Submission to the Productivity Commission on its Draft Report on Section 2D of the Trade Practices Act 1974

Introduction

This submission is in relation to the Productivity Commission's draft report, *Review of s2D of the Trade Practices Act 1974: Local Government exemptions*, May 2002 ("draft report").

In particular it responds to the two options under consideration by the Commission. The first is to retain s2D. The second to replace s2D with a direct provision that limits the application of part IV to business activities of local government.[1]

Option 1 – Retaining s2D

The draft report indicates that central to the question of whether s2D should be retained is whether part IV applies to the *regulatory* activities of local government:

> "Were part IV not to apply to the regulatory activities of local government, then it could be argued that such an explicit exemption is unnecessary."[2]

And:

> "In contrast, were the regulatory activities of local government subject to part IV according to their anti-competitive effect, then the effect of, and hence the benefits from the licensing exemption are far more substantial."[3]

The Commission's finding is that there are different views as to the application of part IV to the regulatory activities of local government.[4]

The proposition that the regulatory activities of local government are not subject to part IV is likely to be more a statement of practice than of the legal operation of the part. Indeed this proposition incorporates a limitation which is not apparent in the Act.

Part of the reason for the different views may stem from the interpretation of what constitutes a regulatory activity. Some guidance on what is a regulatory activity emerges from the Hilmer Committee's discussion of the structural reform of public monopolies.[5] The Hilmer Committee speaks of the need for the separation of regulatory and commercial functions.[6] The Hilmer Committee also noted:

> "…many government agencies were responsible for regulating technical aspects of a particular industry, as well as providing

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1 Draft Report page XV11.
2 Draft Report p 28.
3 Draft Report p29.
4 Draft Report finding 3.1, p28.
5 Report by the Independent Committee of Inquiry into National Competition Policy, August 1993, Australian Government Publishing Service, Canberra.
6 Ibid p 217.

> services that were subject to or affected by those regulations. Telecom provided an example, where it remained responsible for technical regulation of the telecommunications industry …".[7]

Presumably a regulatory function is one that is distinct from a commercial function and would include the regulation of technical aspects of an industry. Under this approach a licensing function would most likely be regarded a regulatory function. If part IV did not apply to a regulatory function, then there may not have been the need for the express protection which s2D provides.

The reason given by the Hilmer committee for recommending a separation of regulatory and commercial functions is that:

> "In a competitive environment, such a deal or role creates a potential conflict of interest between advancing the commercial interests of the enterprise and advancing wider public interest to the exercise of regulatory powers, presenting opportunities for incumbents to misuse control over regulatory standards to frustrate the actions of actual or potential competitors."[8]

In my submission I alluded to this in the context of whether a local government body should be protected from s46:

> "Suppose for example that a local government business is engaged in the retail of electricity within its area of operation. Assume also that a retail of electricity is also required to hold a licence issued by the local government body. There is an incentive for the local government body to not licence a new retailer that might provide a service in competition with it. Alternatively it may grant a licence on more disadvantageous terms. This may have the effect of preventing entry to a market or deterring competitive behaviour amongst those in the market."[9]

In *NT Power Generation Pty Limited v Power & Water Authority* the court considered whether the Northern Territory Power and Water Authority (PAWA) was engaged in a business. [10] PAWA's functions included generating and distributing electricity in the Northern Territory. The applicant NT Power Generation alleged that PAWA breached s46 in failing to allow it access to PAWA's electricity infrastructure to enable NT Power to sell electricity which it generates. Mansfield J found that PAWA was not involved in a business in relation to its conduct in refusing to grant access. As the Act did not apply to it, the s46 claim failed on that basis.[11] However had it not been for this Mansfield J would have found that PAWA breached s46.[12] It demonstrates that a non- business function (but for its nature as such) is capable of attracting part IV.

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7 Ibid p 217.
8 Ibid p 217.
9 Submission, p 11.
10 [2001] FCA 334.
11 Ibid para 303.
12 Ibid para 375.

The reason the Hilmer Committee recommended the separation of regulatory and commercial functions is that in the examples noted above, a regulatory function can be used to inhibit competition by excluding market entry or inhibiting commercial behaviour. This lends support to the view that it was always assumed part IV applied to the regulatory activities of local government because those regulatory activities could be used in some circumstances as a vehicle for anti-competitive conduct and should therefore be subject to part IV. The express inclusion of s2D might have been to preclude this possibility, at least in relation to licensing activities.

It should be noted that there is no express statement in part IV or elsewhere in the Act that excludes the application of part IV to the regulatory activities of an entity. The corollary that part IV only applies to conduct in trade or commerce is also unsupported. As indicated in my submission, "trade and commerce" is not a separate ingredient of a part IV contravention. This is apparent from the fact that the expression "trade or commerce" was expressly included in the prohibition of price discrimination under s49, prior to its repeal in 1995. As a matter of interpretation, the express inclusion of "trade or commerce" only in the repealed s49 (but not elsewhere in part IV,) suggests that trade and commerce is not a requirement of other part IV offences.

The presence of sections 2A and 2B also casts some light on the application of part IV. Sections 2A and 2B expressly provide, among other things, that part IV applies to the Commonwealth and State Crown in so far as they carry on a business. If part IV does not apply to the regulatory activities of an entity then arguably sections 2A and 2B would not be required as part IV would not be capable of applying to conduct, other than the business conduct of the Commonwealth and State Crown. The express statement that the Commonwealth and State crown is bound only if it is engaged in a business excludes the possibility that it may be bound in the exercise of a purely regulatory function.

The presence of 2C is also informative. It is interesting that section 2C(1)(a)(b) expressly provides that a taxing and licensing function does not amount to the carrying on of a business. As licensing must surely be a regulatory function, arguably there is no need for section 2C to specifically provide that it is not a business function if part IV were not capable of applying to a regulatory activity.

There is little evidence to support the view that part IV does not apply to the regulatory activity of an entity. If it does not apply it is not because it in incapable of applying but rather that in practice it is unlikely to apply. In practice it would be difficult to use a regulatory function to engage in anti- competitive behaviour. However it is not impossible as the *NT Power* case suggests. Similarly as the Hilmer Committee observed, there is a very real possibility where an entity engaged in a commercial activity also has responsibility for industry regulation.

The other reason that a regulatory function may not attract liability under part IV is that, in the case of s45 at least, there cannot be a contravention in the absence of some agreement or arrangement. The exercise of a regulatory function does not require an agreement or arrangement. The Australian Government Solicitor also alluded to this in the advice provided to the Commission.[13]

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[13] Draft report p72-73.

If one accepts the proposition that part IV does apply to the regulatory activities of local government then s2D takes on a much greater significance. For without s2D the licensing activities of a local government would be exposed to part IV. Even if one assumes that in practice part IV will have a negligible application, the need for certainty may well justify its inclusion. The lack of certainty may also add to transaction costs.

However the recognition of the role s2D plays in protecting licensing activities is not in itself a sufficient argument for s2D to be retained in its current form. While this might be the easiest option it would nevertheless leave some important issues unresolved, in particular the nature of a licensing activity and the scope of the exemption. There would be merit in clarifying these matters. However there would be little point in amending s2D if corresponding changes were not also made to s2C. Section 2C(1) (b) and the definition of "licence" in s2C (3) are in the same terms as the corresponding provision of s2D. This raises two issues. It may well be beyond the scope of this review to recommend amendments to s2C. Secondly whatever might be its limitations, s2C has been in place and applied since 1995.

If s2D is to be retained this presents an argument for not amending it, (despite some of the observed limits of the licensing function) unless corresponding changes are made to s2C. Otherwise s2D would no longer be aligned with s2C which would create unnecessary confusion..

Option 2 – A direct provision that limits the application of part IV to business activities of local government

Under this option local government would be subject to the Act to the extent that it undertakes a business activity, in much the same way as s2A and s2B apply to the Commonwealth and States.

A factor that influences this decision is the extent to which local government is truly viewed as one of the three tiers of government. A distinction with the other two tiers (the Commonwealth and States) is that they are part of the federal compact whose status may be traced directly to the Australian constitution. Local government is purely a creature of state legislation. Whether this distinction is a sufficient reason to deny local government the same protection as the Commonwealth and States is a different question. Certainly the Act treats local government differently to the Commonwealth and States in the wording of s2D compared with sections 2A and 2B. The reason for this is unclear.

As indicated, the Hilmer Committee was of the view that regulatory and commercial functions should be kept separate. This principle is embodied in clause 4 Competition Principles Agreement.[14] It applies equally to local government.[15] The Committee does not appear to have made a distinction between licensing and other regulatory activities.

There does not seem to be anything usefully served in providing protection for a local government's licensing activities while exposing its other regulatory activities to part IV. However this is a consequence of the current s2D. This creates a level of uncertainty for local government, which is hard to justify.

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14 Signed by the Commonwealth, States and Territories on 11 April 1995.

15 Clause 7 Competition Principles Agreement.

Conclusion

In the end the matter is perhaps best approached by examining how s2D sits within the policy environment articulated by the Hilmer Committee which was the impetus for this and the other 1995 reforms. The overwhelming impression that one gains from examining this debate is that the reforms were intended among other things, to apply part IV to all business entities irrespective of their form. As each tier of government undertakes both regulatory and business activities it was therefore necessary to excise regulatory activities from the Act's reach so that only the residue (business activities) is caught. This is what sections 2A and 2B provide.

As indicated, a distinction can be made between the position occupied by local government and that occupied by the Commonwealth and States under our federal structure. However it is not apparent that this distinction demands that local government be treated differently, especially if the Hilmer framework is accepted as the policy driver. Certainty and reduced transaction costs would justify a direct statement that limits the application of part IV to local government, in much the same way as s2A and s2B.

The concerns that a regulatory function might be used to stifle competition would be enhanced under this option as the protection would be extended beyond licensing to any other activity (however described) that is not a business activity. However this is most likely to occur through the use of a licensing power to deny entry to a market. In any event s2D already provides protection in such a case. As regards the use of non- licensing functions as a tool for anticompetitive behaviour (such as pricing or preferences), one would expect the other Hilmer reforms, notably competitive neutrality policies to address these concerns.

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