A trans-Tasman analysis of competition law

Following is the edited version of a speech delivered by Commissioner Ross Jones in Wellington at the New Zealand IIR Competition Law Master Class Conference in February 2003.

Competition law in Australia and New Zealand

Economic and commercial ties between our two countries reach right back to the days of colonial settlement. Formal relationships, however, and a more integrated approach to market development were given impetus in 1965 with the signing of the New Zealand/Australia Free Trade Agreement and the Australia–New Zealand Closer Economic Relations Free Trade Agreement of 1983.[1]

Since 1983 the legislative paths of competition law in New Zealand and Australia have been similar although not identical. A distinctive New Zealand–Australia case law has also been evolving.[2]

It is a general principle that where markets and competition policy lead competition law tends to follow.

Regulation of network industries and monopoly infrastructure

New Zealand acted to deregulate and privatise industries and utilities before the Commonwealth and state governments in Australia. One possible reason for this is the unitary structure of the New Zealand polity. By way of contrast, Australia exists as a federation; the Australian Constitution confers on the federal government substantial, but not comprehensive, powers over economic behaviour. This means that federal and state governments need, and needed, to cooperate on national policies such as competition policy.

In moving to implement a comprehensive competition policy in the 1990s, which culminated in the so-called Hilmer reforms, Australian policymakers and legislators addressed issues dealing with:

- the extension of competition law to non-incorporated entities and the professions
- the development, between federal and state governments, of a competition principles agreement by which public monopolies were to be reformed, and access regimes to services established.

In part, we observed and benefited from the competition experience of New Zealand and the application of court based remedies arising out of the s. 36 framework. In 1995 the Australian Parliament introduced a specific and formal legislative regime that provides for access to network industries and natural monopoly infrastructure in Part IIIA.

Then, in 1997 specific legislation provided that the Commission would, among other things, regulate access and enforce competitive safeguards in our telecommunications industry. The legislation included specific amendments to the Trade Practices Act, provision for transitional arrangements, a revised *Telecommunications Act 1997*, and amendments to the *Radiocommunications Act 1992*.

The intention of the legislation was to establish open market access to both telecommunications infrastructure and service provision.

Amendments to the Trade Practices Act introduced two new parts (Part XIB and Part XIC): one dealt with anti-competitive conduct, and the other set out the rules and procedures for guaranteeing access to network services.

Further to this, the Australian Government announced a number of changes to the Act in April 2002.

These essentially involved a tightening of the regime and are designed to make the incumbent's (Telstra) costs more transparent, deliver more timely regulatory outcomes and discourage gaming behaviour.

These provisions apply in addition to those parts of the Act that, more generally, regulate restrictive and unfair trade practices.

As a second example, the regulatory regime that applies to the electricity supply industry is neither perfect nor complete. At present the regulatory regime exists as a product of our federal system, and reflects the history, complexity and numbers of the interests involved in generations, transmission and distribution.

1 D White, 'Cross Tasman Trade in Competition Law: Convergence or Divergence', in F Hanks and P Williams (eds), *Trade Practices Act—A Twenty Five Year Stocktake*, The Federation Press, 2001.

2 M Brunt, 'Australia and New Zealand Competition Law and Policy', in B Hawk, (ed), *International Antitrust Law and Policy*, Annual Proceedings of the Fordham Corporate Law Institute, Transnational Juris Publications Inc., New York, 1993, p. 135.

In Eastern Australia (excluding Tasmania) there is currently a single wholesale market for electricity, and an access regime for the transmission and distribution networks in participating jurisdictions. The arrangements for the operation of the national electricity market are set out in the National Electricity Code.

In general, electricity reform has been aimed at exposing the contestable parts of the industry to competition. Elements of the electricity industry, that are not susceptible to competitive pressures such as elements of transmission and distribution network service provision, are subject to regulatory supervision. This supervision is directed at facilitating competition in upstream and downstream markets, partially through eliminating monopoly rent-taking by transmission network service providers.

Competition law

Clearly, there has been a process of trans-Tasman enhancement from which we have learnt and improved on.

For example, the Australian merger test changed from substantial lessening of competition to dominance in 1978 and reverted back to an SLC test in 1992.

In 2001 amendments to the NZ Commerce Act resulted in changes to s. 47 to strengthen the control of business acquisitions by replacing a dominance test with a 'better targeted and stronger SLC test'.

Simultaneously, changes to the NZ Commerce Act's s. 36 had the effect of bringing the provision closer to the Australian Commerce Act's s. 46 (to prevent firms with substantial market power from engaging in illegitimate anti-competitive conduct). That is, NZ changed s. 36 so that the threshold of substantial degree of market power was brought into line with Australia's s. 46.

Turning now to the process whereby mergers and acquisitions are assessed, New Zealand's Commerce Act provides a voluntary notification regime for business acquisitions. Accordingly, parties contemplating acquisitions may submit an application for clearance to the New Zealand Commerce Commission. I note that this replaced a compulsory system of pre-merger notification.

The current system requires that the Commerce Commission give clearance if it is satisfied that an acquisition would not have, or would not be likely to have, the effect of substantially lessening competition in a market.

If clearance is granted, then s. 47 (dealing with acquisitions and whether or not there is the effect of a substantial lessening of competition) does not apply to the proposed acquisition, provided it is made in accordance with the terms of the clearance. As an aside, I am not aware that there has been a call in New Zealand for changes to be made to the way clearances are handled.

I have to say that the circumstances in Australia are a little different, which makes the adoption of a voluntary notification system unlikely.

Ninety-five per cent of mergers investigated by us on average do not raise significant competition concerns. We have an informal system that works efficiently and well. Given this, it is uncertain that a move to a more formal clearance system would improve certainty for parties seeking approval for a merger or acquisition.

I have heard that some New Zealand practitioners argue that Australia's system would be more transparent if we provided reasons such as those set out in clearance decisions. It is sometimes claimed that, while parties generally have a reasonable understanding of the position of the Commission, third parties find it hard to determine with sufficient precision the reasoning behind particular decisions. Without necessarily agreeing with this, I accept the Commission should operate with a fearless transparency, and that the more people know of our reasoning, the better the process becomes.

A final difference in the area of competition law arises from the treatment of parallel imports of copyright works and subject matter. This is a practice allowed in New Zealand since 1998[3]—although I understand that the New Zealand Government has announced a limited reintroduction of bans on parallel imports for certain copyright matter.

The then newly elected New Zealand Government undertook in 2000 to review the parallel importation arrangements with a particular focus on the effect of the arrangements on its creative industries. The review, which involved public consultation, did not find substantial evidence that reintroducing bans on parallel imports would stimulate investment in, and the promotion overseas of New Zealand's creative talent.

In December 2001 the New Zealand Government announced its response to the review. It decided that parallel import bans would not be reintroduced for

3 *Copyright (Removal of Parallel Importation) Amendment Act 1998* (NZ).

sound recordings, books or computer software. However, the government will continue to review the effect of parallel imports on those copyright products for the next three years.

The situation differs therefore from the one in Australia. Legislation to enable the parallel importation of both books and computer software is currently before the House of Representatives.

Air New Zealand and Qantas

I want now to focus my remarks on the matter of Air New Zealand and Qantas. My intention is to give a report of how this issue is progressing under Australian competition law, outline some of the Commission's thinking and detail the process still in front of us.

As background, subsections 88(1) and 88(9) of the Trade Practices Act empowers the Commission to authorise behaviour that may constitute an exclusionary provision within the meaning of the Act, authorise conduct which may substantially lessen competition, or authorise conduct (which otherwise would contravene s. 50) by a party to acquire shares.

Late last year, the Commission received applications from Qantas and Air New Zealand seeking authorisation for:

1. collaborative arrangements between the parties (the Strategic Alliance Proposal)
2. the acquisition by Qantas of an equity interest of not more than 22.5 per cent in Air New Zealand (the Equity Proposal).

The New Zealand Government (in its role as owner of Air New Zealand) gave in-principle support for Qantas to proceed with the Equity Proposal.

Following this, the Commission received further applications for authorisation requesting approval of an ancillary cooperation agreement between Qantas, Air New Zealand and Air Pacific.

Key features of the Strategic Alliance Proposal and the Cooperation Proposal include:

- applicants would coordinate pricing, scheduling, marketing, sales and customer service activities for all Air New Zealand operated flights, all domestic New Zealand flights operated by Qantas, and Qantas-operated international flights arriving in, departing from, or transiting through New Zealand (the so-called JAO network)
- Qantas would have the right to codeshare on all Air New Zealand flights and Air New Zealand would have the right to codeshare on all JAO network flights and to codeshare on those other Qantas flights that reasonably connect with any flight in the JAO network
- Qantas, Air New Zealand and Air Pacific would cooperate in aspects of their services, businesses or operations (including pricing and scheduling) they consider appropriate. The agreement also provides for Qantas, Air New Zealand and Air Pacific to invite other parties to become parties to the Cooperation Agreement.

The main feature of the Equity Proposal is that:

- before the end of three years, Qantas will subscribe for such a number of Air New Zealand shares as would result in Qantas holding up to 22.5 per cent of the equity of Air New Zealand. Qantas will be entitled to maintain this level of shareholding under 'top up' arrangements with Air New Zealand.

Now, in seeking authorisation the applicants have claimed that the proposals will result in a number of substantial, transaction-specific, demonstrable public benefits, including:

- cost efficiencies
- scheduling efficiencies
- increased tourism to Australia
- improved freight operations
- increased international competitiveness of Qantas and Air New Zealand
- preservation of a commercially viable full service Australasian airline and network
- furtherance of the national interest.

The applicants acknowledge that the proposals have the potential to lessen competition within the relevant markets, and that this could result in detriment. However, they are of the view that there will be substantial and demonstrable net benefits overall, taking into account proposed undertakings, and the constraints imposed by existing and future competitors in the relevant markets.

Without going into the detail, undertakings to the Commission could address questions of market entry, market power and consumer protection.

I note, of course, that the applicants must also obtain approval from the New Zealand Commerce

Commission.[4] And, as you would expect, the two commissions are working closely together.

As part of our considerations, we have sought input from a wide range of interested parties including relevant federal and state government ministers and departments, airline carriers and freight forwarders. There is significant media interest in this matter and the Commission has also received unsolicited submissions from members of the public.

The review of the Australian Trade Practices Act

I turn now to the current discussion in Australia about changes to the competition provisions of the Trade Practices Act. You will be aware that the Act has been subject to independent review, and that the final report has been released to the public.

The approach of the Commission has been that the review provided an opportunity to bring the competition provisions of the Act into line with best international practice.

To make the Act work better the Commission is seeking a number of changes.

Criminal sanctions and pecuniary penalties

The first change is the introduction of criminal sanctions under the Trade Practices Act for hardcore collusion by big business.

Hardcore collusion in the form of secret price-fixing agreements, bid rigging and market sharing is extremely harmful both to business customers and consumers.

Hardcore collusion is a silent extortion by organised criminals.

Hardcore collusion is ethically objectionable, a form of theft and little different from classes of corporate crime that already attract criminal sentences. The possibility of criminal sentences is therefore appropriate for this kind of behaviour.

We should join the United States, Canada, Japan, Korea, now Britain and some other parts of the world in having criminal sanctions for collusion. In my view, it is only a matter of time before we do this. I hope we do it as a result of this review.

The Commission believes that the present system is not properly based. The penalty regime is based on imposition of pecuniary penalty and does not allow for criminal sanctions. Pecuniary penalties—or 'fines'—are not a sufficient deterrent to prevent hardcore collusion by big business.

Given the nature and effect of collusion, this is not appropriate.

Now, despite the fact that pecuniary penalties alone provide an insufficient and inappropriate deterrent to hardcore collusion, the existing New Zealand regime is ahead of Australian law.

Civil penalties for price fixing (or hardcore collusion) are calculated differently in our two countries. The sanction in New Zealand provides for a penalty that is the greater of: $NZ10 million; three times the value of any commercial gain or expected commercial gain; or, if the gain is not known, 10 per cent of the turnover of the body corporate. In Australia, there is a fixed upper penalty of $10 million.

That said, the view of the Commission is that the possibility of jail is a far more effective deterrent for the wrongdoer—even more so, when leniency practices are working well.

Before 1993 the pecuniary penalties applicable to breaches of the Act were low. The maximum penalty per offence was $250 000 for a corporation and $50 000 for an individual. Moreover, in no case until then had the total penalty exceeded $250 000.

In 1993 the penalty was increased to a maximum of $10 million for a corporation for an offence and to $500 000 for an individual.

Shortly afterwards in early 1995 penalties of around $15 million were imposed on TNT, Ansett Freight Express and Mayne Nickless for conduct that occurred under the previous penalty regime (of $250 000 maximum).

Individual penalties were also imposed. For example, the CEO of Mayne Nickless was personally subjected to pecuniary penalties for behaviour before he became CEO.

$21 million fines were applied in 1995 under the new penalty regime to Boral CSR and Pioneer for price fixing for ready mixed concrete in South Eastern Queensland.

It could be argued that since 1993 penalties have risen sufficiently to deter hardcore collusion.

[4] Qantas and Air New Zealand will also need approval, though to a lesser extent, from the relevant agencies in the United States, Japan and Fiji.

It is now clear that the new fines are still not sufficient. There has been a considerable number of price-fixing cases since then.

Australian executives were involved in the international vitamin price-fixing cartel well after 1993. Fines of around $26 million were imposed by the Federal Court on the companies and executives.

There has been extensive price fixing in the power transformers industry. Fines of $20 million have already been collected and the case has not concluded at this point. The behaviour persisted until 1999—that is, the behaviour persisted even after fines were increased.

In a recent judgment in the transformers matter,[5] Justice Finkelstein stated:

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

Tax cheats who defraud the Commonwealth of revenue may be subject to criminal liability, depending on the seriousness of their offence. Similarly, those who manipulate Australian stock markets may, upon conviction, be imprisoned. Why should executives who deliberately enter secretive arrangements to defraud their customers be treated any differently?

Aside from important considerations of equity in the law, criminal liability, including jail, provides a deterrence not achievable under a civil regime. Work in the United States indicates that the optimal corporate fine would need to be extremely high if fines were to remove the prospect of profiting from participating in a cartel.

To provide an effective deterrence, the maximum fine should be six or seven times the profit arising from the illegal conduct.

Studies have calculated that had the optimal been imposed on more than 400 corporations found to have participated in cartels in the US, it would have bankrupted more than 60 per cent of the firms.

Let me give one example. It has been estimated that the total value worldwide of the commerce affected by the international vitamin cartel was in the order of $20 billion. Conservative estimates would imply a total gain to the three participants in that cartel of $1 billion to $2 billion.

Once the risk of detection is factored into the calculation, the optimal penalty is between $6 billion and $14 billion. Taking into account record penalties imposed worldwide and civil damages the participants have paid out in the order of $2 billion.

Executives have gone to jail in the US for this cartel, but based on the penalties alone, you would have to ask whether the companies involved (and others observing from the sidelines) would think participation in the cartel was worth the risk.

Not only do large penalties jeopardise the continued existence of the majority of firms, they penalise innocent people—employees, shareholders and creditors.

Some have argued there is no evidence that criminal sanctions and the possibility of jail will be more effective than pecuniary penalties. Of course there is no empirical evidence. How do you show that conduct that did not occur would have, if criminal sanctions had not been in place.

Let me quote to you what James Griffin, the Deputy Assistant Attorney General of the US Department of Justice Anti-trust Division said on a recent trip to Australia. When discussing the deterrent effect of jail sentences he said:

> Of course, it is not possible to quantify the undetected. That is, cartel behaviour that does not occur because it is deterred by the perceived risk of incarceration. However, it seems clear that when the risk of gaol is introduced into the equation, the conventional businessman's risk/reward analysis breaks down, and it is that breakdown which is critical to the effective deterrent of anti-trust crime.

I do not believe that the possibility of criminal sanctions should be of concern to the vast majority of businesses and business leaders in Australia.

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

Secret, unlawful collusion of a major kind is not the practice of the vast majority of Australian business.

When it occurs, however, it is very harmful, and business is most often the first victim. This is because in most price-fixing cases, the customer is a business, not a household consumer.

Most businesses regard price fixing as abhorrent.

Some businesses will argue that they are not opposed in principle to such a law, but they are concerned at the lack of safeguards.

This accurately describes my own view. I believe it essential that such provisions be accompanied by safeguards.

First, the forms of behaviour to which it would apply would need to be defined. For example, criminal sanctions would only apply to defined acts of collusion such as price fixing, market sharing and bid rigging agreements between big businesses. They would not apply to the rest of Part IV of the Act.

Secondly, proof beyond reasonable doubt would be required. At present the standard for Part IV of the Act is balance of probability.

Thirdly, the Director of Public Prosecutions, rather than the Commission, would conduct the case. Incidentally, New Zealand does not have a DPP system and instead has Crown Prosecutors. These are directed by agencies and do not act in the same way as a DPP. Of course, specific safeguards similar to those provided by the DPP could be built into any system.

Fourthly, the matter would be dealt with by a judge and jury, as the Constitution requires. For an indictable offence, that is an offence involving a jail sentence of one year or more, a jury of 12 is required and, according to High Court decisions, its verdict must be unanimous.

Finally, in the case of a guilty decision, a judge would then decide at his or her discretion whether or not someone should be fined or jailed.

Section 46

I now want to turn to how s. 46 can be improved. Section 46 of the Trade Practices Act prohibits corporations with a substantial degree of market power from taking advantage of that power to:

- eliminate or substantially damage a competitor
- prevent the entry of a person into any market
- deter or prevent a person from engaging in competitive conduct in any market.

The purpose of s. 46 is to prevent firms with substantial market power from engaging in illegitimate anti-competitive conduct. Situations in which it may arise include predatory behaviour; refusal to supply in an anti-competitive manner; the illegitimate leveraging of market power in one market to damage competition in another market; and some vertical practices.

This provision, which is similar to laws in New Zealand, in North America and in Europe, is intended to steer a balance between preventing illegitimate anti-competitive conduct and not deterring genuine pro-competitive conduct.

Effects test

The Commission also believes that the introduction of an effects test in s. 46 would improve the effectiveness of trade practices law.

Similar prohibitions against monopolisation or abuse of dominance in the United States, Canada and the European Union all focus on effects as the ultimate issue.

Australia is different and so is New Zealand, which, in this matter, has a similar gap to Australia in the law.

In other countries effects is a normal test and is not the subject of controversy.

The reason is that competition law is seen to be about protecting the process of competition in the modern economy.

It is about economics, about the economic effects of certain behaviour, about the harm to the economy from anti-competitive conduct.

The general approach to competition law around the world is that it is concerned with outcomes rather than just the purposes of behaviour.

The Trade Practices Act is an economic statute expressed through the use of legal instruments.

The concern of economic policy is with the effects of behaviour.

If a firm with substantial market power goes too far in terms of illegitimate anti-competitive behaviour—takes advantage of that power and causes anti-competitive effects—and causes damage to competition, then such behaviour should be prohibited.

To put this another way—if a dominant firm seriously damages the competitive process with illegitimate behaviour of the kind proscribed in the Act, then, unless purpose can be shown, such

behaviour is not unlawful, no matter the harm to competition.

It is difficult to see why this section of the Act should be limited to conduct that has an anti-competitive purpose—other sections are concerned with the purpose or effect of behaviour. In addition, jurisdictions in Europe and in the United States are generally concerned with effects.

Section 46 gives legitimate protection to new entrants to industries dominated by major businesses. Moreover, in my view, such protection is legitimate and appropriate since it is limited to anti-competitive behaviour harmful to competition.

Would an effects test dull competition?

This question is not a matter of argument in Europe or North America.

Section 46 is written with ample safeguards to protect legitimate competitive conduct. Indeed, it has been designed and drafted so as to not compromise vigorous, legitimate conduct. Cases, in practice, are hard to bring and are hard to win.

The High Court's view on this matter is very clear. This section is about protecting competition and interests of consumers. I believe that this would not alter with the introduction of an effects test.

In fact, the competitive process would be helped by the addition of an effects test.

As a final point on s. 46, we have strongly argued the case for the introduction of cease-and-desist powers to quickly stop incidents of misuse of market power. Relief to damaged parties should not take five to seven years, which has been the time in Australia required for courts to come to a final decision in a number of particular cases.

Were Australia to make such a change, we would be following the example set by New Zealand. While cease-and-desist powers are yet to be tested here, they should allow for quicker action than through the usual court processes—and we think this is a good thing.

Conclusion

Clearly, there is a strong similarity between our respective competition laws. By disposition and history, we have bodies of law that are developing an almost perfect congruence.

In addition, however, there are ways to make our law work better. And on this I would welcome closer links and close cooperation.

In Australia, I believe that the Commission faces an important and busy year. I understand that the review is of considerable importance. However, I also believe that it is essential the Commission pays close attention to our normal and usual business, which is the firm and proper enforcement of Australia's competition law.