Moving towards a single economic market: Should Australia and New Zealand further co-ordinate their competition policy?

by

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A thesis submitted in conformity with the requirements
for the degree of Master of Laws
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Abstract

Australia and New Zealand have a long history of close economic relations. Both are former colonies of Britain and inherited its parliamentary and legal system. Prior to adopting and developing US antitrust principles into a distinctly antipodean approach, competition law in both countries was based on UK legislation. Today, competition policy in Australia and New Zealand aims to combat the unique challenges of both countries including their geographical isolation from the world's major markets, relatively small population and insufficient market capacity to produce at minimum efficient scale. Not surprisingly both countries have similar but not identical competition regimes.

Multiple domestic competition regimes entail a number of costs. This thesis considers options for the closer coordination of competition policy between Australia and New Zealand that aims to minimize these costs while at the same time allowing both countries to retain sufficient flexibility to develop a welfare enhancing competition regime that takes into account their unique economic characteristics.

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Setting the scene[1]

On 30 January 2004 the New Zealand Minister of Finance and the Australian Treasurer met to discuss closer economic relations between the two countries. Both agreed to investigate a series of reforms that might lead towards the establishment of a single economic market.

> "The big picture – as both Peter and I see it – is as far as possible moving towards a genuine single market where businesses on each side of the Tasman do not face additional costs imposed by Government regulation."[2]

As part of the big picture both countries have agreed to examine their competition regimes to assess the possibility of greater integration and co-operation. Given the political momentum and support on both sides of the Tasman for increased integration of competition policy this thesis seeks to critically consider a number of options to achieve closer coordination.

By way of background, Chapter 1 will outline in more detail problems that are caused by different approaches to competition law and policy.

Chapter 2 will identify the general aims and objectives of competition policy and show why competition policy is often unique to a particular country and its economic

[1] This thesis benefited from the input from a number of people. In particular I would like to thank my supervisor, Professor Michael Trebilcock, for his patience, guidance and support. Special thanks also go to Rory McLeod, Karen Chant and David Goddard at the Ministry of Economic Development, Wellington, New Zealand for their support and advice. Finally I would like to extend my gratitude to the Competition Team at McMillan Binch LLP, Toronto, for the opportunity to present my thesis and obtain invaluable feedback.

[2] O'Sullivan F, *Cullen says we can waltz with Oz in single economic market*, The New Zealand Herald, 3 February 2004.

characteristics. It will suggest that divergent domestic competition policies make it unlikely that multilateral initiatives aimed at broad-brush international harmonisation will, or should ever, be adopted and implemented.

Chapter 3 will compare competition policy in New Zealand and Australia. Initially it will provide a general overview of the Australian and New Zealand economies before taking a closer look at the three basic types of conduct that the New Zealand *Commerce Act 1986*[3] and the Australian *Trade Practices Act 1974*[4] seek to regulate:

1) co-ordinated anticompetitive behaviour;
2) unilateral anticompetitive behaviour; and
3) mergers and business acquisitions.

For each type of conduct the thesis will compare the regulatory approach of each country. Where there are significant differences it will ask whether the approach can be justified as welfare enhancing, based on each country's economic characteristics. In addition to comparing substantive law, the thesis will also compare procedural matters such as the process for clearances and authorisations.

The conclusions drawn in Chapter 2 and Chapter 3 will then be used in Chapter 4 to identify and consider different approaches for increased coordination between Australia and New Zealand.

[3] *Commerce Act 1986* (NZ), 1986/5, 31RS 71
[4] *Trade Practices Act 1974* (Cth.)

Chapter 1: Problem identification

Traditionally competition law and policy has been considered a domestic issue. With the liberalisation of international trade and foreign investment policies, and improvements in transportation and communications there has been a significant increase in the volume of goods and services that are traded between nations. As trade barriers continue to decrease, there has been a shift in focus to other regulatory mechanisms that countries can implement to increase their competitive advantage, at the expense of global welfare. Competition policy can be used for these purposes.

Countries can design competition regimes to take advantage of gains from trade to the detriment of the wider global community. For instance a country that is export oriented may allow its firms to form export cartels. This increases domestic welfare at the expense of global welfare because the export cartels can earn supra-competitive prices in offshore markets.[5] Export cartels further harm global welfare by creating market distortions.

The increase in international trade has added to the workload of national competition authorities. In a global trading environment national authorities spend more time investigating and enforcing offshore conduct that affects their domestic market. Take, for example, multi-jurisdictional mergers. A multi-jurisdictional merger could result in efficiency gains offshore but may be detrimental to the domestic economy.

[5] Trebilcock M, Iacobucci E, *National Treatment and Extraterritoriality: Defining the Domains of Trade and Antitrust Policy*, in Epstein R, Greve M, ed., *Competition in Conflict: Antitrust Jurisdiction in the Global Economy*, (Washington D.C.: AEI Press, 2004), 152.

Multi-jurisdictional mergers not only create logistical issues for the countries concerned but also create significant costs to the merging entities that try to comply with laws in multiple regimes. These include pre-notification, clearance or authorisation procedures in each country that the merger affects.

Different approaches to dealing with restrictive trade practices can also be problematic to an entity attempting to do business in another country. A firm can face problems gaining access to markets in countries that have inadequate competition laws. Either the domestic firms can participate in, or undertake anticompetitive arrangements or behaviour to exclude the entry of the foreign firm;[6] or the foreign competition authority may fail to enforce the competition laws in order to benefit its domestic producers. Inadequate competition laws allow firms to preserve their market share by erecting barriers to entry with little threat of sanction.

New Zealand perceives one of the main problems with maintaining its own distinct competition law is that it may form an impediment to foreign investment. A multitude of competition regimes can give rise to business uncertainty. From the point of view of businesses the only way to overcome this problem is to become sufficiently familiar with the host countries business law, including its competition law. This can represent an additional cost to a potential investor. Admittedly the outlay involved in becoming familiar with competition law is relatively small compared to the overall costs of investment. Nevertheless it is an incremental cost that may not need to be incurred.

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[6] Peterson A, Matthews A, *New Zealand Competition Law in an International Setting*, in Berry M, Evans L, ed., *Competition Policy at the Turn of the Century: A New Zealand Perspective*, (Wellington: Victoria University Press, 2003), 228 at 235.

In summary, this chapter has identified four problems created by multiple competition regimes:

1. Costs to the domestic economy from negative externalities of conduct occurring offshore.
2. Costs to national competition authorities from investigating conduct and enforcing judgments offshore.
3. Costs to firms from trying to enter markets with inadequate competition laws or enforcement.
4. Duplication costs for firms trying to comply with laws in multiple jurisdictions.

Chapter 2: The aims and objectives of competition policy

In most jurisdictions competition is considered desirable because it leads to a more efficient allocation of resources. Improving the allocation of resources in the domestic economy is generally recognized to be the best way of increasing the average standard of living of people within that economy.[7] Despite the fact that economists generally believe that economic efficiency is the single most effective way to spur economic growth, many jurisdictions do not focus exclusively on the promotion of competition and instead use competition policy to pursue a number of non-efficiency policy goals.

Governments use competition policy to pursue goals such as regional development, increased employment, and the preservation of small and medium sized businesses. In competition law any shift away from efficiency is problematic because pursuing non-efficiency goals is always at the expense of achieving efficiency.

The weighting of non-efficiency goals is entirely subjective. This results in some difficulty in applying policies consistently and increases business uncertainty. Companies may not investigate merger opportunities or other business arrangements that increase efficiency if they believe the merger or arrangement is likely to be prohibited. Many commentators have argued that there are more effective ways of pursuing non-efficiency objectives and that, in the long run, an efficiently functioning market is more likely to create opportunities conducive to meeting wider social objectives.

[7] Crampton P, "Alternative Approaches to Competition Law: Consumers' Surplus, Total Surplus, Total Welfare and Non-Efficiency Goals" (1994) 17 World Competition & Econ. Rev. 55 at 56.

2.1 The influence of economic characteristics

Economic characteristics will almost always impact on the design of competition policy for achieving chosen objectives.

To illustrate these characteristics the literature often distinguishes between small and large economies. Small is a relative term and it can be judged by such factors as high industry concentration, sub-optimal levels of production, openness to trade, and population dispersion.

Small economies often do not have the market capacity to support a large number of competitors. As a result industries in small economies are more likely to be highly concentrated. High industry concentration can be detrimental to efficiency objectives where firms are in a position to take advantage of their market power. Market power allows firms to reduce **allocative efficiency** by engaging in monopoly pricing or other forms of anticompetitive behaviour that distort efficient resource allocation.

It has also been suggested that monopolists face fewer incentives to innovate and therefore high industry concentration also reduces **dynamic efficiency**. This hypothesis has been challenged because monopolists may face additional incentives to innovate in order to maintain their market share. Oligopolistic industries will also face these incentives depending on whether they are in a position to pursue co-operative strategies akin to collusion.[8]

[8] OECD, Global Forum on Competition, *Competition Policy in Small Economies: New Zealand,* CCNM/GF/COMP/WD(2003)29, (2003), 10-13.

Market capacity also impacts on **productive efficiency**. Some industries, predominantly manufacturing, produce goods at less than minimum efficient scale.[9] The effect on such industries is that they are unable to achieve economies of scale and scope, and reduce transaction costs. This has a significant impact on their international competitiveness.

Openness to trade is another factor that impacts on competition policy. In small economies the more open a country is to trade the more plausible the threat of market entry. Consequently competitive pressures, whether they are real or potential, will discipline concentrated industries and encourage allocative, productive, and dynamic efficiency.

Population dispersion can also be problematic. Take Canada for example: geographically it is a large country but its population is dispersed in a way that carves the country into a number of smaller markets. This is one of the reasons why Canada, despite its geographical size, is still subject to a high level of industry concentration.

All of the features of small economies identified above necessitate a different approach to competition regulation in a small economy compared to a large economy. Competition is generally welfare enhancing but in a small economy it should not be pursued at the expense of allocative, productive and dynamic efficiency. A series of principles follow from this basic presumption:

[9] Gal M, *Competition Policy for Small Economies,* (Cambridge, Massachusetts: Harvard University Press, 2003) at 14-18.

- competition does not necessarily require rivalry; the threat of market entry should discipline firms;
- market share is not the same as market power; a firm can have 100% market share but if barriers to entry are low it has little market power;
- competition law is just one aspect of competition policy; other policy instruments such as reducing trade barriers will also affect competition in the market;
- conduct which reduces competition may be efficient where entities are able to take advantage of economies of scale;
- legislation should not seek to eliminate existing market power; instead it should deter conduct arising from market power; and
- competition policy is concerned with deadweight costs, not transfers between consumers and producers.[10]

In theory these principles apply just as much to large economies as they do to small economies. Nevertheless, the legislative emphasis on efficiency as opposed to competition is less apparent in large economies. This may be because the importance of appropriately structured and efficiently enforced competition policy is greater in small economies that in large economies. Gal argues that in small economies the market's invisible hand has a much weaker self correcting tendency; therefore, the costs of improper design and application of competition laws might be higher in both the short and the long run in small economies.[11] Competition policy in small economies needs to

[10] Carlton D, Goddard D, *Contracts that Lessen Competition: What is Section 27 for, and how has it been used?* in Berry M, Evans L, ed., *Competition Policy at the Turn of the Century: A New Zealand Perspective,* (Wellington: Victoria University Press, 2003), 137 at 141.
[11] Gal, *supra* note 9 at 5.

be more precisely targeted so that all abuses or increases in market power come under the scrutiny of the competition authority.

2.2 International approaches to multilateral coordination on competition policy

The above analysis suggests that there may be scope for international consensus on competition policy given that welfare enhancement seems to be a universal goal. This conclusion however ignores the multitude of seemingly unresolvable issues that have arisen in preliminary discussions at an international level.

Consultation and cooperation on competition policy has taken place through a number of international fora including the Organisation of Economic Cooperation and Development (OECD) where countries have adopted a series of recommendations and guidelines relating to anticompetitive practices since 1967. In 1980 participants of the United Nations Conference on Trade and Development (UNCTAD) approved a set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices. More recently work has been pursued within the World Trade Organisation (WTO) where Member States set up a working group on competition policy to take an exploratory look at how trade affected competition policy. Its work was to culminate at the Cancun Ministerial Conference in September 2003 when a decision was to be made on the future of negotiations and the viability of a multilateral agreement on competition policy.

While negotiations at Cancun collapsed[12] before any substantive discussion on competition policy could take place, the report of the working group indicated that there were a number of significant issues that would be difficult to resolve. These included:

- Applying the principle of non-discrimination to export cartels and infant industries.[13] Countries submitted that sometimes, for the sake of development, some anticompetitive practices or mergers should be acceptable in order to achieve long-term gains.[14]
- A number of countries thought that information sharing, especially in an enforcement context, should be voluntary given that a number of countries do not have robust institutional structures in place that would ensure the confidentiality of information. Leaked information could compromise investigations.[15]
- Transparency requirements and enforcement capabilities, essential to a credible competition regime, also impose substantial burdens on countries that do not have the necessary infrastructure in place.[16]

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[12] Compared to previous trade negotiation rounds the scope of negotiations was expanded under the Doha round with the introduction of the Singapore issues (competition, investment, government procurement and trade facilitation). Developed countries, particularly the EU, were strong proponents of the Singapore issues because they believed that as trade barriers were reduced countries would begin to use domestic policies to distort trade flows and increase domestic welfare at the expense of global welfare. Many developing countries feared that by reaching an agreement on the Singapore issues they would unwittingly be restricting their sovereignty. The diversity of views on the Singapore issues and the failure by developed countries to make concessions on agriculture led to an impasse at Cancun. On the final morning of negotiations the EU offered to withdraw competition from the negotiating agenda but by then it was too late, the negotiating positions of developing countries had already become entrenched and negotiations broke down. For further information see "Why did the world trade talks in Mexico fall apart? And who is to blame?" *The Economist* 368:8342 (20 September 2003) 30.

[13] WTO, *Report (2002) of the Working Group on the Interaction Between Trade and Competition Policy to the General Council*, 9 December 2002, WT/WGTCP/6, para. 22.

[14] *Ibid.* at para 35.

[15] *Ibid.* at para 76.

[16] *Ibid.* at para 16.

Countries were also apprehensive about entering into a multilateral agreement on generic competition policy before the principled approach[17] to anticompetitive practices had been tested under the Telecommunications Reference Paper. In the first decision under the Reference Paper, *Telmex*[18], the Panel followed the ordinary meaning approach to interpretation as set out in Article 31 of the Vienna Convention. This approach may create anomalies where an agreement is based on economic concepts. There is also a danger that a panel may be tempted to adopt interpretations from domestic laws. This could result in the importation of doctrine from a country with significantly different economic characteristics that are not appropriate in the defendant country's economy. It is still to early to draw conclusions on the effectiveness of the Reference Paper in regulating anticompetitive practices in the telecommunications industry and whether it offers a suitable model for a multilateral agreement on competition policy. Since Cancun, Member States have not advanced negotiations towards a multilateral agreement.

The issues summarized in this section and the impact of specific economic characteristics of individual countries on competition policy make it unlikely that countries will reach a multilateral agreement on competition policy in the near future. Instead a number of countries, including Australia and New Zealand, are addressing the problems arising from multiple competition laws by pursuing bilateral or regional agreements. However, a bilateral agreement between Australia and New Zealand would not prevent either country from entering into future multilateral agreements.

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[17] The principled approach give countries the flexibility to implement regulation appropriate to their economic characteristics and political system provided it adheres to the principles, such as the prevention of anticompetitive practices in telecommunication, set out in the Reference Paper.

[18] WTO, *Mexico – Measures Affecting Telecommunications Services*, WT/DS204/R (2003)

Chapter 3: Competition Policy in Australia and New Zealand

3.1 Brief history of Australian and New Zealand competition legislation

Prior to 1970 trade practices legislation in both countries was based on a model imported from the United Kingdom (UK). The introduction of the *Trade Practices Act 1974* in Australia marked a substantial departure from existing legislation and drew heavily on United States (US) antitrust law. New Zealand followed but took a less radical position with the introduction of the *Commerce Act 1975*[19]. After a period of deregulation and extensive trade liberalisation in the early 1980's the *Commerce Act 1986* was enacted.[20] This Act was primarily based on the Australian *Trade Practices Act* and drew heavily on its economic concepts.[21] However, a number of provisions departed from the Australian equivalent. This departure was primarily intended to reflect the size of the New Zealand economy and its specific challenges.

Until 1996 Australia had difficulty achieving uniform coverage of competition laws due to the constitutional constraints on the Federal Parliament. The *Trade Practices Act* only applied to trading and financial corporations and to persons engaging in interstate or overseas trade or commerce operating in a Territory or supplying the Commonwealth.[22]

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[19] *Commerce Act 1975* (NZ) 1975/113, 708

[20] Fels A, Chairman, Australian Competition and Consumer Commission, "Building a modern Trade Practices Act: A trans-Tasman analysis" (Speech to the New Zealand Institute of Economic Research), September 2002, [unpublished], http://www.nzier.org.nz/SITE_Default/SITE_News/x-files/613.pdf

[21] Arnold T, Boles de Boer D, Evans L, *The Structure of New Zealand Industry: Its Implications for Competition Law*, in Berry M, Evans L, ed., *Competition Law at the Turn of the Century*, (Wellington, Victoria University Press, 2003), 24.

[22] Australia, Commonwealth, Independent Committee of Inquiry, *National Competition Policy Review*, by Hilmer F, Rayner M, Taperell G, (Canberra: Commonwealth Government Printer, 1993), 91 [herein after referred to as the Hilmer Report]. Also see *Trade Practices Act 1974*, s6, as am. by *Competition Policy Reform Act 1995*. There are also constitutional limitations on the Commonwealth's capacity to regulate state banking and state insurance, see the *Commonwealth of Australia Constitution Act 1900* (UK) s51(xiii) and (xiv).

The Hilmer Report in 1993 highlighted a number of problems with the multiplicity of competition laws in Australia.

Firstly, competition laws were being developed on a sector-by-sector basis without the benefit of a broader policy framework or process. Each policy process would require negotiation on the respective roles of Commonwealth, State, and Territory governments. A national approach to competition policy would present opportunities to advance reforms in a more methodical, coordinated, and consistent manner. It would reduce the costs of developing a plethora of industry specific or sub-national regulatory arrangements.[23]

Secondly, the Report also recognised the reality that Australia is for most purposes a single national market. The significance of State and Territory boundaries was diminishing with advances in transport and communications. Furthermore, the volume of interstate trade was increasing.[24]

Thirdly, the Report stated that inconsistent application of competitive conduct rules can allow exempted firms to engage in anticompetitive behaviour with effects reaching across State borders to the economy more generally. It used the example of a merger rule that allowed a business to acquire sufficient market power to deter competitive entry from firms in other States.[25]

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[23] Hilmer Report, *ibid.* at 13-14.
[24] *Ibid.* at 14.
[25] *Ibid.* at 15.

Finally the Report highlighted the general benefits of having a national approach to competition policy:

> "Developing a nationally consistent approach to competition policy issues presents opportunities to further integrate[26] the national market, reduce complexity and possibly achieve savings through reduced duplication."[27]

The Committee identified and proposed a set of competitive conduct rules that should operate under a national competition policy. These are the restrictive trade practices rules found in Part IV of the *Trade Practices Act* today. The Committee also proposed the application of general conduct rules, including access to essential facilities and the principle of competitive neutrality, to address important competition policy issues facing Australia, particularly where competition is impeded through government regulation or ownership. Furthermore, the Committee suggested that two institutions be set up to assist in the implementation of the proposals. These were:[28]

- the National Competition Council created jointly by Commonwealth, State and Territory governments to provide independent and expert advice on policy; and

[26] The integration argument has also been used extensively to justify a harmonized approach to competition law and policy in the European Union. See **ECJ** *Istituto Chemioterapico Italian SPA and Commercial Solvents Corporation v Commission of the European Communities* [1974] ECR 223 at paragraph 32, http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=61973J0006&model=guichett. The Court found that the prohibitions in Articles 85 and 86 must be read in light of Article 3(F) which provides that activities of the Community shall include the institution of a system ensuring that competition in the common market is not distorted, and Article 2 of the Treaty, which gives the Community the task of promoting "throughout the community the harmonious development of economic activities".

[27] Hilmer Report, *supra* note 22 at 14.

[28] Hilmer Report, *supra* note 22 at 20 –21.

- the Australian Competition and Consumer Commission (ACCC) that would be responsible for administering the general conduct rules and some additional policy elements.

These recommendations were accepted by the Governments and implemented in a package of reforms including the *Competition Policy Reform Act 1995*.[29] Minor amendments have been made to the regime since 1995 but the current regulatory framework is more or less that proposed in the Hilmer Report.

The history of regulation in New Zealand has been different. New Zealand has taken a more light-handed approach to utility regulation,[30] initially relying on the general prohibitions set out in the *Commerce Act* rather than implementing industry specific legislation. More recently New Zealand concluded that certain industries should be subject to industry specific legislation. In this way legislation could be better tailored to meet specific challenges facing the industry. For example, recent legislative reforms include the introduction of the *Telecommunications Act 2001*.[31]

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[29] Kain J, Kuruppu I, Billing R, *Australia's National Competition Policy: Its Evolution and Operation*, online: Parliament of Australia, Parliamentary Library, http://www.aph.gov.au/library/intguide/econ/ncp_ebrief.htm

[30] The different approaches are highlighted by the contrasting approaches to the implementation of obligations under the WTO Agreement on Basic Telecommunications. The underlying philosophy behind New Zealand regulation was that, "market forces will break down market power, markets work best when regulations are minimized and that general competition laws is better than industry specific regulation." See New Zealand, Ministerial Inquiry, *Ministerial Inquiry into Telecommunications*: *Final Report*, September 2000, at 3.5. In contrast Australia chose to implement its commitments by implementing the *Telecommunications Act 1997* (Cth.). The Act sets out a more intrusive regulatory framework that required the competition authority to have regard to a more extensive list of factors that were specific to the telecommunications industry when investigating anticompetitive practices. It also makes provision for an independent regulator that has jurisdiction of service quality issues.

[31] *Telecommunications Act 2001* (NZ), 2001/103, 2075.

3.2 Formal economic relations between Australia and New Zealand

New Zealand and Australia have had strong economic ties since colonial settlement. Formal relationships were established under the New Zealand Australia Free Trade Agreement[32] in 1965 and its successor the Australia New Zealand Closer Economic Relations Agreement (CER)[33] in 1983. CER has led to a series of agreements resulting in free trade in all goods and services.[34] In 1998 a review of CER was conducted. It resulted in the Memorandum of Understanding on the Harmonisation of Business Law.[35] Both countries agreed to look at possible harmonisation of their business laws and regulatory practices. Harmonisation was perceived to be necessary to integrate the economies more closely.[36]

In terms of competition policy, Article 4 of the 1988 Protocol to CER on the Acceleration of Free-trade in Goods recognised that the maintenance of antidumping provisions in respect of goods originating in Australia and New Zealand would be inappropriate upon the achievement of full free trade. As a result, Australia enacted s46A of the *Trade Practices Act* and New Zealand enacted s36A of the *Commerce Act*. These sections extend the prohibition against misuse of market power to businesses involved in trans-Tasman trade. It enables the Federal Court of Australia to sit in New Zealand and the

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[32] *New Zealand Australia Free Trade Agreement*, 31 August 1965, A.T.S. 1966 No.1 (entered into force 1 January 1966).
[33] *Australia New Zealand Closer Economic Relations Trade Agreement, and Exchange of Letters*, 28 March 1983, A.T.S. 1983 No.2 (entered into force 1 January 1983).
[34] NZ, Ministry of Foreign Affairs and Trade, *The Australia New Zealand Closer Economic Relations (CER) Trade Agreement: 1983-2003 Backgrounder*, http://www.mfat.govt.nz/foreign/regions/australia/cer2003/cerbackgrounder.html
[35] *Memorandum of Understanding between the Government of Australia and the Government of New Zealand on Harmonisation of Business Law*, 1 July 1998.
[36] Spier, H, "Australia-New Zealand Competition Law and Administration – What Next From Across the Tasman and Beyond?", (Speech to IIR-New Zealand Competition Law Mastercourse), February 2002, [unpublished], http://tpareview.treasury.gov.au/content/subs/133_AttachmentC_SpierConsulting.pdf

High Court of New Zealand to sit in Australia to adjudicate alleged offences. The amendments also enable the respective competition agencies to act on behalf of each other in relation to statutory demands for information as part of investigations.[37]There is some debate as to the effectiveness of the provisions given that they have never been used.

Under CER neither country can adopt industry assistance measures that have adverse effects on competition. While there is no specific investment agreement both countries have also modified their investment regimes with respect to investments from the other country so that a large majority of investment proposals do not require approval from the investment authority. Neither country has rejected an investment proposal from the other country for at least ten years.[38]

In addition to CER the New Zealand Commerce Commission and the Australian Competition and Consumer Commission (ACCC) have put in place a cooperation agreement that requires each regulatory authority to notify the other regulatory authority of enforcement activities that might affect the other's interests in the application of its competition laws and where possible to coordinate enforcement activities.[39] The ongoing exchange of information and cooperation in a number of areas will enable each agency to be more efficient and effective and better utilise scarce resources.[40]

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[37] *Ibid.* at 5.
[38] Ministry of Foreign Affairs and Trade, CER Backgrounder, *supra* note 34.
[39] *Cooperation agreement between the Commissioner of Competition (Canada), The Australian Competition and Consumer Commission and the New Zealand Commerce Commission regarding the application of their competition and consumer laws*, 19 October 2000, 25 October 2000, Clause 1
[40] *Trade Practices Commission – Commerce Commission – Cooperation and Coordination Agreement*, Australia and New Zealand, July 1994, Clause 2

2003 marked the twentieth anniversary of CER. Over this period the proportion of New Zealand exports going to Australia has increased from 13% to 21%. Today Australia is New Zealand's largest export destination and second only to the US as a favoured destination of foreign direct investment. Likewise Australia is the largest source of foreign investment in New Zealand.[41] While Australia has not seen such a significant increase in trade as a result of CER, New Zealand remains one of its major trading partners. By 2003 New Zealand was Australia's fourth largest export destination and two-way trade was valued at $13.2 billion or 6% of total merchandise trade. Australian exports to New Zealand are valued at $8.1 billion or 8% of total exports.[42]

3.3 The structure of the Australian and New Zealand economies

Geographically Australia is the sixth largest nation in the world after Russia, Canada, China, the United States and Brazil. It has a total land area of 7.7 million square kilometres. Only 20.2 million people inhabit Australia and approximately one third of those live outside of its capital cities.[43]

Despite contributing 1.25% to global GDP[44] the Australian economy faces a number of problems that are characteristic of a small economy. Population dispersion across Australia means that the country is effectively split into a number of smaller, more concentrated, markets. Major population centres mainly lie close to the coast, particularly

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[41] Australia, Department of Foreign Affairs and Trade, *A Celebration of Trans-Tasman Relations… 20 Years of Closer Economic Relations between Australia and New Zealand,* http://www.dfat.gov.au/geo/new_zealand/anz_cer_20years/diffscale.pdf

[42] Australia, Department of Foreign Affairs and Trade, *Composition of Trade 2003*, May 2003, at 17, http:www.dfat.gov.au/publications/stats-pubs/cot_cy2003_analysis.pdf

[43] Australia, Department of Foreign Affairs and Trade, *Australia: Fact sheet,* http://www.dfat.gov.au/geo/fs/aust.pdf

[44] World Bank, *Total GDP 2002*, http://www.worldbank.org/data/databytopic/GDP.pdf

the east coast, with smaller more isolated settlements in Australia's interior. The size of many of the markets means that production, especially in utilities industries where infrastructure covers vast distances to service many isolated populations, is unlikely to reach minimum efficient scale.

Geographically New Zealand is much smaller than Australia with a landmass of 271 000 square kilometres and a population of just over four million.[45] One million of New Zealand's inhabitants are based in Auckland. Auckland is also the largest centre for commercial activity accounting for approximately 35% of New Zealand's GDP.[46] Other major centres include Wellington, the country's capital, and Christchurch, the largest city in the South Island. The size of the population and its dispersion means New Zealand too can be broken down into a number of smaller markets and furthermore many industries do not have sufficient market capacity to produce at minimum efficient scale.

Another geographic consideration shared by both New Zealand and Australia is their distance from major markets. Distance acts as a natural barrier to trade. Both countries have attempted to counter this by unilaterally reducing artificial barriers to trade such as tariffs and quotas. Today New Zealand and Australia are two of the most open economies in the world. Import competition has increased the international competitiveness of firms in the traded sector but in addition it has led to significant regulatory reforms in the non-traded sector to ensure that inputs into the production process do not impede firms from

[45] New Zealand, Statistics New Zealand, *Population Clock,* http://www.stats.govt.nz/domino/external/web/prod_serv.nsf/htmldocs/Pop+Clock
[46] New Zealand, Auckland City Council, *Business and Economy 2003,* http://www.aucklandcity.govt.nz/auckland/economy/business/structure.asp

competing internationally.[47] In terms of trans-Tasman trade Australia is New Zealand's main export market taking 20% (NZ$6.118 billion) of total exports.[48] Furthermore, New Zealand is the fourth largest export destination for Australian goods. New Zealand imports 23%[49] (NZ$7.225 billion) of goods from Australia.[50] Principal exports to New Zealand are motor vehicles, refined petroleum, medicaments, and computers.[51]

Factors including size, population dispersion, and distance from major markets together result in both Australian, but more so New Zealand, markets being significantly more concentrated than those of their larger trading partners.[52]

The following graph shows Australian and New Zealand industrial structure[53] compared to the UK, US, and Sweden. The graph breaks down total industry into nine major categories. Firms are then categorised and the number of firms in each category is represented as a percentage of the total number of firms sampled in each country.[54]

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[47] OECD, OECD Global Forum on Competition, *Competition Policy in Small Economies – Australia,* CCNM/GF/COMP/WD(2003)27 (2003)

[48]New Zealand, Ministry of Foreign Affairs and Trade, *Australia Country Paper – January 2004,* http://www.mfat.govt.nz/foreign/regions/australia/country/australiapaper.html#Economic%20Situation

[49] New Zealand, Statistics New Zealand, *External Trade Key Points - December 2003,* http://www.stats.govt.nz/domino/external/web/prod_serv.nsf/Response/External+Trade+Key+Points+-+December+2003

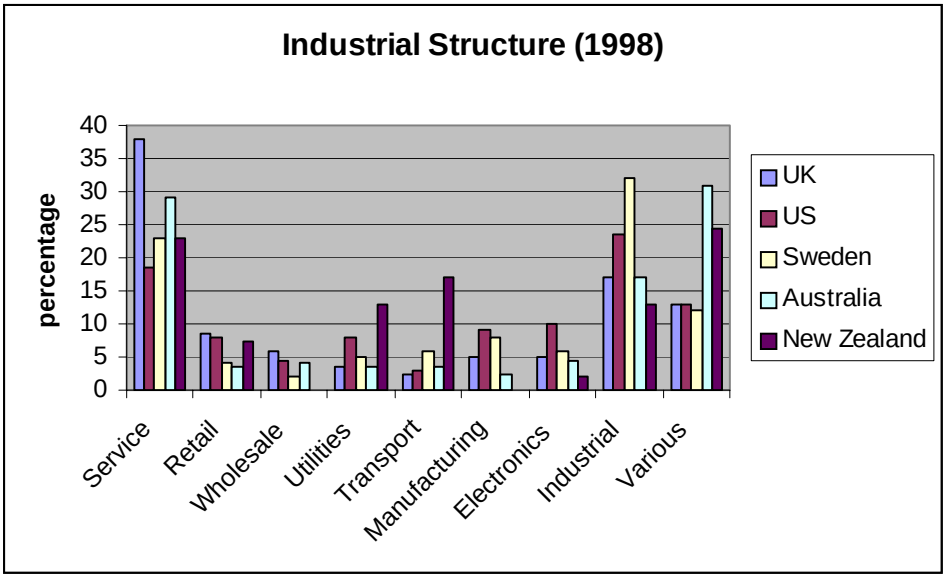
[50] Ministry of Foreign Affairs and Trade, *Australia Country Paper – January 2004, supra* note 48.

[51] Department of Foreign Affairs and Trade, *Composition of Trade – 2003, supra* note 42 at 17.

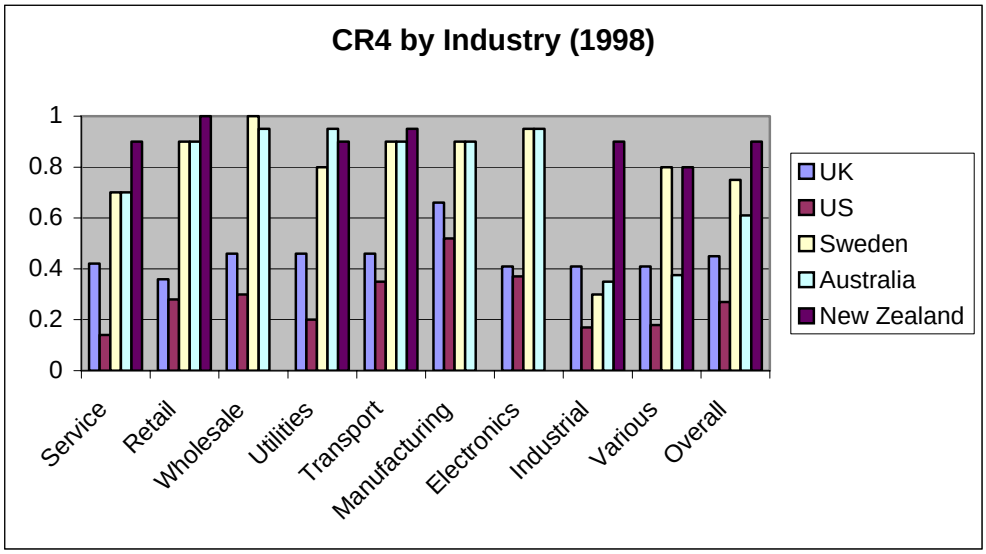
[52] Arnold et al., *supra* note 21 at 31.

[53] Other indicators of industrial structure not presented include: the absolute size of the industry (by revenue and capital employed), economic surplus and operating surplus per unit of capital, and economic cost and operating surplus per unit of revenue. These indicators can be found in Arnold et al., *supra* note 21 at 29-38.

[54] Arnold et al., took their data from the Standards and Poors COMPUSTAT global database. Only sixty New Zealand firms form part of this database so this may limit the accuracy of the results. To counter this the authors compared the industrial structure of the top sixty New Zealand firms to the ANZ database of the top four hundred New Zealand firms with results showing a slightly different mix depending on the size of the sample used. The data is also limited because it is based on firms domiciled in New Zealand and fails to take into account imports. For more information on their methodology see Arnold et al., *supra* note 21 at 30.



Another indicator of industrial structure is depicted in the following graph. It shows the proportion of the market of the four largest firms by revenue. A ratio of one indicates that the top four firms in that category earn 100% of the total market revenues in that category.

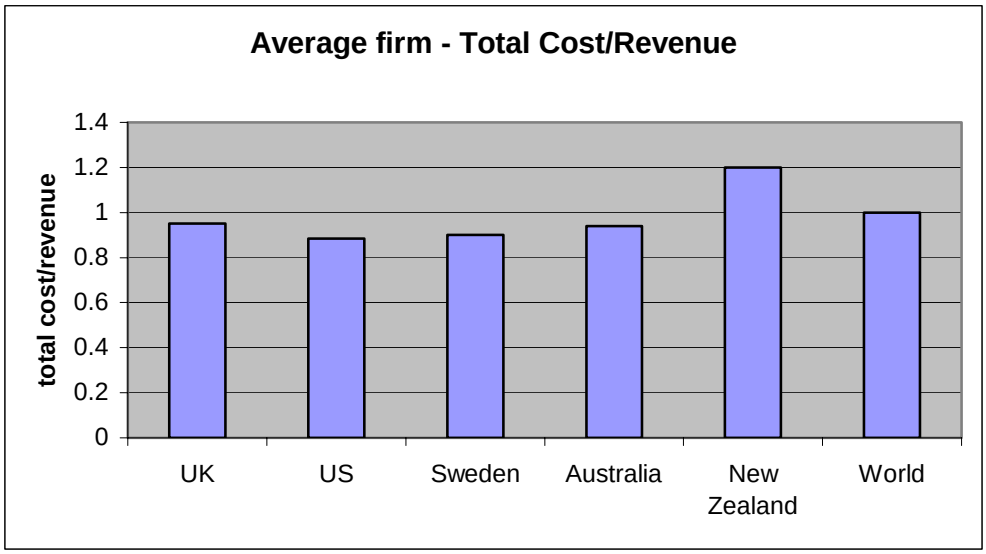


Together both graphs show that Australia, but particularly New Zealand, have more concentrated markets than those of their larger trading partners, the US and UK. The first

graph shows that New Zealand's industrial structure is more akin to Australia than any of the other countries surveyed.[55] [56] Australia and New Zealand both have a large number of firms in the service industry. It has been suggested that this is because service firms generally require less capital relative to labour than other sorts of firms.[57] Australia and New Zealand also have a number of firms listed under 'various'. This sector includes mining, agriculture, textiles, and food and beverage firms.

The second graph shows that New Zealand industrial sectors are highly concentrated. Arnold et al calculated the average industry concentration ratio for the top 60 New Zealand firms to be 0.85 compared to the world average of 0.3. Even where they made the same calculation based on data from the top 400 New Zealand firms the ratio only dropped to 0.8.[58] Australia's concentration ratios are not quite as high as New Zealand but they are still significantly higher than larger economies such as the UK and US. High concentration ratios have implications for the optimum design of competition policy. This is especially so in behavioural provisions preventing the misuse of market power and in structural provisions regulating market power through merger policy.

[55] New Zealand is not represented in a number of categories. This is not because New Zealand does not have firms in these sectors but rather because the firms are not large enough to be part of the Standards and Poors COMPUSTAT database.
[56] Arnold et al., *supra* note 21 at 31.
[57] Arnold et al., *supra* note 21 at 33.
[58] Arnold et al., *supra* note 21 at 32.



The third graph shows the ratio of total economic cost to total revenue. It is a crude indictor of economies of scale or productivity differences, when there is similar output relative to input prices across countries.[59] Ratios less than one indicate that on average the firms sampled in that economy produce at economies of scale or are highly productive.

Ratios greater than one indicate that on average firms in that economy do not produce at minimum efficient scale. The graph shows that New Zealand does not enjoy economies of scale relative to other countries. This is consistent with the small size of the average firm in New Zealand and the high costs relative to output.[60] Diseconomies of scale do not appear to be present in the Australian economy. This could be because the data primarily reflects productivity in Australia's east coast market due to its large size relative to smaller less productive markets in other regions of the country.

[59] Arnold et al., *supra* note 21 at 35.
[60] Arnold et al., *supra* note 21 at 35.

In summary these observations suggest:[61]

- New Zealand and Australian domestic markets are relatively concentrated compared to larger economies such as the US and UK;
- New Zealand industries and firms are capital intensive relative to output; and
- New Zealand industries and firms have relatively high average costs that reflect the absence of economies of scale.

These results are likely to be reflected in the design of each countries competition policy.

3.4 Competition policy objectives in Australia

Section 2 of the *Trade Practices Act 1974* states that the purpose of the Act is "to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection." This was inserted into the Act in 1995 following the Hilmer Report. The Report stated:

> "In its broadest sense, competition policy encompasses all policy dealing with the extent and nature of competition in the economy. It permeates a large body of legislation and government actions that influence permissible competitive behaviour by firms, the capacity of firms to contest particular economic activities and differences in the regulatory regimes faced by firms competing in the one market…
>
> [Competition policy] is not about the pursuit of competition for its own sake. Rather, it seeks to facilitate effective competition in the interests of economic efficiency while accommodating situations where competition does not achieve economic efficiency or conflicts with other social objectives."[62]

[61] Arnold et al., *supra* note 21 at 39.
[62] Hilmer Report, *supra* note 22 at 6.

The Report concluded that the objective of competitive conduct rules should focus on protecting the competitive process rather than supporting particular classes of the community such as consumers, competitors, or small businesses. It emphasised that efficiency is a fundamental object of competition policy because of the role it plays in enhancing community welfare. However, where the competitive process does not promote economic efficiency in a particular market, or where other policy goals conflict with economic efficiency, and require some trade off to be made, exemptions from the general rules should also be granted through exemption mechanisms such as authorisation.[63] Exemption mechanisms only allow departures from the competitive process where it is found to be in the public benefit. In determining what amounts to a public benefit that the Commission will have particular regard to, for example the increase in real value of exports or a significant substitution of domestic products for imported goods, the Commission must take into account all other matters relevant to the competitiveness of Australian industry, as well as any other benefits that might exist apart from those specified in the Act.[64] The focus on efficiency is reflected in the object and structure of the Australian *Trade Practices Act.*

3.5 Competition policy objectives in New Zealand

When the *Commerce Act* was introduced in 1986 s1 provided that the purpose of the Act was to promote competition in markets in New Zealand. The Act did not specifically refer to efficiency although the courts were quick to read this in. In *Tru Tone*[65]the Court of Appeal stated:

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[63] Hilmer Report, *supra* note 22 at 26.
[64] See s90(9A)(a)(i)(ii) & (b) *Trade Practices Act.*
[65] *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [1998] 2 NZLR 352

> "In terms of the long title the *Commerce Act* is an Act to promote competition in the markets in New Zealand. It is based on a premise that society's resources are best allocated in a competitive market where rivalry between two firms ensures maximum efficiency in the use of resources."

The purpose provision was amended in 2001 to "promote competition in markets for the long-term benefit of consumers within New Zealand".[66]Lyn Stevens QC suggests that this change indicates that efficiency is not the sole or even key goal of competition policy. He believes that this change is "a more balanced indication of purpose than the rather bold approach referred to in the original long title."[67] Stevens submits that the change to the purpose provision is evidence of a shift away from the light-handed approach to competition regulation and will achieve greater balance between relevant economic and consumer interests.[68] An alternative view is that the change simply ensures that the Act is not focused on competition for competition's sake, but rather competition as a means to an end – the long-term benefit of consumers in New Zealand. Like its Australian counterpart, the Act achieves this balance by providing an authorisation process based on the public benefit test. Authorisation will be granted where the public benefit of the transaction outweigh the costs of lessening competition. In New Zealand the *Commerce Act* requires the Commission to have regard to efficiencies in determining the extent of the public benefit.[69]

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[66] *Commerce Act 1986,* s1A.
[67] Stevens L, *The Goals of the Commerce Act,* in Berry M, Evans L, ed., *Competition Law at the Turn of the Century,* Wellington, Victoria University Press, 2003, 84, at 100. The original long title refers to the long title to the *Commerce Act 1986* as set out above.
[68] *Ibid.*
[69] *Commerce Act 1986,* s3A.

3.6 Should Australia and New Zealand have the same goal for competition policy?

It is not surprising that efficiency is a central feature of both Acts. While this is not directly mentioned in the purpose provision of either, it is embedded in the structure of the Acts and particularly in the exemption mechanisms that apply a public benefit test. As Gal argues:

> "In a small economy it is vital that the goals of competition policy be clearly, consciously, and unambiguously defined and that economic efficiency be given primacy over other goals… The reason is that in small economies, striking a balance between competing goals raises particularly difficult trade offs that may create high degrees of uncertainty.
>
> "Although these arguments apply to any economy, regardless of it size, smallness intensifies the primacy of efficiency."[70]

Take for example a small country that seeks to protect small firms through competition policy. Where protection is achieved at the expense of efficiency not only are efficiencies forgone but inefficient small firms will also be preserved in the market. This argument applies regardless of size, but the effects of an inefficient policy are magnified in a small economy because firms are already producing at diseconomies of scale. Therefore any a further decrease in efficiency will be passed on through the production chain and affect the countries international competitiveness. In a large economy any market imperfections are likely to be disciplined by competitive market forces and will be unlikely to have the same incremental impact as in a small economy.[71]

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[70] Gal, *supra* note 9 at 47.
[71] Gal, *supra* note 9 at 49.

Given that many markets in New Zealand, and at least some markets in Australia, already operate at less than minimum efficient scale, competition policy in both countries should ultimately be concerned with efficiency. Even in Australia, which based on the third graph above appears to produce at positive economies of scale; an overriding goal of efficiency is crucial so as not to further disadvantage markets that do not produce at minimum efficient scale. Any alternative may result in regional disparities and could weaken Australia's national competition policy.

3.7 Examination of provisions prohibiting unilateral misuse of market power

Today the two main provisions prohibiting unilateral misuse of market power are almost the same on both sides of the Tasman. This was not the case in 1986 when the *Commerce Act* was enacted. The New Zealand legislation opted for a dominance threshold rather than substantial lessening of competition, as used in Australia. This section will examine the history of both provisions to see why New Zealand chose a different legislative provision and how the interpretation by subsequent courts resulted in a more harmonised approach.

3.8 Australia: Trade Practices Act 1974, Section 46

Since the enactment of the *Trade Practices Act* in 1965 the misuse of market power provisions have been under considerable scrutiny. The Dawson Committee undertook the latest review in 2001 and reported to the Australian Treasurer in January 2003. As part of the review process the Committee asked the Law Council of Australia to provide a supplementary submission on the history of s46. In particular, it was asked why s46 focused on individual competitors rather than on competition in the market when the Act was introduced in 1974. The Law Council's findings are summarized below.

Prior to 1974 the *Trade Practices Act 1965* contained provisions prohibiting the practice of monopolisation. For the purposes of the Act a person engages in monopolization if, being in a dominant position, he or she undertake one of three anticompetitive purposes.[72] The Second Reading Speech to the *Trade Practices Act 1965* provides:

> "Stated briefly, examinable monopolization takes place where advantage is taken of a dominant position to do one of three things, namely to induce a refusal to deal with someone, to engage in price cutting to substantially damage a competitor, or impose conditions that could not be imposed but for the position of dominance."

These practices are likely to have been the kinds of conduct that were only participated in by firms with the required market power.

The *Trade Practices Act 1974* lowered the threshold test applied to s46 monopolisation allegations so that a corporation must be in a position to substantially control a market before it can be said to be taking advantage of it power by virtue of its position in that market. Unfortunately there were no references to s46 in any of the relevant Second Reading Speeches, Explanatory Memoranda, textbooks, or journal articles on the rationale for the drafting of s46(1)(a)-(c) of the *Trade Practices Act 1974* that indicate why the threshold test was changed.[73]

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[72] *Trade Practices Act 1965* (Cth.), s37(2).
[73] Law Council of Australia, *Supplementary Submissions to the Trade Practices Act Review Committee*, September 2002, 4, http://tpareview.treasury.gov.au/content/subs/196.pdf

On the recommendations of the Swanson Committee minor changes were made to s46 in 1977. In terms of the threshold test in s46 the words 'for the purpose of' were substituted for the word 'to' at the beginning to subsections (1) (a), (b), and (c). After the 1977 amendments, s46 provided that:

> (1) A corporation that is in a position substantially to control a market for goods or services shall not take advantage of the power in relation to that market that it has by virtue of being in that position <u>for the purpose of</u>
>
> (a) eliminating or substantially damaging a person, being a competitor in that market or in any other market of the corporation or of a body corporate related to the corporation;
>
> (b) preventing the entry of a person into that market or into any other market; or
>
> (c) deterring or preventing a person from engaging in competitive conduct in that market or in any other market.

The changes were intended to clarify the position that only a purpose to monopolise is required and not actual proof that the monopolistic purpose has been achieved.[74]

By 1986 it was accepted that the threshold was still too high and resulted in a narrow application of the section. It only applied to a few powerful corporations with the requisite amount of market power. A number of firms had a substantial degree of market power but were not dominant; nevertheless these firms had sufficient market power to engage in conduct that would otherwise be prohibited under the Act. The *Trade Practices Revision Act 1986*[75] amended the threshold test to catch predatory conduct engaged in by

[74] *Ibid.* at 6.
[75] *Trade Practices Revision Act 1986* (Cth), s17.

a corporation with a 'substantial degree of market power'. This is the same test that is applied by the courts today.

As mentioned above, the latest review of the *Trade Practices Act* was completed in January 2003. A number of submissions suggested that the threshold to s46 was still too high. The ACCC in particular used the latest inquiry as an opportunity to state its case for the introduction of an effects test to supplement the existing purpose test. It was the Commission's view that an effects test would better serve the object of the Act in protecting the process of competition and fair-trading because it would overcome enforcement difficulties associated with proving purpose.[76] It submitted that the current s46 is drafted in terms of anticompetitive 'purpose', and ignores the actual competitive effects of conduct. The Commission believes that commercial strategies that are both non-competitive (inconsistent with competitive behaviour) and lead to actual damage to competition should be prohibited, even though it may not be possible to demonstrate an anticompetitive purpose motivating the conduct.[77] The ACCC's suggestions have not been adopted to date but will be discussed further below.

Section 46(1) currently reads:

> A corporation that has a substantial degree of power in a market shall not take advantage of that power for the purpose of:
> (a) eliminating or substantially damaging a competitor of the corporation or of a body corporate that is related to the corporation in that or any other market;
> (b) preventing the entry of a person into that or any other market; or

[76] Australia, Australian Competition and Consumer Commission, *Submission to the Trade Practices Act Review*, June 2002, 79.
[77] *Ibid.* at 79-80.

(c) deterring or preventing a person from engaging in competitive conduct in that or any other market.

A successful s46 prosecution therefore requires that:

(i) a corporation has a substantial degree of power in a market;

(ii) the corporation has taken advantage of its market power; and

(iii) the conduct has the proscribed anticompetitive purpose.

3.9 Substantial degree of market power

The High Court in *Queensland Wire*[78] stated that market power is an economic concept and defined it as follows:

> "A firm possesses market power when it can behave persistently in a manner different from the behaviour that a competitive market would enforce on a firm facing otherwise similar costs and demand conditions."

As referred to above, Parliament did not intend a substantial degree of market power to require dominance. A court will consider all the various constraints on the defendant's conduct before making an assessment of whether a corporation has the requisite degree of market power. Market power will also be affected by market definition. The wider the market the less likely a firm is to possess market power. The courts have concluded that market definition is a value judgment upon which reasonable minds may differ[79] but it will usually be a matter of commercial common sense.[80]

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[78] *Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd* (1989) 167 CLR 177, 200.
[79] *Boral Besser Masonry Limited (Now Boral Masonry Ltd) v Australian Competition and Consumer Commission* [2003] HCA 5, 72.
[80] *Commerce Act 1986,* s3 (1A).

3.10 Take advantage

Section 46 does not seek to restrict the activities of firms that have achieved market power by competitive means such as superior efficiency. Market power is, therefore, not enough to breach s46: a firm must take advantage of its position in the market. The Court in *Queensland Wire* described take advantage of as analogous to use. A firm must use its market power for the proscribed purpose. The Court did not regard use as requiring hostile intent.[81] The appropriate test was, therefore, whether a corporation would be likely to engage in the same conduct in a competitive market.

The High Court in *Melway* considered the phrase 'taking advantage of market power' and broadened the test to include conduct that is materially facilitated by market power. The Court stated that:

> "in a given case it may be proper to conclude that a firm is taking advantage of market power where it does something that is materially facilitated by the existence of the power, even though it may not have been absolutely impossible without the power."[82]

It does not necessary follow from this conclusion that conduct will not involve the use of market power if the conduct could be undertaken in a competitive market. Rather the appropriate test is whether the corporation would be likely to engage in the same conduct in a competitive market.[83]

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[81] *Queensland Wire Industries, supra* note 78 at 191.
[82] The High Court in *Rural Press Ltd v Australian Competition and Consumer Commission* [2003] HCA 75, para 53, enforced the test based on material facilitation but found that "The Commission failed to show that the conduct of Rural Press and Bridge was materially facilitated by the market power in giving the threats a significance they would not have had without it. What gave those threats significance was something distinct from market power, namely their material and organisational assets."
[83] *Ibid.* at para 42.

The ACCC considers that the take advantage test operates as a crucial filter to the application of s46. It distinguishes conduct that can take place in a competitive market from that which is prohibited under the Act.[84]

3.11 Proscribed purpose

As mentioned above, the words 'for the purpose of' were introduced to replace the word 'to' by the *Trade Practices Amendment Act 1977*. This was designed to reflect the importance of the anticompetitive intent and emphasise that the purpose does not need to be achieved.

Direct evidence of an anticompetitive purpose, such as explicit statements made in internal documents, is often difficult to produce. Section 46(7) allows the court to infer an anticompetitive purpose from the conduct of the corporation or other relevant circumstances. In addition, s84(1) allows the state of mind of a director or agent to be imputed to the corporation.

Despite these provisions the ACCC submits that it is still too difficult to prove the relevant purpose to the satisfaction of the court. In its submission to the Dawson Committee the ACCC stated that in the absence of 'smoking gun' documents, proving the relevant purpose under s46 is onerous.

[84] ACCC, *Submission to the Trade Practices Act Review*, *supra* note 76 at 64.

The ACCC argued s46 would better meet the policy goals of the Act to enhance the welfare of Australians if it were amended to include an effects test. Redrafted the provision would read:

> "A corporation that has a substantial degree of power in a market shall not take advantage of that power for the purpose, **or with the effect or likely effect**, of…"[85]

Since making it submission to the Dawson Committee a number of cases have been decided which tend to weaken the ACCC's submission that it is difficult to prove purpose. In *Safeway* the Full Federal Court stated that too much emphasis was placed on Safeway's intention. Instead the Court should focus on the conduct of the firm in question and draw inferences from that conduct.[86] Furthermore, the inference need only be that the purpose was one of a number of purposes, provided it was a substantial purpose.[87]Given that the courts are open to drawing inferences it is difficult to justify an effects test.

The introduction of the effects test may not necessarily make it easier for the ACCC to bring a successful prosecution. If the focus for deciding between competitive and anticompetitive behaviour becomes whether or not the identified conduct could take place in a competitive market, then the courts may simply require greater evidence at this

[85] ACCC, *Submission to the Trade Practices Act Review*, *supra* note 76 at 94.
[86] *Australian Competition & Consumer Commission v Australian Safeway Stores Pty Limited* [2003] FCAFC 149, paras 340-344.
[87] *Ibid.* at para 341. The Courts reasoning is justified by s4F(1)(b) (i) which states that a person shall be deemed to have engaged or to engage in conduct for a particular purpose or a particular reason if that purpose or reason was or is a substantial purpose or reason.

stage of the inquiry. The introduction of an effects test might shift the balance implicit in the provision in favour of competitors rather than the competitive process.

The Dawson Inquiry recommended that s46 be left as is. One of its main reasons was that the introduction of an effects test would deter legitimate competitive conduct.[88] It also dismissed the ACCC's argument that the introduction of an effects test would bring Australian legislation into line with overseas competition laws. It found countries that had an effects test also employed a higher threshold of dominance.[89]

In March 2004 the Economic References Committee of the Senate also released a report, *The effectiveness of the Trade Practices Act in protecting small businesses.*[90] The report was in response to claims by small businesses that s46 does not provide effective protection from the misuse of market power. The Committee examined a number of issues most of which were considered in the Dawson Review. Its recommendations mainly considered amending the Act to clarify its meaning. The Committee stopped short of recommending the introduction of the effects test.

3.12 New Zealand: Commerce Act 1986, Section 36

The *Commerce Act 1986* was passed as part of a package of reforms aimed at increasing the competitiveness of the New Zealand economy. This included trade liberalisation, fiscal and monetary reforms, industry deregulation and the sale of state owned

[88] Australia, Commonwealth, Independent Committee of Inquiry, *Review of the Competition Provisions of the Trade Practices Act*, by Dawson D, Segal J, Rendall C, (Canberra: Canprint Communications Pty Ltd, 2003), p 80, [herein after referred to as the *Dawson Report*].
[89] *Ibid.* at 79.
[90] Australia, The Senate, Economic References Committee, *The effectiveness of the Trade Practices Act 1974 in protecting small businesses*, March 2004, p7-28.

enterprises. Competition policy sought to minimise government and regulatory intervention in the New Zealand economy. The concept of light-handed regulation[91] is evidenced by the generality of the *Commerce Act* and its universal application to all industries.

Prior to the introduction of the *Commerce Act* New Zealand competition law followed the UK. Competition policy in the 1986 Act changed this direction by adopting a statutory framework similar to the Australian *Trade Practices Act* and as a result implementing principles derived from US antitrust law. The Australian model suited the New Zealand regulatory regime because it was broad enough to incorporate the New Zealand requirements for a liberalised Western economy within the Westminster judicial system. It enabled New Zealand courts to draw on Australian precedent.[92] Coordination was also consistent with the objectives of CER.

The primary purpose of s36 in 1986 was to regulate market power in concentrated industries, especially those that had previously been considered natural monopolies or were government owned. Since New Zealand industrial structure was more concentrated it was felt that the Australian standard would be too wide and may restrict efficiency enhancing conduct by firms. New Zealand, therefore, adopted the dominance threshold in s36 rather than the Australian threshold of a substantial degree of market power.

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[91] Light-handed regulation is based on the Coasian view that given the chance firms will act to minimize their transaction costs, *Ministerial Inquiry into Telecommunications*, *supra* note 30.

[92] Bollard A, New Zealand Commerce Commission, Chairperson, "A Brief Summary of Competition Policy in New Zealand", (Speech to ACCC/PURC Training Programme on Utility Regulation), November 1997.

Prior to the *Commerce Amendment Act 2001*, section 36 (1) read:

> No person who has a dominant position in a market shall use that position for the purpose of –
>
> (a) Restricting the entry of any person into that or any other market; or
>
> (b) Preventing or deterring any person from engaging in competitive conduct in that or any other market; or
>
> (c) Eliminating any person from that or any other market.

3.13 Dominance

The case law on dominance developed in two phases. In the first phase an economic approach was taken; in the second phase the courts adopted a dictionary definition approach.[93]

Initially the New Zealand courts relied on the economic test in the European case, *Re Continental Can Co Inc*[94] that looked to the entity's power to behave independently without taking into account the actions of their competitors, purchasers, or suppliers. In *Re Magnum Corporation Ltd and New Zealand Breweries Ltd,*[95] the Commerce Commission stated:

> "Being in a "dominant position" is interpreted by the Commission, in essence, as having sufficient market power (economic strength) to enable the dominant party to behave to an appreciable extent in a discretionary manner without suffering detrimental effects in the relevant market(s)."

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[93] New Zealand, Ministry of Economic Development, *Review of the Competition Thresholds under the Commerce Act 1986 and Related Issues*, 1999, http://www.med.govt.nz/buslt/bus_pol/thresholds/index.html#TopOfPage

[94] *Re Continental Can Co Inc* (1972) CMLR D11

[95] *Re Magnum Corporation Ltd and New Zealand Breweries Ltd* (1986) 2 TCLR 177, 195-196; (1987) 1 NZBLC (Com) 104,073, 104,088

The High Court in *Telecom Corporation of New Zealand Ltd v Commerce Commission*[96] concluded that dominance is equivalent to a high degree of market power based on the ability to act without regard to other actors within the market. In determining whether a firm is dominant, account will be taken of "features of the firm's external competitive environment that constrain its production and selling policies, not just… market concentration". Barriers to entry are one of the most important factors to consider.

In considering *Telecom*[97], the Court of Appeal moved away from an economic approach and towards a dictionary definition approach. The Court considered synonyms such as prevailing, commanding, ascendant, governing, primary, principal, or leading influence to convey much the same idea as dominance.[98] Dominance required something more than a high degree of market power; the Court held that a high degree of market control was sufficient. This raised the threshold of the prohibition under s36 because under the prior economic approach power to behave independently would have been enough. Subsequent decisions have reinforced the high threshold but retained the economic approach. The High Court in *Port Nelson* followed the Court of Appeals approach. Justice McGechan stated:[99]

> "Dominance" includes a qualitative assessment of market power. It involves more than "high" market power, more than mere ability to behave "largely" independently of competitors...It involves a high degree of market control...There need not be a monopoly...Expression in terms of mastery is perhaps ...misaligned and needs to be read down. To be dominant the firm must be able to act, within

[96] *Telecom Corporation of New Zealand Ltd v Commerce Commission* (1991) 4 TCLR 473, 509.
[97] *Telecom Corporation of New Zealand Ltd v Commerce Commission* (1992) 3 NZLR 429.
[98] *Ibid.* at 434.
[99] *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406

> the limits of commercial reality, without significant competitive or consumer constraints...the ability to dictate must be sustainable."

In 1999 the Ministry of Commerce[100]conducted a review of the thresholds in the Act. In relation to s36 it found that recent judicial interpretations of dominance had resulted in a threshold that was too high to effectively control market power. The *Commerce Amendment Act 2001* lowered dominance to a substantial degree of market power. This was designed to bring more conduct under the scrutiny of the Commerce Commission including major participants in oligopolistic markets and leading firms in less concentrated markets. Firms that do not have a high degree of market control, and are not dominant, but can behave persistently in a manner different from the behaviour a competitive market would enforce, may find themselves with a substantial degree of market power. The change also brings the New Zealand provision into line with Australia.[101]

3.14 Use

No New Zealand case has ever turned on the meaning of the word 'use' in s36(1) of the *Commerce Act 1986*. Nevertheless, the courts have been heavily influenced by Australian jurisprudence. Most cases have relied on *Queensland Wire* where use was found to be the causal link between dominance and purpose.

In *Telecom* the Privy Council indicated that use was more important than purpose because it was possible to infer purpose from use of a dominant position, but not the

[100] Now known as the Ministry of Economic Development.
[101] Ahdar R, *Continuing Uncertainties Surrounding Predatory Pricing: Some New Zealand Reflections*, ECLR 2002, 23(3), 142, 147 (Westlaw).

converse. The Privy Council developed a use test whereby a firm does not use its market dominance if it acts in a way a non-dominant firm in the market would act.[102]

This test is similar to that used in Australia where the courts will consider whether the firm could have undertaken its course of conduct in a competitive market. Subsequent New Zealand courts tend to rely more heavily on *Queensland Wire* where use constitutes a causal connection between dominance and the purpose of the conduct in question.[103]

3.15 Purpose

Like the Australian statute under the *Commerce Act* the purpose must be a substantial purpose. A substantial purpose is material in nature. Jurisprudence in New Zealand has mainly concentrated on whether the purpose must be objective or subjective. In *Port Nelson*, however, the Court of Appeal cast doubt on whether this was even an issue.[104]

Although legislation has only allowed purpose to be inferred since 2001,[105] courts have been prepared to infer purpose when they are presented with satisfactory evidence. As mentioned above this was codified in the *Commerce Amendment Act 2001*.

New Zealand has also considered the introduction of the effects test but decided against it primarily for two reasons. Firstly, introducing an effects test would substantially expand the scope of conduct that would fall under the provision. As a result the provision could

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[102] Ministry of Economic Development, *Review of the Competition Thresholds, supra* note 93.
[103] See the Port Nelson cases, *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406 (HC); *Port Nelson Limited v Commerce Commission* (1996) 7 TCLR 217 (CA).
[104] *Ibid.* Court of Appeal at p 227.
[105] *Commerce Act 1986*, s36B.

deter efficient commercial activity. Secondly, the test would increase the risk of judicial error because of the difficulties in determining whether or not conduct was in breach of the Act.[106] A ruling would require knowledge of:

- what the defendant would, or could, have done if it were in a hypothetical competitive market;
- what the plaintiff would look like if it were a competitor in that hypothetical market; and
- the damage done to the plaintiff by the defendant in the hypothetical market.[107]

These factors would be difficult to predict with reasonable levels of certainty.

3.16 Should Australia and New Zealand have the same misuse of market power provisions?

Today s46 of the *Trade Practices Act* and s36 of the *Commerce Act* contain the same legislative test: taking advantage of market power for anticompetitive purposes. But even before the *Commerce Amendment Act 2001*, courts on both sides of the Tasman were heavily influenced by the development of market power doctrine in the other country. While neither judiciary blindly followed the approach of the other, consideration did result in interpretations that moved in a similar direction.

In her book, *Competition Policy for Small Market Economies*, Professor Gal argues that it would be prudent for economies characterized by highly concentrated industries to adopt lower market power thresholds than large economies. While it would be equally plausible

[106] Ministry of Economic Development, *Review of the Competition Thresholds, supra* note 93.
[107] Ergas H, *Should section 36 of the Commerce Act be amended to include an effects test*, Comments on a paper delivered at the TUANZ Conference on Telecommunications 1998, cited in Ministry of Economic Development, *Review of the Competition Thresholds, supra* note 93.

for small economies to adopt higher market power thresholds so as not to impede legitimate competitive behaviour, Gal suggests that large economies often use market share as a prima facie indicator of market power. In small economies the market share threshold will need to be lower because inefficient economies of scale and high barriers to entry mean that the elasticity of supply will usually be lower and firms will be able to act in a dominant manner without necessarily having a large market share.[108]

An alternative to lowering the market share thresholds is to adopt open terminology in the legislation, such as dominant, that allows the courts to take into account all factors that determine market power. Where open terminology is used there should be no difference between tests applied by large and small economies given that factors in the equation of calculating market power (market share, supply elasticity and demand elasticity) will denote the different circumstances in individual markets. [109]

Neither Australia nor New Zealand has adopted a market share threshold approach. Both countries use open terminology that gives the courts greater discretion. However, one of the problems with this approach is that it gives the courts the power to determine the threshold. For instance, when the New Zealand Court of Appeal adopted a dictionary definition approach to dominance it raised the market power threshold and restricted the effectiveness of the provision.

[108] Gal, *supra* note 9 at 63.
[109] Gal, *supra* note 9 at 63.

Gal also suggests that in small economies tests should be based on economic analysis and ensure that the monopolist's conduct actually reduces welfare before it is prohibited.[110] The problem with this argument is that economic analysis is costly. However, Gal finds that costs can be reduced where the legislation contains a non-exhaustive list of practices that are presumed to constitute abuses of power if engaged in by a dominant firm. This shifts the burden onto the defendant to prove that their actions were justifiable.[111] Unfortunately this solution is not without problems. A non-exclusive list could decrease the incentives of firms to engage in pro-competitive behavior.

Australia and New Zealand have both employed this last technique to differing degrees. Resale price maintenance is specifically mentioned in the *Commerce Act* and is per se illegal. The *Trade Practices Act* has a more comprehensive list of practices that are presumed to be illegal. These include resale price maintenance, boycotts, and exclusive dealing. One reason for the differences could be that when the economic theory is applied to these actions in the Australian economy they are almost never beneficial. In New Zealand, however, they are more likely to result in efficiencies. This seems unlikely, a more apt explanation is that New Zealand had the opportunity to observe the effectiveness of the *Trade Practices Act* and removed any inconsistencies.[112]

After reviewing Gal's proposals for competition law in small economies, competition law in Australia and New Zealand seems to be in reasonably robust shape. But Gal does not come to any conclusions about whether size is relative. Are there any peculiar

[110] Gal, *supra* note 9 at 100.
[111] Gal, *supra* note 9 at 100.
[112] Hilmer Report, *supra* note 22 at 47.

characteristics of the New Zealand economy that would prevent it from further coordinating its misuse of market power provisions with Australia? Gal identifies principles, such as the emphasis on efficiencies, which in theory apply to both large and small economies. In practice, however, it is more important for small economies to strictly adhere to those principles. Australian and New Zealand both have concentrated markets that are not as effectively disciplined by competition, and therefore, they both need to take the same approach to misuse of market power. It makes no difference that Australia is larger and has slightly less concentrated industries; the problem, principles, and solution remains the same.

Industry structure and concentration might change over time as industries mature, trade flows increase, or due to technological innovation. Even if we assume that in the future industry structure will become less concentrated, the fundamental principles behind the misuse of market power provision will not change. Instead it may become more efficient to administer the Act and enforce the provision by adopting a different approach, such as the market power thresholds used in the US.

As we have seen the open terminology used to set market power thresholds is susceptible to welfare reducing judicial interpretations. Any moves towards closer coordination should retain sufficient flexibility to make changes if, in the future, industry structure is not so closely aligned or judicial interpretation results in less than optimal tests being applied.

3.17 Examination of provisions prohibiting co-ordinated anticompetitive behaviour

Like misuse of market power, the provisions prohibiting co-ordinated anticompetitive conduct in the *Trade Practices Act* and the *Commerce Act* are more or less the same. Both Acts take the same structural approach as the US antitrust law and separate conduct into that which is so likely to damage competition that it is prohibited absolutely, without looking to its effect or likely effect on competition (per se prohibitions), and conduct that requires proof of either the purpose, effect, or likely effect of substantially lessening competition (rule of reason prohibitions). Where coordinated behaviour results in public benefit, authorisation may be sought from the competition authority.

The advantage of the per se offences is that they give businesses more certainty and facilitate better compliance with the intention of the legislation. They also reduce the time and cost to businesses and the regulator of an inquiry by limiting the issues to a factual examination of whether the conduct occurred or was attempted, rather than a full inquiry into the competitive effects of the conduct.[113] Per se offences can also restrict efficiency enhancing conduct if they are used to prohibit offences that may have efficiency benefits. In these cases it is more appropriate to apply a rule of reason approach to the conduct in question.

The main difference between the Australian and New Zealand Acts lies in the structure of the legislation. Some offences are treated differently under the *Trade Practices Act* than they are under the *Commerce Act*. Take, for example, third line forcing, which is similar

[113] *Dawson Report*, *supra* note 88 at 208-209.

to tying only it occurs when there is a forced purchase of a second product from another supplier. Under the Australian legislation it is treated as a per se offence whereas in New Zealand it is a rule of reason offence. The Hilmer Committee considered whether third line forcing should be prohibited per se given that some forms of third line forcing, such as bundling, are efficiency enhancing. The Committee recommended that third line forcing be subject to a rule of reason approach. This recommendation has not been adopted. Instead the Act was amended so that third line forcing may be notified to the Commission pursuant to s93 of the *Trade Practices Act*.[114]

Notification is a form of authorisation that places the onus on the ACCC to challenge the conduct if it believes that the public detriment outweighs the public benefits.[115] Parties proposing to enter into an exclusive dealing arrangement can notify the Commission of their proposal. If the Commission raises objections to the proposal then parties to the proposal can choose to modify the proposal, seek formal authorisation under s88 of the *Trade Practices Act*, or drop the proposal. The notification mechanism only applies to exclusive dealing arrangements in Australia and is not used at all in New Zealand.

Over the years the New Zealand courts have drawn heavily on Australian case law and statutory interpretation. Extensive use of Australian jurisprudence has been possible because the general prohibitions against agreements that substantially lessen competition are much the same in both countries. The provisions provide that that contracts,

[114] *Dawson Report, supra* note 88 at 121-123.
[115] *Dawson Report, supra* note 88 at 124.

arrangements and understandings that have the purpose, effect or likely effect of substantially lessening competition in the market are prohibited.[116]

3.18 Contract, arrangement, or understanding

The inclusion of arrangement or understanding is designed to capture transactions or dealings that are informal and do not give rise to a legally binding contract.[117] In *Top Performance Motors Ltd v Ira Berk (Qld) Pty Ltd,* Smithers J held that an arrangement or understanding:

> "must involve the meeting of two or more minds. Where the minds of the parties are at one that a proposed transaction between them proceeds on the basis of the maintenance of a particular state of affairs or the adoption of a particular course of conduct, it would seem that there would be an understanding within the meaning of the Act."[118]

The New Zealand courts followed this approach in *New Zealand Magic Millions Ltd v Wrightson Bloodstock Ltd.*[119] It was subsequently affirmed by the Privy Council in *New Zealand Apple & Pear Marketing Board v Apple Fields Ltd.*[120]

3.19 Purpose, effect, or likely effect

Section 4F(b) of the *Trade Practices Act* and s2(5) of the *Commerce Act* both indicate that it is sufficient if the requisite purpose is one of a number of purposes provided that it is a substantial purpose.

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[116] *Trade Practices Act*, s45, *Commerce Act*, s27.
[117] Corones S, *Competition Law in Australia*, 2nd ed. (Sydney: LBC Information Services, 1999) at 158.
[118] *Top Performance Motors Pty Ltd v Ira Berk (Qld) Pty Ltd* (1975) 24 FLR 286, 291
[119] *New Zealand Magic Millions Ltd v Wrightson Bloodstock Ltd* [1990] 1 NZLR 731.
[120] *New Zealand Apple & Pear Marketing Board v Apple Fields Ltd* [1991] 1 NZLR 257.

In Australia the courts have found that the requisite purpose must be a common or shared purpose. The element is not fulfilled if only one party has the requisite purpose or the other party is merely aware of it.[121] The courts in New Zealand did not follow the lead of their Australian counterparts. Instead the Court of Appeal held that it is sufficient for only one party to have the relevant purpose.[122]

On both sides of the Tasman there has been debate about whether an objective or subjective test should be used for ascertaining purpose. In Australia the courts have taken the approach that a subjective purpose is required,[123] but given that it may not be possible to identify the individuals involved the subjective purpose can be attributed to a class of individuals.[124] In New Zealand subjective purpose could be derived objectively from the likely consequences of the entities action; therefore, the Court of Appeal held that whether the purpose is subjective or objective has little practical importance since it is rare to find clear declarations of subjective purpose.[125]The court will, therefore, require evidence that the business rationale behind a contract or provision involves the lessening of competition.[126]

In their paper *Contracts that Lessen Competition,* Carlton and Goddard suggest that the appropriate test to be applied by the courts is whether upon entering into the contract there was a reasonable foreseeability of harm to competition, based on the information

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[121] *Carlton & United Breweries (NSW) Pty Ltd v Bond Brewing (NSW) Ltd* (1987) 16 FCR 351, 356 cited in Corones, *supra* note 118 at 163.
[122] *Supra* note 103.
[123] *ASX Operations Pty Ltd v Pont Data Australia Pty Ltd (No 1)* (1990) 27 FCR 460.
[124] *TPC v Garden City Cabs Co-operative Ltd* (1995) ATPR 41-410.
[125] *Supra* note 104.
[126] Carlton, Goddard, *supra* note 10 at 161.

available to the firm at the time.[127]They suggest that this approach is consistent with the objectives of competition policy given that competition policy is not concerned with the mental state of the parties. Instead, prohibitions against coordinated anticompetitive behaviour aim to create incentives for firms to avoid harm to competition, without deterring aggressive competitive behaviour.[128]

Carlton and Goddard also argue that if reasonable foreseeability is an appropriate standard for imposing liability *ex post* then there is little need to show that the effect or likely effect of the arrangement is anticompetitive. They believe the key to the effects test lies in the availability of an authorisation by the regulatory authority *ex ante*. In the context of an application for authorization it is appropriate for the regulator to inquire into the likely effects of a proposed arrangement.[129]

In *Port Nelson* the Court of Appeal held that the occurrence of the effect must be "above a mere possibility but not so high as more likely than not and is best expressed as a real and substantial risk that the stated consequence will happen."[130]

3.20 Substantial

In Australia substantial is used in a number of different contexts in relation to restrictive trade practices and mergers. In the case of contracts, arrangements and understandings that lessen competition, the courts have adopted a relative approach to substantial.[131] The

[127] Carlton, Goddard, *supra* note 10 at 161.
[128] Carlton, Goddard, *supra* note 10 at 161.
[129] Carlton, Goddard, *supra* note 10 at 161.
[130] *Port Nelson*, *supra* note 104 at 562-563, cited in Carlton, Goddard, *supra* note 10 at 162.
[131] *Radio 2UE Sydney Pty Ltd v Stereo FM Pty Ltd* (1982) 62 FLR 437, 444. The other approach is the absolute approach that assesses the quantity or size of sales affect by the conduct, see *Tillmans Butcheries Pty Ltd v AMIEU* (1978) 42 FLR 331.

relative approach focuses on the extent to which competition is affected by the conduct relative to the actual or potential competition in the market as a whole.[132] Substantial has been paraphrased by the courts to mean real or of substance, as distinct from ephemeral or nominal,[133] not insubstantial,[134] and more than trivial or minimal.[135] The courts in New Zealand have followed the example set by Australia. Substantial was found to mean "more than insubstantial or nominal. The mere ephemeral and minimal will not suffice."[136]

3.21 Lessening of competition

In both Australia and New Zealand the courts seem to approach the lessening of competition question by asking what the market would look like with and without the coordinated behaviour at issue, and to inquire whether competition in the market is less in the with or without scenario.[137] In *Auckland Regional Authority v Mutual Rental Cars (Auckland Airport) Ltd*[138] the Court followed the Australian case *Dandy Power Equipment Pty Ltd v Mercury Marine Pty Ltd,*[139] which stated:

> "To apply the concept of substantially lessening competition in a market, it is necessary to assess the nature and extent of the market, the probable nature and extent of competition which would exist therein but for the conduct in question, the way the market operates and the nature and extent of the contemplated lessening."

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[132] Corones, *supra* note 118 at 131.

[133] *Tillmans Butcheries Pty Ltd v Australasian Meal Industry Employees Union* (1979) 27 ALR 367, 382.
[134] *Ibid.*
[135] *Ibid.* at 563.
[136] *Port Nelson*, *supra* note 99.
[137] Carlton D, Goddard D, *supra* note 10 at 163.
[138] *Auckland Regional Authority v Mutual Rental Cars (Auckland Airport) Ltd* [1987] 2 NZLR 647
[139] *Dandy Power Equipment Pty Ltd v Mercury Marine Pty Ltd* (1982) ATPR 40-086

This comparative test was affirmed in subsequent New Zealand cases including, *Tru Tone Ltd v Festival Records Retail Marketing Ltd*[140] and *Auckland Regional Authority v Mutual Rental Cars (Auckland Airport) Ltd & Ors*.[141]

There is an inverse relationship between market power and competition. When market power increases competition is lessened.[142] Courts should therefore consider the same factors in assessing competition as they do when assessing market power.[143] However, it must be kept in mind that Acts are concerned with competition in the market rather than the ability of individual sellers to compete.

3.22 Should Australia and New Zealand have the same provisions prohibiting coordinated anticompetitive behaviour?

Provisions regulating coordinated anticompetitive behaviour have two main functions: to deter collusive anticompetitive behaviour and to regulate welfare enhancing cooperative agreements.[144] In both cases the overriding purpose of the provisions is to prevent harm to competition. Competition policy, therefore, is not concerned with collusive or cooperative behaviour that does not increase market power. In small economies the tension between these two functions is more apparent because their highly concentrated market structure makes them more susceptible to collusive anticompetitive agreements. At the same time cooperation between firms may increase productive and

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[140] *Tru Tone Ltd v Festival Records Retail Marketing Ltd* (1988) 2 TCLR 525, 539; and affirmed on appeal (1998) 2 NZLR 352, 362 (CA).
[141] *Auckland Regional Authority supra* note 139 at 671.
[142] Corones, *supra* note 118 at 117.
[143] Market power is a structural concept that will largely be determined by: the breath of the market and the character of demand, the number and size distribution of sellers and buyers; the conditions of entry for new sellers and expansion for existing sellers; the character and importance of product differentiation; and the degree of independence of action among sellers and buyers. See Kaysen C, Turner D, *Antitrust Policy* (Cambridge, Massachusetts: Harvard University Press, 1959) cited in Corones, *supra* note 118 at 119.
[144] Gal, *supra* note 9 at 168-170.

dynamic efficiency that would not otherwise have been possible.[145] Coordinated behaviour presents a dilemma to regulatory authorities because on the one hand coordinated anticompetitive behaviour that increases market power may be welfare enhancing but on the other it creates a market structure that is more conducive to collusive, welfare reducing, anticompetitive behaviour.

To achieve the appropriate balance small countries allow parties to competition reducing agreements to apply for authorisation where they think there is efficiency enhancing benefits that would outweigh the costs from loss of competition. Unlike merger authorisations however, competition authorities often retain the right to vary or revoke an authorisation where there has been a material change in circumstances.[146]The Act, therefore, creates an incentive for parties to the authorised agreement to refrain from unauthorised collusive behaviour. This approach has been followed in both Australia and New Zealand.

The problem with the revocation approach is that it fails to give certainty to parties seeking to rely on the agreement. As a result, entities that require certainty may be more likely to pursue a merger than a long-term cooperative agreement. Assuming that firms organise their affairs in the most advantageous way, a bias created by the legislation towards mergers could result in unnecessary costs. The optimum policy will depend on the cost created by the bias compared to the benefit of the incentive to refrain from unauthorised anticompetitive collusive behaviour created by the revocation provision.

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[145] In large economies there are more opportunities to achieve productive and dynamic efficiencies that do not reduce competition.
[146] *Trade Practices Act*, s91B, *Commerce Act,* s65.

Australia and New Zealand already have more or less the same general substantive provisions prohibiting coordinated anticompetitive behaviour. While there are some differences in the categorisation of offences into per se or rule-of-reason offences these differences are unlikely to be an impediment if both countries sought to further formalise the existing substantive coordination. As mentioned above, the Hilmer Report recommended that third line forcing be subject to a rule-of-reason approach rather than singled out as a per se prohibition in order to encourage efficiency enhancing behaviour. The decision not to implement the recommendation reflects a contrasting view on the most effective way to administer the prohibitions.

On the one hand if both countries were to have the same substantive provisions there may still be differences in their application. The substantive law does not provide much guidance to competition authorities and courts on how to evaluate the public benefit. Competition authorities and courts are, therefore, given a considerable amount of discretion that could result in the same fact pattern being decided differently in each country. On the other hand both the competition authorities and the courts increasingly take account of each other's approaches, so the differences in application may not be so significant.

3.23 Examination of provisions relating to mergers and business acquisitions

Mergers perform an important role in an economy by allowing firms to achieve efficiencies such as economies of scale and scope, synergies, and risk spreading. In

addition, they impose competitive disciplines on managers to perform. Under performing companies will be vulnerable to takeover and management will be replaced.[147]

While most mergers do not raise competition issues some mergers create market structures that increase the risk of anticompetitive behaviour. Increased concentration changes the incentives of firms and makes them more inclined to participate in anticompetitive behaviour.[148]

The merger provisions complete the set of regulatory tools used to promote competitive markets in both the *Trade Practices Act* and the *Commerce Act*. In contrast to s45/s27 and s46/s36, which are often referred to as behavioural provisions because they prevent anticompetitive conduct, the regulation of mergers is aimed at preventing market structures that might give rise to the anticompetitive conduct prohibited by the behavioural provisions.

The *Commerce Amendment Act 2001* brought the provisions regulating merger activity into line with Australia. Both countries prohibit mergers that "would have or be likely to have the effect of substantially lessening competition in a market".[149]

Neither provision has been subject to extensive litigation in the courts. This is mostly due to the authorisation and notification procedures in both countries. This section will

[147] ACCC, *supra* note 84 at 134.
[148] ACCC, *supra* note 84 at 134.
[149] *Trade Practices Act*, s50, *Commerce Act*, s47(1).

examine the choice of threshold in the merger prohibition and explain why Australia and New Zealand have adopted different compliance procedures.

3.24 Australia: Trade Practices Act 1974, Section 50

When the *Trade Practices Act* came into force in 1974 the wording of s50 was based on s7 of the *Clayton Act* in the US. It prohibited the acquisition of assets or shares that resulted in a substantial lessening of competition.[150] The Act also allowed for parties proposing a merger to approach the Trade Practices Commission and ask for a decision on whether the proposal was likely to have the effect of substantially lessening competition.[151]

By 1977 the Commission had a backlog of merger notifications. This seems to be a reason behind the changes enacted in the *Trade Practices Amendment Act 1977*. The Act repealed the voluntary notification provisions despite endorsement by the Swanson Committee. In addition, s50 was changed to dominance to reduce the number of merger applications. An acquisition was prohibited if it resulted in a position of control or dominance in the market.[152] In *TPC v Ansett Transport Industries (Operations) Pty Ltd*, dominance was held to mean something less than control.[153]

In the absence of a statutory notification arrangement an informal voluntary clearance procedure developed.[154] In granting a clearance the ACCC undertakes not to challenge

[150] Corones, *supra* note, 118 at 207.
[151] Dawson Report, *supra* note 88 at 44.
[152] Dawson Report, *supra* note 88 at 44.
[153] *Trade Practices Commission v Ansett Transport Industries (Operations) Pty Ltd* (1978) 32 FLR 305
[154] Dawson Report, *supra* note 88 at 45.

the merger in the Federal Court. Mergers that are notified are assessed on a case-by-case basis in accordance with the requirements set out in the merger guidelines.[155]

In 1984 the government issued a Green Paper in which it proposed a return to the substantial lessening of competition test. Eventually it decided to retain the dominance threshold.[156] The reasons were expressed in the Attorney General's second reading speech to the 1986 amendments:

> "The government is firmly committed to the encouragement of efficient Australian industry and to increasing our competitiveness in world markets. It has been decided that the existing dominance test in s50 should remain essentially unchanged. The coverage of s50 will not be extended beyond those mergers which result in undue concentration in a market. The competitive conduct of firms which increase their market power as a result of other mergers will be subject to scrutiny under s46 as proposed to be amended."[157]

A further review by the Griffith Committee in 1989 found that the dominance test in s50 was effective. However, it acknowledged that its assessment of the adequacy of the merger test was hampered by the lack of empirical evidence on the effect of mergers.[158] In 1990 the Cooney Committee recommended that the test be lowered to substantial lessening of competition, although it also gave the same caveat on lack of economic

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[155] Australia, Australian Competition and Consumer Commission, *Merger Guidelines,* (Canberra: AusInfo, 1999) at 15.
[156] Australia, Attorney-General's Department, *The Trade Practices Act – Proposals for Change,* (Canberra: AGPS, 1984) at para 45 cited in Corones *supra* note 118 at 207.
[157] Australia, Commonwealth Parliamentary Debates, House of Representatives, 19 March 1986, 1927.
[158] Australia, House of Representatives Standing Committee on Legal and Constitutional Affairs, *Mergers, Takeovers and Monopolies: Profiting from Competition?,* (Canberra: Australian Government Publishing Service, 1989) para 3.4.12, [herein after referred to as the Griffith Committee Report].

data.[159] This recommendation was accepted and embodied in the *Trade Practices Legislation Amendment Act 1992.* Another major change was the insertion of s50(3) which sets out a non exhaustive list of matters which must be taken into account in determining whether the relevant acquisition or merger would have or be likely to have the effect of substantially lessening competition in a market.[160] Of particular note is the actual and potential level of import competition in the market.[161]In 1993 the Hilmer Committee concluded that the Griffith Committee and the Cooney Committee had canvassed the merger test extensively and that any further review should await more practical experience with the operation of the amended provisions.[162]

The Dawson Committee undertook the latest review in 2002-3. Unlike past reviews the Dawson Committee focused on the procedural requirements. In contrast to most of its major trading partners Australian legislation does not require parties to a merger to notify the Commission. Instead parties are encouraged to approach the Commission for an informal clearance. Under the clearance process the Commission evaluates whether the merger would be likely to lessen competition based on the factors set out in s50(3) of the *Trade Practices Act.* These include, but are not limited to, barriers to entry, existing market concentration, and the level of actual and potential import competition.[163] If the merger is found to lessen competition then the Commission will advise the parties either to abandon the proposal, modify the proposal (perhaps by way of an undertaking under

[159] Australia, Senate Committee on Legal and Constitutional Affairs, *Report on Monopolies and Acquisitions – Adequacy of Existing Controls*, (Canberra: Australian Government Publishing Service, 1991) para 3.25. Canberra, para 3.25, [herein after referred to as the Cooney Committee Report].
[160] Corones, *supra* note 118 at 203.
[161] *Trade Practices Act*, s50(3)(a).
[162] Hilmer Report, *supra* note 22 at 83.
[163] See s50 (3) for other evaluation criteria.

s87B), or apply for an authorisation under s88 if the acquirer considers the merger to be in the public benefit.[164]

As part of the review the Dawson Committee considered whether s50 should include an efficiencies defence. Including an efficiencies test in s50 would allow the Commission to consider efficiencies under the informal clearance system, which presently only considers whether the merger would be likely to substantially lessen competition. The Committee concluded that substantial lessening of competition was an appropriate test and that consideration of efficiencies at the clearance stage would widen the ACCC's discretion and would require a more structured approach to the application of s50 than is currently offered by the clearance process. If, at the clearance stage, a transaction is found to substantially lessen competition, then it should make a formal application for authorisation.

The Committee found widespread support for the informal clearance system for mergers. It was expeditious, inexpensive, and generally perceived as being effective.[165] However, the Committee received a few submissions that were critical of the clearance process. They submitted that the ability to obtain an informal clearance made the formal authorisation process almost redundant. Where the ACCC declined clearance the merger was either abandoned or resolved by the negotiation of undertakings under s87B. Few

[164] Merger guidelines, *supra* note 156 at 19.
[165] Dawson Report, *supra* note 88 at 49.

mergers ever sought authorisation. Authorisation was perceived as slow and there was a risk of third party intervention by way of appeal to the Tribunal.[166]

In its submission to the Dawson Committee the ACCC noted that the Australian merger law departed from other countries because its laws contained no formal requirement that parties to a proposed merger advise the Commission prior to entering into an agreement. Nevertheless, the informal notification system resulted in administrative efficiencies and a comparatively light regulatory burden.

> "Considering the size of the Australian economy and the level of merger activity, the system works well. The merger notification system of other countries has been criticised because of the compliance burden it imposes, especially given that most transactions raise no anticompetitive concerns."[167]

The other problem with the clearance system that was highlighted in the Dawson Report is its lack of transparency in the decision making process. Given the informal nature of the clearance process the Commission is not required to give reasons for its decision. The Committee concluded that the informal process would be improved, and regulatory error reduced if the ACCC were required, taking care to protect confidentiality, to provide reasons for its decisions when requested to do so by parties and when it rejected a merger or proposed undertaking.[168] This would allow a better understanding of decisions and reduce uncertainty.[169] The courts could not review clearance decisions without formalising the process. The Committee recommended that a voluntary formal process

[166] Dawson Report, *supra* note 88 at 49.
[167] ACCC submission to the Dawson Committee, *supra* note 84 at 148.
[168] Dawson Report, *supra* note 88 at 61.
[169] Dawson Report, *supra* note 88 at 61.

should operate in parallel with the present informal one.[170] These recommendations have not been implemented.

3.25 New Zealand: Commerce Act 1986, Section 47

When the *Commerce Act* came into force in 1986 it retained the formal clearance process set out in the *Commerce Act 1975*. Like the Australian process, a clearance was given if the Commission was satisfied that the proposed merger would not result or be likely to result in any person acquiring a dominant position in a market or strengthening a dominant position in a market.[171]Unlike the informal Australian process, however, the s66(10) *Commerce Act* provided that the Commission state in writing its reasons for the determination.

In 1999 the Ministry of Commerce carried out a Review of Competition Thresholds in the *Commerce Act*. In its discussion document it suggested that the adoption of a competition test for mergers would clearly recognise that single firm dominance is not an essential precondition to market power. The formation of oligopolistic market structures is also detrimental to competition and efficiency in the economy yet the dominance threshold failed to bring a number of mergers that might facilitate collusion under the scrutiny of the Commerce Commission. The adoption of the substantial lessening of competition threshold for mergers would also remove the current inconsistency in the treatment of restrictive trade practices that fall outside the misuse of market power and

[170] Dawson Report, *supra* note 88 at 61.
[171] See *Commerce Act 1986,* as am. by *Commerce Amendment Act 2001***,** s66(3)(a). In 1986 the *Trade Practices Act* also employed the dominance test. In New Zealand the meaning of dominance has mostly arisen in the context of s36, misuse of a dominant position. This is discussed in section 3.13.

the merger provisions.[172] As the discussion document pointed out, anticompetitive outcomes can be the same whether achieved through contract or through merger. If anything the law should be more stringent on mergers than coordinated arrangements, such as joint ventures or strategic alliances, because when firms merge the opportunity for competition is gone forever. The current inconsistency could be creating some incentive for firms to merge to gain the outcomes that they are prohibited from achieving under ss27-29 of the Act.[173] These recommendations were enacted in the *Commerce Amendment Act 2001*.

The impact of the changes is illustrated clearly in the recent case *Progressive/Woolworths*[174]. Immediately before the *Commerce Amendment Act 2001* came into force Progressive Enterprises Limited, in accordance with s66(1) of the *Commerce Act*, gave the Commerce Commission notice seeking clearance for the acquisition of all the shares in Woolworths (New Zealand) Limited. The Commission applied the old s47 test using the dominance threshold and cleared the application. Foodstuffs (Auckland) Limited, Progressive's major competitor, on the basis that the Commission had applied the wrong test. They argued that it should have applied the new substantial lessening of competition test. The Court of Appeal agreed. When the Commission reconsidered the merger under the new test it was not satisfied that the acquisition would not lead to substantial lessening of competition in the market for retail

[172] Long term coordination agreements, that were more or less analogous to a merger, were subject to the lower substantial lessening of competition test under s27. This created a bias in favour of mergers because arrangements that would have been found to substantially lessen competition would not necessary result in the acquiring of a dominant position.
[173] Ministry of Economic Development, *Review of the Thresholds*, *supra* note 93.
[174] *Foodstuffs (Auckland) Ltd v Commerce Commission* [2002] 1 NZLR 353 (CA).

supermarkets.[175] It declined the application. However, it should be noted that the changes to the Act were designed to specifically bring oligopolistic behaviour under the Commission's scrutiny. Given that the majority of merger proposals do not raise competition concerns, the changes will not necessarily increase the percentage of mergers declined by the Commission.

The review of thresholds also briefly examined the pre-merger notification regime. As mentioned above the *Commerce Act* provides a formal process for both clearances and authorisations. A clearance required the Commission to consider whether the acquisition would create or strengthen a dominant position or have the effect or likely effect of a substantial lessening of competition under the new test.[176] An authorisation requires the Commission to consider whether the proposed acquisition is in the public benefit.[177] In evaluating the public benefit the Commission shall have regard to any efficiencies that are likely to occur as a result of the acquisition.[178]The review did not recommend that any changes be made to clearance and authorisation processes.

3.26 Should Australia and New Zealand have the same merger provisions?

In *Competition Policy for Small Market Economies* Gal emphasises that mergers are an important way for small countries to realise potential efficiencies. Small countries need to adopt a merger policy that balances efficiencies against the anticompetitive consequences a merger would create.[179] In Australia and New Zealand prohibiting mergers that would

[175] Progressive subsequently took their case to the Privy Council and won. The Privy Council ruled that the old test should have been applied, *Foodstuffs (Auckland) Ltd v Commerce Commission* [2004] 1 NZLR 145 (PC).
[176] *Commerce Act*, s66.
[177] *Commerce Act* s67.
[178] *Commerce Act* s3A.
[179] Gal, *supra* note 11 at 194-197.

substantially lessen competition while allowing parties to a merger to seek authorisation where they can show that the merger is in the public benefit creates the desired balance.[180]

The phrase 'substantially lessen competition' is used in the provisions prohibiting coordinated anticompetitive behaviour. This would seem to be appropriate given that an agreement or understanding is just another way of affecting the desired conduct. In both countries the legislation focuses on the economic effects of the particular transaction rather than their form. The transaction, whether by way of merger or agreement, should be subject to the same substantive test for legality.[181]

The public benefit test has been described by Gal as a qualified total welfare test. Unlike the total welfare test only efficiency benefits to domestic firms or consumers are to be considered in the assessment of public benefit. Gal considers this approach to be problematic because it violates the national treatment principle enshrined in international trade agreements.[182] Nevertheless, Gal considers the total welfare standard superior to consumer welfare[183] because competition policy is not concerned about transfers from one class of market participants to another.[184]

Merger policy is also an effective tool in the prevention of tacit collusion. Optimal merger policy in all countries, including small countries, should be wary of creating

[180] *Trade Practices Act* s88, *Commerce Act*, s67.
[181] Carlton D, Goddard D, *supra* note 10 at 147.
[182] Gal, *supra* note 11 at 205.
[183] Gal, *supra* note 11 at 247.
[184] Carlton D, Goddard D, *supra* note 10 at 145.

market structures that are conducive to collusion. Where increased concentration is necessary to achieve efficiencies countries should have effective behavioural prohibitions in place.

Gal also encourages small countries to make use of pre-merger consultation proceedings. Australia has achieved this to the point where pre-merger consultation proceedings have almost replaced the authorisation process.

In relation to international competition issues, Gal states that:[185]

> "Small economies have limited tools to combat extraterritorial mergers with anticompetitive effects. They should thus advocate the adoption of global effects rules, or a multinational merger regime, or join forces with other economies to prevent a welfare reducing extraterritorial merger. Alternatively they may use conduct or structural remedies that apply only within their economy."

Imposing structural remedies can sometimes mitigate offshore mergers that have anticompetitive effects on the domestic economy. When British American Tobacco proposed merging with Rothmans it did not create competition concerns in the major jurisdictions. In Australia, however, the competition concerns were more significant because the proposed merger would result in only one major competitor in the Australian cigarette market. The ACCC agreed to the merger but only after the acquiring party agreed to divest itself of some cigarette brands and production and distribution facilities in Australia. Another major international tobacco company that had not previously traded in the Australian subsequently acquired the brands. It should be noted, however, that

[185] Gal, *supra* note 11 at 248.

structural remedies will not necessarily be effective where companies consider that the costs of divestment outweigh the benefits of the merger.

Merger policy in Australia and New Zealand already appears to conform to many of Gal's suggestions and conclusions. Presently the main difference between the two regimes appears to be the use of notification, clearance, and authorisation processes. In a speech to the New Zealand Institute of Economic Research, Allan Fels, then Chair of the ACCC suggested that circumstances in Australia are a little different which made the adoption of a voluntary notification system unlikely.[186] He stated that ninety five per cent of mergers investigated by the ACCC do not raise significant competition concerns.

> "The informal clearance system 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."

However, Professor Fels accepted that there might be some scope for greater transparency in the Commission's reasoning.[187]

Putting aside the fact that practitioners in both countries seem to be happy with their respective regimes, and that neither country is presently looking to make major changes to their procedural requirements, the only reason why Australia and New Zealand should not have the same procedural provisions would seem to be one of resource prioritisation and allocation. Quite simply, as a process becomes more formal the application costs increase. However, this must be balanced against the advantages such as increased

[186] Fels A, *supra* note 20 at 8.
[187] Fels A, *supra* note 20 at 9.

business certainty that a more formal process offers. Australia is also wary of formal processes because it perceives them as restricting communication between the applicants and the Commission. New Zealand on the other hand appears to value the transparency that attaches to a more formal process. If maintaining separate notification, clearance, and authorisation processes creates significant duplication costs then agreement on the presently diverging views on the most effective process is unlikely to be insurmountable if the procedures were to be further coordinated.

Chapter 4: Should Australia and New Zealand further coordinate their competition policy?

The problems that were identified in Chapter 1 have also been the focus of debate at an international level. To date a number of solutions have been proposed although these can be divided into three broad approaches:[188]

Approach A: There should be no systematic international competition policy.

Approach B: Harmonise substantive laws and establish a centralised dispute resolution body.

Approach C: Retain a decentralised system of competition laws but agree on a process to allocate jurisdiction.

This chapter will begin by explaining in greater detail the different approaches proposed in the international debate. It will then apply the different approaches to the four problems identified in Chapter 1 focusing on the implications for closer coordination between Australian and New Zealand competition policy.

4.1 Approach A: There should be no systematic international competition policy

Proponents of this approach argue that neither harmonisation of substantive competition law nor agreements on the allocation of jurisdiction necessarily enhance welfare.[189] The costs of an international competition regime are likely to outweigh the benefits.[190]

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[188] Stephan P, "Against International Cooperation" in ed. Epstein R, Greve M, *Competition Laws in Conflict: Antitrust Jurisdiction in the Global Economy*, (Washington DC: The AEI Press, 2004) 66, and Kerber W, Budzinski O, "Competition of Competition Laws: Mission Impossible?" in ed. Epstein R, Greve M, *Competition Laws in Conflict: Antitrust Jurisdiction in the Global Economy*, (Washington DC: The AEI Press, 2004) 31 at 53.
[189] Stephan, *Ibid.*
[190] Kerber, *supra* note 189 at 53.

Public choice theory assumes that countries choose the optimum set of laws given their economic and political characteristics. Requiring countries with diverse characteristics to conform to a single set of international laws is likely to reduce rather than increase welfare, especially given that the majority of national competition investigations and decisions do not affect the international market. Similarly, if countries were to agree on a procedure to allocate jurisdiction there is no guarantee that the resulting allocation will necessarily increase global welfare. This is because allocation only identifies the decision maker not how they will decide the case.

Substantive harmonisation also raises a number of institutional issues. Countries must first agree on the substantive laws. Then they would need to submit to a dispute resolution system. Designing a system that would give rise to welfare enhancing outcomes without being subverted by nationalistic incentives represents a major challenge, especially since, "competition policy embodies imprecise normative judgements that invite controversy and defection rather than consensus and commitment."[191]Whilst difficult to create, such an institution would be even harder to reform. As circumstances change, the institutional structure may prevent improvement and further reduce both national and global welfare.[192]

In *Against International Competition,* Paul Stephan argues that existing international economic relations can be used to punish nation states that use competition policy to

[191] Stephan, *supra* note 189 at 75.
[192] Stephan, *supra* note 189 at 80.

promote domestic welfare at the expense of global welfare.[193] He also suggests that it is in a state's best interests to expose producers to international competition because empirical evidence suggests that states that protect domestic producers from welfare enhancing competition will tend to experience lower levels of investment and innovation.[194] Furthermore, those countries that use competition laws to punish foreign producers do so at the expense consumer welfare, especially once the innovation losses are taken into account.[195]

4.2 Approach B: Harmonise substantive laws and establish a centralised dispute resolution body

Having introduced the reasons why harmonisation of substantive competition laws should not be pursued Approach B argues that the problems associated with a multiplicity of competition laws cannot be resolved in the absence of harmonisation.

The very existence of distortions created by the failure of domestic decision makers to internalise the costs of their competition policies makes it impossible to defend the status quo.[196] There have been attempts to argue that any form of cooperation at an international level entails significant costs and is inefficient, undemocratic and biased. This dilemma can only be resolved by empirical study of the costs and benefits of an international agreement. In support of international agreements, proponents often point to the success of the General Agreement on Tariffs and Trade, the Trade Related Aspects of Intellectual

[193] Stephan, *supra* note 189 at 67.
[194] Stephan, *supra* note 189 at 67.
[195] Stephan, *supra* note 189 at 67.
[196] Guzman A, "The Case for International Antitrust" in ed. Epstein R, Greve M, *Competition Laws in Conflict: Antitrust Jurisdiction in the Global Economy*, (Washington DC: The AEI Press, 2004) 99 at 111.

Property Agreement, the Basle Accord, and the North American Free Trade Agreement, all of which have generated some costs but also substantial benefits.[197]

Guzman in *The Case for International Antitrust* argues that to reduce the costs of international agreements the preferred form of cooperation is the lowest level that avoids the distortions of non-cooperative policy making.[198]

He argues that voluntary information sharing and cooperation agreements only go so far to remedying the problems created by domestic incentives. Existing agreements do not set out how each state should take into account the effect of anticompetitive conduct on other states. Compliance is largely voluntary because agreements do not include any sort of sanction for failure by a state to fulfil its obligations under the agreement. Nor do the agreements cover whether states should take the interests of other states into account when developing competition policies.[199]

Agreements on jurisdiction lack the ability to prevent what Guzman describes as over regulation and under regulation. Over regulation occurs when states apply their laws extraterritorially and results in firms having to comply with a more burdensome regime than if only subject to a single set of rules.[200] Under regulation occurs when states do not have effective competition laws.[201] Agreements on jurisdiction do not prevent either of these problems. In the case of over regulation firms will still bear the costs of having to

[197] *Ibid.* at 111.
[198] *Ibid.* at 114.
[199] *Ibid.* at 115-116.
[200] *Ibid.* at 104.
[201] *Ibid.* at 105.

comply with the laws in multiple jurisdictions and in the case of under regulation overseas entrants may have difficulty breaking into an under regulated market. In addition, agreements on jurisdiction do not prevent local favouritism and trade induced distortions of national substantive policies.[202]

Guzman believes that "the distortion of domestic incentives cannot be corrected short of cooperation on substantive competition policy."[203] He acknowledges that agreement on substantive policy will be difficult to reach especially when the costs of agreement are high. The challenge, where possible, is to reduce transaction costs. He maintains that the WTO is an appropriate forum for an international agreement on competition policy. It allows countries that suffer from committing to an agreement to be compensated through concessions on other trade related issues such as agriculture or environmental issues.

The national treatment principle is embodied in a number of WTO agreements. In a competition law context it would ensure domestic regulators treat foreign market participants as though they were domestic firms. In theory, this would solve problems of discrimination in the application of competition laws or where regulators refuse to discipline domestic firms for anticompetitive practices against foreign firms. In practice, however, it is difficult to identify *de facto* discrimination because each prosecution turns on a unique set of facts so it often impossible to compare against a domestic precedent.[204] The only solution to *de facto* discrimination is an international dispute settlement regime.

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[202] *Ibid.* at 117.
[203] *Ibid.* at 118.
[204] *Ibid.* at 118.

4.3 Approach C: Retain decentralised system of competition laws but agree on a process to allocate jurisdiction

Approach C encompasses almost everything in between substantive harmonisation and staying with the status quo. There have been a number of proposals put forward that would allow countries to retain control over domestic competition policy but at the same time create a mechanism to resolve the problems created by multiple domestic competition laws. These proposals include:

- A mixture of centralisation and decentralisation within an international multilevel system.[205] This suggestion is akin to the model used in the European Union. Each country retains complete autonomy over domestic issues that do not affect other countries, but in cases where the issue has external international effects then it comes under the jurisdiction of a centralised dispute resolution mechanism.
- The creation of an antitrust code. It is envisaged that a code would advance values integral to the world-trading regime such as non-discrimination, in particular, national treatment.[206] It has been argued that the WTO would be an appropriate forum to administer such a code given that it already has an established institutional structure, has experience identifying discriminatory regulation and has developed a substantial body of jurisprudence surrounding the principle of national treatment.[207]

[205] Kerber W, Budzinski O, *supra* note 189 at 56.
[206] McGinnis J, "The Political Economy of International Antitrust Harmonisation" in ed. Epstein R, Greve M, *Competition Laws in Conflict: Antitrust Jurisdiction in the Global Economy*, (Washington DC: The AEI Press, 2004) 126 at 126-127.
[207] *Ibid.* at 127.

- The enforcement of laws extraterritorially has also been employed where the foreign conduct has a local effect.[208] The effectiveness of such conduct tends to be limited to larger countries with significant economic power that can enforce domestic competition laws offshore.
- The doctrine of positive comity has often been used in private international law to allocate jurisdiction. Under the doctrine one country's competition authority could ask the other country's authority to take measures against activities occurring it its jurisdiction that violate the requesting countries competition laws.[209]
- Agreements that designate a lead agency either to coordinate review, make findings with respect to its own jurisdiction and recommendations in respect of other effected countries, or make findings with respect to all countries.[210]

There are multiple ways to resolve problems arising out of the multiplicity of domestic competition laws. All of these options have one thing in common: they allow countries to retain their own unique competition policy.

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[208] Guzman A, *supra* note 197 at 107. See also Trebilcock M, Iacobucci E, *supra* note 5 at 157. The authors favour application of the national treatment principle and a limited form of extraterritoriality in hard cases "that would permit countries to sanction conduct originating abroad that adversely impacts either consumer or total welfare in the importing country provided that such action satisfies the national treatment principle."

[209] *Agreement between the European Communities and the Government of the United States of America on the application of positive comity principles in the enforcement of their competition laws,* 4 June 1998, 37 ILM 1070. The principle of prescriptive comity has also been discussed by the US Supreme Court in *F. Hoffman-La Roche Ltd v Empagran S.A.* 124 S.Ct. 2359 at 2369 (U.S.Dist.Col. 2004) (WL). The Court up held principles of prescriptive comity finding that US antitrust law should not be applied to foreign jurisdictions where foreign injury is independent of domestic effects.

[210] This is a derivation on the doctrine of positive comity; see Trebilcock M, Iacobucci E, *supra* note 5 at 166.

Proponents of a decentralised system of competition laws perceive substantive harmonisation as restrictive because it lacks the flexibility to change as the political and economic environment changes. International trade agreements and technological innovation both have the potential to significantly change industry structure. Where this happens the existing competition regime may no longer effectively discipline anticompetitive behaviour.

Substantive harmonisation is also discouraged because it impedes policy innovation and development. Countries learn from other regimes with superior competition rules and enforcement techniques and attempt to imitate or improve the policy by modifying it to fit their individual regulatory environment.[211]

A similar line of argument is that jurisdictions can shape their competition laws to attract investment. This creates the incentive for a state to continually improve its competition laws.[212] Substantive harmonisation would take away this ability.

The final reason for rejecting substantive harmonisation is that competition law is essential to the regulation of both the trade and non-traded sectors of the economy. An efficient non-traded sector is essential to provide competitively priced inputs to production in the traded sector. An efficient traded sector is vital for internationally competitive exports. Governments have incentives to ensure international

[211] Kerber W, Budzinski O, *supra* note 189 at 33.
[212] Kerber W, Budzinski O, *supra* note 189 at 34.

competitiveness through appropriately structured competition policy.[213] Substantive harmonisation may result in international trade distortions given that the optimal policy will change depending on each countries economic characteristics.

Approach C allows countries to work out individually tailored solutions to the problems created by multiple competition policies. The optimal policy will be based on their individual economic, political, and institutional features.

4.4 Application of approaches to Australia and New Zealand

Chapter 1 identified four problems created by multiple domestic competition laws. This section will use these problems to evaluate the approaches set out above. The conclusions will be applied to Australia and New Zealand in order to identify possible solutions that are tailored to both countries political, legal and economic characteristics.

4.5 Problem 1: Costs to the domestic economy from negative externalities of conduct occurring offshore

This problem is best exemplified by looking at practical example. Assume that two Australian entities apply to the ACCC for a merger authorisation. They submit that the merger would create substantial productive efficiencies because it would allow them to rationalise their production facilities. As part of the rationalisation process a production facility based in New Zealand will be closed leaving one thousand people unemployed.

Under Approach A, Australia and New Zealand would retain the status quo. The Commission would assess the application in accordance with the public benefit test as set out in s90(9), the public being the public of Australia in accordance with the object of the

[213] Kerber W, Budzinski O, *supra* note 189 at 34.

Act. The Commission would not take into account the costs to New Zealand from the increased unemployment. Retaining the status quo would not solve the problem of negative externalities.

Substantive harmonisation under Approach B would not in itself ensure that the costs to the New Zealand economy were factored into the public benefit analysis. The problem would only be solved if both countries were subject to a centralised dispute resolution body and that body made an assessment based on global welfare or at least the overall welfare of the affected nations. However, even if the dispute resolution body did look at the overall welfare of Australia and New Zealand it may still find that the public benefit outweighs the loss to competition. This decision would be acceptable on an economic basis but might not be as tolerable on a political level. Establishing a centralised decision making body that is accountable to both countries entails a number of design complexities and could be costly.

On a multilateral level Approach C seems to offer a number of ways to resolve the problem of negative externalities. On a bilateral level, however, many of the proposed approaches require a centralised dispute resolution body and as a result raise the same institutional issues as Approach B. The one suggestion that may provide an effective solution is for New Zealand to enforce its domestic competition laws extraterritorially on Australia. Extraterritorial enforcement, however, is impossible where the enforcing country has no jurisdiction. At an international level the threat of trade sanctions may encourage countries to enforce other nation’s competition law but sanctions are less

effective at a bilateral level, especially where the economic and political power of the countries is unequal. New Zealand would be unlikely to impose trade sanctions on Australia[214] because trade sanctions would also hurt New Zealand consumers. Australia and New Zealand are more likely to rely on their pre-existing close economic relationship and come to an agreement that has mutual benefits for both parties.

One possible solution that is more in keeping with Australian and New Zealand economic relations would be to amend the public benefit test so that it evaluated the benefit to the public of Australia *and* New Zealand. Applying this enhanced public benefit test to the merger example, it will not prevent authorisation where the overall benefits outweigh the costs (including the costs to New Zealand). However, changes to the legislation would be beneficial in that it would alert the ACCC to costs imposed on New Zealand and would encourage greater dialogue between the two countries on the matter. As a result the New Zealand government would be forewarned and in a better position to put in place policies to ameliorate the negative effects of the merger.

An alternative or complimentary solution would be to amend the legislation in both countries so as to allow for a complementary trans-Tasman member on each Commission. This would increase awareness of trans-Tasman effects and go some way to discouraging decisions that impose negative externalities on the other country.

[214] Refer to section 3.2 for trade statistics.

A further solution would be to create a common institution. This would ensure that the regulatory authority took into account negative externalities on the other country because it would be accountable to both countries.

4.6 Problem 2: Costs to national competition authorities from investigating conduct and enforcing judgments offshore

Presently competition authorities in Australia and New Zealand cooperate and coordinate on all agency activities.[215] This includes investigating and enforcing judgments offshore.

Staying with the status quo under Approach A would allow both countries to continue to cooperate and enable each agency to be more efficient and effective and better utilise scarce resources.[216] Assuming that the present series of cooperation agreements are working effectively costs to national competition authorities should already be somewhat reduced.

Substantive harmonisation and the establishment of a centralised dispute resolution mechanism under Approach B would not reduce the costs of investigating and enforcing offshore conduct. Costs will only be reduced where both countries do not duplicate the investigation and enforcement function. This would be best achieved by coming to an agreement under Approach C.

There are two main options to prevent the duplication of investigation and enforcement functions. Firstly, a common institution could be established that would investigate and enforce offshore conduct on behalf of both countries. Secondly, a lead agency could be

[215] Australia New Zealand Cooperation Agreement, *supra* note 40 at clause 3.1.
[216] Australia New Zealand Cooperation Agreement, *supra* note 40 at clause 2.1.

appointed to investigate and enforce offshore conduct on behalf of both countries. Given that both countries benefit from the lead agency's actions both countries should contribute resources to the investigations and enforcement. The advantage of the second option is that the arrangement would be less formal than establishing common institutions and hence less costly.

An obvious application of this approach is to the investigation of international cartels. International cartels create a number of problems for competition authorities. Meetings between members often take place offshore and international jurisdictional issues mean that it is difficult to gather sufficient evidence to make a prosecution.[217] Competition authorities conducting investigations are often reluctant to share information for fear of compromising their investigation. Information will only be shared where the authority receiving the information has adequate institutional structures in place to ensure information will not be leaked to members of the cartel. In addition, the problems of gathering evidence worldwide means there is an under-enforcement of cartel activities. As mentioned above when a successful action is brought against a cartel all consumers benefit not just those living in the prosecuting country. This creates a free-rider problem where countries rely on others to do the enforcement but obtain the benefits. The appointment of a lead agency and an agreement to share the costs of investigation and enforcement would go some way to resolving both these issues and reducing the costs of offshore investigation and enforcement in both Australia and New Zealand.

[217] Commerce Commission, Media Release, "Commission says BASF, Roche and Rhone were price fixing, but NZ limitation period and international jurisdiction issues prevent New Zealand court action" May 2004, http://www.comcom.govt.nz/publications/display_mr.cfm?mr_id=772.

4.7 Problem 3: Costs to firms from trying to enter markets with inadequate competition laws or enforcement

Australia and New Zealand both appear to have adequate competition laws in place. In both countries, however, there are a number of exemptions from universal application of the Acts. In Australia the *Trade Practices Act* exempts certain sectors on public interest grounds.[218] Exemptions can also arise independently of a public interest assessment through constitutional limitations and under the legal doctrine of 'shield of the crown', where the Crown is not bound by a statute without express words or necessary implication.[219] In exempted sectors the application of competition principles may be inadequate from the perspective of a foreign firm trying to break into the protected domestic sector.

Bilateral trade agreements may also contain anticompetitive provisions that disadvantage foreign producers. Assume that Australia entered into a free trade agreement with Country X. Country X has health and safety concerns about the quality of imported lamb. The trade agreement therefore contains an exclusive dealing requirement that Australia will be the only supplier of lamb to Country X in return for Australia increasing its quality control procedures. The exclusive dealing provisions in the trade agreement disadvantages lamb producers in New Zealand trying to break into Country X.

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[218] The Hilmer report set out two main categories of public interest grounds. First, some markets or economic activities may have special features, which suggest that competitive markets will not maximize economic efficiency. Second, there are some situations where competitive markets may achieve economic efficiency, but at the cost of other valued social objectives. For further information see Hilmer Report, *supra* note 22 at 88.

[219] Hilmer Report, *supra* note 22 at 92.

Trebilcock and Iacobucci in *National Treatment and Extraterritoriality: Defining the Domains of Trade and Antitrust Policy*, argue that where domestic competition laws are inadequate or not strictly enforced it is not evident that the distortions created require special efforts at international harmonisation.[220] In the above situation, however, it may be difficult to bring an action under the GATT alleging a breach of the most favoured nation principle because Article XXIV provides an exception from the most favoured nation principle for regional trade agreements. In addition, assuming the health risks are justified, the agreement on sanitary and phytosanitary standards may allow the restriction on New Zealand lamb producers. Given that these exemptions are already built into international trade law it is unlikely that substantive harmonisation would necessarily resolve trade related competition issues. It is certainly not a reason for substantive harmonisation.

4.8 Problem 4: Duplication costs for firms trying to comply with laws in multiple jurisdictions

Take for example a New Zealand firm that proposes to enter into a strategic alliance with an Australian firm. The alliance will decrease competition on both sides of the Tasman. Therefore, an authorisation must be sought from both the ACCC and the Commerce Commission. Complying with different laws and procedures of both countries increases the costs to the firms. A similar example occurs where an offshore merger has competition implications for Australia and New Zealand. Under the present law the merging parties would have to comply with the requirements of both countries' competition law. This significantly increases the costs of the merger.

[220] Trebilcock M, Iacobucci E, *supra* note 5 at 153.

Approach A assumes that both countries have implemented different laws and procedures because it is in the best interests of the country. The process for authorisation in New Zealand may be different from that in Australia because New Zealand's economic characteristics and legal regime may require a slightly different analysis to be undertaken and, therefore, necessitate that different or additional information is provided to the Commerce Commission. The institutional structure, including the Commission's resourcing, may also affect the timeframes required to process the authorisation application. Approach A implicitly suggests that the costs to each country of harmonising not only their timeframes but also their method of analysis, as set out in the legislation, would be greater than the costs to the firms seeking to comply with the laws in multiple jurisdictions.

In contrast Approach B seems to argue the opposite. Given that the substantive laws governing cooperative agreements and mergers are almost the same, competition authorities in both countries should apply the same tests and require the same information. However, as pointed out in section 3.22, even if both countries have the same substantive provisions they are still subject to different interpretations by the courts in each country. The implementation of common procedures would not reduce costs if the competition authority required different additional information when it processed the application.

In reality the only solution is for firms seeking to comply with the laws of both countries to deal with a single authority. As suggested above, Australia and New Zealand could

agree to form a common institution. Firms doing business in both countries would still have to comply with the laws of both countries but would only deal with one institution. It is difficult to say whether this would really result in substantial cost savings to the firm because the common institution would still require the same information that would have been required by both authorities. The information would merely be consolidated so that there was no duplication.

The following table summarises the least intrusive solution to each of the four problems:

Problem	***Possible Solutions (most intrusive solution listed first)***
1. Negative externalities	• Common institution accountable to both countries • Legislative amendment to the public benefit test • Each Commission has a trans-Tasman member
2. Offshore investigation and enforcement costs	• Common institution • Agreement to appoint a lead agency and share resources
3. Market access costs	• Outside the sphere of coordinated competition policy
4. Duplication costs	• Common institution • Appointment of a lead agency

Conclusion

Substantive competition laws in Australia and New Zealand are already similar, especially since the enactment of the *Commerce Amendment Act 2001*. This finding is hardly surprising given that both countries have highly concentrated industries many of which fail to produce at minimum efficient scale. Additional characteristics such as distance from major markets exacerbate the problems associated with small size. While these problems are present to a lesser extent in Australia than New Zealand, the principles embodied in the legislation, such as the focus on efficiency, will be the same in both countries. Optimal policy will balance the goals of protecting the competitive process and allowing transactions that create allocative, productive, and dynamic efficiencies.

Formal harmonisation of substantive laws is unlikely to produce any additional benefits. Instead formal harmonisation may create a competition regime that is inflexible to future political and economic change. Countries would also lose the opportunity to learn from one another and adopt superior laws. Nevertheless, both countries would still have an incentive to improve their existing law so as to ensure their export sectors are internationally competitive and their input sectors are efficient.

Harmonisation of competition laws alone cannot guarantee that laws will be enforced and interpreted in the same manner in both countries. The use of open terminology, such as public benefit, in both countries' legislation gives the courts substantial discretion. As a result, different competition jurisprudence may develop in each country. To ensure that

both countries retained the same substantive laws an accompanying dispute resolution body or common institution would need to be established.

The establishment of a common institution or centralised dispute resolution body is more important than substantive harmonisation to the resolution of the problems identified and discussed in the previous section. In fact, substantive harmonisation is not necessary to resolve the identified problems. A common institution that is accountable to both countries, will reduce the costs associated with negative externalities, rationalise costs to national competition authorities including those associated with investigating conduct and enforcing judgments offshore, and reduce the duplication costs to firms trying to comply with laws in multiple jurisdictions. The disadvantage of establishing a common institution is that it is difficult and costly to create.

A number of less costly solutions have also been identified. Firstly, negative externalities could be reduced if both countries agreed to amend their competition legislation so that all references to the benefit of Australian citizens, or the benefit of New Zealand consumers are replaced by the benefit of Australia and New Zealand (together forming a single economic market). Such an agreement would mean that the public benefit test would be less likely to inflict negative externalities on any one country. This option is similar to the existing agreement on antidumping where the misuse of market power provisions in both acts were extended to cover market power in trans-Tasman markets.[221]Speaking to the New Zealand Institute of Economic Research, Allan Fels, then Chair of the ACCC, suggested that there is no reason why these trans-Tasman powers

[221] *Trade Practices Act* s46A, *Commerce Act,* s36A.

cannot be extended to apply to all competition issues, especially given that trans-Tasman competition is relied upon to allow consumer choice.[222]

Secondly, the incidence of negative externalities and *de facto* discrimination could be reduced by an agreement to make legislative provisions for a trans-Tasman member to sit on the other country's Commission. A similar initiative is already in place with respect to the Takeovers Panel in each country. In addition a trans-Tasman member would promote mutual learning from the experiences of the other country and generate greater understanding of the unique challenges faced by each country.

Thirdly, the appointment of a lead agency would reduce the costs of offshore investigation and enforcement and may lessen duplication costs for firms trying to comply with laws in multiple jurisdictions. The extent to which the agreement reduced costs would be dependent on the extent to which the other country ceded decision making authority.[223]

Goddard in *Business Laws and Regulatory Institutions: Mechanisms for CER Coordination*[224] suggests that:

> "successful coordination depends on developing and implementing models for coordination which are appropriate in a particular context, and that different models will be required depending on the objectives of coordination in that context."

[222] Fels A, *supra* note 20 at 10. See also Spiers H, *supra* note 36, on expanding court powers to apply to all competition law provisions; trans-Tasman court/tribunal/commission; and closer links between the Commerce Commission and the ACCC.
[223] Trebilcock M, Iacobucci E, *supra* note 5 at 166.
[224] Trebilcock M, Iacobucci E, *supra* note 5 at 179.

If the preferred form of cooperation is at the lowest level that avoids distortions of non-cooperative policymaking,[225] then the preferred solution will be that which increases welfare at the least cost. This could be achieved by an agreement or series of agreements that implement the initiatives discussed above. In particular:

- amending the legislation in both countries so that Australia and New Zealand are considered a single economic market;
- extending trans-Tasman powers that are currently confined to antidumping under s46A of the *Trade Practices Act* and s36A of the *Commerce Act* to all competition issues;
- placing complimentary trans-Tasman members on each country's Commission; and
- appointing a lead agency to investigate and enforce off shore conduct.

[225] Guzman A, *supra* note 197 at 114.