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Competing Globally, Behaving Locally

The imminent review of the Trade Practices Act by the Commonwealth Government will once again bring into the spotlight conflicting views about the role of the Australian Competition and Consumer Commission (ACCC). Large companies want a reduction in the powers of the ACCC, believing that the current powers restrict their ability to grow and be globally competitive. Smaller companies and individuals want an increase in the ACCC's powers, to overcome what many see as unfair use of market power by major companies.

Whether or not the ACCC acts as a limit on the ability of Australian companies to become globally competitive ultimately depends on how Australia's competition rules compare with those in other countries, and a brief comparison suggests Australian companies have little to complain about.

For Australian farmers in the post-deregulated marketing era, concentrated markets with only a small number of major participants are a fact of life for most farm inputs and most farm outputs.

On the farm input side, markets for supplies of farm machinery, agricultural chemicals, fertilisers and fuel, and services such as wool-broking, are dominated by just a small number of major companies and the trend is toward increased concentration as a result of recent consolidations. Markets for some farm outputs are similarly concentrated, with a small number of major companies dominating markets for dairy products and fresh produce, and consolidation occurring in red meat and poultry processing, and even in grain marketing as statutory marketing boards are progressively disbanded.

In addition, a range of services that are used by farmers and the wider community are increasingly delivered in markets with just one or two dominant players. Electricity, telecommunications and air travel are relevant examples. In fact, the tendency for Australian markets to be dominated by just one or two major companies led a Yale University academic to label Australia 'the land of the duopoly' and that was before some of the more recent corporate consolidations.[1]

Companies which are large relevant to the total market they operate in can generate significant efficiencies, and better meet consumer needs at lower costs, but for consumers and operators of small enterprises such as farmers, concentrated markets present particular challenges. Lack of transparency can result in wrong or poorly timed decisions by farmers supplying these markets. Dominance by one or two firms can create a situation where there is no alternative but to accept contractual terms that are unfair, and prices that may result in abnormal profits for the dominant organisation. Broadly speaking, markets dominated by just one or two major organisations that are acting in a non-competitive manner may be just as inefficient economically as markets regulated by strong government intervention.

The safety-valve for these problems in a small economy such as Australia is relatively open trade policies to encourage competition from imports. Even if a firm has a dominant position in Australian markets, potential competition from imports can be a major deterrent for firms that may be tempted to behave improperly.

However, this is not the complete answer. Even with open trade policies, there can be significant barriers preventing entry by international competitors. For example, the need to maintain a technical support network and to comply with complex registration requirements can act as a short and medium-term barrier to import competition in the chemical industry.

This highlights the important, and finely balanced role Governments and their competition agencies have. Too much control limits the ability of companies to grow and find more efficient ways to satisfy customers, and will be a deterrent to international investment in Australia. Not enough control allows unfair practices such as price-fixing or collusion to occur, with the end result being a less efficient national economy.

There is no readily available objective formula to specify the optimum level of Government intervention to ensure

[1] Australian Financial Review 1998, 'The power of two' July 25, 1998.

markets remain both efficient and fair, so a comparison of policies in place internationally probably provides the best means of assessing which direction Australian competition laws and agencies should take.

Competition laws in Europe

Companies operating in countries that are member states of the European Community operate under two layers of competition laws. Member states each have their own competition regimes, and in addition, the treaty establishing the European Community includes specific competition law provisions. As a general rule, EC competition laws only come into play for situations that extend beyond the border of individual member states, or are of a scale that exceeds thresholds that have been established. In mergers, for example, one of the threshold is a combined aggregate turnover in excess of 5 billion euros. In some cases the laws of member states also require that companies comply with EC rules as part of national compliance regimes.[2] EC competition laws focus on four main areas. These are:

- restrictive agreements and concerted practices
- abuse of a dominant position
- mergers or concentrations
- State aid (or Government support for particular industries or enterprises).

Restrictive agreements and concerted practices are prohibited under Article 81(1) of the EC treaty. These are defined as agreements between firms which '*may affect trade between the Member States and which have as their object or effect the prevention, restriction or distortion of competition*'.[3] A restrictive agreement is a formal agreement between firms, whereas a concerted practice involves coordination between firms but without a formal agreement. The prohibition on these types of agreements applies to both horizontal (firms competing at the same stage of production) and vertical (firms involved in different stages of production of the same goods) agreements.

The range of agreements that are prohibited is quite broad, and includes price fixing, market segmentation, production quotas, agreements to establish joint sales offices, and voluntary restraint agreement between firms. Limited exemptions are possible via an authorisation process, which requires that agreements improve the production or distribution of goods or promotes technical or economic progress.

Abuse of a dominant position is prohibited by Article 82 of the EC Treaty. Abuse is defined as conduct by a dominant firm that influences the structure of the relevant market, or the degree of competition in that market.

It includes:

- directly or indirectly imposing unfair prices or trading conditions
- limiting production or technical developments to the detriment of consumers
- applying dissimilar conditions to equivalent transactions
- incorporating unrelated supplementary obligations into contracts.

There are no exemptions available to these prohibitions, even where the arrangement complies with national laws.

Mergers 'which create or strengthen a position as a result of which effective competition … is significantly impeded' are incompatible with the common market, and therefore prohibited under EC regulations.[4] The European Commission has the power to examine mergers before they take place, to determine whether they should be allowed to proceed. This examination may take five months and involves:

- defining the relevant product market
- defining the relevant geographic market
- assessing the merger impact based on the principle of dominant position

Unlike the US, the EC generally does not identify thresholds of concentration or market share that it uses to test whether or not a merger should be allowed to proceed. The EC law governing merger control states that mergers must be declared unlawful where they 'create or strengthen a dominant position'.[5] A dominant position is defined as one where a company is able to act in the market without having to take account of the reaction of its competitors, suppliers or customers, and without fearing a loss of profits.

State aid that distorts intra-Community competition is prohibited by the EC Treaty. Despite this, the estimated annual level of assistance provided to firms in the Community during the late 1990s was over 93 billion euros.[6] There are a range of exceptions to the prohibition on State aid, and these include situations where regional development needs to be encouraged, or where a firm requires assistance to restructure as part of a restructuring plan that can restore economic viability. Development of small businesses, and incentives to increase research and development are also considered valid reasons for State aid. The European Commission scrutinises in advance any state aid schemes proposed by member Governments, and may authorise them, although it is apparent that Governments proceed to implement state aid without authorisation, despite the EC rules.

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2 Reynolds 1996, 'International Antitrust Compliance for a Company with Multinational Operations', *International Quarterly,* No. 76.

3 European Commission 2002, *Competition*, www.europa.eu.int.

4 EC 2002, EEC Regulation No. 4064/89.

5 Monti 2001, 'Antitrust in the US and Europe: A history of convergence', Address to American Bar Association, Nov. 2001.

6 EC 2002, *Competition Policy in Europe and the Citizen*, www.europa.eu.int

Frequently, processes associated with the application of these competition policies can be as significant as the rules themselves in dictating how firms may or may not operate. In some areas, the EC law is quite strong – for example, under the 'restrictive agreements provisions', all such agreements are declared illegal, unless they are authorised by the EC. Hence a firm wanting to pursue such an agreement would first need to convince the Commission of the merits of the proposal, rather than the Commission having to prove an agreement was likely to harm competition. This reversal of the onus of proof would obviously operate as quite a strong deterrent to the pursuit of such agreements.

The 'threshold' market share levels used by the EC to gauge the potential extent to which an agreement may be damaging competition are 30% for vertical agreements, and 15-20% for horizontal agreements.[7]

There are a range of powers and remedies utilised by the EC to enforce these laws. These include significant powers of investigation, and powers to impose fines of up to 10% of the relevant firm's global turnover. In recent years, fines in excess of 250 million euros were imposed in a cement industry cartel case (including a fine in excess of 30 million euros for one company). Other cases have involved fines of 92 million euros for a cartel of heating pipe suppliers, and more than 50 million for two firms involved in the sugar industry. Penalties and remedies imposed by the Commission are able to be challenged in Court, and no criminal penalties apply in relation to these offences.

It is apparent from a number of sources that the application of EC competition law has been strengthened over recent decades, and that enforcement in member countries has also been enhanced. The UK, for example, introduced a new Competition Act in 1998 and some subsequent changes that mirror the provisions in the EC treaty, but creates the potential for significantly higher levels of fines, proposals to criminalise some cartel activities and introduce custodial sentences, and also involves substantial powers to raid companies and seize documents and information. As the Chairman of the UK Competition Commission has stated: *'The new (competition) regime (in the UK) is now potentially amongst the most powerful in the world, combining as it does various powers of both the European and US systems.'*[8]

Competition laws in the USA

Competition or 'antitrust' law in the USA has a much more extensive history than is the case in most other nations, with the first such laws (the Sherman Act) implemented in the 1890s, and a body of additional law enacted since that time. Broadly speaking, there are three categories or areas of activity addressed by these laws.

Agreements

Section 1 of the Sherman Act outlaws a very broad range of agreements between firms that could be considered a 'restraint of trade'. Court interpretation over the years has resulted in this being interpreted to mean an 'unreasonable' restraint on trade. A range of practices – such as price-fixing – have long been classified as illegal, and in clear-cut cases are subject to criminal prosecution. Such situations require evidence of an agreement, and not just simultaneous price changes or continued high prices.

Other activities such as agreements to restrict output or advertising, boycotts and agreements to divide a market are also illegal. This has also been extended to Codes of Ethics for professions that have the effect of restricting competition, and even agreements between competitors on business hours have been challenged. The key test of any arrangement is its effect on competition, and any possible justification that may exist for the arrangement.

Monopolisation

This is dealt with under Section 2 of the Sherman Act, which makes it unlawful to maintain or attempt to create a monopoly through tactics that either unreasonably exclude firms, or significantly impair their ability to compete. This is slightly different to the European rules, in that it includes an attempt to create a monopoly as illegal, whereas the European focus in on abuse of existing dominant power. As the Chairman of the US Federal Trade Commission recently stated, *'Where we can show that exclusionary conduct reasonably appears capable of making a significant contribution to creating or maintaining monopoly power, we will not hesitate to act.'*[9]

Mergers

Under the Clayton and Sherman Acts, and the Hart-Scott-Rodino legislation, pre-notification of mergers that satisfy certain thresholds is required. A significant body of case-law and precedent surrounds such matters, with the 1992 Horizontal Merger Guidelines issued (and subsequently updated) by the Federal Trade Commission being a key document. The principle underlying these guidelines is that mergers should not be permitted to create or enhance market power, which to a seller is defined as the ability to maintain prices above a competitive level for a sustained period of time. The same rule applies in relation to mergers involving a consolidation of buying power. The Guidelines recognise this is unlikely to occur unless the merger significantly increases concentration (of selling or buying power) in a market, hence there is considerable focus on defining and measuring the relevant market.

The Federal Trade Commission uses the Herfindahl-Hirschman Index (HHI) as a measure of market concentration. This is simply the sum of the squares of firms market shares. A HHI below 1000 is indicative of an unconcentrated market, between 1,000 and 1,800 a moderately concentrated market, and a market with a HHI above 1,800 is considered highly concentrated.[10]

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[7] Monti 2001, op. cit.

[8] Morris 2000, *Competition policy and regulation in the UK: A new era*, Lancaster University, www.competition-commission.org.uk

[9] Muris 2001, Address to American Bar Association Antitrust section Annual Meeting, August 7 2001. www.ftc.gov

[10] FTC 1997, *1992 Horizontal Merger Guidelines* (including 1997 amendments). www.ftc.gov

As a reference point, grocery retailing in Australia was estimated to have a HHI of 2,600 in 1999, and there has been further consolidation in that industry since that time. The HHI estimate is the starting point for further analysis in response to proposed mergers, which includes consideration of factors such as barriers to market entry, potential efficiencies generated by the merger, an the likelihood of those efficiencies being transferred to consumers.

In addition to national laws governing competitive behaviour, the USA also has a series of other competition laws that apply to industries such as agriculture, which have a long history of market power imbalance. The Perishable Agricultural Commodities Act and the Packers and Stockyards Act apply to the horticulture and meat industries respectively. Both Acts impose licensing requirements on buyers of these products, and require buyers to pay proceeds into a trust fund and pay sellers within ten days. They also provide the US Department of Agriculture with significant powers, including powers to seize any records, and also to impose mandatory information disclosure requirements on buyers in particular markets, to ensure these markets remain transparent. Agricultural producer co-operatives have exemptions under the Capper-Volstead Act, which provides them with more flexibility in collective marketing, allowing the exchange of market information without breaching national competition laws.

Enforcement of national competition laws in the USA is the responsibility of two Government agencies, The Federal Trade Commission, and the Department of Justice. In addition, at a State level they are usually enforced by the State Attorney General, which is the reason a number of States have been involved in recent cases, such as the Microsoft case.

Predominantly, enforcement is via court proceedings initiated by the relevant agencies, although there is also relatively open access for any person to take legal action. Proceedings can be initiated at any time – even after a merger has occurred. The courts have very strong powers including powers to order the break-up of dominant firms (such as occurred in the Bell telephone case), to impose penalties that may be many times the estimated value of the damage that has occurred, and to order divestitures. In addition, criminal convictions and imprisonment can also be imposed on guilty parties.[11]

How do Australian Competition laws compare ?

The main national competition law in Australia is the Trade Practices Act, which was enacted in 1974 and has been amended a number of times since then. It is mirrored by State legislation that applies to unincorporated traders who operate solely within one State.

While some of the language used in Australian legislation (such as unconscionable conduct) differs from that used internationally, the principles entailed in the legislation appear similar, and if anything, the enforcement provisions appear less harsh that those applying in international jurisdictions. For example, the criminal provisions that exist in relation to high-level offences against competition law in international jurisdictions, are not present in Australia.

One important difference arises in relation to mergers. Under Australian law, the test applied in considering proposed mergers is whether it will lead to a lessening of competition. On the surface this appears a more stringent test than one that considers whether or not the merger will lead to dominance of the market. However under Australian law (unlike in the US and Europe) there is an authorisation process that enables mergers and other anti-competitive behaviour to proceed where there are sufficient public benefits which will be generated that outweigh the harm to competition. Such benefits may include increased exports, increased substitution of imported goods, efficiencies to benefit consumers, and enhanced competitiveness of Australian industry.

Recent authorisations granted by the ACCC, such as the Nufarm-Monsanto glyphosate case, have demonstrated the application of this public benefits test. In that case, it was estimated the agreement would result in more than three-quarters of the market (for what is arguably the most important herbicide used in Australian agriculture) being held by a single organisation, yet the arrangement was approved.

In fact, the overall level of concentration in a wide variety of markets in Australia highlights that, despite what appears to be a more stringent competition test, Australian markets are generally much more concentrated than in either the USA or Europe. Instances where markets are dominated by just a small number of major organisations include airlines, grocery retailing, banking, agricultural chemicals, petrol, communications, media, and many others. This indicates that irrespective of the strict reading of the legislation, the application of competition law in Australia is considerably less stringent than in other countries. While this may provide the opportunity for Australian companies to grow to international scale, it will not necessarily equip them to operate in the more competitive environment they are likely to encounter when they expand offshore.

Perhaps the final word on this issue should be left to Michael Porter, who conducted a landmark study into factors that make nations and industries competitive.[12] He found that rather than benefiting from weak competition regulation domestically, organisations were more likely to be internationally competitive if they operated in a domestic market where there was a 'cluster' of strongly competing firms in a particular industry. He concluded that *'Companies and nations have the power to choose between the false allure of concentration, collaboration and protection, and the reaffirmation of an economic order based on innovation, competition, and reward for effort. The latter choice is our best hope for sustained economic prosperity.'*

COMMENTS CONTAINED IN THIS DOCUMENT ARE BASED ON INFORMATION AVAILABLE AT TIME OF PUBLICATION.

[11] OECD 1998, *OECD Journal of Competition law and Policy,* Vol 1, No. 1

[12] Porter 1990, *The Competitive advantage of nations*, Macmillan Press.

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