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The Australian difference: has the public benefit test been eroded?

In the previous edition of The State of Competition, we looked at the filings available for statutory immunity in Australia and commented on their use as a tool for businesses wanting to achieve best practice compliance. In this follow-up issue we examine some more complex aspects of filings, including whether they are fulfilling their intended role in our competition law regime.

20 years ago, the Hilmer Committee acknowledged that Australia's system of competition law filings serve the public interest in two ways. The first is where competitive market conduct will not maximise economic efficiency (ie to address 'market failure'). This was the focus of our previous issue, as it serves as the typical basis for immunity in relation to *per se* prohibitions.

The second occurs where competitive market conduct may be economically efficient, but adversely impacts on other valued social objectives (whatever these may be at a particular point in time). With a review of our competition legislation on the cards post-election, it's timely to ask whether a focus on economic efficiency over the last decade has caused us to gradually lose sight of this other public interest rationale for immunity.

The ACCC recently released for public comment a draft revision to its authorisation guidelines updating them to reflect recent decisions and current practice. The draft explains how the ACCC has moved to a market failure framework for assessing authorisations.

> *Parties seeking authorisation from the ACCC are not required to frame their application in terms of addressing market failure. However, as part of the ACCC's assessment of an application it will consider whether there is a market failure or market imperfection, broadly construed, that the proposed conduct is seeking to address. Where this is the case, the conduct is more likely to give rise to public benefit.*

Does this reflect a pragmatic recognition that "other valued social objectives" will only rarely support a case for immunity? As the ACCC notes, "most public benefits accepted by the ACCC can be attributed to improvements in economic efficiency through addressing a source of market failure or market imperfection, broadly construed". Or does a market failure framework make it harder for cases based on the second public interest justification identified by the Hilmer Committee (and thereby discourage the use of authorisation in such cases)? It's an interesting question for 'Son of Hilmer' to explore.

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Following on from last issue's overview of Australia's adjudication system, now it's time for a closer look at how the tests are applied

The public benefit test

The essence of the authorisation test is the concept of "public benefit". As discussed in Issue 11, the Tribunal stated in the 1976 *QCMA* decision that the concept encompassed "… anything of value to the community generally."

For mergers, the authorisation test specifically directs that "a significant increase in the real value of exports"

Welcome to authorisation-lite... All the tasty benefits, with no lessening of competition!

and “a significant substitution of domestic products for imported goods” must be regarded as benefits to the public. More generally, however, the idea of a ‘shopping list’ of public benefits for authorisations was expressly rejected by the 1976 Swanson Committee as such lists were thought to divert attention away from a proper assessment of the benefits claimed and towards debate about whether particular benefits fall into an identified category. But as we’ve come to understand that every business is affected by Australia’s competition law (and indeed, as the law has broadened in scope), it’s not only the small group known as the “Trade Practices Mafia” who has to apply these concepts – perhaps a ‘shopping list’ approach might help *everyone* understand the policy objectives involved?

The Act uses two formulations for applying the public benefit test (depending on the conduct under consideration). The first requires the ACCC to be satisfied that the resulting public benefit outweighs the likely public detriment constituted by any lessening of competition. The second simply requires the ACCC (or, in the case of mergers, the Tribunal) to be satisfied that there would be such a benefit to the public that the conduct should be allowed.

In practice, the ACCC applies both tests in a similar way and considers all likely public benefits and detriments in a weighing up exercise. This is consistent with the approach taken by the Tribunal in the mid-2000s, the last period during which the Tribunal was active in this space.

Key Tribunal decisions that set the stage for the current application of the authorisation test include *Australian Association of Pathology Practices* 2004, *Chicken Meat Growers* 2006, *Qantas* 2006, *Jools* (NSW Taxi Drivers) 2006, and *Medicines Australia* 2007. (Since 2007, the Tribunal’s activities have mainly been in the area of access regulation.)

Our uniquely Australian approach

Former ACCC Commissioner Stephen King, writing earlier this year about various international approaches to competition exemptions, considered Australia to be in a “good place” following the Tribunal’s 2006 *Qantas* decision: broad enough to allow regulatory discretion but tight enough to guide the regulator. In contrast, King described the European approach of formal exemptions (ie safe harbours based on market shares) as lacking nuance and tending to excessive conservatism in order to avoid politically unpopular ‘false negatives’. Meanwhile, the US approach of taking into account offsetting benefits was, in his view, too vague and dependent on the vagaries of regulators and courts.

Economists most likely consider Australia to be in a “good place” thanks to the Tribunal’s adoption of a sophisticated modified total welfare standard under which benefits are defined widely and include benefits to producers and shareholders rather than just direct benefits to consumers or the general public (although tightly held gains are said to be given lesser weight). Many regard this as ‘cutting edge’ economics, but it also has a tendency of turning authorisations into a battle of the economic experts (something about which the Courts and Tribunals are increasingly expressing frustration).

Authorisation-lite takes hold

But one benefit of the European and US approaches is to encourage an integrated analysis in which the conduct is not formally characterised until all pros and cons have been considered, rather than putting benefit and detriment on opposing sides of a set of scales. Our Australian approach has instead tended to become more sequential – considering the pros and cons are increasingly becoming distinct steps. This in turn can lead to a focus on reducing the cons to achieve a ‘healthier’ authorisation-lite: all the great taste of the benefits but now with less detriment.

The debate about collective negotiation versus collective bargaining in the *Chicken Meat Growers* authorisation brought this starkly into focus by suggesting that collective bargaining alone can result in public benefit without any need for a collective boycott. But, in reality, being allowed to ask for the same price and terms without being able to say no at any given point is not negotiating. Indeed, any collective bound by such a restriction is in a position not dissimilar to a vendor undertaking a fire sale.

The focus on low detriment is emphasised by the ACCC’s analysis of recent airline authorisations. By way of conditions (eg locking in excess capacity), apparent “detriments” have been minimised allowing authorisation to be granted without needing to closely examine any claimed public benefit.

In the recent *Qantas Emirates* authorisation, the ACCC concluded it was unnecessary to test claims that Qantas International is in terminal decline and unable to compete effectively or operate profitably due to structural disadvantages (even though the public debate about the alliance had largely focused on such claims). Hence the ACCC declined calls by Senator Xenophon and others to scrutinise Qantas’ books. The ACCC concluded that the alliance had material but not really substantial public benefit, but also had minimal public detriment (due to the capacity conditions imposed for trans Tasman services).

Source: Qantas photo gallery

Are we sacrificing public benefits in an effort to minimise detriment in the form of lessened competition?

Could an authorisation have been justified without the capacity conditions under a more integrated approach? Who knows, but Virgin and Air New Zealand are currently seeking re-authorisation of their trans Tasman alliance absent the capacity conditions they agreed to last time around. They claim that “the public benefits derived from the Alliance are sufficient in and of themselves” and that the inherent inflexibility of capacity conditions inhibit efficient resource allocation. In other words, trying to minimise the detriment might also reduce the benefit – if the benefit is enough to outweigh the detriment in the first place, why not allow full cream milk instead of insisting on low-fat?

Let’s not forget non-economic benefits

Back in 1997, another former Commissioner, Sitesh Bhojani, wrote about the non-economic category of public benefit. It’s worth reviewing his discussion to remember how we used to view public benefit. Bhojani noted that non-economic benefits

might be less tangible and seem less easily demonstrated but nevertheless "they are real benefits" and can be "no less important in the authorisation/notification process than economic benefits".

Reflecting the perspective of the time, he concluded:

> *Parties seeking authorisation from the Commission should not neglect or discount the weight of such benefits. Nor should they be fearful that the Commission would not accept such benefits as properly coming within the concept of "a benefit to the public" for the purposes of the Act.*

A decade later, the Consumer Action Law Centre (**CALC**) published a report on social and environmental considerations in the public benefit test. The CALC noted that the public benefit approach "put the TPA [now CCA] in the world-leading category at its inception". It proceeded to examine the application of this test in both theory and practice, finding a degree of inconsistency and recommending the explicit recognition of non-economic factors in the consideration of both public benefit and detriment.

The CALC was particularly concerned with the application of the public benefit test where the conduct is unlikely to substantially lessen competition (ie where, absent authorisation, the conduct would trigger a *per se* prohibition).

> *Much of the consumer advocacy movement's concerns with the application of the public benefit test arise from cases where the anti-competitive detriment is considered to be low, and the applicant for authorisation or merger has therefore only had to show a minimal, often trivial, public benefit.*

The original authorisation test required public benefit to be substantial and not otherwise available (which the Swanson Committee thought too harsh). Thus, in *QCMA*, the Tribunal concluded that the likely anti-competitive detriment was low but so was the public benefit and hence it denied authorisation.

Is there such a thing as negative public benefit?

Just because conduct is unlikely to lessen competition does not automatically mean that any degree of public benefit should get it over the line. There may be public detriment that should count as 'negative public benefit'.

This is a perspective that doesn't sit altogether well with the 'authorisation-lite' approach.

For example, the CALC criticised the 2003 authorisation of the Australian Direct Marketing Association Code of Practice (a voluntary do-no-contact scheme) as lowering consumer protection standards. But the Code was authorised because the anti-competitive detriment was small and the ACCC considered itself unable to measure the Code against higher State-based standards of consumer protection. The CALC argued authorisation caused consumer confusion (by amounting to an effective 'endorsement' of the Code) and delayed the introduction of the mandatory do-not-contact register.

The CALC suggested that the scope to consider 'negative public benefits' is unclear and, in practice, both the ACCC and Tribunal have tended to focus on economic factors (although noting that there was some preparedness of the Tribunal to consider non-economic factors as detriments in the 2006 *Chicken Meat Growers* decision). The CALC sought greater certainty particularly on the use of social and environmental criteria (including perhaps an inclusive checklist of factors).

It also raised the critical issue of how to empower consumers and consumer representatives to participate effectively in authorisation processes, noting that "consumer organisations may have information that is valuable in weighing benefits and detriments that may arise from authorised conduct". The CALC recommended recognising the standing of consumer organisations to present information on public benefits or detriments to the Tribunal and other means of obtaining such information from the community.

It's an important issue if we want to take non-economic benefits seriously because, short of a plebiscite, how do you really gauge what the community values at any given time? We have seen a recent trend towards increasing consumer engagement as discussed in Issue 10 and further debate about this in an authorisation context should be welcomed.

How to get consumer input?

"The Consumers' Federation of Australia (CFA) is a peak body for over 100 community based consumer organisations and consumer advocates. CFA is managed by a volunteer Executive Committee sourced from member groups and does not employ any full-time staff.

As a result, it is with regret that we decline your invitation to provide a submission. Whilst we agree there is a clear need for a consumer voice to be heard on important issues like code share agreements between airlines, our lack of resources means that CFA does not currently have the capacity to provide input."

Excerpt from a letter by the CFA to the ACCC concerning the Virgin / Air NZ re-authorisation

Benefits & detriments: two sides of the one coin

One of the challenges for our Australian approach is to remember that public benefit and lessening of competition are often two sides of same coin. Excessive focus on reducing the detriment can lead to any public benefit becoming diluted – meaning 'safe' decisions that avoid 'false negatives' but also resulting in decisions that may fall short of serving the public interest.

To find a really good example of this 'two sides of the same coin' concept, one has to look back a fair way. But in 1996, Davids (which later become Metcash) applied successfully for authorisation to acquire the grocery wholesaler QIW. The ACCC accepted there were broad public benefits which outweighed competition effects at a narrower level. Specifically, Davids argued its competition with QIW in wholesaling to independent retailers was "counter productive", occurring at the expense of the independent sector as a whole in competing with the supermarket chains. The ACCC agreed there was public benefit in facilitating a 'fourth force' to counter the three major supermarket chains that existed at that time.

The ACCC's 2008 Grocery Inquiry recognised that it had indeed allowed Metcash to become the only wholesaler on the basis of this justification, providing Metcash the volume and scale to compete against the vertically integrated supermarket chains. However, the inquiry identified a concern that Metcash had exceeded the size where most of the cost advantages from scale were reached. Indeed, Franklins gave evidence that it had been able to re-establish its own vertically integrated wholesale and distribution operation on a much smaller scale, but was still able to obtain more favourable terms and conditions from suppliers than if it went through Metcash.

Notifications, revocations and the strange case of ACCC & Metcash

There has been a notification in place since 2003 concerning the IGA branded stores, requiring them to acquire goods exclusively from Metcash in return for the retail support services Metcash provides to the IGA group. The ACCC initially decided not to object, saying stores had the alternative of just acquiring goods from Metcash without retail support services (and without the exclusivity) and noting that the arrangements were likely to contribute to increased competition with the major supermarket chains. The 2003 notification was again reviewed in 2009 following the acquisition by Metcash of various fresh food suppliers, and allowed to stand.

Subsequently, in the 2010 Metcash merger litigation, the ACCC alleged that most retailers would be unlikely to commit to a new wholesale supplier that did **not** offer retail support services (including branding etc). Indeed, it raised the (notified) exclusivity arrangements as one of the obstacles for a new wholesaler setting up in competition with Metcash. This particular issue did not get much judicial attention as the case ultimately turned on the ACCC's failure to establish the market it pleaded. Oddly, however, the ACCC has made no move to revoke the notication, and so it still stands even though the ACCC has claimed that it raises barriers to entry.

The history of Davids/Metcash also highlights how circumstances – as well as community values – can change. This explains why the ACCC typically sets reasonably short time limits for authorisations, allowing for a fresh assessment when re-authorisation is sought. Other than in the case of merger authorisations, therefore, parties are continually required to deliver on their promises and ensure that their conduct accords with community values.

Is the self-enforcing premise of our law eroding?

We have previously discussed the notion that our law is intended to be 'self-enforcing' (with the primary obligation falling on business to comply with the law, while an enforcement body prosecutes breaches).

A concern identified by the Swanson Committee was the extent to which a lack of confidence by business in the adjudication process (both procedurally and substantively) could break down the self-enforcing nature of the law itself.

For example, the 1974 Act had a clearance process for exclusive dealing which the Swanson Committee recommended removing:

> *[T]he very existence of clearance provisions has meant that in a significant number of cases corporations... have sought clearance of [their] conduct rather than relying on their own decision as to whether... the Act was infringed. This has encouraged the practice of submitting for clearance by the Commission, patterns of business conduct which on any view of the law are likely to be only very marginally anti-competitive. In some measure the existence of the clearance opportunity... has deprived the community of the sort of self-reliance which competition-oriented legislation might be expected to encourage in a private enterprise system.*

The Committee instead recommended notification for exclusive dealing (other than third line forcing):

> *Thereafter, the conduct would be lawful unless and until the Trade Practices Commission determined positively that there was or was likely to be a substantial adverse effect on competition... and that the agreement or practice did not result, or was not likely to result, in a net benefit to the public. By requiring the Commission to determine these matters positively, we believe that much of the present criticism relating to the problem of proof (sometimes put to us as 'guilty until innocence can be proved') is alleviated.*

Using notification to reverse the onus

A number of such strategic 'reverse the onus' filings were made at the end of the 1990s to protect distribution systems involving exclusive dealing (eg adidas and Callaway Golf). These filings occurred around the same time as the *Melway* litigation.

Melway was sued under section 46 for misuse of market power by a distributor, Robert Hicks, who had been refused supply in circumstances where supply would have been inconsistent with Melway's long-standing distribution system involving exclusive market segments. Put simply, Melway already had enough distributors and (as the High Court eventually found) the new distributor would not have brought it any new sales.

Melway lost at first instance and on appeal, highlighting the risk of being seen as 'guilty until proven innocent' once the conduct was characterised as a 'refusal to supply'. Ultimately, the High Court recognised that the real issue was not any refusal to supply; rather it was Melway's distribution system. If the creation and continuation of that distribution system was legal, then Melway's conduct did not involve any use of market power. While the High Court got there in the end, there was still a financial and human cost to Melway, its executives and owners in having to fight so long for vindication.

But if a notification had been in place, even if the conduct *could* have been characterised as a misuse of market power, there could be no section 46 action (at least until the notification was revoked and then only for conduct post-revocation).

Nestlé

Leveraging market power, rather than a refusal to deal, was the focus of ACCC concern in the 2006 revocation of Nestlé Australia's notification concerning the supply of Nestlé branded products to Aldi. Nestlé sought review of the ACCC's decision but the matter never made the Tribunal as the parties reached a commercial resolution. However, the fact that a valid notification was filed removed section 46 from play while the notification stood.

So what exactly did the first 42 blends taste like? Sadly, this question - along with the revocation of the Nestlé notification - was never put to the Competition Tribunal

The game kicked off when Aldi commenced importing Nescafé instant coffee from Indonesia and Brazil. Nestlé Australia (which made Nescafé Blend 43, a popular local version of instant coffee) sought to impose conditions on Aldi regarding the presentation and advertising of the imported product. It argued that the local version had been sourced, blended and roasted in a specific way to suit Australian tastes

and, while the overseas versions had a similar appearance (labelling and overall get-up), they were different in substance. Nestlé claimed consumers who had purchased the overseas version from Aldi believing it to be the local version had complained about the taste (although Aldi said it had not received any such complaints). Interestingly, there were no submissions from any consumer groups or direct consumer evidence on the record.

Nestlé cut off supply of various of its products (including the 'must have' Milo) on the same day it lodged the notification (remembering that immunity arises upon filing). The immunity sought by the filing was wide, essentially allowing Nestle to withhold supply of a range of undisclosed products (which, according to the ACCC, included Milo) not just the instant coffee the subject of the dispute.

Nestlé Australia argued that the notified conduct "promote[d] Australian choices, tastes, local employment and benefits the Australian community" and that consumer confusion could reduce the range of products that it was prepared to offer Australians. The ACCC, however, decided to revoke, stating that the conduct was anti-competitive (leveraging off other 'must have' products to forestall a development which would otherwise place downward pressure on the price of Nestlé instant coffee and, potentially, other imported products). Further, it considered any claimed benefits were insufficient to outweigh this downside. The ACCC was sceptical about the extent of customer confusion and believed that the notified conduct was disproportionate to what was needed to avoid this problem (noting that Aldi had taken other steps to differentiate overseas products from their local equivalents).

It's a pity the review by the Tribunal did not proceed, as this would have been an opportunity to test an interesting issue of public benefit. In particular, how much does the community value downward pressure on the price of a particular brand versus preserving the willingness of the manufacturer to offer a highly popular local product (with all its attendant benefits, including local employment)? This is the same issue at the heart of the angst surrounding the closure of Ford production in Australia and is type of value question that the public benefit test is there to address.

A case for change?

So what's the score card?

For notifications – overall these appear to be working as intended (eg allowing firms to reverse the onus) subject to recognising that revocation is part of the checks and balances in this regime. It is appropriate for the ACCC to monitor, review and revisit notified conduct as circumstances change.

On the other hand, for authorisations, there may well be a case for revision. Perhaps we could consider a separate test for *per se* prohibited conduct, as against conduct that substantially lessens competition. The former could require parties to show there is no detriment (including substantial lessening of competition) to warrant prohibition. The latter could require parties to show that there is sufficient public benefit to warrant immunity. Neither would involve changing the legal prohibitions but such tests may better focus the rationale for immunity under these prohibitions.

It's a similar point to one made by last year's Expert Panel Review of the regime for merit reviews of decisions of the Australian Energy Regulator. One of the things the expert panel recommended was some tweaking of the regulatory objectives to make it crystal clear that the regulation of networks is about promoting the long term interests of consumers "to avoid the manifest economic error that promoting economic efficiency *necessarily* serves this purpose". The expert panel noted that "there should be no displacement of ends (consumer interests) by means to those ends such as economic efficiency, not least because not all efficient outcomes are in consumers' interests".

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