

*COMPETITION POLICY
REVIEW*

Spier

Consulting –

Legal

Competition Policy Review Submission

Competition Policy

Competition is a process, not an outcome. It should not be clouded by “economic correctness.” Competition is supposed to “foster” efficiency but does that follow where unfettered markets lead to fewer players in a market and “managed competition” evolves.

Competition policy should be about economic democracy- anyone is able to participate and be free to make their own decisions. Competition at the end of the day is about competitors. It is folly to foster competition without developing processes to ensure that competitors are not restricted in providing competition.

Competition policy is designed to facilitate competitive markets and not to legislate the right to compete.

It is critical that entry is possible (and exit) and participants can expand and not be hindered unnecessarily.

Added to this is an element that is not economic as such but more about fair conduct and that is the concept that **no business has the right to dictate the operations of another business** under any duress or economic power. This is part of a dynamic market and the incentive to compete. This latter point is all the more important now as more and more sellers of goods and service have as their main competitor their suppliers and the latter will have a tendency to interfere. This conduct may not meet the legal test on substantial lessening of competition (SLC) but will inhibit competitive dynamics and incentives.

Competition policy and Competition law

There are often misconceptions between Competition Policy and Competition law.

Competition law directly affects firms rather than industries or the whole economy. That appears often forgotten when talking about competition law, too much is expected of competition law by some commentators.

Freedom from government regulation of industry is often seen to be necessary in the interests of enterprise/innovation and competition. The whole point of that must be that competition is seen as doing the regulating that otherwise governments would do,

However, if competition is to perform that function then it needs to be effective competition.

If companies themselves restrict competition then the industry is regulated not by government regulation but by private regulation. That is where competition law comes in and competition policy that limits the company's ability to regulate.

Competition cannot be the only regulator, both Government and private regulators can be desirable but they need not interfere with competition. Essentially there has to be a foundation or framework provided for competition to work effectively. Yet in competition law restriction on competition must be substantial, in the real world of cut and thrust any restriction on competition may impact on the ability to compete.

Small business is impacted by this framework.

Small business asks if competition is so important why does regulation not impact on any restriction on competition and not only on a substantial lessening in what are often broad markets. Markets that often appear alien to small business. The 1965 Trade Practices Act had a 'restriction on competition' test and then a non-exclusive listing of conduct that may restrict competition.

During the past two decades, the rapid pace of technological change and innovation, coupled with 'globalization' has intensified competition, and new products, services, business organizational forms, industries and markets have been created.

As 'winners and losers' emerge in the market place, there have been calls for government regulation—especially by registering complaints with competition authorities. Assessing competition in dynamic and innovation markets and establishing whether consumers are adversely affected poses risks. Application of conventional investigative techniques to define markets, and gauge 'market power' could result in misinterpreting pro-competition business behaviour as being anticompetitive, and dampen innovation, productivity and economic progress.

Modern competition law and policy aims at protecting and promoting the competitive process and not competitors. Insulating businesses from competitive forces fosters mediocrity, misallocation of society's scarce resources and ultimately contributes to a lower standard of living.

However, promoting the competitive process does entail a need to facilitate competitors to compete. "Competition uber alles" is not a viable option in the competitive process as it will eventually lead to anti-competitive structures.

Regulatory Impediments to Competition.

Ideally there should be no regulatory impediments to competition but that is simplistic.

Removing some so called impediments could add to anti-competitive structures in the long term, for example ,it is easy to advocate the removal of planning restrictions but that may mean that the major players will simply expand, that in itself becomes a foreclosure issue. In the ACT ALDI could only enter the grocery market after the ACT Government intervened to allocate some sites to ALDI.

Having said that, all such regulatory impediments should be subject to a legislative review as was done following the Hilmer Report BUT such reviews should be transparent and should also highlight negative aspects of the removal of such impediments. Especially as the previous compensation regime is unlikely to be repeated, compensation that was normally paid to governments and not to those who were impacted by the changes.

Government provided goods and service and competitive neutrality,

Government's commercial operations should all be reviewed to see what is best for the public. Competitive neutrality needs to be re assessed and another way found to police it. Some private rights of action might act as a way to police competitive neutrality.

Further government agencies should not be exempt from normal commercial law, such as Australia Post being exempt from some aspects of the CCA.

Governments in their acquisition of goods and services should be bound by the same laws as commercial players. The phrase "in the course of business" in Sections 2 (A)-(C) in the CCA should be expanded to cover all commercial dealings by governments at all levels.

Competition law

The existing law (CCA) and its predecessors, has served Australia well but needs some refinement and simplification. Australia has had competition law since 1906 but the current framework became law in 1974. There have been great changes to the Australian and global economy since then and there have been changes to the law to accommodate domestic and global issues.

Nevertheless the current law is far too complex, often said to be due to our Constitution but the system of Schedules, an alphabet soup of sections and complex drafting is confusing. There must be a better way.

Yet we should not be deceived by some overseas examples that look simple but need to be read in conjunction with decades of court decisions, exemptions from the law in other statutes and courts adopting tools such as the rule of reason to get around inflexible legislation. Over simplification may well give regulators and Courts too much discretion.

NZ has a reasonable model. It, of course, is not a federation.

The definition of market- that is a question of fact and not definition. Artificial market definitions have perverse effects. Some consideration of the necessary level of anti-competitive impact on markets may be worthy of consideration. Is SLC the appropriate test?

Misuse of market power- this is a vexed issue. There is a sound argument to change the section to add a **competition** test and an **effects** test and take out the need to prove **taking advantage**.

However, that may have some unfortunate impacts as long as an impact on competitors stays but to take that out will be a wrong signal to small business. Further what of a situation where a business with market power deliberately eliminates small players and particularly new entrants. Each single elimination may not amount to an SLC but, like with creeping acquisitions, there is a longer terms issue.

If the competition test is not SLC but a lower impact threshold this may overcome some of the problems with the current provision.

The Section might read, “A corporation with a substantial degree of market power shall not engage in conduct with the purpose or effect or likely effect of restricting competition in a market in Australia.”

If such a section is adopted it maybe that the conduct should be open to authorisation in what would be limited circumstances and when assessing restrictions on competition a de minimus criteria be factored in to such an assessment.

If section 46 is substantially altered to take out impact on competitors that should not occur until unfair contracts law is introduced.

The “Birdsville” amendment has not really worked. It is suggested that it be altered to take out the need for any below cost pricing to be for a “sustained period” but have a meeting of competition defence. Assuming it is not repealed.

Discriminatory conduct

There are calls to bring back the price discrimination law (section 49). Such calls are understandable as at the time of its repeal the then Government stated that section 46 would cover such conduct. That was a bit of a long bow.

The real issue is that price discrimination was almost impossible to prove and in any cases added to price competition in the market.

I would suggest that consideration be given to a prohibition of “inducing price or other discrimination with the purpose or effect of restricting competition”. Some might argue that section 46 may catch such conduct now but a specific provision might put that beyond doubt.

Unfair contracts and unconscionable conduct- the unconscionable law has been unsuccessful but the current ACCC action against Coles is a welcome development. Unfair contracts, which is the subject of a subsequent discussion paper, is critical to small business but needs to be somewhat different from the consumer version.

I do not propose to comment on unfair contracts law proposals in this submission.

There is a reasonable argument to repeal unconscionable conduct law if unfair contracts law is introduced. Care must be taken to avoid some legislative gap as one talks of conduct, the other of unfair contract terms.

Small business

Many of the comments throughout this submission relate to small business issues. Essentially small business primarily sees obligations imposed on it by the CCA and little rights but this may change with unfair contracts legislation.

A real issue for small business is that conduct that appears to damage an individual business does not substantially lessen competition in a market. A solution would be to take out the word substantial but that may cause unexpected problems.

In my view small business cannot expect much from a competition statute and has to look at issues such as unfair contracts.

Cartels

Generally the law has worked well but the legal processes to enforce the law need to be examined. Further the drafting needs simplification, made all the more complex by the introduction of the criminal cartel provisions.

Some issues now caught by the law may need a block exemption such as collective bargaining by small business, as in most cases there is no SLC but the risk is there.

It is also suggested that collusive tendering and bid rigging be made specific offences and be per se offences.

Price signalling

There are calls to extend the price signalling laws. With the recent actions of airlines and insurance companies calling for the end of price wars, this may be worth considering.

However, in my view the provisions on information sharing should be repealed and left to the general cartel law. This prohibition covers conduct that is normally innocuous and amounts to a form of censorship.

Third line forcing

The constant call for third line forcing to be made subject to a competition test is totally misconceived and knee jerk economic correctness. This approach was tried in 2005 but dropped by the then Government due to strong small business objections, although third

line forcing of related entities prohibition was repealed. This repeal facilitated the role out of the “shopper docket” regime. That change in the law might be reconsidered.

This issue relates particularly to bundling and no one says bundling is bad but how can third line forcing or for that matter full line forcing when done on **condition** be acceptable conduct. Maybe it should not be in the competition provisions of the Act yet it will sometimes be a competition issue.

I would however repeal the notification process and leave any exemption to a simplified and fast authorisation process.

The type of conduct that may constitute third line forcing includes the following,

- A bank will only agree to a loan if insurance is taken out with Shonk Insurance P/L
- A car dealer will only sell a car if finance is obtained from Kickback Finance.
- Members of a taxi co-op must buy their petrol from Moshell.
- A doctor who wants to use a local hospital must only use a nominated pathology service.
- A retirement country club sells retirement units subject to a condition that purchasers, when reselling their units, engage a real estate agent nominated by the club.
- Underprivileged people seeking long term accommodation in mobile home parks are told they can only stay there longer than a month if they buy their mobile home from a specified supplier and finance it through a specified lender. Both companies pay a kick-back to the park owner and customers are forced to pay a higher price.
- A nursing home provides medical services provided the patient also agrees to buy all pharmaceutical products and medicines from the chemist shop in the nursing home premises.
- Elderly people are admitted to a nursing home on condition that they acquire a pre-paid funeral from a specified funeral parlour at the time they move into the home.

All the above are based on real examples. Much of the conduct has been eliminated since 1974 or has become public through the Notification process or ACCC /TPC

action. The **Bill Express** case taken by the ACCC in 2009 is an example of conduct caught by the third line forcing prohibition where some 4000 newsagents were damaged by the conduct.

All the above conduct is anti-consumer and anti-small business. In most cases there is a kickback or some benefit flowing from the third party to the first party and in many cases the purchaser is forced to pay higher prices.

In some cases the purchaser may be put in an anti-competitive position as a result of the third line forcing but will it be enough to amount to a substantial lessening of competition- a notoriously difficult concept to prove.

Resale price maintenance

The current law is far too complex. It should be dramatically simplified. The requirement that RPM must be by reference to a specified price should be deleted and the below cost defence should be deleted.

Secondary Boycotts

The provisions should be left as is but the drafting needs simplification. It may be argued that the non-competition provisions should be taken out and there is a case for them being in other legislation. However wherever they are the ACCC is in the best situation to enforce such law. It does drag the ACCC into union and political fights but the ACCC does not exist to shirk away from such issues.

Mergers

The law operates fairly well but see attached article that was published in the **Australian Competition and Consumer Law Journal in 2011.**

The informal merger review system was introduced by the ACCC/TPC many years ago, it has no legislative basis and is free. ***The regime should be given a legislative basis and substantial fees.***

There may be some debate on the introduction of mandatory pre notification. If the informal review has some legislative backing then pre notification is not needed.

A residual issue in relation to mergers is the exclusive jurisdiction of the Australian Competition Tribunal for applications for authorisation. This was an unfortunate

amendments a few years ago. The applicant should have the option of going to the ACCC and then perhaps on appeal to the ACT or direct to the ACT.

Statutory exemptions

Should all be reviewed in terms of how they meet the objectives of the Act and are in the public interest. Care needs to be taken to avoid forcing political decisions on exemptions because the law is too inflexible.

The IP exemption should be revisited. The Ergas report did that in 2000 but most of its recommendations were never implemented.

The Authorisation process – see attached article published in the Australian Competition and Consumer Law Journal in 2009.

The authorisation process has been critical to the introduction of competition law in Australia but it needs reviewing, both in process and substance. The authorisation role has ensured the independence of the ACCC and its predecessors. Over the years there have been proposals for other agencies to take over ACCC roles as enforcement but the adjudication role was always one for an independent body.

Query whether both authorisation and notification should remain.

The notification process might be abolished. Leave it all to authorisation but substantially change that process.

Australia still has a steady stream of authorisations each year unlike NZ. In NZ the Commerce Commission cannot consider an application for authorisation unless it is of the view that there is a breach of Act. That condition precedent does not apply in Australia and might be considered.

The attached article gives more suggestions on streamlining the authorisation and notification regimes.

Collective bargaining

Collective bargaining has been a part of the competition law regime in Australia since 1974, it particularly developed in the 1980's with authorisations applications relating to small business collective bargaining being in the TPC/ACCC and the Australian

Competition Tribunal. In some cases such collective bargaining authorisations arose out of high profile quasi industrial disputes. (footnote to list some cases)

However the authorisation process was seen as cumbersome, slow and expensive and exposed applicants to possible appeal to the Australian Competition Tribunal.

The ACCC has in recent times developed a quicker and less formal authorisation process for collective bargaining applications for authorisation but it still has many of the hallmarks of the statutory authorisation process.

It is also important to note that most collective bargaining authorisations applications are granted by the ACCC.

Following on from small business concerns the Dawson Committee recommended a fast track notification process for small business collective bargaining. That Committee strongly supported some form of statutory exemption for small business collective bargaining and boycott within the CCA.

Consequently as from 1 January 2007 the CCA was amended to introduce a fast track collective bargaining notification regime for collective bargaining and in some cases collective boycott.

Despite high expectations in the small business community there have been less than 10 notifications in relation to the new regime. On one view, the problem lies with some of the detail, especially the requirements in the corresponding regulations and forms. An alternative view is that the nature of the conduct involved often does not, on its face, trigger genuine competition law concerns. Businesses may well be engaging in similar conduct without knowledge of the risk of breach. In terms of the detail of the regime the following issues arise:,

- The notification could only involve one target.
- The collective bargaining group could not change and if it did the protection would not extend to new members and a new notification had to be lodged,
- The lodgement fees could not be waived
- The Threshold of \$3 mill was a little low for some sectors,
- The written consent of each party to the collective bargaining group had to be obtained and lodged with the ACCC, and

- A new notification could not be lodged within 12 months of the former.

In order to make the system more workable changes need to be considered

However as part of simplification of the Act a more dramatic option may be considered, namely re-consider whether the Act should catch conduct such as small business collective bargaining and even boycotts as a per se offence.

It can be argued that in many cases the collective arrangements which would benefit from the collective bargaining regime are in any case unlikely to have a substantial impact on competition in the respective markets.

Should the per se nature of the Act be preserved, changes to the Act or Commission processes should be considered to enhance timeliness and cost. The changes could be:

- Collective bargaining by small business be assumed to be a public benefit unless the Commission considers otherwise.
- Interim authorisation to collective bargaining applications should be automatic within 14 days (in line with current third line forcing exclusive dealing notifications) unless ACCC decides otherwise.
- Collective bargaining applications be deemed authorised/exempted within 28 days unless ACCC decides the application is against the public interest.
- ACCC should initially grant immunity for 5 years and any subsequent re authorisation to be for 10 years, unless in the view of the ACCC there are special reasons not to do so.
- ACCC to publish guidance note on when collective bargaining and other agreements involving small businesses would substantially lessen competition.

Codes of Conduct

Mandatory industry codes of conduct.

These can be important in setting standards of appropriate conduct by large and powerful companies towards small business and farmers.

Such codes of conduct can play a vital role in promoting transparency and alternative dispute-resolution processes in relationships where small businesses and farmers may be vulnerable to abuses of contractual power by a larger and more powerful company. All too often there are information asymmetries whereby the larger and more powerful company may possess information that is not being disclosed to the small business or farmer despite that information being critical to the ability of the small business or farmer to make an informed decision.

Similarly, mandatory industry codes of conduct can assist in setting out processes for the resolution of disputes in a timely and low-cost manner, without recourse to expensive legal action by the small business and farmer. Such processes can include mediation, arbitration or expert determination. There may also be scope to appoint an industry ombudsman.

The detailed provisions in the CCA about voluntary codes are of limited use. The ACCC may give informal advice but should not get involved in great detail unless the parties to a code seek authorisation.

Parties should take their own advice and if need be code developed on a self-regulatory basis and authorisation sought from the ACCC for any anti-competitive elements of the code.

Enforcement powers

Compliance Notices

It is suggested that the ACCC be given a form of “cease and desist” power, with safeguards. Although a better name should be used, such as “Compliance Notices”.

The Commission has been given extensive enforcement powers as part of the ACL but more is needed in other areas of the Act and particularly tools to stop conduct quickly and to avoid the Courts where possible,

A possible Compliance Order regime could be as follows;

- Where the ACCC is of the opinion that a corporation may be involved in an ongoing breach of the Act it may issue a compliance notice,
- Such notice will specify the possible breaches of the Act and demand that the corporation cease the conduct,

- Such notice will be valid for a period of 60 days,
- A corporation receiving such a notice can appeal the validity of the notice to the Court at any time of the duration of the notice,
- A notice will be accepted as prima facie evidence by a Court of a breach of the Act in any application by the Commission for interim orders within the period of the notice, and
- The Commission is not immune to any action for damages arising out of its issuing a notice.

Divestiture

Whilst a likely last resort option, the Court should be able to order divestiture for any breach of the CCA and not only mergers

Damages

The 1974 Act envisaged a private action regime and “coat tails” damages action following on from successful regulators action. The former has had some success, the latter, none. **See the attached Journal article from 2008.**

Small business enforcing its rights

Small business often feels that they are disenfranchised in terms of the CCA.

In most cases when a small business raises issues with the ACCC the response is that there is not a breach of the Act or it is outside priorities. In most cases the ACCC response is understandable. In many cases the ACCC response takes months.

Small business needs to look past the ACCC for help. The various Small Business Commissioners are a valuable resource but not enough and not flexible enough.

In my view only the small business itself or its trade associations have the incentives to resolve issues. Small business is fearful of court/tribunal action but should be helped to do so where possible. Trade associations should act for their members including taking court/tribunal action as a last resort.

One solution would be to empower trade associations and as such give them standing in courts and tribunals and some public and maybe business funding to

handle such matters. This will also allow settlements of disputes on a compromise basis, something publicly funded bodies are not properly equipped to do.

Penalties

Courts are very cautious when faced with uncertain concepts such as impacts on competition and might tend to avoid imposing substantial fines when faced with that situation. Consideration might be given to repealing penalties in non per se offences but keep all other possible order, including divestiture.

Administration of Competition Policy

Generally the institutions are operating well but some changes should be considered.

Australian Competition and Consumer Commission

The ACCC and its predecessors, the TPC the Commissioner of Trade Practices, has been the great regulatory survivor. The ACCC role has grown and grown and has diverse and sometimes conflicting functions. Further there has been a buildup of community expectations that simply cannot be met.

The ACCC has been a very successful and vital agency. However, it is time that its functions, structure and processes of the regime are reviewed. Much of this is dictated by legislation and that legislation is subject to this review.

Some issues to consider are,

- **Does it have too many roles?** In my view it does. The ACCC should focus on market conduct and not become a policy player. There is a good case for taking the purely regulatory role away from the ACCC and have a specialist national regulator for issues such as energy, communications, water, ports and other utilities and networks. If that happens two ACCC Commissioners should be appointed to any new body to maintain a competition culture.
- **Should it have an express complaint handling role?** My first reaction is No. The issue is- can it be avoided and if the ACCC does not do it who does, especially in relation to small business? Ideally the States/Territories small business commissioners (where they exist), specialist ombudsman and trade associations should handle such matters but there are constant expectations

raised re the ACCC role.

- **Should Commissioners be more removed from staff roles?** Yes, there is a conflict between Commissioners sitting as adjudicators and being part of the investigation process. Commissioners can guide investigations but should not be part of them. The Act could be amended to clarify the role of Commissioners. I would not envisage the US FTC 'front office' model but some light handed separation.
- **Are there too many full time Commissioners?** In my view there are but that is dependent of the next question in this list. The current number is to some degree predicated on an activist role by Commissioners and see my view above on that.
- **Should there be more Associates?** Yes and must be able to be appointed quickly and for special purposes. Neither is possible at the moment. Associates are a difficult logistical exercise but bring valuable insights and contacts.
- **Is there a conflict in the Commission's adjudicative and enforcement roles?** There is in theory but it has not caused problems if managed sensibly.
- **Should the 'free' merger review role be continued?** It should no longer be free, see earlier comments.
- **Should the ACCC have a regular role of undertaking market studies?** No, this diverts resources for uncertain outcomes, it gets the ACCC into economic advocacy and into political fights. Also there are potential conflicts between what ACCC says in a study and what it may have to do in an enforcement role. An example is when the ACCC sought to oppose a tugboat merger in the Courts, the Judge depended on a price surveillance market studies report by the price surveillance section of the ACCC to refuse the ACCC application.
- **Should there ex post evaluation of major ACCC decisions?** Yes. This was in fact promised to various Parliamentary committees over the years but was not factored into ACCC programs. Due primarily to the issue of the potential cost. Query whether these should be carried out by the ACCC? I would suggest that they be done by independent bodies.
- **Protection of witnesses.** Getting cooperation from industry is a constant problem for the ACCC and the ACT. Devices such as friendly section 155

notices are utilized but more protection is needed.

- **Should there be some time “limits” on ACCC investigations?** This should be considered as parties being investigated should not be left in limbo. The ACCC should be required to tell parties under investigation each month what is happening including the likelihood of ACCC action.
- **Should ACCC be liable for the cost of section 155 Notices in some circumstances?** The ACCC has a widespread practice of using section 155 Notices as a matter of course, in the past they were only used as a backup tool. In some circumstances parties subject to section 155 Notices should be able to demand that the ACCC pay expenses, including legal costs. If the ACCC refuses the parties should be able to go to an arbitrator for a ruling. The ACCC might be liable for costs if it imposed unreasonable expenses on the parties, the ACCC investigation is of doubtful probity, the ACCC investigation was unlikely to lead to any breaches of the CCA to be proven.
- **Does the ACCC spend too much on the legal costs of its cases?** This has always been a moot point. Past assessments have shown that the ACCC case are more costly than similar cases in NZ, Canada and the US. This is not just an ACCC issue but one of the legal and Courts system. The ACCC should be able to be the solicitor on the record in Federal Court cases, similar to the ATO and ASIC. Further the constant use of senior barristers can be questioned for many of the ACCC cases. There may need to be greater transparency on ACCC litigation costs and in the Annual Report the costs of completed cases could be listed plus what was received back in costs in successful cases.

National Competition Council

It should return to its original roles of legislative review and access assessment .

The previous NCC/COAG roles, with compensation payments, was effective.

Federal Court of Australia

The role of the Federal Court in issues such as merger needed to be re considered.

The “Metcash” merger litigation case calls the role of the FCA in question. The Court treated the matter as a commercial battle between rivals and not as public interest

litigation. This issue has arisen before in the FCA but the Full Court in the Coles/Foodland case in the early 1990s' seemed to recognize that the ACCC is a special litigant and ACCC cases are "public interest" litigation.

Further much of the evidence in the 'Metcash" case was treated as if the case was a criminal one with endless arguments and rulings on hearsay and other technical legal issues.

It may be that mergers and any competition case should be heard in the ACT with some lateral thinking needed to overcome any constitutional issues. As was the case with the former Trade Practices Tribunal and its orders were enforced in the Federal Court. That process withstood a constitutional challenge.

Australian Competition Tribunal

The ACT has had a positive influence on the Competition regime through its decisions but its processes have been a problem. It is very much a copy of the FCA despite having lay members.

The whole issue of the ACT review being de novo adds time and cost, the insistence on high standards of proof etc. makes matter before the Tribunal troublesome.

That is not to say that it should not be formal and authoritative but it needs more flexibility.

The Judicial process

As can be seen from my comments above and through this submission the judicial process that permeates the regime is cumbersome and expensive. If there is a move away from per se offences then the whole role of the Federal Court in competition issues should also be reviewed.

Some additional issues

- **Agency-** this is a legal point of some concern to small businesses. The ACCC and the Courts in some cases have taken the view that businesses in an "agency" or similar relationship to a supplier are not in competition with the supplier and hence some of the CCA prohibitions do not apply. This is not the way agents would see the market dynamics and this issue may need to be

clarified. There is an appeal by the ACCC to the Full Federal Court that hopefully will clarify the issue.(ACCC v ANZ)

- **Regional issues**- somewhat outside the terms of reference but consideration could be given to the Pacific region competition and consumer agencies having a common “back office”. This would enhance the cooperation that already exists and help the smaller jurisdictions.
- **ASIC**- again outside the direct terms of reference but if the ACCC jurisdiction is in any way to be streamlined consideration should be given to repealing the financial services carve out which takes the ACCC out of consumer protection in relation to ‘ financial services’.

June 2014

Commission cameos

POST “METCASH” – SHOULD WE RECONSIDER THE ACCC MERGER REVIEW PROCESSES?

Australia has a unique merger review regime, an informal process that totally overwhelms the formal review processes set out in legislation.¹ A review decision from the Australian Competition and Consumer Commission (ACCC) has no legal status and is simply a commercial comfort (or no comfort) decision. The commonly used language of ACCC “approval” or “clearance” is somewhat misleading. The informal process has no legal basis, no fees. The ACCC has, over the years, made the process semi formal but in very recent times the time frames seem to have become spongy.

As a result of the informal process, the Federal Court is the final port of call, where parties who wish to proceed with a merger despite a negative ACCC view can challenge the ACCC’s opinion. To date no one has used the formal clearance process nor the process of applying direct to the Australian Competition Tribunal (the Tribunal) for authorisation. The formal processes, be they clearance or authorisation, have the Tribunal as the final port of call. A formal process that is common overseas, namely mandatory pre-merger clearance, does not exist in Australia; the informal process has taken that role. Clearly, merging parties see great advantage in the informal process, especially since the *Metcash* decisions.²

Generally, parties to a merger do not challenge the ACCC’s view because it is assumed that the ACCC’s opinion is law and final. However, the ACCC decision is only a view on whether or not it will oppose a merger. Furthermore, undertakings obtained by the ACCC in a merger matter usually allow an otherwise anti-competitive merger to proceed on the basis that the undertakings will overcome the anti-competitive aspects – usually after the merger has been closed.

It should be noted that the ACCC developed the informal process as a free service to the merging parties. Some jurisdictions would be horrified by this idea. Even the ACCC has balked when parties come to it with a series of merger options and want free advice.

It is generally acknowledged that the informal process has worked well but the question remains whether it is still the best approach, or has outlived its usefulness.

In this writer’s view, the *Metcash* cases have raised serious issues, though the decisions by the Federal Court or whether the ACCC ran an adequate case will not be specifically discussed in this report. The concern is that the court process is wanting when deciding serious economic and commercial issues. Anyone who sat through the *Metcash* proceedings saw a case between two private parties utilising legalistic concepts and tactics. At no stage was there any aura of a public interest case. Despite the fact that the ACCC is supposed to represent the public in seeking to stop anti-competitive mergers, this case was very much ACCC against Metcash, as demonstrated by the forensic tactics and processes.

Much has been said by those in the media about the need for commercial reality and avoiding theoretic submissions. However, what is reality and theory? One outcome of the case in real terms is that Metcash has terminated the contract with a major customer who was the other bidder and who assisted the ACCC. Further, Metcash is using its market power to claw back from supplier’s rebates etc that it thinks Franklins would have got had Metcash controlled Franklins earlier. Metcash is also tightening up on the terms and conditions of supply to its franchisees. That is the reality.

It appears to the writer that the whole philosophy of the *Competition and Consumer Act 2010* (Cth) (CCA) has vanished from the minds of many now involved in trade practices issues, especially mergers. The ACCC is seen as a player in the market and not a custodian of the public interest. Many complain about concentration in Australian markets yet the ACCC is hampered in acting.

¹ *Competition and Consumer Act 2010* (Cth), ss 50, 50A, 95AA-AZN.

² *ACCC v Metcash Trading Ltd* (2011) 282 ALR 464; *ACCC v Metcash Trading Ltd* (2011) 198 FCR 297.

The ACCC has to go to the Federal Court if challenged, and the onus is on the ACCC to present hard evidence to succeed – an uphill task. Commercial parties are fearful of giving public evidence and courts seem unsympathetic to protecting commercial information – they have an idealistic view of confining access to information to lawyers. Commercial parties simply do not trust that, especially if the lawyers are the usual lawyers for a party.

It is not suggested that courts should not be involved in the process; only that their role be confined to points of law and not the assessment of the facts that lead to decision on competitive impact. We are likely to face more and more mergers in the foreseeable future and more are likely to breach the CCA. Do we want such mergers to proceed because the ACCC cannot get past the courts? Mergers are about the future and the impact is hard to prove but possible to postulate to a reasonable degree.

The *Metcash* case also shows that the courts have no faith in markets. They want almost certain counterfactuals and to let the merging parties almost dictate the likely outcome if the merger is blocked. Markets have a remarkable ability to find outcomes and the courts should simply assess whether or not there is a likely substantial lessening of competition based on s 50 and then assume that the market will find a solution. The solution might not totally suit the vendor but it should suit competition or at least stop an anti-competitive outcome. Too often there seems to be an expectation that the CCA is about pro-competitive outcomes. It is not: it seeks to prevent anti-competitive outcomes. Then it is up to the market, not judges or the ACCC.

To be fair to the Federal Court, the ACCC has taken the counterfactual issue too far in mergers. It is a proper issue in authorisations, but should not be taken too far in merger matters.

The ACCC Chairman has indicated business as usual despite *Metcash*, although he has made some noises about more commercial assessment. What that means precisely, is uncertain, since the lack of commercial assessment lay with the court rather than the ACCC. If there was a failing with the ACCC case, it was in its presentation.

ARE THERE ALTERNATIVES TO THE CURRENT PROCESS?

Answer: Yes.

Option 1 – No legislative amendments necessary

This is essentially the current legislative regime:

- Section 50 – self assessment by parties.
- Formal application to ACCC for clearance on competition ground within strict time frames and for substantial fees.
- Review of ACCC decision by the Tribunal on competition grounds, again within strict time frames.
- Application for authorisation to the Tribunal on public benefit grounds within strict time limits. ACCC acts to assist the Tribunal.
- ACCC can go to court if parties have made no formal application for clearance or authorisation and ACCC is of the view that parties breached s 50.

The ACCC would abandon its informal process.

Option 2 – Legislative amendments necessary

- Introduction of mandatory pre-merger clearance, with a reasonable threshold based on concentration factors, and the ACCC is to consider both competition and public benefit cases. Parties falling below the threshold can notify on a voluntary basis within strict time frames.
- Review of ACCC decision by the Tribunal.
- The courts only become involved where parties refuse to notify. The courts would assess competition issues and refer any breach to the Tribunal if there is a public benefit issue. In any case penalties for non notification if the court finds a substantial lessening of competition.
- As with Option 1, substantial fees would apply.

Neither of the above should change outcomes, since most mergers raise no issue and these can be equally accommodated by the informal or formal clearance process. It is those in the grey area that need a new process – one which is not stacked against the ACCC.

The two models take the Federal Court largely out of the picture. Further, they take the ACCC out of the informal regime that, in the writer's view, works against the public interest in cases where there is likely to be a competition issue. Both suggested options add transparency and hopefully do not add to time frames.

It gives a bigger role to the Tribunal, which some might say is no better than a court. However, Tribunal members can be trusted to avoid the pitfalls of the strict legal processes and look more at the merger review role as being a public interest role and not simply a private fight between the ACCC and merging parties. In the past it was assumed that the ACCC would fare badly before the Tribunal. That was based on a view that the informal process made the ACCC the last port of call, but with more parties challenging the ACCC, it is the Federal Court that determines outcomes.

The Full Federal Court has said in the past³ that the ACCC is in a special category when seeking an interim injunction in relation to mergers. That view seems to have passed into history and the ACCC is seen as just another commercial litigator – even the fact that the ACCC does not have to give an undertaking as to damages is used against it. It was a legislative signal that the ACCC has a special role but is now seen as unfair to the other party in ACCC litigation.

“THE ACCC IS NOT AN ADR AGENCY”

At a small business function soon after his appointment, the ACCC Chairman Rod Sims said “the ACCC is not an ADR agency”. That statement has to be applauded generally, and although some small business groups may not welcome it, most will see its sense.

For too long politicians and the ACCC have not been game to say that. It is the truth and small business has been given unrealistic expectations. Not that the ACCC does not assist small business; it does but on a broad basis, not on individual issues. This ACCC focus has meant that other means of small business ADR have been ignored or are patchy. Some States have Small Business Commissioners, some trade associations help their members with disputes, and some small businesses fight their own battles.

Recently, the then Commonwealth Minister for Small Business issued a paper on small business ADR⁴ and that work is progressing with the new Minister. Hopefully, a regime will arise where the ACCC will act to condition market behaviour but others will pursue or deal with individual disputes. That way small business will have an equivalent to what consumers have in the combination of the ACCC and State and Territory fair trading authorities.

Having said that, these publicly funded regimes have to be supplemented by individual action and appropriate access to the courts and the Tribunal must not be overlooked.

Finally, the ACCC or those handling disputes have to fashion their action in terms of the framework of the law. The new regime should not be a total panacea to small business issues, some of which can never be resolved because they are a direct consequence of being a small business. Government proposals for small business unfair contracts provisions in the CCA should be revived. Only then will the framework be completed.

ACCC COMPLIANCE PROCESSES

There seems to have been some subtle changes made in the ACCC's treatment of incoming matters. Tools such as litigation and enforceable undertakings are still properly utilised but the Commission appears to be also using the following:

³ *TPC v Rank Commercial Ltd* [1994] ATPR 42,498.

⁴ Commonwealth Minister for Small Business, *Resolution of Small Business Disputes*, Options Paper (May 2011).

Commission cameos

- *Warning letters* for less serious or uncertain offences. This puts parties on notice for future action. This may not fully satisfy a complainant, but appears to be an efficient way to seek compliance which, after all, is what the ACCC is about.
- *Written undertakings* short of an enforceable undertaking. Again, this appears to be a good way to get compliance without the tortuous formal undertaking process and the subsequent publicity.

The ACCC has more formal powers than ever but the informal should not be forgotten. The recently issued ACCC Compliance and Enforcement Statement⁵ reinforces the above.

THE REGION

The ACCC has had a high international profile for many years, including cross-membership with the New Zealand Commerce Commission (NZCC), plus two significant agencies in the South Pacific.

There are many more competition and consumer agencies in the South Pacific, most of which struggle. Therefore, the writer proposes that the ACCC and NZCC develop closer relations with all of these and perhaps even form a loose “federation”, with the sharing of back offices and developing cross-membership.

The largest and most successful of the South Pacific agencies is the Papua New Guinea (PNG) Independent Consumer and Competition Commission. The relevant PNG legislation⁶ provides for a non-resident Commissioner – this could easily be a member of either the ACCC or NZCC. Further, the Commissioner of the PNG ICC could be an associate member of the ACCC or NZCC.

A regional co-operation move such as this should be taken on board and a firm regional network established. Not only will this facilitate information and skill exchange, but it will also give stability to the smaller agencies.

*Hank Spier
Spier Consulting
ACT*

⁵ ACCC, *Compliance and Enforcement Policy* (February 2012).

⁶ *Independent Consumer and Competition Act 2003* (PNG), s 11(3).

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A “MATURE” TRADE PRACTICES ACT NEEDS SOME FINE TUNING IN SOME CORE AREAS

The Trade Practices Commission (TPC)/Australian Competition and Consumer Commission (ACCC) has had a phenomenal growth in its size and roles. Yet, its basic role is largely the same as when the late Lionel Murphy introduced the *Trade Practices Act 1974* (Cth) (TPA), which replaced the *Trade Practices Act 1965* (Cth). With the TPA possibly about to be renamed, it is well to remember its history.

The ACCC has been the great survivor amongst regulatory agencies and it no doubt will continue to grow. However, it may be time to review some of the core functions and roles; not to dramatically alter them, but to update and fine tune.

What follows is not criticism of the ACCC; rather, it is to be seen as constructive commentary. The suggested areas for review are:

- the authorisation process (ss 88-95); and
- compensation for victims of anti-competitive conduct (ss 82-83, 87).

THE AUTHORISATION PROCESS

The authorisation provisions of the TPA are a critical part of the Australian regime. In the author’s view, this is what guaranteed the independence of the TPC/ACCC over the years.

It brought an Australian aspect to the competition law regime – an aspect often scorned by North Atlantic competition authorities because it brings into play considerations other than economic correctness.

The early history of the TPA was dominated by the authorisation process, which is still important today.

The initial response by businesses to the 1974 Act was to lodge some 29,000 plus applications for authorisation. Many were agreements that had previously been registered under the 1965 Act and, hence, were exempted under the old law. These were re-lodged in the hope that they would be exempted under the public benefit test.

To some extent, the then new TPC encouraged businesses to lodge applications for authorisation by indicating that anyone who lodged by February 1975 would be given automatic interim authorisation. As a result, around 20,000 interim authorisations were granted.

In many cases, authorisations were appealed to the then Trade Practices Tribunal (now the Australian Competition Tribunal). The Commission also conducted a number of court cases. While court success in the competition area was limited, the Commission was highly successful in consumer protection cases, and there were several landmark decisions.

It is sometimes said that in Australia little has been done in relation to the competition cases. This view overlooks the authorisation role and the role of the Trade Practices Tribunal. In the early days, the matters that went to authorisation in Australia were often the subject of court cases in other jurisdictions, especially in North America. Authorisation is the converse of breach.

The TPC’s authorisation work continued for many years. It is a slow process by its very nature, and there were some dramatic decisions in relation to industries and issues such as newsagents, motion picture distributors, brewery ties, petrol company ties, engineers and many more.

In those early days there were also clearances for mergers and non-mergers. The TPC was required to assess whether the conduct was in breach of the competition provisions before any public benefit aspect could be considered. This resulted in a huge workload for the TPC and a number of internal divisions were created to handle the workload. Merger clearances had to be done in 30 days. Even shopping centre leases had to be “cleared” by the TPC.



Ironically, in those days the TPC's role was somewhat more regulatory, since most of its work was not responding to market place conduct but, rather, to applications for approval of specific conduct.

The 1970s was a rocky time for trade practices law. It was the era of the Swanson Committee and the generally unsupportive Fraser Government which issued formal directions on what the TPC could do. The political environment at the time was also generally hostile towards trade practices law, particularly within the Commonwealth and State bureaucracies. Business was also generally opposed to the law.

Nevertheless, the Act stayed alive and there continued to be major authorisation decisions such as the *Stock Exchanges* case and the *IATA* case in the early 1980s. Major court cases were conducted, such as the *Glucose* case (*TPC v Allied Mills Industries Pty Ltd* (1981) 60 FLR 38) and the first *TNT* case (*TPC v TNT Management Pty Ltd* (1985) 6 FCR 1). One was won by the TPC, the other lost.

All along, the authorisation process continued steadily. The law was altered a little over the years but not substantially; mainly minor process matters or playing around with s 47(6) of the TPA (third-line forcing). A major recent and most unfortunate change was to have merger authorisations go directly to the Australian Competition Tribunal. To date, no applications have been made to the Tribunal.

An issue often overlooked is that much of the TPC/ACCC regulatory work utilised the authorisation provisions or adopted similar processes. Unlike many regulatory regimes in Australia, TPA adjudication largely is transparent, timely, accountable, and cost effective.

Authorisation is a critical and unique feature of the law, but probably needs some reassessment in some areas. The following comments are split into ACCC and Tribunal processes. Some of the comments will require legislative change, some will not. Further, the comments apply to the traditional authorisation processes and not to the as yet unutilised direct application to the Tribunal for merger authorisations,

The ACCC process

Pre-lodgement processes

The TPA could provide for a confidential and without prejudice mandatory pre-lodgement process. This would formalise what is often done today, but add safeguards and make it mandatory. This would avoid unnecessary applications and assist applicants as to what is possible and what is needed.

Information demands on the applicant

Is it possible to cut down such demands where the ACCC is familiar with the industry?

Draft determination to be issued early

Where at all possible, the ACCC should issue a draft at an early stage and use that as a basis of information and view collection, thereby avoiding the current two lots of consultation.

Confidentiality

The confidentiality provisions in s 89 of the TPA are quite limited and appear to have been a little expanded by the ACCC beyond the strict language of the law. The ACCC appears to grant confidentiality for issues not contemplated by the section, such as giving confidentiality to the names of persons making submissions to the ACCC on authorisation matters. The provision might well be reviewed and made more relevant. Further, grants of confidentiality could be time limited.

Minor variations

Applications for minor variations are virtually the same as a full application, but without the fee. That was never the intention and could be reviewed. A simple lodgement process with no public process could be considered where the Commission is of the view that the minor variation does not change the authorisation in any material way.

Revocations

It is not easy to revoke an authorisation and the cards are stacked against the ACCC. Should this be the case?



Public benefit

Public benefit is not defined in the TPA. Is it now time to give some guidance in the legislation? In particular, there are some areas that may not fit into an economic framework, but in these there could be a rebuttable presumption of public benefit, eg collective bargaining.

Interim authorisations

The Commission is understandably reluctant to issue interim authorisations, but perhaps this should be re-thought. "Interims" may often be a way of testing what may happen post an authorisation, where the authorisation can be undone.

Notifications – impact on competitors.

Many notifications are let stand because they do not lessen competition nor are they a public detriment. However, many will affect competitors or customers adversely, but little can be done where the ACCC has let them stand. Should the whole concept of notification be reviewed – in particular, the issue of third-party impact?

The Tribunal processes**De novo consideration of appeals**

Should there be an option for a limited, as distinct from a total review of an authorisation or the refusal or revocation of a notification? This might focus and shorten some matters.

Costs issues

Should general costs rules apply to the Tribunal?

Court-like process

The Tribunal process is highly legalistic and mirrors Federal Court processes. This should be reviewed and perhaps simplified. There is a huge contrast between the form of material submitted to the ACCC and Tribunal on the same matter, which can result in the Tribunal having far less material before it than the ACCC, and it making decisions based on different information. Essentially, the Tribunal gets everything in sworn form, the Commission has no such formality.

DAMAGES FOR VICTIMS OF ANTI-COMPETITIVE CONDUCT**Background**

The TPA is very much part of our commercial landscape and the role of the ACCC is entrenched as the public's policeman. However, the TPA is not only about public enforcement by the ACCC; private action has an important role to play too. Overseas competition authorities in the United Kingdom and the European Union are currently actively encouraging private action as an arm of enforcement policy.

Since its inception, the TPA had a strong self-enforcing structure: s 82 provides for private action for damages; and s 83 was intended to facilitate private litigants taking such action in that it provides for "coat tails" damages action flowing from an ACCC action.

Such actions cover all of the provisions of the TPA, including cartels. Private action under the TPA has become very common, but primarily for the consumer protection provisions and in particular s 52 (misleading and deceptive conduct).

It appears that very few private actions against cartels or other anti-competitive conduct have reached a court. Part of the reason is likely to be the difference in remedial provisions under the Australian and American laws. The *Clayton Act 1914* (US) in the United States provides for treble damages, as well as a one-way cost rule favouring plaintiffs. In Australia, only single damages apply, there is uncertainty about full cost recovery, and there is no one-way rule.

There is another hurdle to successful private litigation in Australia, and the failure to emulate the "piggy-back" (coat tails) partnership that operates so well in America. While both countries aim to motivate a private party to seek damages by accepting a "finding of fact" in other proceedings as prima facie evidence of that fact, there is considerable uncertainty that this applies in Australia when the ACCC operates against cartels by way of consent penalties, or even where there is a contested case.



What the ACCC often does, rather than submit to a full trial, is negotiate admissions and penalties with, say, cartel members, and submits an agreed proposal to the Federal Court for approval. The process started in 1981 in *TPC v Allied Mills Industries Pty Ltd* (1981) 60 FLR 38 and has gathered pace in recent years. However, “findings of fact” are the first casualty of settlement negotiations.

No doubt there are benefits from the process. It saves the resources of the Federal Court and those of the parties. The attendant publicity the ACCC generates after approval of the big fines also, arguably, improves compliance.

But there are also some downsides. Some Federal Court judges have raised concerns that there is a minimisation of matters determined on their merits, thereby diluting the pool of authorities, the possible avoidance of detection of other breaches, and the greater difficulty of determining whether a penalty is within an appropriate range.

Another downside is the potential effect of consent penalties on the recovery of damages by the actual victims under s 82 of the TPA. The ACCC can take representative action to seek damages for victims under s 87 but seldom does. This is not a criticism of the ACCC; there are some good policy reasons for a public body not seeking private damages. Nevertheless, the public body should then assist those private litigants seeking to take coat tails damages action. Sadly, the ACCC does not do that.

Compensation is the driver of private enforcement and is one of the two fundamental objectives of the TPA and the American legislation it emulates. As the Hilmer Committee noted about the TPA in its *Report on National Competition Policy* (1993) p 161: “The basic objectives of a system of remedies are to deter people from contravening the law and to compensate injured parties.”

The ACCC focuses on deterrence and largely ignores compensation. Unfortunately, that focus makes compensation harder to achieve for two reasons.

First, s 83 of the TPA was intended by the Parliament to support claims for compensation by providing for a finding of fact, but it is not clear that admissions agreed upon in consent penalties can be relied upon as proof of unlawful conduct in a proceeding for damages. This greatly adds to the risk and cost of litigation.

Secondly, the pursuit of headline-grabbing high penalties may empty the coffers of the miscreants for the subsequent payment of damages. At the least, it will reduce their capacity to pay. This is despite the fact that s 79A directs the court to put compensation first.

A better way

There must be a better way to achieve the twin objectives of deterrence and compensation *and* to motivate private litigants as an instrument of enforcement.

Corporate victims of cartel conduct generally do not want the government to fight their battles. They want to do it themselves but the law must assist or at least not be a barrier. That is not to say that that corporate victims necessarily want to litigate, but they want the ability to do so. The threat of litigation will help in any negotiations that lead to compensation, and even if there is litigation, most will be settled.

The ACCC has in the past obtained compensation for consumer victims using s 87(2) but that was eventually thwarted by the Federal Court (see *Medibank Private v Cassidy* (2002) 124 FCR 40). This issue will be resolved by the Australian consumer law amendments contained in the *Trade Practices Amendment (Australian Consumer Law) Act 2009* (Cth). They allow the ACCC to seek compensation in relevant consumer protections cases, but do not overcome the private litigant “coat tails” issue for either consumer protection or anti-competitive conduct cases.

It is now high time in the history of the TPA and of the ACCC that the interests of victims of anti-competitive conduct be considered. Often the ACCC successfully takes action and the victims, who often assisted the ACCC in the case, find that they are severely hindered in taking action for damages.

It is hard enough to win a damages action. Any litigant will need to prove the causal connection and the quantum of damages, but having to prove – again – the breach of the TPA makes the case very

difficult. Further, if private action was easier, more cases of damages would be settled and damages would be part of the deterrent armoury of the TPA.

Professor David Round, an eminent trade practices economist, states in his article, “Consumer Protection: At the Merci of the Market for Damages” (2003) 10 CCLJ 231:

If it were correct that agreed statements of fact presented to the court could not be regarded as findings of fact by the court in a subsequent private action for damages, then the policy intent of s 83 will be defeated.

While the ACCC’s approach may be socially efficient in terms of saving valuable court and enforcement time, a very large evidentiary burden may as a consequence be placed on those parties who have suffered losses from anti-competitive acts, and who wish to proceed with a claim for damages. Under such circumstances, the cost of seeking damages could be prohibitive and the aims of s 83 would be frustrated. Affected parties should have the right to rely on the facts pleaded by agreement in such cases.

Revisions to s 83 are necessary to overcome this legal curiosum that would require the (re)proving of facts that have been admitted to the court. If such an amendment is not forthcoming, those entities charged by the ACCC have yet another reason to submit agreed statements of facts and penalties to the Federal Court – not only do they hope to limit their exposure to a social penalty, but they also create a shield for themselves from the prospect of the future payment of private damages.

ACCC impact

The possibility of private actions flowing from successful ACCC action may mean that there are fewer settlements with the ACCC. However, should that be a reason for not facilitating private action? It may also mean lower fines because money will be expected to be paid by way of damages; again, is this reason not to facilitate private action?

The ACCC could now alter its processes and legal proceedings to facilitate private actions. This will mitigate against settlements, slow ACCC cases, and assist corporate victims to some degree, but does not overcome the problem in a way that legislation would. Also, private litigants want to be free to take coat tails action and not bother the ACCC.

In any case, settlement will not be all that likely in criminal cartel cases.

An example of the issue

Many corporate victims have been frustrated in taking action following successful ACCC action. The following are comments by Energex, a large Queensland utility, taken from its submission to the Dawson Committee in 2002 (*Review of the Competition Provisions of the Trade Practices Act* (2003)):

Recent developments in the way in which the ACCC presents to the Federal Court agreements made with respondents as to both guilt (by way of agreed statements of facts) and mutually acceptable penalties, have led to some uncertainty now as to whether businesses that have suffered from this illegal conduct can rely on these admitted statements of fact presented to the court to press their claims under S 82.

In a recent application to the Federal Court for ENERGEX to be granted access to statements of agreed facts and outlines of submissions, in a case where its suppliers of transformers were found guilty of price-fixing on their own admissions ...

Finkelstein J decided that he had “no doubt that the proper approach is that access should be allowed unless the interests of justice require a different course.”

Further, he stated “Surely a potential victim of anti- competitive conduct is entitled to see the evidence in which the court found that there had been contraventions to decide whether he will prosecute a civil case.”

While granting Energex access to the documents, however, the judge remarked that,

“I note in passing that when deciding the case against the Alstom parties I made orders that statements of agreed facts in that case were relevant facts for the purpose of s 83 of the *Trade Practices Act*. Although there is some doubt as to whether I should have made the order ... it would have little practical utility if ENERGEX were to be denied access to the documents which founded the order: It is true that s 83 only comes into operation when a new proceeding is commenced. But commonsense



suggests that a party such as ENERGEX who may obtain a forensic advantage by use of the section, should have access to the findings to decide whether those findings will usefully advance its position.”

Another example

The ACCC took action in New South Wales against Coles (Liquorland) and Woolworths alleging anti-competitive conduct in relation to liquor retailing. Coles settled with the ACCC. Woolworths did not settle but the court found against Woolworths.

Competitors of Coles and Woolworths targeted by them are seeking compensation but are finding that difficult because Coles settled with the ACCC and findings of fact are a problem. Even the *Woolworths* court decision is confusing on the issue of findings of fact. The victims are all small liquor merchants or hotels. (See *ACCC v LiquorLand (Australia) Pty Ltd* [2006] ATPR 42-123; *ACCC v Woolworths Ltd* [2002] ATPR 41-889.)

The problem

In recent years, the ACCC has taken many cases where damages are a potential consequence of the unlawful conduct. These cases would involve cartels, secondary boycotts, resale price maintenance and primary boycotts. Industries have included concrete, vitamins, liquor retailing, transformers, freight, bread, newspaper, and records.

The essential issue is that parties who seek to take advantage of successful ACCC actions are not able, or find it very difficult, to do so. This has become a cause of some concern with victims of the cardboard box cartel.

The so called findings of fact do not emerge as part of ACCC litigation, as was expected by the Parliament when enacting s 83. Parties are faced with having to prove the basic breach afresh.

The difficulties in obtaining damages by victims of anti-competitive conduct has spawned a number of large class actions and disputes between plaintiff lawyers and the ACCC over access to documents. This is all very wasteful; the ACCC should be assisting in damages claims, not obstructing them.

In looking at a solution, the enforcement framework in the TPA needs to be scrutinised.

1. Section 76 – a court can impose a penalty for contravention of the anti-competitive conduct provisions, if it is satisfied that there is a contravention.
2. Section 77 – action to collect penalties.
3. Section 79B – the courts are to give preference to compensation.
4. Section 80 – the court can grant an injunction if it is satisfied that there was a contravention.
5. Section 80(1AA) – a court can grant a consent injunction, whether or not it is satisfied that there is a contravention.
6. Section 82 – private action for damages.
7. Section 83 – coat tails action for damages.
8. Section 87 – other orders open to the court.

It is suggested that where the court is satisfied in ACCC initiated proceedings that there has been a contravention of the TPA, then this general finding of fact/breach in those proceedings should be able to be used in subsequent damages proceedings.

Those seeking compensation will, of course, still have to prove the causal link and the quantum of damages.

Further, where there is an application for a consent injunction without the court being satisfied that there has been a contravention, the court should be required to ascertain whether any third parties will be detrimentally affected by such an order. If so, then the court can only make a consent order if it is satisfied that there has been a contravention.

SUGGESTED AMENDMENTS TO THE TPA

Section 83 – Finding in proceedings to be evidence.

- (1) In a proceeding against a person under s 82 or in an application under subs 87(1A) for an order against a person a finding by a court made in any proceedings under this Act, in which a person has been found to have contravened, or to have been involved in a contravention of, a provision of this Act is prima facie evidence of the fact that a contravention has occurred.
- (2) For the purposes of subs (1), a finding of contravention may:
 - (a) be proved by production of a document under the seal of the court from which the finding appears; and
 - (b) also be proved by the evidence contained in documents available at the hearing of the proceeding for the contravention or offence, including:
 - i. written statements or admissions admissible as evidence on the hearing of the application;
 - ii. depositions taken at the application proceeding; or
 - iii. any written statements or admissions used as evidence in the proceeding.
- (3) In any proceeding under s 82 or an application under s 87(1A), a court will accept any of the matters listed in subs (2) above as conclusive of a finding of contravention, unless there is evidence to the contrary.

Section 80 – Consent injunctions

- (a) In a consent application under subs (1AA), the court shall take reasonable steps to determine whether such an order, without the Court being satisfied that a person has engaged, or is proposing to engage, in conduct in contravention of the Act, will detrimentally affect any other persons.
- (b) If the court is of the view that any other persons will be detrimentally affected the Court shall not make a consent order, without being satisfied that a person has engaged, or is proposing to engage, in conduct in contravention of the Act.

There are possibly other solutions but this suggestion hopefully meets its goal to start a much needed debate on the underlying issue.

*Hank Spier
Spier Consulting, Deakin, ACT*



Abuser pays – compensating the victims of cartel conduct

Trevor Lee and Hank Spier*

Much has been said about cartels and their evils, as well as the amendments that have been made to the Trade Practices Act 1974 (Cth) (TPA) to make participating in cartels a criminal offence. What is often forgotten in the media hype surrounding cartels is the victims of cartel conduct. This article seeks to bring the victims into the foreground and examine what is needed to prove damages and what those seeking compensation can expect by way of tactics from cartel members. The TPA has, from its inception, provided for cost tails damages action for victims. This policy has failed and the article seeks to initiate a debate to amend the TPA to devise a policy that works.

BACKGROUND

While public interest in cartels is in vogue these days, they have always existed, robbing the unwary and diminishing the economy. This article focuses on what should be a major arm of enforcement in Australia – the successful recovery of damages for victims of cartels. It teases out the economic issues likely to be raised at trial, or in negotiations, as victims attempt to recover their money after the Australian Competition and Consumer Commission (ACCC) has been successful in a cartel case.

Respondents in cartel cases for compensatory damages typically construct a sequential three-tiered defence. First, is the time-honoured strategy of putting up legal hurdles to drain the resources of, and to wear down, the plaintiff. Next, is a range of economic arguments excusing the conduct or lessening the alleged effects. The final focus is on the quantum of damages, with the purpose of undermining the estimates in the claims and the credibility of expert witnesses.

Until now, the first line of defence has worked well. Ever since the legal problems of the first case in Australia (Coal Vend),¹ few victims have sought compensation. Following the ACCC's successful action in the transformer case,² only two of the 17 major Australian buyers have taken action. Yet, the transformer private action case³ has removed one of the major legal hurdles – the time limitation issue.

The Full Federal Court ruled, in effect, that questions of time limitation should be determined at trial and not at a preliminary point, thus removing interminable delaying tactics. This decision also meant that potential claims may not be as much reduced or eliminated as previously feared if the six-year timer starts to run when the cartel is revealed and not when the purchase was originally made; that is, under s 82 of the *Trade Practices Act 1974* (Cth) (TPA), the true value in a rigged market “crystallises only upon discovery of the anticompetitive conduct in question”.⁴

The main remaining hurdle is the possibility that s 83 of the TPA may require the reproving of facts that have already been admitted in another court. The intent of the Parliament was clearly that

* Trevor Lee has held senior positions with the Federal Treasury, the ACCC and the OECD and is currently the principal of Development Economics. Hank Spier was the CEO of the ACCC and Trade Practices Commission and is currently the principal of Spier Consulting Pty Ltd. Both are Directors of the Cartel Compensation Group.

¹ *AG v Adelaide Steamship Co Ltd* (1913) 18 CLR 30.

² *ACCC v ABB Transmission & Distribution Ltd* [2001] ATPR 41-815.

³ *Energex Ltd v Alstom Australia Ltd* [2005] ATPR 42-086.

⁴ *Energex Ltd v Alstom Australia Ltd* [2005] ATPR 42-086 at [60] (Finkelstein J).



the section supports a s 82 action for damages. Yet Finkelstein J has questioned whether this applies to consent admissions, a process used in many ACCC cartel cases.⁵

The authors have written elsewhere on ways to reduce legal impediments, including emulating the proposals of European Commissioner, Neelie Kroes. Since then, in November 2007, the United Kingdom Office of Fair Trading has issued a further list of recommendations to facilitate private actions. In both the European Union and the United Kingdom, private actions are now seen as an essential part of competition law enforcement.

This article addresses the second and third lines of defence, with the aim of raising the probability of successful prosecution and civil suit. The article may also help to improve the detection of cartels once purchasing agencies understand how cartels operate and what to look for. No standard compliance regime has ever detected a cartel and, absent a whistleblower, never will. Indeed, the procurement practices of government agencies greatly assist cartels. However, there are ways in which the risk of a cartel remaining undetected can be reduced.

The article will first explain the nature of cartels before describing five requirements for operating a successful cartel. It will then deal with the broad forms of defensive economic arguments likely to be mounted by respondents at trial or in settlement – that they provided net benefits; that they could have adopted a legal alternative with the same effect; that they only shared the market with no effect on price; that their low profits are evidence of no price effect; and that any effect was passed on to others.

Next, the article deals with the objectives of damages under the legislation and describes how damages may be estimated. Finally, the last section outlines how damages can be determined for private actions in the box case, *ACCC v Visy Industries Holdings Pty Ltd*.⁶

THE NATURE OF CARTELS

The authors propose seven principles relating to the nature of cartels from their history and the legislation in various countries.

1. The meaning of the word “cartel” is equivalent to the word “monopoly”.
2. All firms in an industry will always earn higher profits by forming a cartel. The only modification is if the costs of the cartel, together with the probability of detection and the penalties imposed, are so high as to outweigh those returns.
3. For the individual firm, it is more profitable to join the cartel and then to cheat on other members, except if there is market sharing.
4. The primary purpose of the cartel (whether legal or illegal) is to maximise returns by raising prices above what would otherwise prevail.
5. The means employed by a cartel to maximise returns are equivalent to those of a multi-plant single-seller monopoly. It is possible for cartels and monopolists to make losses in the short term.
6. Cartels impose costs on customers which are additional to the pure price effect. Important categories of additional costs are X-inefficiency; inappropriate scale, scope and capacity utilisation; the retardation of technical progress; and the diminution of quality.
7. In longer-lived cartels, these additional costs can be greater than the allocative losses from monopoly prices, and are recoverable in claims for damages.

Cartels were first recorded in Egypt, Phoenicia, Palestine and India some 5,000 years ago. The characteristics of the modern cartel had developed by about 600 years ago. For example, in 1470 in Britain, a cartel in the supply of alum fixed market shares and prices, exchanged statistical information, provided for inspections to guard against cheating, and had a combat clause to destroy outsiders. While they were described as monopolies, they were, in fact, cartels.

⁵ *ACCC v ABB Transmission & Distribution Ltd (No 2)* [2002] ATPR 41-872 at [51]; *ACCC v ABB Transmission & Distribution Ltd (No 3)* [2002] ATPR 41-873 at [9].

⁶ *ACCC v Visy Industries Holdings Pty Ltd (No 3)* [2007] ATPR 42-185.

In 1601, Queen Elizabeth I denounced monopoly abusers and scorned monopolists (cartel members) as “varlets, lewd persons, abuses of my bounty”. In 1623, the *Statute of Monopolies* provided for damages for such abuses at three times the value, predating the American *Clayton Act 1914* by three centuries.

The use of the word “cartel” in its economic sense first appeared in reference to German transport industries in 1879. Before that, it had different meanings, including a truce to end hostilities in wars and related documentation. The legislation and economists often view the words “cartel” and “monopoly” as being equivalent. The current British competition legislation has gone further, including tacit collusion among oligopolists along with cartels in what it calls a “complex monopoly”. The authors define a cartel as an agreement between rivals to end hostilities in the market place and to act as if members were a single seller.

It can be demonstrated that no matter what the conditions – large number of firms, different cost structures, non-homogeneous products, declining costs, imperfect knowledge etc – it is always possible for the cartel to maximise profits (or minimise losses) by following relatively simple rules.

Thus, the incentive for cartel conduct is ever present, as Adam Smith famously observed in his *Wealth of Nations* in 1776:

People in the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.

Legal cartels can be formed where, in public announcement terms at least, there may be official objectives other than the full use of market power. The *Webb-Pomerence Export Act 1918* (US) provides exemptions, and Australia allows support through statutory marketing authorities and in liner shipping. The TPA provides for the authorisation of certain arrangements which, in effect, are cartels.

Nonetheless the United States Congress itself recognised that the real purpose of that Act is to achieve higher prices, and various Productivity Commission inquiries have shown that higher charges for foreigners often provokes higher domestic prices. Inquiries into liner shipping have shown much the same.

While the purposes of cartels and monopolies are the same, their effects are very different. That difference is costs, and this has implications for damages and for public policy. As Professor Areeda explains:

They want the profits that could be earned if that market were occupied by a single-firm monopolist. But the cartel’s economic performance may well be worse. Unlike the monopolist who will utilise only his most efficient low-cost productive facilities, the cartel must please most members in order to maintain their allegiance. Thus, neither the discipline of the competitive price nor the direction of central management will mitigate costs. Cartels typically produce inefficiency, maintain wasteful unused capacity, and even build excess capacity.⁷

X-inefficiency alone could well outweigh the price effect of cartels.

A familiar plea of cartels which have been discovered and are facing penalties and damages is that they cannot pay. Yet there are many examples of firms quickly eradicating X-inefficiency and becoming both competitive on price and profitable. A prime example is ICI in the United Kingdom which, after 30 years of cartelisation, restructured and faced up to competition with much lower costs.

Inappropriate scale and capacity utilisation are additional costs. An OECD analysis of industries across eight countries found that many high-cost plants of inefficient scale only survived because of cartelisation.

The relationship between market power and the rate of innovation, or technical progress, has been one of the most studied aspects of competition policy. The problem with cartels is that the drivers for innovation first identified by Joseph Schumpeter in various publications between 1939 and 1949 work in the opposite direction. Cartel members are already earning returns above the competitive rate (or are dissipating the profits); the risk is in the undermining of the cartel through innovation either inside or outside the cartel, hence the stifling of innovation.

⁷ Areeda P, *Anti Trust Analysis; Problems, Texts, Cases* (1974) p 269.

In summary, the potential “rewards” of cartelisation are of a dual nature: monopoly pricing; and the ability to sustain inefficient operations and lower quality levels.

From a societal point of view, this means that there is a greater welfare loss than expected. It is estimated that cartel costs are more important than cartel prices by a factor of about three. When costs are involved, the welfare loss has as its major dimension the whole output of the cartelised industry, not just the change in output associated with a monopoly price. This is worsened by a lack of dynamism in production, which is not captured in the static welfare model.

In other words, even if cartel members could credibly show that prices had not been inflated, it would be incorrect to infer that customers and society had suffered no damage. They have paid higher prices because of higher costs. Another consequence is that profit, as reported by cartel members, is meaningless as a measure of the effects of their conduct.

OPERATING A SUCCESSFUL CARTEL

Cartelisation is facilitated by five rules or requirements, which can be viewed as stages in the process of entrenching a monopoly position.

1. An agreement between the parties which recognises mutual interdependence and, where such an agreement is illegal, the need to preserve secrecy.
2. A mechanism for detecting cheating.
3. A method for punishing cheating, short of abandoning the agreement.
4. A method for distributing joint profits.
5. Joint action to preserve the monopoly position, especially deterring new entry and imports and restricting innovation. Meshing in with any relevant international cartel will serve this purpose.

The list may be overly extensive. However, those cartels that incorporate all five appear to be very long lived. A tongue-in-cheek list of 37 rules and subrules to effect a proper conspiracy was compiled in the wake of the collapse of an electrical equipment cartel which lasted 63 years. The compiler of the list, under an obvious non-de-plume from Harvard notes:

Now that the smoke has lifted from the price-fixing conspiracy rubble of the electrical equipment industry, boardrooms across the nation will be submerged in pipe-sucking reflection on the lessons to be learned from it. Surely a most striking aspect of this antitrust fiasco is that so many capable executives could make a botch of the relatively simple job of running a tidy conspiracy. Many basic rules of successful conspiracy were sadly neglected.

Sadly, the Australian transformer and box cartel members did not heed Rule 6 of that list:

Do not take notes; do not leave papers, work sheets, scratch pads, and the like lying around in hotel rooms; do not register in your real name; do not travel with your co-conspirators in public transportation to and from meetings; do not make conspirational telephone calls from your office,

nor Rule 15:

Do not be greedy.

The first stage – reaching an agreement, arrangement or understanding – is also the hardest, particularly when there is product heterogeneity and members are of different sizes with plants at varying levels of efficiency. For instance, an investigation of six legal cartel agreements in Holland found that they had been concluded with great difficulty, with mutual suspicion and distrust over such matters.

Colluding firms will have much to discuss and negotiate if they are to provide for a stable cartel. They must agree upon the price structure and price classes necessary to tailor prices to the diversity of transactions. They need to agree on banning internal price and non-price competition, discouraging other competition, pooling patents, assigning quotas and customers, and much more. There is simply no way, as is often asserted, that all this can happen in an unspoken or tacit way, or by unconscious parallelism.

Once there is an over-arching agreement, the next step is to counter the incentive for individual members to cheat. Again, as with maximising joint profits, there is a body of technical analysis and sets of rules which can be followed – indeed, one of the Harvard “rules” for running a successful

cartel includes employing a modeller experienced in these areas. There is even a set of rules for optimising internal enforcement so that the cartel can continue, while taking into account the penalties likely to be endured if the cartel is inadvertently detected.

Most cartels need not go to such lengths. Indeed, enforcement can be a pleasant matter when members are few and industry sales and shares are readily known. Witness the “Gary dinners”, where Judge Elbert H Gary, who was also chairman of a major producer in a steel cartel, held regular high table dinners in which enforcement ensued in a mutually respectful manner.

It is even easier if the cartel can obtain transaction prices from buyers to check on fellow members. The best type of buyer who not only reveals the price he pays, but also is unlikely to accept secret benefices from the chiseler, is the government.

Even better is market sharing, since this *eliminates* the incentive to secret price-cutting. This is because each cartel member is moving along a demand curve which is a fixed share of industry demand, and so has the same elasticity on the industry curve at every price, once a maximum profit price has been established. In one fell swoop this solves the problems of how to act together to maximise profits and to stop cheating. It also solves the informational problem because relative shares can usually be readily determined. As long as the cartel decides to change shares occasionally, and there is an appropriate formula for redistributing the gains and losses from departures from quotas, the agreement could go undetected indefinitely.

This is precisely what happened in the American electrical equipment cartel which, on and off, lasted from 1896 to 1959 when they forgot Rule 15: “Do not be greedy”. Each seller was assigned a share in the various markets. For example, General Electric’s share of the high voltage switchgear market was 40.3% in 1958. A “phases of the moon” system was used to allocate low-bidding privileges so that an ostensibly random pattern of quotations conveyed the impression of independent pricing behaviour, but was co-ordinated so that predetermined shares were maintained. A complex pricing formula book was provided to each member.

The Australian transformer cartel operated in a similar way for, in the authors’ estimation, at least 40 years. Its members also forgot Rule 15. In these two cases, and more generally, it is the small members who are responsible for the dissolution of cartels. They are more focussed on the highest short-term profit and appear to consider the fixed prices to be truly parametric – that is, not perceptibly affected by their own decisions. This is also why large cartel members often make concessions to smaller members in agreements, as in OPEC.

A similar approach was used in the British “Water-Tube Boilermakers’ Agreement” cartel. When a buyer called for bids, the cartel’s director nominated a member to undertake the job based on market shares. The nominated firm could then quote as it wished. Since nomination depended on shares and not prices, there was no incentive to cheat.

Distributing joint monopoly profits is straightforward in bidding and in market-sharing cartels. It is wise, though, to devise ingenious rotating systems and keep losing bids close to the price of the nominated winner. As in the transformer cartel, that has the advantage of “proving” the industry is “competitive” and explaining how another firm bids lowest next time around. When the Australian cartel is meshed in with international cartel arrangements, “evidence” can also be presented to show that imports would be more expensive.

Distributing joint profits in rationalisation cartels is problematic because it involves the allocation of quotas based on relative efficiency and a system of side payments, which need to be disguised. Such cartels are rarely stable, for a range of reasons, including more efficient members claiming larger shares of joint profits over time.

Large member cartels need a central control agency to organise the distribution of quotas, profits and so on, such as the single-desk cartels in Australia. These are also typical in the coal industry, as in the cartels in Europe and the Appalachian Mountains cartel, which has 137 members. The International Notification and Compensation Agreement cartel in capital goods goes one better. The nominated winner must pad out its prices to pay compensation to the losers for their trouble and for the administration of the scheme. This has the merit of ensuring that the buyer not only pays monopoly prices but also the costs of running the cartel which is gouging him or her.

A strong central agency is necessary if new entry and imports are to be deterred and innovation restricted. The International Electrical Association (IEA) cartel holds all the necessary techniques: home-market protection, hunting-ground agreements, price-fixing and market-sharing arrangements, and technological accords etc.

An example of how this can operate is the sale of transformers in Brazil. The problem was that two non-cartel local companies started operating, undermining the high prices applied by the IEA. The monopoly price paid for supplies to Brazil at that time is not known, but what is known is that Venezuela was obliged to pay 238% of the IEA's reference (or monopoly) price for transformers. First, the IEA provided a war chest to undercut the two local producers to below their costs of production and also arranged for the withholding of supplies, including copper wire. It then applied a technological constraint on their use of certain porcelain bushes. As the two local firms collapsed, two cartel members set up in Brazil with the remaining segment of the market again supplied by imports from fellow members.

This meshing of local and foreign cartels into an international web with a central authority with all the trappings of plush headquarters and administrative staff was once apparent in a number of industries. However, public outrage and the attention of antitrust authorities means arrangements now are no longer so obvious.

NET BENEFITS

As Areeda has noted:

Whatever the collaborators' true reasons, hardly any cartel has undertaken to fix prices without insisting that it served the public interest to do so.⁸

The sort of reasons given include that cartelisation was necessary to prevent destructive price wars; to preserve the capacity of an essential supply industry; to reduce uncertainty and increase investment; for orderly and timely supply responses; to help preserve domestic small firms at times of economic fluctuations and uneven demand; to fund desirable collaboration such as joint research groups; to fund activities such as R and D and innovation; to increase countervailing power against rapacious suppliers; and to provide protection against quality debasement.

Examples of these arguments can be found on the website of the Wilson Transformer Company, a convicted cartel member. None of the arguments has merit. As already shown, for instance, innovation is inimicable to cartels. As Areeda argues, "we look to competition and not to combination to protect the public in maximum efficiency and progress at the lowest long-run cost".⁹

Even so, it may be useful for plaintiffs to prepare refutations when such arguments are put in settlement negotiations, including the trickier argument that the arrangements could have been authorised.

It is true that some of the benefits alleged by cartel members are similar to those recognised by the ACCC and the Australian Competition Tribunal as public benefits. But the obvious retort is why did they not therefore apply for authorisation? The fact they did not seek immunity under an authorisation suggests that there was a price fix and one of sufficient size to outweigh any public benefits, as well as the consequences of being caught.

LEGAL ALTERNATIVES

Another common defence by cartels is that the effects of their arrangements were no different from those which can occur under legal forms of organisation.

Consequently, there is no separate and additional "but for the illegal conduct" price, and no damage.

Thus – the argument goes – while we may have been remiss in not rearranging our ownership or contract structures, and there has been but a technical breach of the legislation, there has been no

⁸ Areeda, n 7, p 269.

⁹ Areeda, n 7, p 270.

additional effect from what can happen in partnerships, joint ventures and merged entities, or under certain types of legal oligopoly or by tacit collusion. While the result may not have been a competitive price, it would have been a price within the law.

They could point to partnerships in law firms, for example, as these involve agreements on prices and allocating markets.

The partnerships and joint ventures defensive argument, however, was demolished, in the authors' view, in several early cases under the *Sherman Act*.

In the Addystone Pipe cartel case, *United States v Addystone Pipe and Steel Co* 86 F 271 (1898). Judge Taft (later to be a Supreme Court Chief Justice) drew on the history of inhibitions to distinguish between valid restraints, which had a legal purpose, and the constraints in cartels which had an illegal purpose, with the basic insight being that the former had a capacity for improving the efficiency of an integration.

Thus, the typical law firm comprises lawyers who would otherwise compete with one another but who have eliminated rivalry and integrated their activities in the interest of a more effective operation. Not only are members usually forbidden to take legal business on their own, but the partnership operates on the basis of an agreement to fix prices and share markets (agreed fees and fields of specialisation). However, it is not the purpose to restrict output or apply a monopoly price. The purpose is to create efficiencies, and the agreement is necessary to deliver these efficiencies, including by preventing the free rider problem.

Price fixing and market sharing work in opposite directions in legal entities as compared with cartels. Production costs in partnerships will be lower than otherwise, including through economies of integration, and prices will trend downwards under the pressure of competition (for example, from other law firms and highly mobile clients).

The same approach was taken by Lockhart J in the *Radio 2UE*, case¹⁰ where he remarked:

My approach to the construction and operation of Section 45A is generally in accord with the approach taken by the courts of the United States of America in decisions under the *Sherman Act*.¹¹

The judge went on to distinguish between arrangements restraining price competition and those which merely incidentally affect it or improve competition.

It can be expected that the line of defence that the cartel acted no differently from legal forms of oligopoly will become more popular because it is a complex technical area where courts can become easily confused. For this reason, the authors have examined all the models of oligopoly and have found that almost all do not reproduce cartel outcomes. Some models can have a cartel price but this happens only for an instant in a process of continuous change. Some price leadership models can raise prices but do not emulate cartels. Chamberlin's model replicates cartel prices but depends on unrealistic assumptions such as costs of zero. When any of these assumptions is relaxed, the model disintegrates.

American case law appears to view tacit collusion as collective or concerted action rather than unilateral or independent behaviour, and is therefore subject to the *Sherman Act*.¹²

Tacit collusion is voluntary behaviour and not an unconscious state. No firm should have a problem in determining when it is behaving non-competitively, and therefore the *Sherman Act* applies. The above cases suggest that behaviour merely suggestive of the vaguest course of action will establish a breach, such as a "meeting of minds" or a "knowing wink".¹³ Under the TPA, for there to

¹⁰ *Radio 2UE Sydney Pty Ltd v Stereo FM Pty Ltd* (1982) 62 FLR 437.

¹¹ *Radio 2UE Sydney Pty Ltd v Stereo FM Pty Ltd* (1982) 62 FLR 437 at 448.

¹² See *American Tobacco Co v United States* 328 US 781 (1946).

¹³ *ESCO Corp v United States* 340 F2 1000 (1965) at 1007.

be an arrangement or understanding, there must be a meeting of minds and a consensus as to what is to be done, rather than a mere hope that something will be done.¹⁴

In *TPC v Nicholas Enterprises*, Fisher J stated (at 89) that the essential elements of a meeting of minds was that each of the parties communicates with every other party, that each raises an expectation in the mind of the others, and that each accept an obligation qua the other. This seems more restrictive than decisions under the *Sherman Act*, and the Federal Court in *Morphett Arms Hotel v TPC*¹⁵ which was expressly reserved on whether or not mutual obligation was a necessary element.

Reliance by cartel members that what they did was no worse than if they had engaged in tacit collusion is therefore an unattractive option, particularly for those companies with a restrictive practices history.

MARKET SHARING

The defence that the arrangements of the respondents only extended to market sharing and had no price effect is a favoured line and some of its forms can be found on the website of the aforementioned Wilson Transformer Company.

Such arrangements are common in cartels for a good reason, as Stigler writes: “Fixing market shares is probably the most efficient of all methods of combating secret price reductions.”¹⁶ As noted earlier, it has other advantages, and can provide optimal outcomes under imperfect conditions. Consequently, as there is always monopoly pricing and no price cutting, there is always a separate and additional “but for the conduct” potential damages claim.

Market sharing is also the favoured instrument of legal cartels such as liner conferences and the International Air Transport Association (IATA). The Prices Surveillance Authority found in 1993 that, while the shipping conferences were not perfect cartels, prices were close to the monopoly outcome. Nor is IATA perfect as there were a few small non-members such as Icelandic Airlines which competed on main routes at substantially lower prices.

Respondents in the transformer, box and other cartels have attested that market sharing had no effect or resulted in “reasonable” prices. They were only sharing markets for altruistic, benign or public benefit reasons. There is no theoretical model that provides for market sharing with no price effect. A 1979 study of 65 cartels found that all included monopoly overcharges. The authors have found no evidence of any cartel, having achieved a monopoly position at great risk, subsequently eschewing super profits and providing competitive or reasonable prices.

Reasonableness in pricing was rejected as a defence in the first cartel case to be appealed to the United States Supreme Court: *Trans Missouri Freight Association* 166 US 290 (1897).

Judge Taft made a similar finding in *Addystone Pipe*, adding that the prices were not reasonable anyway. All this was restated by the Supreme Court in *Trenton Potteries*¹⁷ in 1927. The court added in *Socony-Vacuum*¹⁸ in 1940 that if reasonableness of prices became an issue, the *Sherman Act* would soon be emasculated.

It is not altogether clear that the Federal Court recognises that market sharing is merely the instrument of fixing a monopoly price with no cheating, and not an end in and of itself, as the court in *ACCC v Simsmetal Ltd*¹⁹ and *Nicholas Enterprises* seems to be suggesting some separateness.

In case anyone is persuaded by the Wilson Transformer Company’s website mentioned earlier in this article, the following is what actually transpired in the formation of that cartel. The cartel member companies compiled a list of contracts expected to become available over the forthcoming year and

¹⁴ See *TPC v Nicholas Enterprises Pty Ltd* (1979) 40 FLR 83.

¹⁵ *Morphett Arms Hotel Pty Ltd v TPC* (1980) 30 ALR 88.

¹⁶ Stigler GJ, “A Theory of Oligopoly” (1964) 72 *Journal of Political Economy* 44.

¹⁷ *United States v Trenton Potteries Co* 273 US 392 (1927).

¹⁸ *United States v Socony-Vacuum Oil Co* 310 US 150 (1940).

¹⁹ *ACCC v Simsmetal Ltd* [2000] ATPR 41-764.

allocated each one so that a monopoly position was achieved. If the contract did not eventuate or an unexpected contract became available, there was a reallocation, with an “unders and overs” account to ensure shares were maintained. The selected winners could simply raise the price to the limit of customers having to make transformers themselves as there were no substitutes, the import market was contaminated and, by law, energy companies had to maintain and expand electricity supply to existing and all new customers. The cartel only broke up because of a fight over shares in a very large and lucrative contract.

LOW PROFITS

Can cartel members plausibly argue that their record of poor profitability – assuming that such a record is submitted – is proof that monopoly prices were not charged?

One problem in assessing profitability is knowing when a cartel is operating. Cartels can be very long-lived but with interludes of competition. These may result from the enforcement of disciplinary action against a recalcitrant member or a maverick; a response to a temporary change in economic conditions; a sort of re-booting at a time of product mix changes; or a bit of argy-bargy before new arrangements are made.

Such interludes are also useful in confusing antitrust bodies and customers. This was evident in the electrical equipment cartel where the United States Justice Department was shocked to find that the cartel it first thought had only operated in the 1950s was in fact formed in 1896. The carbon brushes cartel discovered in the United Kingdom in 2005 had operated off and on since before WWII.

The formal admissions made to the ACCC in the transformer case before Emmett J went back to 1993, and Finkelstein J found that cartel arrangements went back to 1989. Yet George Fox, one-time Managing Director and Deputy Chairman of one of the suppliers has said that the cartel was operating at least from 1960, with monthly meetings at 11 Loftus Street, Sydney. A similar situation appears to be developing in the box cartel, with a former senior executive reporting the cartel was operating in 1989.

A second problem is that monopoly profits may not be recorded in financial statements but in separate sets of books (as in the transformer case) or dissipated in an endless variety of ways. These include paying higher rewards to factors of production and the ability to sustain inefficient and outdated plants.

There is also the fact that even price setters can make losses in the short term. It is just that those losses are a lot less than the profits that are made.

PASSING ON

The passing-on defensive line is usually put in terms such as: the plaintiff suffered no real damage because it passed on any overcharge; the TPA does not provide for compensation to direct purchasers in this situation; to provide such compensation would be an unjustifiable windfall; the penalties already paid have covered any damage; or in any event, the plaintiff has no standing since it does not represent end-users.

American authorities are useful in this regard. In *Hanover Shoe*,²⁰ the United States Supreme Court held that an antitrust violator may not defend a suit by proving that the plaintiff passed on all or part of an illegal overcharge. The reasoning was that to allow such a defence would have unduly complicated damage litigation and might have resulted in violators retaining the benefit of their conduct.

In *Illinois Brick*,²¹ the Supreme Court held that subsequent purchasers further down the chain may not recover an illegal overcharge that was passed on. It noted that while *Hanover Shoe* precluded the *defensive* use of the passing-on argument, its finding would protect defendants from the *offensive* use of the argument and the risk of duplicative treble-damage liability (six times the damage).

²⁰ *Hanover Shoe Inc v United Shoe Machinery Corp* 392 US 481 (1968).

²¹ *Illinois Brick Co v Illinois* 413 US 720 (1977).

Two additional reasons were the difficulty of apportioning damage between direct and indirect purchasers; and to avoid the dilution of claims and thereby the incentive for private action and enforcement.

It is submitted that other doctrines and concepts such as standing, remoteness and speculation suggest that *Hanover Shoe* and *Illinois Brick* are relevant under the TPA. Moreover, the wording of s 82(1) of the TPA is simple. There is no subordinate, conditional or qualifying clause about what the victim may claim or about subsequent action to mitigate against the higher price it paid. This is in line with the Supreme Court's finding of the difficulty of apportioning damage.

DAMAGES

An important reason why damages should have a broad perspective in Australia and America is the need for private enforcement. The framers of the legislation in both countries saw actions for compensatory damages as equal to penalties, or even the primary instrument. That is why, for instance, the United States Congress provided no funds for any public enforcement in passing both the *Sherman Act* and the *Clayton Act 1914*, relying solely on the initiative of victims. In practice, of course, successive governments in both countries have provided funding so that public and private enforcement could operate in a piggy-back fashion.

Both Chief Judge Posner of the United States Court of Appeals and the Hilmer Committee in Australia have used nearly identical words to describe the current systems of remedy in the two countries, with the twin objectives of deterring people from violating the law and compensating injured parties. Yet the role of private enforcement in Australia has been largely overlooked.

There is also an identity of words and meaning in the relevant jurisdictional legislation, including countries such as Canada, with respect to the right of private parties for compensation. Section 4 of the *Clayton Act*, s 82(1) of the TPA and s 36 of the Canadian *Competition Act 1986* could have been written by the same hand. Of course, the *Clayton Act* provides for the right to recover "threefold the damages".

The language of the remedial area of the TPA is also broad, and compatible with a legislative desire for a wide scope of recovery, involving no suggestion that the amount that may be recovered is to be limited by some comparison with the common law, the law of contract or the law of tort; nor any limitation on the kinds of loss or damage. Where there is uncertainty in assessing damages, speculation and guesswork are permissible. Section 87 of the TPA also appears to cover losses that are likely to occur in future. There is also no reference in s 82(1) to what happened under the penalties provision (s 76), thus demolishing any line of defence that respondents would be paying twice. That is, any overlap in what was considered in the setting of penalties would appear to be their misfortune.

An over-arching view of the legislation and case law in Australia, Canada, the United Kingdom and the United States suggests that the objectives of damages would include, but would not be limited to, the following:

1. Compensate the victims by "making them whole".
2. Motivate the victims to sue or settle for damages.
3. Compensate the victims for the difficulty of suit.
4. Punish the violator.
5. Deter the potential violator.
6. Repair the damage to society.

If compensation is to restore the position of victims by making them whole with respect to the amount of damages sustained, then the quantum of damages should be at least sufficient to make victims indifferent to the conduct. This follows logically from the meaning of the word "whole" – "the full, complete, or total amount, the assemblage of all the parts" (*Oxford English Dictionary*).

The notion of indifference is fundamental to many areas of economics, including welfare economics, which lies at the heart of the TPA and its purpose.

The notion of indifference, first conceived by Edgeworth, is the observation that any person, given the choice of two bundles of goods, is able to say whether he prefers one or the other, or whether he

is indifferent between them. Pareto developed this concept into what has become regarded as a value-free test in welfare economics. Indifference and welfare economics, in turn, have been developed into measures of the competitive economy in terms of defining economic efficiency, evaluating this under systems of resource allocation, and analysing which policies improve social welfare.

The TPA, as an economic law, has as its purpose, as set by the Parliament, the enhancement of economic welfare through competition (s 2). Cartels impose damage directly on purchasers and indirectly on the welfare of all Australians, as noted by Heerey J in the box cartel case. One objective of setting damages must be to make victims indifferent to the conduct.

Private enforcement requires some incentive, given the costs and risks of suit, and is one of the original justifications of treble damages. The United States Supreme Court in *American Society of Mechanical Engineers*²² confirmed the need to compensate plaintiffs for the difficulty of bringing private actions to successful fruition, as well as compensating them for losses. The court also referred to objectives of punishment and deterrence. Compensation at treble the rate has a strong deterrent effect but may not be at the optimal level of deterrence. In Australia, of course, successful actions may be more difficult, including the uncertainty of reliance on s 83 of the TPA, but only single damages applies.

The extent to which all six of the objectives listed are relevant under the TPA is a matter for debate and it is not altogether clear in America, which has had a richer debate. For example, at a high policy level, the United States House Committee of the Judiciary in 1984 made plain that the statutory provisions for damages are to include punishment and deterrence in addition to compensation, yet those elements are not obvious in the findings of damages cases. In Australia, punishment and deterrence appear to be the proper primary purposes of penalties. It is not obvious that damage to other parties and to society have ever been properly calculated and included either as penalties or damages in either Australia or America.

One difference at a practical level between the Australian and American approaches that was significant – but is now much less so – is the standard of proof for damages. The TPA provides for speculation and guesswork. However, the United States courts initially took a hard line, reflecting the English common law heritage of requiring hard evidence of actual damage.

The principle that has emerged though is that compensation must be rendered, no matter how difficult the computation, and that the defendant is not entitled to complain about lack of exactness.

ESTIMATING DAMAGES AND “BUT FOR” PRICES

Three approaches accepted by the courts for estimating damages are: before and after, yardstick theory, and market-share theory. “Before and after” was commonly used in tort and contract cases well before the *Sherman Act*. It examines prices or profits in what is assumed to have been a non-conspiracy period as benchmarks for what would have been *but for* the illegal conduct. When a cartel has operated for many years, the “after” period is usually simply selected.

Another way around contaminated markets is yardstick theory, which compares the plaintiff’s financial performance with those of a similar sort of company in another (uncontaminated) market.

Market-share theory involves estimating the plaintiff’s lost market share and translating this into lost revenue. There are a number of practical difficulties involved in this approach, including defining the relevant market and obtaining data on sales from competitors.

There are also three classes of measuring instruments: direct evidence, engineering analysis, and quantitative and econometric analyses. The “but for” condition is a hypothetical world in which the violations never occurred.

Unless plaintiffs are confident about the origin of direct evidence – as occurred in the transformer case when papers intended for the shredder, including relevant handwriting, were retrieved by a whistleblower – there is a chance that it is contaminated.

²² *American Society of Mechanical Engineers v Hydrolevel Corp* 456 US 565 (1982).

The engineering approach usually involves the reconstruction of the costs of production to establish an efficient and competitive price, and this serves as a benchmark against the rigged prices.

If before or after data are sufficient, various types of econometric analysis may be conducted, or quantitative techniques; autoregressive and moving average models; and probit and logit analyses. There is enough technical complexity in this area, and many problems, to warrant a separate article. For one thing, any error will inevitably bias damages estimates downwards through the “error in variables” phenomenon.

BOX CASE DAMAGES

The box industry in Australia is highly concentrated and vertically integrated and is part of an integrated international packaging industry. The international box industry has a long history of cartelisation. For example, American firms have been prosecuted for fixing prices back to the 1930s. The first damages suit for price fixing and market sharing was in 1939. After a long period of violations and complaints, the government cracked down on the industry in 1967, its attack including the use of divestiture orders to end communications on prices. The largest damages suit under the *Sherman Act* up until that time occurred in 1976 against 37 box suppliers for price fixing. This was settled for \$US550 million. There was also a separate indictment and action over folding cartons. Further damages cases were brought in the 1990s, with some large settlements. There was a settlement of \$US230 million in 2003.

In determining damages from the Australian box cartel, the authors have adopted the “before and after” approach and used engineering analysis. The first task was to explore the structure, conduct and performance of the industry here and overseas and to investigate the economics of box making and best practices in production. Part of this work was to understand how a number of technological landmarks had affected costs. The origins of boxes and folding cartons can be traced back to 1850 in the United States. The first corrugated material was patented in England in 1856. Unlined corrugated material was beginning to be widely used by 1870, and a liner was added to prevent the flute from stretching in 1874. Wells Fargo constructed the first mass production methods in 1890.

There have been various technological breakthroughs since that time, including in box making itself, the capabilities of the box, optimisation in delivery, in printing, and in both standardising and customising boxes. Once all this was understood, the authors could start to understand where the local suppliers stood in terms of relative practices and performance, given their other research on relative structures, conduct and performance across countries. Findings included that economies of scale and of vertical integration are significant; also, that re-usable plastic containers are beginning to become competitive with boxes in some product areas.

The next step was to determine the relative competitiveness of the Australian box industry with those in the United States and major European countries. One finding here was that the Australian industry was not only less efficient, it also lagged behind the productivity growth of other countries even though it occupied a higher position on the long-run average cost curve. In other words, it could have achieved a superior productivity growth if it had reformed and modernised, as it lies on a steeper part of the cost curve, but it did not.

Once these data had been obtained, the next step was to establish what was paid by victims – the nominal prices net of any rebates for the various types of purchases, multiplied by quantities, for each year.

Next, the authors constructed what competitive prices would be for the various products. They were assisted in this by overseas sources who had already done much of the work for a similar purpose, to assist buyers in suspected cartelised markets when negotiating packaging prices. This provided a structure of costs and competitive margins for the products. It was then possible to estimate efficient total costs and competitive prices in Australia for the products for each year by deflating each cost element by relevant official Australian Bureau of Statistics (ABS) cost indices and productivity growth.

The conservative option was always taken in these calculations. For instance, input indices were not adjusted for the likely exercise of market power by the integrated producers here, even though the

authors had a measure of this effect from the United States. Nor was any adjustment made for over-capacity, which would have been lower if the market had been competitive over the period. Other indices could also have been used on some cost elements, which would have increased the claims.

This method of providing for changing cost drivers has not been applied before in Australia and only rarely overseas. This eliminates the defence of respondents that price increases were cost related. No speculation was involved.

Competitive prices were then compared with actual prices. Many interesting matters emerged from such an analysis: when the cartel was in full flood, when and if it stopped, what each cartel member did and when, what happened on individual products, what happened to different victims, how this coincided with admissions and other evidence etc.

The final step was to calculate damages as the net present value of the difference between what was paid and the competitive price. The discount rate reflects the opportunity cost for the victims and their financial positions.

A weighted average cost of capital was applied, adjusted to make reasonably sure that the true cost of capital and asymmetric risk were covered. A moderate coverage was applied by methods proposed by the Productivity Commission and others. It is strongly arguable that provision should have been made for greater coverage where victims were highly exposed in the markets in which they operated, such as export markets.

There is a range of reasons why these estimates were conservative, including the following.

- No provision was made for the five other objectives of damages mentioned in this article. A general estimate of the damage to society has been made, and it is considerable. However, no allowance was made for the difficulties of damage recovery, the pursuit of litigation etc, even though these costs are significant, including the diversion of top management.
- No allowance was made for a number of costs, including the overcapacity effect and lack of dynamic efficiency. On the contrary, the authors provided for full profits and full fixed cost recovery in every year in the benchmark prices.
- No allowance has been made for the profit increases that would otherwise have occurred but for the curtailment of business by the violations, including the expansion of output if clients had faced lower prices, and the loss of value of assets,
- Not all the costs and risks associated with making the victim whole have been included in the opportunity cost, and it is strongly arguable that hurdle rates and not the weighted average costs of capital should have been used in these cases, which would have significantly increased estimated damages.
- No allowance was made for an alleged drop-off in quality, mainly because of the difficulty of data on box durability from an earlier time. This could have been estimated and included, since obtaining it was a result of the cartel members' "own wrong".

IMPLICATIONS

Professors Karmel and Brunt²³ estimated that most Australian industries were cartelised in the 1960s. Today, applying OECD estimates of undetected cartels to investigators could mean that some 400 cartels are currently operating. While things have undoubtedly improved, the diversity, pervasiveness and stability of cartels is still a significant problem for the Australian economy and individual firms and their customers.

It is submitted that part of the solution lies in promoting and improving the compensatory approach so that private actions fully complement public enforcement. If more victims seek recovery of damages and improve their responses to defences, there can be hundreds of policemen, not one, with greater resources, from private and not public sources, brought to bear.

The authors have attempted to show that the success rate in recovering damages through the courts or in settlement could be high because the defensive lines typically mounted by cartels can be

²³ Karmel PH and Brunt M, *The Structure of the Australian Economy* (Angus & Robertson, 1962).



countered. Secondly, the quantum of damages is likely to be a lot higher than victims imagine. While only single damages apply under the TPA, compensation may nevertheless be substantial, much larger than the monopoly margin applied by the cartel.

Detection and prevention could also be improved if purchasing departments understood how cartels operate and what to look for, and if Boards implemented compliance procedures to prevent cartel activities in their own companies.

Finally, for government, the positive initiatives being taken by the European Commission and the United Kingdom Office of Fair Trading to facilitate private damages actions against cartels are worthy of consideration, as is the revision of s 83 of the TPA which apparently requires the reproving of facts that have already been admitted to in another court. This is clearly defeating the original policy intent of the Parliament.

