subsequent Commonwealth statutes. However, the Committee recommends that the current provision should be amended to improve the transparency of any exemptions in this area. In particular, it is recommended that any new exemptions should be required to be in statutes, rather than regulations, and to expressly state that the authorisation or approval is for the purposes of the relevant provision(s) of the competition statute.

As discussed below, the Committee considers that similar provisions deferring to State and Territory statutes and regulations should be repealed in their entirety. Although this conclusion is justified by the very different nature and operation of the exceptions in the two cases, the Committee is aware that this may give rise to concerns over a lack of symmetry in a federal system.

Leaving aside the question of whether symmetry should be a goal in its own right, the Committee considers that concerns in this area may be ameliorated if the Commonwealth Government agreed to consult State and Territory Governments before exercising this power in a way that had a significant impact on their interests. Furthermore, the Commonwealth should consider proposals from State or Territory Governments that the power be exercised to exempt

particular conduct, where such proposals would not have adverse national consequences and are in the public interest. To assist in resolving disputes on such matters, it may be appropriate to seek the advice of the proposed National Competition Council.

In addition, the Australian Competition Commission should be required to monitor such exemptions and publish a list as part of its annual report. The competition authority might also make recommendations to the government proposing the repeal of such exemptions where it considers that the continuing exemption from conduct rules is no longer justified in the public interest.

Existing exemptions that do not meet the new requirements should be deemed to have lapsed within three years.

## 5. Exemption by State/Territory Statute or Regulation.

The TPA currently provides that State or Territory statutes or regulations may specifically authorise or approve conduct that would otherwise offend the Act.<sup>62</sup> The Commonwealth has the power to over-ride particular State-based exemptions by regulation, and has used this power once.<sup>63</sup> The provision rests on considerations of comity in a Federal system<sup>64</sup> rather than any constitutional limitations on the Commonwealth.

As with Commonwealth legislation mentioned above, it is important to distinguish State and Territory legislation relevant to this provision from other legislation which, although anti-competitive in consequence, achieves its result in a way that does not involve conduct in breach of the Act. States may create statutory monopolies,<sup>65</sup> regulate prices or establish other anti-competitive

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<sup>62</sup> See s.51(1)(b), (c) and (d). While the "specificity" requirement has been interpreted strictly (*In re Ku-ring-ai Building Society (No.12) Ltd & Anor* (1978) ATPR 40-094.), it has been held that the provision "should be construed generously in favour of the State" (*Paul Dainty Corporation Pty Ltd v National Tennis Centre Trust* (1990) ATPR 41-029 at 51,465).

<sup>63</sup> See s.51(1)(b), and note s 51(1)(d) in relation to the ACT. The Commonwealth power to over-ride State exemptions was exercised in respect of third-line forcing of insurance by building societies approved under the *Cooperation Act 1923* (NSW): see *Trade Practices (Removal of Exception) Regulations*.

<sup>64</sup> See *Paul Dainty Corporation Pty Ltd v National Tennis Centre Trust* (1990) ATPR 41-029 at 51,465. Not dissimilar approaches have developed by the courts in Canada (see *A-G Canada v Law Society of British Columbia* [1982] 2 SCR 307 and the US (see *Parker v Brown* 317 US 341 (1943) and *California Retail Liquor Dealers Assn v Midcal Aluminium* 445 US 97 (1980)).

<sup>65</sup> Eg, s.36 *Electricity Act 1976-89* (Qld).

arrangements without necessarily involving conduct that would offend the Act. Some of the distinctions in this area are illustrated in Box 2.<sup>66</sup>

The extent of State- and Territory-based derogations from the Act is difficult to identify with certainty<sup>67</sup> and in many cases it can be questioned whether the conduct approved of would otherwise involve a contravention of the Act.<sup>68</sup> However, purported derogations of this kind appear to be prevalent in relation to legislation authorising anti-competitive conduct by professional associations,<sup>69</sup> agricultural marketing bodies<sup>70</sup> and some State or Territory-owned businesses.<sup>71</sup> As with the similar provision relating to Commonwealth statutes and regulations, there are currently no limits on the possible beneficiaries or rationales for States or Territories to rely on such provisions.<sup>72</sup>

### Conformity With Agreed Principles

This provision reflects some of the advantages and disadvantages of the provision for special treatment in Commonwealth Acts or regulations. There are additional disadvantages, however. Specifically:

- as the question of public interest is being determined by a regional rather than a national body, there is the question of whether the interest of a single State or Territory will always coincide with

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<sup>66</sup> See Executive Overview.

<sup>67</sup> In 1979 the Trade Practices Consultative Committee noted in relation to the agricultural sector that "It has not been possible to make a general assessment of the extent of exceptions because even an exhaustive analysis of the laws in force at both the Commonwealth and State level would not finally determine clearly whether conduct of a type prohibited by the Act is exempted" : *Report to the Minister for Business & Consumer Affairs on the Operation of the Trade Practices Act in relation to Primary Production in Australia* (1979) at 14.

<sup>68</sup> For example, the *Victorian Arts Centre (Amendment) Act 1988* (Vic) was passed to specifically authorise the making of certain agreements that were found not to violate the Act even without such protection. See *Paul Dainty v National Tennis Centre* (1990) ATPR 41-029.

<sup>69</sup> Eg, the *Legal Profession Practice Act 1958* (Vic) enables members of the Law Institute of Victoria to reach agreement about restrictions on behaviour and, through the Law Institute Council, have such rules approved by the Chief Justice. It has been suggested that a rule restricting fee advertising has implications under the Act: see Law Reform Commission of Victoria, *Competition Law : The Introduction of Restrictive Trade Practices Legislation in Victoria* (1991) at 63.

<sup>70</sup> Eg, *Marketing of Primary Production Act 1983* (NSW), s.164.

<sup>71</sup> Eg, *Victorian Arts Centre (Amendment) Act 1988* (Vic). See also s.86 of the *State Owned Enterprises Act 1992* (Vic)

<sup>72</sup> Eg, the *Industries Development Act 1941* (SA) provides a general regulation making power to exempt activity that is not confined to any particular class of market participants or conduct.

the national interest. Although the Commonwealth is empowered to over-ride State-based exemptions, it may be difficult to uncover offending exemptions when they are embodied in diverse statutes and regulations in each of the States and Territories;

- while the legislative and regulatory processes involved in assessing the public interests involved in a particular exception are similar to like processes at the Commonwealth level in terms of transparency and capacity for review, the sub-national focus of these processes reduces the scrutiny of particular proposals, particularly where regulations rather than statutes are involved;
- State- or Territory-based exemptions have the effect of fragmenting the coverage of competitive conduct rules according to sub-national borders, and are thus not consistent with the goals of developing an open, integrated domestic market for goods and services; the increasingly national operation of markets; reducing complexity; or eliminating administrative duplication (principle d); and
- State- or Territory-based exemptions in disparate State and Territory statutes and regulations fragment the body of competition law and thus contribute to complexity. While there are some problems of fragmentation with Commonwealth statutes and regulations, in the case of the States and Territories this problem potentially is magnified ninefold (principle d).

### Overseas Experience

The US courts developed a "state action" doctrine in the 1940s which allows States to approve conduct that would otherwise offend Federal competition law if the restraint is "one clearly articulated and actively expressed as state policy" and the State "actively supervises" the conduct in question.<sup>73</sup> The doctrine has been subject to considerable criticism<sup>74</sup> and there have been suggestions that it is likely to be reconsidered by the Supreme Court in the near future.<sup>75</sup>

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<sup>73</sup> See *Parker v Brown* 317 US 341 (1943) and *California Retail Liquor Dealers Assn v Midcal Aluminium* 445 US 97 (1980).

<sup>74</sup> Eg, Areeda PE & Hovenkamp H, *Antitrust Law* (1990 supp) at 126-129.

<sup>75</sup> See Baker D I, "High Court Sheds Light on State Action", *National Law Journal* (1 Feb 1993) at 21.

Significantly, the US does not have a process akin to authorisation by an independent body.

The Canadian courts have developed a “regulated industries” exemption which deals with potential conflicts between Provincial regulation and Federal competition law,<sup>76</sup> although the breadth and rationale of the doctrine remain uncertain.<sup>77</sup> Canada does not have a process akin to authorisation by an independent body.

In the European Community, there is no provision for Member States to authorise conduct that offends the competition law provisions of the Treaty of Rome.<sup>78</sup>

### Submissions

Repeal of the provision was advocated by the TPC and a number of other submitters,<sup>79</sup> with most emphasising the benefits of consulting with States and Territories and carefully reviewing existing exemptions prior to repeal. One submission argued that the provision should be narrowed<sup>80</sup> while others supported retention providing steps were taken to improve the transparency of exemptions.<sup>81</sup>

### Consideration

From the perspective of a national competition policy, the current provision has two main defects. First, there are the impacts of diverse State and Territory exemptions on the transparency and cohesion of national law. Second, there are the potential commercial impacts of such exemptions on the efficient operation of an integrated national market.

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<sup>76</sup> See *Jabour v Law Society of British Columbia* (1982) 2 SCR 397.

<sup>77</sup> See *Kaiser GE & Nielsen-Jones I*, “Recent Developments in Canadian Law : Competition Law”, *Ottawa Law Review* (1986) 18, 401-517.

<sup>78</sup> EC law overrides law of the Member States to the extent of any inconsistency: *Costa v ENEL* (1964) ECR 585.

<sup>79</sup> TPC (Sub 69); Prof R Baxt (Sub 18); VLRC (Sub 2); Law Institute of Victoria (Sub 13); Treasury (Sub 76).

<sup>80</sup> Unilever Australia Ltd (Sub 28).

<sup>81</sup> Trade Practices Committee of the Law Council of Aust (Sub 65); Mr M Corrigan (Sub 72).

- *Transparency & Cohesion Concerns*

The transparency and cohesion concerns noted above inhibit the effective operation of a national policy, fragment its coverage and obscure the appraisal of the costs and benefits of particular exemptions suggested to be in the public interest.

One response to these concerns would be to qualify State- and Territory-based exemptions in the same way as it is proposed to qualify Commonwealth exemptions. That is, the provision could be amended to require new exemptions to be in statutes, rather than regulations, and to expressly state that the authorisation or approval is for the purposes of the relevant provision of the competition statute. In addition, the national competition authority could be required to monitor such exemptions, publish a list as part of its annual report, and undertake periodic reviews to determine whether the provision was justified and consistent with relevant national interests. Existing exemptions that did not meet the new requirements within three years could be deemed to have lapsed.

- *Impacts on National Markets*

State-based exemptions also distort the operation of the national market. Apart from condoning inefficiencies that flow on to the national economy, State-based exemptions have the potential to impact directly on competition between industries or businesses located in different States.

The Committee considered two possible responses to this concern.

First, the scope of operation of the provision could be substantially narrowed. For example, it seems difficult to justify a State being able to exempt a merger from the Act, given that all mergers prohibited by the Act must involve a substantial lessening of competition in a substantial market in Australia, and would thus likely have national, not just local, implications. Similarly, it can be argued that conduct of the kind prohibited by the misuse of market power provision of the Act should not be capable of authorisation under State or Territory law. According to this approach, the scope for authorisation by State or Territory law would be limited to horizontal or vertical agreements of the kind discussed in Chapter Three, perhaps with an added

requirement that the conduct does not have a significant spill-over effect to businesses or consumers in other jurisdictions.

A second approach would be to repeal the provision in its entirety, leaving businesses who sought immunity from national competition rules to apply for authorisation through the Commission in the usual way, or to achieve the intended policy objective by legislating for that result directly, rather than approving the voluntary conduct of particular businesses.

Although there were suggestions that repeal of the provision would of itself see a large range of anti-competitive regulations being overridden, particularly in agricultural marketing and professional regulation, this is not borne out by a close analysis of the State and Territory laws in question. The overwhelming majority of laws examined by the Committee in areas such as these were found to achieve their anti-competitive effect in a way that did not involve conduct that would otherwise have been in breach of the Act, making the current provision irrelevant to their future operation.

For example, a law requiring the owner of an electricity transmission grid only to purchase electricity from particular generators might have the same effect in the marketplace as an exclusive dealing agreement or a misuse of market power. But in these circumstances a refusal to deal with other generators would not fall within the TPA's prohibitions, because the refusal would not occur pursuant to a contract, arrangement or understanding, and the purpose of the refusal would be compliance with legislative requirements rather than any proscribed purpose. The repeal of the provision which permits States to specifically authorise or approve conduct would not affect such arrangements.

## Conclusions

The Committee favours repeal of the provision in its entirety. This might be accomplished by preventing any new exemptions of this kind and deeming any existing exemptions to have lapsed within three years, thus providing time to consider transitional or alternative authorisation arrangements.

If, contrary to the Committee's recommendation, a provision of this kind is to be retained, the Committee proposes that it be modified to



increase the transparency of exemptions by requiring that any exemption be specified in legislation, rather than regulation, and that the legislation expressly state that the authorisation or approval is for the purposes of the relevant provision of the competition statute. In addition, the Committee considers that State- or Territory-based exemptions should, at a minimum, be expressly limited to horizontal and vertical agreements of the kind currently proscribed by ss.45 and 47 of the TPA.

As noted above, the Committee has responded to possible concerns over asymmetry between the Commonwealth on the one hand and the States and Territories on the other by suggesting that the Commonwealth consult with the States and Territories on certain aspects related to the exercise of its power.

## 6. Limitations through Constitutional Factors

The Commonwealth's legislative power in the competition law area is not unlimited. As currently drafted, the TPA draws primarily upon the constitutional power to regulate corporations, although it also applies to unincorporated businesses to the extent that they engage in interstate or overseas trade or commerce, operate in a Territory or in so far as they supply the Commonwealth.<sup>82</sup> Although the Commonwealth could make greater use of its constitutional powers to extend the coverage of the Act, it seems that some areas of economic activity would remain beyond the scope of Commonwealth law. For example, there are express constitutional limitations on the Commonwealth's powers over State banking and State insurance.<sup>83</sup>

The effect of limitations derived from constitutional considerations can be seen in relation to three main areas: some government-owned businesses; some professions; and other unincorporated businesses.

### Conformity With Agreed Principles

Limitations of this kind offend each of the agreed principles. Specifically:

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<sup>82</sup> The Act is based primarily on the Commonwealth's power in relation to "financial and trading corporations", but s.6 of the Act extends the Act through use of other Commonwealth powers. For a fuller discussion of this issue see Heydon J D, *Trade Practices Law* (1993) 1052-1054; and Tonking AI & Alcock RJ, *Australian Trade Practices Reporter* (1993), ¶480.

<sup>83</sup> See Constitution s.51(xiii) & (xiv) and *Bourke v State Bank of NSW* (1990) 64 ALJR 406.

- it is difficult to identify any obvious “public interest” rationale for permitting such blanket exclusion from market conduct rules, particularly when the factors relevant to the exception are arbitrary and unrelated to any criterion of contemporary relevance (principle a);
- to the extent that there might be a public interest rationale for exemption in some cases, the blanket exclusion means that it is not subject to assessment by a transparent process to demonstrate the nature and incidence of the public costs and benefits claimed; necessarily, there is no process for review (principle c);
- as the limitation operates to discriminate between corporate and non-corporate forms of business, it specifically offends the principle that the form of ownership of a business should not be relevant to the application of market conduct rules (principle b);
- the limitation leads to differences in the application of conduct rules between the States and Territories, and between intrastate and interstate transactions, and is thus not consistent with the development of an open, integrated domestic market for goods and services (principle d); and
- uncertainties over the precise boundaries of Commonwealth constitutional power lead to uncertainty over the scope of the exception and thus conflict with the need to reduce complexity in increasingly national markets (principle d).

### Overseas Experience

No other jurisdiction appears to discriminate between businesses depending on the legal form of ownership.

The reach of US antitrust laws does depend on some impact on interstate commerce. However, this requirement has been interpreted so broadly that it has been said that:

In the field of economic regulation, at any rate, the notion that the States must be left with an area of exclusive power has been fully abandoned. While theoretically an effect on commerce might be regarded as too remote or not "substantial" enough to bring its control within power, it is difficult to imagine examples where such a finding would be made and there are no recent cases that have so found.<sup>84</sup>

While the application of Canadian competition law was also originally limited by constitutional requirements, the current law operates without such fine distinctions. As it was said in one case:

A scheme aimed at the regulation of competition is in my view an example of the genre of legislation that could not practically or constitutionally be enacted by a provincial government. ... Canada is, for economic purposes, a single huge marketplace. If competition is to be regulated at all it must be regulated federally.<sup>85</sup>

### Submissions

The overwhelming majority of submissions received by the Inquiry — including those from consumer, business and industry groups and individual businesses, small and large<sup>86</sup> — argued for the current gaps in coverage of market conduct rules to be filled. No submission supported the continuation of the current exclusions based on constitutional limitations.

### Consideration

As discussed in the following Chapter, the current exclusion does not correspond closely with any particular group, sector or public interest rationale. Some professionals, farmers, small business people and government businesses benefit from the immunity while others do

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<sup>84</sup> Zines L, *The High Court and the Constitution* (3 ed, 1992) at 51. An equally liberal approach is taken to the construction of "interstate commerce" in the antitrust laws themselves. In *Burke v Ford*, 389 US 320 (1967) the Supreme Court held that interstate commerce was adequately affected by an alleged intrastate territorial division among local wholesalers. The Court recognised that a territorial allocation of liquor sales within Oklahoma would tend to raise the price of liquor and would therefore tend to reduce the local demand for that product and thereby tend also to reduce the demand for liquor coming into the state. In *McLain v Real Estate Bd.*, 444 US 232 (1980) the Supreme Court was satisfied that price fixing among Louisiana housing brokers would tend to increase house prices and thereby reduce the demand for interstate financing and title insurance.

<sup>85</sup> *A-G of Canada v Canadian National Transportation Ltd et al* (1984) 3 DLR (4th) 16, 79.

<sup>86</sup> These submissions are considered in the following Chapter in relation to the particular sectors benefiting from the current exclusion.

not. The primary determinants are the legal form of the business and the inter-state character of transactions.

The notion that a business should be entitled to engage in anti-competitive conduct with impunity because of factors such as these is impossible to defend on considered public policy grounds. If some businesses currently excluded from the TPA claim some particular public interest rationale for continued exclusion, those claims can and should be tested in the same way as the claims of any other business.

### Conclusion

There should be no room for limiting principles such as this in a national competition policy. The current gap should be filled as a matter of priority. Options for achieving this, and appropriate transitional arrangements, considered in Chapter 15.

## 7. Shield of the Crown Doctrine

According to ancient doctrine, the Crown and its instrumentalities will not be found to be bound by a statute except by express words or necessary implication.<sup>87</sup> As a result of recommendations by the Swanson Committee, the TPA was amended in 1977 to clarify that the Act was intended to apply to the Crown in right of the Commonwealth and its instrumentalities to the extent it engages in a business.<sup>88</sup>

Although the Swanson Committee also recommended action in relation to the Crown in right of the States, no such action has been taken. In 1979 the High Court found that the TPA was not intended to bind the Crown in right of the States<sup>89</sup> and this exemption has been held to also extend to the Territories.<sup>90</sup> The scope of application of the doctrine is uncertain, however, for whether or not a particular entity is entitled to claim the protection of the doctrine requires a close examination of the legislation establishing the entity and the activities undertaken pursuant to it.<sup>91</sup>

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<sup>87</sup> For a review of the origins and significance of the doctrine see: Senate Standing Committee on Constitutional Legal Affairs, *The Doctrine of the Shield of the Crown* (1992).

<sup>88</sup> See s.2A of the Act and discussion in Chapter Six.

<sup>89</sup> *Bradken Consolidated Ltd v BHP* (1979) 145 CLR 107.

<sup>90</sup> *Burgundy Royale Investments Pty Ltd v Westpac Banking Corporation* (1988) 18 FCR 212.

<sup>91</sup> For examples of the application of the doctrine see discussion in Chapter Six.

An important aspect of the doctrine is that it not only exempts the agency entitled to the immunity, but also other persons engaged in doing business with the agency.<sup>92</sup>

While the High Court has recently expressed a more flexible approach to the application of the doctrine,<sup>93</sup> it has also indicated that it did not intend to overturn the settled construction of statutes passed before its decision.<sup>94</sup> Accordingly, an amendment to the competition statute seems necessary to address this matter. Significantly, there is no constitutional impediment to the Commonwealth doing this unilaterally.

### Conformity With Agreed Principles

In its current operation, the application of the doctrine offends each of the principles already agreed between Heads of Australian Governments. Specifically:

- it is difficult to identify any obvious “public interest” rationale for permitting such a blanket exception from conduct rules, particularly in light of the increasingly commercial orientation of many government-owned businesses (principle a);
- to the extent that there might be a public interest rationale for exemption in some cases, it is not assessed by a transparent process to demonstrate the nature and incidence of the public costs and benefits claimed; necessarily, there is no process for review (principle c);
- as the doctrine is applicable only to government-owned businesses, it offends the principle that ownership of a business should not be relevant to the application of competitive conduct rules (principle b);
- it is difficult to see how the continued operation of the principle, which will differ in its practical effect between similar businesses in different States, is consistent with the development of an open,

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<sup>92</sup> See *Bradken Consolidated Ltd v BHP* (1979) 145 CLR 107.

<sup>93</sup> See *Bropho v State of Western Australia* (1990) 171 CLR 1.

<sup>94</sup> *Ibid* at 22.

integrated domestic market for goods and services (principle d);  
and

- uncertainties over the scope and application of the doctrine, which can be considerable, conflict with the need to reduce complexity in increasingly national markets (principle d).

### Overseas Experience

International competition laws do not generally provide exemptions for government businesses.

The Crown is bound by competition law in New Zealand, in so far as it engages in trade,<sup>95</sup> and in Canada in respect of commercial activities.<sup>96</sup> US law limits the liability of local governments to treble damages remedies<sup>97</sup> but otherwise offers no special treatment for public agencies.

The competition law of the EC binds government businesses of the Member States. Although there is a qualification that application of the law should not obstruct the performance of particular tasks assigned to undertakings "entrusted with the operation of services of general economic interest", the overarching principle is that "the development of trade must not be affected to such an extent as would be contrary to the interests of the Community".<sup>98</sup>

### Submissions

The extension of competitive conduct rules to all government-owned businesses, Commonwealth, State or Territory was supported by the overwhelming majority of submissions that dealt with this issue.<sup>99</sup>

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<sup>95</sup> See s.5 of the Commerce Act .

<sup>96</sup> See s.2(1) of the *Competition Act 1986* .

<sup>97</sup> See *Local Government Antitrust Act 1983*.

<sup>98</sup> See Article 90 of the Treaty of Rome. Although the qualification extends to "undertakings having the character of a revenue-producing monopoly", EC law, unlike the general rules proposed for an Australian national policy, extends to the charging of monopoly prices (see Article 86).

<sup>99</sup> Eg, Victorian Law Reform Commission (Sub 2); Industry Commission (Sub 6); Dr R Albon (Sub 8); Dr W Pengilley (Sub 11); Law Institute of Victoria (Sub 13); Mr Al Tonking (Sub 16); Prof R Baxt (Sub 18); Esso Aust (Sub 21); Aust Institute of Petroleum (Sub 22); AGL (Sub 24); Caltex Aust (Sub 27); Unilever Aust (Sub 28); Shell (Sub 30); Carlton & United Breweries (Sub 34); Spark & Cannon (Sub 36); Aust Mining Industry Council (Sub 39); Aust Information Industry Association (Sub 40); DPIE (Sub 50); MTIA (Sub 59); Trade Practices Committee of the Law

The TPC argued that the application of conduct rules to the commercial activities of Commonwealth Departments should be clarified.<sup>100</sup>

### Consideration

As discussed in more detail in Chapter Six, the blanket exclusion for government-owned businesses is difficult to justify in light of the increasingly commercial operation of those businesses and their significance as suppliers of key inputs to other industries. The practical uncertainty surrounding the question of whether a particular entity qualifies for protection under Shield of the Crown, and hence whether firms dealing with the entity can enjoy the benefits of that protection, also presents a strong case for the removal of this source of exemption.

It would seem especially important to remove the exemption where government businesses compete with private businesses. Because firms dealing with an emanation of the Crown can share in the immunity granted to the Crown, there is scope for collusive activity between competitors. For example if the Crown in right of a State were engaged in electricity generation in competition with private firms, a collusive agreement between the generators might be immune from the competitive conduct rules. Concerns of competitive neutrality, discussed in Chapter 13, also suggest that Crown businesses should be subject to the same rights and obligations as their competitors.

The Crown in right of the Commonwealth and its authorities are covered by the TPA "in so far as ... [it] ... carries on a business", and "business" is defined to include a business not carried on for profit.<sup>101</sup> Despite this provision, there are questions concerning the extent to which the TPA applies to intra-governmental activities of a commercial nature, including the case where one branch of the Commonwealth supplies another branch, in competition with private suppliers. Although such transactions may have what is commonly

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Council of Australia (Sub 65); TPC (Sub 69); National Bulk Commodities Group (Sub 71); Mr M Corrigan (Sub 72); Australian Chamber of Manufactures (Sub 73); Pioneer International (Sub 81); AMP Society (Sub 82); ABARE (Sub 95); PSA (Sub 97); Small Business Coalition (Sub 100); DITARD (Sub 101); Australian Consumers' Association (Sub 131); BHP (Sub 133).

<sup>100</sup> TPC (Sub 69).

<sup>101</sup> See s.2A and s.4.

understood to be a commercial nature, because the Crown is one indivisible entity, intra-governmental transactions can be argued not to amount to "business" activities, which would require at least two parties. Thus, for example, the supply of leased vehicles by the Commonwealth Department of Administrative Services to the Department of Defence may be argued not to be a business transaction, even though the Department of Administrative Services may be competing with private firms for the right to supply the Department of Defence.

The Committee considers that such transactions should be subject to the competitive conduct rules, and supports the principle, reflected in Canadian law, that the Crown should cease to enjoy immunities to the extent it is competing with private firms. In this regard, the notion of competition should include potential competition, so that the legislation would cover situations where new firms could establish competing businesses but for the anti-competitive conduct of incumbent government businesses.

### Conclusions

The Committee considers that the shield of the Crown doctrine should have no place in the competitive conduct rules of a national competition policy. The provision by which the Crown in right of the Commonwealth is bound to comply with the competitive conduct rules should be extended to cover intra-governmental commercial transactions which occur in actual or potential competition with private firms. The Crown in right of the States and Territories should be bound in the same manner as the Crown in right of the Commonwealth.

## **C. RECOMMENDATIONS**

The Committee recommends that:

- 5.1 An authorisation process of the kind currently administered by the TPC constitute the primary means of permitting exceptions to the competitive conduct rules of a national competition policy. However:



- (a) the authorisation provisions should be amended to confirm that economic efficiency is the primary consideration in assessing public benefits; and
- (b) permitting the waiver of recently introduced fees in appropriate circumstances should be considered.

5.2 Specific exemptions in the competition statute may be appropriate in certain circumstances; recommendations on individual exceptions in the current Act are contained in Chapter Six.

5.3 Provision for exceptions by regulation made under the Act be replaced by a regulation power unlimited as to subject matter, but strictly limited as to time. The Committee proposes two years as an appropriate period. The competition authority — the Australian Competition Commission — should be required to monitor such exemptions and publish a list as part of its annual report.

5.4 Provision for the specific approval or authorisation of particular conduct by other Commonwealth laws be subject to the requirements that the approval or authorisation:

- (a) be in statutes, rather than regulations; and
- (b) expressly state that the approval or authorisation is for the purposes of the relevant provision(s) of the competition statute.

In addition, the competition authority should be required to monitor such exemptions, publish a list as part of its annual report, and undertake periodic reviews to determine whether such exemptions continue to be justified in the public interest.

5.5 Provision for the specific approval or authorisation of particular conduct by State and Territory laws be repealed.

5.6 Current limitations in the application of competitive conduct rules arising from constitutional factors be removed.

5.7 Current limitations in the application of competitive conduct rules arising from the shield of the Crown doctrine be removed from the Crown in right of the Commonwealth, the States and Territories in so far as the Crown in question carries on a

business or engages in commercial activity in competition (actual or potential) with other businesses.

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## 6. Scope of Application - Review by Sectors & Activity

Chapter Five argued that an authorisation process administered by an independent body — the proposed Australian Competition Commission — should be the primary means of exempting conduct from the competitive conduct rules of a national competition policy. In addition, however, some residual role was proposed for specific exemptions in the competition statute itself; for certain conduct that was specifically authorised by other Commonwealth statutes; and for temporary exemptions through regulations made under the competition statute.

The Committee's recommendations are to remove current exemptions or limitations on the *Trade Practices Act 1974* (TPA) arising from constitutional limitations; the shield of the Crown doctrine in so far as the Crown engages in business or engages in commercial activity in competition with private firms; specific authorisation by Commonwealth regulations made under other statutes, or by State and Territory statutes or regulations; and removal of the current provision of the TPA permitting certain categories of exemptions to be made by regulation.

As a corollary to that discussion, Section A of this Chapter reviews the impact of the current exclusions and the Committee's proposals on the twelve main sectors and activities currently subject to special treatment under the TPA. Section B presents the Committee's recommendations in relation to the current specific exemptions in the TPA.

### A. SECTORS & ACTIVITIES SUBJECT TO SPECIAL TREATMENT

The main sectors and areas of activity currently subject to special treatment under the TPA are:

1. Government-owned businesses
2. Professions
3. Other unincorporated businesses

4. Agricultural marketing
5. Overseas shipping
6. Intellectual property
7. Labour
8. Approved standards
9. Export contracts
10. Restrictive covenants
11. Consumer boycotts
12. Conduct or arrangements pursuant to international agreements.

Each of these areas relies on one or more of the exemption mechanisms discussed in Chapter Five. The result of the Committee's recommendations would be to limit the special treatment accorded a number of these areas, particularly the first four. Each area is discussed in turn.

## **1. Government-Owned Businesses**

The current exceptions for Government-owned businesses differ substantially between the Commonwealth and the States and Territories, and each category is considered separately below.

### **(a) The Commonwealth and Its Authorities**

#### *• Current Exceptions*

Commonwealth-owned businesses are largely subject to the same competitive conduct rules as private businesses.<sup>1</sup> Since 1977 the Commonwealth and its authorities have been denied the protection of the shield of the Crown doctrine in so far as they carry on a business.<sup>2</sup> While this covers a wide range of commercial activity, it may not cover the supply of goods or services from one Commonwealth Department to another, even if in competition with other firms.<sup>3</sup>

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<sup>1</sup> A Commonwealth business, AOTC, was recently found liable for a breach of the misuse of market power provision of the TPA: see *General Newspapers Pty Ltd & Ors v Australian & Overseas Telecommunications Corporation* (1993) ATPR ¶41-215.

<sup>2</sup> "Business" is defined in the Act to include business not carried on for profit (s.4).

<sup>3</sup> This argument rests on the notion that the Crown is indivisible. Thus, two Departments of the Crown — including businesses conducted as trust accounts under a Department — would be treated as part of a single entity, or a single corporation for the purposes of s.2A(2)(a).

There are no constitutional limitations on the application of the TPA to Commonwealth businesses.<sup>4</sup> There is provision to exclude particular conduct of the Commonwealth or its authorities by regulation,<sup>5</sup> although this has been used only once and the exemption has expired.<sup>6</sup>

The power to specifically authorise or approve conduct by other Commonwealth statute or regulation<sup>7</sup> has been used in relation to the special competition policy arrangements in the telecommunications sector, where it is not limited to the Commonwealth-owned business.<sup>8</sup>

- *Submissions*

The TPC argued that the application of conduct rules to the commercial activities of Commonwealth Departments should be clarified.<sup>9</sup> Several submissions expressed concern over aspects of the business conduct of Commonwealth Departments.<sup>10</sup>

- *Consideration*

The general inclusion of Commonwealth business activity within the Act's coverage is consistent with the increasingly commercial orientation of much governmental activity.

The concerns expressed in submissions over the possible advantages Commonwealth-owned businesses enjoy when competing with private firms extend beyond the application of competitive conduct rules, and are explored more fully in Chapter 13. However, uncertainty over the application of conduct rules to situations where one Commonwealth department is supplying goods or services to another arm of the Commonwealth in competition with private firms

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<sup>4</sup> See s.2A(2), which deems the Commonwealth and its instrumentalities to be corporations for the purposes of the Act in so far as they engage in business.

<sup>5</sup> See s.172(2)(c).

<sup>6</sup> The exception was made in 1988 for Commonwealth businesses in the telecommunications sector: see Trade Practices (Telecommunications Exemptions) Regulations.

<sup>7</sup> See s.51(1)(a) of the Act.

<sup>8</sup> See ss.236 & 237 of the *Telecommunications Act 1991* (Cth), which cover certain acts by both the Commonwealth owned business (AOTC) and private firms.

<sup>9</sup> TPC (Sub 69).

<sup>10</sup> Eg, Spark & Cannon Pty Ltd (Sub 36); Australian Legal Reporting Group (Sub 66); Assn of Consulting Engineers Aust (Sub 127); Screen Production Assn of Aust (Sub 123).

warrants attention. This issue is likely to be of increasing significance as such markets are opened up to competition, a situation probably not envisaged when the TPA was extended to Commonwealth businesses in 1977.

- *Recommendations and Impact*

The Committee recommends that the general conduct rules of a national competition policy confirm that the rules apply to commercial transactions between Commonwealth agencies when those transactions are undertaken in (actual or potential) competition with private firms. This may require some Commonwealth entities to review their current business practices, but is not expected to involve any significant transitional arrangements.

The Committee also recommends that the provision in the TPA permitting certain activity of Commonwealth government businesses to be exempted by regulation be repealed.<sup>11</sup> As this provision has not been used for a number of years its repeal should not present any transitional difficulties.

(b) State- and Territory- Owned Businesses

- *Current Exceptions*

State- and Territory- owned businesses may be exempt from the TPA in three possible ways.

Some State- and Territory-owned businesses may benefit from the shield of the Crown doctrine.<sup>12</sup> The exact extent of this immunity is uncertain, and requires the legislation establishing the entity and the activities engaged in pursuant to that legislation to be analysed. Bodies found to benefit from the immunity include the Queensland Commissioner of Railways,<sup>13</sup> the Government Insurance Office of New South Wales,<sup>14</sup> the Northern Territory Loans Management

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<sup>11</sup> See Chapter Five.

<sup>12</sup> For the States see *Bradken Consolidated Ltd v BHP*(1979) 145 CLR 107. For the Territories see *Burgundy Royale Investments Pty Ltd v Westpac Banking Corporation* (1988) 18 FCR 212.

<sup>13</sup> See *Bradken Consolidated Ltd v BHP*(1979) 145 CLR 107, where the Queensland Commissioner of Railways was alleged to have offended ss.45 and 47 of the Act.

<sup>14</sup> See *State Government Insurance Corporation v Government Insurance Office of NSW* (1991) ATPR ¶41-110.

Council<sup>15</sup> and the Metropolitan Water, Sewerage and Drainage Board.<sup>16</sup> However, other bodies have been found not to come within the doctrine, for example, Royal Prince Alfred Hospital.<sup>17</sup>

As the TPA is currently framed, State-owned businesses may also be able to avoid the TPA if they are not trading or financial corporations<sup>18</sup> and are not engaged in interstate or overseas trade or commerce. State banking has also been found to benefit from immunity under the Constitution,<sup>19</sup> and the same reasoning probably applies to State insurance.<sup>20</sup> Territory-owned businesses are not excluded from the TPA on constitutional grounds.<sup>21</sup>

States and Territories may also specifically approve or authorise particular conduct of their businesses (as well as conduct of any other business) by statute or regulation,<sup>22</sup> although the Commonwealth may over-ride such exemptions by regulation. As discussed in Chapter Five, the extent to which State or Territory statutes or regulations rely on this facility, as opposed to legislating to achieve particular anti-competitive outcomes in a way that does not involve conduct prohibited by the TPA, is often difficult to uncover. Moreover, some conduct that is expressly approved of in this way may not have involved a contravention even without such approval.<sup>23</sup>

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15 *Burgundy Royale Investments Pty Ltd v Westpac Banking Corporation* (1988) 18 FCR 212.

16 *See F Sharkey & Co Pty Ltd v Fisher & Ors* [1980] 33 ALR 173.

17 *E v Australian Red Cross Society* (1991) ATPR ¶41-085.

18 The following State bodies have been held to be trading corporations within the meaning of the Act: the Government Insurance Office of NSW (*State Government Insurance Corporation v Government Insurance Office of NSW* (1991) ATPR ¶41-110); Royal Prince Alfred Hospital (*E v Australian Red Cross Society* (1991) ATPR ¶41-085) and the State Superannuation Board (*State Superannuation Board v TPC* (1982) 60 FLR 165). The position of the Queensland Commissioner of Railways was not finally decided by the High Court in *Bradken* (*ibid*). The Tasmanian Hydro-Electric Commission has also been found to be trading corporations for the purposes of Commonwealth constitutional authority: see *Cth v Tasmania* (1983) 158 CLR 1.

19 *See Bourke v State Bank of NSW* (1990) 64 ALJR 406 and Constitution, s.51(xiii).

20 *See* Constitution, s.51(xiv) and McLachlan J, "The Application of the *Trade Practices Act 1974* (Cth) to State Government Instrumentalities" (1990) 64 ALJ 710-714 at 714.

21 The Commonwealth's authority over the Territories is established by s.122 of the Constitution, and is reflected in the extended reach of the Act provided for in s.6 of the Act.

22 *See* s.51(1)(b)&(c) of the Act. Examples of the application of this provision to State-owned business include s.86 of the *State Owned Enterprises Act 1992* (Vic) and the *Victorian Arts Centre (Amendment) Act 1988* (Vic).

23 *Eg*, arrangements specifically approved by the *Victorian Arts Centre (Amendment) Act 1988* (Vic) were found not to have involved a contravention of the Act even without such approval in *Paul Dainty v National Tennis Centre Trust* (1990) ATPR ¶41-029.

• *Submissions*

The current exemptions of State and Territory-owned businesses from market conduct rules were raised as a matter of concern by the large majority of submissions received by the Inquiry. Application of competitive conduct rules to government businesses was supported by consumer, business and industry groups, individual businesses and a host of other submitters.<sup>24</sup>

The New South Wales Government supported application of competitive conduct rules to government-owned businesses when they operated in competitive markets.<sup>25</sup> The Australian Capital Territory and South Australian Governments expressed concern over the potential impact of conduct rules on revenue objectives and community service obligations.<sup>26</sup> The Queensland Government argued that legislative extension of the conduct rules to cover State owned enterprises was unnecessary, at least in Queensland, because it already expressly provided for the application of the Act on a case by case basis.<sup>27</sup> Application of conduct rules was not opposed by some government businesses<sup>28</sup> or their representatives<sup>29</sup> but was resisted by others.<sup>30</sup> Some submissions, including those from groups representing government-owned businesses, emphasised the need to remove uncertainties over the application of the TPA.<sup>31</sup>

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<sup>24</sup> Eg, Victorian Law Reform Commission (Sub 2); Dr R Albon (Sub 8); Dr W Pengilly (Sub 11); Mr A I Tonking (Sub 16); Prof R Baxt (Sub 18); Esso Aust (Sub 21); Aust Institute of Petroleum (Sub 22); AGL (Sub 24); Caltex Aust (Sub 27); Unilever Aust (Sub 28); Shell Co of Aust Ltd (Sub 30); Carlton & United Breweries (Sub 34); Spark & Cannon Pty Ltd (Sub 36); Aust Mining Industry Council (Sub 39); Aust Information Industry Assn (Sub 40); Aust Earthmovers & Road Contractors Federation (Sub 49); DPIE (Sub 50); MTIA (Sub 59); Mr P Argy (Sub 60); Trade Practices Committee of the LCA (Sub 65); TPC (Sub 69); National Bulk Commodities Group (Sub 71); Mr M Corrigan (Sub 72); Aust Chamber of Manufactures (Sub 73); Aust Road Transport Federation (Sub 74); Treasury (Sub 76); Pioneer International Ltd (Sub 81); AMP Society (Sub 82); NFF (Sub 90); BCA (Sub 93); Small Business Coalition (Sub 100); Aust Consumers' Assn (Sub 131).

<sup>25</sup> NSW Govt (Sub 117).

<sup>26</sup> SA Govt (Sub 98); ACT Govt (Sub 109).

<sup>27</sup> Qld Govt (Sub 104).

<sup>28</sup> Eg, Gas and Fuel Corporation of Victoria (Sub 7).

<sup>29</sup> Eg, ESAA (Sub 89).

<sup>30</sup> Eg, Fremantle Port Authority (Sub 55).

<sup>31</sup> Eg, ESAA (Sub 89); ACT Govt (Sub 109).



• *Consideration*

Government-owned businesses constitute 10% of Australia's GDP.<sup>32</sup> Rail, electricity, gas and water utilities alone account for nearly 5% of GDP.<sup>33</sup> By any measure, they are a significant part of the economy.

As the reach of the present exceptions rests in large part on doctrines or principles of imprecise scope, it is difficult to judge what proportion of State- or Territory-owned businesses are already subject to the TPA. Certainly, as government businesses become more commercial in their operation they are less likely to be able to rely on the shield of the Crown, and corporatisation and related initiatives will see more of these businesses falling within the TPA as trading or financial corporations.

Historically, government-owned businesses have lagged behind their private sector counterparts in terms of efficiency. In the case of rail, electricity, water and gas utilities, for example, the Industry Commission has identified opportunities for increasing GDP by over 2%, or \$8 billion per annum.<sup>34</sup>

Inefficiencies of this kind can be attributed in part to regulatory arrangements or government policy decisions that shelter these businesses from competition. Application of the conduct rules will not serve to over-ride these arrangements: nothing in the competitive conduct rules will over-ride regulatory restrictions on competition or oblige governments to permit competition where there is currently none.<sup>35</sup> Nevertheless, application of the rules would prevent the protected enterprises from expanding the boundaries of their mandated monopolies or restrictive regimes through private anti-competitive arrangements or the misuse of their market power. Such conduct is not unknown in the government-business sector.<sup>36</sup>

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32 See Clare R & Johnston K, *Profitability & Productivity of Government Business Enterprises*, (1992).

33 See Industry Commission: *Rail Transport (1991); Energy Generation and Distribution (1991); Water Resources and Waste Water Disposal (1992)*.

34 *Ibid.*

35 The removal of regulatory restrictions on competition is discussed further in Chapter Nine.

36 The current exemptions and immunities generally mean that particular allegations of anti-competitive conduct by government-owned businesses are never proven in a court. However, such allegations have included anti-competitive agreements and exclusive dealing by the Queensland Commissioner of Railways (eg, *Bradken Consolidated Ltd v BHP*(1979) 145 CLR 107) and price-fixing agreements between a City Council and a competitor in the crematorium business (see NSW

As regulatory restrictions on competition are dismantled or relaxed, the application of competitive conduct rules becomes increasingly important. The non-competitive habits developed through decades of operation in a tightly regulated environment run the risk of being perpetuated through private arrangements. For example, many of the benefits of introducing competition into the electricity sector would be lost if ostensibly competing generators were able to engage in price-fixing or other collusive behaviour, or if a government-owned transmission grid were able to engage in anti-competitive conduct to limit competition in downstream markets.

More generally, government-owned businesses are increasingly competing directly with private firms in a range of activities. It is important on both efficiency and equity grounds that businesses competing in the same market face the same rules governing competitive conduct. This holds true whether the government business in question is a trading or financial corporation or is in some other form.

As the Swanson Committee observed: "The same standards of commercial conduct are clearly as appropriate for officers of the government as for persons in a less protected position".<sup>37</sup>

Similar sentiments were reflected by the High Court when it observed that:

the historical considerations which give rise to a presumption that the legislature would not have intended that a statute bind the crown are largely inapplicable to conditions in this country where the activities of the executive government reach into almost all aspects of commercial, industrial and developmental endeavour and where it is common place for governmental, commercial, industrial and developmental instrumentalities and their servants and agents ... to compete and have commercial dealings on the same basis as private enterprise.<sup>38</sup>

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Regulatory Review Unit, *Application of the Commonwealth Trade Practices Act to New South Wales State Government Instrumentalities* (1988) at 2).

<sup>37</sup> Trade Practices Act Review Committee (Swanson Committee), *Report to the Minister Business and Consumer Affairs* (AGPS, Canberra, 1976) at 87.

<sup>38</sup> *Bropho v State of Western Australia* (1990) 171 CLR 1 at 19.

The NSW Regulation Review Unit cited a number of expected benefits from applying the TPA to State government instrumentalities, including:

- fostering a greater respect for Government by the business community by forcing the State Government instrumentalities, in engaging in trade or commerce, to do so in accordance with the same rules and regulations that apply to private companies; and
- imposing a greater discipline upon each State Government instrumentality in making commercial decisions and, in particular, ensuring that those decisions do not substantially lessen competition or, if they do so, that the result is justifiable.<sup>39</sup>

As noted in Chapter Five, the most important bases for exempting State- or Territory-owned business from the conduct rules — the shield of the Crown doctrine and constitutional limitations — do not reflect any conscious judgment as to special claims or circumstance of those businesses. They specifically offend each of the principles already agreed by Heads of Government.

Removal of exemptions in this area would be consistent with the principles agreed between the Australian governments and the approaches adopted in other federal jurisdictions, including the United States<sup>40</sup> and Canada,<sup>41</sup> as well as in the European Community.<sup>42</sup>

- *Recommendations and Impact*

In Chapter Five the Committee recommended that the shield of the Crown exception be removed from State and Territory businesses in so far as they engage in business, including intra-governmental commercial transactions, in competition (actual or potential) with

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<sup>39</sup> NSW Regulation Review Unit, *Application of the Commonwealth Trade Practices Act to New South Wales State Government Instrumentalities* (1988) at 12-13.

<sup>40</sup> The only exemption the US appears to extend to sub-national levels of government is a limitation on the liability of local governments for treble damages: see *Local Government Antitrust Act 1984* (PL 98-544).

<sup>41</sup> Section 2.1 of Canada's Competition Act applies the Act to Federal and Provincial Crown Corporations in respect of commercial activities engaged in in competition, whether actual or potential, with other persons.

<sup>42</sup> Article 92 of the Treaty of Rome applies the Treaty's competition policy provisions to public undertakings of the Member States with minor qualifications not relevant to the application of the conduct rules like those proposed by the Committee.

private businesses; that limitations based on constitutional considerations that protect unincorporated government businesses be removed; and that the provision permitting State and Territory Governments to specifically authorise or approve particular conduct be repealed.

Some governments expressed concern that application of competitive conduct rules would affect their businesses' capacities to raise revenue. However, nothing in the proposed general conduct rules affects the creation of statutory monopolies, the charging of excessive prices or other pricing arrangements determined by regulatory (as opposed to collusive or other anti-competitive) processes. To this extent, the profitability of such businesses would be unaffected.

It is possible that some government businesses might seek to increase their profits by entering into price-fixing arrangements with their competitors or seeking to increase their market power by engaging in anti-competitive behaviour such as exclusive dealing with a supplier or customer. This behaviour would be prohibited by the proposed conduct rules, as would similar activity by any other business. However, it is doubtful if any additional revenue obtained by such behaviour would be significant in a budgetary sense, and permitting such behaviour to continue seems difficult to justify.

Some governments expressed concern at the potential impact of applying conduct rules on their businesses' capacity to deliver community service obligations (CSOs) or achieve other governmental objectives.<sup>43</sup> However, nothing in the proposed general conduct rules affects the capacity of governments or their businesses to pursue non-commercial objectives providing they do so without acting anti-competitively. For example, the proposed conduct rules do not require a government business to place orders with the most efficient supplier or to charge all customers a uniform price. Nor do the rules affect budgetary assistance provided to particular groups or to arrangements that are required by State or Territory law.

The impact of applying the rules to State and Territory government businesses would be to require them to observe the same standards of competitive conduct as any other business. For example, they could not collude with competitors or engage in anti-competitive exclusive

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<sup>43</sup> SA Govt (Sub 98); ACT Govt (Sub 109).

dealing unless that conduct were demonstrated to be in the public interest before an independent Commission. Nor would they be permitted to misuse their market power for a proscribed purpose.

The Committee does not envisage that these changes would require substantial transitional arrangements, and considers that a two year period of adjustment would be ample. Transitional arrangements are discussed in more detail in Chapter 15.

## 2. Professions

### Current Exception

Contrary to some suggestions, there is currently no exemption from the Act for the professions *per se*; indeed, "work of a professional nature" is specifically included in the definition of services.<sup>44</sup>

However, as some professionals practice in partnerships or in other non-corporate forms they are excluded from the Act on constitutional grounds unless they are engaged in trade or commerce across State or national borders or within a Territory. Historically, professions were not regarded as being part of trade and commerce,<sup>45</sup> although this argument seems less likely to be accepted today.<sup>46</sup>

In some States and Territories, certain conduct by some professions is exempted by being specifically approved or authorised by legislation.<sup>47</sup> However, this practice varies widely between States and Territories and between professions.

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<sup>44</sup> See s.4, TPA.

<sup>45</sup> For example, see *R v Small Claims Tribunal; Ex Parte Gibson* (1973) Qd.R 490 at 491 and see McGrath T G, "Apocalypse Now : Lawyers and the Trade Practices Commission", *Queensland Law Society Journal*, (Feb 1992) 35-47 at 37.

<sup>46</sup> A number of cases have held that certain professional services were offered in trade and commerce for the purposes of Part V of the Act (eg, *Bond v Thiess* (1987) 14 FCR 215; *Argy v Blunt* (1990) ATPR ¶40-015; and *Wan v McDonald* (1992) ATPR ¶46-088). In *Helco v O'Haire* (1991) 28 FCR 230 the Federal Court held that no professional activity should be excluded *a priori* from the likelihood of being conduct in trade or commerce. The distinction has been rejected by the United States Supreme Court in *Goldfarb v Virginia State Bar* 421 US 773 (1975).

<sup>47</sup> Eg, the *Legal Profession Practice Act 1958* (Vic) enables members of the Law Institute of Victoria to reach agreement about restrictions on behaviour and, through the Law Institute Council, have such rules approved by the Chief Justice.

## Submissions

The overwhelming majority of submissions dealing with the professions supported removal of existing exemptions. Proponents of this view included the consumer, business and industry groups, individual businesses, and a host of other submitters.<sup>48</sup>

State and Territory governments either supported application of competitive conduct rules<sup>49</sup> or did not express opposition to this result.<sup>50</sup>

Some professional associations supported application of competitive conduct rules.<sup>51</sup> The Australian Council of Professions did not oppose application of the Act but argued that such application should not constrain professional associations from continuing to set and enforce entry requirements and practice standards, other than relating to fees.<sup>52</sup> The Australian Medical Association argued that were the Act to be applied to the medical profession there was a need for consultation over transitional arrangements.<sup>53</sup> The Victorian Bar Council argued that, as it did not engage in anti-competitive conduct, application of the Act was unnecessary.<sup>54</sup>

## Consideration

There is no legal or universally agreed definition of the professions,<sup>55</sup> and statistics covering the field are generally poor. However, data

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<sup>48</sup> Eg. Law Reform Commission of Victoria (Sub 2); Dr W Pengilly (Sub 11); Prof R Baxt (Sub 18); Caltex Aust (Sub 27); Unilever Aust Ltd (Sub 28); Shell Aust Ltd (Sub 30); Carlton & United Breweries (Sub 34); AMIC (Sub 39); Aust Earthmovers and Road Contractors Federation (Sub 49); DEET (Sub 57); MTIA (Sub 59); Mr P Argy (Sub 60); Trade Practices Committee of the LCA (Sub 65); TPC (Sub 69); Aust Chamber of Manufactures (Sub 73); Treasury (Sub 76); Pioneer Ltd (Sub 81); DHHCS (in relation to the health professions) (Sub 84); BCA (Sub 93); Small Business Coalition (Sub 100); Aust Consumers' Association (Sub 131).

<sup>49</sup> NT Govt (Sub 91); ACT Govt (Sub 109).

<sup>50</sup> The NSW Govt agreed with the principle of universal coverage (Sub 117); SA Govt noted the need to have regard to the role of professional bodies in meeting public interests (Sub 98); and the Qld Govt noted the impact of mutual recognition and increased incentives for incorporation on professions, and suggested that the removal of exemptions for architects and engineers might be considered by the review (Sub 104).

<sup>51</sup> Eg. the Law Institute of Victoria (Sub 13); National Institute of Accountants (Sub 88).

<sup>52</sup> Australian Council of Professions (Sub 12).

<sup>53</sup> Aust Medical Assn (Sub 20).

<sup>54</sup> Victorian Bar Council (Sub 33).

<sup>55</sup> See TPC, *Regulation of Professional Markets In Australia : Issues For Review* (Discussion Paper, 1990). Note that the membership of the Australian Council of Professions comprises

for 1987-88 suggests that five occupational groups alone — lawyers, accountants, engineers, architects and real estate agents — accounted for nearly 2% of GDP.<sup>56</sup> The professions clearly comprise an important sector of the economy, and their services are a significant cost to many businesses which compete internationally.<sup>57</sup>

Whatever significance is attributed to the professions generally, it is important to emphasise that their partial exclusion from the Act is primarily due to a constitutional limitation which is unrelated to the status of professions. The scope of the exception depends largely on the legal form of the business, which varies widely across professions. Thus, for example, at the end of 1988 some 50% of engineering firms and 22% of accounting firms were incorporated, compared with less than 2% of legal practices.<sup>58</sup> Similarly, the constitutional limitation effectively discriminates between professions operating in States and in Territories, and between those firms that operate within a single State and those which operate nationally, as is increasingly the case with lawyers, accountants and engineering businesses. The overall result is patchy and difficult to justify on public policy grounds. As discussed in Chapter Five, limitations of this kind offend each of the principles already agreed by Heads of Government.

Restrictive practices in the legal profession have also been a matter of increasing concern to the community, as evidenced by the level of recent scrutiny at State, Territory and Federal levels.<sup>59</sup> Many of these issues could be addressed in a uniform national way by removing any gaps or uncertainty in the application of competitive conduct rules.

The recent agreement between governments on the mutual recognition of occupational regulation should overcome much of the fragmentation of professional regulation across States and

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architects, engineers, dentists, veterinarians, chemists, lawyers, accountants, surveyors, pharmacists, actuaries, quantity surveyors and physiotherapists.

<sup>56</sup> Based on ABS turnover figures, cited in Trade Practices Commission, *Regulation of Professional Markets in Australia: Issues for Review* (1990).

<sup>57</sup> For example, businesses are the largest consumers of legal services, accounting for 70% of barristers' services and 61% of solicitors' services in 1987-88: see TPC, *Legal Profession: Issues Paper*, (1992) at 11.

<sup>58</sup> See TPC, *Regulation of Professional Markets in Australia: Issues For Review* (1990) at 39.

<sup>59</sup> See, eg, Victorian Law Reform Commission, *Restrictions on Legal Practice* (1992); Senate Standing Committee on Constitutional & Legal Affairs, *Cost of Justice Inquiry* (Various reports, 1992-93); NSW Attorney-General's Department, *The Structure and Regulation of the Legal Profession* (Issues Paper - Nov. 1992); TPC, *Legal Profession* (Issues Paper- July 1992) and *The Legal Profession, Conveyancing & the Trade Practices Commission* (Draft report - Nov 1992).

Territories. Application of uniform competitive conduct rules would be consistent with this approach, and need not offend the goal of professional self-regulation.

Removing the special treatment enjoyed by some professions would also be consistent with the approach in several overseas jurisdictions, including the US,<sup>60</sup> New Zealand<sup>61</sup> and the EC.<sup>62</sup>

### Recommendations and Impact

The Committee has recommended that the competitive conduct rules be extended to include all non-incorporated businesses and that the provision permitting State and Territory laws to specifically authorise or approve conduct be repealed.<sup>63</sup>

The impact of the Committee's recommendations on the professions would depend on the nature of the restrictions on competition in question.

Where anti-competitive restrictions on professional practice are imposed by Commonwealth, State or Territory law — such as through a licensing regime of some kind — compliance with that law would not involve conduct in breach of the proposed market conduct rules. Arrangements of this kind, including statutory monopolies for some professions, would not be affected.

Where restrictions on professional practice are imposed through the rules of professional associations, rather than law, rules that had the purpose or effect of substantially lessening competition would be prohibited unless authorised by the Commission on the showing of a net public benefit.<sup>64</sup> Arrangements involving architects,<sup>65</sup> doctors and solicitors<sup>66</sup> and pharmacists,<sup>67</sup> have already been authorised by the TPC.

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60 See *Goldfarb v. Virginia State Bar* 421 US 773 (1975).

61 Commerce Act (NZ). Note that a special provision for professional fee scales was removed from the Act in 1986: see Van Roy Y, *Guidebook To New Zealand Competition Laws* (1991).

62 Articles 85 & 86 of the *Treaty of Rome* (EC) apply to "undertakings", which is interpreted widely to include any commercial activity.

63 See Chapter Five.

64 See s.45 of the TPA and the discussion of horizontal agreements in Chapter Three.

65 Royal Australian Institute of Architects, Code of Conduct (Auth App No.A58)(1984).

66 Law Society (ACT) & Australian Medical Association (ACT), Agreement on Charges (Auth App No.A90406)(1985).

67 Pharmacy Guild of Australia (Qld) 'Pharma Care' Group (Auth App No.A2563)(1983).



A third category of restrictions is those that are imposed by the rules of professional associations, and the making of those rules or arrangements has been specifically approved or authorised by Commonwealth, State or Territory law. The Committee proposes that legislative exemption at the sub-national level be no longer possible. Professional rules that offend the conduct rules would have to be modified, authorised by the Commission or exempted by the Commonwealth Parliament.

Application of the competitive conduct rules would not undermine the self-regulation of the professions. In conformity with relevant State or Territory law, professional bodies can continue to determine and enforce ethical and other standards for their respective professions. However, self-regulation could not be used to restrict competition in a way that was not justified in the public interest.

The Committee's examination of transitional issues is contained in Chapter 15. That Chapter recommends that legislation removing constitutional exemptions be passed as soon as possible, but not come into force until two years later. Exemptions currently provided by specific State or Territory statutes or regulations would be deemed to lapse three years after the new competition legislation is passed.

### **3. Other Unincorporated Businesses**

#### **Current Exception**

There is no specific exception in the Act for unincorporated businesses. However, the constitutional limitations on the reach of the Act have this effect unless the business in question is engaged in interstate or overseas trade or commerce, operates in a Territory, or supplies the Commonwealth.

#### **Submissions**

No submissions supported this exemption. A number of submissions, including that of the Small Business Coalition,<sup>68</sup> specifically

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<sup>68</sup> Small Business Coalition (Sub 100).

mentioned unincorporated businesses when arguing for extended application of the Act.<sup>69</sup>

### Consideration

As noted in Chapter Five, exemption on constitutional grounds offends each of the principles already agreed by Heads of Governments. In the case of unincorporated businesses, this limitation is particularly arbitrary, and permits businesses to evade regulation through the expedient of non-incorporation. The operation of the limitation may distort competition between corporate and non-corporate businesses, and between unincorporated firms situated in States and Territories.

It is sometimes assumed that unincorporated businesses are "small businesses", and worthy of special consideration on this basis. This is not necessarily the case, as partnerships may comprise up to 400 members<sup>70</sup> and a proprietary company can have as few as two members.<sup>71</sup> Rather, the choice of legal form as between companies, partnerships, sole proprietorships or the like will be influenced by a range of considerations including tax treatment and the desire to limit liability and financing requirements. In any event, this Committee, like previous Committees in 1976 and 1979,<sup>72</sup> considers that there is no reason for creating a general exemption for small business, however defined.

Application of competitive conduct rules to businesses irrespective of their legal form would be consistent with comparable overseas countries.

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69 Eg, Dr W Pengilly (Sub 11); Unilever Aust Ltd (Sub 28); Aust Earthmovers & Road Contractors Federation (Sub 49); Mr P Argy (Sub 60); NT Govt (Sub 91); ACT Govt (Sub 109); Aust Consumers' Assn (Sub 131).

70 See Application Order No 1 of 1990 under the Corporations Law (Cth), specifying that partnerships for lawyers and accountants can be of up to 400 members before being required to incorporate.

71 See s.114 of the Corporations Law (Cth).

72 See Trade Practices Act Review Committee, *Report to the Minister for Business and Consumer Affairs* (1976) at 88-91 and Trade Practices Consultative Committee, *Small Business and the Trade Practices Act* (1979) at 36.

## Recommendations and Impact

The Committee has recommended that the competitive conduct rules be extended to include all unincorporated businesses.<sup>73</sup> Although no substantial transitional difficulties are anticipated, any concerns could be met by appropriate transitional arrangements. In Chapter 15 it is proposed that unincorporated businesses be afforded a two year transitional period to modify their conduct or seek authorisation.

### 4. Agricultural Marketing

#### Current Exception

There is provision in the TPA for regulations to be made exempting conduct engaged in by specified primary commodity marketing organisations.<sup>74</sup> While this provision was used quite extensively until recently,<sup>75</sup> all such regulations have now expired.

Some agricultural producers may not operate in corporate form or engage in interstate or overseas trade or commerce, and may escape the reach of the Act on this basis.<sup>76</sup> It is possible that some statutory marketing authorities may be excluded from the TPA under the shield of the Crown doctrine.

Some agricultural marketing arrangements that involve voluntary conduct that would otherwise offend the Act may be specifically authorised or approved by Commonwealth, State or Territory legislation.<sup>77</sup> These arrangements must be contrasted with those where conduct is required by law, however, which would not involve contraventions of the TPA.

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<sup>73</sup> See Chapter Five.

<sup>74</sup> See s.172(2)(a).

<sup>75</sup> Regulations had been made covering products including mushrooms, oysters, citrus, dried fruit, bananas, apples, cherries, raw cotton, vegetables, macadamia nuts. See Trade Practices (Primary Products Exemptions) Regulations.

<sup>76</sup> A 1979 review of the application of the TPA to primary production noted that a "significant number" of primary producers were excluded from the Act on this basis: Trade Practices Consultative Committee, *Report to the Minister for Business & Consumer Affairs on the Operation of the Trade Practices Act in Relation to Primary Production in Australia* (1979) at 16.

<sup>77</sup> Eg, *Marketing of Primary Production Act 1983* (NSW) s.164.

## Submissions

Although a number of submissions raised concerns about competition in the agricultural marketing sector, many of these did not distinguish between mandated arrangements — which are not affected by application of general conduct rules — and voluntary arrangements — where fuller application of conduct rules might have more significant results.

The National Farmers' Federation agreed on the need for reform to agricultural marketing arrangements, particularly at the State level, and supported application of the TPA.<sup>78</sup> Producer groups generally supported existing arrangements for milk<sup>79</sup> while there was difference of opinion on the detail of appropriate arrangements for sugar.<sup>80</sup>

Industry groups<sup>81</sup> and Federal agencies<sup>82</sup> supported universal application of the TPA and emphasised the benefits of reform of statutory marketing arrangements.

The Northern Territory Government supported application of the TPA to statutory marketing arrangements.<sup>83</sup> The New South Wales Government argued that, in line with the broad principle that nationally uniform rules of market conduct should apply equally to all sectors, the establishment of statutory marketing authorities be preceded by a public benefit assessment through an authorisation process.

## Consideration

Agricultural marketing in Australia has long been dominated by statutory schemes of various forms, with rationales including price support to growers, price stabilisation, and the provision of countervailing market power to producers. Schemes vary between products and jurisdictions, but can include anti-competitive practices

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78 NFF (Sub 90).

79 Eg, Aust Dairy Farmers' Federation (Sub 10); United Dairyfarmers of Vic (Sub 52); Aust Dairy Industry Council (Sub 53);

80 Eg, Canegrowers (Sub 67); Qld Sugar Corp (Sub 51); Mackay Sugar Co-op Assn Ltd (Sub 70).

81 Eg, Food Industry Council of Aust (Sub 79); MTIA (Sub 59); BCA (Sub 93).

82 Eg, DPIE (Sub 50); ABARE (Sub 95); DITARD (Sub 101); Treasury (Sub 76).

83 NT Govt (Sub 91).

ranging from production controls and compulsory acquisition of product to price fixing and monopoly marketing arrangements.

Arrangements of this kind are often grossly inefficient, and effectively tax users and consumers. According to the Industry Commission, such arrangements effectively taxed users and consumers by \$550 million in 1988-89.<sup>84</sup> Benefits to these groups from reform of the milk, sugar and egg industries alone are estimated to total some \$346 million per annum.<sup>85</sup>

The chief executive of one of Australia's major food processors has remarked that only about 20% of Australia's growers were as competitive as their off-shore counterparts, with the remainder falling behind in large part due to the operation of statutory marketing arrangements.<sup>86</sup> As he observed:

SMAs seek price and income stability for all growers and in pursuing such objectives increase the price to allow less efficient operators to continue production. The cost to Australia, unfortunately, is the loss of world competitiveness, higher domestic prices and less consumer choice.

As well as the impact on consumer prices, price and quality effects of these arrangements flow on to Australia's food processing industry, and can impede the development of internationally-competitive value-added industries in Australia.<sup>87</sup> In recent years, there has been an increasing appreciation of the costs of such arrangements to the economy, and Australian governments have undertaken important reforms.<sup>88</sup>

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<sup>84</sup> IC, *Statutory Marketing Arrangements for Primary Products* (1991).

<sup>85</sup> *Ibid.*

<sup>86</sup> Brass P, "Driving with a Destination: The Need for a National Vision", *Business Council Bulletin*, (May 1993) at 78.

<sup>87</sup> See Minister for Industry, Technology & Commerce and Minister for Primary Industries & Energy, *Australian Agri-Food Industries*, (Joint Statement, July 1992)

<sup>88</sup> For example, NSW has deregulated its egg industry and reformed its agricultural marketing arrangements more generally; Queensland has undertaken reforms in the dairy, bread, meat, and peanut industries; Victoria has commenced reform in the dairy and egg industries; Western Australia has undertaken a range of agricultural reforms, as have South Australia and Tasmania. The Commonwealth has undertaken a range of reforms, including in wheat and wool.

The effect of the current exemptions from competitive conduct rules depends on whether the marketing scheme operates by government mandate or through voluntary arrangements between growers.

Where the scheme operates by government mandate — such as where a law provides for compulsory acquisition, vests monopoly marketing powers in a single body, or stipulates the prices at which goods are to be sold — application of competitive conduct rules will not of itself upset these arrangements, for they achieve their anti-competitive effect without requiring conduct of the kind prohibited by the conduct rules. Nevertheless, application of conduct rules to marketing authorities will prevent them from engaging in anti-competitive conduct not required by their legislation, such as by misusing their often considerable market power.

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.

Exemptions that rest on constitutional limitations or shield of the Crown offend each of the principles agreed between governments. Exemptions that rely on private behaviour being specifically authorised or approved by State or Territory law fragment the operation of national markets. As exemptions in this area often exist under regulations, rather than statutes, and are scattered across scores of legislation in most jurisdictions, there is typically little scrutiny over the continuing public interest rationale for continuing preferential treatment.

Benefits of reform include lower prices for consumers and improved prospects for developing internationally-competitive domestic food processing industries.

## Recommendations and Impact

The Committee recommends repeal of the special provision permitting agricultural marketing arrangements to be authorised by regulation made under the TPA. As this provision has not been used in recent years, no special transitional considerations are required.

The Committee also recommends removal of the constitutional limitation and shield of the Crown exemptions. The Committee does not anticipate any special transitional issues for the agricultural sector from these reforms. It proposes removal of these exemptions forthwith, but not commencing the relevant parts of the legislation for a period of two years, during which time existing arrangements can be modified or authorised by the Commission.

The Committee also recommends repeal of the provision permitting conduct to be specifically approved or authorised by State or Territory law or regulation. In line with laws relating to other sectors, the Committee proposes that three years be permitted before current exemptions under State and Territory laws are deemed to lapse. This should provide ample opportunity to review existing statutory arrangements in this area.

As with other sectors of the economy, conduct in the agricultural sector can be authorised by the Commission on the showing of a net public benefit, and authorisations have been made for arrangements dealing with products including oysters,<sup>89</sup> macadamia nuts,<sup>90</sup> apples and pears,<sup>91</sup> milk<sup>92</sup> and wine grapes.<sup>93</sup> The arrangement authorised for wine grapes is explicitly structured in both form and duration to allow transition from a regulated to a deregulated market. The Committee envisages that authorisations would continue to be granted by the proposed Australian Competition Commission as appropriate.

In this regard it should be noted that the TPA generally does not permit authorisation of price-fixing agreements. The Committee proposes a further tightening of the rules in this area, including by

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<sup>89</sup> See *Re Tasmanian Oyster Research Council Ltd* (1991) ATPR ¶50-106.

<sup>90</sup> *Re Macadamia Processing Co and Suncoast Gold Pty Ltd* (1991) ATPR ¶50-109.

<sup>91</sup> *Re Ardmona Fruit Products Co-op Ltd* (1987) ATPR (Com) ¶50-065.

<sup>92</sup> *Re Southern Farmers Co-operative Ltd* (1986) ATPR (Com) ¶50-102.

<sup>93</sup> See TPC (Sub 69).

removing the current exemption from the *per se* prohibition for recommended price agreements involving 50 or more persons. These arrangements will continue to be able to be authorised, however.<sup>94</sup> As a special measure to facilitate transition to the new regime, the Committee also recommends in Chapter 15 that price fixing arrangements of currently exempt firms be capable of authorisation by the Commission, on the demonstration of net public benefits, with any such authorisations lapsing no more than four years after the passage of the new competition law.

Given the export orientation of much of Australia's agricultural sector, it should also be noted that the Committee proposes to retain the special exception in the TPA for certain export contracts.<sup>95</sup>

Finally, the Committee notes that, notwithstanding some encouraging progress, there appears to be a substantial agenda of important potential reforms in relation to the many regulatory restrictions operating in the agricultural marketing area. As application of competitive conduct rules is not itself sufficient to achieve reform in this area, the Committee proposes in Chapter Nine a new mechanism aimed at removing regulatory restrictions on competition that cannot be justified in the public interest.

## 5. Overseas Shipping

### Current Exception

Outward cargo (liner) shipping services operated by cartels (known as conferences) are regulated in Part X of the Act. Liner shipping services operate over specific routes and on regular schedules.

Practices of outwards conference operators that are currently exempt from the general conduct rules are the fixing of freight rates; the pooling or apportionment of business; the imposition of cargo restrictions; decisions on conference membership; loyalty agreements with shippers; and practices essential to the conference service and of overall benefit to exporters.<sup>96</sup> Shipping lines are exempt only if they lodge their conference agreements on a public register and negotiate freight rates and service arrangements whenever requested by a

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94 See Chapter Three.

95 See s.51(2)(g), discussed below.

96 See Division 5 of Part X.



designated peak shipper body (currently the Australian Peak Shippers' Association).<sup>97</sup> However, the contents of registered agreements may be made confidential at the request of conference members if certain conditions are met, including no disadvantage to Australian exporters.<sup>98</sup>

Practices of inwards conference operators are provided with automatic immunity from aspects of the general conduct rules without the obligations imposed on outbound operators subject to Australian law. This difference reflects the difficulties in regulating inwards operations differently from the approach taken by originating countries.

### Submissions

A number of submissions recommended that Part X be repealed, allowing anti-competitive conduct alleged to be in the public benefit to be subject to administrative authorisation.<sup>99</sup> The Department of Industry, Technology and Commerce also expressed concern that shipping costs be established in competitive markets.<sup>100</sup> No submissions supported retention of the current exemption.

### Consideration

Ocean freight rates are the largest single cost component in transporting imports and exports and rates are influenced by the restrictive agreements operated by shipping conferences. On average, conferences transport 55% by volume and 60% by value of outbound and inbound liner cargo, with this share declining markedly over the last two years.<sup>101</sup> The conference shipping sector, largely exempt from competition law, carries in excess of \$25 billion in freight annually.

The stated objective of Part X has been to ensure Australian exporters and importers have access to internationally competitive liner cargo services of satisfactory frequency, reliability and port coverage. The former Managing Director of ANL, Australia's only conference

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97 See ss.10.03 & 10.41.

98 See ss.10.34 to 10.37 of the TPA.

99 AMIC (Sub 39); TPC (Sub 69); NFF (Sub 90); NT Govt (Sub 91); PSA (Sub 97).

100 DITARD (Sub 101).

101 ABS, *Foreign Trade: Australian International Cargo* (Cat No 5440.0).

operator, recently noted that there was “an increasingly blurred distinction in shippers’ minds between conference and non-conference” operators.<sup>102</sup> If this is the case, it seems increasingly difficult to justify giving some operators special immunity from competition law.

The Committee’s attention was drawn to a number of undesirable aspects of the current arrangements, including:

- the industry-wide centralised approach promoted by Part X has encouraged average (pan Australian) freight rates and industry-wide solutions rather than competitive resolution of freight rate issues (including inter-port competition) and greater regional specialisation. Moreover, the pooling and averaging of revenues and costs within conferences have reduced normal market incentives for increased efficiency;
- conferences effectively set benchmark port service and other ancillary charges which are then uniformly charged throughout the industry;
- many of the industry’s commercial problems result from the cartel structure which has encouraged the provision of excess capacity<sup>103</sup> and inhibited desirable rationalisation of shipping services. Liner shipping is not a unique industry and other industries with similar characteristics do not receive similar immunity from competition law;
- price fixing is inherently anti-competitive with negligible, if any, offsetting public benefits and should no more be permitted in liner shipping than in other sectors. Ship operators would still be able to trade slots, and higher quality services would be available, for a premium, in a competitive market. Anti-competitive practices which enhance the quality of services would be authorisable under the general competition rules in any event, where there are net benefits; and

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<sup>102</sup> Bicknell J, Speech to Australian Peak Shippers’ Association Seminar (May 1992) at 15.

<sup>103</sup> PSA, *Inquiry into Land Based Charges in Australian Ports by Ocean Carriers and Conferences*, (1992) at 35.

- the provision of assistance to ANL, which is publicly owned and a high cost operator, through the granting of special status for conferences is inefficient and impairs the international competitiveness of our traded goods sector. It is unlikely that ANL's participation in conferences significantly enhances its value, and there is little evidence that "protection" of ANL is yielding benefits for the Commonwealth budget or national economy.

The Committee considers that there is substantial evidence that the current Part X arrangements are a source of inefficiency and have contributed to the difficulty exporters and importers have experienced in realising the benefits that should be flowing from the gains in waterfront efficiency. On this basis, the case for special treatment of the anti-competitive behaviour in this sector should be viewed with scepticism.

The Committee notes that this scepticism is evident internationally in increasing scrutiny of the special arrangements covering international shipping conferences,<sup>104</sup> and any case for continuing special treatment of this industry is diminishing rapidly as greater efficiency is required of the domestic and international economy, and conferences lose market share to non-conference operators.

No compelling arguments for the retention of Part X were made to the Committee, and both the material presented to the Committee and the importance of this sector to the Australian economy suggest that the onus must rest with proponents of a continuing exemption to demonstrate that this would yield net public benefits. Overseas cargo shipping was first exempted from Australian competition law in the 1930s, primarily to protect services to a wide range of ports. This reasoning is clearly not relevant to Australia's contemporary circumstances, and pan-Australian freight rates and lack of transparency are inhibiting the development of inter-port competition.

Part X was to have been reviewed in 1994, but this review has been brought forward following the recent Prices Surveillance Authority Report.<sup>105</sup> The Commonwealth Government has established a

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<sup>104</sup> Eg, *Report of the US Advisory Commission on Conferences in Ocean Shipping* (1992).

<sup>105</sup> PSA, *supra*, n 102.

separate review of Part X, which is to be completed by November 1993.

### Recommendations

In view of the decision to establish a separate review of Part X, this Committee refrains from making comprehensive recommendations on this issue. However, submissions received by the Committee suggest that claims for continuing the current exemption will need to be assessed critically to ensure any restraints on competition are in the public interest. Moreover, consistent with the Committee's views on exemption from the conduct rules, any decision to continue special treatment should be reviewed regularly to ensure that the alleged benefits of anti-competitive activity exceed the costs of such behaviour, and that liner shipping policy objectives are being pursued in a way that is least injurious to competition.

It is not clear that the ability to fix prices is essential for conferences to provide the public benefits which are claimed to justify their existence. Indeed, there are understood to be conferences operating in other parts of the world which do not involve price fixing. Accordingly, any proposal to continue price fixing arrangements should be viewed with great care.

Removal of the special exemption for liner shipping conferences would raise the question of the scope for authorising price-related arrangements under the general rules, and the means for implementing any associated obligations on conference members considered appropriate. Although the Committee has recommended that, after an appropriate transitional period, price fixing for services no longer be authorisable, it may be that conference arrangements could still qualify for authorisation under the exemption for joint ventures.<sup>106</sup> Such authorisations could be conditional, or subject to undertakings imposing obligations on conference participants to limit their anti-competitive conduct.

If authorisation were not available under the joint venture exemption and some additional transitional period for conferences was considered desirable, this could be accommodated by an appropriate amendment to s.45A of the TPA limited to conferences.

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<sup>106</sup> See s.45A(2)(a), discussed in Chapter Three.

## 6. Intellectual Property

### Current Exception

The Act provides a specific and limited exemption for conditions contained in licences or assignments of intellectual property rights.<sup>107</sup> The scope of the exception varies somewhat between forms of intellectual property. The most important requirement for each is that the condition being imposed or enforced in such a licence must "relate to" the subject matter of the intellectual property (ie, invention, design). Moreover, the exemption does not extend to prohibitions on the misuse of market power or resale price maintenance.

### Submissions

Retention of the existing provision was supported by the Australian Industrial Property Organisation, the Australian Information Industry Association and the Institute of Patent Attorneys of Australia.<sup>108</sup> The Commonwealth Department of Primary Industries and Energy supported the existing treatment of plant variety rights in the Act.<sup>109</sup>

One submission<sup>110</sup> argued that the interface between intellectual property licensing and competition policy required reconsideration. Although citing no practical problems with the current regime, it was suggested that the current exemption should be replaced by a new provision that is more certain in ambit and provides that any exercise of an intellectual property right that extends it in time, in scope or in strength would be subject to the TPA, but not otherwise.

The TPC proposed that this exemption be repealed, with intellectual property licensing matters addressed in the authorisation process.<sup>111</sup>

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<sup>107</sup> Section 51(3) sets out the exemptions from the Act provided for patents, trademarks, designs, copyright and circuit layouts. Note also s.51(1)(a) and the *Plant Varieties Act 1987*.

<sup>108</sup> Aust Information Industry Assn (Sub 40); Inst of Patent Attorneys of Aust (Sub 43); AIPO (Sub 77).

<sup>109</sup> DPIE (Sub 50).

<sup>110</sup> Mr S Stern (Sub 64).

<sup>111</sup> TPC (Sub 69).

## Consideration

The limited exemption is intended to allow the owner of certain intellectual property rights to assign or license those rights in ways that enhance the owner's control of the exercise of those rights. But for a provision of this kind, some licensing or assignment restrictions might be prohibited by the TPA unless authorised.

The true scope and hence significance of the provision remains uncertain because the important "relates to" requirement has not been subject to any definitive judicial interpretation. However, it has been suggested that exclusive grants, territorial, price and quota restrictions and minimum royalty/quantity requirements sufficiently relate to the product licensed to fall within the exception. Full or third-line forcing and many "non-competition" clauses, on the other hand, arguably relate to matters collateral to the product itself and would thus fall outside the exception.<sup>112</sup>

The difficulties of determining the proper balance between the exercise of intellectual property rights and the promotion of competition poses particular difficulties in this area. On the one hand, licensing of intellectual property rights benefits the competitive process by encouraging rapid commercial application of innovations, helping competitors to capture their rewards, and increases the incentive to innovate. At the same time, licensing agreements can be used to cartelise an industry or to increase the market power of a single licensor.

Although no submissions pointed to practical problems with the current provisions, the Committee has concerns about a number of aspects of the regime. The Committee was not presented with any persuasive arguments as to why intellectual property rights should receive protection beyond that available under the authorisation process. In this regard it notes that in 1984 the Stonier Committee recommended that particular arrangements in relation to patent licences and assignments be vetted on a case-by-case basis under the authorisation process.<sup>113</sup>

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<sup>112</sup> See TPC, *Application of the Trade Practices Act to Intellectual Property* (1991).

<sup>113</sup> See Industrial Property Advisory Committee, *Patents, Innovation & Competition in Australia* (1984).

Even assuming that some special exemption is warranted, it is not apparent that the current exemption meets the relevant policy goal, particularly given the uncertainty over its scope. The current provisions also treat differently the various forms of intellectual property right. While each intellectual property regime no doubt reflects a different balance of relevant policy interests, it is not clear that different treatment as to the application of the competitive conduct rules is warranted.

### Recommendations and Impact

The Committee saw force in arguments to reform the current arrangements, including the possible removal of the current exemption and allowing all such matters to be scrutinised through the authorisation process.

Nevertheless, it was not in a position to make expert recommendations on the matter and recommends that the current exemption be examined by relevant officials, in consultation with interested groups. The examination should assess whether the policy reflected by the exemption is appropriate and, if so, whether it is expressed with sufficient precision and consistency regarding the range of intellectual property rights affected or potentially affected.

## 7. Labour

### Current Exception

The TPA currently excludes from consideration any act done, or any provision of, a contract, arrangement or understanding, to the extent that it relates to the remuneration, conditions of employment, hours of work or working conditions of employment. The exception is available to employers and employees, and does not extend to the secondary boycott or resale price maintenance provisions.<sup>114</sup>

### Submissions

The Business Council of Australia<sup>115</sup> proposed that the provision be repealed and reliance placed instead on the authorisation provisions

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<sup>114</sup> Section 51(2)(a). Note that while this exception does not apply in relation to secondary boycotts, s.45D(3) provides for similar considerations to operate as a defence.

<sup>115</sup> BCA (Sub 93).

of the TPA. The Small Business Coalition suggested that the provision be reviewed to ensure consistency with relevant industrial legislation.<sup>116</sup> Two other submissions raised the general issue of coverage of trade unions.<sup>117</sup>

The current exemption was supported by the Australian Council of Trade Unions and State Public Services Federation.<sup>118</sup>

### Consideration

But for a provision of this kind, collective agreements between employees (or employers) on employment related matters could be found to be agreements that substantially lessen competition in the labour market, and thus prohibited by the TPA unless authorised by the Commission. Where the agreement extended to remuneration, the agreement could constitute a price-fixing agreement that is prohibited *per se* by the Act and, if the Committee's recommendations were adopted, could not be authorised.

As well as agreements of this kind, the exception extends to any "act done" in relation to employment conditions and the like. It has been held that the relationship between the act and the employment conditions etc, must be direct and immediate.<sup>119</sup>

The special treatment of labour relations is a common feature of competition law in most comparable countries, and exemptions of this kind appear to exist in the US,<sup>120</sup> Canada,<sup>121</sup> the United Kingdom<sup>122</sup> and New Zealand.<sup>123</sup> As has been said in relation to a comparable New Zealand provision:

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<sup>116</sup> Small Business Coalition (Sub 100).

<sup>117</sup> Mr W J Rourke, AO (Sub 4); Prof R Baxt (Sub 18).

<sup>118</sup> State Public Services Federation (Sub 108); ACTU (Sub 113).

<sup>119</sup> See *Ausfield Pty Ltd v Leyland Motor Corp of Australia Ltd* (1977) ATPR ¶140-025 at 17,350.

<sup>120</sup> See s.6 of the Clayton Act (US) and *Connell Constructions Co v Plumbers & Steamfitters Local 100*, 421 US 616, 635 (1975).

<sup>121</sup> See s.4 of the Competition Act (Canada).

<sup>122</sup> See s.9(6) of the Restrictive Trade Practices Act (UK).

<sup>123</sup> See s.44(1)(f) of the Commerce Act (NZ).



Although labour relations is part of economic policy, it is based on collective action and regulation rather than individual action and competition. The social issues arising under labour law differ markedly from those relating to the conduct of firms in other markets.<sup>124</sup>

While recent developments in Australian industrial relations may place a greater emphasis on individual action and responsibility, collective agreements between groups of employees appear likely to remain important. Except for such a provision many labour agreements could infringe the competitive conduct rules. Such an outcome might infringe Australia's obligations under relevant International Labour Organisation Conventions which allow employees' freedom to organise and form trade unions.<sup>125</sup>

### Recommendation

The Committee proposes no change to the current provision.

## 8. Approved Standards

### Current Exception

The TPA specifically exempts any provision of a contract, arrangement or understanding obliging a person to comply with, or apply, standards of dimension, design, quality or performance prepared by or approved by the Standards Association of Australia or by any prescribed association or body.<sup>126</sup> To date the only prescribed body is the Australian Gas Association.<sup>127</sup>

### Submissions

The Standards Association of Australia supported the current exemption, and the Australian Gas Association proposed that it continue to be an approved body for the purposes of the provision.<sup>128</sup>

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<sup>124</sup> Van Roy Y, *Guidebook To New Zealand Competition Laws* (1991) at 28.

<sup>125</sup> The International Covenant on Civil and Political Rights provides that "everyone shall have the right to freedom of association with others, including the right to form and join trade unions for the protection of his (sic) interests". The International Covenant on Economic, Social and Cultural Rights provides that parties to the Covenant will ensure "the right of everyone to form trade union and join the trade union of his (sic) choice" and "the right of trade unions to function freely".

<sup>126</sup> Section 51(2)(c).

<sup>127</sup> See reg.8 of the Trade Practices Regulations.

<sup>128</sup> Australian Gas Assn (Sub 17); Standards Assn of Aust (Sub 106).

Some submissions expressed concerns about services providing for the certification of compliance with standards<sup>129</sup> and about standards imposed by regulations,<sup>130</sup> although neither are affected by the current exemption.

### Consideration

But for a provision of this kind, arrangements requiring compliance with some standards might possibly constitute a breach of s.45 of the TPA unless authorised. Even if a breach of the TPA were unlikely, it has been argued that an exemption encourages the use of standards by providing a useful assurance that litigation will not result from the imposition of such requirements.<sup>131</sup>

Comparable provisions exist in the UK<sup>132</sup> and New Zealand.<sup>133</sup>

Standardising products and systems may substantially enhance efficiency, increase competition by making products more readily substitutable, facilitate development of service industries for standardised goods and assist consumers and businesses in evaluating products.<sup>134</sup> Standards are becoming increasingly important to business operations for these reasons.

However, there is a risk that standards may be used as a barrier to market entry, particularly where they are mandatory and supported by regulation. Examples could include a standard that advantaged one product or producer over a rival on other than objectively reasonable, public interest grounds, or mandated particular technologies or systems rather than performance outcomes.

The Committee noted that this provision is broadly drafted, which is appropriate given the benefits of encouraging the use of appropriate standards. However, should any evidence come to light that

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<sup>129</sup> Aust Electrical & Electronic Manufacturers' Assn (Sub 118).

<sup>130</sup> DITARD (Sub 101).

<sup>131</sup> Eg, Van Roy Y, *Guidebook to New Zealand Competition Laws* (1991) at 27.

<sup>132</sup> See ss.9(5) of the Restrictive Trade Practices Act (UK), which exempts arrangements requiring compliance with standards approved by either the British Standards Institution or the Secretary of State for Trade and Industry.

<sup>133</sup> See s.44(1)(e) of the Commerce Act (NZ), which exempts standards approved by the Standards Association of New Zealand or any other prescribed body.

<sup>134</sup> Heydon J D, *Trade Practices Law* (1993) at 2296.

standards and the protection afforded by this provision are being used to stifle innovation and competition, the provision should be reviewed. No such evidence was brought to the Committee's attention during the Inquiry.

Standards and certification arrangements established by government regulation raise more difficult issues but are not addressed by application of competitive conduct rules. Means of addressing these issues are discussed in Chapter Nine.

### Recommendation

The Committee supports retention of the current exemption.

## 9. Export Contracts

### Current Exception

The TPA specifically exempts provisions of contracts (not conduct) that relate exclusively to the export of goods from Australia or to the supply of services outside Australia, provided full particulars are registered with the TPC before 14 days from the making of the contract.<sup>135</sup> The provision does not extend to contracts, arrangements or understandings for the export of goods by sea, which are governed by Part X of the Act.<sup>136</sup>

There were no submissions commenting on this exception.

### Consideration

A provision of this kind allows certain export contracts to be made which, if they related to domestic commerce, would offend competitive conduct rules. However, provisions of this kind may still be subject to scrutiny under the competition laws of other countries.

It has been said that this exemption rests on the belief that Australian businesses operating on world markets will be more competitive if permitted to behave in anti-competitive ways which would be

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<sup>135</sup> Section 51(2)(g).

<sup>136</sup> See *Refrigerated Express Lines (A'Asia) Pty Ltd v Australian Meat and Livestock Corporation & Ors* (1980) ATPR 40-156 and the discussion in Tonking A I & Alcock R J (eds) *Australian Trade Practices Reporter* at 8,631.

prohibited in Australia.<sup>137</sup> For example, a group of exporters may need to combine their efforts to take advantage of economies of scale in exporting, or to improve their bargaining power when dealing in world markets.

The Committee notes this provision relates exclusively to exports so that any impact on competition in Australia is likely to be at most indirect, that exempt agreements must be registered with the competition authority, and that a provision of this kind is far from unique to Australia. For example, similar exemptions exist in New Zealand,<sup>138</sup> Canada<sup>139</sup> the UK,<sup>140</sup> and the US.<sup>141</sup>

### Recommendation

In the absence of persuasive argument for removing or modifying the provision, the Committee supports continuation of the current exemption.

## 10. Restrictive Covenants

### Current Exceptions

Restrictive covenants are provisions included in agreements that restrict the liberty of one party from engaging in a rival business. They can be inserted in employment contracts, partnership agreements or on the sale of goodwill in a business. Historically, the enforceability of such conditions has been governed by the restraint of trade doctrine of the common law, where the reasonableness of the restraint is the primary consideration.

The TPA specifically excludes three kinds of restrictive covenant from the Act so that their validity will continue to be determined according to the common law doctrine.<sup>142</sup> These are:

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<sup>137</sup> Heydon J D, *Trade Practices Law* (1993) at 1667.

<sup>138</sup> See s.44(1)(h) of the Commerce Act (NZ).

<sup>139</sup> See s.45(5) of the Competition Act (Canada).

<sup>140</sup> See *Anti-Competitive Practices (Exclusion) Order 1980* (UK). Also note s 10(1)(f) and 19(1)(f) Restrictive Trade Practices Act (UK).

<sup>141</sup> See the Webb-Pomeroy Act, 15 USC ss. 61-65.(1982).

<sup>142</sup> Section 4M provides that the TPA does not affect the operation of, inter alia, the law relating to the restraint of trade in so far as that law is capable of operating concurrently with the Act.

- provisions of a contract under which a person (not being a body corporate) agrees to accept restrictions as to the work he or she may engage in during or after the termination of the contract (Section 51(2)(b));
- provisions of a contract, arrangement or understanding between partners (none of whom being a body corporate) concerning restrictions on competition between the partners during or after the termination of the partnership (Section 51(2)(d)); and
- provisions of a contract solely for the protection of the purchaser of the goodwill of a business. These will usually involve restrictions on the vendor's ability to compete with his former business. (Section 51(2)(e)).

There were no submissions commenting on this exception.

### Consideration

Contractual provisions of the kinds referred to in these exceptions are unlikely to substantially lessen competition in a market as distinct from lessening competition between individual competitors or potential competitors. In any event, the courts will strike down restrictions under the common law doctrine to the extent that they are unreasonably wide.<sup>143</sup>

The aim of these exceptions is to avoid further regulation of such contractual provisions by the TPA, and thus avoid introduction of a conflicting basis on which to regulate them.<sup>144</sup> There are obvious benefits in having this area of law subject to the degree of certainty and consistency provided by judicial precedents on such matters.

Similar provisions exist in New Zealand,<sup>145</sup> and a provision akin to s.51(2)(e) exists in the UK.<sup>146</sup>

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<sup>143</sup> In NSW the common law on this subject is modified by the Restraints of Trade Act (NSW).

<sup>144</sup> Tonking AI & Alcock RJ (eds), *Australian Trade Practices Reporter* at 8,611.

<sup>145</sup> See ss.44(1)(a),(c) and (d) of the Commerce Act (NZ).

<sup>146</sup> See *Restrictive Trade Practices (Sale and Purchase & Share Subscription Agreements)(Goods) Order 1989* SI 1989/1082 and *Restrictive Trade Practices (Services) (Amendment) Order 1989* SI 1989/1082.

## Recommendation

In the absence of submissions arguing the contrary, the Committee supports retention of these provisions in their current form.

## 11. Consumer Boycotts

### Current Exception

The Act specifically exempts consumer boycotts against the suppliers of goods or services, providing they are carried out otherwise than in the course of trade and commerce.<sup>147</sup> The exemption dates from 1977 and does not extend to the resale price maintenance provisions of the TPA.

There were no submissions commenting on this exception.

### Consideration

But for this provision, consumers who combined to exert pressure on a supplier could be liable under competitive conduct rules. It has been observed that, in contrast to some places overseas, consumer lobbying groups have not been particularly active in Australia.<sup>148</sup> A similar provision exists in New Zealand.<sup>149</sup>

### Recommendations

While the Committee questioned whether this exemption was a significant one in practice, in the absence of submissions on the underlying policy rationales it was prepared to support retention of the current provision.

## 12. Conduct or Arrangements Pursuant to International Agreements

### Current Exception

The TPA allows regulations to be made that exclude from the Act contracts or conduct made or engaged in, in pursuance of or for the purposes of a specified agreement, arrangement or understanding

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<sup>147</sup> Section 51(2A).

<sup>148</sup> Tonking AI & Alcock RJ, *Australian Trade Practices Reporter*, (1990) at 14-315.

<sup>149</sup> See s.44(1)(h) of the Commerce Act (NZ).

between the Government of Australia and the Government of another country.<sup>150</sup>

There were no submissions commenting on this exception.

### Consideration

No regulations have ever been made under this provision. The rationale for a special provision of this kind remains obscure.

### Recommendations and Impact

The Committee proposes repeal of this and other narrowly focussed regulated exemptions under the TPA, preferring instead a more general regulation power that is limited in duration.<sup>151</sup> If the Commonwealth sought to have such conduct or arrangements exempted from the Act it could seek authorisation from the Commission, pass legislation specifically authorising or approving that conduct or rely on a more general but temporary regulatory authorisation of the kind proposed by the Committee.

## **B. RECOMMENDATIONS**

In addition to the recommendations made in Chapter Five in relation to particular exemption principles and mechanisms, the Committee makes the following recommendations in respect of matters currently subject to specific statutory exemption under the Trade Practices Act:

The Committee recommends that:

- 6.1 The following statutory exemptions contained in the Act be continued under the competitive conduct rules of a national competition policy:
- (a) a provision dealing with labour along the lines of s.51(2)(a) of the Act;
  - (b) a provision dealing with standards along the lines of s.51(2)(c) of the Act;
  - (c) a provision dealing with export contracts along the lines of s.51(2)(g) of the Act;

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<sup>150</sup> Section 172(2)(b).

<sup>151</sup> See Chapter Five.

- (d) provisions dealing with restrictive covenants along the lines of s.51(2)(b), (d) & (e) of the Act; and
  - (e) a provision dealing with consumer boycotts along the lines of s.51A of the Act.
- 6.2 The provision exempting certain intellectual property matters be reviewed by relevant officials, in consultation with industry and other interested persons, to determine whether the current exemption is warranted; and if so, whether the current legislative formula meets the intended policy objective, and whether current inconsistencies between various intellectual property rights are justified.



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## 7. Enforcement

Compliance with the competitive conduct rules is encouraged by the provision of an effective enforcement regime. The determination of issues under prohibition-based rules is inherently a matter for judicial decision-making. This Chapter examines three key questions concerning the design of such a regime:

- What remedies should be available to redress contraventions of the rules?
- Who should be able to bring an action to enforce the rules?; and
- What processes should be available to assist courts in making decisions?

### A. REMEDIES

The basic objectives of a system of remedies are to deter people from contravening the law and to compensate injured parties. The current competitive conduct rules of the *Trade Practices Act 1974* (TPA) can, in appropriate circumstances, attract pecuniary penalties, injunctions, divestiture, damages, declarations and other compensatory orders. The adequacy of remedies under the Act is currently being considered by the Australian Law Reform Commission (ALRC), although the primary focus of that Inquiry is the consumer protection provisions of the Act.

#### Review of Current and Potential Remedies

In respect of the competitive conduct rules, the Committee is generally satisfied that the current remedies provide an appropriate level of deterrence and compensation, and is not convinced of the need for additional remedies.

##### 1. Penalties (s.76)

Penalties provide the most direct form of deterrence for contraventions of the competitive conduct rules. To the extent that

the system provides appropriate deterrence, there will be fewer occasions when parties are injured and may require compensation.

To provide a suitable deterrent, penalties should be set at levels which reflect the significant profits that might be gained from anti-competitive conduct in contravention of the TPA, the costs to society of that conduct and the probability of detection. The economic objective of deterrence should be balanced against the legal system's concern with justice. Thus it will also be appropriate to examine matters such as the deliberateness of the contravention, whether the firm has shown a disposition to cooperate with the enforcement authorities, and the level of involvement of senior management. In assessing penalty levels, the courts take into account these various factors.<sup>1</sup>

Until recently the maximum level of penalties under the TPA was set at \$250,000, which was clearly inadequate to achieve the deterrence objective. As one judge said:

one can only suspect that the penalties have not been taken very seriously. Their deterrent effect has been insufficient, it appears, to counter-balance the profit apparently derived.<sup>2</sup>

In late 1992, the level of penalties was substantially increased to a maximum of \$10 million.<sup>3</sup> Bearing in mind the principles courts apply in assessing penalties in particular cases, it can be expected that the maximum penalties will be applied only in extreme cases. The recent amendments have re-established penalties as a credible deterrent. The Committee considers that the current level of penalties, applied in accordance with current judicial principles, would be appropriate in a national competition policy.

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<sup>1</sup> See eg, *TPC v Stihl Chain Saws (Aust) Pty Ltd* (1978) ATPR ¶40-091 at 17,896; *TPC v CSR Ltd* (1991) ATPR ¶41-076 at 52,152.

<sup>2</sup> *TPC v Sony (Aust) Pty Limited & Ors* (1990) ATPR ¶41-053 at 51,691, Pincus J.

<sup>3</sup> See s.76. Maximum penalties for contraventions of the competition provisions, other than the secondary boycott provisions, are \$10 million in the case of a body corporate and \$250,000 in the case of a natural person. For secondary boycotts the maximum penalty is \$250,000 for a body corporate; penalties are not applied against natural persons.

## 2. Injunctions (s.80)

Under the TPA, courts may order injunctions to restrain firms from engaging in current or future conduct, or to compel them to engage in a particular form of conduct. The exercise of this power in cases involving the setting of prices has been the subject of some criticism, which is discussed below. Otherwise, the power is largely uncontroversial, and the Committee accepts it as a necessary and desirable mechanism for enforcing competitive conduct rules.

## 3. Divestiture (s.81)

An order for divestiture requires a firm to sell particular assets or particular parts of its business. The Committee considers that divestiture is appropriate in merger cases, but is not persuaded that the many disadvantages of providing a general divestiture power are outweighed by the possible advantages.

Under the current regime, divestiture is only available as a remedy in cases of mergers or acquisitions to undo the transaction. Some submissions to the Inquiry argued that divestiture should be available as a remedy in cases involving the misuse of market power, arguing that dismembering the firm removes the source of the problem.<sup>4</sup> The proposal was opposed by a number of other submissions.<sup>5</sup>

Arguments in favour of divestiture as a more generally available remedy are that it provides a structural remedy to a structural problem, rather than attempting to merely redress particular conduct; that it provides a strong deterrent to firms; and that it provides a strong negotiation tool in the hands of regulators seeking non-judicial dispute resolution.

Against this, a general divestiture remedy would give rise to a number of difficulties. It will often be arbitrary since it will not be clear what parts of a firm should be divested (contrast the case of mergers, where it is clearly the acquired assets or shares which should be divested). To break up a firm may eliminate economies of

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<sup>4</sup> Mr R Copp (Sub 107); Mr CA Sweeney (Sub 119).

<sup>5</sup> IC (Sub 6); Treasury (Sub 7); Trade Practices Committee of the LCA (Sub 65); BCA (Sub 93); Qld Govt (Sub 104); BHP Ltd (Sub 133).

scale and/or scope or generally decrease economic efficiency. Divestiture could involve reshaping an entire industry with consequent disruption to all who deal with it. It would involve the courts in a process with inevitable political implications, something more appropriate for decision by governments than by the courts.

The severity of the remedy is such that firms facing divestiture proceedings could be expected to strenuously oppose the proceedings using every legal means to impede the enforcement agency and try to obtain a political settlement or abandonment of proceedings. In a long case the market situation can undergo fundamental changes and the original reason for bringing the case may become irrelevant.<sup>6</sup> The process of divestiture could also be expensive to administer.

There have been no cases in Australia of persistent misuse of market power and there is no demonstrated need for such a remedy. With increased penalties it is difficult to argue that divestiture is needed as a deterrent. The argument that divestiture provides a negotiation tool for regulators is simply a reiteration of the deterrent effect of divestiture.

The Griffiths and Cooney Committees both considered allowing divestiture as a remedy in cases of persistent misuse of market power, but recommended against such a proposal. A significant factor influencing these recommendations was that, in contrast to most other remedies, structurally separating a corporation will not have a predictable result. Indeed, as noted by the Cooney Committee, as a result of divestiture "the resulting parts of the corporation may be made less productive, less efficient, perhaps unprofitable, perhaps even non-viable."<sup>7</sup>

To some degree, pressures to restructure government monopolies have influenced debate on whether a more general divestiture power should be included in the Act. As discussed in Chapter Ten,

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<sup>6</sup> Eg, the *IBM case* in the US ran for 14 years before being abandoned by the US Department of Justice. While the legal battle proceeded there were fundamental changes in the structure of the market, including the development of two new generations of computers.

<sup>7</sup> Senate Standing Committee on Legal and Constitutional Affairs, *Mergers Monopolies and Acquisitions - Adequacy of Existing Legislative Controls* (1991) at 98.

the Committee does not favour court-ordered divestiture as a mechanism for restructuring public enterprises.

#### 4. Damages (s.82)

Under the TPA, a person who suffers loss or damage as a result of a contravention may recover the amount of the loss or damage from any person involved in the contravention. The Committee considers that the existing provision for damages is a suitable model for a national competition law.

The prospect of orders for damages may provide an element of deterrence, but the essential role of damages is to provide monetary compensation to parties injured by contraventions of the competitive conduct rules. Damages also provide an incentive for private enforcement of the rules, easing the burden on public enforcement agencies.

In the United States, successful plaintiffs can receive awards for treble damages, that is, a sum of money which is three times the damage actually suffered. Although this approach enhances the deterrent value of damages and provides a greater incentive for private enforcement, the Committee notes that it also results in windfall gains to successful plaintiffs and may lead to speculative or vexatious litigation. The Committee considers that the advantages of a multiple damages scheme are outweighed by the disadvantages.

#### 5. Declaration (s.163A)

There are occasions on which parties to a dispute wish simply to have a court clarify the nature of existing legal rights and obligations, without seeking to have the court provide a substantive remedy. The Committee considers that a power to grant declarations should be included in the enforcement regime of a national competition policy.

The TPA permits parties to seek a declaration in relation to the operation of the competition rules, or the validity of any proposed or actual conduct. Before the court will exercise its discretion to grant a declaration it must be satisfied that the question before it is

real and not theoretical; that the person raising the question has a real interest; and that there is someone whose interests are opposed to the declaration sought. The existing provision is uncontroversial, and would provide a suitable model for incorporation into nationally applicable laws.

#### 6. Other Court Orders (s.87)

The TPA permits the court to make a wide range of orders to compensate damaged parties or reduce loss or damage which has occurred or may occur. A non-exhaustive list of orders is provided in section 87, which includes voiding contracts, varying contracts, and requiring the supply of specified services.

The Committee considers that the wide range of orders which the court can make under s.87 provides a powerful and flexible tool for achieving justice between the parties, and that such a power should be included in a system of national competitive conduct rules.

#### 7. Remedies Involving Prices

Misuse of market power situations, particularly refusal to deal cases, may involve courts in ordering one party to deal with another at a particular price, or at a price calculated using a particular formula. Some submissions have observed that courts are reluctant to be involved in setting prices and lack expertise in such matters, and have suggested that pricing remedies should be settled by a specialist economic body, such as the PSA.<sup>8</sup> Such proposals include the possibility of having courts refer such matters to a specialist body for advice, with the final determination of remedies remaining for the courts. Underlying these criticisms of the current regime is a belief that a specialist economic body could provide pricing remedies which are in some way "better" than those currently provided by the courts.

Pricing remedies under the current Act may take the form of mandatory injunctions or other orders.<sup>9</sup> Generally, however, Australian courts are "slow to impose upon the parties a regime

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<sup>8</sup> Trade Practices Committee of the LCA (Sub 65); Dr S Coronos (Sub 86); PSA (Sub 97); Matilda Fuel Supplies (Sub 120).

<sup>9</sup> See ss.80 & 87.

which could not represent a bargain they would have struck between them.”<sup>10</sup> Thus courts have proven more willing to order that dealing occur at a particular price in cases where there has been a previous course of dealings.<sup>11</sup> In principle, courts could also order firms to deal on a non-discriminatory basis, or fix prices by reference to the market price for a comparable product.

What is more difficult is the issue of setting prices where there is no reference price. An important policy decision in such cases is whether firms with market power should be permitted to set high, monopolistic prices or whether they should be compelled to deal at low “as if competition” prices. Low prices would reduce economic profits and hence reduce the signals attracting the entry of new firms into the market. Such remedies might thus extend the duration of market power problems. Since charging high prices is not of itself a contravention of the competitive conduct rules there is an argument that where firms with market power are compelled to deal with others it should be on the basis of a high price. But to enshrine such a principle in the procedures for dealing with misuse of market power would undermine the bargaining power of persons seeking to deal with firms with market power.

Quite apart from the technical difficulties associated with price setting, there is no clear *policy* basis for the setting of prices where there is no reference price.<sup>12</sup> In such circumstances improving the technical expertise of courts, or referring pricing matters to specialist bodies, would not improve upon the existing regime, and for this reason the Committee does not propose to make any special provision for pricing remedies.

As barriers to imports are removed and the economy becomes more competitive, the likelihood of refusals to deal occurring diminishes. The courts may be prepared to grapple with the difficult policy judgments involved in setting prices in circumstances where there is no clear reference price. The possibility remains, however, that

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<sup>10</sup> *ASX Operations Pty Ltd v Pont Data Aust Pty Ltd* (1991) ATPR ¶41-109.

<sup>11</sup> *Maclean v Shell Chemical (Aust) Pty Ltd* (1984) ATPR ¶40-462; *O’Keefe Nominees Pty Ltd v BP Australia Ltd* (1990) ATPR ¶41-057; *ASX Operations Pty Ltd v Pont Data Australia* (1991) ATPR ¶41-109.

<sup>12</sup> See Chapter 11 for a discussion of some of the competing policy considerations involved in the setting of prices.

some cases of refusals of supply in breach of s.46 may arise in which the court may not be prepared to specify a price so as to frame an appropriate order for supply. Where parties find the remedies available through the existing regime to be unsatisfactory they may in appropriate circumstances find relief through declaration for prices oversight purposes,<sup>13</sup> or through the system of special market access rules proposed in Chapter 11. The Committee has not been prepared to provide more prescriptive remedies in this area considering the circumstances in which they could be used might be relatively rare, but that their mere existence might have considerable adverse effects on incentives for investment.

### 8. Other Remedies

The Committee also considered the possible merits of other remedies, such as administratively-applied cease and desist orders.<sup>14</sup> Cease and desist orders effectively reverse the onus of proof, which could be particularly harsh where complex economic matters are involved, as is often the case in competition cases. In instances where there is an urgent need to prevent particular conduct, the competition authority may seek interim injunctions to preserve the status quo pending a full hearing. Overall, the Committee is not satisfied of the need for such additional remedies.

### Conclusion

The Committee is satisfied that the current range of remedies available under the Act is suitable for inclusion in the competitive conduct rules of a national competition policy.

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<sup>13</sup> See Chapter 12 for a discussion of the prices oversight mechanism proposed for a national competition policy.

<sup>14</sup> A cease and desist order would be issued by the competition authority when it had reason to believe that a contravention of the Act had occurred. The recipient of the order would then be obliged to refrain from engaging in the conduct specified in the notice, unless it could be shown that the conduct did not contravene the Act. See, eg, s.5 Federal Trade Commission Act (US).



## B. PRIVATE vs PUBLIC ENFORCEMENT

The current enforcement arrangements permit both private and public enforcement activities and, in the Committee's view, provide a suitable model for a national competition law.

### Consideration

The arguments for private enforcement are simple. It provides a direct mechanism for injured parties to obtain compensation, and lessens the public burden of ensuring compliance with the competitive conduct rules.

There are a number of rationales for a system in which a public enforcement agency is charged with the responsibility of bringing actions in the courts against firms it considers have contravened the competitive conduct rules. The desirability of pecuniary penalties as a deterrence mechanism suggests a need for public enforcement. Private litigants would generally not have an incentive to request that pecuniary penalties be imposed and are not appropriate persons to assess the public interest in arguing for a particular level of penalty. In many restrictive practices cases the social costs of contraventions may be significant in total but be dispersed among many individuals. In such cases the costs of litigation militate against private actions,<sup>15</sup> again suggesting a role for public enforcement. A specialist enforcement agency may have greater resources for, and expertise in, investigating suspected conduct than private litigants, and may be entrusted with information gathering powers which it would be inappropriate to entrust to private litigants.<sup>16</sup> The mere existence of such an agency may enhance the deterrent value of the competitive conduct rules.

The current approach provides for both public and private enforcement of the provisions of the Act in most cases. Private

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<sup>15</sup> Class action rules, recently introduced in the Federal Court, may, however, encourage private actions in such cases.

<sup>16</sup> Eg, the recipients of a notice from the TPC under s.155 of the Act are required to provide the requested information, notwithstanding that it may establish a contravention of the Act.

parties may not institute proceedings to obtain pecuniary penalties<sup>17</sup> or to obtain an injunction to prevent a merger.<sup>18</sup>

One submission has suggested that a private right of injunctive relief should be available in merger cases.<sup>19</sup> The right to obtain a private injunction to prevent a merger which contravenes the merger test was removed in 1977, on the basis that opponents of a merger could use the injunction process for purposes unrelated to competition, particularly in cases involving listed companies attempting to resist hostile takeovers. The Griffiths Committee recommended that the right be re-introduced but that takeover targets and associated persons should be excluded from the right. The Cooney Committee disagreed, concerned that it would not be possible to adequately protect against abuse by takeover targets and associated persons.

One argument in favour of a private right is that a public enforcement agency may not have full information, and that private litigants may be better placed to bring an action. But if such litigants wished to bring an action they could inform the enforcement agency.

### **Conclusion**

The Committee has not been presented with evidence of practical difficulties caused by the absence of a private injunctive relief in merger cases, and on this basis has no difficulties with maintaining the current balance between public and private enforcement in merger cases.

### **C. COURTS' USE OF ECONOMIC MATERIAL**

The competitive conduct rules require a number of judgments to be made about various economic facts, such as market definition, levels of market power, and the extent to which particular conduct lessens competition. Submissions to the Inquiry suggest a degree of dissatisfaction with the current court procedures for the utilisation

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<sup>17</sup> Section 77.

<sup>18</sup> Section 80(1A).

<sup>19</sup> Mr P Argy (Sub 60).

of economic material in the process of making such judgments.<sup>20</sup> In part, expressions of dissatisfaction with existing procedures may be the product of dissatisfaction with decisions in particular cases. In this respect, there will always be scope for disagreement, given the adversarial nature of a prohibition-based system.

### Possible Reforms

The submissions raised a number of constructive proposals to improve current processes, many of which were not confined in their impact to competition matters but had implications for the justice system more generally. The Committee was not satisfied that any perceived difficulties peculiar to competition law and law enforcement were of sufficient magnitude to warrant major departures from current practices and procedures. Some of the proposals may warrant follow-up in the context of ongoing refinements of the justice system. The Committee outlines the six main proposals below.

#### 1. Delegated Role for Trade Practices Tribunal

A number of submissions proposed an enhanced role for the Trade Practices Tribunal (TPT).<sup>21</sup> The Tribunal is not a court, is not bound by the rules of evidence, and has mixed membership of a presiding judge and appropriately qualified lay members. It is well regarded for its expertise and competence in handling complex economic issues.

The Griffiths' Committee recommended that consideration be given to enabling the Federal Court to refer economic issues to the Tribunal, more fully utilising the Tribunal's expertise and overcoming some of the perceived deficiencies of the court system. There are a number of potential difficulties with this proposal. Referring matters to the Tribunal may have the effect of increasing the time and cost of proceedings. There are constitutional difficulties with performance of judicial functions by non-judicial

<sup>20</sup> Eg, IC (Sub 6); Prof R Baxt (Sub 18); Mr P Argy (Sub 60); TPC (Sub 69); Treasury (Sub 76); National Institute of Accountants (Sub 88); Small Business Coalition (Sub 100); Mr CA Sweeney (Sub 119); Mr R Copp (Sub 107). For a discussion of many of the issues raised by these submissions see Yeung K, "The Court Room Economist in Australian Anti-Trust Litigation: An Under Utilised Resource?" (1992) 20 *Australian Business Law Review* 461.

<sup>21</sup> IC (Sub 6); Mr P Argy (Sub 60); Mr R Copp (Sub 107); Mr C A Sweeney (Sub 119).

bodies, and there are sound reasons for upholding this constitutional distinction: in matters with potential penalties of up to \$10 million, or remedies as extreme as divestiture, it is appropriate that the assessment and balancing of evidence and the making of final decisions should lie with a judicial body.

## 2. Specialist Division of the Federal Court

One proposal for improving the expertise of judges involved in trade practices cases is to establish a special division of the Federal Court.<sup>22</sup> In addition to the existing Industrial and General Divisions, there might be a Competition or an Economic Division. Permitting judges to specialise in this particular area might have the advantage of enhancing expertise, but judges might become too specialised and, particularly with a Competition Division, may not have a sustainable case load.

Despite the difficulties associated with this proposal there may be merit in exploring this and other options for increasing the specialisation of judges involved in competition matters.

## 3. Assessors

Some submissions proposed the use of assessors, particularly referring to New Zealand experience.<sup>23</sup> Assessors, qualified by particular knowledge, skill or experience, sit with the bench during judicial proceedings to assist in the understanding of evidence. Assessors act as a source of information on matters concerning their special knowledge or skill. Judges need not indicate the nature or extent of reliance on assessors.

In New Zealand, the Administrative Division of the High Court is required to have at least one member qualified by knowledge or experience in industry, commerce, economics, law or accountancy when hearing appeals from decisions of the Commerce Commission.<sup>24</sup> The model appears to be successful. The NZ Court of Appeal has commented:

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<sup>22</sup> Treasury (Sub 76).

<sup>23</sup> Mr P Argy (Sub 60); TPC (Sub 69).

<sup>24</sup> Section 77(9) Commerce Act (NZ).

In providing for the appointment of lay members in appropriate cases the legislation recognises that in this complex area the knowledge and experience in a particular field or fields of a member of the court is likely to contribute to the just resolution of proceedings. It is not surprising that in the present case where, as it transpired, the parties placed great emphasis on the evidence of economists and on the impact of competition and the inhibition of competition in this industry it was considered desirable to appoint to the court a lay member with special expertise in commerce and economics ... In these circumstances we consider that the High Court, constituted as it was, was in a particularly good position to compare and assess the competing views and that its conclusions as to the acceptability and weight-worthiness of the expert opinion are entitled to great weight.<sup>25</sup>

Assessors in New Zealand participate in the decision-making process. This would present constitutional difficulties in Australia, where the Constitution provides that only judges may exercise judicial power. One method of addressing this problem might be to appoint as judges persons qualified by reason of their economic or business expertise. A less problematic method for the introduction of assessors would be to restrict them to a purely advisory role. One difficulty with this option is that parties are denied the opportunity to test assessors' advice to the court, although the judges might overcome this difficulty by adopting a practice of disclosing to the parties the nature of the issues raised and views expressed by the assessor, to give the parties a fair opportunity of dealing with them.

#### 4. Court Experts

Greater utilisation of court experts was another proposal for assisting judges in their handling of economic issues.<sup>26</sup>

The *Federal Court Rules* permit the Court on the application of any party, to appoint an expert to inquire into and report on questions which arise in the proceedings.<sup>27</sup> The Court may:

- (a) appoint an expert as court expert to inquire into and report upon the question;

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<sup>25</sup> *TruTone Ltd v Festival Records Retail Marketing Ltd* [1988] 2 NZLR 352 at 357.

<sup>26</sup> *Mr R Copp* (Sub 107).

<sup>27</sup> Order 34, *Federal Court Rules*.

- (b) authorise the court expert to inquire into and report upon any facts relevant to his inquiry and report on the question;
- (c) direct the court expert to make a further or supplemental report or inquiry and report; and
- (d) give such instructions as the court thinks fit relating to any inquiry or report of the court expert.

This option has rarely been used in practice. It may increase the costs of litigation, judges may have concerns that the choice of a court expert may be perceived as compromising the judges' impartiality, and litigants may be unlikely to seek the appointment of a neutral expert because they do not have control over this aspect of the litigation.

There seems to be little scope for improvements in the use of court experts — the existing legislation has provided opportunities for the use of court experts, but parties cannot be forced to take advantage of those opportunities.

## 5. Expert Witnesses

One submission suggested that existing procedures did not provide adequate latitude for parties to call their own expert witnesses.<sup>28</sup>

There seems little doubt that expert witnesses can enhance the court's understanding of economic issues. While making an evaluation of evidence presented to the court is inherently a matter for judges there are other areas in which expert economic evidence can be useful.

Some reforms may be desirable in the area of admissibility of expert evidence.<sup>29</sup> In particular, the desirability of the "basis rule" (the inadmissibility of opinion evidence based on material not already admitted) and the "ultimate issue rule" (the inadmissibility of evidence as to the ultimate issues in a case) could usefully be

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<sup>28</sup> IC (Sub 6).

<sup>29</sup> See Yeung K, "The Court Room Economist in Australian Anti-Trust Litigation: An Under Utilised Resource?" (1992) 20 *Australian Business Law Review* 461; Blunt G, Shafron P & Kenneally B, *From Arnotts to QIW: A Study of Expert and Survey Evidence in Trade Practices Case* (paper presented at the Trade Practices Workshop, presented by the Business Law Section of the LCA, Canberra, July 1993).

examined. The basis rule can pose problems in competition cases where, for example, an expert economist discusses the principles by which market boundaries are established before the facts to which those principles relate are established. The ultimate issue rule can pose difficulties where, for example, it prevents expert economists from providing their opinions on the boundaries of a particular market, or whether conduct will substantially lessen competition.

Under these rules experts may be called to explain the economic theory underlying the process of market definition, but may not express an opinion on what the actual market is:

Economists are able to assist the court in relation to economic principles. But once the relevant principles are expounded, their application to the facts of the case is a matter for the court. The proper definition of a market is entirely a matter of fact, the determination of which ought not to be made more protracted and expensive by the adduction of unnecessary expert evidence.<sup>30</sup>

In the US, expert opinion evidence is not objectionable on the ground that it embraces an ultimate issue, and there is no direct equivalent of the basis rule.<sup>31</sup>

The Federal Court Rules permit the relaxation of the rules of evidence in certain circumstances, but these may not be sufficiently broad to cover all cases in which expert evidence could usefully be admitted.

The ALRC considered the question of expert evidence in its reports on evidence.<sup>32</sup> Most of the recommendations of the final report were given effect in the Evidence Bill 1991, which was introduced into the Commonwealth Parliament but lapsed with the calling of the 1993 Federal election. If enacted the Bill would have resolved many of the current difficulties with expert opinion evidence, by modifying the "basis rule" and abolishing the "ultimate issue" rule.<sup>33</sup>

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<sup>30</sup> *TPC v Australia Meat Holdings* (1988) ¶ATPR 40-876, per Wilcox J.

<sup>31</sup> There is no requirement that the evidence which forms the basis of an expert's opinion be admissible in evidence, and the evidence need not be disclosed prior to the hearing.

<sup>32</sup> ALRC, *Evidence (Interim)* (1985); *Evidence* (1987).

<sup>33</sup> See clauses 66, 85 and 86.

The Bill codified the opinion rule, confirming that evidence of an opinion is not admissible to prove the existence of a fact about the existence of which the opinion was expressed.<sup>34</sup> However it also provided that the opinion rule would not apply to expert opinion wholly or substantially based on specialised knowledge gained through training, study or experience.<sup>35</sup> The basis rule would have been modified by allowing courts to admit evidence, including expert evidence, provisionally, where the relevance of the evidence is dependent on some other finding (in the case of expert opinion evidence, that the factual basis is as the expert asserts).<sup>36</sup>

The proposed amendments would have overcome many of the practical difficulties currently faced in competition cases. The Committee supports the Bill's treatment of these issues.

## 6. Evidence

One submission suggested that court procedures for dealing with survey evidence were inadequate.<sup>37</sup>

Survey evidence may assist in defining market boundaries and in determining the state of competition within the market. By avoiding the need to prepare considerable numbers of affidavits or to call witnesses, accurate and reliable surveys have the potential for significant time savings, in both the preparation for, and conduct of, court proceedings.

Historically there have been difficulties in admitting survey evidence because it has been seen as conflicting with the rule against hearsay<sup>38</sup> evidence, but this objection appears now to have been overcome. In the *Arnotts'* case<sup>39</sup> the trial judge was prepared to exercise his discretion to dispense with compliance with the rules of

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<sup>34</sup> See clause 82.

<sup>35</sup> See clause 85.

<sup>36</sup> See clause 66.

<sup>37</sup> IC (Sub 6).

<sup>38</sup> Hearsay evidence is evidence given by one person of what another person has been heard to say, as opposed to the direct evidence of that other person.

<sup>39</sup> *Arnotts Ltd v TPC* (1990) 97 ALR 555.



evidence "where such compliance might occasion or involve unnecessary or unreasonable expense or delay".<sup>40</sup>

On appeal, the Full Court did not think it was "very profitable" to spend time in determining whether a particular survey was hearsay, reasoning that market survey techniques had now been refined to the point where they were capable of providing answers which were highly likely to be accurate (subject to a small sampling error) provided they were undertaken by experienced, professional people. In the event that a survey is hearsay, the Court felt use of the discretion was appropriate. Of course, such evidence would still only be one element in the overall picture, its importance varying from case to case.

The Full Federal Court adopted the following criteria for the adoption of survey evidence and noted that a survey which did not comply with the criteria, if admitted, should be given little weight:

The offerer has the burden of establishing that a preferred poll was conducted in accordance with accepted principles of survey research, ie that the proper universe was examined, that a representative sample was drawn from that universe, and that the mode of questioning the interviewees was correct. He should be required to show that: the persons conducting the survey were recognised experts; the data gathered was accurately reported; the sample design, the questionnaire and the interviewing were in accordance with generally accepted standards of objective procedure and statistics in the field of such surveys; the sample design and the interviews were conducted independently of the attorneys; and the interviewers, trained in this field, had no knowledge of the litigation or the purposes for which the survey was to be used. Normally this showing will be made through the testimony of the persons responsible for the various parts of the survey.<sup>41</sup>

Although these criteria appear to be reasonable, there may be merit in a more detailed appraisal of them. The suggestion has been made that the Federal Court should develop a practice note which would usually apply in relation to survey evidence.<sup>42</sup> Representatives of the Federal Court and the Law Council of Australia have conducted

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<sup>40</sup> Order 33, rule 3 *Federal Court Rules*.

<sup>41</sup> *Arnotts Ltd v TPC* (1990) 97 ALR 555, at 602-609.

<sup>42</sup> *Interlego AG v Croner Trading Pty Limited* (1991) ATPR ¶41-125, per Sheppard J.

discussions with a view to preparing such a practice note. The Committee fully supports this initiative.

Apart from survey evidence, proof in accordance with the rules of evidence of all the facts necessary to define "markets" and to assess the competitive effects of conduct in those markets will frequently be cumbersome, time consuming and expensive. In this regard, the rules of evidence can at times appear to be unnecessarily obstructive, and options for avoiding the more restrictive effects of the rules have attracted some attention. That relaxation of the rules need not detract from the efficacy of the decision-making processes is illustrated by the TPT, which is not bound by the rules of evidence,<sup>43</sup> and the New Zealand High Court, which may receive in evidence any information which would assist it to deal effectively with the case, except in pecuniary penalty and criminal proceedings.<sup>44</sup>

The Federal Court Rules permit the court to dispense with the rules of evidence in certain circumstances, but it will usually hesitate to do so unless the parties agree or it is clear that none of the parties will be prejudiced. This is understandable as findings in trade practices cases may result in severe penalties and other sanctions.

It may, nevertheless, be desirable to give the court a clearer mandate to waive the rules of evidence. Proposals made by the ALRC and reflected in the Evidence Bill 1991 would provide a wide power to waive the rules of evidence in civil matters not genuinely in dispute or if unnecessary expense or delay would be caused.<sup>45</sup> An alternative approach might be to adopt the TPT or New Zealand High Court models and waive the rules of evidence in cases other than those involving pecuniary penalties.

## Conclusion

The Committee considers that of the main proposals for refinement of court processes, three are especially worthy of further consideration: arrangements for increasing the specialisation of judges involved in competition matters; the use of assessors; and

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<sup>43</sup> Section 103(1)(c), *TPA*.

<sup>44</sup> Section 79, *Commerce Act (NZ)*.

<sup>45</sup> See clauses 177 and 188.

relaxation of the rules of evidence. The Committee suggests that an appropriate consultative process be established to consider these proposals. One possible mechanism might be a working group of officials and members of the legal profession, with consultation, where appropriate, with members of the Federal Court. Examination of these proposals should not, however, warrant delay in the implementation of the Committee's other recommendations.

#### **D. RECOMMENDATIONS**

The Committee recommends that:

- 7.1 The remedies for the competitive conduct rules of a national competition policy be based on those currently available under the Trade Practices Act.
- 7.2 The arrangements for private and public enforcement of the competitive conduct rules of a national competition policy be based on those currently available under the Act.
- 7.3 The processes for assisting courts to make judgments on economic questions under the competitive conduct rules of a national competition policy be based on those currently available under the Act. However, without delaying the implementation of other recommendations, an appropriate consultative process could be established to consider proposals for refinement of current court procedures, including:
  - (a) arrangements for increasing the specialisation of judges involved in competition matters;
  - (b) the use of assessors; and
  - (c) relaxation of the rules of evidence.



## **PART II: ADDITIONAL POLICY ELEMENTS**



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## 8. Overview of Additional Policy Elements

In announcing the establishment of this Inquiry, the Prime Minister indicated that there was to be a specific emphasis on areas currently outside the *Trade Practices Act 1974* (TPA).<sup>1</sup> These were widely understood to include many government businesses (including public monopolies), statutory marketing arrangements for certain agricultural products and some professions.

The overwhelming majority of submissions received by the Inquiry argued that these sectors should be brought within a national competition policy, and concerns over a range of anti-competitive practices and arrangements were documented. A number of these submissions assumed that application of rules of the kind contained in the TPA would address their concerns and allow freer and more effective competition in these sectors.

While application of the Act has many benefits, much more is required if free and open competition is to be introduced to these and many other sectors of the economy. Regulatory restrictions on competition will often need to be removed or modified. The structure of public monopolies will often need to be reformed. Competitors may need to be assured of access to certain facilities that cannot be duplicated economically. Concerns over monopoly pricing may require attention. And the special advantages enjoyed by some government businesses when competing with private firms may need to be addressed. An effective national competition policy requires measures to respond to each of these issues.

Policies addressing these issues have important implications for Commonwealth, State and Territory Governments. It is their laws and their businesses that will be most directly affected. In some cases there may be wider implications for government revenues or the delivery of community service obligations, although these may, and in some cases should, be dealt with through alternative arrangements.

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<sup>1</sup> See Statement by the Prime Minister of 4 October 1992 (110/92).

The Committee is aware of the potential sensitivities in these areas. It has attempted to develop its recommendations in ways that respect the interests of sovereign governments, while ensuring vital national interests are not lost sight of. The Committee has also attempted to build on the lessons being learned in other Australian cooperative economic reforms, but is taking a bolder stance because of the importance of the reform task and the belief that precedents should be considered as steps towards effective national reform rather than as desirable models in and of themselves.

Implementation issues for these additional policy elements are considered in Part III of this Report. That Part includes details of the role of the proposed National Competition Council, the proposed Australian Competition Commission, and relevant legal, transitional and resource issues.

This Chapter presents a brief overview of each of the five additional policy elements the Committee proposes for inclusion in a national competition policy.

## **A. REGULATORY RESTRICTIONS ON COMPETITION**

The greatest impediment to enhanced competition in many key sectors of the economy are restrictions imposed by government regulation or through government ownership. Examples include legislated monopolies for public utilities, statutory marketing arrangements for many agricultural products and licensing arrangements for various occupations and professions.

Compliance by a business (private or public) with government regulation is not prohibited by the TPA, however anti-competitive the consequences. Nor is imposition of the regulation. Application of the TPA will not be sufficient to overcome regulatory arrangements that establish monopolies, provide for the compulsory acquisition of crops, regulate prices, restrict the performance of certain activities to licensed occupations or a host of other regulatory restrictions on competition. Even if all exemptions from the TPA were eliminated — including the potential for Commonwealth, State or Territory laws



to authorise certain conduct<sup>2</sup> — these regulatory arrangements would be disturbed little if at all.

If Australia is to take competition and competition policy seriously, a new mechanism is required to ensure that regulatory restrictions on competition do not exceed what is justified in the public interest. Chapter Nine argues that all Australian governments should agree to adopt a set of principles aimed at ensuring statutes or regulations that restrict competition are justified in the public interest. This would involve increased scrutiny of new regulatory proposals and a more systematic review of existing regulations. An independent advisory body — the proposed National Competition Council — would support this process by undertaking and/or coordinating nation-wide reviews in specified areas and providing guidance on transitional issues.

## **B. STRUCTURAL REFORM OF PUBLIC MONOPOLIES**

The removal of regulatory restrictions on competition may not necessarily, and perhaps even usually, be sufficient to foster effective competition in sectors currently dominated by public monopolies. Recent work by the OECD has highlighted the importance of creating competitive market and industry structures if effective competition is to emerge.<sup>3</sup> Structural reform of existing public monopolies may be required, as governments have recognised with reforms in place or underway in a number of sectors. Nothing in the TPA addresses concerns of this kind; an effective competition policy must include a mechanism to fill the void.

Chapter Ten identifies three main forms of structural reform particularly relevant to the introduction of competition to markets currently dominated by public monopolies. These are: (1) separating regulatory responsibilities from commercial activities; (2) separating natural monopoly elements of an organisation from activities which are contestable; and (3) separating the potentially contestable elements of a monopoly into several independent businesses operating in the one market.

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<sup>2</sup> See s.51(1) of the Act, discussed in Chapter Five.

<sup>3</sup> OECD, *Regulatory Reform, Privatisation & Competition Policy* (1992) at 43.

The Chapter argues that all Australian Governments should agree to adopt a set of principles aimed at ensuring public monopolies are subject to appropriate restructuring before competition is introduced or substantial assets are privatised. While the implementation of these principles is left largely to individual governments, the NCC could be given references to advise governments when required.

### **C. ACCESS TO ESSENTIAL FACILITIES**

Introducing competition in some markets requires competitors to be assured of access to certain facilities — referred to as “essential facilities” — that cannot be duplicated economically. Thus, for example, effective competition in electricity generation and rail services requires access to the electricity transmission grid and rail tracks respectively.

While the misuse of the market power provision of the TPA can sometimes provide a remedy in these situations, submissions to this Inquiry confirmed the Committee's own assessment that something more is required to meet the needs of an effective competition policy.

Chapter 11 argues that a special legal regime should be established under which firms could, in certain circumstances, be given a right of access to specified “essential facilities” on fair and reasonable terms. The regime would operate by declaration under a general law, provide safeguards for the owner of the facility and users, and have the flexibility to deal with access issues across a range of industry sectors. It could be applied to assets irrespective of ownership, although primary emphasis should be on consent of the owner when government-owned assets are involved. The NCC would play a central role in advising on when access rights should be created and on what terms and conditions.

### **D. MONOPOLY PRICING**

In markets characterised by workable competition, charging prices above long-run average full costs will not be possible over a sustained period, as above-commercial returns will attract new market participants or lead consumers to choose a rival supplier or substitute product. Where the conditions for effective competition are

absent — such as where a firm has a legislated monopoly or the market is otherwise poorly contestable — firms may be able to charge prices above efficient levels for periods beyond a time when a competitive response might reasonably be expected. Such “monopoly pricing” is detrimental to consumers and to the community as a whole. Nothing in the TPA addresses this issue, and the Prices Surveillance Act has significant limits on its reach.

The Committee considers the primary response of competition policy in these markets should be to increase competitive pressures, including by those measures proposed in Chapters 9-11. Where these measures are not practicable or sufficient, some form of price-based response may be appropriate.

Chapter 12 argues that a national competition policy should include a carefully targeted prices monitoring and surveillance process. An independent inquiry into the competitive conditions of a market should precede the application of the mechanism to particular businesses. The mechanism could be applied to assets irrespective of ownership, although primary emphasis should be on consent of the owner when government businesses are involved. The NCC would assist governments in advancing pricing reform of public monopolies.

## **E. COMPETITIVE NEUTRALITY**

Submissions to the Inquiry raised concerns over the special advantages many government businesses enjoy when competing with private firms. As competition of this kind is likely to increase over the next decade, there is a growing need to find some mechanism to deal with “competitive neutrality” concerns. Nothing in the TPA or other relevant legislation addresses this issue.

Chapter 13 argues that all Australian Governments should agree to adopt a set of principles aimed at ensuring government-owned businesses comply with certain competitive neutrality requirements when competing with private firms. The principles distinguish between markets in which the government business has traditionally operated — where some transitional arrangements may be appropriate — and new markets, where no such transitional arrangements are considered appropriate. The NCC would support the development of appropriate principles in this area.



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## 9. Regulatory Restrictions on Competition

The competitive conduct rules proposed in Part I address restrictions on competition arising from the voluntary behaviour of firms. However, they do not address regulatory restrictions on competition, whether contained in statutes or subordinate legislation. Regulatory restrictions pervade the economy, ranging from government-sanctioned monopolies to licensing regimes and various restrictions on particular competitive conduct. In many areas currently at least partially exempt from the reach of competitive conduct rules — particularly government-owned businesses, agricultural marketing arrangements and the professions — removal of restrictions on competition will be the primary focus and means of implementing competition policy.

Government regulation will continue to be an important feature of our society, and there is wide community support for regulation to protect consumers, public health and safety, the environment and other significant interests. However, many of these laws were designed without explicit consideration of their impact on competition. Over the last decade or so, governments around the world have recognised that regulatory restrictions on competition impose substantial costs on consumers and society, through either cross-subsidies or reduced incentives for firms to innovate and improve their efficiency.

Proposals for new regulation are now subject to closer scrutiny to ensure they restrict competition no more than is necessary, and that the expected benefits to society outweigh any associated costs. Existing regulation put in place when there was greater confidence in regulation and less appreciation of its costs is generally reviewed as political priorities permit, with varying degrees of independent analytical rigour. Beneficiaries of the restrictions usually have powerful incentives to resist reform, with those advocating change bearing the burden of establishing that existing restrictions are not justified. While there have been important reforms, success has varied widely between sectors and different Australian jurisdictions.

The Committee believes that the time has come to progress regulatory reform more broadly, and to do so by reversing the onus of proof in considering the desirability of reforming particular regulation. Consistent with the principles already agreed between governments in relation to market conduct, the Committee considers that *there should be no regulatory restriction on competition unless clearly demonstrated to be in the public interest.*

This principle is the starting point for the Committee's proposals for more systematic review of regulations that restrict competition — including those relating to statutory marketing arrangements and the professions. A more rigorous review process of this nature was supported in many submissions to the Inquiry,<sup>1</sup> and can be an important and dynamic element of a national competition policy.

This Chapter comprises four sections.

**Section A** examines the impact of regulation on competition and outlines some of the key types of regulatory restrictions.

**Section B** outlines existing review processes and considers the case for adopting a more systematic, nationally-focussed approach.

**Section C** proposes a new approach to the reform of regulatory restrictions on competition as part of a national competition policy and considers alternative implementation options.

**Section D** presents the Committee's recommendations.

## **A. REGULATION & COMPETITION POLICY**

In commissioning this Inquiry, Australian Governments agreed that "no participant in the market should be able to engage in anti-competitive conduct against the public interest". Where voluntary behaviour of firms is concerned, this principle can be implemented by application of the general conduct rules, with exceptions only granted where a business can show that the public benefit from engaging in the conduct outweighs its costs.

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<sup>1</sup> Eg, Dr R Albon (Sub 8); Treasury (Sub 76); DHHLGCS (Sub 84); NFF (Sub 90); BCA (Sub 93); Small Business Coalition (Sub 100); NSW Govt (Sub 117).

However, where anti-competitive consequences flow from government regulation, the public interest justification generally rests on policy judgements of elected governments and parliaments. These decision-makers are entrusted with defining and implementing the public interest, and must evaluate a range of competing considerations. While perceptions of public interest requirements evolve over time, regulations remain in place unless reviewed. Regulation that confers benefits on particular groups soon builds a constituency with an interest in resisting change and avoiding rigorous and independent re-evaluation of whether the restriction remains justified in the public interest.

Governments intervene in markets for many reasons and in many ways. At one level, all such interventions affect competition. Taxation policy, for instance, often deliberately discriminates between various classes of businesses or business activities, potentially affecting their relative competitive positions.<sup>2</sup> Similarly, regulation impacting on business costs affects the relative competitive position of Australia and its firms.<sup>3</sup> In this sense, almost no regulatory activity is neutral in its implications for competition.

However, there are two forms of regulation that impact on competition most directly: regulation that restricts market entry, and regulation that restricts competitive conduct. Both forms of regulation were the subject of numerous submissions to this Inquiry<sup>4</sup> and are considered separately below.

## **1. Regulatory Barriers to Market Entry**

Regulatory barriers to market entry have the most direct influence over competitive conditions within an industry and, in the case of a monopoly, can prevent any competition. Other restrictions on market entry may be characterised according to whether they operate by reference to the number of suppliers, the qualifications of suppliers, or the origin of the goods or service providers. Extending the reach of market conduct rules will not affect these barriers to entry.

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<sup>2</sup> Examples drawn to the attention of the Inquiry are noted in Chapter 13.

<sup>3</sup> Mr P J Boyle (Sub 5).

<sup>4</sup> Eg, Dr R Albon (Sub 8); Shell (Sub 30); Mr R Sutherland (Sub 56); DHHLGCS (Sub 84); NFF (Sub 90); BCA (Sub 93); SBC (Sub 100); NSW Govt (Sub 117).

The importance of entry barriers has been highlighted by recent work on “contestability” — the idea that even the threat of potential competition can have efficiency effects similar to actual head-to-head competition.<sup>5</sup> Removing entry barriers can thus have an important impact on performance even if few or no new firms actually enter the market. Firms which were once isolated from competition realise that, unless they become more competitive, new entrants may seize opportunities and erode their market share.

### (a) Barriers Creating a Monopoly

Government-sanctioned monopolies fall within four main categories.

- *Public Utilities*

Australian governments have largely entrusted the delivery of water, electricity, rail, road, postal and telecommunications services to public monopolies. Government-mandated monopolies were often justified on the basis that the activities in question were “natural monopolies”. It was thought that a single producer was able to supply the service in question most efficiently, and that allowing additional suppliers would lead to “wasteful competition”.<sup>6</sup>

At the same time, governments have used their businesses to ensure that communities have equal access to services irrespective of locations and different costs of providing the services. Monopolies have often been required to cross-subsidise between users or provide other “community service obligations”. Monopoly profits have also been raised as a substitute for taxation, although not all monopolies have made profits, and fewer have made profits that exceed the cost of capital invested in them<sup>7</sup>.

The costs to the community of monopolists’ pricing and management practices are receiving increased attention. Inefficiency costs in the electricity sector alone were estimated at \$2.2 billion per annum in

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5 See Baumol W, “Contestable Markets : An Uprising in the Theory of Industry Structure”, *American Economic Review* 72 (Mar 1982) 1-15; and Gilbert R J, “The Role of Potential Competition in Industrial Organisation”, *Journal of Economic Perspectives* (Summ 1989) 107-127.

6 For example, in 1923 Alfred Marshall observed that “The supply of water, gas, or electricity to any locality cannot be distributed over several rivals: for to say nothing of its wastefulness ...”, *Industry and Trade* (4 ed, 1923) cited in Nowotny K, Smith D B & Trebing H M, *Public Utility Regulation* (1989) at 11.

7 See Box 12.4 in Chapter 12 for data on profits earned by Government Businesses.



1991.<sup>8</sup> At the same time, technological and other developments have eroded the extent of most genuine “natural monopolies” and eliminated others altogether. For example, while it is accepted that electricity transmission grids, rail tracks and local telecommunications networks probably continue to exhibit natural monopoly characteristics, electricity generation, rail and long-distance telecommunications services do not, and even local phone networks face competition from alternative technologies. Moreover, the natural monopoly element often accounts for only a small part of the range of activities carried on by legislated monopolies.

The recent introduction of competition to the telecommunications industry provides an example of the possible benefits. Although competition remains at an early stage of development, there is evidence that it is leading to reduced rates and improvements in productivity and service quality by the former monopolist.<sup>9</sup>

Some public utilities maintain their monopoly status without a formal regulatory barrier to new market entry.<sup>10</sup> In some cases the monopoly may be still be protected informally, however, such as through the exercise of discretions over various requirements relevant to the operation of the business, including development approvals and the like.

- *Monopolies over Budget-Funded Services*

A further form of monopoly exists where budget-funded government services are provided within government, without being subject to a competitive tendering process. Examples drawn to the Committee’s attention ranged from road construction,<sup>11</sup> rail transport<sup>12</sup> and port services<sup>13</sup> to the delivery of welfare and community services.<sup>14</sup> In

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<sup>8</sup> IC, *Energy Generation & Distribution in Australia* (1991).

<sup>9</sup> For example, over the period from June 1992 (when Optus entered the market) to May 1993, the STD peak rate on the Melbourne-Sydney route has fallen some 21%: AUSTEL advice based on published Telecom and Optus rates.

<sup>10</sup> Eg, in South Australia there appears to be no legal impediment to new firms entering the electricity market: see NGMC, *Regulatory Framework Issues for a National Electricity Market* (1993) at 28.

<sup>11</sup> AFCC (Sub 31).

<sup>12</sup> IC, *Rail Transport* (1991).

<sup>13</sup> IC, *Port Authority Services & Activities* (1993).

<sup>14</sup> Mr A Greig (Sub 3).

these cases, the monopoly is supported by policy decisions rather than formal regulations, although the effect on competition is the same.

Studies indicate that average cost savings in the order of 20% can be expected from exposing government provided services to competitive tendering. In some cases, such as cleaning services in Sydney hospitals, competitive tendering has realised average savings of almost 30%.<sup>15</sup>

Progress is evident in most government sectors. At the Commonwealth level, most services provided by the Department of Administrative Services<sup>16</sup> and most legal services provided by the Attorney-General's Department<sup>17</sup> will be open to competition within the next few years. The NSW Government noted that its current reform program includes the introduction of greater competition in areas including schools and colleges, hospitals and health services and in community services.<sup>18</sup>

- *Rural Marketing*

Monopolies over the marketing of agricultural products have their origins in economic and institutional circumstances of several decades ago.<sup>19</sup> Governments have created quasi-monopoly marketing rights in a number of agricultural boards, sometimes accompanied by a power of compulsory acquisition of crops, controls over pricing and/or production quotas.

The rationales for domestic monopoly arrangements of this kind have varied over time, including increasing returns to farmers, stabilising prices or providing farmers with countervailing market power vis-a-vis buyers. The costs of these arrangements to the community have become apparent in recent years, with reforms in areas including domestic wheat marketing, domestic barley marketing in some States and egg production and marketing in most States.

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<sup>15</sup> A number of these studies are summarised in Domberger S, "Competitive Tendering and Contracting Out: Recent Experience and Future Policy" *Policy* (Autumn 1993) at 23-27.

<sup>16</sup> DAA (Sub 83).

<sup>17</sup> Attorney-General's Department, *Annual Report 1991-92* (1992).

<sup>18</sup> NSW Govt (Sub 117).

<sup>19</sup> IC, *Statutory Marketing Arrangements for Primary Products* (1991) at 1.

Providing rural producers with countervailing market power will only rarely be justified on efficiency grounds,<sup>20</sup> and the dangers of quarantining prices from market forces have recently been illustrated by the wool industry.<sup>21</sup> Providing income support to producers can generally be achieved at lower cost to the community by other means.

Governments have also conferred monopoly status on exporters of certain products, such as wheat<sup>22</sup> and sugar<sup>23</sup>, where it is considered that the monopoly power will assist Australia to compete in world markets.

- *Other Government-Sanctioned Monopolies*

Australian Governments also sanction monopolies in other circumstances.

Temporary monopolies are given to protect the intellectual property rights of inventors and creators under the laws of patents and copyright. In the absence of such protection, there is concern that difficulties in controlling the use made of their ideas might diminish the incentives for socially-useful innovation.<sup>24</sup> The extent of monopoly required to achieve this goal is often open to debate.<sup>25</sup>

Most State governments reserve the transport of some commodities — including coal, timber, cement and petroleum — to rail. While monopolies of this kind may sometimes be justified on safety grounds, they also allow monopoly profits to be made which can be a significant source of State revenue in some cases (notably carriage of coal in NSW and Queensland).<sup>26</sup>

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20 Eg, see ABARE (Sub 95); and IC (March 1991).

21 Eg, see DPIE (Sub 50) at 24.

22 See Mr V Kelly (Sub 110); Grains Council of Australia (Sub 134).

23 See Qld Sugar Corp (Sub 51); Canegrowers (Sub 67); Mackay Sugar Co-op Assn (Sub 70).

24 Eg, see Australian Information Industry Assn Ltd (Sub 40); AIPO (Sub 77); DITARD (Sub 101).

25 Eg, see PSA, *Book Prices* (1989); *Sound Recordings* (1990); and *Inquiry into Prices of Computer Software* (1992). Also see Chapter Six for a consideration of current exemptions from the competitive conduct rules for intellectual property.

26 For a discussion of the use of Qld Railways to raise monopoly profits, see Galligan B, "Queensland Railways and Export Coal", (1987) 46 *Australian Journal of Public Administration* at 77.

(b) Restrictions that Operate by Reference to the Number of Producers or Product

Competition in some areas of the economy is restricted by licensing regimes or similar arrangements that regulate the number of producers or the volume of production. Under these arrangements, competition is permitted, but only within a rigidly controlled industry structure.

In some cases, such as restrictions on the harvest of timber and fish, regulations may be supported on resource-management or conservation grounds.

In many cases, restrictions may be based more on an "orderly marketing" rationale, in the belief that "too much" competition might be disruptive. Examples of schemes that appear to fall within this category are production quotas or similar licensing regimes for eggs, milk<sup>27</sup> and potato<sup>28</sup> producers, taxis,<sup>29</sup> and intrastate aviation services in NSW and Tasmania. While restrictions on some agricultural products were traditionally justified on public health grounds, it is now clear that these standards can be maintained without quantitative restrictions.

Restrictions of this type are often connected with price regulation of various kinds, and are usually difficult to reconcile with the modern understanding of the benefits of vibrant competition to consumers and the economy generally. While domestically focussed arrangements have their primary impact on consumer prices, they may also undermine the development of efficient export industries by distorting input prices.<sup>30</sup>

The potential benefits of reform are significant. Deregulation of egg production and marketing in NSW led to a fall in average retail prices of 38 cents per dozen, with savings to consumers of \$21m in a full year.<sup>31</sup> Deregulation of domestic aviation in 1990 led airfares to fall significantly; average fares are up to 29% lower than they were prior

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27 See, for example, Australian Dairy Farmers' Federation (Sub 10).

28 See Pacific Dunlop (Sub 112).

29 See Aerial Taxi Cabs Cooperative Socy (Sub 102); Australian Taxi Industry Assn (Sub 114).

30 Eg, see Brass P, "Driving with a Destination - The Need for a National Vision" *Business Council Bulletin* (May 1993) at 78.

31 NSW Egg Corporation, *Annual Report 1990-91*.

to deregulation on virtually all routes and the range of discounts has greatly increased.<sup>32</sup> Welfare gains to the community from aviation deregulation have been estimated at \$100m per annum.<sup>33</sup>

(c) Restrictions that Operate by Reference to Standards or Qualifications

Entry to many markets is restricted to goods or service providers which meet some prescribed standard or qualification. There are over 160 licensed occupations in Victoria alone, ranging from chicken sexers to boxing matchmakers and scrap metal merchants.<sup>34</sup> Other examples include product and building standards, and requirements for banks to comply with prudential requirements.

Such regulatory regimes may be more restrictive than necessary to protect the public interest objectives for which they were imposed. For example, the Prices Surveillance Authority (PSA) recently argued that the requirements for entry to the real estate agency industry went "way beyond what is necessary to protect consumers".<sup>35</sup> Similarly, the scope of the monopoly traditionally reserved to lawyers has been under intense scrutiny in recent years.<sup>36</sup> A number of governments have removed the lawyers' monopoly over conveyancing services, and accountants argue that other aspects of the lawyers' monopoly are too wide.<sup>37</sup>

Even if the standards are objectively reasonable, there may be concerns over whether they are administered or enforced in a way that unduly favours incumbents.

The recent agreement on the mutual recognition of regulatory requirements and occupational licensing is generating closer scrutiny of standards, particularly for occupations or products that are not regulated in all jurisdictions. While a mutual recognition regime offers the prospect of breaking down barriers between different

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<sup>32</sup> PSA, *Monitoring of Movements in Average Air Fares* (Report No. 5, July 1993).

<sup>33</sup> Bureau of Transport & Communications Economics, *The Progress of Aviation Reform* (Report 81, 1993).

<sup>34</sup> Victorian Regulation Review Unit, *Principles For Occupational Regulation* (1992).

<sup>35</sup> PSA (Sub 97) at 53.

<sup>36</sup> Eg, see Law Reform Commission of Victoria, *Restrictions on Legal Practice* (1992); NSW Attorney-General's Dept, *The Structure & Regulation of the Legal Profession* (1992); and TPC, *Study of the Professions : The Legal Profession* (1992).

<sup>37</sup> Inst of Chartered Accountants / Aust Socy of CPAs (Sub 99).

jurisdictions, from a competition policy perspective there is a concern — whether justified or not — that standards may be harmonised at the level of the most restrictive standard, rather than the most appropriate.

(d) Barriers Operating against Inter-State Goods or Service Providers

Section 92 of the Constitution restricts regulations that discriminate against interstate trade and commerce and which have the purpose or effect of protecting intrastate trade or industry against competition from other States.<sup>38</sup> The provision has been used to challenge a range of discriminatory arrangements.<sup>39</sup>

Recent inter-governmental efforts have focussed on removing differences in regulatory requirements which restrict inter-state trade. The agreement on mutual recognition of product standards and occupational licensing is an important achievement in this regard.<sup>40</sup>

Impediments to the creation of a truly national market remain, however, including policies and laws not affected by s.92 or the mutual recognition arrangement. For example, it has been argued that different regulatory measures and infrastructure investment decisions in the various States have led to the sub-optimal use of Australia's gas reserves.<sup>41</sup> It has also been claimed that national policies, such as protection of domestic shipping, inhibit interstate trade by increasing its cost.<sup>42</sup>

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<sup>38</sup> Section 92 provides that "trade, commerce and intercourse among the States ... shall be absolutely free". The interpretation of the provision was recently settled by the High Court after many years of uncertainty: see *Cole v Whitfield* (1988) 165 CLR 360.

<sup>39</sup> Eg, *James v South Australia* (1927) 40 CLR; *North Eastern Dairy v Dairy Industry Authy of NSW* (1975) 7 ALR 433. See generally, Coper M, *Freedom of Interstate Trade* (1983).

<sup>40</sup> The Mutual Recognition Agreement was signed by Heads of Government in May 1992 and provides for the States and Territories to refer power to the Commonwealth to enable it to enact national legislation to provide the detailed conditions of mutual recognition. The *Mutual Recognition Act 1992* (Cth), which came into force on 1 March 1993, and at time of preparing this report applied to NSW, Qld, the NT, ACT and the Commonwealth; with Tas and Vic expected to proclaim the relevant legislation in the near future.

<sup>41</sup> See DPIE, *A National Strategy for the Natural Gas Industry: A Discussion Paper* (1991) at 12-13; and Australian Petroleum Exploration Association Ltd (Sub 128).

<sup>42</sup> Eg, NT Govt (Sub 91) and Tas Govt (Sub 115).

(e) Barriers Operating against Foreign Goods or Service Providers

Although restrictions on international competition are traditionally treated as part of trade policy, as distinct from competition policy, reforms in this area improve competition in the domestic economy and are consistent with competition policy objectives.

Examples of entry barriers that operate by reference to the national origin of goods and services include import tariffs and quotas, foreign investment and immigration controls, rules governing local content in broadcasting and shipping cabotage policies. Barriers of this kind are generally erected to protect some distinctive national interest such as a domestic industry or cultural values.

Traditionally, Australia imposed relatively high import barriers to protect its manufacturing sector. Since the 1980s there has been increased understanding of the costs of such policies to consumers and the economy generally, and the effective rate of assistance for manufacturing has been reduced from 22% in 1983-84 to 15% in 1990-91. The Government has set out a fixed schedule of reductions that will leave most manufacturing industries with little industry-specific assistance.<sup>43</sup>

The impact of increased import competition on industry efficiency is illustrated by developments in the motor vehicle industry. The abolition of import quotas and a program of phased tariff reductions has led to improved productivity growth since 1988 and to a fall in the average level of faults per vehicle by 39% over the same period.<sup>44</sup>

Barriers against foreign banks and foreign investment generally have also been relaxed. Increased international exposure is an important means of improving competition and efficiency in a relatively small economy like Australia's, both directly through import competition, and indirectly by allowing foreign firms to operate in Australia on the same basis as Australian firms.

As noted in Chapter One, this Inquiry has focussed on competition policy issues within the domestic economy in developing its proposals, and thus does not deal with policy addressing barriers operating

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<sup>43</sup> IC, *Annual Report 1991-92* (1992) at 268-269.

<sup>44</sup> EPAC (Sub 126) at 15.

against foreign goods or service providers, many of which operate under, or are subject to, treaty obligations.<sup>45</sup> However, there are other important links between these policy areas. As well as their common effect in increasing competition in the domestic market, it is important to ensure that liberalisation of domestic barriers to competition accompanies trade liberalisation, so that domestic producers have the flexibility and incentives to enter promising markets, expand profitable operations, shift product lines and exit from shrinking markets.<sup>46</sup>

## 2. Restrictions on Competitive Conduct

Many sectors of the economy, including agriculture and many professions, operate under regulatory regimes which restrict certain forms of competitive behaviour. These regulatory restrictions range from price controls at one extreme to requirements to comply with generally accepted ethical standards at the other. Many of these restrictions may be justified as desirable for the protection of consumers, but the benefits to consumers of other restrictions are less obvious. For example, price regulation intended to assist favoured classes of producers or consumers restricts competition, and restrictions on advertising may serve to protect the interests of producers.

Where these restrictions are maintained by private agreement between producers, they would be subject to the competitive conduct rules proposed in Part I, but because they are imposed by government regulation, they are generally immune from the *Trade Practices Act* (TPA). Simple extension of the TPA, without removal of the regulatory restrictions, would often have a negligible impact because doing, or refraining from doing, an act in order to comply with government regulations is not usually conduct prohibited by the TPA.

## 3. Conclusions

The above review highlights the diversity of forms and possible rationales for regulatory restrictions on competition.

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<sup>45</sup> Submissions concerning international barriers included Dr R Albon (Sub 8); Australian United Fresh Fruit & Vegetable Assn (Sub 45); and Qantas (Sub 78).

<sup>46</sup> See Frischtak C R, *Competition Policies For Industrialising Countries* (1989).



The recent reforms mentioned illustrate the benefits to consumers and the economy generally of removing unjustified restrictions on competition. Submissions to this Inquiry confirmed the Committee's assessment that there remains a vast amount of regulation that is perceived to be restricting competition without adequate justification. Examples given in submissions covered almost every sector of the economy, including agriculture,<sup>47</sup> the professions,<sup>48</sup> transport<sup>49</sup> and government monopolies.<sup>50</sup>

Clearly, much more needs to be done if Australia is to meet the challenge of building a more dynamic and efficient economy.

## **B. CURRENT REFORM & REVIEW PROCESSES**

The determination of whether a regulatory restriction on competition is justified on public interest grounds largely depends on perceptions of the "public interest". In a democracy, this question is determined by elected governments and parliaments, though at times independent agencies are asked to make the judgement. In Australia's federal system, there are nine governments involved in this process.

Governments and parliaments accept that their judgements are not infallible. Increasingly, governments are implementing new procedures to assist in determining whether the benefits of a proposed regulation are likely to outweigh the costs to society. Similarly, there is an acceptance that perceptions of what the public interest requires will evolve over time, and that there is a need to bring existing regulations under scrutiny from time to time. Current processes differ between Australian jurisdictions.

### **1. Scrutiny at the Commonwealth Level**

The Commonwealth has adopted a policy of "minimum effective regulation" which is applied by the Office of Regulation Review (ORR). This requires that proponents of new regulation demonstrate

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<sup>47</sup> Eg, Australian United Fresh Fruit & Vegetable Assn (Sub 45); Pacific Dunlop (Sub 112).

<sup>48</sup> Eg, Mr P R Meatheringham (Sub 9); Australasian Dental Technician's Socy (Sub 14); Hospital Scientists Branch, NSW Public Service Assn (Sub 19); Assn of Hospital Pharmacists of Victoria/Medical Scientists Assn of Victoria/Victorian Psychologists Assn (Sub 26); Inst of Chartered Accountants/Australian Socy of CPAs (Sub 99); Chiropractor's Assn of Aust (Sub 137).

<sup>49</sup> Eg, Aust Inst of Petroleum (Sub 22); ARTF (Sub 74).

<sup>50</sup> Eg, Dr R Albon (Sub 8); AFCC (Sub 31).

that their proposals address real problems, that non-regulatory alternatives have been considered and that the expected benefits of the regulation outweigh the costs. Where regulation is considered justified, the ORR seeks efficiency in its design. The ORR is a formal part of the machinery of government and advises the Cabinet on submissions involving regulation issues.<sup>51</sup>

Scrutiny of existing regulations with significant economic impact is often undertaken by independent reviews, either by ad hoc public inquiries — such as the present one — or independent bodies including the Industry Commission (IC), PSA and TPC. The Australian Law Reform Commission may also be involved in this work.<sup>52</sup>

The IC and its predecessors traditionally focussed on import restrictions, where its independent analytical work has been an important impetus for reform. It has also focussed on inefficient industries where competition is weak for reasons other than import restrictions — such as rail, electricity, gas and water. More recently, it has been providing policy advice on industries considered to have growth potential.<sup>53</sup> It uses a public inquiry process and takes an economy-wide view of issues.

The PSA has also undertaken inquiries into areas where regulatory restrictions on competition affect performance, with recent studies on restrictions on real estate agents and on the parallel importation of books, records and computer software.<sup>54</sup> Like the IC, the PSA uses a public inquiry process and applies economic analysis with a nation-wide perspective.

Although the primary focus of the TPC has been on the conduct of firms, its recent work on the professions included an examination of regulatory restrictions on competition.<sup>55</sup>

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51 See IC, *Annual Report 1991-92* (1992) at 159-160.

52 Eg, ALRC, *Designs: Issues Paper* (1993).

53 See IC, *Annual Report 1991-92* (1992) at 24.

54 PSA (Sub 97).

55 TPC (Sub 69).

## 2. Scrutiny at the State Level

Most States have units similar to the Commonwealth's Office of Regulation Review,<sup>56</sup> which are part of the machinery of government rather than independent, and advise government on regulatory issues and proposals. They can also investigate complaints about government regulation.

Some States have instituted automatic revocation or sunset programs, which provide for automatic repeal of regulation after a specified time frame (generally 10 years) unless retentive action is taken.<sup>57</sup> In Victoria, regulation may be enacted or retained only following an impact assessment process which must establish a net public benefit, and include a public discussion process.<sup>58</sup>

There are no State equivalents of the IC, although the Commission is increasingly involving the States in its work. The terms of reference for many of its inquiries are now agreed between the Commonwealth and State Governments, and many of its more significant reports in recent years have been on sectors dominated by the States (eg, electricity, gas, rail, and marketing of primary production). States also commission work and hold public inquiries.<sup>59</sup>

## 3. The Need to Move on a Broader Front

The last decade has witnessed a growing appreciation by governments and the community of the costs to society of regulation that unjustifiably restricts competition. Proposals for new regulation are now subject to closer scrutiny to ensure they are no more restrictive of competition than necessary, and that the expected benefits to society outweigh any associated costs. Existing regulation put in place when there was greater confidence in regulation and less appreciation of its costs is also being reviewed, albeit usually on an ad hoc basis and with varying degrees of independent analytical rigour.

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<sup>56</sup> Eg, Office of Regulation Review (SA); Business Regulation Review Unit (Qld); Business Deregulation Unit (NSW); Regulation Reform Branch (Vic); and the ACT Regulation Review Unit. Tasmania has passed legislation to establish a review of all subordinate legislation (the *Subordinate Legislation Act 1993*), and is reviewing all legislation that affects business activity.

<sup>57</sup> IC, *Annual Report 1991-92 (1992)* at 129.

<sup>58</sup> The *Subordinate Legislation Act (Vic)* sunsets all regulations made prior to June 1982. Any proposed replacement regulations are required to meet "sunrise" assessment processes, including cost-benefit assessment. See IC, *Annual Report 1991-92 (1992)* at 129.

<sup>59</sup> Eg, Energy Board of Review, *The Energy Challenge for the 21st Century (1993)*.

The challenge of reform is great. Restrictions in place for long periods usually have usually developed a constituency of interests. Other things being equal, a business would rather face less competition than more. While protected businesses generally have a keen appreciation of the implications of change, the benefits of reform to the wider economy are typically dispersed, reducing the constituency for reform. In this setting, protected businesses are often well-placed to resist change, with proponents of reform usually bearing the burden of establishing that existing restrictions are not justified.

Australia has begun to address this challenge but priorities and progress continue to vary between jurisdictions and sectors. In the meantime, the inefficiencies arising from unnecessarily restrictive regulations are disadvantaging consumers and businesses that rely on inputs from protected sectors to contend with international competition.

The recent inter-governmental agreement on the mutual recognition of product standards and occupational licensing is a significant achievement in adopting more coordinated and broadly based reforms. It recognises the reality that Australia is one market, and that regulation in one jurisdiction often has implications beyond State borders. That agreement will not reach all restrictions on competition, however, and its liberalising potential can be subverted by adopting uniform regulations that are themselves unnecessarily restrictive.

The increasing involvement of the States in the work of the IC is also an important step forward.

Existing reform efforts affecting State-based regulations are not coordinated but appear to have a "bandwagon" effect. When public concern arose over the effects of restrictions in the legal profession there was not one substantial review adopting a national perspective, but a series of studies including by the Victorian Law Reform Commission,<sup>60</sup> the NSW Attorney-General's Department,<sup>61</sup> the

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<sup>60</sup> Law Reform Commission of Victoria, *Restrictions on Legal Practice* (1992).

<sup>61</sup> NSW Attorney-General's Dept, *Structure & Regulation of the Legal Profession* (1992).

Senate Standing Committee on Legal and Constitutional Affairs,<sup>62</sup> and the Trade Practices Commission,<sup>63</sup> covering substantially the same ground. While the result of such a barrage of reviews may be improved prospects of reform, it raises the question of whether the same or even better work might not have been pursued through a cooperative mechanism of some kind. Similarly, there would be benefits in pursuing coordinated national reform of agricultural arrangements.

An important first step is to ensure unjustifiably restrictive regulations are not imposed in the first place. While decisions on these questions are ultimately for individual governments and parliaments, it seems possible to develop a more consistent, national approach to scrutinising proposals to restrict competition through regulation or statute.

Where such regulation is in place, the challenge is to overcome the resistance of protected groups. This might be facilitated by governments accepting the principle that there is a presumption that competition is desirable, placing the onus on those proposing continuation of a restriction to demonstrate why it is justified in the public interest. Experience shows that improving the transparency of the costs and benefits of particular restrictions is usually a vital part of reform processes,<sup>64</sup> and a common commitment to such processes could expedite reform across the economy. Undertaking those analyses through an economy-wide, coordinated approach could reinforce the important national perspectives involved, while providing some economies of scale in resources and expertise.

### C. REGULATORY REFORM UNDER A NATIONAL COMPETITION POLICY

A mechanism to facilitate the reform of government regulation that unjustifiably restricts competition should be a central plank of a national competition policy. The starting point should be acceptance by all governments of the principle that there should be no regulatory restrictions on competition unless clearly demonstrated to be in the

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<sup>62</sup> Senate Standing Committee on Legal & Constitutional Affairs, *Cost of Justice* (1992).

<sup>63</sup> TPC, *Study of the Professions : The Legal Profession* (1992).

<sup>64</sup> Eg, see Derthwick M & Quirk P J, *The Politics of Deregulation* (1985).

public interest. This Section proposes a set of principles and recommends a cooperative implementation approach.

## 1. Policy Principles

The Committee's review of regulatory restrictions on competition supports the following broad principles as a basis for a national policy.

- I *There should be no regulatory restrictions on competition unless clearly demonstrated to be in the public interest. Governments which choose to restrict consumers' ability to choose among rival suppliers and alternative terms and conditions should demonstrate why this is necessary in the public interest.*

This principle is unexceptional but gives formal recognition to the new consensus over the proper role of competition in building an efficient and dynamic economy capable of delivering improved living standards. The principle recognises that while it may be appropriate to restrict competition in some circumstances, this should not be done lightly. The principle would apply to proposals for new regulations and statutes, as well as the scrutiny of existing restrictions.

The principle is directed at "regulatory" restrictions, and does not address situations where monopolies are maintained or competition restricted through government decisions on sourcing budget-funded goods or services. Decisions in this area are commonly regarded as management prerogatives, as they are in the private sector. However, contracting-out and competitive tendering have been seen to offer substantial cost savings in many areas, and governments are encouraged to continue exploring opportunities for creating new competitive markets in this way.

- II *Proposals for new regulation that has the potential to restrict competition should include evidence that the competitive effects of the regulation have been considered, that the benefits of the proposed restriction outweigh the likely costs, and that the restriction is no more restrictive than necessary in the public interest. Where a significant restriction on competition is identified, the relevant regulation should be subject to a sunset provision deeming it to lapse within a period of no more than 5 years unless re-enacted after further scrutiny in accordance with Principle III.*

This principle is aimed at ensuring that the costs and benefits of regulations which have the potential to restrict competition are considered in a transparent process before being put in place. Some jurisdictions have already adopted this approach. The sunset provision places the onus on those wishing to maintain a restriction on competition to justify that such a restriction continues to be in the public interest.

The Committee envisages a pragmatic interpretation of "significant restriction on competition", focussing on barriers to market entry and prohibitions on competitive conduct. The Committee is not prescriptive as to the methodology for assessing costs and benefits but notes that existing agencies are developing experience in this area which might be harmonised between jurisdictions.

- III *All existing regulation that imposes a significant restriction on competition should be subject to regular review to determine conformity with Principle I. The review should be performed by an independent body, involve a public inquiry process and include a public assessment of the costs and benefits of the restriction. If retained after initial review the regulation should be subject to the same requirements imposed on new regulation under Principle II.*

This principle involves governments adopting a pro-active, systematic and rigorous approach to the review of existing regulation that restricts competition. It also recognises that both existing and new regulation should be subject to the same scrutiny regarding their net public benefit.

The requirement that the body undertaking the review be “independent” excludes not only the industry subject to the regulation but also the government agency responsible for creating and administering the regulation.

*IV To the extent practicable and relevant, reviews of regulation undertaken pursuant to Principles II and III should take an economy-wide perspective of the impact of restrictions on competition.*

This principle reflects the necessity to account for impacts beyond a single State or Territory border. While individual governments may not be well placed to adopt such a perspective in all cases, cooperative mechanisms such as those set out below can assist in ensuring larger national interests are given due weight.

These principles are not exhaustive and could be further refined and be supplemented by more detailed principles governing particular forms of restriction or sectors, such as agricultural marketing.

## **2. Implementing a National Policy**

The Committee considered several options for implementing policy principles of the kind proposed above. While favouring cooperative and decentralised approaches, it proposes that a new institution — the National Competition Council (NCC) — play a role in coordinating reforms and facilitating the cooperative process generally.

### **(a) Implementation Options**

The main options in this area distinguish between the treatment of the regulation review activity and the possible role for a legal regime to over-ride regulations found to be inconsistent with the principles.

- *Review Activity*

Assessment of the costs and benefits of new regulatory proposals is clearly a matter for each jurisdiction. However, there may be benefits in collaboration to develop consistent methodologies.

Reviews of existing regulations present more options. A single national body could be given jurisdiction to review all existing



Commonwealth, State and Territory regulations, including through inquiries with compulsory information gathering powers. At the other extreme, each jurisdiction could be responsible for reviewing its own regulations, subject to conforming with the agreed principles. A middle course would see each jurisdiction primarily responsible for its own regulations, but providing a mechanism to facilitate cooperative nationally-focussed action where appropriate.

- *Implementing Review Findings*

Where a review of a regulation concludes that the costs to the community outweigh its claimed benefits, the question arises as to how that finding might be carried into effect.

One option would be to have a single national law that would over-ride the regulation in question. Although the Commonwealth's constitutional powers are not unlimited, it may be possible for the Commonwealth to over-ride State and Territory laws by effectively creating a "right to compete" or a "right to buy", qualified as appropriate to take account of other social goals. The operation of such a law might be triggered by the finding of a national review authority, or by some process agreed by governments.

Alternatively, individual governments could retain responsibility for reforming their own laws.

- (b) *Consideration & Conclusions*

As in other areas, the Committee starts with a preference for respecting the prerogatives of sovereign governments unless there is a clear national interest at stake that could not be resolved cooperatively. There are two main issues: the review process, and a power to over-ride State and Territory regulations as a possible response to the findings of that review.

- *The Review Process*

Evidence of Commonwealth-State cooperation on matters such as interstate rail, the waterfront, road transport and mutual recognition suggests that cooperation in this area is likely to be successful, though the pace of such cooperative effort is at times of concern. However,

given the experience that is developing with cooperative arrangements, the Committee supports this approach.

Under the Committee's preferred approach, each government would be responsible for implementing the principles within its jurisdiction, but could call on a nationally-focussed, independent advisory body — the proposed NCC — to facilitate cooperative efforts.

Thus, for example, each government would be responsible for applying Principle II — relating to scrutiny of new regulatory proposals — in its own jurisdiction. In many cases, this task is already being performed by a specialist agency, and this work would continue. However, the NCC could assist in working towards more consistent approaches between jurisdictions, including on methodological questions.

In relation to the review of existing regulations, each government would be primarily responsible for implementing the agreed principles within its jurisdiction. However, where particular regulations that were of concern to more than one jurisdiction were involved, the NCC could be given a reference by governments to coordinate or undertake economy-wide reviews of the regulations in question. Such a process may present economies for individual jurisdictions and could be used to accelerate reform across targeted sectors of the economy. While the areas of early interest may be those constraining competition in the infrastructure industries, agricultural marketing and the professions, the NCC's work program could be agreed between governments.

At present, the TPC and PSA undertake some work on regulatory restrictions on competition, and have taken a national view of State and Territory regulations in areas such as real estate agents and the professions. Their activity does not appear to have intruded unduly into State prerogatives in this regard, and the Committee supports a continuing role in this area for the proposed successor to these bodies, the Australian Competition Commission. To avoid duplication it would be important for the work program of all reviewing bodies to be coordinated, and the NCC should undertake this task. Moreover, it would be important that the ACC's work be seen as complementary to the work of the NCC, and that any reviews the ACC initiates are genuinely economy-wide in focus or significance.

In view of the cooperative nature of the envisaged regulation review process, the Committee does not see a need for review bodies to have powers to compel the disclosure of information, although powers of these kinds might be conferred on these bodies for the purposes of specific reviews where such powers were considered essential.

Although the proposed process would see a number of bodies involved in reviewing regulations that restrict competition, there may be fewer inquiries than under the current, more ad hoc approach in each jurisdiction. The NCC should assist in avoiding unnecessary duplication.

A further task is to develop and refine the broad proposition reflected in Principle I, including by developing more detailed principles governing particular forms of regulatory restrictions or particular sectors of the economy. For example, it should be possible to develop more detailed guidelines governing the reform of particular restrictions in the agricultural sector, or for removing regulatory impediments to competition in infrastructure industries such as electricity and gas. While decisions on what principles should apply in these areas are for governments, the NCC should be well-placed to assist them in developing and refining appropriate principles.

- *Over-Ride Power*

In view of its preference for a cooperative approach to the review of regulations in this area, the Committee does not recommend that the Commonwealth enact a law to over-ride relevant State or Territory regulations which do not comply with agreed principles. Nevertheless, an approach of this kind should not be ruled out as a possibility if the cooperative approaches recommended by the Committee prove inadequate to meet the national interests at stake.

## **D. RECOMMENDATIONS**

The Committee recommends that:

- 9.1 A mechanism to promote reform of regulation that unjustifiably restricts competition form a central plank of a national competition policy.

- 9.2 All Australian Governments agree to abide by the following principles:
- I *There should be no regulatory restrictions on competition unless clearly demonstrated to be in the public interest. Governments which choose to restrict consumers' ability to choose among rival suppliers and alternative terms and conditions should demonstrate why this is necessary in the public interest;*
  - II *Proposals for new regulation that have the potential to restrict competition should include evidence that the competitive effects of the regulation have been considered; that the benefits of the proposed restriction outweigh the likely costs; and that the restriction is no more restrictive than necessary in the public interest. Where a significant restriction on competition is identified, the relevant regulation should be subject to a sunset period deeming it to lapse within a period of no more than five years unless re-enacted after further scrutiny in accordance with Principle III.*
  - III *All existing regulation that imposes a significant restriction on competition should be subject to regular review to determine conformity with Principle I. The review should be performed by an independent body, involve a public inquiry process and include a public assessment of the costs and benefits of the restriction. If retained after initial review the regulation should be subject to the same requirements imposed on new regulation under Principle II.*
  - IV *To the extent practicable and relevant, reviews of regulation undertaken pursuant to Principles II and III should take an economy-wide perspective of the impact of restrictions on competition.*
- 9.3 An independent, nationally-focussed advisory body — the proposed National Competition Council — be charged with assisting governments in developing and implementing the agreed principles, including by:

- (a) undertaking and/or coordinating economy-wide reviews of particular regulatory restrictions, in accordance with a work program agreed with governments; and
- (b) developing for the consideration of governments more detailed principles governing the treatment of particular sectors and forms of regulatory restrictions.

9.4 The national competition authority — the proposed Australian Competition Commission — continue to be able to undertake reviews of regulations restricting competition. Activity in this area should complement that of the National Competition Council, focus on matters of economy-wide significance, and be consistent with any work program agreed under the auspices of the Council.



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## 10. Structural Reform of Public Monopolies

The introduction of effective competition into markets traditionally supplied by public monopolies will often require more than the removal of regulatory restrictions on competition. Where the incumbent firm has developed into an integrated monopoly during its period of protection from competition, structural reforms may be required to dismantle excessive market power and increase the contestability of the market.

From a competition policy perspective, questions about the most appropriate structure for public monopolies arise in two main contexts. First, there is the concern that reforms involving the introduction of competition to former monopoly markets should result in effective competition, with minimal need for ongoing regulatory intervention. Pro-competitive reforms of this kind have already been undertaken in the Australian telecommunications industry, and are being pursued in sectors such as electricity. The second setting is where a public monopoly is being privatised. While the Committee recognises that privatisation may offer efficiency benefits, there is a risk that privatisation without appropriate restructuring may entrench the anti-competitive structure of the former public monopolies, making structural reform even more important.

In either setting, establishing the conditions for effective competition may require the structures of public monopolies to be reformed to ensure they are compatible with more competitive markets. Responsibility for regulatory functions may have to be separated from commercial functions. Natural monopoly elements may need to be separated from potentially competitive activities. And in some cases it may be desirable to separate potentially competitive parts of the enterprise so that it becomes several distinct businesses.

While issues of this kind are of particular concern to owning governments, the structural reform of businesses owned by State and Territory Governments increasingly also has a national significance. This Chapter proposes that a national competition policy should include a mechanism for enhancing cooperation and coordination on such matters, including inter-governmental agreement on a set of

principles which would be supported by appropriate institutional arrangements.

**Section A** examines the role of structural reform of public monopolies in competition policy and concludes that it should form part of a national competition policy.

**Section B** considers the policy content and implementation approach for dealing with structural reform of public monopolies in a national competition policy.

**Section C** presents the Committee's recommendations.

## **A. THE STRUCTURE OF PUBLIC MONOPOLIES & COMPETITION POLICY**

The structure of a market is one of the key determinants of competitiveness and hence efficiency. In competitive markets, the structure of firms and the industry as a whole evolves over time in response to changes in market conditions. In the case of many public monopolies, however, protection from market forces through government regulation or other government policies has often allowed enterprises to develop structures unlikely to be found under normal market conditions.<sup>1</sup>

While questions of the most appropriate structure for public enterprises may be of interest from a public management perspective generally, competition policy concerns come to the fore when government decisions are being taken that may affect the competitive conditions, and hence efficiency, of markets.

This Section considers the dimensions of the task of structural reform in terms of the three main forms of structural separation that may need to be considered to facilitate effective competition, and notes some of the reforms already in progress. It then considers the different contexts in which structural reform issues arise and argues

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<sup>1</sup> Several submissions noted the key role of structural reform in introducing competition into markets hitherto dominated by public monopolies. Eg, IC (Sub 6); Dr R Albon (Sub 8); Esso Aust (Sub 21); Shell Aust (Sub 30); Vic Gas Users Group (Sub 47); DPIE (Sub 50); DOTAC (Sub 58); Trade Practices Committee of LCA (Sub 65); Treasury (Sub 76); BCA (Sub 93); Queensland Govt (Sub 104); NSW Govt (Sub 117); BHP (Sub 133).



that the privatisation of public monopolies raises special concerns. The Section concludes that the increasing national significance of these issues warrants the inclusion of appropriate policy measures in a national competition policy.

## 1. Dimensions of Structural Reform

The primary focus of competition policy in this area is to dismantle excessive market power that may impede the introduction of effective competition into markets traditionally supplied by public monopolies. This may require structural separation in three main areas:

- the separation of regulatory and commercial functions;
- the separation of natural monopoly and potentially competitive activities; and
- the separation of potentially competitive activities.

Each dimension of structural separation is considered separately in relation to its rationale from a competition policy perspective and recent experience in considering or implementing the necessary reforms.

### (a) Separation of Regulatory and Commercial Functions

Reflecting their origins in departments of state, many government agencies were responsible for regulating technical aspects of a particular industry, as well as providing services that were subject to or affected by those regulations. Telecom provides an example, where it remained responsible for technical regulation of the telecommunications industry until these functions were transferred to an independent regulator, AUSTEL, in 1989.

In a competitive environment, such a dual role creates a potential conflict of interest between advancing the commercial interests of the enterprise and advancing wider public interests through the exercise of regulatory powers, presenting opportunities for incumbents to misuse control over regulatory standards to frustrate the actions of actual or potential competitors.<sup>2</sup> The rationale for separating the

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<sup>2</sup> The potential difficulties that may arise where such separation is not carried out before the introduction of competition are illustrated by the New Zealand telecommunications market. New

regulatory and commercial functions of a public enterprise is widely appreciated, and was acknowledged by a number of submissions to the Inquiry.<sup>3</sup>

There are a number of options for dealing with the regulatory functions hitherto performed by a public monopoly. In some cases it may be possible to replace government regulation with industry codes of practice, which can be vetted by the competition authority if appropriate.<sup>4</sup> Where the regulatory function is to continue to be exercised through a government agency other than the incumbent, there may still be a need to consider the potential for conflicts of interest. For example, placing these responsibilities in a government department may create concerns that regulatory discretions will be exercised to the benefit of the government-owned business — and hence maximise government revenues — rather than in a more even-handed manner. A technical regulator at arm's length from the government will generally be preferred.<sup>5</sup>

(b) Separation of Natural Monopoly Elements & Potentially Competitive Activities

A number of industries currently dominated by public monopolies involve an element with natural monopoly characteristics, in the sense that a single firm can supply the entire market most economically — examples include electricity transmission grids and rail tracks. In many cases, these natural monopoly elements have been integrated with potentially competitive activities (such as electricity generation or rail services). Integration of this kind may be through a vertical

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Zealand Telecom continues to perform various regulatory and quasi-regulatory functions, and this appears to be one factor which has hampered the achievement of effective competition in that market. For example, problems have arisen in relation to numbering and directory access, where New Zealand Telecom has retained control of the numbering plan. See NZ Commerce Commission, *Telecommunications Industry Inquiry Report* (1992).

<sup>3</sup> Eg, AUSTEL (Sub 41); DOTAC (Sub 58); ESAA (Sub 89); Govt of Victoria, (Sub 122). The Victorian Government recently announced that, as part of the proposed restructuring of the SECV, regulatory responsibilities would be separated from the SECV: Office of the Treasurer and the Energy Minister (Vic), "Major Restructuring of Electricity Industry Commences" (News Release, 10 August 1993).

<sup>4</sup> A code of practice agreed between industry participants may constitute a "contract, arrangement or understanding" for the purposes of s.45 of the TPA, and would thus be prohibited if it substantially lessened competition unless it was authorised by the TPC.

<sup>5</sup> This approach is consistent with the telecommunications reforms (where the regulatory functions were given to AUSTEL), and with the conclusions of the Carnegie report into the structure of the WA energy industry: see Energy Board of Review, *The Energy Challenge for the 21st Century* (1993) at 74.

relationship — so that one activity is upstream from another — or a horizontal relationship — where there are no essential links between the two activities. There are two main competition policy concerns.

First, irrespective of whether the natural monopoly element is integrated vertically or horizontally with the potentially competitive element, industry structures of this kind present opportunities for cross-subsidisation.<sup>6</sup> Monopoly returns made in the monopoly market may be used to finance otherwise unprofitable prices in the competitive market, potentially driving out or disadvantaging competitors. Indeed, even the prospect of such conduct may deter competitive market entry unless appropriate safeguards are in place.<sup>7</sup> This concern will be more pressing where the potentially competitive market is itself not highly contestable.

A second concern can arise where there is a vertical relationship between the two activities, particularly when access to the natural monopoly element is essential for effective competition in the downstream or upstream market. For example, effective competition in electricity generation requires access to electricity transmission grids. In this case, integration of the natural monopoly element (transmission grids) and a potentially competitive activity (electricity generation) raises concerns that control over access to the monopoly element may be misused to stifle or prevent competition in the potentially competitive sector. Even if access is not actually misused, the potential for such behaviour may deter new entry to, or limit vigorous competition in, markets dependent on access to the natural monopoly element.

There are two broad alternatives for addressing concerns of these kinds. First, the natural monopoly element can be separated from the potentially competitive elements. Alternatively, the integrated structure could be left intact, and reliance placed instead on more intrusive regulatory controls to guard against cross-subsidisation and, where a vertical relationship is involved, the potential misuse of control over access to the natural monopoly element.<sup>8</sup>

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<sup>6</sup> Eg, see Ordover J A & Pittman R W, *Competition Policies for Natural Monopolies in a Developing Market Economy* (1992).

<sup>7</sup> Although s.46 of the TPA is potentially applicable to pricing conduct of this kind, the delays and uncertainty associated with judicial proceedings may still have a deterrent effect on competition.

<sup>8</sup> A possible regulatory response to access issues is proposed in Chapter 11.

In each case an assessment of the relevant costs and benefits is required. Structural separation involves some immediate costs of transition, and possibly some additional transaction costs on an ongoing basis. However, these have to be weighed against the benefits of developing a more efficient and dynamic industry structure, and of avoiding the costs of ongoing regulatory intervention. Regulatory approaches involve costs for the parties and for the regulatory authority, and will rarely be as dynamic as market-driven outcomes.

It is sometimes suggested that the degree of separation required is merely "accounting" separation, so that the financial relationships between two parts of a business become more transparent. While separation of this kind may place some practical constraints on cross-subsidisation, and facilitate regulation of the natural monopoly element, it will not be sufficient to remove potential incentives to misuse control over access to a vertically integrated element. Full separation at the level of ownership or control is required.

While full separation of ownership or control should facilitate the emergence of effective competition in the potentially competitive element of the business, it does not exhaust the competition policy interest in such firms. The natural monopoly element will still be in a position to use its market power to charge monopoly prices, which may itself warrant some form of response.<sup>9</sup>

• *Recent Experience & Studies*

The Victorian Government has recently announced plans to restructure the State Electricity Commission of Victoria (SECV) by separating the generation, transmission and distribution elements of electricity supply.<sup>10</sup> Also in the electricity industry, vertical separation of the natural monopoly and potentially competitive elements was supported by the Industry Commission,<sup>11</sup> the National Grid

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<sup>9</sup> Chapter 12 discusses possible responses to monopoly pricing concerns. In some circumstances it will be appropriate to address these concerns in tandem with access issues as part of the access regime outlined in Chapter 11.

<sup>10</sup> Office of the Treasurer and the Energy Minister (Vic), "Major Restructuring of Electricity Industry Commences" (News Release, 10 August 1993).

<sup>11</sup> IC, *Energy Generation and Distribution* (1991).

Management Council,<sup>12</sup> and the Carnegie report into the Western Australian industry.<sup>13</sup>

Separation of the natural monopoly and potentially competitive elements has also been recommended for the rail industry<sup>14</sup> and for the Western Australian gas industry,<sup>15</sup> but not for the water resources and waste disposal industry.<sup>16</sup> The pro-competitive reforms to the telecommunications industry did not include vertical separation due to a concern that AOTC, at least for the 5 years from the introduction of competition, required the economies of scale and scope of an integrated business to compete effectively in global markets.<sup>17</sup>

Based on a survey of experience in member countries, the OECD has also recommended that, wherever possible, potentially competitive activities should be separated from those of a monopoly.<sup>18</sup> Experience in the UK gas industry is considered above in Box 10.1.

• *Consideration & Conclusions*

The Committee strongly supports structural reforms over more intensive conduct regulation. While particular structural reform proposals need to be evaluated carefully on their merits, the Committee is sensitive to the difficulties in demonstrating the longer term dynamic benefits of creating a more competitive industry structure. The Committee is also mindful that incumbents — and sometimes owning governments — may have strong incentives to resist wide-ranging structural reform.

Against this background, the Committee considers that these issues should be subject to a rigorous, open and independent analysis of the costs and benefits of various reform options. Moreover, where the natural monopoly element is vertically integrated with the potentially competitive activity, the Committee considers there should be a presumption in favour of full structural separation, leaving those who

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12 NGMC, *Structure of an Interstate Transmission Network for Eastern & Southern Australia* (1993).

13 Energy Board of Review, *The Energy Challenge for the 21st Century* (1993) at 86-87.

14 IC, *Rail Transport* (1991)

15 Energy Board of Review, *The Energy Challenge for the 21st Century* (1993) at 86-87.

16 IC, *Water Resources and Waste Water Disposal* (1992).

17 For a critical discussion, see Corones S G (ed), *Competition Policy in Telecommunications & Aviation* (1992).

18 OECD, *Regulatory Reform, Privatisation and Competition Policy* (1992).

support some lesser reform to establish why this is in the long term public interest.

**Box 10.1 : Structural Reform in the UK Gas Market**

British Gas (BG) was privatised in 1986 without separation of its natural monopoly and potentially competitive elements, and BG retains control over the transmission, distribution and sale of gas in the British market. BG currently has a monopoly on the domestic gas market, but is subject to competition from independent suppliers in the industrial gas market.

As a result of this industry structure, independent suppliers in competition with BG must rely on access to the pipeline — a natural monopoly — owned by BG. BG has also been permitted to re-enter the production of gas, an activity from which it had previously been required to withdraw. This situation has raised concerns that BG may be in a position to use its control over the gas pipeline to shelter other elements of its business from competition or disadvantage its competitors.<sup>19</sup>

The UK gas regulator — OFGAS — has made a submission to the Mergers and Monopolies Commission (MMC) arguing that the gas purchasing and gas supply activities of BG should be separated, and that the gas supply activities be separated into twelve separate companies. The results of the MMC's investigation of the gas industry are expected to be announced shortly.

(c) Separation of Potentially Competitive Activities

Under the protection of government ownership, many public enterprises developed into large, integrated businesses meeting requirements across an entire State, or in the case of Commonwealth businesses, across the country. Even where no element of natural monopoly is involved, there are a number of circumstances where effective competition may be enhanced by separating such enterprises into a number of independent businesses.

Where there is no element of natural monopoly involved, there are less concerns over cross-subsidisation or misuse of control over access

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<sup>19</sup> See Bishop M & Kay J, *Does Privatisation Work? Lessons from the UK*, (1988) at 17; *The Economist*, "British Gas — Better Broken Up" (8 August 1992) at 44; and "British Gas — Under Fire" (24 July 1993) 51-52.

to a vertically integrated element. Nevertheless, structural separation may be a useful mechanism for dismantling the market power of the incumbent, for facilitating new market entry and for creating competition where there was none. These issues can arise in three main contexts, depending on the balance of private and public activity a government wishes to support.

First, where a government intends to privatise a hitherto publicly-owned monopoly, restructuring of potentially competitive activities may be necessary to reduce concern over monopoly abuse by the privatised entity, and will ease the burden on conduct regulation. In many cases it is quite feasible to establish a more competitive industry structure as a central feature of the reform process. Where a substantial business is involved, reducing its size through restructuring also increases the probability of takeover if management fails to perform, providing another spur to management efficiency.<sup>20</sup>

Second, where it is intended to keep the business in public ownership, but to open a market to new entrants, restructuring the incumbent may reduce its capacity to dominate new entrants, and thus encourage competitive entry and ease the burden on conduct regulation to guard against predatory behaviour. In this case, optimal results require a clear separation of management and control between the new entities.

Finally, even where no private ownership or new market entry is envisaged in the immediate future, horizontal restructuring of an enterprise will permit "yardstick" competition between what were previously parts of a single business. In this case, even separation at the accounting and management level may lead to greater efficiency and limited competition if managers are provided with sufficient incentives to perform — for example, by means of the remuneration process.

The potential benefits of separating potentially competitive activities will depend in part on the contestability of the market. The case for such separation will be stronger where there are substantial barriers to new market entry. The economies of scale and scope of each industry also need to be considered, as do the costs of transition, although these should not obscure the assessment of the longer term benefits of creating more competitive industry structures.

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<sup>20</sup> See Bishop & Kay, *Supra*, n 19, at 17.

Ultimately, structural reform in this area leads to questions over how many business units will serve the market most efficiently, taking account of both static and dynamic efficiency considerations. In some cases, the creation of only two entities has been found insufficient to ensure vigorous rivalry — the UK experience in electricity is discussed below in Box 10.2.<sup>21</sup> There are no simple or universal answers to this question, however, and the costs and benefits of alternative reform options need to be evaluated carefully in the context of each industry.

**Box 10.2 : Structural Reform in the UK Electricity Market**

Structural reform in the UK electricity industry included the creation of two thermal generation companies, and a third state-owned nuclear generating company. While the restructuring of the industry has been far-reaching — with electricity generation and distribution separated from transmission — some have argued that the monopoly thermal generating company should have been separated into more than two businesses.

Prior to the restructuring, Robinson questioned whether competition would arise in generation, as the established generators would have a strong incentive to collude and restrict entry into the industry.<sup>22</sup> Green and Newberry have recently argued that a competitive industry structure should have been put in place prior to privatisation, as the existing duopoly (in effect) does not sufficiently subject the incumbent generators to competitive pressures.<sup>23</sup> The UK electricity regulator, OFFER, has also concluded that the structure of the industry has enabled the two major generators to influence and control prices.<sup>24</sup> The lack of competition in the generation aspect of the industry appears to have been a key factor influencing the amount of ongoing regulation required in the industry.<sup>25</sup>

• *Recent Experience & Studies*

The Industry Commission has recommended horizontal separation of electricity generating companies,<sup>26</sup> and the NSW government has

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21 See also Axelrod R, *The Evolution of Co-operation* (1984).

22 Robinson C, *Competition in Electricity?* (1988).

23 Green R & Newberry D, "Competition in the British Electricity Spot Market", *Journal of Political Economy* (1992) 100, 5, 929-953.

24 UK Office of Electricity Regulation (OFFER), *Report on Pool Price Inquiry* (1991).

25 Eg, see Commonwealth Treasury, "Electricity Reform in Australia: Some Lessons from the UK Experience", *Economic Round-up* (July 1993) 49-60.

26 IC, *Energy Generation & Distribution in Australia* (1991).



restructured Pacific Power into three generation profit centres.<sup>27</sup> The Victorian Government has announced that the electricity generation and distribution elements of the SECV will be separated into a number of different bodies to facilitate competition,<sup>28</sup> and is also examining options for structural reform in a number of industries currently dominated by public monopolies.<sup>29</sup> It has recently been argued that the gas supply operations of British Gas — a privatised public monopoly — be restructured into twelve separate companies.<sup>30</sup>

• *Consideration & Conclusions*

While the potential benefits of separating the potentially competitive elements of public monopolies can be considerable, judgements ultimately turn on an analysis of the costs and benefits of particular proposals. Unlike situations where natural monopoly elements are vertically integrated with potentially competitive elements, the Committee was not persuaded that there should be a general presumption favouring structural separation in this setting.

Nevertheless, the potential benefits of reforms of this kind are sufficient to warrant a more systematic exploration of options in this area, at least where competition is being introduced or the public monopoly is being privatised. As with the structural separation of natural monopoly elements from potentially competitive elements, however, reforms of this kind may be resisted by incumbents or, in some cases, owning governments. Accordingly, any more systematic approach to this question should place emphasis on rigorous, open and independent analysis.

## 2. Contexts for Considering Structural Reforms

From a competition policy perspective, structural reforms of these kinds can arise in two main contexts; pro-competitive reforms generally and privatisation. The latter context raises special considerations from a public policy context.

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<sup>27</sup> NSW Government, *Performance of NSW Government Businesses* (1992) at 47.

<sup>28</sup> Office of the Treasurer and the Energy Minister (Vic), "Major Restructuring of Electricity Industry Commences" (News Release, 10 August 1993).

<sup>29</sup> Victorian Govt (Sub 122).

<sup>30</sup> See Box 10.1.

(a) Pro-competitive Reforms Other than Those Involving Privatisation

Owning governments may seek to restructure their enterprises for a range of reasons, although achieving improved efficiency has clearly been the most pressing goal in recent years.<sup>31</sup>

From a competition policy perspective, structural reforms will be particularly relevant where traditional monopoly markets are being opened to competition, and it is desired to ensure that effective competition can be established with minimal need for ongoing regulatory supervision. Reforms of the three kinds noted above may all be important parts of that process.

(b) Privatisation

In recent years there has been a world-wide trend in favour of transferring ownership of hitherto public businesses to the private sector.<sup>32</sup>

The ownership of a business is not of itself a matter of direct concern from a competition policy perspective.<sup>33</sup> Nevertheless, there is evidence that privatisation may increase the efficiency of many businesses,<sup>34</sup> which is consistent with the overall goals of competition policy.

However, privatisation is less likely to offer significant public benefits if appropriate structural reforms are not carried out before or concomitant with the privatisation, possibly entrenching the monopolistic structure of the industry.

The concerns in this area are pronounced when one considers that privatisation may be driven by budgetary goals as well as efficiency objectives, and that businesses with a substantial degree of market power may attract premiums on sale. These concerns have led

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<sup>31</sup> For example, structural reform is an integral part of the Queensland Government's corporatisation policy, as enshrined in s.19(d) of the *Government Owned Corporations Act 1993*.

<sup>32</sup> See OECD, *Regulatory Reform, Privatisation and Competition Policy* (1992); and Shirley M & Nellis J, *Public Enterprise Reform - The Lessons of Experience* (1991).

<sup>33</sup> Of course, government ownership may be relevant to the application of competitive conduct rules under the current regime (see Chapter Six) and may give rise to special "competitive neutrality" concerns (see Chapter 13).

<sup>34</sup> See Shirley M & Nellis J, *Public Enterprise Reform - The Lessons of Experience* (1991) at 67-68; and OECD, *Regulatory Reform, Privatisation and Competition Policy* (1992).

commentators to warn of the dangers of trading “cash for competitiveness” when privatising government enterprises.<sup>35</sup> Governments considering privatisation must often choose between short-run revenue objectives and longer-run costs to the economy associated with transferring the ownership of a business which has not been properly restructured to the private sector, where there are fewer constraints on profit-maximising behaviour. Of course, those costs would be exacerbated if the relevant market was poorly contestable by reason of regulatory restrictions on competition or long-term supply contracts entered into as part of the privatisation.

Moreover, unless appropriate structural reform is accomplished before or at the time of sale, the only means of addressing industry structure is through divestiture, with implications for the shareholders of the newly privatised entity. The TPA does not currently contain a general divestiture power, and the Committee has not proposed that such a general power form part of the general conduct rules of a national competition policy. The question remains as to whether some special divestiture power may be desirable to deal with this special setting.

These considerations reinforce the need for a national competition policy to place special emphasis on structural reform issues in the privatisation context.

### **3. A National Approach**

Questions of the appropriate structure of public assets have traditionally been seen as a prerogative of ownership for the government concerned. While reports by the Industry Commission have contributed to the debates in sectors such as electricity, gas, rail and water, decisions on whether to pursue any of the Commission’s proposals, and if so by what means and over what timetable, have until recently been regarded as a matter exclusively for the individual governments concerned.

The recent work by the NGMC on the structure of the electricity supply industry is an important milestone. Governments have recognised that the structure of a public monopoly in one state can have important consequences for the development of national markets and the conduct of inter-state trade and commerce.

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<sup>35</sup> Eg, see “Greiner has doubts about coalition privatisation plan”, *Australian Financial Review*, (25 February 1993) at 2.

Much of the work in the electricity sector thus far has focussed on the structure and ownership of the transmission grid, which is an interstate asset. This work is clearly of vital importance if national markets are to be developed. However, even questions of the structure of the generation sector may have potential implications for interstate trade if vertical or horizontal linkages, or control over technical regulation, create possibilities for the misuse of market power. While the general conduct rules proposed in Part I may offer a remedy in some circumstances, structural approaches will always be the "first-best" solution.

The Industry Commission has provided timely advice as to where Australia's public monopolies should be heading. However, there is scope for greater coordination between governments on key questions associated with the implementation of reforms in individual sectors. The more detailed structural work being performed by the NGMC in relation to electricity could usefully be done in other sectors where an interstate or national dimension exists or is likely to evolve. And even in sectors where the interstate links are less substantial, the importance of the government business sector to the international competitiveness of the national economy suggests opportunity for greater coordination and cooperation between governments.

There may also be a role for a coordinated process to ensure that structural reforms in particular industries proceed as rapidly as is feasible.

As discussed above, a special issue arises in relation to proposals to privatise substantial public monopolies without appropriate restructuring. In addition to direct interstate impacts, there is a clear national interest in ensuring that the economy does not become encumbered with private monopolies, with costs in terms of efficiency and more intensive conduct regulation. The national interests in this setting are increasingly recognised; for example, the Victorian Government recently asked the Trade Practices Commission to monitor competition policy aspects of the privatisation of one of its businesses.<sup>36</sup>

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<sup>36</sup> Victorian Govt (Sub 122). The Victorian Government invited the TPC to monitor the proposed privatisation of Heatane, the LPG division of the Gas and Fuel Corporation of Victoria. The TPC will consider whether any of the parties bidding for Heatane will be in danger of breaching the merger provisions of the Act.

The Committee is satisfied that questions associated with the structural reform of public enterprises are an important element of a national competition policy, albeit one that may be of primary significance during a transition period when more competitive industry structures are put in place. The desirable content and implementation approach for such a policy is explored in the next Section.

## **B. STRUCTURAL REFORM UNDER A NATIONAL POLICY**

There is increasingly a national element in many questions associated with the structural reform of public monopolies. This Section considers how a national competition policy might best contribute to Australia's goals in this area, and proposes the establishment of a new mechanism to facilitate cooperative action on structural reform issues.

### **1. Policy Principles**

The Committee's review of the competition policy aspects of the structural reform of public monopolies supports the adoption of a set of relatively simple principles. These are:

- I *Before competition is introduced to a sector traditionally supplied by a public monopoly, any responsibilities for industry regulation should be removed from the incumbent. The location of regulatory functions should place special weight on the need to avoid conflicts of interest.*

Acceptance of this principle would be especially important for situations where new entry into a market is being encouraged, as potential industry participants will often need assurance that control over regulation will not be used to anti-competitive ends.

The principle is not prescriptive as to the most appropriate means of handling the regulatory functions previously performed by the public enterprise. In some cases, voluntary codes of practice may be appropriate, with the competition authority vetting arrangements that might substantially lessen competition. In other cases, an independent technical regulator — possibly based on the telecommunications model — may be appropriate.

- II *Before competition is introduced to a sector traditionally supplied by a public monopoly, there should be a rigorous, open and independent study of the costs and benefits of separating any natural monopoly elements from potentially competitive activities. Where the natural monopoly element is vertically integrated with potentially competitive activities, there should be a presumption in favour of separation at the ownership or control level.*

This principle distinguishes between situations where the natural monopoly element is integrated horizontally or vertically. In the former case, concerns over cross-subsidies may warrant close examination. In the latter case, the coincidence of cross-subsidy concerns and potential incentives to misuse control over access to the natural monopoly element are considered sufficient to warrant a presumption in favour of separation, although that presumption can be rebutted by appropriate evidence.

The requirement that the studies be rigorous, open and independent should be axiomatic. If studies of this kind are to be of value, they must reflect a disinterested view of the issues. The findings of industry participants or others with a stake in the outcome, however altruistic and public spirited, may always be open to suspicion. For example, there has been criticism of the work of the National Grid Management Council, largely because an ostensibly inter-governmental process appears to be dominated by industry participants.<sup>37</sup>

- III *Before competition is introduced to a sector traditionally supplied by a public monopoly, there should be a rigorous, open and independent study of the costs and benefits of separating potentially competitive activities of the monopoly enterprise.*

This principle is not prescriptive as to the outcome of such studies, but does require that governments more systematically explore options in this area as part of other pro-competitive reforms. As with the preceding principle, the studies in question should not be performed by the incumbent or any other interested party, and should place due weight on the dynamic benefits of establishing more competitive industry structures.

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<sup>37</sup> Eg, see "Pulling the Plug on the Power Lobby", *Australian Financial Review* (18 November 1992); and "Power Council Rejects Vested Interest Claim", *The Australian* (2 March 1993).

Although the operation of the principle is limited to situations where governments have already decided to introduce competition to an industry, studies of this kind may usefully be undertaken before that time so that governments and the wider community have a greater appreciation of the various considerations involved in introducing competition.

IV *Where privatisation of a substantial public monopoly is proposed, there should be a rigorous, open and independent study of all related structural issues. There should be a presumption in favour of vertical structural separation.*

This principle, including the creation of a general presumption in favour of structural separation, reflects the special problems raised in the privatisation context discussed above. Further details concerning the implementation of this principle are considered below.

## **2. Implementing a National Policy**

The policy principles outlined above are capable of being implemented in a number of ways. The discussion below canvasses some of the broad options and, while supporting cooperative approaches, distinguishes between situations where privatisation is involved and other settings.

### **(a) Broad Implementation Options**

The main options in this area distinguish between the treatment of the inquiry into structural matters and the possible role of a divestiture power to enforce the findings of such an inquiry.

- *Inquiry*

There are a variety of ways in which the requirement for an independent inquiry into structural reform matters could be implemented. One option would be a national law establishing an enforceable mechanism for conducting certain reviews, including designation of a national body that would have primary jurisdiction over these matters. At the other extreme, compliance with the requirement to conduct relevant studies could be left to individual governments.

- *Role for Mandatory Divestiture*

Where review of a particular public monopoly situation concluded that structural reform was appropriate, the question arises of how these findings could be implemented if the owning government resisted reform. Several submissions argued against widening the divestiture power within the TPA,<sup>38</sup> although some suggested that the current divestiture power may need to be broadened.<sup>39</sup>

One option would be to have a divestiture power, possibly limited to cases where there was an adverse finding by a review body. The divestiture power could be exercised, say, at the initiative of the competition regulator or the Minister, and would probably require supervision by the courts. Although the Commonwealth's constitutional powers are not unlimited, there may be ways the Commonwealth could support such a law under its corporations power or its powers for interstate trade and commerce. A variation on this approach would be for exercise of the divestiture power to require, say, a majority vote of Commonwealth, State and Territory Governments.

- (b) *Consideration & Conclusions*

As with other areas of its work, the Committee starts with a preference for respecting the prerogatives of sovereign governments unless there is a clear national interest at stake that cannot be resolved cooperatively. Its recommended implementation approaches differ between the privatisation context and other settings.

- *Pro-competitive Reforms Other than Those Involving Privatisation*

The Committee considers implementation of its proposed principles should generally proceed by a cooperative process, rather than unilaterally by a Commonwealth or a national body.

Under a cooperative approach, governments would formally adopt a set of principles along the lines proposed. Such a decentralised approach would allow each government to determine its own reform agenda — subject to meeting the broad requirements of the principles

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<sup>38</sup> Eg, IC (Sub 6); Trade Practices Committee of LCA (Sub 65); Treasury (Sub 76); BCA (Sub 93); Qld Govt (Sub 104); BHP (Sub 133).

<sup>39</sup> Eg, TPC (Sub 69); Mr R Copp (Sub 107); Mr C Sweeney, QC (Sub 119).



— and to sponsor its own studies to meet the requirements of the principles.

In some cases there will be advantages in governments pooling their resources to examine structural reform issues of common concern in a particular industry. The recent work by the NGMC illustrates the potential benefits of such approaches. There may be more detailed implementation issues arising out of Industry Commission reports that could be considered, as well as a host of other structural reform issues which have national or interstate dimensions or implications.

The Committee proposes that a national competition policy should include as a key institution an independent and expert body — the proposed National Competition Council (NCC) — capable of examining these issues at the request of governments. The Council could receive references from any government and would generally adopt a public inquiry approach.

The Committee has not recommended that a more general divestiture power be included as part of the enforcement regime for generally applicable market conduct rules.<sup>40</sup> In that context, however, the primary focus was on means of dealing with firms that emerged in a competitive environment and which were found to be persistently misusing their market power. By contrast, most public monopolies developed their anti-competitive structures while sheltered from competition through government ownership or government regulation.

Another of the Committee's concerns with a divestiture power is the difficulties traditionally experienced in deciding through judicial processes which parts of a firm should be separated.<sup>41</sup> This issue is simpler where administrative approaches can be used to add more expertise to the adjudication. The use of administrative processes would also overcome the delays and uncertainty often associated with court-ordered divestiture.<sup>42</sup>

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<sup>40</sup> See Chapter Seven.

<sup>41</sup> Because of concerns like these, Posner argues that "structural" remedies such as divestiture should be confined to the divestiture of assets recently acquired in an unlawful merger. Posner R A, *Antitrust Law: An Economic Perspective* (1976) at 78.

<sup>42</sup> For example, the *IBM* case was abandoned by the US Department of Justice after 14 years of litigation. The delays in cases such as this can often be accompanied by fundamental changes in the market structure, and thus make the original reasons for bringing the case irrelevant. For example, two new generations of computers were developed while the *IBM* case was pending.

Overall, the Committee is persuaded that its preference for cooperative approaches should generally extend to decisions of governments on whether or not to implement the findings of the review process. Accordingly, it does not recommend that any legal regime put in place to implement its recommendations should include a general divestiture power directed at government businesses.

- *Privatisation of a Substantial Public Monopoly*

As indicated in Principle IV, the Committee considers that where privatisation of a substantial public monopoly is proposed, there should be a rigorous, open and independent study of all related structural issues, and that there should be a presumption in favour of vertical separation.

While the Committee considers that a decentralised and cooperative process is most appropriate for implementing the other principles, it believes that the privatisation of a substantial public monopoly without appropriate restructuring raises a number of special considerations. These include:

- the likelihood that, once privatised, the monopolist would be subject to fewer constraints in exercising its market power;
- the possible incentives for governments to increase the proceeds from a privatisation by not sufficiently dismantling the market power of a monopoly before sale;
- the absence of a general divestiture power able to effect structural reforms after privatisation; and
- the consideration that, whatever its status while in public ownership, there is no persuasive argument for treating a former public monopolist with greater deference than any other private firm.

Against this background, the Committee proposes that its fourth structural reform principle be supported by a special mechanism intended to encourage appropriate reforms before or concomitant with privatisation.

The Committee proposes that any government — including the privatising government — should be able to give a reference to the proposed independent advisory body, the NCC, to investigate the competitive impact of a proposed privatisation involving a substantial public monopoly. The reference could be made before a privatisation was effected or, if insufficient notice of the intended privatisation had been given, within a reasonable time after the privatisation.

In making its assessment, the NCC would take into account relevant market characteristics as well as any long-term contracts or regulatory restrictions that might serve to perpetuate or extend an anti-competitive structure in private hands.

The inquiry process would be designed to be as unobtrusive as possible consistent with the protection of the national interests involved. Where appropriate, inquiries could be fast-tracked; the Trade Practices Commission currently has 45 days to consider applications for a merger authorisation, and a similar period should be feasible in this context. To the extent possible, the inquiry would avoid duplicating the detailed analytical work undertaken by the privatising government as part of the privatisation proposal. However, in many cases there would be no duplication, for a competition analysis is typically very different from the financial analyses characteristic of pre-privatisation studies. The NCC's findings would be made public, although it would be directed to protect commercially-sensitive material obtained through the inquiry process. Although it need not have powers to compel the disclosure of information, the process of which it is part encourages cooperation from privatising governments.

If the NCC identified no competition policy concerns arising from the proposed privatisation, no further action would be taken. The sale could proceed without concern over subsequent structural intervention from other levels of government, although the privatised entity would remain a candidate for the national prices oversight mechanism outlined in Chapter 12 and, if appropriate, declaration under the general access regime outlined in Chapter 11. It would also remain subject to the competitive conduct rules proposed in Part I of this Report.

If the NCC recommended that particular structural reforms be undertaken before or concomitant with the privatisation, any action on

those recommendations would be a matter for decision by government. If the privatising government did not agree to amend its privatisation proposal in line with the NCC's recommendations within say, 45 days of the report, the matter would be referred to other Australian Governments for consideration. Within some further specified period, they would be required to either "clear" the privatisation notwithstanding the NCC's report, or to indicate what specific action was proposed. That action might include the passage of specific legislation (probably by the Commonwealth Parliament) to prevent the privatisation; to prevent it except on certain conditions (eg, that regulatory restrictions or long-term contracts be amended); or ultimately, to effect a divestiture of the privatised monopoly.

A process of this kind should assist governments in developing their privatisation proposals and to bring to early resolution any issues of possible divestiture or other structural intervention that might impact on the sale price of the asset. If the proposed privatisation were "cleared" by the NCC, the sale could proceed with greater confidence to shareholders. If the proposal were the subject of an adverse finding by the NCC, these issues could be ventilated publicly, allowing the privatising government to reconsider its plans. If the privatising government declined to act on the recommendations, other governments would be required to come to an early view on their response. If they express an intention to intervene in the situation, prospective shareholders in the privatised monopoly would be on notice of possible future action. Indeed, the very threat of such action should diminish the incentives to privatise a substantial public monopoly without appropriate restructuring, thus reinforcing the likelihood of appropriate structural decisions in the privatisation context.

In most cases it will be desirable for governments to undertake structural reforms at an early stage prior to privatisation. This permits initial judgements about the appropriate degree of structural reform to be tested through experience in a more competitive market, and allows further reform to be undertaken, if necessary, without adverse effects on private shareholders.<sup>43</sup> Strategies of this kind are consistent with the development of more competitive and efficient market

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<sup>43</sup> For example, the Victorian Government, which has stated that it may further privatise elements of its electricity industry, has recently announced a major pro-competitive restructuring of that industry: Office of the Treasurer and the Energy Minister (Vic), "Major Restructuring of Electricity Industry Commences" (News Release, 10 August 1993).

structures and in many cases would avoid the need for vetting of privatisation proposals by a process of the kind proposed by the Committee.

Threats of divestiture or other intervention from other levels of government are clearly only appropriate in extreme circumstances, which the Committee hopes would never arise. It is for this reason that the Committee proposes that specific legislation to effect structural remedies of these kinds be introduced into Parliament only if and when required, rather than providing a more general power of intervention to deal with the contingency should it arise. While the Committee is mindful of the potential difficulties associated with divestiture after privatisation, including the impact on shareholders, this is a matter to be considered by the privatising government in arranging the sale of its assets.

### C. RECOMMENDATIONS

The Committee recommends that:

- 10.1 A mechanism to facilitate the pro-competitive structural reform of public monopolies form part of a national competition policy.
- 10.2 All Australian Governments agree to abide by the following principles:
  - I *Before competition is introduced to a sector traditionally supplied by a public monopoly, any responsibilities for industry regulation be removed from the incumbent. The location of regulatory functions should place special weight on the need to avoid conflicts of interest.*
  - II *Before competition is introduced to a sector traditionally supplied by a public monopoly, there be a rigorous, open and independent study of the costs and benefits of separating any natural monopoly elements from potentially competitive activities. Where the natural monopoly element is vertically integrated with potentially competitive activities, there should be a presumption in favour of separation at the ownership or control level.*

- III *Before competition is introduced to a sector traditionally supplied by a public monopoly, there be a rigorous, open and independent study of the costs and benefits of separating potentially competitive activities of the monopoly enterprise.*
- IV *Where privatisation of a substantial public monopoly is proposed, there be a rigorous, open and independent study of all related structural issues. There should be a presumption in favour of vertical separation.*
- 10.3 An independent, nationally-focussed body — the National Competition Council — should be charged with assisting governments to progress cooperative reform in accordance with these principles.
- 10.4 Any government be permitted to give a reference to the NCC to investigate the competition implications associated with privatising a substantial public monopoly. If the inquiry recommends that structural reform be carried out before or concomitant with the privatisation, and those recommendations are not acted upon by the privatising government, other governments should consider the matter and may consider remedial action including the passage of specific legislation to prevent the acquisition; to prevent it except on certain conditions; or ultimately, to effect a divestiture of the privatised monopoly.

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## 11. Access to “Essential Facilities”

In some markets the introduction of effective competition requires competitors to have access to facilities which exhibit natural monopoly characteristics, and hence cannot be duplicated economically. For example, effective competition in electricity generation and telecommunications services requires access to transmission grids and local telephone exchange networks respectively. Facilities of this kind are referred to as “essential facilities”.

An “essential facility” is, by definition, a monopoly, permitting the owner to reduce output and/or service and charge monopoly prices, to the detriment of users and the economy as a whole. In addition, where the owner of the facility is also competing in markets that are dependent on access to the facility, the owner can restrict access to the facility to eliminate or reduce competition in the dependent markets. Mechanisms to guard against potential abuses of this kind are expected to play a vital part in pro-competitive reforms in network industries such as electricity, gas and rail.

This Chapter proposes the establishment of a new legal regime under which firms can be given a right of access to essential facilities when the provision of such a right meets certain public interest criteria. The regime is general in nature and has the flexibility to deal with access pricing and related issues in designated essential facilities irrespective of ownership. In designing the regime the Committee was conscious that almost all cases of essential facilities identified for the Committee were in the public sector because of the history of government ownership of infrastructure. While the public interest rationale for providing an access right is the same irrespective of ownership, the proposed regime takes account of the special considerations that can arise when the facility is owned by a State or Territory government.

**Section A** examines the nature of the “essential facilities” problem in more detail, and considers some of the broad alternative approaches to dealing with this issue in a national competition policy. It concludes by proposing the creation of a new access regime that operates by Ministerial declaration.

**Section B** considers the general rules that should apply to the access regime, including the circumstances in which a right of access might be conferred, pricing arrangements and possible additional safeguards.

**Section C** considers the application of the proposed general regime to facilities that are owned by governments. It concludes that while the general regime should be applicable to such facilities, some special considerations need to be taken into account before a right of access is granted to assets owned by State and Territory Governments.

**Section D** presents the Committee's recommendations.

## **A. "ESSENTIAL FACILITIES" & COMPETITION POLICY**

This Section considers the nature of the "essential facilities" problem, reviews some of the alternative means of guaranteeing access to those facilities and argues that a new access regime should be the preferred response for Australia.

### **1. The "Essential Facilities" Problem**

Some economic activities exhibit natural monopoly characteristics, in the sense that they cannot be duplicated economically. While it is difficult to define precisely the term "natural monopoly",<sup>1</sup> electricity transmission grids, telecommunication networks, rail tracks, major pipelines, ports and airports are often given as examples. Some facilities that exhibit these characteristics occupy strategic positions in an industry, and are thus "essential facilities" in the sense that access to the facility is required if a business is to be able to compete effectively in upstream or downstream markets. For example, competition in electricity generation and in the provision of rail services requires access to transmission grids and rail tracks respectively.

Where the owner of the "essential facility" is not competing in upstream or downstream markets, the owner of the facility will usually have little incentive to deny access, for maximising

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<sup>1</sup> See IAC, *Government (Non-Tax) Charges* (1989) Vol III, Appendix J.



competition in vertically related markets maximises its own profits.<sup>2</sup> Like other monopolists, however, the owner of the facility is able to use its monopoly position to charge higher prices and derive monopoly profits at the expense of consumers and economic efficiency. In these circumstances, the question of "access pricing" is substantially similar to other monopoly pricing issues, and may be subject, where appropriate, to the prices monitoring or surveillance process outlined in Chapter 12.<sup>3</sup>

Where the owner of the "essential facility" is vertically-integrated with potentially competitive activities in upstream or downstream markets — as is commonly the case with traditional public monopolies such as telecommunications, electricity and rail — the potential to charge monopoly prices may be combined with an incentive to inhibit competitors' access to the facility.<sup>4</sup> For example, a business that owned an electricity transmission grid and was also participating in the electricity generation market could restrict access to the grid to prevent or limit competition in the generation market. Even the prospect of such behaviour may be sufficient to deter entry to, or limit vigorous competition in, markets that are dependent on access to an essential facility.

As discussed in Chapter Ten, the preferred response to this concern is usually to ensure that natural monopoly elements are fully separated from potentially competitive elements through appropriate structural reforms. In this regard it is important to stress that mere "accounting separation" will not be sufficient to remove the incentives for misuse of control over access to an essential facility. Full separation of ownership or control is required. In fact, failure to make such separation despite deregulation and privatisation is seen as a major reason why infrastructure reform in the UK has been disappointing.<sup>5</sup>

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<sup>2</sup> See Areeda P & Hovencamp H, *Antitrust Law* (1990 Supp) at 779-780.

<sup>3</sup> Whether the issues arising in relation to a particular facility would be best addressed under the access regime or prices oversight process would be considered on a case-by-case basis.

<sup>4</sup> The main cases where the owner of a vertically integrated monopoly will have an incentive to deny access to an essential facility are where the owner is price regulated in the essential facility market and where providing access might undermine a profit-maximising price discrimination strategy in the dependent market. See Note, "Refusals to Deal by Vertically Integrated Monopolists" (1974) 87 *Harvard L Rev* 1720 at 1727-1728; and New Zealand Ministry of Commerce, *Guarantee of Access To Essential Facilities: A Discussion Paper* (1989) at 4-5. Cp. PSA (Sub 97) at 19.

<sup>5</sup> For a discussion of the UK reforms see Vickers J, "Government Regulatory Policy", *Oxford Review of Economic Policy*, 7 (1991) 3, 13-30; and Bishop M & Kay J, *Does Privatisation Work? Lessons from the UK* (1988) at 17.

Where such structural reforms have not occurred, the challenge from a competition policy perspective is to provide a mechanism that will support competitive market outcomes by protecting the interests of potential new entrants while ensuring the owner of the natural monopoly element is not unduly disadvantaged. A mechanism of this kind seems likely to play a pivotal role in a national competition policy as competition is introduced to areas previously reserved to public monopolies.

## 2. Guaranteeing Access to “Essential Facilities”

As a general rule, the law imposes no duty on one firm to do business with another. The efficient operation of a market economy relies on the general freedom of an owner of property and/or supplier of services to choose when and with whom to conduct business dealings and on what terms and conditions. This is an important and fundamental principle based on notions of private property and freedom to contract, and one not to be disturbed lightly.

The law has long recognised that this freedom may require qualification on public interest grounds in some circumstances, particularly where a form of monopoly is involved. Thus, for example, the natural monopoly character of certain transport functions gave rise to the common law notion of “common carriers”, where such carriers have an obligation to carry certain goods.<sup>6</sup>

The law has developed two broad alternatives for creating obligations to deal in the “essential facility” area. First, persons seeking access to such facilities may rely on the general competitive conduct rules governing a misuse of market power. Secondly, special legislative regimes can be created to guarantee access to such facilities. Both approaches are reflected in current Australian law.

### (a) Reliance on the General Competitive Conduct Rules

- *Current Australian Approach*

As discussed in Chapter Four, s.46 of the *Trade Practices Act 1974* (TPA) prohibits the taking advantage of a substantial degree of power

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<sup>6</sup> See Gorton L, *The Concept of Common Carrier in Anglo-American Law* (1971) at 20-33. For a statement of current Australian law see *Halsbury's Laws of Australia* (1992) 3 at 121,149-121,152.

in a market for the purpose of (a) eliminating or substantially damaging a competitor; (b) preventing the entry of a person into a market; or (c) deterring or preventing a person from engaging in competitive conduct in a market.

Section 46 is potentially applicable in essential facility situations. If a facility is truly essential, its owner will always have a substantial degree of market power within the meaning of s.46.<sup>7</sup> There should also be little difficulty in establishing that a refusal to deal in an essential facility context constitutes a “taking advantage” of that market power, given that in the absence of such market power access to the facility would be available.<sup>8</sup> A refusal to provide access to an essential facility could conceivably occur for any of the three proscribed purposes.<sup>9</sup>

There have been suggestions that the US essential facility doctrine, discussed below, could be imported into Australia through judicial interpretation of s.46. However, the High Court has not embraced such a doctrine and the Federal Court has specifically rejected it.<sup>10</sup> In these circumstances, unless s.46 were amended in some way, access would only be available where a firm was able to prove that it had been denied access, or access on reasonable terms, because of a proscribed purpose.

In addition to the difficulties in demonstrating a proscribed purpose, there may be difficulties in courts determining the terms and conditions, particularly the price, at which such access should occur.<sup>11</sup> The courts do have the power to make orders varying contracts, including the power to vary prices,<sup>12</sup> and the provisions of the Act are probably wide enough to permit courts to fix prices where there have

<sup>7</sup> On the meaning of “substantial” in the phrase ‘substantial degree of power in a market’, see L’Estrange P, “‘Substantial’ Definition” (1992) *Law Institute Journal*, at 654.

<sup>8</sup> The test for deciding whether a corporation has used its market power is whether it could afford, in a commercial sense, to engage in the conduct only by virtue of its substantial market power, or alternatively, whether it could achieve its anti-competitive purpose other than by virtue of its substantial market power: see *Queensland Wire Industries Pty Ltd v BHP* (1989) 167 CLR 177.

<sup>9</sup> Cases involving refusal of access to products or facilities include: *Queensland Wire* — (refusal to supply Y-bar to a rival in a downstream market); *Pont Data Australia Pty Ltd v ASX Operations Pty Ltd* (1990) ATPR ¶41-007 (refusal to supply “Signal C” wholesale to a rival in a downstream market); and *Dowling v Dalgety Australia Limited* (1992) ATPR ¶41-165 (refusal to permit a potential rival use the Goondiwindi Saleyards).

<sup>10</sup> *Queensland Wire Industries Pty Ltd v BHP* (1988) ATPR ¶40-841 at 49,076 - 49,077.

<sup>11</sup> See Wright R, “Injunctive Relief in Cases of Refusal to Supply” (1991) 19 ABLR 65.

<sup>12</sup> See s.87(2).

been no previous dealings between the parties.<sup>13</sup> However, as discussed in Chapter Seven, Australian courts are "slow to impose upon the parties a regime which could not represent a bargain they would have struck between them".<sup>14</sup> Although the courts have been prepared to grant injunctions requiring one firm to deal with another on the basis of previously agreed prices,<sup>15</sup> they may decline to order supply because of the difficulties in calculating a reasonable price.<sup>16</sup>

• *Overseas Approaches*

Courts in the US have developed an "essential facility doctrine" through interpretation of the Sherman Act. One statement of the principles involved in this doctrine<sup>17</sup> requires:

- (1) control of the essential facility by a monopolist;
- (2) a competitor's inability practically or reasonably to duplicate the essential facility;
- (3) the denial of the use of the facility to a competitor; and
- (4) the feasibility of providing the facility.

The limits of the US doctrine are not yet clear, and it has been observed that "the doctrine has not developed with clarity, coherence or consistency, let alone with strong economic foundations".<sup>18</sup> Decisions which have relied on the doctrine have found essential facilities in situations ranging from local telephone networks<sup>19</sup> to football and basketball stadiums.<sup>20</sup>

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<sup>13</sup> See s.80 and s.87(1).

<sup>14</sup> *Pont Data Australia Pty Ltd v ASX Operations Pty Ltd* (1990) ATPR ¶41-109, at 52, 666.

<sup>15</sup> *Pont Data v ASX Operations Pty Ltd* (1990) ATPR ¶41-007. Note that at first instance the court was willing to set new prices which reflected the cost of supply and a margin of profit similar to that charged by competitive suppliers. Two interlocutory cases in which the court has been prepared to order access, and to fix prices on the basis of previous dealings are: *Macleay v Shell Chemical (Australia) Pty Ltd* (1984) ATPR ¶40-462; and *O'Keefe Nominees Pty Ltd v BP Australia Ltd* (1990) ATPR ¶41-057.

<sup>16</sup> In *Berlaz Pty Ltd v Fine Leather Care Products* (1991) ATPR ¶41-118, one of the reasons given for refusing an injunction was that "... the hearing produced no satisfactory explanation of how the court should perform the task of setting the prices and other terms of trade if an injunction were granted."

<sup>17</sup> *MCI Communications Corp v American Telegraphic & Telephone Co* (1983) 708 F.2d 1081 at 1132.

<sup>18</sup> See Vautier K M, *The "Essential Facilities" Doctrine* (1990) at 65. See also Areeda P, "Essential Facilities: An Epithet in Need of Limiting Principles" (1990) 58 *Antitrust Law Journal* 841.

<sup>19</sup> *MCI Communications Corp v American Telegraphic & Telephone Co* (1983) 708 F.2d 1081.

<sup>20</sup> *Hecht v Pro-Football Inc* 570 F 2d 982 (DC Cir 1977); *Fishman v Wirtz* 1981-2 Trade Cas (CCH) ¶64,378 (ND Ill 1981).

New Zealand deals with essential facility situations under the misuse of market power provision of its Commerce Act, which is similar to s.46 of the TPA. Although an early court decision suggested that situations of essential facilities, as identified in accordance with the US doctrine, might raise a presumption of proscribed purpose,<sup>21</sup> this suggestion was subsequently rejected.<sup>22</sup>

The New Zealand Government chose to rely on the provisions of the Commerce Act to resolve access disputes arising from the introduction of competition to its telecommunications market.<sup>23</sup> The need to negotiate interconnection agreements with NZ Telecom has proved to be a significant barrier to entry by new competitors,<sup>24</sup> and the Commerce Commission has suggested that the general provisions of the Commerce Act are unlikely to be fully effective in removing obstacles to competition where an essential facility access issue is involved.<sup>25</sup>

#### (b) Creation of Special Access Rights

In order to overcome the uncertainties and delays associated with reliance on the general competitive conduct rules, a number of jurisdictions have developed specific access rights to particular essential facilities.

- *Current Australian Approach*

The *Telecommunications Act 1991* (Cth) illustrates one means of creating and administering special access rights on an industry-specific basis. The Act creates a right for any carrier to connect its facilities to the network of any other carrier, and to have its calls carried and completed over that network. The pricing principles that must be applied in determining access charges are determined by the Minister. Interconnection issues are determined by agreement between carriers, but where agreement cannot be reached an industry-specific regulator,

21 *Auckland Regional Authority v Mutual Rental Cars (Auckland Airport) Ltd* (1987) 2 NZLR 647.

22 *Union Shipping NZ & Anor v Port Nelson* [1990] 3 NZBLC 101-618.

23 The *Telecommunications (Disclosure) Regulations* provide limited assistance in the resolution of such disputes, by requiring the disclosure of certain financial information by NZ Telecom.

24 There has been considerable lengthy litigation by Clear to obtain access to certain facilities held by NZ Telecom, which has not always been successful.

25 NZ Commerce Commission, *Telecommunications Industry Inquiry Report* (23 June 1992) at 7.

AUSTEL, may intervene and arbitrate.<sup>26</sup> In view of the vast market power of the incumbent, the Act also includes various additional pro-competitive safeguards.<sup>27</sup> Supplementary access rights can also be created in respect of customer billing, operator assistance, listing in published directories, and access to facilities such as radio-communications masts and antennae as conditions of carriers' licences.<sup>28</sup>

The *Petroleum Pipelines Act 1969 (WA)* provides another illustration of an industry-specific access regime.<sup>29</sup> Upon application from a person seeking access to a petroleum pipeline, the Minister may give directions to the applicant and to the owner, permitting the applicant to use the pipeline, subject to the owner's right to convey its own petroleum through the pipeline in priority to any other petroleum. The Minister's discretion in making directions is largely unfettered, and includes the ability to specify the price to be paid for access.

In relation to gas, the Commonwealth Government has recently announced that it intends to legislate special access arrangements to facilitate access to inter-state gas pipelines.<sup>30</sup> In addition, a Code of Practice for access to inter-state gas pipelines has been announced by various industry participants.<sup>31</sup> While the Code is an important contribution to the development of open access regimes, it does not provide any legally enforceable rights; it provides for a "right to negotiate" rather than a "right of access"; does not give guidance on pricing principles; and has no binding dispute resolution mechanism.

In the electricity sector, the Council of Australian Governments, with the assistance of the National Grid Management Council, is

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26 Section 137(2)(b) *Telecommunications Act 1991 (Cth)*.

27 Discussed in Section B (below).

28 Section 187 also provides essential facilities rules for some services markets.

29 Section 21 *Petroleum Pipelines Act 1969 (WA)*.

30 News Release from the Minister for Resources, "New Arrangements for Interstate Gas Trade", (June 2, 1993). The Carnegie Report into the WA gas and electricity industries also proposed the establishment of access rules governing gas pipelines: see Energy Board of Review, *The Challenge For the 21st Century* (1993).

31 See Australian Gas Association, Australian Petroleum Exploration Association Limited, Australian Pipeline Industry Association, "Pipeline Access Code" (Joint Media Release, 23 July 1993).

considering arrangements to provide access rights for generators to electricity transmission grids.<sup>32</sup>

- *Overseas Approaches*

Notwithstanding the wide reach of its court-based essential facility doctrine, the US has recently introduced a new legislative regime to facilitate access to inter-state electricity transmission grids. The new regime requires a finding that an access order is in the public interest and sets out relevant pricing principles and other terms and conditions of access, with individual applications settled by a regulator.<sup>33</sup>

The UK also provides industry-specific access regimes in relation to industries including telecommunications and gas. Licences granted under the *Telecommunications Act 1984* may include conditions requiring the licensee to connect to particular telecommunication systems, or permit the connection of another telecommunication system or apparatus, and requiring the licensee not to show undue preference to, or undue discrimination against, such connected systems.<sup>34</sup> Under the *Gas Act 1986*, there is an administrative discretion to direct the owner of a gas pipeline to carry the gas of an applicant, including the ability to specify prices, terms and conditions.<sup>35</sup> Such direction will not occur where the pipeline is already running at full capacity. Prices are determined having regard to principles which apportion costs and permit an appropriate return on capital.<sup>36</sup>

## Submissions

The majority of submissions to the Inquiry on this issue indicated a lack of confidence in the ability of the general misuse of market power provision, s.46, to deal effectively with essential facility issues in the context of introducing competition to markets traditionally supplied

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32 NGMC, *Network Service Pricing: An Information Paper* (1992); *National Grid Protocol* (First Issue: 1992).

33 See Title VII of the Energy Policy Act of 1992 (PL 102-486), which inserted new provisions in the Federal Power Act (16 USC 824j).

34 Section 8 *Telecommunications Act 1984* (UK).

35 Section 19 *Gas Act 1986* (UK).

36 Section 19 *Gas Act 1986*.

by public monopolies.<sup>37</sup> As well as difficulties of demonstrating the proscribed purpose, submissions pointed to the difficulties of courts determining appropriate access prices.

Several submissions supported an additional mechanism for guaranteeing access to certain essential facilities on fair and reasonable terms.<sup>38</sup> One submission argued that access rules should not require legislatively forced inter-connection to gas pipelines.<sup>39</sup>

### Consideration & Conclusions

The Committee is conscious of the need to carefully limit the circumstances in which one business is required by law to make its facilities available to another. Failure to provide appropriate protection to the owners of such facilities has the potential to undermine incentives for investment.

Nevertheless, there are some industries where there is a strong public interest in ensuring that effective competition can take place, without the need to establish any anti-competitive intent on the part of the owner for the purposes of the general conduct rules. The telecommunications sector provides a clear example, as do electricity, rail and other key infrastructure industries. Where such a clear public interest exists, but not otherwise, the Committee supports the establishment of a legislated right of access, coupled with other provisions to ensure that efficient competitive activity can occur with minimal uncertainty and delay arising from concern over access issues.

Importantly, the Committee is not convinced that access regimes of this kind need be legislated and administered on an industry-specific basis. While each industry has its own peculiar characteristics, there are also important similarities between access and related issues across the key infrastructure industries. The development of a common legal framework offers the benefits of promoting consistent approaches to

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<sup>37</sup> Dr W Pengilly (Sub 11); AUSTEL (Sub 41); DPIE (Sub 50); DOTAC (Sub 58); Mr Michael Corrigan (Sub 72); Treasury, (Sub 76); Dr S Coronos (Sub 86); Optus Communications (Sub 87); Mr B Akhurst (Sub 94).

<sup>38</sup> Eg, Shell (Sub 30); Vic Gas Users Group (Sub 47); DPIE (Sub 50); DOTAC (Sub 58); Treasury (Sub 76); ESAA (Sub 89); SECV (Sub 92); PSA (Sub 97); DITARD (Sub 101); TPC (Sub 69). BHP Ltd argued that if s.46 was considered inadequate, any more stringent regime should be quarantined to particular industries, rather than apply to all businesses (Sub 135).

<sup>39</sup> AGL Ltd (Sub 24).



access issues across the economy. It also permits expertise and insights gained in access issues in one sector to be more readily applied to analogous issues in other sectors. For similar reasons, and as discussed more fully in Chapter 14, the Committee considers that an access regime of this kind should be administered by an economy-wide body rather than a series of industry-specific regulators.

The Committee recognises the important industry-specific work undertaken to date on facilitating access to various essential facilities of national importance. Some of this work may provide a useful foundation for access declarations under the Committee’s proposed access regime, should the decision be made to provide a right of access in the relevant industries.

The Committee considers that any legal framework providing access must be national in scope and operation. State-based regimes are incapable of dealing effectively with access issues affecting inter-state or national facilities, and different approaches or pricing principles adopted in different States have the potential to impede the development of efficient national markets for electricity, gas, rail and other key industries.

A general access regime of the kind recommended by the Committee requires some flexibility to be adapted to differences between industries and within an industry over time. The following two Sections consider the detail of such an access regime as it might apply to infrastructure industries across the economy.

## **B. GENERAL RULES GOVERNING ACCESS TO “ESSENTIAL FACILITIES”**

This Section looks at certain general rules governing the creation of a legislated right of access, and considers six questions:

- When should an access right be created?;
- How should access prices be determined?;
- What other terms and conditions might be required to protect the owner of the facility?;

- What additional safeguards might be required to protect the competitive process?;
- What remedies should be available for failure to comply with requirements of the access regime?; and
- How should the proposed regime interact with existing access regimes?

These rules were designed recognising the fact that in Australia, whilst the majority of "essential facilities" have traditionally been owned by governments, there are many examples of privately owned facilities of similar nature. The general rules proposed are intended to cover essential facilities, irrespective of ownership, where certain public interest and other criteria are met. The need for additional adaptations in the case of government-owned facilities is considered in Section C.

### 1. When Should a Legislated Right of Access Be Created?

As the decision to provide a right of access rests on an evaluation of important public interest considerations, the ultimate decision on this issue should be one for Government, rather than a court, tribunal or other unelected body. A legislated right of access should be created by Ministerial declaration under legislation.<sup>40</sup> At the same time, the existence of a broad discretionary regime may create pressures on the Minister to declare an essential facility to advance private interests.<sup>41</sup> Accordingly, the Committee proposes that the Minister's discretion be limited by three explicit legislative criteria, and by a requirement that the creation of such a right has been recommended by an independent and expert body — the proposed National Competition Council (NCC).

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<sup>40</sup> The Minister would be a Commonwealth Minister. The role of State and Territory Governments is discussed in Section C (below) and in Chapter 14.

<sup>41</sup> Concerns of this kind led to a reluctance to adopt a broad access regime in New Zealand, where it was observed that: "Ministers are ... likely to face considerable pressure to declare an essential facility to advance private interests. These situations do not necessarily coincide with the promotion of the competitive process or the overall public interest": NZ Ministry of Commerce, *Review of the Commerce Act 1986: Reports & Decisions* (1989) at 8.

Unless the owner of a facility consents to access being declared, the Minister could only make such a declaration where:

I *Access to the facility in question is essential to permit effective competition in a downstream or upstream activity;*

Clearly, access to the facility should be essential, rather than merely convenient.

II *The making of the declaration is in the public interest, having regard to:*  
(a) *the significance of the industry to the national economy; and*  
(b) *the expected impact of effective competition in that industry on national competitiveness.*

These criteria may be satisfied in relation to major infrastructure facilities such as electricity transmission grids, major gas pipelines, major rail-beds and ports, but not in relation to products, production processes or most other commercial facilities.<sup>42</sup> While it is difficult to define precisely the nature of the facilities and industries likely to meet these requirements, a frequent feature is the traditional involvement of government in these industries, either as owner or extensive regulator.

Moreover, when considering the declaration of an access right to facilities, any assessments of the public interest would need to place special emphasis on the need to ensure access rights did not undermine the viability of long-term investment decisions, and hence risk deterring future investment in important infrastructure projects. Accordingly, wherever possible the likely obligations to provide access should be made clear before an investment is made, whether that be through licensing requirements of a new facility or the acquisition of an asset formerly owned by government. Where this is not possible, due account of the likely impact on incentives to invest should be made in determining whether or not to create a right of access, and if access is declared, through the declaration of appropriate pricing principles and other terms and conditions.

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<sup>42</sup> Eg. in the US case of *Berkey Photo v Eastman Kodak Co* 603 F 2d 263 (2d Cir 1979), a small photographic company sought (albeit unsuccessfully) to obtain access to the products of Kodak's research and development before Kodak could market its own innovations. This case illustrates the need to ensure that the proposed access right does not deprive investors of the fruit of risk-taking investment.

- III *The legitimate interests of the owner of the facility must be protected through the imposition of an access fee and other terms and conditions that are fair and reasonable, including recognition of the owner's current and potential future requirements for the capacity of the facility.*

Pricing and related issues are considered below.

- IV *The creation of such a right must have been recommended by an independent and expert body.*

An affirmative recommendation of the NCC on whether or not the three previous criteria are satisfied should be a prerequisite to the creation of a legislated access right, although the Minister could decline to make a declaration notwithstanding the recommendation of the body. The recommendations of the Council would be based on an investigation of the facility and markets in question and would take account of submissions from interested persons. The recommendations would be made public. Inquiries could be triggered by references to the Council from any government — Commonwealth, State or Territory.

While these requirements focus on the policy underpinnings of the regime, it may also be necessary to ensure such a regime falls within the Commonwealth's heads of legislative power. This requirement will be readily met where the owner of the facility is a trading corporation, or where access relates to an inter-state transaction. It may also be sufficient if the beneficiary of the access right is a trading corporation, on the ground that the creation of such a right would be a means of protecting that corporation's trading activities.<sup>43</sup>

Where these requirements are met the Minister could declare an enforceable right of access to the facility described in the declaration. The declaration might be expressed to apply to a particular user or a particular class of users. Thus, for example, access to an electricity grid might be provided to all generators over some minimal output requirement. However, any restrictions of this kind should be clearly justified on efficiency or other grounds, and reflect the findings of the NCC inquiry.

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<sup>43</sup> These issues are examined in more detail in Chapter 15.

It may often be appropriate to apply such an access regime to a particular facility or activity within an industry as an integral part of reforms intended to introduce competition to a hitherto monopoly activity. This approach would provide a transparent and predictable regulatory environment within which competitive trading arrangements could evolve, with increased certainty facilitating efficient investment decisions by potential new entrants. In other cases it may be appropriate to allow private parties to come to their own arrangements, and only declare such a right if experience shows that access is being abused. A declaration under the regime could be reviewed at intervals stipulated in the access declaration that are appropriate to the circumstances of each industry. A declaration could be revocable on the showing of a material change in circumstances.

The general regime could apply to a range of facilities and does not require industry-specific regulation. The access declaration would reflect particular considerations relevant to individual industries or facilities, the details of which are considered below.

## **2. Determination of Access Prices**

Access to a facility should only be declared if the legitimate interests of the owner of the facility are protected through a requirement for a "fair and reasonable" fee for providing access, and other appropriate terms and conditions.

Neither the application of economic theory nor general notions of fairness provide a clear answer as to the appropriate access fee in all circumstances. Policy judgments are involved as to where to strike the balance between the owner's interest in receiving a high price, including monopoly rents that might otherwise be obtainable, and the user's interest in paying a low price, perhaps limited to the marginal costs associated with providing access. Appropriate access prices may depend on factors such as the extent the facility's existing capacity is being used, firmly planned future utilisation and the extent to which the capital costs of producing the facility have already been recovered. Decisions in this area also need to take account of the impact of prices on the incentives to produce and maintain facilities and the important signalling effect of higher returns in encouraging technical innovation. For example, relatively low access prices might contribute to an efficient allocation of resources in the short term, but in the longer term the reduced profit incentives might impede technical innovation.

An indication of the range of possible policy judgments in this area is reflected in some of the pricing rules already in place. Examples include:

- Under the Australian *Telecommunications Act 1991*, the new entrant, Optus, is being permitted access to the interconnection network of the incumbent at an initial price based on directly attributable incremental costs, with this relatively low price intended to assist the new entrant overcome the competitive advantages of the incumbent.<sup>44</sup>
- In the New Zealand telecommunications market, it has been held that New Zealand Telecom is entitled to charge an access fee which allows it to recover the opportunity costs of providing access — the so-called "Baumol Willig" rule.<sup>45</sup>
- Under the US regime governing access to interstate electricity transmission grids, the overarching goal is that prices will "promote the economically efficient transmission and generation of electricity". It permits owners of transmission grids to recover: "... all the costs incurred in connection with the transmission services and necessary associated services, including, but not limited to, an appropriate share, if any, of legitimate verifiable and economic costs, including taking into account any benefits to the transmission system of providing the transmission facilities."<sup>46</sup>
- In the UK, charges for access to gas pipelines are based on principles which apportion costs and permit an appropriate return on capital.<sup>47</sup>

An access regime capable of application to several sectors in the economy requires the flexibility to respond to circumstances peculiar to particular industries and facilities, as well as changes in industry

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<sup>44</sup> See Leonard P & Waters P, "Regulating For Competition : The Telecommunications Act 1991" in Corones S (ed), *Competition Policy in Telecommunications & Aviation* (1992) at 81-86.

<sup>45</sup> *Clear Communications Ltd v Telecom Corporation of New Zealand Ltd* (1992) (unreported). See TPC (Sub 69); Farmer J A, "Competition Law" (1993) NZ Recent Law Review 14 at 20.

<sup>46</sup> See s.212(a) of the *Federal Power Act* (US).

<sup>47</sup> Section 19 *Gas Act 1986* (UK).

conditions over time. No single principle or rule of any degree of specificity is likely to meet the policy concerns of every market.

The Committee considered two broad responses to this issue.

First, a broad discretion could be entrusted to an independent regulator, leaving it to decide where the balance should be drawn in particular circumstances, perhaps guided by some broad and general guidelines as to the factors to be taken into account. An approach of this kind was supported by the Prices Surveillance Authority.<sup>48</sup>

A second approach would be to require the relevant Minister to stipulate more specific pricing principles in the context of declaring a right of access to particular facilities. Once those principles were established, the parties would be free to negotiate access agreements, subject to a requirement to place those agreements on a public register. If the parties could not agree on an access price, either party could insist on binding arbitration in accordance with the declared principles. This approach is similar to that adopted under the Telecommunications Act.<sup>49</sup>

The Committee favours the second approach under which the key policy issues relating to pricing principles are more transparent and are made by an elected representative. Once principles are in place the parties have a greater degree of certainty over their respective rights and obligations. This approach is also less interventionist than regulated outcomes and should facilitate the evolution of more market-oriented solutions over time.

While the Committee believes the ultimate determination of an appropriate pricing principle for any given facility should be made by the Minister, he or she should be required to seek independent and expert recommendations on this issue from the NCC. That body's advice would be based on an assessment of the industry and would take account of submissions received from interested parties. The recommendations of the Council would be made public and would be

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<sup>48</sup> PSA (Sub 97).

<sup>49</sup> See ss.140-172. Under the Telecommunications Act, access agreements must comply with the Ministerially-determined pricing principles (ss.140-143); under the Committee's proposed regime this would be primarily a matter for the parties, and if need be the arbitrator, although additional pro-competitive safeguards may be declared in appropriate circumstances (see below).

binding on the Minister unless the owner of the facility agreed to an alternative arrangement.

If, despite the existence of an access right and declared pricing principles, the parties could not reach agreement, binding arbitration would be available under the auspices of the competition authority — the proposed Australian Competition Commission. The Commission could appoint independent commercial arbitrators or itself provide the arbitration function. In some circumstances the access declaration might specify that arbitration should only be conducted by the Commission. Whether or not the Commission is the arbitrator, the arbitrator’s determination would be binding and appeals would be limited to matters of law.

To facilitate negotiation of appropriate access agreements once a facility has been declared, the owner of the facility should be required to provide relevant cost or other data to the party entitled to seek access and, if need be, to the arbitrator.

### **3. Other Terms and Conditions Required to Protect the Owner**

In some cases it may be appropriate to qualify the right of access, such as by imposing quality requirements on the gas or water put in a pipeline, the minimum or maximum volumes of throughput or other conditions.

With privately-owned facilities, in particular, it would be appropriate to ensure that an obligation to provide access does not unduly impede an owner’s right to use its own facility,<sup>50</sup> including any planned expansion of utilisation or capacity. It may be appropriate to require that access be provided on a “non-discriminatory” basis, although what this is intended to mean in a particular setting should be spelt out. For example, it may be appropriate for the owner of a private facility to give priority to its own requirements in determining access to the facility in some circumstances. Similarly, discrimination between different third-party users should not be prohibited where the discrimination relates to objective efficiency-related considerations, including different costs associated with providing access to different users.

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<sup>50</sup> For example, under the UK gas regime, access will not be ordered at all where the pipeline is already running at full capacity: see s.19, *Gas Act 1986*. See also *Petroleum Pipelines Act 1969* (WA), which gives priority to the owner of the pipeline.



The relevant terms and conditions will tend to vary between industries and between facilities and should be subject to Ministerial determination under the same declaration process used for determining relevant pricing principles, including the role for advice from the NCC.

#### **4. Additional Safeguards to Protect Competition**

In some situations there may be concern that the assurance of access on fair and reasonable terms will not be sufficient to protect competition in a newly competitive market, and that some additional safeguards are required to ensure that an incumbent does not misuse its market power to damage emerging competition.

Under the *Telecommunications Act 1991* (Cth), for example, the new entrant was given access to the interconnection network at what is regarded as a relatively inexpensive price to help offset the competitive advantages of the incumbent. In addition, the Act includes:

- prohibitions on the dominant carrier engaging in price discrimination;<sup>51</sup>
- prohibitions on the dominant carrier favouring its own operations in the setting or applying of terms or conditions for the supply of its own basic carriage services;<sup>52</sup>
- practical constraints on cross-subsidies through requirements to maintain accounts in prescribed forms and scrutiny of such records by the regulator,<sup>53</sup> and
- extensive administrative scrutiny of pricing and marketing practices.

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51 Section 183.

52 Section 187.

53 Part 5, Division 5.

These safeguards are designed to become less prescriptive and intrusive as competition develops, and are expected to be phased out as certain predetermined market shares are achieved by the new entrant.

The circumstances of the emerging Australian telecommunications market are relatively unusual. The incumbent dwarfs the new entrant; a regulated duopoly limits the contestability of the market; and the large number of different products in that industry presents the opportunity for the incumbent to exploit its market power in less contestable market sectors to resource cross-subsidies in sectors where competition has commenced or is expected to emerge.

The same conditions appear unlikely to exist to the same degree in other infrastructure industries that may be subject to an access regime. In most of these industries, there is often only one relatively homogeneous product (such as electricity or gas) and appropriate regulatory and structural reform should increase the contestability of the market. Accordingly, the Committee considers that any concerns over predatory or unduly discriminatory behaviour will generally be met by requirements to provide cost data relevant to the application of the pricing principles; to place access agreements on a public register; and to ensure all parties are subject to the general competitive conduct rules proposed in Part I. Additional safeguards that intrude into the rights of the owner are even less likely to be appropriate in the case of private facilities, as the costs of pro-competitive policies ought to be borne by the public, either via its ownership of the facility or otherwise, since the beneficiaries of the policy are consumers generally.

If additional safeguards are considered necessary in a particular market, they could be specified by the Minister as part of the process of declaring a particular facility. Examples might include a requirement that any arbitration be conducted by the Commission itself rather than simply under its auspices; that access agreements be subject to scrutiny by the Commission to ensure they conform with declared principles; or more detailed requirements tailored to the circumstances of the particular declaration. Any such additional measures should be transparent and kept under regular review to ensure they are not unnecessarily interventionist and in particular do not become a prop for inefficient competitors. Importantly, the

decision as to whether to provide such safeguards should be based on the advice of the NCC.

## 5. Remedies

The proposed access regime relies on negotiation between parties to settle access disputes. Where agreement cannot be reached between the parties, an arbitral process is proposed. The arbitral award would be binding in the usual manner of a commercial arbitration, and non-compliance with the determination could be addressed through civil actions for injunctions or actions for damages.

In some cases, however, the prospect of normal civil remedies may not be considered sufficient to ensure full and timely compliance with the requirements of the access regime. Additional remedies — such as pecuniary penalties of the kind proposed for the competitive conduct rules of a national competition policy<sup>54</sup> — might be declared as part of the access declaration where this is recommended by the NCC.

## 6. Relationship with Existing Access Regimes

As noted above, there already exist some examples of legislated access regimes.<sup>55</sup> Where such a regime provides access on fair and reasonable terms there will usually be no need for declaration under the proposed general access regime, as effective competition in upstream or downstream markets will already be possible. If the NCC were given a reference to inquire into whether or not an access declaration should be made under the proposed general regime, it would be required to have regard to existing arrangements in framing its recommendation.

If the Council considered that an existing industry-specific access regime was unduly restrictive or discriminatory, had a detrimental effect on inter-state trade or otherwise adversely affected Australia's international competitiveness, it might recommend a declaration under the new general regime. In such cases the proposed general access regime would prevail over the existing access regime.

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<sup>54</sup> See Chapter Seven.

<sup>55</sup> See eg *Telecommunications Act 1991* (Cth); s.21 *Petroleum Pipelines Act 1969* (WA).

Upon declaration of a facility, the proposed regime should provide an exhaustive statement of access rights. It would thus also operate to exclude any claims under s.46 of the TPA, to the extent that they relate to allegations of a refusal to provide access to a declared facility.

## **7. Conclusions**

The Committee proposes the establishment of a new access regime potentially applicable to any sector of the economy. In practice, however, such a regime should be applied sparingly, focussing on key sectors of strategic significance to the nation. Concerns over access to facilities that do not share these features should continue to be addressed under the general conduct rules. The key elements of the Committee’s proposals are summarised in Box 11.1.

### **C. ACCESS TO “ESSENTIAL FACILITIES” OWNED BY GOVERNMENTS**

Many of the facilities potentially subject to an access regime are currently owned by Commonwealth, State and Territory Governments. This is particularly so of key infrastructure assets such as electricity transmission grids, rail tracks and the telecommunications network, and the Committee was cognisant of this fact in designing the general rules outlined above. Indeed, as these assets are held on behalf of the public, the benefits to the public of improving the efficient use of those assets, and improving the competitiveness of the economy generally, will usually be additional factors supporting the creation of an effective access regime.

A number of concerns were raised in submissions and discussions with States that might arise from the application of an access regime to State-owned assets. In the Committee’s view, none of these concerns provides a reason for excluding State assets from an access regime, although these special considerations should be taken into account.

<b>Box 11.1: General Access Regime — Summary of Key Elements</b>	
<b>WHEN:</b>	<p>The designated Commonwealth Minister could only declare access to a particular facility if:</p> <ul style="list-style-type: none"> <li>(a) the owner agrees; or</li> <li>(b) the Minister is satisfied that:               <ul style="list-style-type: none"> <li>(i) access to the facility in question is essential to permit effective competition in a downstream or upstream activity;</li> <li>(ii) such a declaration is in the public interest, having regard to:                   <ul style="list-style-type: none"> <li>(1) the significance of the industry to the national economy; and</li> <li>(2) the expected impact of effective competition in that industry on national competitiveness; and</li> </ul> </li> <li>(iii) the legitimate interests of the owner of the facility will be protected by the imposition of an access fee and other terms and conditions that are fair and reasonable.</li> </ul> </li> </ul> <p>Where the owner of a facility has not consented to a declaration, the Minister may only make such a declaration if recommended by the independent advisory body and only on terms and conditions recommended by that body or on such other terms and conditions as agreed by the owner of the facility.</p>
<b>ACCESS PRICE:</b>	<p>Each access declaration would specify pricing principles that provide for a "fair and reasonable" access fee. The principles would be determined by the NCC, but declared by the Minister. They could be altered by agreement with the owner of the facility.</p> <p>The parties are then free to negotiate their own agreements, subject to a requirement to place them on a public register.</p> <p>If the parties cannot agree, either party may seek binding arbitration by or under the auspices of the Australian Competition Commission.</p>
<b>OTHER TERMS &amp; CONDITIONS</b>	<p>Each access declaration would specify any other terms and conditions relating to access designed to protect the legitimate interests of the owner of the facility and which were "fair and reasonable". The terms would be declared by the Minister and be based on the recommendations of the NCC.</p>
<b>ADDITIONAL SAFEGUARDS</b>	<p>As a general rule, the requirement to place access agreements on a public register should suffice to protect the competitive process. Where recommended by the independent body, the Minister may also declare that other safeguards should apply aimed at protecting the competitive process.</p>

## 1. Potential Concerns

State and Territory Governments raised three main concerns about pro-competitive policies that might relate to the Committee's access proposal. These were potential revenue impacts, potential implications for community services obligations and more abstract sovereignty concerns.

### (a) Potential Revenue Impacts

Profits derived from government-owned businesses are often regarded as an important source of government revenue. Although requirements for government-owned businesses to make a commercial rate of return on investments are consistent with economic efficiency, there have been suggestions that some governments rely on the monopoly status of their businesses to charge monopoly prices and hence achieve returns in excess of what might be possible in a competitive market.

The extension of a legislated right of access to government-owned assets has the potential to impact on monopoly profits at two levels:

- application of an access regime to a government-owned facility (such as an electricity transmission grid) would limit the potential for that facility to charge monopoly access prices to new entrants (such as private electricity generators); and
- application of an access regime will permit competition in dependent markets, such as electricity generation, and thus limit the potential for any government-owned generators to charge monopoly prices.

The actual impact on the profitability of a business would depend on the extent to which current returns relied on monopoly pricing behaviour, and were thus inconsistent with competitive market outcomes. Normal commercial returns on assets are consistent with competitive markets and would not be affected. While some governments have been taking increasing dividends and other payments from their business enterprises in recent years, the Committee was presented with no material that would allow it to judge to what extent, if any, those profits exceeded a commercial rate

of return.<sup>56</sup> Indeed, many government businesses are earning returns below the commercial level. The introduction of competition into many sectors may not have any impact on profits, but it could allow similar profits to be earned more efficiently, and hence at lower costs to consumers and the economy generally.

If there are indeed profit implications associated with the application of an access regime, the revenues in question will have been obtained at the expense not only of consumers but of a more efficient economy generally. From a national interest perspective, therefore, the issue is one of ensuring appropriate transitional arrangements rather than permitting the status quo to continue. In this regard the NCC would have a specific mandate to advise on transitional issues associated with its recommendations.

#### (b) Implications for Community Services Obligations

Many government businesses are required to perform community service obligations (CSOs) of various forms, at least some of which may be funded from cross subsidies between different classes of consumers.

Application of an access regime to government-owned businesses would facilitate the introduction of competition, which in turn may threaten the viability of CSOs funded through cross-subsidies. Unless alternative funding arrangements are put in place, new market entrants would be able to target the customers that have been charged higher prices to fund CSOs.

This issue is common to other pro-competitive regulatory and structural reforms discussed in Chapters Nine and Ten, and can be addressed by using alternative funding arrangements for CSOs. Options include direct budget funding and, as is being done in the telecommunications regime, funding via levies imposed on all competitors in the market, based on their respective market shares. The issue is thus one of appropriate transitional arrangements. In some circumstances transitional concerns of this kind could be accommodated by the imposition of appropriate terms and conditions of access under the proposed access regime. For example, a condition

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<sup>56</sup> See Box 12.4 in Chapter 12 for an indication of the earnings, before income and tax, of various government businesses.

of access might be imposed requiring beneficiaries of the access right to contribute to a fund to meet community service obligations.

(c) Sovereignty Concerns

A third consideration peculiar to assets owned by governments are the constitutional and other considerations arising in a federal system. Necessarily, the issues vary as between Commonwealth, State and Territory Governments.

- *Assets Owned by the Commonwealth*

There are no constitutional impediments to the Commonwealth dealing with its own assets, and no other circumstances that might be used to justify the exclusion of Commonwealth assets from a national access regime. Indeed, the Commonwealth has already exposed AOTC to an access arrangement through an industry-specific legislative scheme, and has experience in dealing with CSOs and like matters in a competitive environment.

- *Assets Owned by State & Territory Governments*

Although the Commonwealth’s constitutional powers are not unlimited, it seems that there are a number of circumstances where the Commonwealth could validly create access rights to assets owned by State Governments.<sup>57</sup> This is clearly so in respect of facilities that are owned by trading corporations or where the facility or the proposed access arrangement has an inter-state dimension. It may also be possible to create such a right in respect of State assets irrespective of the legal form of ownership or interstate character of the facility or transaction if creation of an access right would protect a trading corporation from possible restrictions imposed on its trading activities. The Commonwealth’s legislative powers in respect of the Territories are plenary.

While it seems likely that the Commonwealth has power to create access rights to many of the more significant infrastructure facilities, the principle of comity between governments in a federal system suggests that the Commonwealth Government should generally respect the prerogatives of a State government unless an important

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<sup>57</sup> For a further discussion of these issues see Chapter 15.



national interest is at stake. The Committee supports this principle, and encourages the use of cooperative processes wherever they will meet the national interest.

## 2. Consideration and Conclusions

The Committee sees no reason why the access regime it proposes should not apply to relevant assets owned by the Commonwealth.

In principle, the same should be true of assets owned by State and Territory Governments. In this respect the Committee notes that the proposed scheme is constrained in its potential impact on State-owned assets in a number of ways. The most important limitation is the requirement that access only be granted if to do so would be in the public interest having regard to the significance of the industry to the national economy and the expected impact of effective competition in that industry on national competitiveness. There is a requirement that the legitimate interests of the owner of the facility be protected by imposition of an access fee and other terms and conditions that are fair and reasonable. And access rights could not be created without the affirmative recommendation of the NCC which, as discussed in Chapter 14, would be established jointly between Commonwealth, State and Territory Governments.

The proposed regime provides for the owner of a facility to consent to a declaration, and this should be the primary mechanism for bringing State-owned assets within the regime. The NCC could still furnish advice, but could do so to assist relevant governments reach agreement, and to provide guidance on any associated transitional arrangements.

The Committee considers that cooperative approaches of this kind should be the preferred method of making progress in this area, and governments may wish to establish informal inter-governmental arrangements to facilitate the obtaining of agreement. Where agreement is not forthcoming, however, the Committee considers the important national interests at stake in some circumstances may be sufficient to justify possible unilateral action by the Commonwealth, albeit subject to the safeguards outlined above.

## D. RECOMMENDATIONS

The Committee recommends that:

- 11.1 Concerns over access to "essential facilities" be dealt with under a national competition policy by a new legal regime that creates a right of access in prescribed circumstances.
- 11.2 The legal regime underpinning access rights be general, rather than industry-specific.
- 11.3 Access rights be created by a process of declarations made by the designated Commonwealth Minister.
- 11.4 A right of access to a facility only be created if:
  - (a) the owner agrees; or
  - (b) the designated Commonwealth Minister is satisfied that:
    - (i) access to the facility in question is essential to permit effective competition in a downstream or upstream activity;
    - (ii) such a declaration is in the public interest, having regard to:
      - (1) the significance of the industry to the national economy; and
      - (2) the expected impact of effective competition in that industry on national competitiveness; and
    - (iii) the legitimate interests of the owner of the facility will be protected by the imposition of an access fee and other terms and conditions that are fair and reasonable.

Where the owner of a facility has not consented to a declaration, the Minister may only make such a declaration if recommended by the National Competition Council and only on terms and conditions recommended by that body or on such other terms and conditions as agreed by the owner of the facility.

- 11.5 The access regime have the following features:
  - (a) an access declaration should indicate:
    - (i) the facility or facilities subject to the declaration;
    - (ii) the user or class of users benefiting from the right;

- (iii) the pricing principles governing access to the facility;
  - (iv) any other terms and conditions to protect the legitimate interests of the owner of the facility;
  - (v) any additional safeguards required to protect the competitive process;
  - (vi) whether arbitration is required to be conducted by the Australian Competition Commission, or whether it may be conducted by others acting under the auspices of the Commission; and
  - (vii) what, if any, specific penalties should be available for non-compliance with an access right.
- (b) if the parties cannot agree on particular terms and conditions, either party may seek binding arbitration by, or under the auspices of, the Australian Competition Commission;
  - (c) agreements, whether achieved through negotiation or arbitration should be placed on a public register held by the Australian Competition Commission;
  - (d) declarations should be subject to periodic and open review at periods appropriate to the circumstances of the industry, and should lapse automatically unless renewed following a review; and
  - (e) firms party to an access declaration should be provided with a formal mechanism to petition for revocation or modification of a declaration based on a material change in market circumstances.

11.6 Where a facility is declared under the proposed general access regime, the resulting access rights should constitute an exhaustive statement,

- (a) taking precedence over access rights created under existing legislation; and
- (b) excluding any right to bring an action in relation to an allegation of refusal to provide access to a declared facility under the misuse of market power provisions of the competitive conduct rules.

- 11.7 The proposed general access regime be capable of application to facilities owned by State or Territory Governments. As a measure of comity to other governments in a federal system, the Commonwealth should place primary emphasis on cooperative approaches to the the declaration of access, based on the agreement of the owner of the facility. Where that cooperation is not forthcoming, however, the Committee considers the important national interests at stake in some circumstances may be sufficient to justify unilateral action.

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## 12. Monopoly Pricing

As a general rule, "high" prices lead to increased competition. They provide the signal that spurs innovation and risk-taking investment. In markets characterised by workable competition, charging prices above the level of long run average costs will not be possible over a sustained period, for higher returns will attract new market entrants or lead customers to choose a rival supplier or product. Consequently, the general conduct rules proposed in Part II do not seek to regulate "high" pricing directly, relying instead on the competitive process.

Where the conditions for workable competition are absent — such as where a firm has a legislated or natural monopoly,<sup>1</sup> or the market is otherwise poorly contestable — firms may be able to charge prices above the efficient level for periods beyond those justified by past investments and risks taken or beyond a time when a competitive response might reasonably be expected. Such "monopoly pricing" is seen as detrimental to consumers and to the community as a whole. The primary goal of competition policy is to increase the competitive pressures in these industries, and some of the mechanisms for achieving this were discussed in earlier Chapters.<sup>2</sup> Where those measures are not practicable or sufficient, however, some form of price-based response may be appropriate.

This Chapter proposes the establishment of a prices monitoring and surveillance process for a national competition policy. The process would be applied sparingly and only after proper investigation of the underlying market circumstances, and would not directly control prices. In principle, the same process is applicable to all firms regardless of ownership, although the process takes account of the special considerations that can arise with Government owned-businesses.

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<sup>1</sup> A natural monopoly can be defined as a market where the entire output can be supplied by a single firm at a lower cost than by any combination of two or more firms (IAC, *Government (Non-Tax) Charges*, Vol III, (1989) at 79). Major natural monopolies have been held to include some electricity transmission grids, rail tracks, gas pipelines, parts of the water industry and local telephone networks.

<sup>2</sup> Means of enhancing competition were canvassed in Chapter 9 (Regulatory Restrictions on Competition); Chapter 10 (Structural Reform of Public Monopolies); and Chapter 11 (Access to "Essential Facilities").

**Section A** examines the nature of the monopoly pricing issue and reviews some of the alternative means of dealing with this issue in a national competition policy.

**Section B** outlines a general prices oversight process, including the circumstances in which it should be applied and other aspects of the process.

**Section C** considers the application of the proposed general prices oversight process to government businesses. It concludes that while, in principle, the same process should be applicable to all businesses, greater emphasis on cooperative approaches will be appropriate for State and Territory government businesses.

**Section D** presents the Committee's recommendations.

## **A. MONOPOLY PRICING & COMPETITION POLICY**

This Section considers the nature of the "monopoly pricing" problem, reviews some of the alternative responses to the problem and concludes that a national competition policy should include a limited prices oversight process.

### **1. The "Monopoly Pricing" Problem**

Where a firm is not subject to effective competitive pressure — including both actual and potential competition — it may be able to restrict output and charge higher prices than would be possible in a contestable market. This behaviour is known as "monopoly pricing" and can result in higher prices to consumers and a misallocation of resources.

There are two situations where "monopoly pricing" may occur. The first is where firms enjoy a legislated or natural monopoly over a particular activity and thus are typically in a position to monopoly price. In many of these cases, governments have responded by regulating prices. However, economic efficiency has seldom been the sole or even principal criterion in regulating prices, with governments often choosing to regulate to favour particular categories of consumers or to achieve other social or political objectives. Price regulation of this kind may come at a cost to economic efficiency. "High" prices

provide an important signal to potential competitors that finding ways to "crack the monopoly" are worthwhile. For example, many of the recent innovations in telecommunications were undoubtedly spurred on by the high profits of the industry during the 1970s and 1980s. Regulation of prices for social ends can slow this type of innovation. Another cost of price regulation, particularly cost-based regulation, is that it may often reduce a firm's incentives to increase efficiency. While a number of other pricing models are being tried (eg, price capping or CPI-X regulation), there has historically been a tendency for price regulation to foster a "cost plus" mentality in regulated firms.

The second situation where "monopoly pricing" may occur is in poorly contestable, though largely unregulated, markets. In markets comprising only a few firms, and where barriers to entry are high, there may be concerns over monopoly pricing behaviour. In these cases, in assessing whether prices charged by firms are "too high" it will be important to understand the underlying industry characteristics. What appears a "high" price may reflect no more than a competitive return on capital, given risk factors and pay-back periods. Firms without a legislated or natural monopoly rarely enjoy the capacity to charge excessive prices over a sustained period.<sup>3</sup> Intervening to restrict prices can deter new investment, constrain productivity growth and dull the signal to new firms to enter the market. Nevertheless, there may be some poorly contestable markets where there is reasonable concern over potential monopoly pricing behaviour.

In either monopoly or poorly contestable markets, the nature of the intervention will be important. Regulated solutions can never be as dynamic as market competition, and poorly designed or overly intrusive approaches can reduce incentives for investment and efforts to improve productivity. There are costs involved in administering and complying with pricing policies. Finally, from a government's perspective, resort to price control might be seen as an easy and popular way of dealing with what is in reality a more fundamental problem of lack of competition in an area. Since price control never solves the underlying problem it should be seen as a "last resort". For all these reasons, regulatory responses to monopoly pricing concerns must be approached with caution.

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<sup>3</sup> For example, the IC (Sub 6) noted that firm profitability in the short to medium term is generally a poor indicator of whether there is sufficient competition in a particular market.

## 2. Possible Responses

Given the risks associated with regulatory responses, the "first best" solution is to address the underlying cause of monopoly pricing by increasing the contestability of the market. This might be achieved by removing or reducing regulatory barriers to entry; restructuring public monopolies; or providing rights of access to certain "essential facilities".

Where measures to improve the degree of competition *within* the market are not practicable or sufficient — such as where an industry has natural monopoly characteristics — it may be possible to create competition *for* the market, also known as franchising or competitive licensing. For example, firms could compete for the right to operate a natural monopoly for a certain period, with the firm tendering the lowest reasonable supply price being awarded the monopoly right (subject to quality of supply and other considerations). This form of competition may generate some of the efficiency gains which arise where competition within the market is possible. While measures of this kind have attracted considerable attention in the literature, they have been applied only in a limited number of cases.<sup>4</sup>

Where none of these measures is practicable or sufficient, some form of limited price-based response may be justified. The following Sections outline a proposed prices oversight process for a national competition policy.

### B. GENERAL PRICES OVERSIGHT PROCESS

This Section proposes the basic features of a targeted, economy-wide prices oversight process. It argues that the application of prices oversight should be restricted by explicit legislative criteria and transparent and independent processes; that oversight should be limited to monitoring and surveillance; and that the bases for assessing prices should be confined to efficiency and competition considerations.

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<sup>4</sup> See Demsetz H, "Why Regulate Utilities?", *Journal of Law and Economics*, 11 (1968) 55-65; Tasman Economic Research Ltd, *Harnessing Competition in the Provision of Electricity and Water*, (1992); Schmalensee R, *The Control of Natural Monopolies* (1979); Dnes A, *Franchising and Privatisation: Issues and Options*, (1989); and IC, *Energy Generation and Distribution* (1991).



## 1. When Should Prices Oversight Be Applied?

Any form of prices oversight will involve costs for the firm subject to the process and the regulator. The Committee proposes that firms should be subject to prices oversight in only limited circumstances defined by statutory criteria and after an independent inquiry has investigated the market situation, alternative pro-competitive reforms and recommended that prices oversight is appropriate.

### Current Approach

Although there are a number of prices oversight and regulatory arrangements currently operating in Australia, the system with the widest coverage is that provided by the *Prices Surveillance Act 1983* (PS Act) and administered by the Prices Surveillance Authority (PSA), an independent body. There are around 50 firms operating in 18 industries currently declared under the Act, including ACI Ltd, Arnott's, Australia Post, BHP Ltd, Carlton and United Breweries, Colgate-Palmolive, the Federal Airports Corporation, National Brewing Holdings and Nestles.<sup>5</sup>

The PS Act provides that the Commonwealth Treasurer may declare firms under the Act, which, in turn, requires those firms to notify the PSA of proposed price increases.<sup>6</sup> There are no criteria in the Act governing when a firm can be declared, although the Second Reading Speech of the Act canvassed criteria including the pervasiveness of wage and price decisions, in combination with a lack of effective competitive market discipline.<sup>7</sup> While the PSA often holds an inquiry into the competitive conditions of a market before firms in that market are subjected to prices surveillance, this is not a statutory requirement.

A second generic kind of price regulation is that administered by the NSW Government Pricing Tribunal (GPT), under the *NSW Government Pricing Tribunal Act 1992*. This body investigates and reports on the determination of maximum prices for government monopoly suppliers and the pricing policies (including the pricing structure) of

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<sup>5</sup> PSA (Sub 97) contains a list of declared companies.

<sup>6</sup> A firm may be declared for the purposes of one or more of the goods or services that it supplies.

<sup>7</sup> *Ibid.*

such suppliers. The GPT has a standing reference covering, inter alia, electricity, rail and water authorities in NSW.

### Submissions

A number of submissions claimed that current PSA declarations were inappropriate for particular firms and industries, essentially on the ground that effective competition existed in relevant markets.<sup>8</sup>

### Consideration and Conclusions

There will usually be scope for debate over whether a particular firm is in a position to engage in monopoly pricing and, if so, whether the costs of a prices oversight process outweigh the potential costs of monopoly pricing. While not in a position to pass judgement on individual markets or firms, the Committee considers that the application of the pricing mechanism of a national competition policy should be subject to more explicit statutory criteria than at present and should be guided by an open inquiry process. The Committee expects that the effect of these recommendations would be a more focussed, analytical and transparent approach to price oversight.

Importantly, the Committee considers that, unless a firm agrees to administrative prices oversight, the responsible Commonwealth Minister should only declare a firm where that firm has a substantial degree of power in a substantial market,<sup>9</sup> and an independent body, the proposed National Competition Council (NCC), has examined the market and concluded that the conditions for effective competition are lacking and that prices oversight is appropriate. The market examination would comprise a public inquiry and involve an assessment of barriers to entry, and other factors bearing on the contestability of the market. The NCC could recommend reform of regulatory barriers to entry or other pro-competitive reforms where these were adjudged to be desirable. The Minister would not be bound to declare a firm if it was recommended by the NCC.

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<sup>8</sup> Eg, Australian Institute of Petroleum (Sub 22); Caltex Aust (Sub 27); Shell Ltd (Sub 30); Carlton & United Breweries (Sub 34); Coopers & Lybrand (Sub 42); BP Aust (Sub 46); Pioneer Ltd (Sub 81); BHP Ltd (Sub 133). Treasury argued that "while it is often difficult to assess the case for price regulation in oligopolistic markets, it is arguable that surveillance in a number of areas currently covered may not be warranted on monopoly pricing grounds" (Sub 76). The Trade Practices Committee of the LCA (Sub 65) argued that price regulation should be imposed only in markets which are natural monopolies or have unusual barriers to entry.

<sup>9</sup> Accordingly, the mechanism need not be limited to monopolies.

These requirements should be set out in the legislation itself, and could be supplemented by guidelines issued by the Minister or the NCC.

<sup>5</sup> Declarations under the Act should also be subject to periodic and transparent review to ensure that prices oversight remains justified and responsive to market conditions. In particular, declarations should lapse automatically after a period of no more than three years, and should be renewed only after a further inquiry. In addition, a formal procedure should exist to allow firms that are subject to declaration to petition for a revocation on the grounds of a material change in circumstances.

Existing declarations should lapse automatically within two years, but relevant firms, goods and services might be subject to declaration under the new process.

In some cases, firms may derive substantial market power by owning so-called "essential facilities" to which other firms require access to compete in upstream or downstream markets. In such circumstances, it may often be appropriate for a firm's facility to be subject to the access regime outlined in Chapter 11, rather than prices oversight.<sup>10</sup>

## 2. Intensity of Prices Oversight

Where it is considered that some form of prices oversight is necessary in the public interest, that oversight could include powers of prices monitoring, prices surveillance and prices control.

### Current Approach

Firms declared under the PS Act have their prices surveilled but not controlled. Surveillance involves the PSA examining (usually) each proposed price increase of declared firms and products and indicating whether it has any objection to that increase. Firms are not obliged to comply with the PSA's findings but have always done so to date. The PSA also engages in prices monitoring, although this does not have any statutory backing and therefore requires the consent of the monitored firms. Prices monitoring requires firms to provide certain

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<sup>10</sup> Whether the issues arising in relation to a particular facility would best be addressed under the access regime or the prices oversight process would be considered on a case-by-case basis.

price and cost data to the PSA at regular intervals, but those prices are not subject to notification, recommendation or control.

The PSA has powers under the PS Act in relation to public inquiries and the administration of the prices surveillance arrangements, including the power to obtain information and the power to summons persons to attend inquiries.<sup>11</sup> Confidential information is required to be maintained within the PSA.

The NSW GPT has the power to set maximum prices for services supplied by NSW government monopolies.

### Submissions

Some submissions considered that the PSA's monitoring function should be given a more formal basis.<sup>12</sup> The PSA also argued for a prices control power, on the basis that this would be necessary to restrain the prices of natural monopolies and other firms considered to have a high degree of market power.<sup>13</sup>

Some submissions argued that the costs of compliance with PSA processes were a substantial problem, consuming significant corporate and government resources.<sup>14</sup> The PSA noted, however, that it strives to reduce the costs of its surveillance by accepting data from companies which is in line with their existing information systems and by accepting the different ways in which companies account for cost and revenue items.<sup>15</sup>

### Consideration and Conclusions

The Committee supports formalising a prices monitoring power as a less intrusive form of overseeing pricing behaviour in carefully specified situations.

A surveillance power in a simplified form to that currently exercised by the PSA may be an appropriate response in circumstances where prices monitoring may be insufficient. The Committee considers there

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11 See s.32 of the Prices Surveillance Act.

12 Caltex Australia (Sub 27); PSA (Sub 97).

13 PSA (Sub 97).

14 Eg, Carlton & United Breweries (Sub 34); Coopers & Lybrand (Sub 42).

15 PSA (Sub 97).

may be opportunities to streamline the operation of the current prices notification and assessment process. For example, it may be possible to fast-track prices surveillance arrangements where the administrator of the prices oversight process<sup>16</sup> considers the proposed price increase is clearly justified. Other measures to reduce the compliance burden of surveillance should also be explored. With refinements of this kind, and providing its application were more limited and focussed, the Committee considers it may be appropriate for a surveillance power to continue under a national competition policy.

The Committee was not persuaded of a need to include a price control power. Regulated prices increase the risk of deterring efficient business activity. Moreover, firms have accepted all price recommendations of the PSA to date. In these circumstances, the Committee favours reliance on less intrusive powers unless and until serious compliance difficulties are encountered. The Committee sees some consistency in this regard with its strong stand against price fixing by firms — to the maximum extent possible, pricing decisions should be made by individual firms rather than regulators or cartels.

The Committee considers that current information-gathering powers available to the PSA provide an acceptable basis for the proposed prices oversight arrangements.

### **3. Bases for Assessing Notified Prices**

Where prices surveillance is ordered, it is necessary to determine what pricing behaviour will be considered appropriate, ie, does not constitute monopoly pricing behaviour. Prices can be assessed by reference to general policy principles and/or criteria referring to appropriate benchmarks.

#### **Current Approach**

The PS Act requires the PSA to take account of the need to:

- maintain investment and employment, including the influence of profitability on investment and employment;

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<sup>16</sup> As outlined in Chapter 14, this body is proposed to be the Australian Competition Commission, which would administer the general conduct rules and parts of the additional policy elements, including the prices oversight mechanism.

- discourage a person who is in a position substantially to influence a market for goods or services from taking advantage of that power in setting prices; and
- discourage cost increases arising from increases in wages and changes in conditions of employment inconsistent with principles established by relevant industrial tribunals.

In addition, the PSA must have regard to two general Ministerial directions:

- the Government's policy of generally not supporting price increases in excess of movements in unit costs; and
- the Government's policy that increases in executive remuneration in excess of those permitted under wage fixation principles and decisions by the Australian Conciliation and Arbitration Commission in national wage cases should generally not be accepted as a basis for price increases.

The PSA generally assesses prices by reference to movements in unit costs, although it has recently moved towards reference points based on movements in the general price level.<sup>17</sup>

The NSW GPT may fix the maximum price for a government monopoly service in any manner the Tribunal considers appropriate, but must have regard to the factors set out in Box 12.3 in the next Section. In its interim report on the water industry it favoured a CPI-X revenue cap.

### Submissions

The PSA expressed support for access to wider and more flexible bases for examining the appropriateness of price behaviour, including price capping arrangements of the CPI-X variety.<sup>18</sup> Some submissions observed that the PSA was subject to broad and potentially conflicting objectives.<sup>19</sup>

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<sup>17</sup> See PSA, *A Review of the Prices Surveillance Authority's Role*, (1991) at 77.

<sup>18</sup> PSA (Sub 97). DPIE (Sub 50) also suggested that there may be a need to allow alternatives to cost-based prices surveillance.

<sup>19</sup> Eg, Carlton and United Breweries (Sub 34); and Pioneer (Sub 81).

## Consideration and Conclusions

The Committee supports the inclusion in the relevant Act of guidelines to assist the NCC in framing recommendations on appropriate price behaviour. However, it considers that several of the existing principles are not appropriate for a national competition policy. Under a new policy regime, principles should focus on competition and efficiency concerns, rather than broader and potentially conflicting social and political goals. For example, a more appropriate principle for a national competition policy might be for the NCC to have regard to:

the promotion of long term economic efficiency, taking into account the desirability of fostering investment, innovation and productivity improvement, and the desirability of discouraging a person who has a substantial degree of power in a market from using that power to set prices above efficient levels.

There are several potential bases, or benchmarks, which can be used to assess the appropriateness of a firm's proposed price increases, including movements in the firm's costs,<sup>20</sup> movements in the general price level, and so-called "yard-stick" competition, where the performance of comparable firms is used as a reference.<sup>21</sup> Box 12.1 sets out some of the possible pricing approaches.

The Committee considers a national policy should have the flexibility to draw on a range of bases. The determination of which is most appropriate for a particular market situation should be made by the inquiry preceding the application of prices surveillance, and be subject to a formal decision by the Minister as part of the declaration process. Declarations could also specify whether or not each proposed price increase should be notified to the administrator of the prices oversight mechanism, the proposed Australian Competition Commission (ACC).

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<sup>20</sup> See, for example, Beesley M & Littlechild, S, "The Regulation of Privatised Monopolies in the United Kingdom", *RAND Journal of Economics*, (1989) 20, at 454.

<sup>21</sup> See Cave M, *Recent Developments in the Regulation of Former Nationalised Industries*, (1991).

<b>Box 12.1: Examples of Possible Pricing Approaches</b>		
<b>APPROACH</b>	<b>ELEMENTS</b>	<b>COMMENTS</b>
Cost Based	Price changes linked to changes in firm's costs	<ul style="list-style-type: none"> <li>• Flexible as to changes in costs</li> <li>• Limited incentive to improve efficiency</li> </ul>
Price (or Revenue) Capping ("CPI - X")	Price (or revenue) changes linked to a set rate ("X") below (usually) increases in the Consumer Price Index	<ul style="list-style-type: none"> <li>• Clear benefits to consumers</li> <li>• Incentive to improve efficiency (particularly if X is set for reasonably lengthy periods)</li> <li>• Allows firms to restructure prices</li> </ul>
Yardstick	Price changes linked to average (or lowest) changes in costs of a group of peer firms	<ul style="list-style-type: none"> <li>• Incentive to improve efficiency</li> <li>• Eliminates need to determine X</li> <li>• Most effective when firms are readily comparable</li> </ul>

#### **4. Summary of Proposed Prices Oversight Mechanism**

The Committee supports the inclusion of a limited and focussed prices monitoring and surveillance process as part of a national competition policy. The main features of the proposed system are summarised in Box 12.2.

#### **C. PRICES OVERSIGHT OF GOVERNMENT BUSINESSES**

Firms with the greatest potential to engage in monopoly pricing are those protected by legislated monopolies. In Australia, the overwhelming majority of these are owned by Commonwealth, State and Territory Governments. This Section examines the potential application of the proposed national prices oversight mechanism to these government enterprises.

Government businesses raise a number of special considerations in this context. While their monopoly permits them to charge inefficiently high prices, traditional approaches to prices regulation have encouraged a "cost-plus" mentality, allowing these businesses to operate very inefficiently. Under government direction, these



**Box 12.2 : Main Features of Proposed Prices Oversight Process**

WHEN APPLIED	<ul style="list-style-type: none"> <li>• Concerns over possible monopoly pricing should be addressed primarily through reforms aimed at improving the contestability of the market</li> <li>• Prices oversight should be declared by the designated Commonwealth Minister only where satisfied that it is in the public interest and the firm:             <ul style="list-style-type: none"> <li>(a) agrees; or</li> <li>(b) has substantial market power in a substantial market in Australia <u>and</u> application of prices oversight has been recommended by an independent body (NCC) after a public inquiry.</li> </ul> </li> </ul>
INTENSITY OF OVERSIGHT	<ul style="list-style-type: none"> <li>• Prices oversight powers should be limited to:             <ul style="list-style-type: none"> <li>– monitoring, which requires a firm to provide specified cost and price data to the pricing body at regular intervals; or</li> <li>– surveillance, which requires a firm to provide specified cost and price data and seek the pricing body's non-binding recommendation as to prices; current administrative arrangements should be reviewed to ensure they are cost-effective.</li> </ul> </li> </ul>
ASSESSMENT OF PRICES	<ul style="list-style-type: none"> <li>• Pricing principles should be limited to efficiency and competition concerns</li> <li>• Price bases could be determined according to the characteristics of individual markets.</li> </ul>

businesses often charge "monopoly" prices to some customers to cross-subsidise inefficiently low prices to other customers or to fund other community service obligations. Increasingly, it appears that governments have also been looking to their businesses as a source of revenue, although many government businesses still make large losses.

Recently, there has been increased appreciation of the cost of inefficient government businesses to society, particularly where their inefficiencies are passed on as higher costs to firms which compete in

world markets. The pro-competitive reforms discussed in the previous three Chapters are an important part of the response to this problem. Where those reforms are not practicable or sufficient, however, the question arises of whether some prices oversight mechanism is required. In a Federal system like Australia's, the question also arises as to whether that prices oversight should be administered nationally or by individual governments.

### Current Approach

All Australian Governments use pricing mechanisms to guard against monopoly pricing by their businesses which have substantial market power.

Commonwealth-owned monopolies are subject to prices surveillance by the PSA, an independent body. Particularly when examining government enterprises, the PSA does not limit its attention to price levels *per se*. It also looks at whether costs are minimised and at the structure of prices, including inefficiently low prices achieved through cross-subsidisation between different classes of consumers.<sup>22</sup> It also draws on new pricing approaches (such as CPI - X) to break the link with the "cost plus" mentality commonly associated with earlier forms of price regulation, thus improving incentives for achieving higher productivity. It can also take account of explicit community services obligations and appropriate levels of profitability. In each case, however, the overarching goal is to ensure that, within the constraints imposed by owning governments, monopolies operate efficiently and do not misuse their market power in setting prices.

State and Territory government businesses are specifically excluded from the reach of the PS Act.<sup>23</sup>

Since 1992, New South Wales government monopolies have been subject to price setting by an independent Government Pricing Tribunal. The Tribunal takes a similar approach to that of the PSA in terms of a broader focus on efficiency issues, and its enabling legislation allows it to have regard to a range of factors peculiar to government businesses. Some of the principal factors are set out in Box 12.3.

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<sup>22</sup> See, for example, PSA, *Inquiry into the Aeronautical & Non-Aeronautical Charges of the Federal Airports Corporation* (Draft Report, June 1993).

<sup>23</sup> See s.4(2) of the *Prices Surveillance Act 1983*.

### Box 12.3: Matters to be Considered by NSW Government Pricing Tribunal

Section 15 of the NSW *Government Pricing Tribunal Act 1992* requires the Tribunal to have regard to, inter alia:

- the cost of providing services;
- the protection of consumers from abuses of monopoly power in terms of prices, pricing policies and standard of services;
- the appropriate rate of return on public sector assets, including appropriate payment of dividends to the Government for the benefit of the people of New South Wales;
- the need for greater efficiency in the supply of services so as to reduce costs for the benefit of consumers and taxpayers; and
- the impact of pricing policies on borrowing, capital and dividend requirements of the government agency concerned.

Other States and Territories leave pricing decisions to Ministers or Cabinet without the benefit of independent and expert advice. Efficiency reforms appear to be pursued primarily on an enterprise by enterprise basis. However, Queensland has recently canvassed the possibility of establishing a body similar to the NSW Tribunal.<sup>24</sup>

### Submissions

Several submissions expressed concern at alleged monopoly pricing and cross subsidies by State Government businesses<sup>25</sup> and another argued that the PSA should be responsible for overseeing pricing of interstate industries including electricity and gas.<sup>26</sup> The TPC also pointed to the benefits of adopting a national approach to monopoly pricing concerns.<sup>27</sup>

The NSW Government argued that the States should retain responsibility for pricing matters and other State and Territory

<sup>24</sup> Qld Govt, *Corporatisation in Queensland: Policy Guidelines* (1992) at 99.

<sup>25</sup> Eg, Australian Institute of Petroleum (Sub 22); Shell Australia (Sub 30); Victorian Gas Users Group (Sub 47); National Bulk Commodities Group (Sub 71); NFF (Sub 90); BCA (Sub 93); Burdekin Canegrowers (Sub 105).

<sup>26</sup> DPIE (Sub 50).

<sup>27</sup> TPC (Sub 69).

Governments raised more general concerns over revenue matters or community service obligations.<sup>28</sup>

The PSA proposed that the pricing body under a national competition policy should be jointly responsible to the Commonwealth and State Governments with respect to State government businesses, and that State Governments should agree to refer their enterprises to coverage by the national body.<sup>29</sup>

### **Consideration**

The extension of competitive conduct rules and other competition policy elements to government-owned businesses raises the question of whether the proposed new prices oversight mechanism should also be extended to them, and if so in what circumstances.

Finding the most effective means of dealing with government businesses with monopoly pricing capability that have not been subject to pro-competitive reforms, or for which such reforms have been found impracticable or insufficient, is an important question for Australia, particularly as these businesses tend to supply key inputs to sectors that compete in global markets.

#### **Commonwealth Government Businesses**

Commonwealth businesses such as Australia Post and the Federal Airports Corporation are already subject to prices surveillance by the PSA. The proposed new prices oversight mechanism would appear to be appropriate for these businesses.

#### **State & Territory Government Businesses**

The application of a national prices oversight mechanism to State and Territory government businesses offers several possible advantages. Independent and expert analysis of monopoly pricing issues would be applied to government businesses currently immune from such scrutiny. This would be a beneficial development in sectors such as electricity, rail, and ports that provide key inputs to export and import competing businesses. A national body could examine pricing issues affecting industries around Australia in a consistent and nationally-

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<sup>28</sup> Eg. SA Govt (Sub 98); ACT Govt (Sub 109); NSW Govt (Sub 117).

<sup>29</sup> PSA (Sub 97).

focussed way. And technical expertise could be consolidated, avoiding any unnecessary fragmentation or duplication of resources and effort.

The application of a single national prices oversight process would be particularly desirable where a government business has a clear inter-state dimension, such as where an inter-state pipeline or electricity grid is jointly owned by several governments. In these circumstances, individual State or Territory prices oversight could lead to regulatory overlap and potentially distort inter-state or national markets, particularly where different approaches adopted. Where the facility in question was subject to an access declaration under the regime proposed in Chapter 11, access prices would be determined nationally. Even in the absence of an access declaration, there are strong national interests in ensuring such key national infrastructure operates efficiently and does not misuse its market power in setting prices.

Against this, there may be three potential concerns.

The first relates to possible *revenue impacts* on States. As indicated in Box 12.4, a number of government businesses have increased their profits significantly in recent years. However, the Committee was not presented with any material that would allow it to conclude whether those profits exceeded commercial or efficient levels and would thus be contrary to economic efficiency. The current national prices surveillance arrangement makes provision for commercial profits, as would the proposed new price oversight mechanism. To the extent prices exceeded commercial levels, a surveillance process would increase the transparency of the pricing arrangements but not control prices. Where prices surveillance served to improve the efficiency of the business, profitability would be able to be maintained at lower cost to consumers and the community generally. Furthermore, as set out in Chapter 15, transitional arrangements would apply in relation to prices oversight arrangements. The proposed NCC — which would be established jointly by the Commonwealth, State and Territory Governments — would have a specific mandate to advise on transitional arrangements associated with its recommendations.

The second concern related to the potential impact of a prices oversight process on *community service obligations* (CSOs), particularly those currently funded by cross-subsidies. The proposed prices oversight process would be able to take these into account in

considering pricing arrangements, as does the PSA currently in relation to businesses like Australia Post. However, an important object of prices surveillance is to improve the transparency of CSOs and identify means of improving the efficiency of the funding of CSOs (this will often involve funding via government budgets).<sup>30</sup>

A third potential concern relates to more general *sovereignty* issues. Contrary to some suggestions, there appears to be no constitutional impediment to the Commonwealth imposing a prices oversight process on State Government businesses.<sup>31</sup> However, the Committee has accepted the principle that, as a matter of comity between governments, the prerogatives of State and Territory Governments should generally not be over-ridden unless this is required in the national interest.

Viewed in this light, the Committee believes the primary means of progressing pro-competitive pricing reform relating to government businesses should be via cooperative approaches between the Australian Governments. Governments should work together to improve the pricing efficiency of government businesses, with emphasis on businesses in transition to a more competitive operating environment, or which are of national economic significance. Government revenue requirements and CSOs may be important matters for cooperative action.

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<sup>30</sup> For example, see Qld Govt, *ibid*, at 94: “the preferred option would be for a fee paid to an enterprise for the provision of CSOs to be funded directly from the Budget.”

<sup>31</sup> Legal and constitutional issues are discussed in Chapter 15.

<b>Box 12.4: Government Businesses — Earnings before Interest &amp; Tax (\$m)<sup>32</sup></b>			
	1989-90	1990-91	1991-92
<b>Commonwealth</b>			
TELECOM / AOTC	2,332	2,565	2,419
QANTAS	10	225	307
Australian Airlines	14	205	18
Australia Post	26	141	213
OTC	348	408	n/a
Snowy Mountains Authority	77	83	-13
ANR	-36	-16	-184
AUSSAT	16	7	n/a
ANL	25	20	-17
Pipeline Authority	51	47	49
Commonwealth Serum Lab.	14	9	14
<b>Total Commonwealth</b>	<b>2,877</b>	<b>3,695</b>	<b>2,807</b>
<b>Electricity &amp; Gas</b>			
EC NSW / Pacific Power	623	802	1,186
SECV	1,177	1,132	1,151
Gas & Fuel Corp of Victoria	171	153	169
Electricity Supply QLD	537	368	571
Electricity Trust SA	219	198	200
Energy Commission WA	527	539	583
HEC Tasmania	166	148	203
ACTEW	16	31	28
Power & Water NT	-46	-53	-19
Sydney Electricity	-6	163	120
<b>Total Electricity &amp; Gas</b>	<b>3,382</b>	<b>3,480</b>	<b>4,191</b>
<b>Rail</b>			
QLD Railways	168	176	298
State Rail NSW	-345	-373	-440
Public Transport Corp.	-985	-1,031	-886
Westrail	15	39	54
<b>Total Rail</b>	<b>-1,147</b>	<b>-1,188</b>	<b>-974</b>
<b>Water</b>			
Rural Water Victoria	16	20	12
E&WS South Australia)	116	117	100
Water Authority WA	98	151	154
Sydney-Ilwarrara-Blue Mt WB	424	465	506
Dept Water Resources	-73	-80	-94
Hunter WB	43	16	27
Melbourne Water	395	449	559
<b>Total Water</b>	<b>1,018</b>	<b>1,139</b>	<b>1,265</b>

<sup>32</sup> From Clare R & Johnstone K, *Financial Performance of Government Business Enterprises: An Update*, (1993). Note that no attempt was made to reconstruct the accounts of the various enterprises. Notes on the various data are presented in the above document.

An important element in this process would be for governments to consider establishing independent pricing bodies along the lines of the NSW model. These pricing bodies should be encouraged to work together and with the national body in establishing principles and approaches consistent with the aims and limitations of price regulation set out in this Report. Governments could also progress pricing reform by agreeing to subject a particular area of activity to the proposed national prices oversight process. This would be particularly appropriate where facilities involve a number of States or where there is a significant interstate or international dimension to the prices charged.

While these two approaches should be the primary means of dealing with State and Territory government monopoly pricing issues, there may be exceptions. In the unlikely event that a government failed to progress effective pricing reform in an area which had significant direct or indirect impacts on interstate or overseas trade, it may be appropriate to take steps to declare that business notwithstanding a lack of consent by the owning government. An application to the NCC seeking a finding on this issue should be able to be made by any government.

Commonwealth-State discussions on these issues, including their interface with other pro-competitive reforms, would be assisted by the analysis and advice of the independent and expert body, the NCC, the establishment of which is proposed in Chapter 14. It is proposed that all Australian Governments would be fully involved in establishing the NCC. As any unilateral Commonwealth declaration of a business would require such a recommendation being made by the NCC, the NCC has an important role in ensuring that the legitimate interests of owners of businesses, including State and Territory governments, are safeguarded.

The Committee considered whether further protection of State and Territory interests was appropriate under these processes. However, the Committee considers that where a government business has been found by the NCC — an independent and expert body — to have failed to progress effective pricing reform in an area that was judged to have a significant direct or indirect impact on interstate or overseas trade, and there has been due consultation, the Commonwealth should be prepared to act to protect the national interests involved. In these circumstances, it would not be appropriate to allow the States or



Territories in question to have a right of veto over Commonwealth action.

## **Conclusions**

Governments should work together to address government monopoly pricing issues, particularly in the context of introducing competition in markets or improving the efficiency of sectors of national economic significance. State and Territory Governments should consider establishing expert and independent bodies along the lines of the NSW Government Pricing Tribunal. Governments may also agree to subject their government enterprises, on a case-by-case basis, to the national prices oversight arrangements. These cooperative efforts should be supported by the proposed National Competition Council.

The national prices oversight arrangements should generally only be applied to a State or Territory government business by consent of the owning government. However, consent should be able to be waived where a government has failed to progress effective pricing reform in an area that was judged to have a significant direct or indirect impact on interstate or overseas trade, and there has been due consultation.

## **D. RECOMMENDATIONS**

The Committee recommends that:

- 12.1 Concerns over monopoly pricing be addressed primarily through appropriate regulatory and structural reform to enhance competition, with prices oversight being a residual and second-best option.
- 12.2 A national competition policy include a targeted prices oversight mechanism to deal with those situations where pro-competitive reforms are not adequate or practicable. That oversight would provide for prices monitoring or surveillance but not prices control.

- 12.3 Under a national competition policy, prices oversight of a firm (either generally or in relation to specified goods or services) only be declared by the Commonwealth Minister where the Minister is satisfied that declaration is in the public interest and the firm:
- (i) has agreed to the declaration; or
  - (ii) has substantial market power in a substantial market in Australia and application of prices oversight has been recommended by the proposed National Competition Council after a public inquiry.
- 12.4 Prices oversight powers should be limited to:
- (i) monitoring, which requires a firm to provide specified cost and price data in respect of declared goods or services to the Australian Competition Commission at prescribed intervals; and
  - (ii) surveillance, which requires that a firm provide specified cost and price data to the Australian Competition Commission and seek its recommendation as to whether its prices are consistent with the principles set out in the relevant declaration.
- 12.5 In recommending pricing principles to the Minister, the National Competition Council have regard to statutory principles emphasising the efficiency rationale of prices oversight and taking into account the need for a firm to receive a reasonable rate of return on its assets.
- 12.6 Declarations lapse automatically after a period of no more than three years, unless renewed following a further public inquiry.
- 12.7 Declarations under the current Prices Surveillance Authority arrangements lapse within two years, although relevant firms, goods or services might be subject to declaration under the new prices oversight arrangements.

- 12.8 A formal mechanism be provided to allow firms subject to declaration to petition for revocation or modification of a declaration based on a material change in market circumstances.
- 12.9 Opportunities to streamline the administration of the prices oversight arrangements be examined.
- 12.10 Pricing issues affecting government businesses be dealt with according to the following principles:
- (a) Governments should work together to address monopoly pricing issues, particularly in the context of introducing competition to public monopoly markets or improving the efficiency of sectors which are of national economic significance. A national, independent, advisory body — the National Competition Council — should assist governments in this regard. State and Territory governments should consider establishing independent and expert prices bodies along the lines of the NSW Government Pricing Tribunal;
  - (b) Governments may agree to subject their enterprises, on a case-by-case basis, to the national prices oversight mechanism; and
  - (c) the national prices oversight mechanism should generally only be applied to a government business with the consent of the owner. Consent may only be waived where:
    - (i) on the application of any government, the NCC has found that the owning government has failed to progress effective pricing reform in an area that was judged to have a significant direct or indirect impact on interstate or overseas trade;
    - (ii) there has been due consultation; and
    - (iii) the processes prescribed under Recommendation 12.3 have been complied with.



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## 13. Competitive Neutrality

Competition policy does not require that all firms compete on an equal footing; indeed, differences in size, assets, skills, experience and culture underpin each firm's unique set of competitive advantages and disadvantages. Differences of these kinds are the hallmark of a competitive market economy.

In some cases, however, firms competing in the same market face different regulatory or other requirements, potentially distorting competition and raising efficiency and equity concerns. While some submissions to the Inquiry expressed concern at such differences operating between private firms, by far the most systematic distortions appear to arise when government businesses participate in competitive markets. In particular, government businesses were often seen as enjoying a unique set of competitive advantages by virtue of their ownership, including exemption from tax. Policies dealing with these kinds of distortions can be described as elements of "competitive neutrality". Issues in this area are likely to be of increasing importance in Australia as public management reforms increase the commercial orientation of government businesses and pro-competitive reforms increase the number of government businesses which compete with private firms or with government businesses from different jurisdictions.

This Chapter argues that a mechanism to deal with these concerns in a systematic, nationally-consistent manner be established as part of a national competition policy. It proposes that Australian Governments agree to a set of principles aimed at addressing the distortions that can arise when government businesses compete with other firms. The principles would build on governments' current competitive neutrality reforms and, while not having the force of law, would be supported by appropriate institutional arrangements.

**Section A** examines the concept of competitive neutrality as it may apply to competition involving government businesses<sup>1</sup> and to competition between private firms. It concludes that a national

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<sup>1</sup> "Government businesses" are taken to include government departments, statutory authorities, corporations and other bodies that provide commercial goods or services to the public, private firms or other Government agencies.

competition policy should include a special mechanism to deal with competitive neutrality issues where competition involves government businesses, but that the proposed arrangements for reviewing regulatory restrictions on competition should address any similar issues affecting competition between private firms.

**Section B** considers the content and implementation approach for national competition policy to deal with competitive neutrality issues arising where government businesses engage in competition. It concludes that all Australian governments should agree to abide by a set of principles which would be implemented cooperatively and supported by appropriate institutional arrangements.

**Section C** presents the Committee's recommendations.

## **A. COMPETITIVE NEUTRALITY & COMPETITION POLICY**

Differences in regulatory and other requirements imposed on firms competing in the one market may distort competition and hence undermine market efficiency. Differences of these kinds may also be seen as inequitable, particularly where they are not clearly supported on public interest grounds.

Australian competition policy has not traditionally dealt with competitive neutrality as a distinct policy element. However, the Constitution imposes some limits on discriminatory laws<sup>2</sup> and there is international precedent for disciplines over measures that specially advantage one competitor over another.<sup>3</sup>

In considering appropriate policy responses in this area it is useful to distinguish distortions affecting competition between private firms from distortions arising from the participation of government businesses. Distortions of the former kind generally arise through deliberate and open policy action by governments, typically

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<sup>2</sup> For example, s.92 limits the capacity of regulations to discriminate against interstate trade, and s.99 prohibits the Commonwealth from preferring one State over another by any law or regulation of trade commerce or revenue.

<sup>3</sup> For example, Article 92(1) of the EC Treaty of Rome restricts State aids which distort competition by favouring certain enterprises, or the production of certain goods, in so far as they affect trade between the countries of the EC. Article XVI of the General Agreement on Tariffs and Trade imposes some disciplines on subsidy practices, which have been built on in a separate Subsidy Code.

manifested in legislation. However, those in the latter category may be less deliberate and transparent, and typically flow from a failure to reform laws, policies and practices to keep abreast of developments as bureaucratic and monopolistic enterprises move to more commercial and competitive operating environments.

## 1. **Competitive Neutrality Issues Involving Government Businesses**

As part of moves to improve the efficiency of the public sector, governments in Australia<sup>4</sup> and around the world<sup>5</sup> are requiring their agencies to operate more commercially. Increasingly, government businesses are being exposed to greater competition in their traditional markets and, in some cases, government businesses are moving into traditional private sector markets. Recent and proposed reforms cover services provided to the public (such as telecommunications, electricity and gas) as well as to other arms of government (such as government printing, legal services and car fleets).

Reforms of these kinds have the potential to offer significant public benefits, including improved service delivery and lower costs to users and taxpayers. In the case of the Commonwealth Department of Administrative Services, for example, commercialisation and the untying of government clients has led to productivity improvements of 5% pa and a reduction in real costs by \$250 m pa.<sup>6</sup> The recent introduction of competition into telecommunications has already seen significant price falls, including 20% on the peak rate on Sydney-Melbourne calls.<sup>7</sup>

At the same time, developments of these kinds strike at the heart of traditional differences between public and private organisations, and raise new and challenging questions for policy-makers. For example, recent reports have questioned whether more commercially-oriented

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<sup>4</sup> For a discussion of the reform context and an overview of approaches in different jurisdictions see Halligan J & Power J, *Political Management in the 1990s* (1992).

<sup>5</sup> For a discussion of developments in the US see Rehfuss J, "A Leaner, Tougher Public Management? Public Agency Competition With Private Contractors" *Policy Analysis Quarterly* (Summer 1991) 239-252; and Osborne D & Gaebler T, *Reinventing Government : How The Entrepreneurial Spirit Is Transforming The Public Sector* (1992).

<sup>6</sup> Tanzer N, "Has Micro-Economic Reform in the Public Sector Run its Full Course?" (1993).

<sup>7</sup> AUSTEL advice based on published Telecom and Optus rates over the period from June 1992 (when Optus entered the market) to May 1993.

government operations should continue to enjoy various Crown immunities,<sup>8</sup> or continue to be subject to administrative, judicial and ombudsman review and freedom of information requirements.<sup>9</sup> From a competition policy perspective, the challenge is one of ensuring that government and private firms operate in a competitively neutral environment, thus promoting effective competition, without creating unnecessary impediments to other worthwhile reforms.

The following discussion examines the potential competitive advantages that government businesses may enjoy in competing with other firms; the competition policy impacts of those advantages; options for addressing competitive neutrality concerns; and the rationale for adopting a national approach to this issue.

(a) Potential Competitive Advantages/Disadvantages of Government Businesses

Government businesses may enjoy several kinds of competitive advantage relative to other firms, as well as some competitive disadvantages.

As discussed in Part I of this Report, the continuing exemption of some government businesses from competitive conduct rules is particularly anomalous, and the Committee has argued that these exemptions be removed as a matter of priority. However, this step alone is not sufficient to address the potential competitive distortions which may arise when government businesses compete with private firms, or government businesses from different jurisdictions compete in the one market.

Some of the other special advantages often enjoyed by government businesses by virtue of their ownership include: immunity from various taxes and charges; immunity from various regulatory requirements; explicit or implicit government guarantees on debts; concessional interest rates on loans; not being required to account for depreciation expenses; not being required to achieve a commercial rate of return on assets; and effective immunity from bankruptcy. In

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<sup>8</sup> Senate Standing Committee on Legal & Constitutional Affairs, *The Doctrine of the Shield of the Crown* (1992).

<sup>9</sup> Administrative Review Council, *Administrative Review of Government Business Enterprises: Discussion Paper* (1993).



some cases a government business will also operate in both monopoly and competitive markets, presenting opportunities for cross-subsidisation.

At the same time, government businesses may enjoy unique competitive disadvantages by virtue of their ownership, with examples including greater accountability obligations; requirements to provide various community services obligations; reduced managerial autonomy; requirements to comply with government wages, employment and industrial relations policies; and higher superannuation costs. In any particular case, it may be difficult to determine the extent of the net competitive advantage or disadvantage with precision.

#### (b) Competition Policy Impacts of Net Competitive Advantages

Where a government business enjoys net competitive advantages it may be able to price below more efficient or equally efficient rivals. This has the potential to reduce economic efficiency and community welfare by distorting the allocation of resources between advantaged government firms and other firms. If a less efficient government business is able to rely on a net competitive advantage to take business from a more efficient firm, society's resources are not being put to their best use. From an equity perspective, the disadvantaged firm may feel justifiably aggrieved in this situation, particularly if its owners consider they are, in effect, subsidising their rival through their tax contributions.

Special competitive advantages enjoyed by government agencies also have the potential to retard the development of effective competition in many areas of the economy. For example, a government-owned electricity generator that retained non-commercial advantages might be able to under-cut more efficient rivals, whether they be private firms or generators owned by other governments. Similarly, reforms intended to promote the contracting out of services traditionally supplied by an in-house monopoly provider may be thwarted or undermined if the in-house producer's advantages serve to limit the emergence of effective competition.

Competitive neutrality concerns arising from the participation of government enterprises in competitive markets were raised in many

submissions to the Inquiry.<sup>10</sup> In assessing the impact of this issue, a distinction can be drawn between competition in a government business's traditional markets and competition in markets where the government business has not formerly operated. Competitive neutrality concerns are more pressing in the second case.

- *Traditional Markets*

Many government businesses' traditional markets are effective monopolies, either through legislation (eg, Australia Post in letter carriage), or because the businesses were created to be the sole supplier to government. While the activity remains monopolised, competitive neutrality issues do not arise.

Where the monopoly market is opened up to competition, any market share gained by private competitors should result in improved efficiency and a net gain to those competitors. Allowing the incumbent to enjoy some special competitive advantage for a temporary period may delay the benefits of more even-handed competition, but may be seen as justified as part of the transition to a competitive market. Where those advantages are allowed to continue, the benefits of the intended reform are diminished and may even be lost altogether.

Submissions received by this Inquiry claimed that measures to address competitive neutrality issues in traditional monopoly areas had not been taken in areas such as road and other construction services<sup>11</sup> and project design services.<sup>12</sup>

Government enterprises whose traditional markets are not monopolies, eg, Commonwealth and State banks, often already operate in a competitively neutral environment. Where they do not, they should be subject to competitive neutrality reforms. In these cases, and as with enterprises which traditionally enjoyed a monopoly, some transitional arrangements may be acceptable

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<sup>10</sup> See, ACP (Sub 12); AFG (Sub 15); AGL Ltd (Sub 24); Unilever (Sub 28); AFCC (Sub 31); Spark & Cannon (Sub 36); AIIA (Sub 40); AERCF (Sub 49); Aust Legal Reporting Group (Sub 66); ACM (Sub 73); AMP (Sub 82); BCA (Sub 93); SBC (Sub 100); Aerial Taxis (Sub 102); National Registries (Sub 121); SPAA (Sub 123); ACEE (Sub 127); and AOQ (Sub 135).

<sup>11</sup> AFCC (Sub 31); AERCF (Sub 49).

<sup>12</sup> ACEA (Sub 127).

provided the enterprises do not expand their operations into new fields.

- *New Markets*

As part of their increasingly commercial operating culture, some government businesses are venturing into markets not traditionally supplied by them. If steps are not taken to neutralise any net competitive advantages they enjoy, government businesses may corrupt these markets and take business away from more efficient private businesses. While some period of temporary advantage may be acceptable in the traditional market, as private suppliers can only benefit, the same is not true in this situation. Even if moves into new markets coincide with the opening up of a former monopoly market, there can be no assurance that this fact alone will produce net public benefits if the government business remains, in effect, subsidised by virtue of various competitive advantages. The Committee was presented with no persuasive argument for allowing government businesses to enjoy net competitive advantages outside their traditional markets, even on a temporary basis.

Several submissions claimed that government agencies created to supply a traditional monopoly market have been permitted to compete for business in new markets without addressing competitive neutrality issues. Although the Committee was not in a position to assess individual claims, allegations were made in submissions relating to activities as diverse as court reporting,<sup>13</sup> printing,<sup>14</sup> audio-visual production,<sup>15</sup> and debt registry services.<sup>16</sup>

### (c) Options for Dealing with Competitive Neutrality Concerns

The need to address competitive neutrality issues arising from the participation of government businesses in competitive markets is attracting increasing attention around Australia and overseas.<sup>17</sup>

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<sup>13</sup> Spark & Cannon (Sub 36); and Australian Legal Reporting Group (Sub 66). Auscript has responded to these submissions (Sub 125).

<sup>14</sup> ACM (Sub 73).

<sup>15</sup> SPAA (Sub 123).

<sup>16</sup> National Registries (Sub 121). The RBA has responded to this submission (Sub 132).

<sup>17</sup> For example, UK Treasury Guidelines state that "Normally, in-house bids should be based on full cost, whether or not all of such costs are charged to that budget... it will be important to ensure that tax differences should not be allowed to distort decisions" (HM Treasury, Public Competition and Purchasing Unit, *Market Testing and Buying In* (Guidance No.

Within Australia, however, there are no nationally-consistent norms governing this issue.

In principle, concerns over competitive neutrality involving government businesses could be addressed through four main ways: privatisation; corporatisation; reform of particular sources of advantage and disadvantage; or pricing directions. All Australian governments have adopted at least some of these measures.

- *Privatisation*

Privatisation involves transferring the ownership of the government business to the private sector. This approach fully removes any competitive advantages or disadvantages associated with government ownership, and may be the most appropriate response in many circumstances.

- *Corporatisation*

Full "corporatisation" is a means of converting a public enterprise into a firm which is as similar in terms of its objectives, incentives and sanctions to a private firm as is feasible while retaining the enterprise in government ownership.<sup>18</sup> This will involve eliminating, as far as possible, any special advantages and disadvantages which may flow from government ownership.

Although the concept of corporatisation as it applies to government businesses is subject to different interpretations between the Australian jurisdictions, it has been described as entailing comprehensive reform incorporating five basic principles: clarity and consistency of objectives; management authority; performance monitoring; effective rewards and sanctions; and competitive neutrality.<sup>19</sup> Competitive neutrality is achieved by ensuring that,

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34). However, it has been observed that "Surprisingly few governments attack state-enterprise problems by putting public and private competitors on equal terms ... [H]elping state-owned firms become responsive to competition ... governments may also need to reform laws and regulations that discriminate in favour of state firms" : Shirley M & Nellis ], *Public Enterprise Reform: The Lessons of Experience*, (1991) at 9.

<sup>18</sup> Forsyth P, *Public Enterprises : A Success Story of Microeconomic Reform?* (1992) at 20.

<sup>19</sup> Allan P, *A Guide to the Theory and Practice of Commercialisation & Corporatisation in NSW* (1992) 2. Also see Task Force on Other Issues in the Reform of Government Trading Enterprises, *Characteristics of a Fully Corporatised Government Trading Enterprise* (1991).

inter alia, industrial relations, financing and taxation arrangements are the same as apply in the private sector.<sup>20</sup>

Governments around Australia are increasingly using the corporatisation model to reform their government agencies. The Commonwealth has corporatised entities through agency-specific legislation<sup>21</sup> while most States and Territories have recently introduced generic corporatisation legislation.<sup>22</sup>

While there is a clear trend towards corporatisation of government businesses, there are many exceptions, including in sectors likely to be open to increasing competition in coming years.<sup>23</sup> Significantly, no Australian government appears to have adopted the policy stance that its businesses must be corporatised before they may compete with other firms.

- *Reform of Specific Advantages and Disadvantages*

Another approach to competitive neutrality issues is to address the specific source of particular advantages or disadvantages directly. Removal of exemptions from the competitive conduct rules would be an example of reform of this kind, as would reforms relating to the availability of crown immunity<sup>24</sup> and application of administrative law requirements.<sup>25</sup>

A recent example of this kind of reform was the in-principle agreement of Premiers and Chief Ministers to apply the full range of Government taxes and charges to all commercial government

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<sup>20</sup> Note, however, that State government agencies may pay tax to the owning government in lieu of the Commonwealth Government.

<sup>21</sup> Eg, see *Australian and Overseas Telecommunications Corporation Act 1991*.

<sup>22</sup> Eg, *State Owned Corporations Act 1989* (NSW); *Public Corporations Act 1993* (SA); *Territory Owned Corporations Act 1990* (ACT); *State Owned Enterprises Act 1992* (Vic); *State Authorities Financial Management Act 1990* (Tas); and *Government Owned Corporations Act 1993* (Qld).

<sup>23</sup> For example, most enterprises in the electricity sector are not corporatised, although Vic, Qld and WA have announced the corporatisation of elements of their systems.

<sup>24</sup> See Senate Standing Committee on Legal & Constitutional Affairs, *The Doctrine of the Shield of the Crown* (1992).

<sup>25</sup> See Administrative Review Council, *Administrative Review of Government Business Enterprises : Discussion Paper* (1993).

enterprises through the creation of tax equivalent payments encompassing both State and Commonwealth taxes.<sup>26</sup>

While these approaches address the underlying concerns, and hence serve to reduce the magnitude of net advantages, reforms typically proceed on an issue-by-issue basis and more comprehensive reform may take some time to achieve.

- *Pricing Directions*

In the absence of privatisation or corporatisation, efforts to comprehensively address net competitive advantages typically involve directions aimed at ensuring that the full economic costs of the resources deployed by the government business are reflected in its prices.<sup>27</sup> Under this approach, government businesses would be required to account for costs incurred by the business itself (such as wages), other associated costs (such as accommodation) and implicit costs (such as a commercial rate of return and income tax equivalents). This approach would lead to net competitive advantages held by a government business being offset, thus preventing them from pricing below equally efficient private firms.

Approaches of this kind are essentially accounting measures and are likely to be less effective in addressing competitive neutrality concerns than corporatisation, where competitive advantages and disadvantages are removed. However, they may be acceptable if corporatisation is not practicable, the relevant directions give due weight to competitive neutrality concerns, and those directions are strictly enforced. In this regard it is significant that many entities which submitters alleged to have taken advantage of special competitive advantages in determining pricing strategies appear to have been subject to pricing directions or guidelines of some form.

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<sup>26</sup> Premiers and Chief Ministers Meeting, *Communique*, 21-22 November 1992 at 8. Also, the Commonwealth and the States have agreed to explore the process for subjecting State Trading Enterprises to Commonwealth income and wholesale sales tax, in return for compensation payments from the Commonwealth. See Treasurer, *Premiers' Conference/Loan Council Outcome for 1993-94*, (July 1993) at 4.

<sup>27</sup> For example, Commonwealth Finance Directions generally require Commonwealth Departments to adopt "full cost pricing" when supplying other Commonwealth agencies. However, there is provision to rely on market prices for a reasonable period if the public sector producer is not as efficient as a competitor and full cost pricing would render the public sector supplier unattractive. See Department of Finance, *Guidelines for Costing of Government Activities* (1991).

- *Conclusion*

Privatisation and corporatisation are likely to be the most effective means of addressing competitive neutrality concerns, although they may not be appropriate in all circumstances where government businesses compete with other businesses. There is clearly a role for ongoing review of the existing bases for special treatment of government businesses, particularly as they relate to such antiquated doctrines as Crown immunity. Pricing directions also have a part to play in some circumstances.

(d) **A National Approach**

The Committee considers competitive neutrality issues should be addressed in a nationally consistent and coordinated manner.

Failure to neutralise effectively the advantages of a government business which competes in a national or interstate market has the potential to distort the development of effective competition in such markets. For example, a State-owned electricity generator that retained non-commercial advantages might be in a position to undercut more efficient competitors, whether they be private firms or generators owned by other governments.

Differences in competitive neutrality arrangements between governments may also lead to particular distortions when government businesses from different jurisdictions compete in the one market, which may soon be a feature of competition in inter-State electricity generation, for example.

A national approach to competitive neutrality would also complement the proposal to ensure the competitive conduct rules of a national competition policy had consistent national application, including in relation to government businesses.

Overall, the Committee saw persuasive grounds for ensuring that responses to these issues form part of a national competition policy.

## **2. Competitive Neutrality between Private Businesses**

Government interventions in markets supplied by private firms are generally intended to be neutral in their impact, or where

discrimination is involved, this is generally based on considered policy grounds. For example, a special tax provision favouring activities with a high research and development component may be "discriminatory" but may reflect government policy that encouragement of such activities is desirable. A number of such examples were raised in submissions to the Review.<sup>28</sup> In other cases, however, differences in the regulatory environment faced by competing firms may arise from developments leading to traditionally distinctive classes of suppliers competing in the same market,<sup>29</sup> or through anomalies arising from the pursuit of unrelated policy objectives.<sup>30</sup> In each of these cases, there will usually be pressure to review the rationale for the discrimination.

Where government regulations have a discriminatory impact, particularly in relation to market entry or permissible market conduct, they may be examined through the regulation review process proposed in Chapter Nine of this Report.<sup>31</sup> The discriminatory impacts of regulation as between competitors did not itself appear to warrant separate treatment under a national competition policy.

## **B. COMPETITIVE NEUTRALITY UNDER A NATIONAL POLICY**

This Section proposes a set of principles to address competitive neutrality concerns where government businesses compete with other firms. It proposes a cooperative model whereby governments agree to the proposed principles but are individually responsible for their implementation. It proposes that an independent and expert body be

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<sup>28</sup> For example, the Inquiry received submissions claiming the Medicare system distorted competition between non-medical practitioners and medical practitioners who provided similar services: see Hospital Scientists Branch of the NSW Public Service Assn (Sub 19); Assn of Hospital Pharmacists of Vic, Medical Scientists Assn of Vic and Vic Psychologists Assn (Sub 26). Other submissions claimed that legislation discriminated against chiropractors (Chiropractors' Assn of Australia : Sub 137); non-uniform taxation arrangements applying to onshore and offshore gas fields distorted competition in the gas market: (BHP : Sub 133); and government policy discriminated between quality management training organisations: (Australian Organisation for Quality : Sub 135).

<sup>29</sup> For example, the Inst of Chartered Accountants/ Aust Socy of CPAs (Sub 99) argued that their members are disadvantaged in the provision of tax advisory services relative to lawyers as only lawyers can offer clients the benefits of legal professional privilege.

<sup>30</sup> For example, it has been claimed that the Government's policy on rebates for diesel excise but not other fuels distorts competition between crop dusters whose aircraft use different fuels: see Superair (Sub 124).

<sup>31</sup> Such an examination could assess each distortion in context to determine whether the alleged discrimination was justified on considered policy grounds.



tasked with assisting governments on the implementation and further elaboration of the principles, and that a mechanism be established to facilitate prompt examination of allegations of non-compliance with these principles.

## **1. Policy Principles**

The Committee's review of competitive neutrality issues supports the establishment of a set of principles to guide policy in this area. The Committee recognises that the issues in this area can be complex and that the proposed principles may need to be refined and developed in the light of practical experience. However, the principles should provide at least a starting point for progressing more concerted reform efforts.

- I *Government businesses should not enjoy any net competitive advantage by virtue of their ownership when competing with other businesses.*

This principle reflects the competition policy concern that firms should compete on the basis of their relative intrinsic efficiencies, without any net competitive advantages arising through government ownership. Net competitive advantages of these kinds reduce economic efficiency and community welfare, have the potential to impede the development of efficient national markets and can also give rise to legitimate equity concerns. This and other principles should apply when government businesses are competing with private firms and/or with government businesses from other jurisdictions.

- II *Government businesses competing against other firms within their traditional markets should be subject to measures that effectively neutralise any net competitive advantage flowing from their ownership. Unless exceptional circumstances exist, those advantages should be neutralised within one year of the introduction of competition:*

- (a) *where the government business has traditionally provided services directly to the public, there should be a presumption that this be achieved through corporatisation; and*

- (b) *where the government business has traditionally provided services only to other government entities, this may be achieved through corporatisation or the application of effective pricing directions.*

The effective implementation of pro-competitive reforms, such as opening former monopoly markets up to competition, requires competitive neutrality considerations to be addressed. However, where a government agency is subject to competition in its former market, and does not expand its operations into other markets, there may be some tolerance for a transition towards full competitive neutrality. Any transition period should be limited to ensure that the full efficiency and other benefits of a competitive market are realised.

Corporatisation is the most effective means of resolving competitive neutrality issues and is the preferred solution. When the government business has traditionally provided commercial services direct to the public — as is the case with public utilities — there should be a strong preference for corporatisation.<sup>32</sup> Where the government business primarily serves other entities within government, corporatisation may not always be practicable or appropriate, and there should be greater tolerance for the application of effective pricing directions.

III *Government businesses should not compete against other businesses outside their traditional markets without being subject to measures that effectively neutralise any net competitive advantage flowing from their ownership. No transition period should be permitted in this setting:*

- (a) *where the government business has traditionally provided services directly to the public, there should be a presumption that this be achieved through corporatisation; and*

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<sup>32</sup> The IC has recommended corporatisation of, inter alia, electricity, gas and rail authorities; see IC, *Energy Generation & Distribution* (1991) and *Rail Transport* (1991). The Victorian Government has recently announced the corporatisation of its electricity supply sector: Office of the Treasurer of Vic, "Major Restructuring of Electricity Industry Commences" (News Release, 10 August 1993).

- (b) *where the government business has traditionally provided services only to other government agencies, this may be achieved through corporatisation or the application of effective pricing directions.*

This principle is similar to Principle II, except that it applies to government businesses which compete outside their traditional markets and proposes that no transitional period be permitted before measures are applied to neutralise any net competitive advantage. Put simply, such businesses should not be permitted to wander outside their traditional domain without ensuring that they do not undermine or distort competition in those markets.

## **2. Implementing a National Policy**

The Committee considered two issues relating to the implementation of the above principles: the role of legal rules versus more cooperative approaches; and the possible roles for institutional support.

### **(a) Legal Rules versus Cooperative Approaches**

The Committee considered a range of possibilities in this area, including the development of a national law that prohibited government agencies from competing against private firms unless they met requirements based on the above principles. The Committee ultimately favoured a more cooperative approach, however, reflecting considerations of comity in a federal system as well as concerns that the threat of legal sanctions might deter desirable pro-competitive reforms.

The Committee proposes that governments consider the adoption of a set of principles on competitive neutrality along the lines of those set out above. More detailed requirements may need to be developed over time, particularly where competitive neutrality concerns have a significant and particularly interstate or national impact.

### **(b) Proposed Institutional Support**

The Committee considers that, to be effective, a cooperative approach of this kind needs to be supported by appropriate institutional arrangements.

The Committee considers that an independent and expert advisory body — the proposed National Competition Council (NCC) — should be tasked with assisting governments in the implementation, elaboration and refinement of the principles. In particular, it could be tasked with assisting governments to develop an agreed definition of core concepts such as “fully corporatised” as well as appropriate pricing directions.

The Committee also considers that implementation of the agreed principles would be strengthened by establishing a mechanism for receiving and evaluating allegations of non-compliance with the agreed principles. The national competition authority — the Australian Competition Commission — should be tasked with reporting to the NCC and the owning government on any allegations of non-compliance with the agreed principles. The role would be more one of reacting to complaints than pro-active enforcement.

### **C. RECOMMENDATIONS**

The Committee recommends that:

- 13.1 A mechanism to deal with competitive neutrality as between government businesses and other businesses form part of a national competition policy.
- 13.2 All Australian Governments agree to abide by the following principles:
  - I *Government businesses should not enjoy any net competitive advantage by virtue of their ownership when competing with other businesses.*
  - II *Government businesses competing against other firms within their traditional markets should be subject to measures that effectively neutralise any net competitive advantage flowing from their ownership. Unless exceptional circumstances exist, those advantages should be neutralised within one year of the introduction of competition:*

- (a) *where the government business has traditionally provided services directly to the public, there should be a presumption that this be achieved through corporatisation; and*
- (b) *where the government business has traditionally provided services only to other government entities, this may be achieved through corporatisation or the application of effective pricing directions.*

III *Government businesses should not compete against other businesses outside their traditional markets without being subject to measures that effectively neutralise any net competitive advantage flowing from their ownership. No transition period should be permitted in this setting:*

- (a) *where the government business has traditionally provided services directly to the public, there should be a presumption that this be achieved through corporatisation; and*
- (b) *where the government business has traditionally provided services only to other government agencies, this may be achieved through corporatisation or the application of effective pricing directions.*

13.3 An independent, nationally-focussed body — the proposed National Competition Council — be charged with assisting Governments develop and further refine these principles.

13.4 The national competition authority — the Australian Competition Commission — be required to report allegations of non-compliance with the agreed principles to the owning government and the National Competition Council.



## **PART III: IMPLEMENTATION**





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## 14. Institutional Arrangements

The institutional framework for implementing a national competition policy is critical to its success and, ultimately, to the efficient operation of markets in Australia.

This Chapter outlines proposals for two institutions that would play key roles in implementing the Committee's recommended policies.

A **National Competition Council** would be created jointly by Commonwealth, State and Territory Governments to assist in coordinating cooperative reform and provide independent and expert policy advice on issues arising from the policy proposals contained in Part II of this Report. It would provide guidance on issues associated with transition to more competitive markets, and act as a check on unilateral Commonwealth action in the few cases where that is possible.

An **Australian Competition Commission** would be the key administrative body under the new national policy. It would assume the administrative responsibilities currently performed by the Trade Practices Commission (TPC) and the Prices Surveillance Authority (PSA) and also undertake some new administrative responsibilities in relation to the additional policy elements.

**Section A** reviews the key tasks required to be performed under the Committee's policy proposals, and the proposed institutions to perform those tasks.

**Section B** examines the roles of the Commonwealth, State and Territory Governments in the proposed institutional arrangements.

**Section C** presents the Committee's recommendations.

### A. KEY TASKS & PROPOSED INSTITUTIONS

Achieving the most appropriate institutional framework for a national competition policy is at least as important as the detail of the

policy itself, and the Inquiry received a number of thoughtful submissions on this question.

The PSA put forward a proposal for a “Monopolies Commission” that would provide an administrative approach to issues dealing with public and private firms with substantial market power.<sup>1</sup> The TPC proposed a merger with the PSA and suggested that the combined body be responsible, *inter alia*, for settling access disputes through arbitration.<sup>2</sup> The Industry Commission (IC) proposed that the Trade Practices Tribunal (TPT) be given an enlarged role and that a new agency be established to advise on access issues.<sup>3</sup> The Business Council of Australia (BCA) proposed the establishment of a National Competition Authority and an independent agency reporting to the Council of Australian Governments to advise on structural reform and pricing and access issues.<sup>4</sup> Some submissions suggested enlarging the role of the TPT,<sup>5</sup> and others argued that industry-specific regulators should play a role in relation to some matters or in particular circumstances.<sup>6</sup>

While these proposals assisted in illuminating some of the key considerations involved, the Committee’s recommendations on the most appropriate institutional arrangements were ultimately shaped by the tasks required to be performed under its particular policy proposals. In this regard the Committee distinguished between tasks associated with the generally applicable conduct rules outlined in Part I — where existing institutional arrangements were found to be operating satisfactorily and extending the coverage of the rules would not raise any substantial new tasks — and implementation of the additional policy elements outlined in Part II — which would involve a number of new and challenging tasks, as well as presenting opportunities to streamline current institutional arrangements.

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1 PSA (Sub 97).

2 TPC (Sub 69).

3 IC (Sub 6).

4 BCA (Sub 93).

5 Eg, Prof R Baxt (Sub 18); Mr P Argy (Sub 60).

6 Eg, AUSTEL (Sub 41); DOTAC (Sub 58); DOF (Sub 61); Treasury (Sub 76); Optus Communications (Sub 87); ESAA (Sub 89); SECV (Sub 92); DITARD (Sub 101); Qld Govt (Sub 104); ATUG (Sub 111); Communications Law Centre (Sub 116).

## 1. Competitive Conduct Rules

The Committee has recommended universal application of a set of competitive conduct rules that are a slightly modified version of those contained in Part IV of the *Trade Practices Act 1974* (TPA). The Committee has also proposed streamlining the exemption processes.

Key tasks relating to the rules involve both policy advice and administration. In both cases, the present institutional arrangements appear to be operating satisfactorily, although there is scope for providing for greater participation by State and Territory Governments.

### (a) Policy Advice

Policy questions relating to the content of the rules and legislated exemptions are currently a matter for the Commonwealth Parliament; regulated exemptions and appointments to the TPC are a matter for the Commonwealth Government; and the relevant Commonwealth Minister has some discretions over enforcement actions and the giving of directions to the Commission. Legislative changes are typically the subject of wide community consultation.

As discussed in Section B, the Committee considers that cooperation by the States in ensuring a fuller application of the conduct rules would make it appropriate to provide them with a greater role in these processes. Beyond that, however, the Committee does not see any need to revise current arrangements.

### (b) Administration of the Rules

Administrative functions relating to the rules are currently entrusted to the TPC, an independent body. It is responsible for enforcing the rules and, subject to appeals to the TPT, administering the authorisation process. It also has more general functions in relation to public education on competition matters, has undertaken some reviews of regulatory restrictions on competition, notably in relation to the professions, and administers some other Parts of the Act.

The Committee found broad support for the current institutional arrangements for administering the general conduct rules, in particular for the rules being administered by a single, economy-wide

body.<sup>7</sup> Apart from reduced administrative costs, this approach promotes consistency in application between different industries and regions and overcomes concerns over particular interests “capturing” this regulatory process.

One profession argued that its registration bodies should deal with any alleged contraventions of the rules by its members.<sup>8</sup> However, the Committee agrees with the observation of the Swanson Committee that “no section of the community is entitled to be the judge in its own cause”.<sup>9</sup> In this respect, the Committee is satisfied that an authorisation process of the kind currently administered by the TPC provides ample opportunity for interested persons, including representative bodies, to present relevant material. Where conduct is not authorised, alleged non-compliance with the rules is a serious matter and should be subject to adjudication before the courts in the usual way.

There were also suggestions that experts from particular industries might be appointed to the competition authority, possibly as Associate Commissioners, to assist in considering authorisation matters relevant to those industries.<sup>10</sup> The Committee is not persuaded that any particular sector raises issues of the kind that could not be dealt with through existing processes. It is also mindful that special treatment for one sector could create pressure for many sectors to insist on similar treatment, with moves in this direction having the potential to erode the independence and the economy-wide perspective of the Commission. Nevertheless, the Committee does not rule out the appointment of persons with particular industry knowledge where such an appointment is appropriate.

As discussed in Part B, the Committee considers that cooperation by State and Territory Governments in extending the operation of the rules would make it appropriate for them to be consulted on appointments to the Commission. The Committee is firmly of the view, however, that the rules should continue to be administered

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<sup>7</sup> Eg, VLRC (Sub 2); IC (Sub 6); Trade Practices Committee of the LCA (Sub 65); TPC (Sub 69); Treasury (Sub 76); BCA (Sub 93); PSA (Sub 97); Australian Consumers' Assn (Sub 131); BHP (Sub 133).

<sup>8</sup> AMA (Sub 20).

<sup>9</sup> Trade Practices Act Review Committee, *Report to the Minister for Business and Consumer Affairs* (1976) at 88.

<sup>10</sup> NFF (Sub 90).

through a single, national body, rather than through separate agencies in each State or Territory. A fragmented regime of that kind would introduce risks of inconsistent approaches between jurisdictions and arid jurisdictional disputes and be far less "national" than the current regime.

## Conclusions

The Committee considers that the current institutional arrangements relating to the general conduct rules are operating satisfactorily and are appropriate for the competitive conduct rules of a national competition policy. Opportunities to increase the involvement of the States and Territories in some decision-making processes can be accommodated without modifying the existing institutional structure.

The Committee proposes that the TPC be renamed the Australian Competition Competition. As discussed below, it is also proposed that the Commission assume some new responsibilities under the additional policy elements.

## 2. Additional Policy Elements

The Committee has recommended that a national competition policy should include additional elements to deal with the reform of regulatory restrictions on competition; the structural reform of public monopolies; the guarantee of access to certain essential facilities; the oversight of certain pricing behaviour; and questions of competitive neutrality.

These policy elements differ from the competitive conduct rules in significant ways. While prohibitions on market conduct can be defined with some precision, and then administered through administrative bodies or the courts, the additional elements typically involve more difficult policy assessments. The application of relevant measures may also have more significant impacts for particular businesses and industries and will typically raise more important transitional issues. In a number of areas there are also important State and Territory interests involved. The key institutional tasks under these policy elements were shaped accordingly.

**(a) Policy Analysis & Advice**

In broad terms, the Committee's recommendations in relation to the additional policy elements follow one of three models.

First, in relation to matters of regulatory review, structural reform of public monopolies, competitive neutrality and many issues associated with monopoly pricing by government businesses, the Committee has recommended cooperative and decentralised approaches. Governments would agree on core principles and work together in progressing particular reforms, but leave final decisions on matters such as the modification of a restrictive law with the government in question. To facilitate this process the Committee sees substantial benefits in creating an institutional mechanism that would facilitate the policy dialogue through independent analysis and advice and provide a vehicle for coordinating or undertaking certain cooperative projects.

The second main model relates to the two areas where it was considered the Commonwealth should be in a position to act unilaterally if required: the creation of certain access regimes with a clear national dimension and the application of the national prices oversight mechanism. Both measures are more selective in their application and potentially more intrusive than the general conduct rules, and were found to require special safeguards to provide owners of the assets in question with confidence that the exercise of the power in a particular case is justified. The independent advisory function takes on a new significance in these circumstances, for the Committee has recommended that the Commonwealth Minister not be able to act under these powers without the affirmative recommendation of the advisory body.

The third model is a hybrid of the first two, and applies only where a government is proposing to privatise a substantial public monopoly without appropriate restructuring. In this narrow and exceptional circumstance, the Committee saw the need for a mechanism to provide independent analysis and advice that could be triggered, if need be, without the consent of the privatising government. Unlike the access regime, however, there would be no legal provision permitting the Commonwealth to act unilaterally on the recommendation of that body; the next steps would be a matter for

consideration by governments, although the possibility of the Commonwealth passing a specific law is not ruled out.

There is no existing institution currently performing these roles and, in the Committee's view, the tasks are sufficiently important to warrant the establishment of a new institution, the NCC.

The Council would have six key characteristics:

- its functions would be **purely advisory**: action on the Council's recommendations would be a matter for relevant governments; it would not perform any administrative functions.
- it would be **independent of any government**: this is particularly important when, as in the case of the proposed access and prices oversight regime, its recommendations would be an essential prerequisite to unilateral Commonwealth action.
- it would take an **integrated, economy-wide view** of competition policy matters: in the public monopoly area, for example, each of the five policy elements may be relevant to a single set of pro-competitive reforms. Industry-specific expertise could be drawn on when required.
- it would be directed to take a **pragmatic, business-like approach**: focussing on facilitating practical reforms in the nearer term, rather than solely on longer term or more broad brush prescriptions. It would have a specific mandate to consider transitional issues arising from its recommendations.
- it would operate through **open processes**: allowing all affected interests to present their views.
- it would **not duplicate the skills or resources of other agencies**: rather it would draw on them for expert analytical work.

It is envisaged the Council would comprise a full-time chairperson and up to four other members (some of whom may be part-time) who would be selected for their knowledge of, or experience in, industry, commerce, economics, law or administration. Appointing members of high calibre and independence would clearly be the top priority.

The Council would be supported by a Secretariat of around twenty people, and would contract out analytical work to other agencies where appropriate. For example, the Industry Commission (IC) might be engaged to undertake analytical work on some structural reform issues while the Australian Bureau of Agricultural and Resource Economics might be best placed to provide specialist assistance on regulatory reform in the agricultural sector. State and Territory agencies could also be drawn upon when appropriate, as could private organisations or consultants. The Council's work program would be determined by references from governments.

The NCC would be expected to accelerate current pro-competitive reform efforts in a range of key markets. This will be an intensive task over the medium term, but once the major reforms are underway the need for the NCC should be re-assessed. Accordingly, the Committee recommends that a five year sunset period be placed on the NCC, with a review of its functions and operations to be undertaken during this time.

In developing this proposal, the Committee acknowledges the contributions to competition policy development by existing bodies. The Industry Commission has undertaken important work in sectors such as electricity, gas, rail, water, statutory marketing arrangements, ports and postal services; the TPC has undertaken useful work on the professions; and the PSA has also done important work in a number of areas. Cooperation between Governments has also occurred on a sector-specific basis in areas such as rail, gas and electricity, with endeavours in the electricity sector supported by the National Grid Management Council (NGMC). There has also been important work by a range of other agencies at the Commonwealth, State and Territory level.

While this work has been important, the Committee considers that a new institutional body is required to advance competition policy reform at the national level. Importantly, the Committee considers that the need for Australia to pursue reforms on a broad front indicates that an economy-wide advisory body is required. Such a body would facilitate pooling of expertise, and its broad responsibilities would promote national needs rather than those of industry-specific groups. Where appropriate, the body could appoint technical experts from particular industries, and commission work from outside parties.



The Committee also considers that a single body should advise on all aspects of the additional policy elements, thereby gaining the benefits of an integrated approach to these issues, many of which may be present simultaneously. For example, a single industry (such as electricity) may present issues relating to regulatory restrictions on competition, restructuring of public monopolies, access to essential facilities, monopoly pricing and competitive neutrality. There are obvious benefits from a single body coordinating reform efforts across this spectrum of issues. The capacity of the NCC to contract out work to government and private organisations should address concerns over duplication of resources and ensure that existing expertise can be drawn upon.

It is also important to stress that the Committee's recommendations relate to competition policy issues; it has not addressed questions of, say, technical or safety regulation, which could be dealt with in a variety of ways consistent with the Committee's recommendations.

The role of the NCC can be illustrated in relation to each of the five additional policy elements.

- *Reform of Regulatory Restrictions on Competition*

The Committee has recommended that governments adopt a set of principles aimed at improving the scrutiny of regulations that restrict competition, but leaving the decision on whether or not to repeal or modify particular regulations to individual governments. The primary role for the NCC in this area is to provide independent and expert advice on further refinement of these principles, and to undertake or coordinate reviews of regulatory restrictions common to more than one jurisdiction.

- *Structural Reform of Public Monopolies*

The Committee has recommended that governments adopt a set of principles aimed at ensuring public monopolies are appropriately restructured as part of other pro-competitive reforms. While the monopoly in question remains in public hands, the decisions in this area are left to owning governments. The primary role for the NCC in this case is to provide an independent and expert source of advice

on further elaboration of these principles, and to undertake or coordinate inquiries by reference from individual Governments.

If a public monopoly is being transferred to private ownership, the Committee has recommended that a mechanism be established to allow any government to trigger an independent review of any competition issues arising from the structure of the privatised monopoly. The inquiry would be completed before privatisation, or if insufficient notice of the privatisation had been given, within a reasonable period after privatisation. The NCC would be the appropriate body to undertake such reviews. Inquiries of this kind may be of some sensitivity to the privatising and other governments, reinforcing the importance of ensuring that the NCC enjoys the confidence of all Governments as well as the wider community. Decisions on what action should follow from the report of this body would be for relevant governments.

- *Access to Essential Facilities*

The Committee has recommended that a special access regime be established which, in appropriate circumstances, could be applied to assets irrespective of their ownership. Access regimes have the potential to intrude into the prerogatives of owners and must be subject to safeguards to ensure that application in any particular case is clearly justified in the public interest. Ultimately, decisions of this kind should be made by an elected Minister, rather than an independent body. However, as an additional safeguard on the exercise of this power, the Committee has proposed that the Minister not be able to apply the regime to a particular asset without the consent of the owner unless application was recommended by the NCC after a public inquiry.

- *Prices Oversight Mechanism*

The Committee's proposals in the prices oversight area reflect two main concerns. First, the Committee considers that the national prices oversight mechanism needs to be applied sparingly, and only when other pro-competitive reforms are not practicable or sufficient. The ultimate decision to apply the mechanism should rest with a Commonwealth Minister. As with the access regime, however, the Committee considers that the Minister's discretion should be conditioned by express criteria and the requirement for an affirmative

recommendation by the NCC. The emphasis on other pro-competitive reforms would be reinforced by the NCC also being responsible for advising on the other additional elements of the national policy.

The second concern is to preserve, to the extent consistent with the national interest, the autonomy of State and Territory governments on pricing issues relevant to their businesses and to encourage cooperative approaches in this area. The NCC would be well-placed to facilitate cooperative reforms of this nature. In the one limited circumstance when the Committee considers it may be appropriate for the Commonwealth to apply the national prices oversight mechanism to a State or Territory business without the owning government's consent, this again would be conditional on a positive recommendation being made by the NCC.

- *Competitive Neutrality*

The Committee has recommended that governments adopt a set of principles aimed at addressing competitive neutrality concerns when government businesses compete with private businesses. Implementation of the reforms to comply with these principles is left to individual governments. The primary role for the NCC in this area is to provide independent and expert advice on the development and further elaboration of these principles.

The key functions of the council are summarised in Box 14.1.

**Box 14.1: National Competition Council — Key Functions**

- **Regulatory Restrictions on Competition**
  - Provide advice to Governments on the development and implementation of agreed principles governing the review of regulatory restrictions;
  - At the request of Governments, undertake or coordinate economy-wide reviews of particular regulatory restrictions.
- **Structural Reform of Public Monopolies**
  - Provide advice to Governments on the development and implementation of agreed principles governing the structural reform of public monopolies;
  - At the request of Governments, undertake economy-wide reviews of structural reform issues associated with enhancing competition in the public monopoly sector;
  - At the request of any Government, investigate proposed privatisations that may involve the transfer of a significant public monopoly to the private sector.
- **Declarations of Access Rights**
  - Provide advice to the Commonwealth Minister on whether a legislated right of access should be created in particular circumstances, and if so what pricing principles and other terms and conditions should apply.
- **Pricing Matters**
  - Provide support for the development of agreed pricing approaches for public monopolies;
  - Provide advice to the Commonwealth Minister on whether a particular firm or market should be subject to the national prices oversight mechanism.
- **Competitive Neutrality**
  - Provide advice to Governments on the development and implementation of agreed principles governing competitive neutrality issues.
- **Transitional**
  - Provide advice to Governments on issues associated with transition towards a more competitive environment for public monopolies and regulated industries.
- **Other Matters**
  - At the request of Governments, provide advice on the development and implementation of the national competition policy.

## (b) Administrative Tasks

The administrative tasks arising under the proposed additional policy elements are relatively modest and often left to arrangements within individual governments. This is particularly so in respect of matters where the proposed policy element involves adoption of principles. There are potentially more significant administrative tasks associated with the access regime and the national prices oversight mechanism, although the content of these policy elements has been designed to avoid substantial regulatory intervention. There are also some supporting roles in relation to other policy elements.

- *Access Regime*

The Committee considered two main issues: whether the proposed access regime should be administered by an economy-wide or industry-specific regulator; and whether this function should be integrated with other competition matters.

### Industry-Specific vs Economy-Wide Administration

At present, access issues relating to the telecommunications network are administered by an industry-specific regulator, the Australian Telecommunications Authority (AUSTEL), although these arrangements are scheduled to be reviewed before 1997. So far, arrangements for the inter-state transmission of electricity have been progressed on an industry-specific basis, although no final decisions have been made concerning administrative arrangements for access issues. There are also a number of other network industries, such as gas, rail and postal services, where similar issues may arise in the near future.

Overseas experience illustrates both ends of the industry-specific/economy-wide spectrum. In the United Kingdom, separate industry-specific regulators have been established for sectors including electricity, gas, water and telecommunications.<sup>11</sup> In New Zealand, the introduction of competition into the telecommunications market has relied on application of the general conduct rules

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<sup>11</sup> For a critical review see Veljanovski C, *The Future Of Industry Regulation in the UK* (1993).

administered by the general competition body.<sup>12</sup> Both models have their strengths and weaknesses.

Proponents of industry-specific arrangements argue that they are necessary to “nurture” competition in newly competitive markets. There may be concerns that technical issues associated with access are beyond the capacity of generalist bodies, and that a general body may be less well-placed to guard fledgling competitors against the substantial market power of incumbents. Submissions favouring industry-specific regulatory arrangements came from some interests associated with the telecommunications<sup>13</sup> and electricity<sup>14</sup> industries. The difficulties experienced under the general arrangements governing telecommunications in New Zealand were often cited in support of this position.<sup>15</sup>

Proponents of more general models argued that industry-specific bodies are more prone to “capture” by the industries they regulate;<sup>16</sup> that they risk inconsistent and potentially inequitable treatment between industries; that they create possible problems of “regulatory overlap”; and that there are unnecessary administrative costs in maintaining numerous industry-specific regulators.<sup>17</sup> There is also concern that industry-specific regulators established as a transitional measure face incentives to prolong their existence beyond that which is justified in the public interest.<sup>18</sup>

A number of submissions distinguished between technical regulation — which might be administered on an industry-specific basis — and

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12 For a critical review see NZ Commerce Commission, *Telecommunications Industry Inquiry Report* (1992).

13 AUSTEL (Sub 41); Optus Communications Pty Ltd (Sub 87); ATUG (Sub 111); Communications Law Centre (Sub 116).

14 ESAA (Sub 89); SECV (Sub 92).

15 Eg, Mr B Akhurst (Sub 94).

16 The “capture theory” of regulation predicts that regulatory agencies gradually adopt a posture of serving and defending the regulated group, rather than the public interest. See Berry WD, “An Alternative to the Capture Theory of Regulation: The Case of State Public Utility Commissions”, *American Journal of Political Science* 28 (1984) 524-558; and Wenders, J “Commentary” in Nowotny K, Smith B & Trebing H M, *Public Utility Regulation*, (1989) at 78-83. This argument was advanced by: Dr R Albon (Sub 8); Dept of Finance (Sub 61); TPC (Sub 69); Treasury (Sub 76); PSA (Sub 97); Qld Govt (Sub 104); Mr H Ergas (Sub 129).

17 TPC (Sub 69) at 16-17.

18 This concern was raised during a number of meetings with the Committee and by the TPC (Sub 69) and Mr H Ergas (Sub 129).

economic or competition regulation — which should or need not.<sup>19</sup> Others suggested that industry-specific approaches may be appropriate as a transitional measure only.<sup>20</sup>

In assessing these arguments, the Committee started from the proposition that competition policy across all Australian industries should desirably be administered by a single body. In particular, the Committee considers that there are sufficient common features between access issues in the key network industries to administer them through a common body. As well as the administrative savings involved, there are undoubted advantages in ensuring regulators take an economy-wide perspective and have sufficient distance from particular industries to form objective views on often difficult issues.

While every industry involves its own set of unique technical or other issues, the Committee is not persuaded that these cannot be taken into account by an economy-wide body. The Committee's proposed access framework provides the flexibility to adapt to the requirements of individual industries. Technical issues that do not have a significant competition element can be addressed in a number of ways consistent with the Committee's recommendations, including industry-specific regulation and industry codes, with or without industry-specific technical regulators. In the Committee's view, no case has been made to establish industry-specific bodies to administer the access and related arrangements of its proposed policy.

While there are undoubtedly important technical issues associated with introducing competition into infrastructure areas traditionally dominated by public monopolies, many of the key technical issues bearing on access arrangements would be considered by the NCC in framing recommendations on the terms and conditions of access. The NCC will rely on a public inquiry and will have access to whatever industry-specific expertise is required. Thereafter, issues associated with enforcement of the access declaration can be resolved through binding arbitration under the auspices of the competition regulator, which can include the appointment of industry experts if required.

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<sup>19</sup> AOTC (Sub 44); DOTAC (Sub 58); Optus Communications (Sub 87); ESAA (Sub 89); PSA (Sub 97); Communications Law Centre (Sub 116).

<sup>20</sup> Eg. AUSTEL (Sub 41); AOTC (Sub 44); DPIE (Sub 50).

As emphasised in Chapter 11, the Committee does not envisage access issues in most infrastructure industries raising the types of concerns that would warrant imposition of additional pro-competitive safeguards such as those currently in place in the telecommunications sector. However, where safeguards are declared as part of an access declaration, the Committee is confident that a general regulator would be able to develop and apply the necessary expertise.

The Committee is less impressed by arguments that industry-specific bodies inevitably lead to "regulatory capture". While this risk is greater with industry-specific bodies, recent empirical work shows that the capture theory is over-simplistic and overlooks, inter alia, the goals and incentives of regulatory personnel and the resources available to the regulator.<sup>21</sup> Recent experience in the UK appears to confirm this more sceptical view.<sup>22</sup> Nevertheless, risks in this area are reduced by reliance on a more general body.

The Committee also considers that the establishment of a range of industry-specific bodies would fragment Australian expertise and experience in this area, and represent lost opportunities to ensure that lessons learned in introducing competition in one industry were applied in other sectors.

#### Integration with Other Competition Matters

The Committee considered there would be considerable advantages in locating administration of the general access regime with the broader competition responsibilities of the Australian Competition Commission. Under the Committee's proposed access model, there will usually be limited need for intensive regulatory intervention, and a separate access agency may not be viable unless or until a relatively large number of access declarations were in force. Integration of these functions should foster a "pro-competition" culture among administrators, may assist in coordinating regulatory activity in

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<sup>21</sup> See for example, Quirk P J, *Industry Influence in Federal Regulatory Agencies* (Princeton 1981); Berry W D, "An Alternative to the Capture Theory of Regulation: The Case of State Public Utility Commissions", *American Journal of Political Science* 28 (1984) 524-558. See also Wilson J Q, *Bureaucracy: What Government Agencies Do and Why They Do It* (1989).

<sup>22</sup> One observer of the industry-specific regulators in the UK has pointed to the adversarial nature of many of the relationships between regulators and their charges, and the influence of the personal styles of heads of the regulatory agencies: see Veljanovski C, *The Future of Industry Regulation in the UK* (1993).



relation to particular industries and may also present administrative savings.

The Committee therefore recommends that the access regime of a national competition policy be administered by the Australian Competition Commission.

- *National Prices Oversight Mechanism*

As with access, the Committee considered two main issues: whether the proposed prices oversight mechanism should be administered by an economy-wide or industry-specific regulator; and whether this function should be integrated with other competition matters.

#### Industry-Specific vs Economy-Wide Administration

The Commonwealth PSA oversees pricing decisions in relation to prescribed private firms and Commonwealth businesses. Pricing of State government businesses is performed by a general price regulator in New South Wales and on a sector-by-sector basis in other States and Territories.

The PSA has an economy-wide, rather than industry-specific, focus, although State- and Territory-owned businesses are specifically excluded. In conjunction with the industry-specific access arrangements, telecommunications prices are overseen by Austel.

Although the Committee envisages a reduced role for pricing oversight across the economy, it considers that where any national measures are applied they are most likely to maintain their broad focus if administered by an economy-wide rather than industry-specific body. This proposition was not challenged in submissions.

#### Integration with Other Competition Matters

The Committee's proposals for a national prices oversight mechanism brings it more closely into line with competition concerns, rather than wider social or political goals. In principle, amalgamating this function with the administration of the general conduct rules of a national competition policy would reinforce this

orientation. Several submissions supported the amalgamation of the two functions into a single competition body.<sup>23</sup>

The PSA and two other submitters expressed concerns over such a merger, noting that information obtained through the prices surveillance function should not be able to be used as a basis for prosecutions under the competitive conduct rules.<sup>24</sup> The Committee is not satisfied that these concerns constitute an insuperable obstacle. It has been observed that the type of information gathered through a prices oversight function is different in kind to that obtained for the purposes of trade practices litigation, and therefore there will usually be little practical overlap, particularly if the prices oversight function is carefully targeted to markets where the conditions for effective competition do not exist.<sup>25</sup> It has also been argued that information which relates to a breach of the general conduct rules should be used to enforce the law, whichever power it is obtained under.<sup>26</sup> If there were a desire to limit the use of information between the two functions, appropriate safeguards could be implemented through legislation governing the combined body's information gathering powers and/or through internal organisational arrangements.

Accordingly, the Committee proposes that the national prices oversight function be administered by the Australian Competition Commission.

- *Regulatory Restrictions on Competition, Competitive Neutrality & Structural Reform of Public Monopolies*

The remaining policy elements do not involve significant new administrative responsibilities, and are considered below.

### Regulatory Restrictions on Competition

Scrutiny of new regulatory proposals would be left to individual governments — existing regulation review bodies in each jurisdiction may be well-placed to fulfil this function. The more systematic and rigorous review of existing regulatory restrictions on competition, including through use of public inquiries, may be conducted in a

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<sup>23</sup> Eg, TPC (Sub 69); BCA (Sub 93); ACTU (Sub 113).

<sup>24</sup> Trade Practices Committee of the LCA (Sub 65); PSA (Sub 97); BHP Ltd (Sub 133).

<sup>25</sup> TPC (Sub 69).

<sup>26</sup> TPC (Sub 69).

number of ways. Individual governments may pursue their own programs or, particularly when a regulatory issue is common to more than one jurisdiction, references may be given to the NCC to undertake or coordinate economy-wide reviews.

At present, a number of Commonwealth agencies also undertake reviews of regulatory restrictions on competition, including the TPC, the PSA and the IC. The Committee favours more rather than less activity of this kind, and thus recommends that the successor to the TPC and the PSA — the ACC — continue to play a role in this area as a complement to its wider responsibilities in the competition policy area. Relevant agencies could agree on a work program to avoid possible duplication, with the NCC well placed to provide coordination.

### **Competitive Neutrality**

The implementation of the proposed principles would be left largely to individual governments, with the NCC supporting policy development in this area. There are no administrative functions as such. Nevertheless, submissions to the Inquiry suggest a need for a more effective mechanism for responding to alleged non-compliance by government businesses' with any existing or new norms. The Committee proposes that this issue be addressed by the ACC being tasked with reporting on allegations of non-compliance with agreed principles to owning governments and the NCC. The envisaged role is one of receiving complaints and initiating preliminary investigations rather than a more pro-active enforcement function.

### **Structural Reform of Public Monopolies**

There are no administrative functions arising from the Committee's recommendations in this area.

### **Conclusions**

The Committee concludes that, in addition to its administrative role in relation to the general conduct rules, the ACC should be tasked with administering relevant aspects of the additional policy elements. Its combined functions are summarised in Box 14.2.

The ACC would be based on the TPC with functions drawn from the PSA.

Appeals on authorisations would be heard by the TPT, which could be re-named the "Australian Competition Tribunal".

**Box 14.2: Australian Competition Commission — Key Functions**

- **Competitive Conduct Rules**
  - Enforce and monitor compliance with the conduct rules;
  - Administer the authorisation process;
  - Monitor and report annually on legislated and regulatory exemptions.
- **Regulation Review**
  - Undertake reviews of regulatory restrictions on competition.
- **Access Regime**
  - Oversee the general administration of the national access regime;
  - Provide arbitration facilities to parties subject to an access declaration;
  - Oversee the implementation of any pro-competitive safeguards.
- **Prices Oversight**
  - Administer the prices oversight function of the national policy.
- **Competitive Neutrality**
  - Report on allegations of non-compliance with agreed principles to owning government and the NCC.
- **Public Education**
  - Provide public education on the conduct rules and the role of competition in the community.
- **Other**
  - Administer other specified Parts of the Act.

## **B. ROLES OF GOVERNMENTS**

This Section examines the roles of the Commonwealth, State and Territory Governments in the proposed institutional arrangements of a national competition policy.

The Committee's proposals support cooperative models where appropriate, particularly where government interests are directly affected. However, this view must be tempered by the need to provide streamlined decision-making processes where important national interests are at stake, and by the importance of ensuring competition regulators operate independently to the extent appropriate.

The Committee was also influenced by the extent to which the various parts of its proposed policy would affect the prerogatives of individual governments. While the general conduct rules would have negligible impact on those prerogatives, the impact of the additional policy elements may in some cases be more significant. The consideration that substantially all of the Committee's proposals could be implemented unilaterally by the Commonwealth was also a factor, although the Committee has looked beyond questions of constitutional law to take account of comity considerations in a federal system.

The roles for the various levels of Government can be considered in relation to the ACC and the NCC.

### **1. Australian Competition Commission**

The Committee proposes that the ACC would administer both the general conduct rules and parts of the additional policy elements. These are considered in turn in relation to the roles of the Commonwealth, State and Territory Governments.

#### **(a) General Conduct Rules**

At present, matters relating to the TPA are within the Commonwealth's exclusive domain. In considering the extent to which the States and Territories might play a formal role in the ACC, the Committee was mindful that the rules already cover most of the economy, and that their application could be extended further — including to most State and Territory businesses — by amendments to the Act that would not raise substantial constitutional questions.

The Committee also took account of the consideration that the extended application of the rules would have negligible effect on the prerogatives of State and Territory Governments. In particular, they would not restrict the capacity of Governments to achieve policy objectives (such as creating legislated monopolies or licensing regimes, or conferring special benefits on particular sectors) by legislating for that result directly. Similarly, application to State and Territory government businesses that are not already subject to the rules would not threaten government budgets or prevent the delivery of CSOs. The primary impact of extending the coverage of the rules

would be to prevent currently excluded businesses from engaging in behaviour of the kind few governments would be likely to condone.

The Committee has already argued that it would not be appropriate for the general conduct rules to be administered by separate institutions in each State and Territory. The question remains of the extent to which the States and Territories might participate more fully in the ACC or other aspects of the Act's administration. These questions relate to the content of the Act; the scope of its application; enforcement proceedings; and other matters.

- *Content*

At present, the Commonwealth Parliament is the sole decision-making body responsible for determining the content of the rules. Amendments to the legislation typically follow a period of wide community consultation, with opportunities for State and Territory Governments to present their views.

The Committee considers that the interests of State and Territory Governments do not require substantial additional protection in this regard. The currently excluded sectors would comprise only a relatively small part of the Act's jurisdiction, and extension of the Act to those sectors would have a negligible impact on the prerogatives of State and Territory Governments. These considerations, and the need to ensure economic legislation can be amended quickly if required, led the Committee to conclude that it was neither necessary nor desirable for all governments to have a veto over proposed amendments to the rules. Nevertheless, the Commonwealth should ensure the State and Territory Governments are consulted and given adequate opportunity to comment on any proposed amendments. Where particular proposed amendments are considered to be of special significance to the States and Territories, Governments might wish to seek the views of the NCC, although this need not be an inflexible requirement.

- *Scope of Application*

The primary source of exemptions from the rules would be authorisation by the ACC. As the currently excluded sectors would comprise a relatively small proportion of the ACC's jurisdiction, the Committee is not persuaded that State and Territory Governments

should have a veto over appointments to the ACC. Nevertheless, the Commonwealth should consult State and Territory Governments on proposed appointments.

Under the current regime, States and Territories can specifically authorise or approve conduct otherwise in breach of the Act, subject to the Commonwealth's capacity to over-ride particular exemptions. The Committee proposes removing this basis for exemption from the Act. As discussed in Chapter Five, the significance of this provision was found to be widely over-estimated, and State and Territory Governments would retain the capacity to achieve similar results without a provision of this kind.

As the Commonwealth Parliament cannot, under the principle of sovereignty of Parliament, bind itself, the Committee decided in the interests of transparency that the Act continue to allow the Commonwealth to specifically authorise or approve conduct under other Commonwealth laws, albeit subject to more rigorous requirements than at present. The Commonwealth would also retain a power to make exemptions by regulation, although these would be intended primarily as an emergency measure and be limited in duration.

The Commonwealth should consult State and Territory Governments on proposed actions under these powers that would have a significant impact on State or Territory Governments or their businesses. The Commonwealth should also respond constructively to proposals from State and Territory governments for exemptions of these kinds, providing those exemptions would not have the effect of fragmenting the operation of the rules according to State and Territory borders and are otherwise consistent with the public interest. It may be appropriate for the views of the NCC on particular proposals to be sought on some occasions, although this should not be an inflexible requirement and could be dealt with through an arrangement between the governments.

- *Enforcement*

The general conduct rules would be enforced by the ACC or, in most cases, private action. Possible involvement of the States and Territories in appointments to the ACC was discussed above.

At present the Commonwealth Minister also has a discretion to initiate enforcement proceedings under the Act.<sup>27</sup> The Committee was not persuaded that it would be appropriate to extend this discretion to State and Territory Ministers, or to make the Commonwealth's exercise of its discretion contingent on approval by the State and Territory Governments. Nevertheless, the Commonwealth Minister might give an undertaking not to exercise his or her discretion to initiate enforcement proceedings against a State or Territory government business. The discretion of the ACC should remain unfettered, however, as it is in relation to Commonwealth businesses.

• *Other Matters*

At present, the Commonwealth Minister may direct the competition authority to give special consideration to certain matters in determining applications for authorisations, or in connection with the exercise of certain of its powers.<sup>28</sup> The Commonwealth should consult the States and Territories before issuing such a direction where the interests of the States or Territories are particularly affected.

(b) Administration of Additional Policy Elements

The ACC's principal administrative responsibilities under the additional policy elements relate to the access regime and the national prices oversight mechanism.

The proposed access regime and prices oversight mechanism could only be applied to assets owned by State and Territory Governments in limited circumstances, requiring either their consent or the recommendation of the NCC, in which all governments will participate. Once a declaration under either regime is made, any ongoing administrative involvement will usually not be substantial and would focus on implementation, rather than policy, issues. The Committee has proposed that the Commonwealth consult the States

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<sup>27</sup> Eg, s.77(1) – pecuniary penalties; s.80(1) – injunctions; s.81(1) – divestiture. This discretion has only been used twice: *Fife v Seaman's Union of Australia Ltd & Ors* (1977) ATPR 40-045, 40-049; and *Attorney-General v Davids Holdings Pty Ltd & Ors* (1993) ATPR 41-226.

<sup>28</sup> See s.29(1). Note that the Minister is specifically precluded from directing the Commission how to exercise its powers in an authorisation proceeding in relation to individual cases.



and Territories on appointments to the ACC, and is not persuaded that any greater involvement in the administration of these arrangements is appropriate.

## **2. National Competition Council**

The Committee's proposals in relation to the additional policy elements may impact on a number of sectors of the economy, some of which are of particular importance and interest to governments. The Committee proposes that the NCC provide advice to governments on these matters. As declaration of a business under the access or prices oversight mechanisms requires the recommendation of this body, the independence and expertise of that body is critical to safeguarding legitimate interests, including those of State and Territory governments.

In recognition of these interests, it is vital that Commonwealth, State and Territory governments participate fully in the establishment and oversight of the independent body, including by agreeing on appointments to the body, accountability arrangements and other matters. While the Committee has not made recommendations on the detail of these matters, the success of the proposal clearly depends on full and effective participation by all Australian Governments.

Before arriving at this proposal, the Committee considered a number of alternative means of balancing comity considerations with the need to ensure that reforms that could be demonstrated to be in the national interest could be advanced expeditiously. This was particularly so with respect to the creation of access rights to declared essential facilities.

The Committee considered that the option of allowing the owner of a facility to veto the creation of an access right when a clear national interest had been demonstrated was unacceptable, whether the owners of that facility were private shareholders or the citizens of a particular jurisdiction. Decision-making through a Ministerial Council arrangement was considered but seen as inappropriate for dealing with situations where the facility in question was located in a single jurisdiction; appropriate voting arrangements in this setting would be problematic, and run the risk of inaction. Use of Ministerial Council arrangements would also create a distinction between public and private assets, which is difficult to justify in light of the

increasingly commercial operation of government businesses. Court- or Tribunal-based approaches were also considered but found to be less appropriate for dealing with complex economic issues of this kind, and the Committee saw advantages in ensuring the body involved in access issues was also able to draw on wider competition policy perspectives.

The Committee's preferred decision-making structure is thus to confer the ultimate decision-making authority on whether or not to create an access right on a Commonwealth Minister, but to condition that power on various criteria, including, significantly, the affirmative recommendation by the NCC.

The Committee has recommended that when assets owned by State or Territory governments are involved, primary reliance should be placed on the consent of the owning Government. Informal inter-governmental processes may be best placed to facilitate agreement on these questions, and are not inconsistent with the Committee's proposals. However, processes of this kind, even formalised as a Ministerial Council, would not overcome the need for a mechanism to guide the exercise of the Commonwealth's power where it is sufficiently demonstrated to be in the national interest.

As well as their participation in establishing the NCC, State and Territory Governments should be consulted on legislation required to implement the access regime and prices oversight mechanism and on subsequent amendments to those regimes of potential significance to the States and Territories.

### **C. RECOMMENDATIONS**

The Committee recommends that:

14.1 A National Competition Council be established to advise Australian Governments on:

- (a) regulatory restrictions on competition;
- (b) the restructuring of public monopolies;
- (c) the declaration of access rights to essential facilities;
- (d) pricing matters;
- (e) competitive neutrality matters;
- (f) issues associated with the transition to competitive markets; and

- (g) other matters as directed.
- 14.2 Commonwealth, States and Territories participate fully in the establishment and oversight of the Council, including by agreeing on appointments, accountability arrangements and other matters.
- 14.3 The Council comprise a Chairperson and up to four other members with knowledge of, or experience in, industry, commerce, economics, law or administration.
- 14.4 The Council be established for a period of five years in the first instance, during which time its role, functions and operation be reviewed by the establishing governments.
- 14.5 An **Australian Competition Commission** be established to:
- (a) enforce and monitor compliance with the general conduct rules;
  - (b) administer the authorisation process under those rules;
  - (c) monitor and report on legislated or regulatory exemptions under those rules;
  - (d) undertake reviews of regulatory restrictions on competition;
  - (e) administer the access regime;
  - (f) administer the national prices oversight process;
  - (g) report allegations of non-compliance with agreed competitive neutrality principles to owning governments and the Council;
  - (h) promote public education on the conduct rules and the role of competition in the community; and
  - (i) administer other specified Parts of the Act.
- 14.6 The Commission comprise a Chairperson and such number of other members as are from time to time appointed with knowledge of, or experience in, industry, commerce, economics, law or administration appointed by the Commonwealth Government in consultation with State and Territory Governments.
- 14.7 The Trade Practices Tribunal, which might be re-named the Australian Competition Tribunal, continue to consider appeals on authorisation decisions made by the Commission.

- 14.8 The Commonwealth consult State and Territory Governments on the proposed legislation giving effect to the new competition policy regime, and on any subsequent amendments of potential significance to them.
- 14.9 In relation to the general conduct rules, the Commonwealth should agree to:
- (a) not initiate enforcement proceedings against State or Territory government businesses;
  - (b) consult with the States and Territories on proposed actions relating to legislated or regulatory exemptions to the Act that would have a significant impact on States or Territory Governments or their businesses;
  - (c) respond constructively to proposals from State and Territory Governments for legislated and regulatory exemptions that would not have the effect of fragmenting the operation of the rules according to State and Territory borders and are otherwise consistent with the public interest; and
  - (d) consult the States and Territories before issuing a direction to the ACC where the interests of the States and Territories are particularly affected.

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## 15. Legal, Transitional & Resource Issues

This Chapter examines the legal, transitional and resource issues which need to be addressed in the implementation of the Committee's proposals.

**Section A** considers the constitutional and legal issues associated with implementing a national competition law and policy in a timely and effective manner. It is proposed that the legal regime of a national competition policy be implemented by combined Commonwealth and State legislation. While the Committee understands that the Commonwealth is likely to be able to implement all, or substantially all, of the Committee's proposals by relying more fully on its existing heads of constitutional power, cooperative approaches to implementation are consistent with the broader thrust of the Committee's proposals and would result in a simpler legislative scheme. The Committee therefore favours a cooperative approach to the legal implementation of a national competition policy and recommends that this be achieved through a referral of powers by the States as required.

**Section B** proposes a set of transitional arrangements for the implementation of the Committee's proposals, and distinguishes between the general conduct rules proposed in Part I and the additional policy elements proposed in Part II.

**Section C** considers the possible resource implications of the Committee's recommendations, concluding that they are relatively modest.

**Section D** presents the Committee's recommendations on these issues.

### A. CONSTITUTIONAL & LEGAL ISSUES

Implementing an effective and consistent national competition policy gives rise to a number of constitutional and legal issues which vary between the generally applicable conduct rules proposed in Part I and the additional policy elements proposed in Part II.

## 1. Competitive Conduct Rules

Chapters Five and Six proposed that a number of current exemptions from the generally applicable conduct rules be removed or modified. The Committee considers that the most appropriate method for removing the shield of the Crown exception is unilateral legislative action by the Commonwealth. In extending the rules to cover currently exempt unincorporated businesses, the Committee understands that unilateral action by the Commonwealth is possible, but that a cooperative approach offers the prospect of a simpler legislative scheme.

### (a) Shield of the Crown

Removal of the "shield of the Crown" exemption enjoyed by some government businesses can be achieved by express legislative intention on the part of the Commonwealth. Although this approach is not the only one possible, the Committee considers that it offers the best result in terms of national consistency, ease of implementation and legislative simplicity.

The shield of the Crown doctrine is a presumption that legislation is not intended to bind the Crown.<sup>1</sup> The first step, then, is to determine whether or not this presumption has been rebutted, such as by a clear expression of legislative intent. The relevant statute in this context is the competition statute. The *Trade Practices Act 1974* (TPA) has been interpreted as not being intended to bind the Crown in right of the States<sup>2</sup> or Territories,<sup>3</sup> primarily because the Act states that it is intended to bind the Crown in right of the Commonwealth in so far as it engages in business, but does not refer to the Crown in right of the States and Territories.<sup>4</sup>

Only if the competition statute is found not to bind the Crown is it necessary to consider whether any particular body is entitled to enjoy the Crown's immunity. This may involve a complex investigation of relevant legislation and other matters and has given rise to a great deal

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1 See *Province of Bombay v Municipal Corporation of Bombay* (1947) AC 58.

2 Eg, *Bradken Consolidated Ltd & Anor v Broken Hill Pty Ltd & Ors* (1979) ATPR 40-106.

3 Eg, *Burgundy Royale Investments Pty Ltd v Westpac Banking Corp & Ors* (1988) ATPR 40-835.

4 See s.2A of the TPA.

of uncertainty in recent years.<sup>5</sup> The High Court has also sent a clear signal that it will be less tolerant of the doctrine in contemporary circumstances, stating that:

the historical considerations which give rise to a presumption that the legislature would not have intended that a statute bind the Crown are largely inapplicable to conditions in this country ... where it is common place for governmental, commercial, industrial and developmental instrumentalities and their servants or agents ... to compete and have commercial dealings on the same basis as private enterprise.<sup>6</sup>

There are no constitutional or other constraints on the Commonwealth removing this exception by simply amending s.2A of the TPA to state clearly that it is intended to bind the Crown in right of the States and Territories to the same extent as the Crown in right of the Commonwealth.<sup>7</sup>

An alternative to unilateral Commonwealth legislation would be State or Territory legislation which extends the operation of the competitive conduct rules to State and Territory businesses. However, this involves duplication of legislative activity, could involve an unnecessary delay in implementation or inconsistent approaches between the States and Territories, and is not required by constitutional considerations.

The Committee considers that an amendment of the Commonwealth statute is the simplest and most efficacious way to implement its proposal. It would, of course, be appropriate for the Commonwealth to consult fully with the States over appropriate transitional arrangements, which are considered in Section B of this Chapter.

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<sup>5</sup> Submissions expressing concern at the current uncertainty included those of the ESAA (Sub 89) and ACT Govt (Sub 109).

<sup>6</sup> *Bropho v Western Australia* (1990) 64 ALR 374 at 379.

<sup>7</sup> See *Tasmania v Commonwealth* (1983) 158 CLR 1 and Mr M Corrigan (Sub 72). Although the States may enjoy some implied immunities from Commonwealth law, so that the Commonwealth may not "discriminate against or 'single out' the States so as to impose some special burden or disability upon them ... [or] inhibit or impair the continued existence of the States or their capacity to function" (*Victoria v Australian Building Construction Employees' & Builders Labourers' Federation* (1982) 152 CLR 25 at 93 per Mason J), the Committee has been advised that application of generally applicable competition rules to State commercial activity would not offend this principle. The same issue does not arise in relation to the Territories.

(b) Currently Exempt Unincorporated Businesses

At present some unincorporated businesses escape liability from the TPA, although the Committee considers fewer businesses may be exempt than often believed. In the case of government businesses at the State and Territory level that are not trading or financial corporations for constitutional purposes, this exemption requires attention even if the Shield of the Crown immunity is removed.

• *Possible Options*

There are a number of possible options for extending the rules to cover currently exempt non-incorporated businesses. The Commonwealth could act unilaterally relying on an expanded use of its existing constitutional powers; the Commonwealth could legislate unilaterally but with a reference of powers from the States; the States could enact legislation which applies Commonwealth legislation in their jurisdictions; or the States could enact their own legislation embodying the competitive conduct rules.

Unilateral Commonwealth Action

The current competitive conduct rules do not generally apply to unincorporated businesses unless they are located in a Territory, engage in interstate or overseas trade or commerce, or supply the Commonwealth. The Commonwealth has, however, made greater use of its corporations power in s. 45D of the TPA, which applies to any person who causes substantial loss or damage to the business of a corporation, and s. 50, which applies to any person who acquires shares in a corporation or assets of a corporation.

In considering the options for extending the reach of the competitive conduct rules to unincorporated bodies — whether they be partnerships, sole proprietorships, individuals or statutory authorities and the like — it seems that the Commonwealth has not exhausted the constitutional authority provided by existing heads of power.

In particular, the Commonwealth may be able to rely on the corporations power<sup>8</sup> to apply the competitive conduct rules to the conduct of persons in connection with the supply to, or purchase from, trading or financial corporations, and to the conduct of persons

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<sup>8</sup> Section 51(xx) of the Constitution.



competing with such corporations.<sup>9</sup> Extension of the Act to cover all businesses in their dealings or competition with trading or financial corporations would fill a substantial part of the gap in the TPA's coverage. It would cover the arrangements affecting the business-oriented dealings of professions such as lawyers, accountants and engineers, as well as many government businesses, including those in the energy and transportation sectors.

The trade and commerce power<sup>10</sup> also appears capable of supporting unilateral Commonwealth action to extend the operation of competitive conduct rules, possibly to include the supply of goods or services to persons engaged in interstate or overseas trade and commerce, or even to conduct that has economic effects on interstate and overseas trade. The full extent of the Commonwealth's power over interstate and overseas trade and commerce has not yet been fully explored.<sup>11</sup>

If the Commonwealth were to act unilaterally there might be some residual gaps in coverage. State banking and State insurance enjoy a specific immunity from Commonwealth regulation under the Constitution.<sup>12</sup> Some businesses that supply mainly personal services, such as doctors, dentists and hairdressers, might also escape application unless they were incorporated.

Drafting the competitive conduct rules to apply on the basis of several sources of power could result in some added complexity for

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<sup>9</sup> In *Actors and Announcers Equity Association v Fontana Films Pty Ltd* (1982) 150 CLR 169 the High Court upheld the validity of s.45D(1)(b)(i) of the TPA, establishing that the Commonwealth's power over trading and financial corporations is not limited to laws imposing obligations on such corporations, but also supports laws imposing obligations on others *for the protection of those corporations*.

<sup>10</sup> Section 51(i) of the Constitution.

<sup>11</sup> Many of the earlier cases concerning the definition of interstate trade and commerce have concerned s.92 of the Constitution which provides limits on both Commonwealth and State legislative power. Since the decision in *Cole v Whitfield* (1988) 165 CLR 360, s.92 has been interpreted as directed at discriminatory laws of a protectionist nature. Under this interpretation there is less reason for a restrictive interpretation of interstate trade and commerce. This suggests a more expansive operation for the existing provisions of the Act, as well as any future provisions based on the power. See also Zines L, *The High Court & The Constitution* (3 ed, 1991). Other avenues for extension of the conduct rules would be to use the postal, telephonic, telegraphic and broadcasting powers, as has already occurred in relation to the consumer protection provisions of the Act (see s.6(3) TPA). The Commonwealth might also be able to rely on other powers such as those in relation to the Inter-State Commission (see s.101 of the Constitution).

<sup>12</sup> Section 51(xiii) and s.51(xiv) of the Constitution; *Bourke v State Bank of New South Wales* (1990) 170 CLR 276.

businesses, and a degree of uncertainty unless and until any challenges to the legislation were determined. Against this, substantially uniform coverage would be achieved in the areas of greatest impact on Australia's international competitiveness.

### Referral of Powers

One mechanism for ensuring consistent and simple laws of universal application is a referral of powers by the States to the Commonwealth, under s 51(xxxvii) of the Constitution. Under this approach, States might refer the power to enact laws for the protection of competition. The Commonwealth could then draft legislation which applies to all businesses regardless of ownership or legal form. Such an approach would fill any gaps in the application of Commonwealth law and provide an opportunity to substantially simplify the drafting of the current Act, which is already complex because of its reliance on several heads of constitutional power.

States would carefully define the power which is referred to the Commonwealth, and would retain the power to amend or revoke the referral.<sup>13</sup> Reference legislation which is still in force applies in air transport<sup>14</sup> and in relation to the debt conversion agreement.<sup>15</sup> There is also precedent for the referral of powers over trade practices.<sup>16</sup>

### Application Acts

Another mechanism for ensuring consistent national competitive conduct rules is for the States to pass application Acts, applying the Commonwealth legislation as it is amended from time to time. The Commonwealth law would apply in each jurisdiction as a law of that particular jurisdiction. The Commonwealth could pass legislation based on its plenary powers in respect of Territories.

This model would achieve universal coverage and has recently been used in applying the Corporations Law. However, it would result in a

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<sup>13</sup> If there were any doubt about States' abilities to revoke a referral, the initial referral could be qualified by an express reservation of the power to revoke the referral.

<sup>14</sup> *Commonwealth Powers (Air Transport) Act 1950* (Qld); *Commonwealth Powers (Air Transport) Act 1952* (Tas).

<sup>15</sup> *Debt Conversion Agreement Act 1931 (No. 2)* (Vic); *The Commonwealth Legislative Power Act, 1931* (Qld); *Commonwealth Legislative Power Act, 1931* (SA).

<sup>16</sup> See *Commonwealth Powers (Trade Practices) Act 1966* (Tas).

more complex legislative scheme than under a referral of power, involving the mechanics of applying the legislation in different jurisdictions.

### Mirror Legislation

A fourth option for achieving national competitive conduct rules would be for the States to pass legislation which effectively copied the Commonwealth law. This model was used in the cooperative scheme of companies legislation, and is used in relation to consumer protection. It has the significant disadvantage of requiring all Parliaments to act in concert to keep the application of the legislation current and consistent. Experience suggests that delays or failures to make corresponding amendments are an inevitable feature of such a scheme. The Committee considers that the significant potential for differences in legislation would be an unacceptable source of uncertainty for businesses, and that this approach is an unsatisfactory basis for a national legal regime operating in such an important area.

- *Conclusion*

In considering alternative implementation approaches, the Committee places primary emphasis on the need to achieve wide application with minimal delay and uncertainty. Accordingly, it supports a reference of powers as the simplest, cleanest and most effective means of achieving uniform national coverage. If the States could not agree on this approach the Committee would support State application legislation if it could be achieved without unnecessary delay. If the States were not to pass such legislation within a reasonable period (ie not more than two years), the Committee considers that unilateral Commonwealth action without a reference of powers could be justified in the national interest. Mirror State legislation is an unsatisfactory solution.

- (c) *Current Provision For State or Territory Legislation To Specifically Authorise or Approve Particular Conduct*

In Chapter Five the Committee recommended repeal of the provision of the TPA permitting States or Territories to specifically approve or authorise conduct that would otherwise contravene the Act. The current provision does not reflect any constitutional constraint on the

Commonwealth and should be repealed unilaterally, subject to the transitional arrangements discussed in Section B.

## 2. Additional Policy Elements

In addition to the generally applicable competitive conduct rules, the Committee proposes national laws dealing with an access regime and prices oversight mechanism. The other additional policy elements do not involve the application of a national law and do not give rise to legal or constitutional questions of this kind.

### (a) Access Regime

The access regime proposed in Chapter 11 would provide a right of access to certain declared essential facilities. The Commonwealth appears to have the legislative capacity to create such a right of access unilaterally, without any reference of powers from State Governments. It can clearly do so when the facility is owned by a trading or financial corporation or otherwise has a sufficient nexus with interstate or overseas trade. It also seems likely that the Commonwealth could create such a right in any case where, *inter alia*, a denial of access to the facility would prevent a trading or financial corporation from engaging in competitive activity.<sup>17</sup>

As with the competitive conduct rules, there appear to be no special constitutional impediments associated with creating such a right in respect of facilities owned by a State or Territory Government.<sup>18</sup>

The creation of an access right might constitute an "acquisition of property" in terms of s 51(xxxi) of the Constitution, thus requiring the acquisition to be "on just terms". However, this requirement should be met by the proposed requirement that the owner of the facility receive a fair and reasonable access fee.

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<sup>17</sup> See the discussion of the "protective" jurisdiction of the Commonwealth's corporations power, *supra*, note 9.

<sup>18</sup> As noted above, the Commonwealth can over-ride the shield of the Crown doctrine providing the law is otherwise within power, and the Committee has been advised that the implied immunity enjoyed by the States and mentioned in note 7 (above) would not be an impediment to a generally applicable law.

(b) Prices Oversight Mechanism

There seems to be no question that the Commonwealth could validly apply the Committee's proposed prices surveillance and monitoring mechanism to trading and financial corporations, as well as to unincorporated businesses where there is a sufficient nexus with interstate and overseas trade. It also seems likely that the Commonwealth can apply the mechanism to businesses in any case where it operates to protect trading corporations from monopoly pricing behaviour.

As with the other elements discussed above, there appear to be no special constitutional impediments associated with creating such a right in respect of businesses owned by a State or Territory Government.<sup>19</sup>

(c) Conclusion

Based on advice received by this Inquiry, the Commonwealth appears able to implement both of the Committee's proposed new laws unilaterally, without the need for supporting legislative action by the States and Territories. Any residual uncertainties in this area could be addressed through cooperative action, including a reference of powers from the States.

## **B. TRANSITIONAL ISSUES**

The urgent need to improve the competitiveness of the Australian economy provides a strong case for rapid implementation of the competition policy proposed in this Report. Nevertheless, firms have organised their affairs on the basis of the existing regime, and in some cases transitional arrangements will be justified to facilitate adjustment to the new circumstances.

Firms becoming subject for the first time to general conduct rules of the kind proposed in Part I should have a period of transition to the

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<sup>19</sup> As noted above, the Commonwealth can over-ride the shield of the Crown doctrine providing the law is otherwise within power, and the Committee has been advised that the implied immunity enjoyed by the States and mentioned in note 7 (above) would not be an impediment to a generally applicable law, even if it did impact on profits obtained from monopoly businesses, although application of the proposed surveillance and monitoring mechanism would not directly impact on such profits.

new regime. The Committee sees its proposals for price fixing raising special transitional issues, as they will concern firms and commercial practices which have hitherto been largely exempt from competition law and has taken this into account in formulating its transitional proposals.

The Committee's proposals relating to the additional policy elements in Part II are such that individual businesses will not be affected until case-by-case appraisals of public benefit are made. In these areas, the Committee considers transitional arrangements should be determined in the context of individual cases, guided by advice from the National Competition Council (NCC).

### **1. Competitive Conduct Rules**

The Committee was satisfied that, with some modifications, the rules contained in Part IV of the TPA provide an appropriate basis for the competitive conduct rules of a national competition policy. The need for transitional arrangements arises from the new obligations imposed by the extension of the rules to cover currently exempt businesses or modification of existing rules. A transitional period should provide an opportunity for businesses caught by the modification or extension of the rules to modify their behaviour, or to seek authorisation from the Australian Competition Commission. In some very limited cases, businesses might also require time to seek new legislative arrangements to ensure conduct of that kind no longer offends the competitive conduct rules.

#### **Submissions**

A number of submissions noted the importance of a transitional period to provide time for firms to assess and modify their conduct to comply with the new regime, and for the competition authority to examine requests for authorisations.<sup>20</sup>

The Victorian Law Reform Commission (VLRC)<sup>21</sup> examined the impact of applying the existing rules in Victoria, and proposed that

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<sup>20</sup> Eg, Law Reform Commission of Vic (Sub 2); AMA (Sub 20); AERCF (Sub 49); Fremantle Port Authority (Sub 55); TPC (Sub 69); Treasury (Sub 76); SA Govt (Sub 98); Inst of Chartered Accountants/Aust Socy of CPAs (Sub 99); Vic Govt (Sub 122).

<sup>21</sup> Law Reform Commission of Vic, *Competition Law The Introduction of Restrictive Trade Practices Legislation in Victoria* (1992) at 50.

constitutional limits on the application of competitive conduct rules and most exemptions by State legislation be removed immediately. Three years later, all other activities (ie, activities subject to shield of the Crown and remaining State legislative exemptions) would become subject to the rules. After this time, any further exemptions would be by way of authorisation by the competition authority. The VLRC suggested that the competition authority should provide interim authorisations for any current activities, providing exemption until final determination. The VLRC's proposal was supported by the Treasury.<sup>22</sup>

## Consideration & Conclusions

- *Removal of Particular Exemptions*

The Committee considered a range of possible transitional arrangements, including delayed removal of the exemptions or more immediate removal coupled with some form of special transitional mechanism, including interim authorisations from the competition authority, a notification regime and staged implementations through regulations made under the competition statute. Each has their own set of advantages and disadvantages.

In determining appropriate transitional measures the Committee was mindful that application of the general conduct rules would not have the far reaching consequences suggested by some observers. In the case of government businesses, for example, legislated monopolies and other regulatory arrangements would remain intact, and nothing in the rules would have a significant impact on profitability or the delivery of community service obligations. In the case of statutory marketing arrangements, application of the Act will not of itself remove a range of anti-competitive arrangements implemented through regulation in a way that does not involve conduct in contravention of the Act. Similarly, most professional firms are already fully subject to the Act.

The Committee is concerned to ensure that all currently exempt firms have an opportunity to become familiar with the new regulatory requirements, review their behaviour and if need be seek authorisation from the competition authority, the proposed Australian

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<sup>22</sup> Treasury (Sub 76).

Competition Commission. At the same time, this period should be no longer than necessary, and should not create administrative bottlenecks while authorisation arrangements were being pursued.

Reflecting on these considerations, the Committee proposes various arrangements as follows.

In the case of firms currently exempt through constitutional exemptions or the shield of the Crown doctrine, the Committee considered that the legislation removing these exemptions should be passed as soon as possible, but that it not come into effect until a specified date two years later.

In the case of activities currently exempt by virtue of specific authorisation or approval by other Commonwealth laws, all new exemptions must comply with the new transparency requirements. Existing exemptions that did not meet the new requirements would be deemed to lapse three years after the legislation was passed.

In the case of activities currently exempt by virtue of specific authorisation or approval by State or Territory statutes or regulation, no new exemptions would be permitted. Existing exemptions would be deemed to lapse three years after the legislation was passed.

In the last two cases a slightly longer period is permitted to allow current laws or regulations possibly relevant to these exemptions to be reviewed.

The competition authority might issue guidelines prior to the commencement of the relevant legislation to assist sectors currently excluded from the regime. Those guidelines could indicate the type of conduct which is prohibited, how firms can modify their behaviour to comply with the new legislation, and how firms can seek authorisation for their conduct.

- *Amendments to the Competitive Conduct Rules*

Most of the Committee's proposed amendments are permissive, rather than imposing new obligations, and can be applied without the need for any transitional arrangement. This applies, for example, to the repeal of the specific prohibition on price discrimination, the introduction of authorisation for resale price maintenance, and the



application of a competition test to third-line forcing. Other procedural amendments to the Act, such as the proposed clarification that efficiency considerations are paramount in authorisation proceedings, fall within the same category.

New obligations will, however, be created through the removal of authorisation for price fixing agreements relating to services, the change in the treatment of recommended price agreements with 50 or more parties, and the extension of the exclusive dealing and resale price maintenance provisions to transactions involving services. The last three cases present no particular difficulties as authorisation is proposed to be available in respect of these forms of conduct. The Committee considers that these amendments should commence immediately, noting that under the arrangements set out above, currently exempt firms would not be subject to any of the prohibitions during the applicable transitional period. However, it may be appropriate for the ACC to prepare early guidelines on the authorisation process for parties affected by these changes.

The removal of authorisation in relation to price fixing does, however, raise special issues, since under the proposed rules authorisation will not be available for price-fixing in relation to goods or services. In respect of currently covered firms the Committee sees no reason why further authorisations should be granted. Any existing authorisations applying to price fixing agreements in relation to services should lapse after two years, providing affected firms with a suitable period in which to modify their conduct.

Particular issues are raised in connection with the extension of the rules to currently exempt businesses. The transitional regime set out above in relation to such businesses relies on the availability of authorisation, but some of these businesses may currently engage in some form of price-fixing, and thus be unable to take advantage of the normal transitional processes.

In the interests of achieving a smooth transition, the Committee proposes that the Commission be granted a discretion to issue "transitional" authorisations in relation to price fixing. These authorisations would be issued where the Commission is satisfied that the net public benefit is such that the authorisation should be granted and that authorisation is necessary to achieve a smooth transition to the new regime. As they are provided simply for transitional

purposes, they would only be available to currently exempt firms. There may be some questions over whether particular firms are currently exempt. The legislation should ensure that the Commission's discretion is sufficient to resolve such issues without the need for litigation. These authorisations could be sought at any time from the commencement of the new regime, but all such authorisations would expire, at the latest, four years after the commencement of the new regime.

Transitional authorisations of this kind may be applicable to liner shipping conferences if, following the report of the separate Inquiry, the Government decided to repeal Part X of the TPA and rely instead on the authorisation provisions under the general rules. If some additional period of transition was considered appropriate for this sector, it may be that conference arrangements could qualify under the exemption for joint ventures.<sup>23</sup> If need be, an appropriate amendment could be made to s.45A to specifically permit authorisation for price fixing by conferences.

## **2. Additional Policy Elements**

The additional policy elements proposed in Part II of the Report potentially have more significant implications for businesses and governments. For these reasons, the Committee has proposed that there should be specific transitional arrangements for each policy element.

In the case of regulatory restrictions on competition and the structural reform of monopolies, for example, decisions would be for individual governments.

In the case of legislative rights of access, transitional considerations would be determined as part of the process of determining whether to create a right and if so on what terms and conditions.

Application of the prices oversight mechanism does not require any transitional arrangements; indeed, application of such a mechanism may be part of the transition to a more competitive environment.

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<sup>23</sup> See s.45A(2)(a), discussed in Chapter Three.

The proposed principles on competitive neutrality involve their own transitional requirements, although compliance will be a matter for governments rather than the courts.

In respect of each element, an independent advisory body, the NCC, will be available to guide decision-makers on relevant transitional issues and arrangements.

The Committee is aware of arguments that limitations on State and Territory Governments' revenue sources may impede their capacity to implement pro-competitive reforms. The Committee also heard arguments that any budgetary impacts from the adoption of pro-competitive reforms, where they exist, would largely be confined to transfers between individual governments and their residents, and would not involve more than negligible revenue transfers between different levels of government. Matters of this kind are clearly of some sensitivity in a Federal system.

The Committee notes that implementation of the overwhelming majority of its recommendations would not affect the budgetary positions of Commonwealth, State or Territory Governments. Where there may be some potential implications for government budgets — such as through the application of the access regime to certain government-owned assets — the Committee was not presented with any material that would allow these implications to be quantified. However, it observed that most government businesses are not making even commercial returns, let alone monopoly profits, and that introduction of competition could help to drive out inefficiencies without necessarily reducing the returns to governments. Concern over the budgetary implications of applying particular aspects of the proposed regime could be the subject of independent analysis and advice by the NCC, which would have a specific mandate to consider issues associated with the transition to more competitive arrangements.

### **C. RESOURCE CONSIDERATIONS**

The main resource requirements arising from the Committee's recommendations relate to the creation and maintenance of the NCC. The Committee is concerned that this body be adequately resourced as it will only succeed if able to produce and commission high quality

work. However, the Committee does not envisage the creation of a large institution; the Council would comprise a small secretariat of around 20 people, contracting out much of the analytical work it will require for particular references.

As the Council is to be jointly accountable to the Commonwealth, State and Territory governments, the Committee considers it important that all governments are involved in the oversight of this body and commit resources to it.

The Australian Competition Commission will progressively assume a slightly larger jurisdiction through extended coverage of the general conduct rules, and will also assume some new functions. The resource implications will depend on a variety of factors and can be expected to evolve over time.

Possible requirements for resources additional to those currently allocated to the Trade Practices Commission may relate to:

- **Authorisation applications in those sectors being brought within the general conduct rules for the first time:** Existing exemptions would be removed progressively over a period of years following passage of the new competition law, allowing resource implications to be considered in light of experience;
- **Monitoring and reporting on legislated exemptions under s.51(1)(a) and under the new regulation power:** There are very few such exemptions at present and they will be readily identified under the new transparency requirements. This task should not require significant additional resources;
- **Administration of the access regime:** Any demands on the ACC under this regime will depend on the number of declarations and the administrative requirements arising from individual declarations;
- **Administration of prices oversight mechanism:** The Committee envisages fewer declarations under the new regime than at present. Moreover, the ACC's role in the process would be limited to administration of the regime, and would not extend to the conduct of inquiries relating to actual declarations, which would be the responsibility of the NCC;

- **Reviews of regulatory restrictions on competition:** The ACC's role in this area would be shared with State and Territory bodies and the NCC. Subject to the work program settled in consultation with the NCC, this function may not involve significant resources; and
- **Reporting to governments on allegations of non-compliance with agreed competitive neutrality principles:** This task is not a substantial enforcement function and should not involve significant additional resources.

Resources for meeting the tasks of the ACC and NCC could be drawn from the TPC and the PSA.

#### **D. RECOMMENDATIONS**

The Committee recommends that:

- 15.1 The national competition statute clearly state that it is intended to bind the Crown in the right of the States and Territories to the same extent that it binds the Crown in the right of the Commonwealth.
- 15.2 The exemptions from the general conduct rules for certain non-incorporated businesses be removed by a referral of powers from the States to the Commonwealth. If this could not be agreed, the Committee would favour States enacting application legislation to the same effect. If this were not to occur in a timely manner, the Committee considers that the Commonwealth should expand the application of the conduct rules by reliance on existing constitutional heads of power.
- 15.3 The proposed additional policy elements be implemented through Commonwealth legislation, with a referral of powers from the States if and where needed to ensure universal coverage.
- 15.4 Legislation removing exemptions based on constitutional limitations and Shield of the Crown be passed as soon as possible, but not come into force until two years after passage.

- 15.5 Exemptions currently provided by specific authorisation or approval under Commonwealth laws other than the competition statute be deemed to lapse three years after the new competition law is passed unless they comply with the new transparency requirements.
- 15.6 Exemptions currently provided by specific authorisation or approval by State or Territory statutes or regulation be deemed to lapse three years after the new competition legislation is passed.
- 15.7 Any existing authorisations for price fixing in relation to services should lapse two years after enactment of the new competition law.
- 15.8 The Australian Competition Commission should be given the discretion to authorise price fixing agreements for currently exempt firms, on the demonstration of net public benefits, with any such authorisations lapsing no more than four years after the passage of the new competition law.
- 15.9 Transitional arrangements for the additional policy elements proposed in Part II should be considered on a case-by-case basis under each policy element, with the National Competition Council providing advice to governments on issues associated with the transition to a more competitive environment.
- 15.10 Adequate resources be made available to create and maintain the National Competition Council, and to meet any additional resource requirements of the Australian Competition Commission arising from implementation of the Committee's recommendations.

# **ANNEXES**





# ANNEX A: Terms of Reference

## NATIONAL COMPETITION POLICY REVIEW

1. I, Paul John Keating, Prime Minister of the Commonwealth of Australia, having regard to the agreement between myself and the Premiers of the States of New South Wales, Queensland, South Australia, Tasmania, Victoria and Western Australia and the Chief Ministers of the Australian Capital Territory and the Northern Territory that national competition policy and law should give effect to the following principles:
  - (a) no participant in the market should be able to engage in anti-competitive conduct against the public interest;
  - (b) as far as possible, universal and uniformly applied rules of market conduct should apply to all market participants regardless of the form of business ownership;
  - (c) conduct with anti-competitive potential said to be in the public interest should be assessed by an appropriate transparent assessment process, with provision for review, to demonstrate the nature and incidence of the public costs and benefits claimed;
  - (d) any changes to the coverage or nature of competition policy should be consistent with, and support, the general thrust of reforms:
    - (i) to develop an open, integrated domestic market for goods and services by removing unnecessary barriers to trade and competition; and
    - (ii) in recognition of the increasingly national operation of markets, to reduce complexity and eliminate administrative duplication;

appoint Professor Fred Hilmer to Chair the Committee of Review of the Application of the *Trade Practices Act 1974*, and Mr Geoff Taperell and Mr Mark Rayner as the other two Committee members.

2. The Committee is to inquire into, and advise on appropriate changes to legislation and other measures in relation to:
  - (a) whether the scope of the *Trade Practices Act 1974* should be expanded to deal effectively with anti-competitive conduct of persons or enterprises in areas of business currently outside the scope of the Act;
  - (b) alternative means for addressing market behaviour and structure currently outside the scope of the *Trade Practices Act 1974*; and
  - (c) other matters directly related to the application of the principles above.
  
3. In conducting the review the Committee should consider, against the background of the nature of markets in Australia and influences upon them:
  - (a) whether the authorisation and exemption provisions of the *Trade Practices Act 1974* have sufficient scope, flexibility and transparency;
  - (b) the need for, and approaches to, the transition of government regulatory arrangements — including any associated revenue impact on States — to more competitive and nationally consistent structures;
  - (c) the best structure for regulation including price regulation, in support of:
    - (i) pro-competitive conduct by government business and trading enterprises and in areas currently outside the scope of the *Trade Practices Act 1974*; and
    - (ii) the interests of consumers and users of goods and services; and
  - (d) the past and present justification for the current exemptions from application of the *Trade Practices Act*.

4. In performing its functions, the Committee is to:
- (a) take into account:
    - (i) the principles stated in paragraphs 1(a) to (d) inclusive;
    - (ii) legislation other than the *Trade Practices Act* and other arrangements that affect market behaviour and structure; and
    - (iii) the fact that some government business and trading enterprises may operate in industries having aspects, including pricing, of natural monopoly; and
    - (iv) current moves to reform government trading enterprises; and
    - (v) overseas experience.
  - (b) take written submissions; and
  - (c) consult interested parties where necessary; and
5. The Committee is to report to me by May 1993.<sup>†</sup>

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<sup>†</sup> In May 1993 the Prime Minister announced that the Inquiry would be extended until August 1993 to facilitate further consultations with the States and Territories.



## **ANNEX B: List of Submissions**

- 1 Jatco (Australia) Pty Ltd \*
- 2 Law Reform Commission of Victoria
- 3 Mr A Grieg
- 4 Mr W J Rourke, AO
- 5 Mr P J Boyle
- 6 Industry Commission
- 7 Gas & Fuel Corporation of Victoria
- 8 Dr R Albon
- 9 Mr P R Meatheringham
- 10 Australian Dairy Farmers' Federation
- 11 Dr W Pengilley
- 12 Australian Council of Professions
- 13 Law Institute of Victoria
- 14 Australasian Dental Technicians' Society – South Australian Branch
- 15 Australian Forest Growers
- 16 Mr A I Tonking
- 17 Australian Gas Association
- 18 Professor R Baxt
- 19 NSW Public Service Association – Hospital Scientists Branch

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\* Confidential submission.

*Annex B — List of Submissions*

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- 20 Australian Medical Association
- 21 Esso Australia Ltd
- 22 Australian Institute of Petroleum
- 23 Sydney Public Television Group
- 24 AGL Gas Companies
- 25 ANZ Bank Ltd
- 26 Association of Hospital Pharmacists of Victoria/Medical  
Scientists Association of Victoria/ Victorian Psychologists  
Association
- 27 Caltex Australia Ltd
- 28 Unilever Australia Ltd
- 29 New Zealand Ministry of Commerce
- 30 Shell Australia Ltd
- 31 Australian Federation of Construction Contractors
- 32 Public Broadcasting Association of Australia
- 33 Victorian Bar Council
- 34 Carlton & United Breweries Ltd
- 35 New Zealand Commerce Commission
- 36 Spark & Cannon Pty Ltd
- 37 United Independent Cinemas Ltd
- 38 Professor S Domberger
- 39 Australian Mining Industry Council

\* Confidential submission.

- 40 Australian Information Industry Association
- 41 Australian Telecommunications Authority
- 42 Coopers & Lybrand
- 43 Institute of Patent Attorneys of Australia
- 44 Telstra Corporation Ltd
- 45 Australian United Fresh Fruit & Vegetable Association Ltd
- 46 BP Australia Ltd
- 47 Victorian Gas Users Group
- 48 State Energy Commission of Western Australia
- 49 Australian Earthmovers & Road Contractors Federation
- 50 Department of Primary Industries & Energy (Commonwealth)
- 51 Queensland Sugar Corporation (Confidential material excluded)
- 52 United Dairyfarmers of Victoria
- 53 Australian Dairy Industry Council
- 54 Western Australian Regional Port Authorities/Department of Transport (Western Australia)
- 55 Fremantle Port Authority
- 56 Mr R Sutherland
- 57 Department of Employment, Education & Training (Commonwealth)
- 58 Department of Transport & Communications (Commonwealth)

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\* Confidential submission.

- 59 Metal Trades Industry Association of Australia
- 60 Mr P Argy
- 61 Department of Finance (Commonwealth)
- 62 State Chamber of Commerce & Industry (Queensland)\*
- 63 Sydney Electricity
- 64 Mr S Stern
- 65 Law Council of Australia – Trade Practices Committee
- 66 Australian Legal Reporting Group
- 67 Canegrowers
- 68 Real Estate Institute of Australia
- 69 Trade Practices Commission
- 70 Mackay Sugar Co-op Association Ltd \*
- 71 National Bulk Commodities Group
- 72 Mr M Corrigan
- 73 Australian Chamber of Manufactures
- 74 Australian Road Transport Federation
- 75 A & R Removals
- 76 The Treasury (Commonwealth)
- 77 Australian Industrial Property Organisation
- 78 Qantas Airways Ltd
- 79 Food Industry Council of Australia

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\* Confidential submission.



- 80 Gas Council of New South Wales
- 81 Pioneer International Ltd
- 82 AMP Society
- 83 Department of the Arts & Administrative Services  
(Commonwealth)
- 84 Department of Health, Housing, Local Government &  
Community Services (Commonwealth)
- 85 Hoyts Fox Columbia TriStar Films Pty Ltd
- 86 Dr S Coronos
- 87 Optus Communications
- 88 National Institute of Accountants
- 89 Electricity Supply Association of Australia
- 90 National Farmers' Federation
- 91 Northern Territory Government
- 92 State Electricity Commission of Victoria
- 93 Business Council of Australia
- 94 Mr B Akhurst
- 95 Australian Bureau of Agriculture & Resource Economics
- 96 Australian Federation of Travel Agents
- 97 Prices Surveillance Authority
- 98 South Australian Government
- 99 Institute of Chartered Accounts/Australian Society of Certified  
Practicing Accountants

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\* Confidential submission.

- 100 Australian Chamber of Commerce and Industry
- 101 Department of Industry, Technology & Regional Development  
(Commonwealth)
- 102 Aerial Taxi Cabs Co-operative Society Ltd
- 103 Roadshow Film Distributors Pty Ltd
- 104 Queensland Government
- 105 Canegrowers - Burdekin District
- 106 Standards Australia
- 107 Mr R Copp
- 108 State Public Services Federation
- 109 ACT Government
- 110 Mr V Kelly
- 111 Australian Telecommunications Users Group
- 112 Pacific Dunlop Ltd
- 113 Australian Council of Trade Unions
- 114 Australian Taxi Industry Association
- 115 Tasmanian Government
- 116 Communications Law Centre
- 117 New South Wales Government
- 118 Australian Electrical and Electronic Manufacturers'  
Association Ltd
- 119 Mr C A Sweeney, QC

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\* Confidential submission.

- 120 Matilda Fuel Supplies
- 121 National Registries Pty Ltd
- 122 Victorian Government
- 123 Screen Production Association of Australia
- 124 Superair
- 125 Auscript
- 126 Office of the Economic Planning Advisory Council
- 127 Association of Consulting Engineers Australia
- 128 Australian Petroleum Exploration Association Ltd
- 129 Mr H Ergas
- 130 Australian Petroleum Agents and Distributors Association
- 131 Australian Consumers' Association
- 132 Reserve Bank of Australia
- 133 BHP Limited
- 134 Grains Council of Australia
- 135 Australian Organisation for Quality
- 136 Federal Bureau of Consumer Affairs
- 137 Chiropractors' Association of Australia
- 138 Centre for Plain Legal Language

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\* Confidential submission.



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