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TREASURY EXECUTIVE MINUTE

Minute No.

22 October 2010

Parliamentary Secretary to the Treasurer cc: Deputy Prime Minister and Treasurer

ANTICOMPETITIVE PRICE SIGNALLING AND INFORMATION EXCHANGE

Timing: For information, as requested by your office.

Recommendation: That you note the attached briefing outlining developments in relation to the consideration of anti-competitive price signalling and information exchange under the *Trade Practices Act 1974* (TPA).

Noted Signature:...................................... ...../...../2010

KEY POINTS

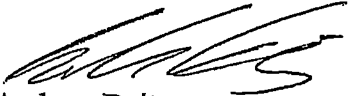
- The Treasury has previously advised the Deputy Prime Minister that there is merit in prohibiting anticompetitive price signalling and information exchange (collectively referred to as facilitating practices below) and has previously provided advice as to options to address these practices within the framework of the TPA.
- Facilitating practices are those practices that help firms, particularly in certain oligopolistic markets, avoid the usual tensions and uncertainties associated with competition. As a consequence, it assists those firms to achieve and maintain prices above the competitive level. In some cases, outcomes can be as harmful to competition and consumers as cartel behaviour.
- Competition laws cannot force firms to compete where they have little or no incentive to do so. Rather, the TPA endeavours to prohibit conduct likely to harm consumers by inhibiting or preventing competition in a market.
- Information exchange plays a vital role in our economy. Firms should continue to be free to communicate to the public and stakeholders their market positioning and branding intentions, where such communications are perfectly legitimate, pro-competitive and efficiency enhancing.
- In January 2009, as a result of the concerns raised by the ACCC in its 2007 Petrol Report, Treasury issued a discussion paper regarding the meaning of 'understanding' in section 45 of the TPA, which deals with cartel conduct. Through this process, considerable concern was raised that some harmful forms of anti-competitive conduct (such as facilitating practices) are not currently caught by the TPA (for further detail, see Additional Information and Attachment A for a detailed summary of the submissions). These views were in line with evidence from other jurisdictions.
- Treasury, in close consultation with the ACCC, has previously developed and advised on a proposed model for addressing the issue of facilitating practices to the Deputy Prime Minister (for further detail, see Additional Information). This model proposed that:
  - The TPA be amended to include a *per se* prohibition on the private disclosure between competitors of pricing information.

- The TPA be amended to prohibit information disclosure by a corporation with the purpose of substantially lessening competition in a market.

- Exemption from prosecution on public interest grounds be made available via modification of the existing Authorisation and Exemption processes.

- In addition to advice provided by the ACCC, this model was developed with reference to expert legal advice provided by [ ] (see Attachment B) and the [ ] (see Attachment C) and expert economic advice provided by Dr Jill Walker (see Attachment D).

Exempt under section paragraph 22(1)(a)(ii) (ie. not relevant)



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ADDITIONAL INFORMATION

ACCC 2007 Petrol Report and facilitating practices

- One of the issues considered in the 2007 Report of the ACCC inquiry into the price of unleaded petrol was the role of the TPA in addressing impediments to competition, in particular anticompetitive agreements under section 45.
  - The ACCC expressed concerns that court decisions have, over time, narrowed the kind of conduct that is caught by the term 'understanding' in the TPA. The ACCC also raised concerns about the Court's readiness to draw inferences from evidence in determining whether parties have reached an understanding.
  - To address these concerns, the ACCC recommended that amendments to the TPA be made in order to broaden and clarify the meaning of the term 'understanding'. It recommended that the TPA provide that an understanding may be found to have been arrived at, notwithstanding that it was ascertainable only by inference from surrounding circumstances. The proposed amendments included a list of factors which the Court could consider in determining the existence of an understanding.
- These concerns came about largely as a result of the outcomes from the high-profile petrol cases of *Apco v ACCC* and *ACCC v Leahy.*

Discussion Paper – Meaning of 'understanding'

- In response to the concerns expressed by the ACCC in its 2007 petrol inquiry, on 8 January 2009, the then Assistant Treasurer and Minister for Competition Policy and Consumer Affairs, Chris Bowen MP, released the discussion paper 'Meaning of 'Understanding' in the *Trade Practices Act 1974*'.
  - It sought submissions from interested parties regarding the adequacy of the current interpretation of the term 'understanding' in the TPA to capture anticompetitive conduct.
- The closing date for submissions was 31 March 2009. Treasury received 15 public submissions, and one confidential submission.

Key summary of submissions

- Most submissions suggested that it is not necessary to clarify or define the meaning of 'understanding'; and that the Court is not currently constrained in its ability to draw inferences or rely on circumstantial evidence. A majority of the submissions did not support the ACCC's proposed amendments.
- Key comments and issues arising from the submissions include the following:
  - that the ACCC's assertion that there has been a shift in the interpretation of 'understanding' is questionable; and
  - that the ACCC's proposed amendments to remove the element of commitment in the term 'understanding' would depart from the approach taken in comparable jurisdictions and be over-inclusive.

- A number of submitters, including the Law Council of Australia Trade Practices Committee, considered that it was more desirable to address concerns regarding facilitating practices through a more direct and specific amendment to the TPA, rather than through amendments to the meaning of 'understanding'.

Proposed form of amendments to the TPA

Per Se Prohibition

- Firstly, a *per se* provision would prohibit the private disclosure of pricing information between competitors (the *per se* prohibition). The *per se* nature of such an offence is appropriate as such private exchange of pricing information is highly likely to result in harm to competition and consumers, and is most unlikely to have any offsetting pro-competitive features.

- A *per se* test requires no proof as to the purpose or effect of the conduct. It has therefore been reserved for private disclosure of price information between competitors, since such conduct is inherently anti-competitive. However, the *per se* nature of the test allows very little flexibility in the event that there arise any instances of private disclosure of pricing information which do not harm competition.

- While it is widely accepted that private disclosure of future pricing intentions is unambiguously anti-competitive, there may be instances of private disclosure of current prices that are benign or even pro-competitive. Although likely to be rare, such instances can be appropriately dealt with by authorisation and applying exemptions similar to those already applying in the TPA, such as for joint ventures. Nevertheless criticism is likely to arise.

- It will be necessary to define 'private disclosure' appropriately to capture the conduct of concern, that is, disclosure of information that is not available to the public.

Substantial Lessening of Competition Prohibition

- A second provision would provide a mechanism to capture a broader range of facilitating practices engaged in with the *purpose* of substantially lessening competition in a market (the SLC prohibition).

- A possible criticism of this provision is that it imposes a very high burden of proof on the ACCC. Similar criticisms have been levelled at s 46 of the TPA which includes the same test of establishing the purpose of the firm engaged in the conduct.

  - In order to make it clear that there is no necessity for a 'smoking gun' document to establish that a firm had the requisite purpose, we consider that a provision similar to s 46(7) should be included. This provides that a Court can infer the existence of purpose from the conduct of the corporation or of any other person or from other relevant circumstances.

Exempt under section 42
(ie Legal professional privilege)

- The appropriateness of an effects test can be further considered once case law has developed in this area.

Authorisations and Exemptions

- It is expected that businesses would be able to access appropriate arrangements to seek an exemption from any new provision/s. This would allow businesses to proceed with conduct which is of net public benefit which would otherwise breach any proposed amendments to the TPA. Such arrangements would be consistent with those provided in other sections of the TPA, where businesses able to demonstrate a net public benefit from the proposed conduct can be granted case by case exemption (known as 'authorisation').
- Available exemption mechanisms also include, where appropriate, legislative and/or regulatory exceptions through section 51 of the TPA for particular activities which the Government is satisfied are providing net public benefits.

<table>
<tr><th>SUBMISSION</th><th>SUMMARY</th></tr>
<tr><td>1. Article (Understanding 'Understandings,' Ian Wylie, 21 Jan 09</td><td>
Comparable position in NZ, EU and US
• Wylie analyses the comparable positions in the following countries:
– US: s1 of the Sherman Act prohibits every contract, combination or conspiracy in restraint of trade. Parallel conduct is admissible as evidence but falls short of establishing a contract, combination or conspiracy. To establish this, need to establish that, in addition to parallel conduct, the defendant acted contrary to their individual economic interests.
– NZ: s27 of the Commerce Act (identical to s45 of the TPA). Notes that NZ Court of Appeal held that in Giltrap City Ltd v Commerce Commission, the Court considered that to establish an understanding, what is needed is consensus and an expectation that some action or inaction would take place.
– EU: Art 81 of EC Treaty prohibits decisions by associations of undertakings and concerted practices which may affect trade. Notes that in A Ahlstrom, it was held that parallel conduct is sufficient proof only if concertation is the only plausible explanation of it (i.e. market conditions do not explain parallel conduct). There must also be evidence of 'plus factors' in addition to parallel conduct.
Federal Court cases
• Wylie analyses a number of Federal Court cases which suggest that for there to be an 'understanding', there must be: consensual dealing; communication; meeting of minds; a moral duty to conduct in a particular way; must assume an obligation, assurance or undertaking (expectation is not sufficient); consensus (not mere hope as what might be done or happen); reciprocity of commitment; commitment at the time of formation; and a substantial provision providing for something to occur or not occur (but parties can withdraw). Also notes that parallel conduct combined with communication is insufficient to prove understanding.
Suggestions
• Wylie considers that the TPA could accommodate an 'understanding' arising from parties which are on parallel paths as a result of communications arriving at the same state of mind as to future conduct.
• Wylie suggests that section 45 could be amended by:
– inserting procedural provisions to facilitate easier proof from indirect evidence and use of admissions;
– amending substantive provisions to capture a broader range of conduct (i.e. adopt the EU approach to catch 'decisions by associations of undertakings and concerted practices'); and/or
– incorporating an economic self interest test or other explicit 'plus factor' test.
Comments on ACCC proposal
• Suggests that the ACCC's recommendation does not sufficiently identify the problem or provide a solution to it for the following reasons:
– the approach is based on advice that the approach of the courts has excluded behaviour which Parliament intended to prohibit. However, the writer notes that there is no evidence of legislative intention;
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	– what is said to be a significant shift in recent cases is in not correct; and – the ACCC's approach does not address the distinction between commitment in formation of an understanding and commitment as to its content and enforceability. If the intention is to proscribe a creation of an expectation regarding future conduct by one party short of a commitment by another party, then suggests ACCC's proposal in paragraph (a)(ii) could do this. However, the writer believes that the ACCC's proposal is over-inclusive, since it could catch unilateral conduct.
2. Email and paper, Carol O'Donnell, 9 Jan 09	• O'Donnell considers that the meaning of understanding should have exactly the same meaning as that a reputable dictionary. She also comments on the Constitution and the Hilmer review.
3. Article, Institute of Public Affairs, 28 Jan 09	• IPA's article mainly focuses on cartels. The IPA expresses the view that Government intervention against cartels is seldom effective and sometimes counterproductive. A number of markets are then analysed to support their theory. • In relation to the understanding issue, the IPA firmly rejects ACCC's proposals. It believes that ACCC's proposals would give the ACCC excessive power by reversing the onus of proof and assuming an existence of a breach on the basis of suspicion. Also believes that the proposals would result in endless and harmful litigation.
4. Email, Carol O'Donnell, 16 March 2009	• The submission mainly deals with the consumer law discussion paper. • Suggests that laws should have aims and definition of key terms as close to common dictionary definitions and that the TPA be repealed because it is an unworkable piece of legislation.
5. Motor Trades Association of Queensland, 17 March 2009	• Strongly supports a statutory definition of the term 'understanding' under the TPA. • The current interpretation of an 'understanding' limits the ability of the TPA to property address anticompetitive conduct. Having a definition under the TPA would constitute a guide, having the potential to deter anticompetitive and market distorting behaviour. • Suggests that the statutory definition should encompass both explicit and implicit understandings (understanding does not have to be written). In deciding whether an understanding is reached, the judge should be able to take into account the behaviour of the defendant.
6. American Bar Association, 26 March 2009	• The ABA does not support the ACCC's proposed amendments in relation to the definition of understanding for the following reasons: • the amendments are premised on two erroneous assumptions: – that failures to prove the existence of an understanding in recent cases are as a result of shortcomings in the statute (the ABA submits that the issues arise instead from a failure of proof); and – that there has been a shift in the nature of commitment that is required in establishing the existence of an understanding (the ABA submits that the Australian courts have consistently required the element of commitment or a meeting of minds).

	• The amendments also dispense with the requirement of a meeting of minds or commitment in establishing an 'understanding', which would be inconsistent with economic literature and major antitrust jurisprudence. • The ABA further submits that the proposed amendments regarding proof are unnecessary because Australian jurisprudence has long allowed consideration of a wide range of circumstantial evidence.
7. Trade Practices Committee of the Law Council of Australia, 31 March 2009	• The LCA submits that there is no need to clarify the meaning of understanding. The LCA also submits that the ACCC's proposed amendments regarding the definition of understanding are unnecessary and inappropriate for the following reasons: – the proposed amendments would not restore a previous interpretation of the law but rather expand on the concept; – the proposed amendments are over inclusive and may have unintended effects - without commitment, there is a risk that economic efficient concerted action may be condemned; and – any amendment to the meaning of understanding in the TPA could have unintended flow on effects on tax, corporate and other legislation. • The LCA suggests that if the Government considers that it is desirable to amend the TPA to prohibit a broader range of conduct, then this should be achieved by a specific provision rather than adopting the ACCC's proposed amendment. • The LCA further submits that the proposed amendments regarding proof are unnecessary for the same reasons provided by the ABA. However, the LCA suggests that if the Government decides that the codification of factors is required, then the Government should consider including other factors, such as the extent to which conduct is inconsistent with the independent economic self interest of the parties.
8. Caron Beaton Wells and Brent Fisse, 31 March 2009	• Beaton Wells and Fisse submit that case law has failed to provide a clear conceptual definition of conduct that should be caught in the 'contract, arrangement, or understanding' (CAU) requirement and suggests that amendments to the TPA may be necessary to rectify this. However, they do not support the ACCC's proposed amendments. • Instead, they suggest the following: – adopting the European Commission's concept of 'concerted practices' in the interpretation of an understanding in section 45 and the civil prohibitions; – imposing liability for an attempt to contravene or induce contravention of the TPA and pursue a passive recipient of information on the basis of ancillary liability; or – drawing on the 'invitation to collude theory' or related theory of 'solicitation to conspire' (however, the authors note that this option is not as appealing as the 'concerted practice' option). • Beaton Wells and Fisse also do not support the ACCC's proposed amendments regarding proof of an understanding. They note that the

	proposed amendments are unlikely to make any difference for the same reasons as provided by the ABA. The authors also submit that the list of factors is unsatisfactory because, amongst other things, they encourage a factor by factor approach rather than a holistic approach. • Beaton Wells and Fisse describe 'concerted practices' as conduct that enables competitors to determine a coordinated course of action and to ensure its success by prior elimination of all uncertainty as to each other's conduct regarding the essential elements of that action.
9. Maurice Blackburn Lawyers (MB), 31 March 2009	• MB supports the ACCC's proposed amendments. They submit that the current court interpretation of an understanding is unsatisfactory because it: – undermines the object of the TPA in its effectiveness against anticompetitive conduct; – fails to give a realistic or practical approach; and – facilitates the avoidance of liability for collusive conduct. • MB also supports the ACCC's proposed amendments regarding proof of an understanding and its list of factors. However, they suggest that the ACCC's list could also include other factors such as whether parties acted against self interest. • MB also suggest the following alternative approaches: – equate understanding with the notion of 'concerted practices' used in the EU (as suggested by Beaton-Wells and Fisse); and – shift the onus of proof from the regulator or plaintiff to the defendant once certain threshold requirements are established.
10. Business Council of Australia, 2 April 2009	• Does not support any amendments to the term 'understanding.' • Suggests that lowering threshold: – may produce unintended consequences; – widens the scope of the laws and may be disproportionate or stifle ordinary and legitimate business behaviour and supports the TPC's submission that the ACCC's amendments would be over inclusive; and – is inappropriate when the Government is also trying to introduce criminal sanctions for understandings that contain cartel provisions.
11. BP Australia, 31 March 2009	• Do not support the ACCC's amendments - they create uncertainty and complexity, especially in light of the proposed criminal penalties. • Suggests that the if the court is reluctant to draw inferences, then it is a result of prosecution deficiencies.

	• ACCC amendments are overinclusive because: – they catch parallel conduct which the ACCC state is not the aim of section 45; – they capture circumstances where information is received indirectly; and – they capture corporations seeking formation gained directly and deliberately to better understand the market; • Suggests that there must be a minimum requirement for an understanding – the court's interpretation requiring a meeting of minds achieves this.
12. Motor Trades Association of Australia, 30 March 2009	• Suggests that the current meaning is adequate and do not support any changes. • TPA should be amended to allow courts to infer behaviour but this should be considered as a wider issue.
13. Lovegrove & Lord Commercial and Construction Lawyers, 31 March 2009	• Does not support the ACCC proposed amendments - creates uncertainty. • Suggests: – there is no controversy to the meaning of an understanding – removing the element of commitment would be a move against a long line of case law; – ACCC has considerable power to gather evidence under section 155 of the TPA – if the ACCC cannot obtain direct evidence, then it should not issue proceedings; and – the introduction of the Cartels Bill is already significant enough without the ACCC's proposed amendments. • Notes that the courts already have the power to draw inferences and that it is appropriate for the court to be reluctant to draw inferences where the consequences of a breach are significant.

Exempt under section 45
(ie information provided in-confidence)

Exempt under
Section 45C
(ie information provided in-confidence)

15. Ian Tonking SC, 26 March 2009	• Tonking submitted two articles – one on the meaning on understanding (published in 2008) and one on the interaction of the proposed amendments with the proposed criminal cartel offences (published in 2009). • The article on understandings rejects the ACCC's proposed amendments. The article submits that the proposals are too broad because they capture unilateral conduct. The article suggests the adoption of a new test which eliminates the need to prove commitment. Consistent with most other submissions, the article also submits that the ACCC's proposals regarding proof are unnecessary. • The other article submits that the proposed amendments in its present form are not well adapted to the proposed criminal offences and the Criminal Code. Accordingly, the article suggests that more thought needs to be given on these issues.
16. Australian Institute of Company Directors, 9 April 2009	• ACCCs proposed amendments introduce an uncertain aspect to the proposed civil and criminal provisions of the Cartels Bill. • AICD do not support any amendments to the TPA for the following reasons: – commitment has always been an essential element of understanding; – there is no evidence to suggest that the current judicial approach to the interpretation of understanding limits the ability of the TPA to properly address anticompetitive practices; and – court has discretion to draw inferences and it is appropriate for courts to be reluctant to draw inferences where there are significant penalties and consequences.

ATTACHMENT B

Legal advice provided by [Exempt under paragraph 22(1)(a)(ii) i.e. not relevant]

Pages 13 to 27 exempt under
section 42 (ie Legal professional privilage)

ATTACHMENT C

Legal advice provide by [Exempt under Paragraph 22(1)(a)(ii) (not relevant)]

Pages 29 to 38 exempt under
section 42 (ie legal professional privileged)

ATTACHMENT D

Economic advice provide by Dr Jill Walker (LECG)

LECG

Attachment 2

MEMORANDUM

DATE:	5 May 2009
TO:	Bruce Cooper and Ian Lawrence
FROM:	Dr Jill Walker
RE:	Facilitating practices and "Understanding"

Background and Introduction

1. The Full Federal Court decision in *Apco Service Stations PTY Ltd v ACCC* (2005) and the subsequent Federal Court decision in *ACCC v Leahy Petroleum Pty Ltd* (2007) – "the petrol cases" – have highlighted the narrow interpretation of "understanding" as a type of agreement for the purpose of s.45 and s.45A[1] of the *Trade Practices Act* (the Act).

2. The issue is not a new one. My understanding of the Courts interpretation of s.45 is that it has consistently required three elements for a finding of any type of "agreement":

    a) communication between the parties;

    b) a "meeting of minds" between the parties to the alleged agreement; and

    c) an element of commitment by at least one party to the agreement.

   The concepts of "arrangement or understanding" have been treated as essentially synonymous and less formal than a "contract".[2]

3. The *Email* case[3] tested the limits of the law, in terms of the ability of s.45 to catch "facilitating practices" (see further below) and the law was found wanting. Despite the fact that Email and Warburton Franki regularly exchanged proposed price lists in advance and submitted identical tenders based on those price lists, Lockart J failed to find the requisite "meeting of the minds" or that there was any obligation on either party to adopt those price lists:

   > *Email issued a price list some four weeks before the tender closed; but I have no doubt that this was merely in furtherance of its price leadership and was in no way intended as some form of signal to Warburton Franki.*[4]

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1 Henceforth I shall simply refer to s.45, but my comments are relevant to both.

2 See my own comments in Jill Walker "Mergers, Horizontal Agreements and the Problem of Oligopoly" (2000) in Ray Steinwall (ed.) *25 Years of Australian Competition Law*, Butterworths, particularly pp.246-248.

3 *Trade Practices Commission v Email Ltd & Anor* (1980) ATPR 40-172.

4 *Ibid.* at 42,374.

4. For many years the Trade Practices Commission (TPC) and subsequently the Australian Competition and Consumer Commission (ACCC) pursued more straightforward cases under s.45, with a high success rate. Twenty five years after *Email*, it might have been hoped[5] that the greater economic sophistication of the Courts would have enabled them to broaden the interpretation of "understanding" for the purposes of s.45 to incorporate facilitating practices, but the petrol cases have given a clear indication that this will not happen without a change in the law.

5. I have been asked to provide an economic perspective on the problem of "facilitating practices" and the interpretation of "understanding" under s.45. Four separate issues arise:

   a) Is there an economic problem which should be caught by the law?

   b) If so, should the concept of "understanding" in s.45 be broadened, or should a separate offence be added, along the lines of the European concept of "concerted practices"?

   c) What should be the threshold test for such practices to be unlawful?

   d) Should the forthcoming criminal cartel offence extend to facilitating practices?

6. The focus of this Memo is on the first and third questions, which call for the most economic input. I will also express some thoughts on the second question, more from the perspective of someone who has worked in the field for a long time, rather than because economics has anything particular to say about it. I will say very little at all about the final question, which is not the current focus of attention.

The Problem of Oligopoly[6]

7. Oligopolistic markets are characterised by a small number of large players, sometimes with a fringe of smaller rivals. It should also be kept in mind that what is a "large" player depends on the size of the relevant market. In some cases that market may be a local retail market. Whereas in perfectly competitive, and often workably competitive, markets individual suppliers are "price takers", too small relative to the market for their actions to have any significant impact on market outcomes or the actions of other suppliers, this is not the case in oligopolistic markets. Individual suppliers in oligopolistic markets recognise their mutual interdependence, anticipate that their actions will have an effect on market outcomes and will cause reactions from their rivals and take account of their expectations about those effects in their own price and output decisions.

5 I expressed that hope myself in Walker (2000), *op.cit.*, p.260.

6 While the issue of facilitating practices generally arises in the context of oligopoly, it is equally applicable to situations of oligopsony and any changes to the law should apply equally, just as s.45 currently does.

PRIVILEGED AND CONFIDENTIAL

8. Economists have devised many many models of oligopoly, particularly since the widespread adoption of "game theory". The outcome of these models depends on the structural characteristics of the market and the rules by which the players are assumed to play the game. The so called "folk theorem" of oligopoly has been paraphrased as "anything can happen".[7] The outcome of repeated oligopolistic interaction over time, where the only "communication" is market action, can range from the competitive outcome to the monopoly outcome.

9. The achievement of supra-competitive prices simply through the dynamic interaction of oligopolists acting unilaterally in the market is often referred to as "tacit collusion" in the economic literature, i.e. the achievement of a collusive outcome without any explicit agreement:[8]

> *The key to tacit collusion is that when firms interact repeatedly, they may react not only to fundamental market conditions but also to each other's past behaviour. The fundamental idea behind all models of tacit collusion is that firms may have an incentive to set a price higher than the price they would otherwise wish, because of the fear that if they do not do so, other firms will react by setting lower prices in the future.*[9]

Whether they do in fact have such an incentive will depend on how much the firm has to gain from undercutting now, how likely other firms are to cut future prices in response, how much they would lose from rivals price cuts in the future and the firm's discount rate on those future profits relative to profits today. Even models with relatively large numbers of players can result in collusive outcomes, depending on the assumptions.

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7 See Gregory J Werden (2004) "Economic Evidence on the Existence of Collusion: Reconciling Antitrust Law With Oligopoly Theory", *Antitrust Law Journal* 71, pp.719-800 and M. Scherer and David Ross (1990), *Industrial Market structure and Economic Performance*, 3rd Edition, p.220.

8 I note that Caron Beaton-Wells and Brent Fisse refer to tacit collusion and facilitating practices as one and the same, and more generally there is something of a lack of consensus on what exactly is encompassed by tacit collusion. In this note I use the term tacit collusion to cover conduct which achieves a collusive outcome without explicit agreement. This may simply involve a dynamic oligopoly in which players learn from repeated interaction and reach a sustainable anti-competitive outcome. It may or may not be supported by facilitating practices. Furthermore, facilitating practices may support both tacit and explicit agreements by assisting parties to reach and maintain either type of agreement.

9 Marc Ivaldi, Bruno Jullien, Patrick Rey, Paul Seabright and Jean Tirole (2003) *The Economics of Unilateral Effects*, Interim Report for DG Competition, European Commission, Final Draft, November, p.17.

10. The question for both oligopolists and competition policy is how do we know which outcome is likely to occur when and what can we do about it? The problem for oligopolists is that many factors can intervene to prevent them reaching or maintaining a collusive agreement, whether tacit or explicit, pushing the market outcome towards a more competitive rather than a collusive outcome.[10] Market participants may be numerous and difficult to coordinate and may have divergent interests, price cutting will be tempting to one but can ultimately undermine the agreement if it is not detected and punished. These problems affect both explicit and tacit collusion.

11. Oligopolists can engage in various forms of communication, both spoken and unspoken, which can reduce the range of possible outcomes and help push the final result towards the collusive outcome. This communication may involve an explicit agreement that would be recognised as such by the Courts in Australia, or it may involve what have generally been termed "facilitating practices" in the economic literature, which appear to be synonymous with the concept of "concerted practices" in European competition law. Facilitating practices have been defined as:

> *... behaviour that, either by design or happenstance, helps the firms in the market overcome the complicating factors that make pure oligopolistic interdependence infeasible or insufficient to yield monopoly profits.*[11]

12. As noted above, economists generally talk about the problem of collusion as one of reaching and maintaining, by detecting and punishing "cheating", agreement on the collusive outcome. The same problem applies to tacit as to explicit collusion. Facilitating practices can help to solve the problem of collusion, both explicit and tacit, by increasing the probability that the parties will reach an agreement, and that cheating can be detected and punished. They do this by:[12]

    a) increasing transparency; and/or

    b) changing incentives.

13. Increased transparency reduces uncertainty about rivals actions, can facilitate reaching an agreement, through "negotiation" and the creation of "focal points", and can facilitate the detection and effective punishment of cheating and the avoidance of mistakes. The incentive to reach and maintain an agreement is increased when the relative pay-off from doing so increases, e.g. the gains from discounting are reduced and/or the costs, in terms of punishment, are increased.

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10 George J Stigler (1964), "A Theory of Oligopoly", *Journal of Political Economy* 72, pp.44-61.

11 George A Hay (1984), "Facilitating Practices: The Ethyl Case", in Kwoka and White (eds), *The Antitrust Revolution*, 3rd edition, Oxford, 1999, p.189.

12 See Steven C Salop (1986), "Practices that (credibly) facilitate oligopolistic coordination" in Stiglitz and Mathewson (eds.) *NewDevelopments in the Analysis of Market Structure*, MIT Press. Note that the Beaton-Wells and Fisse submission emphasises the former, more obvious, effect of facilitating practices, but economists would emphasise both effects.

14. The range of practices encompassed by the term "facilitating practices" is potentially very large, depending on the opportunities which arise in any particular market setting. The exchange of price lists or proposed prices, which were the subject of the *Email* and petrol cases, are perhaps the most obvious. The *Airline Tariff Publishing Company (ATPCO)* case involved both signalling proposed price increases and likely punishments through a central clearing house for distribution of airline fare change information to customers, travel agents and airlines.[13] These types of practices allow rivals to engage in "cheap talk", signalling and "negotiating" a collusive outcome before it is implemented. Other practices include the use of delivered pricing or common base point pricing, which help prevent competition over freight rates undermining product price coordination. Similarly, product standardisation can discourage cheating on price agreements through quality improvement and product differentiation. The use of "most favoured nation or customer (MFN or MFC)" clauses can discourage offering lower prices to win particular customers because the same price must be offered to others, reducing the pay-off, while "match the competition (MTC)" commitments can also discourage price cutting by increasing the likelihood of detecting otherwise secret price cuts and increasing the likely speed of rivals reactions and hence the pay-off to the price cutter. RPM can also be a facilitating practice for upstream collusion where price monitoring is easier at the retail level. One paper has drawn attention to the use of surcharging to pass through cost shocks as a facilitating practice to help avoid the potential disruption they can cause to price coordination.[14]

15. Facilitating practices may be undertaken by multiple players in the market or by one. An example of the latter, based on a real case, might be where a market leader – in terms of market share and cost efficiency – in a duopoly signals to their rival that they want to end a price war between them and return to "commercially sensible" pricing. They indicate a proposed price increase, which can be withdrawn if it is not matched, and they indicate that the consequence of not matching it could be the poaching of two customers for every one taken by the rival and an even worse price war. They might signal this directly and/or indirectly through customers. The rival is in no position to weather such a price war and signals that they will follow prices up. These communications have clearly helped the parties to achieve a collusive outcome to the detriment of consumers, but they involved no more than "cheap talk"[15] by the market-leader and accommodating action by the weaker player. It seems unlikely that this type of conduct would meet the requirements for an "agreement" under the current state of Australian law.

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13 Severin Borenstein (1994) "Rapid Price Communication and Coordination: The Airline Tariff Publishing Case" in Kwoka and White (eds), *The Antitrust Revolution*, 3rd edition, 1999, Oxford.

14 Luke Garrod (2006), *Surcharging as a Facilitating Practice*, CCP Working Paper 06-17, Centre for Competition Policy, University of East Anglia.

15 "Cheap talk" is used by economists to describe conduct which is cheap to the party in the sense that they can easily rescind the proposed action at little or no cost to themselves.

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16. In some cases Government or regulators can themselves, generally unwittingly, engage in facilitating practices. Examples of this include price regulation where competition is feasible and requirements to publish prices.[16] Excessive regulation of product and service standards by Government may also facilitate price coordination.

17. The consequences of tacit collusion and facilitating practices can be every bit as bad, or worse than, explicit collusion. An explicit agreement between competitors to fix prices may have little chance of "success" where the parties face competition from actual and/or potential rivals who are not party to the agreement and/or where cheating on the agreement is attractive and/or cannot be detected and punished. By contrast, a tight oligopoly facing little threat of entry, where all participants recognise their mutual self-interest in achieving a tacitly collusive outcome and are able to encourage that outcome by engaging in facilitating practices, can be much more "successful" and harmful to consumers.

18. It may also be the case that enforcement action against explicit cartels, and their impending criminalisation, may encourage the substitution of facilitating practices for the explicit agreements currently recognised under s.45.

What to do about it?

19. Most economists and Courts around the world agree that purely unilateral market conduct by oligopolists, taking into account the expected reactions of others, should not constitute a breach of the law. The main reason for this is that there is no clear remedy – telling oligopolists to pretend they are in a workably competitive market and to act irrationally when setting their prices does not seem to be a workable solution. This will include conduct in some markets which results in a tacitly collusive outcome. Most would agree that the only remedy for this problem is structural, through regulating mergers and reducing entry barriers to the extent possible.

20. Where oligopolists go beyond purely unilateral market conduct, and engage in some form of identifiable facilitating practice, however, there is the potential for a remedy – stopping the conduct which is facilitating the collusive outcome.

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[16] See, for example, Svend Albaek, Peter Mollgaard and Per B Overgaard, "Government Assisted Oligopoly Coordination? A Concrete Case", *The Journal of Industrial Economics*, Vol. XLV, No.4, December 1997, pp.429-443; Jill Walker and Luke Woodward, "The Ampol/Caltex Australia Merger: Trade Practices Issues", Trade Practices Law Journal, Vol.4, No.1, March 1996, p.21; Prof Stephen Davies, Prof Catherine Waddams Price and Cheryl Whittaker, "Competition Policy and the UK Energy Markets", Consumer Policy Review Jan/Feb 2007, Vol 17, 1 at p. 5.

21. Facilitating practices generally involve some type of "communication" – in its broadest sense - with competitors, either directly or indirectly via customers or public announcements, about what rivals intend to do and/or the consequences of actions. As discussed above, these communications increase transparency and/or change incentives, making it easier for rivals to achieve and maintain a collusive outcome. Consequently, economics would suggest that they should be captured by competition law. While the law might currently recognise that facilitating practices involve communication, thereby satisfying the first requirement for an agreement, satisfying the second and certainly the third requirements does not currently seem to be contemplated.

22. This gap in the law could be tackled in one of two ways:

    a) by expanding the concept of an "agreement", particularly an "understanding", to incorporate these practices; or

    b) by adding a separate offence of facilitating or concerted practices.

23. I understand that the law in the United States is at least capable of incorporating the former approach, where "agreement" requires a meeting of minds, but the "mere whiff" of such a consensus may be enough, and there is no requirement for commitment. By contrast, the European Community and several member countries have added the concept of "concerted practice" to the list of offences, which seems to correspond to what economists know as facilitating practices.

24. While the first approach is clearly possible and is certainly consistent with the economics of tacit collusion, the current state of the law in Australia seems to clearly indicate that the Courts will not entertain it on their own.[17] In order to incorporate this approach into Australian law, the legislature will essentially have to force it upon the Courts by inserting specific guidance into s.45, along the lines proposed in the petrol report and Julian Burnside's advice.[18] It seems to me that any such amendments are likely to be fraught with difficulty. They may raise more questions than they answer[19], may encourage undue weight to be placed on whether particular factors are present in particular cases and may fail to capture the full spectrum of such practices, which are probably only limited by the imagination of oligopolists. If the law is amended so that a commitment is not required for an "understanding", Courts may still effectively require this to recognise a "meeting of minds".

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17 Rhonda L Smith, Arlen Duke and David K Round (2009) "Signalling, Collusion and s.45 of the TPA", *Competition and Consumer Law Journal*, forthcoming, suggest that the field of contract law may be more open to relational contract theory and the idea that parties have "drifted into an agreement", a concept which may capture tacit collusion. However, this still leaves open the question of "what is the offending conduct?"

18 ACCC (2007), *Petrol Prices and Australian Consumers*, December, p.232 and pp.372-74.

19 See, for example, Caron Beaton-Wells and Brent Fisse (2009), *Meaning of 'Understanding' in the Trade Practices Act 1974*, submission in response to Treasury Discussion Paper.

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25. These considerations would seem to favour adopting the alternative approach of adding a specific offence of facilitating or concerted practices. The latter word might be preferable, encouraging the Courts to look to Europe for some guidance. Beaton-Wells and Fisse suggest a number of ways in which this could be achieved. Their preference is to add a definitional provision to the effect that "understanding" includes the concept of concerted practice as used in EC law. While I bow to legal expertise on this point, I would lean towards their first option of replacing the phrase "contract, arrangement or understanding" with "agreement or concerted practice", since the term "agreement" would be widely understood to include "contract, arrangement or understanding".

26. The recent school fees case in the UK[20] is a clear example of concerted practices which facilitated supra-competitive pricing without anything which Australian Courts would probably recognise as an "agreement". It should also be remembered that facilitating practices can be used to support explicit as well as tacit agreements. Indeed, this seems to be the context in which they have often been challenged overseas.[21]

The Relevant Threshold

27. While facilitating practices can help parties to achieve a collusive outcome, the very same practices can often be pro-competitive in different market circumstances. This is particularly the case where they provide consumers and potential entrants with better information on which to base their decisions and drive competitive market outcomes. Indeed, the communication of information through markets is a critical underpinning of the economy.

28. One example of the difficulties that might arises is the use of price boards by adjacent petrol stations, which can facilitate reaching a tacitly collusive outcome, since posted increases can be quickly rescinded if they are not followed.[22] However, such price boards also benefit consumers by informing them of prices and facilitating comparison between retailers before they drive up to the pump. This can be contrasted with the rapid transmission of Informed Sources price data to petrol retailers across a relevant market, which could facilitate market wide price coordination but the data is not available to consumers.

20 OFT decision CA98/05/2006.

21 OECD (2007), *Facilitating Practices in Oligopolies.*

22 See George A Hay (1999), *op.cit.*

29. Debate around the proposed Fuelwatch scheme reflected a similar dilemma – a Government requirement for the comprehensive posting of petrol prices could facilitate the "negotiation" of a tacitly collusive outcome, but it would also provide consumers with better information on which to base their purchasing decisions. Advanced communication of proposed price increases can allow consumers to bring forward purchases and take advantage of lower current prices. The use of MFN or MTC clauses may also be requested by consumers to provide them with assurance that they are getting the "best price". However, it should be noted that MFN clauses may find favour with customers, even where they result in higher prices, if they enable downstream competition between those customers to be better managed.[23]

30. This suggests that few, if any, facilitating practices should be subject to a per se test. One candidate, however, is the secret exchange of price lists between competitors. It is hard to imagine that this practice has any redeeming virtues, despite the comments in *Email* – where the conduct almost certainly facilitated price leadership, but this was not a good thing for consumers. If there was a public benefit claim to be made out, this could be tested under the authorisation provisions. Making this practice a per se offence, would seem to align neatly with the current per se offence for price fixing "agreements" under s.45A. The problem is that such a provision seems likely to simply result in the modification of conduct to publicise the price exchanges, thereby lifting the conduct out of the per se category, because it would be too difficult to draw a bright line between those public actions which should be condemned per se and those which should not. It all depends on the market circumstances. If it is not possible to carve out a workable per se offence in practice, however desirable in theory, the same considerations would seem to suggest it would be inappropriate to extend criminal liability to facilitating practices.

31. The logical approach would be to extend the current test of "purpose, effect or likely effect of substantially lessening competition in a market" to the conduct of concerted practices. I see no reason to limit the test to an effects test or to require proof of actual effects, especially since authorisation should be available where the practices can be shown to have public benefits. Practices which are clearly directed at facilitating collusive outcomes, regardless of whether they succeed or can be demonstrated to have succeeded, should be discouraged.

32. Nor do I see any reason to add a second threshold requirement of "no business justification" or similar.[24] This language is foreign to the Act and has the potential to cause confusion – raising prices and profits through facilitating practices and saving firms from "ruinous competition" can be regarded as business justifications. Limiting the business justifications to those which are "legitimate" further begs the question "what is legitimate in the pursuit of profit?" This would seem to be a potentially slippery slope. Rather, authorisation, and perhaps notification, should be available for these practices where public benefits and/or no likely detriment to competition can be demonstrated.

23 See Salop (1986), *op.cit.*, p.278.

24 See Beaton-Wells and Fisse (2009), *op.cit* and Smith et.al. (2009), *op.cit.*

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Conclusions

33. Economic theory clearly recognises that oligopolists can, at least in theory, achieve a collusive outcome simply through repeated market interaction over time. Consistent with most Courts, however, economists would not generally condemn such behaviour, which simply involves the rational unilateral setting of prices and outputs by firms in the market.

34. However, there are many obstacles to achieving and maintaining collusive outcomes in practice. Collusion does not generally "just happen". Firms can, however, improve their chances of success by engaging in various "facilitating practices", which either increase the transparency of market behaviour and/or change behavioural incentives. Tacit collusion supported by facilitating practices can be every bit as harmful to consumers as the type of explicit collusion currently recognised by Australian Courts. For this reason, competition law should condemn such conduct.

35. While economists would generally have no problem calling such conduct a "collusive agreement", Australian Courts clearly do. Accordingly, it may be better to extend the law by adding an additional offence of facilitating or "concerted practices", in line with EC law.

36. However, it should also be recognised that many facilitating practices can also be pro-competitive or neutral in different market circumstances. Accordingly, most or all such practices should be subject to the usual competition test and be capable of authorisation and/or notification. While in theory there is a case for making certain practices per se, in practice such a carve-out may be difficult.

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