

MALLESONS STEPHEN JAQUES

Department of the Senate
Parliament House
Canberra
Australian Capital Territory
economics.sen@aph.gov.au

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Inquiry into competition in the Banking Sector

We refer to the request by the Senate Economics Committee for written submissions to its Inquiry into Competition in the Banking Sector. We appreciate the opportunity to make this submission.

We have limited our submission to those aspects of the Terms of Reference for the Inquiry that relate directly to law or issues relating to law reform. Accordingly, we make comments on the following:

- the proposed reforms to the Trade Practices Act in relation to price signalling; and
- the opportunity for facilitating funding of financial institutions through reforming interest withholding tax laws; and
- the potential impact of implementing further regulation of the financial services sector.

These are set out in turn below.

1 Proposed reforms to the Trade Practices Act

Attached to this letter is a short analysis of the scope of the existing provisions of the Trade Practices Act to address price signalling behaviour. For the reasons expressed in it, we consider the current wording of the Trade Practices Act is sufficient for the Australian Competition and Consumer Commission to address price signalling behaviour. On this basis, we consider that further amendments to the Trade Practices Act should not be needed.

If the Australian Government does decide to reform the Trade Practices Act by extending the reach of provisions in relation to price signalling, then we submit that some thought should be given to its interaction with other laws, such as those relating to continuous disclosure. This would be important to avoid the possibility of competing laws requiring market participants to both disclose, and also to not disclose, the same piece of information.

2 Facilitating funding of financial institutions

If reform is to be undertaken to facilitate further competition in the banking sector then an important part of it would be to facilitate access to offshore funding by Australian financial institutions. In this regard, we note that Australian tax law relating to interest withholding tax (IWT) can create some distortions in accessing foreign debt capital markets.

Accordingly, we support the introduction of a broad IWT exemption in respect of interest paid to non-residents by financial institutions as proposed by the Henry Review (see Recommendation 33) and the Johnson Report (*Australia as a Financial Centre - Building on Our Strengths*, Recommendation 3.4). Such an IWT exemption should apply to a broad range of institutions, including Authorised Deposit-taking Institutions such as banks, building societies and credit unions, as well as other financial institutions such as money market corporations. A broad IWT exemption of this kind would be similar to exemptions in other comparable jurisdictions (such as the United Kingdom).

We note the proposed measures for a phasing down of IWT on certain transactions involving financial institutions as outlined in the Federal Budget Press Release of 11 May 2010 (Treasurer's Media Release no. 35). While we generally support those proposals, they should be considered only as interim measures pending the introduction of a broader IWT exemption for financial institutions. Further, those Federal Budget proposals would not be of equal benefit for all financial institutions (eg those who do not borrow by way of offshore retail deposits or from an overseas head office).

In the short term, we also support the comments in the Henry Review that "consideration should be given to streamlining" the existing rules for publicly offered debt in section 128F of the Income Tax Assessment Act 1936 for all Australian corporate borrowers. The existing public offer tests no longer reflect commercial practices in the debt capital markets and impose procedural burdens on Australian borrowers that confuse international participants in those markets.

We submit that by facilitating access to foreign debt capital markets, these reforms to Australian taxation law should assist more financial institutions derive funding needed to compete in the Australian banking sector.

3 *Impact of further non-integrated financial services regulation*

Appropriate regulation of the banks and other financial institutions operating in Australia is important for the proper functioning of our financial system. Over the last decade there have been a number of significant law reforms relevant to the business of financial institutions. These include law reforms relating to:

- financial services generally (the reforms of "FSR" and its subsequent changes)
- prudential guidelines and capital standards
- privacy
- anti-money laundering
- margin lending
- unfair contract terms
- consumer credit

- personal property securities
- payment systems and electronic funds transfers.

Each of these law reforms was designed to achieve particular regulatory policy outcomes of the Australian Government. However, not all of these law reforms have operated in an integrated way. For example, recent law reforms relating to unfair contract terms and consumer credit apply differing tests as to their application so that it becomes necessary for some market participants to use multiple documents and systems with customers to ensure compliance with the new laws.

The costs involved in implementing new financial services regulation can represent a substantial investment - for existing participants, large or small, and for potential new entrants in the market. This investment is increased if the regulation is not integrated into existing financial services regulation, or with other law reforms applicable to the sector. If the costs of new regulation are substantial, the new regulation may serve to encourage smaller participants to reduce their footprint in the sector (or possibly leave the sector) and could even dissuade new participants from entering the market. If this happens then the further reform, even if intended to promote competition in the financial sector, could actually reduce competition.

We understand that the costs of compliance, and its associated impact on competition, are part of the usual consideration of the regulatory impact of new laws. For example, the need to consider the potential for regulation to “significantly alter costs of entry to, or exit from, an industry” is specifically mentioned in the Australian Government’s *Best Practice Regulation Handbook*. We submit that this consideration is particularly relevant to the financial services sector given the amount of new regulation which has been introduced or which has been foreshadowed. If the Australian Government does choose to introduce further law reform in order to achieve a policy objective of facilitating further competition in the banking sector, then the reform should be effected in a manner which is integrated into the existing financial services regulatory framework. An integrated approach should assist in managing the risk that the costs of implementing regulation to facilitate further competition in the financial services sector has the unintended consequence of reducing some existing and potential participants’ ability to compete.

Thank you for your consideration.

Yours faithfully

Price Signalling

1 Price Signalling - the current debate

The central issues in the current debate about price signalling are:

- whether it should be against the law for competitors to exchange information about future prices;
- if it should be against the law for competitors to exchange information about future prices, in which type of circumstances should the new law apply; and
- whether the current law is sufficient for the Australian Competition and Consumer Commission to successfully prosecute a person for making information about their future prices available to one of their competitors when (importantly) the competitor who receives the information does not commit to act on the information but makes a unilateral and independent decision to act on the information.

For example, if one supplier announces their future price through the media, in the absence of an understanding with their competitors about what the competitors will do with the price information and the competitors act on the information, should the supplier who makes the announcement be found to have breached the law?

Further:

- how would any new law treat a legitimate rationale for the announcement, such as a need to notify a wide customer base of a future price increase;
- should any new law be based on the need for the announcement to have a detrimental effect on the competitive process; and
- if any new law is to be based on the need for the announcement to have a detrimental effect on the competitive process, how significant should the detriment be?

2 The regulator's view

The Australian Competition and Consumer Commission and some commentators consider that the way the *Trade Practices Act* is currently drafted makes it challenging (if not impossible) to prosecute competitors for exchanging future pricing information in the absence of a commitment by the competitors to act on the information.

Hence, the Commission has proposed amendments to the *Trade Practices Act* to allow it to more easily prosecute price signalling.

3 Our view

In our view, the *Trade Practices Act* (as currently drafted) would allow the Commission to successfully prosecute one or more competitors for exchanging information about a future price by proving that:

- one or more competitors was attempting to arrive at an understanding that had the purpose or likely effect of fixing, controlling or maintaining a price or a component of a price;¹ or
- one or more of the competitors was attempting to arrive at an understanding to exchange information about future prices and the understanding had the purpose, or would be likely to have the effect of substantially lessening competition in a market;² or
- two or more competitors had arrived at an understanding to exchange pricing information, and the understanding to exchange the pricing information had the purpose or would have likely effect of substantially lessening competition in a market;³ or
- two or more competitors had arrived at an understanding that had the purpose or likely effect of fixing, controlling or maintaining a price or a component of a price.⁴

4 Law of attempts

4.1 An intention to bring about a result

In the case of an attempt to arrive at an understanding (examples (a) and (b) above), the current law requires an intention to bring about a result.⁵

In the context of the current debate, this means that the person who makes available information about their future prices to one or more of their competitors would need to have intended to bring about an understanding with their competitors to fix, control or maintain a price (or a component of a price), or intended to bring about an understanding that had the likely effect of substantially lessening competition in a market.

It would not be necessary for the understanding to have been formed.

4.2 A suggestion that the recipient might act on the information

According to J.D. Heydon:⁶

“[a statement made] unilaterally of any intention to do something or refrain from doing something, with no suggestion express or implied that other might act in the same way, is hard to visualise as an attempt to ... arrive at an understanding for the control of discounts on the sale of steel products.”⁷

That is, the mere provision of the pricing information to a competitor, without a suggestion that the competitor will act on the information, is not sufficient for an attempt to enter into an understanding.

¹ Sections 76(1)(a), 44ZZR(2) and 44ZZRJ of the *Trade Practices Act*.

² Sections 76(1)(a) and 45(2)(a) of the *Trade Practices Act*.

³ Section 45(2)(a) of the *Trade Practices Act*.

⁴ Sections 44ZZR(2) and 44ZZRJ of the *Trade Practices Act*.

⁵ Heydon, J.D., *Trade Practices Law*, Volume 2A at [18.290].

⁶ *ibid.*

⁷ *TPC v Tubemakers of Australia Ltd* [1983] ATPR 40-358 at 472.

4.3 Two requirements of an attempt

Therefore, in the context of price signalling, the current law of attempts requires:

- an intention to signal a price; and
- an express or implied suggestion that the recipient of the information might act on the information that has been signalled.

In the absence of any legitimate commercial rationale for providing the pricing information to a competitor, arguably the provision of the information itself could be argued to amount to an intention to signal a price with an implied suggestion that the recipient act on the information that has been signalled.

4.4 Defence for an alleged attempt

The current law contains a defence relieving persons who have acted reasonably and honestly and who ought to be excused when all the circumstances of the case are taken into account.⁸

4.5 Challenge for the Commission

The challenges of establishing the two requirements of an attempt - an intention to signal a price and a suggestion that the recipient of the information might act on the information - form part of the basis of the Australian Competition and Consumer Commission's desire to amend the *Trade Practices Act* to make it easier to successfully prosecute price signalling.

5 Understanding to exchange information

5.1 Commitment to act

In the case of an understanding to exchange information (examples (c) and (d) above), the current law requires a commitment to act.

A mere expectation on the part of the party who signals the price is not enough to establish a commitment to act under the current law.⁹

5.2 Apco Service Station case - commitment and expectation

The Apco Service Station case demonstrates the point. In that case, Apco Service Station and its managing director successfully appealed a decision of a single judge of the Federal Court of Australia¹⁰ in which the Australian Competition and Consumer Commission made allegations of price fixing against a number of service stations in Victoria.

At first instance and during the appeal, Apco and its managing director argued that they had merely received phone calls where the caller (a competitor) divulged future pricing information.

⁸ Section 85(6) of the Trade Practices Act. The defence allows the Court to relieve the person wholly or partly from liability to any penalty or damages on such terms as the Court thinks fit.

⁹ *Apco Service Stations Pty Ltd v Australian Competition and Consumer Commission* (2005) ATPR ¶42-078. See too *Australian Competition and Consumer Commission v Leahy Petroleum Pty Ltd* (2007) ATPR ¶42-162, per Gray J at [35]-[37].

¹⁰ *Australian Competition and Consumer Commission v Leahy Petroleum* (2004) ATPR (Digest) ¶46-260

Apco and its managing director had not initiated the calls, and had not committed to act on the information they received during the calls, although the information was described by them as having “commercial utility.”

The lack of commitment by Apco and its managing director to act on the information they received during the calls, and the fact that the respondents to the original proceedings (who had initiated the phone calls) had no expectation that Apco or its managing director would match the increases in prices, led the Full Court of the Federal Court to “the unavoidable conclusion” that the calls did not involve an understanding to fix prices.

5.3 The pleadings in the Apco Service Station case

Importantly, in the Apco case, the Commission pleaded that there was an understanding between the service station owners that had the purpose or likely effect of fixing, controlling or maintaining the price of petrol.

The Commission’s pleadings did not include a lesser type of understanding, being an understanding to exchange information which had the purpose or likely effect of substantially lessening competition, or an attempt to enter into such an understanding.

It is possible that the Commission may have succeeded in the Apco case if it had pleaded the lesser type of understanding to exchange information. After all, since Apco and its managing director willingly participated in the telephone calls and described the information they obtained during the calls as having “commercial utility”, there must have been an understanding for one person to give the information and for the others to receive it.

5.4 Challenge for the Commission

The question of whether the Apco case demonstrates a gap in the current law, or whether the judgment was due to the way the Commission pleaded its case, is an important one in any assessment of the Commission’s desire to amend the Trade Practices Act to make it easier to successfully prosecute price signalling.

6 Price Signalling in Europe

The European Court of Justice has held that the provision of information about a future price that is **capable of removing uncertainties** concerning intended conduct may be an “object restriction.”¹¹

An “object restriction” is one that results in a breach of article 101(1) of the Treaty on the Functioning of the European Union without the need to prove any actual anti-competitive effect.

6.1 European Commission’s draft rules

In its draft rules on agreements between competitors, the European Commission states that it considers the following types of information exchanges to be unlawful “object restrictions”:

- exchanges of individual data about intended future prices or capacity;
- exchanges of information about current conduct that reveal intentions about future behaviour;

¹¹ Case C08/08, T-Mobile.

- cases where the combination of different types of data enables the direct deduction of intended future prices or capacities; and
- some other types of information exchanges, including private exchanges the aim of which is to restrict competition in a market.

6.2 Aim of the information exchange

The examples of “object restrictions” cited by the European Commission seem to involve a smaller cohort of conduct than conduct that is “capable of removing uncertainties”, and seem primarily focussed on the aim of the information exchange.

6.3 Effect restrictions

In addition to “object restrictions”, the European Commission’s draft rules also deal with “effect restrictions.”

An exchange of information would result in a breach of an “effect” restriction if the exchange actually has the effect of restricting competition.

The European Commission assesses the effect of the exchange by having regard to the number of suppliers and customers in the market, the stability of demand, the level of transparency in the market, the strategic value of the information, whether the information is public or private, the age of the information, the frequency of the exchanges and the extent of market coverage. These are similar factors to those the Australian Competition and Consumer Commission would take into account during an investigation of price signalling.

6.4 Consideration of pro-competitive effects

Regardless of whether a restriction is classified as an “object” or an “effect restriction”, a breach of article 101 also requires an assessment of the pro-competitive effects of the restriction.

Specifically, article 101(3) provides a defence to a breach of article 101(1) where the relevant agreement, decision or practice:

- contributes to improving the production or distribution of goods or to promoting technical or economic progress;
- allows consumers a fair share of the resulting benefit;
- does not impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives; and
- does not afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

The parties wishing to rely on the defence bear the burden of establishing the matters set out in article 101(3).

6.5 Third party exchanges

The European Commission does not appear, in its draft rules, to distinguish between direct and indirect (that is, through third parties) information exchanges.

However, in the United Kingdom, it has been held by the Court of Appeal that:

“Where retailer A discloses to supplier B its future pricing intention in circumstances where A may be taken to intend that B will make use of that information to influence market conditions by passing that information to other retailers (of whom C may be one) and B does, in fact pass the information to C in circumstances where C may be taken to know the circumstances in which the information was disclosed by A to B and C then makes use of that information in determining its future prices, then A, B and C are all party to a concerted practice having as its object the restriction or distortion of competition.”¹²

This case involved a ‘hub and spoke’ price fixing arrangement involving two retailers of toys and games (Argos and Littlewoods), and a major supplier of toys and games in the United Kingdom (Hasbro).

While there was no evidence of direct contact between the competing retailers in relation to the prices at which Hasbro toys and games would be retailed, each retailer agreed separately with Hasbro that they would sell its toys and games at the recommended retail price, without offering any discounts against that price. Hasbro passed back to each retailer the other’s intention to offer Hasbro’s toys and games at the recommended retail price.

The Court of Appeal found there were separate arrangements between Argos and Hasbro, and Littlewoods and Hasbro, that the retailers would price at or near the recommended retail prices in question for most of the products in the ranges in question.

These arrangements were held to breach the prohibition on price fixing.

Further, the Court of Appeal found, on the basis that each retailer must have known or could reasonably have foreseen that its discussion with Hasbro reflected Hasbro's discussions with other retailers, a tripartite concerted practice between Hasbro and each retailer, to the effect that each retailer would to a material extent price at or near Hasbro's recommended retail prices on certain products. The object or effect of the concerted practice was to prevent, restrict or distort competition, within the meaning of the Competition Act 1998.

7 The Government’s proposed legislation

The Government is proposing to introduce a Bill into Parliament to amend the *Trade Practices Act* to outlaw price signalling, but it has not yet done so. This does tend to indicate that the Government accepts the concerns expressed by the Australian Competition and Consumer Commission about a gap in the law.

8 The Coalition’s Bill

On 22 November 2010, the Shadow Minister for Small Business and Competition Policy, Bruce Billson, introduced a Bill into Parliament to amend the *Trade Practices Act* 1974.¹³ The Bill is called the Competition and Consumer (Price Signalling) Amendment Bill.

8.1 Definition of price signalling

The Bill would prohibit price signalling, which the Bill defines as a corporation communicating price-related information to a competitor, for the **purpose** of inducing or encouraging the competitor **to vary a price**, where the communication of the price-related

¹² *Argos v OFT* and *JJB Sports v OFT* [2006] EWCA Civ 1318.

¹³ To be known as the Competition and Consumer Act, from 1 January 2011.

information is **likely to have the effect of substantially lessening competition** in the market for the goods or services in question.

8.2 Purpose of price signalling

The Bill states that the **purpose** of the communication may be inferred from the circumstances (that is, the purpose of the understanding may be inferred from the circumstances notwithstanding direct evidence to the contrary from the person who made the communication).

8.3 Variation of a price

The Bill states that a competitor **varies** a price if, after receiving the information, the competitor offers to supply the goods or services in question on terms, or at a price, that differ materially from the price or terms that would have existed in the absence of the information.

8.4 Aggregate likely effect on competition

In addition, the Bill states that a communication will have the likely effect of substantially lessening competition if it has that effect on its own, or in combination with other communications or other acts.

8.5 Exceptions

The Bill provides a number of exceptions, including for:

- private communications between related bodies corporate and between parties to a joint venture;
- communications that have been authorised by the Australian Competition and Consumer Commission;
- communications required by law;
- transmission or re-transmission of information that is in the public domain; and
- communications between suppliers and customers where the principal purpose of the communication is to inform the customer of a proposed variation in price the customer must pay to the supplier.

9 Our assessment of the Coalition's Bill

The Coalition's Bill, if enacted, would remove the need for the Commission to demonstrate an understanding in a prosecution of price signalling.

The Commission would only need to demonstrate a communication by a corporation:

- of price related information;
- done for the purpose of inducing or encouraging a competitor to vary a price or a term;
- which would be likely to have the effect of substantially lessening competition.

The Coalition's Bill is primarily directed at the purpose of the person who makes the communication, and the likely effect on competition of the communication.

The Bill does not propose a strict liability provision and would, as a consequence, avoid persons breaching the law when their conduct would not be likely to have a substantial detrimental effect on the competitive process.

However, the Bill (if enacted) may not have changed the outcome in the Apco case because Apco Service Station and its managing director did not communicate the price information. Rather, they received the price information without giving any commitment to the persons who disclosed the information that they would act on it. The Bill does not attach liability for price signalling (as defined in the Bill) to the competitor receiving the price related information.

10 Are changes to the law necessary?

If it is accepted that the current law prevents the Australian Competition and Consumer Commission from successfully prosecuting cases of price signalling, the Coalition's Bill would not close the perceived gap.

The Coalition's Bill would not close the perceived gap because it would not alter the outcome in a case like the Apco case, where the Court found, contrary to the Australian Competition and Consumer Commission's pleadings, that the persons who received the information about future prices had not committed to act on the information.

However, in our view, the Commission should be able to successfully prosecute cases of price signalling under the current law.

We consider, based on the facts as we understand them (and we were not involved in the Apco case), that if the Commission had pleaded an understanding to exchange information in the Apco case, the Commission would likely have succeeded against Apco and its managing director.

Further, in other cases, we can envisage that the Commission could successfully prosecute cases of price signalling if it were to plead an attempt to enter into an understanding (which can include an understanding to exchange price information) where that understanding has the purpose or likely effect of fixing, controlling or maintaining a price (or a component of a price) or an attempt to enter into an understanding that had the purpose or likely effect of substantially lessening competition.

Therefore, in our view, there is no need to amend the current law.

Further, any amendment to the current law to close a gap which does not exist will only unnecessarily increase the costs of doing business in Australia. This is in part because the proposed prohibition would not necessitate consideration of the pro-competitive effects or public benefits of any price related disclosure, and parties wishing to contend that such benefits exist will need to seek formal authorisation from the Australian Competition and Consumer Commission (which is itself a time consuming and expensive process).